



**GOVERNMENT
SUPERANNUATION FUND
AUTHORITY**



**Statement of Performance
Expectations**

1 July 2014

2014

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Statement from the Board

The Government Superannuation Fund Authority (**the Authority**) is an autonomous Crown Entity established under the Government Superannuation Fund Act 1956 (**the Act**).

The functions of the Authority are to manage and administer the Government Superannuation Fund (**GSF or the Fund**) and the GSF superannuation schemes (**the Schemes**) in terms of the Act.

The Fund has an actuarial deficit in that its assets are significantly less than the gross liabilities of the Schemes. The deficit exists primarily because, over the years, successive governments have elected not to pay employer contributions on behalf of their staff. Instead, governments provided funding as entitlements were paid. The Authority places reliance on the provisions in the Act for the Minister of Finance (**Minister**) to ensure that sufficient funds are available, or will be available, to the Fund to pay entitlements as they fall due.

In carrying out its functions, the Authority has established two desired outcomes:

1. Contribute to an improvement in the Crown's overall economic position by endeavouring to minimise the Crown's contributions to the Fund.
2. Meet the needs and reasonable expectations of stakeholders.

The Authority seeks to improve the Crown's overall economic position and meet the needs and reasonable expectations of the Crown, as a key stakeholder of the Fund, by maximising the returns of the Fund within acceptable levels of risk, controlling costs and ensuring members receive their entitlements in accordance with the Act.

The members of the Schemes and the employer contributors to the Schemes are also key stakeholders of the Fund. The Authority has determined the needs and reasonable expectations of the members and the employers to be as follows:

- Members - for entitlements to be calculated correctly, consistent with the Act and the policies maintained by the Authority, and to be paid on time. Meeting this need and reasonable expectation is a key factor in the Authority's management and administration of the Schemes.
- Employers - for contributions to be minimised.

These objective and strategies are outlined in more detail on the Investment and Schemes chapters.

The Authority takes a long term view when developing its investment strategy because the Fund is expected to pay entitlements for the next 50 years. The Fund's investment objectives and strategy are outlined in more detail in the Investment chapter but are based on following "Best Practice Portfolio Management".

It has adopted an Investment Objective and strategy that involves taking additional investment risk to improve the Crown's position compared to investing solely in New Zealand Government Stock.

The Authority believes diversifying away from equity risk into alternative sources of additional return and engaging skilled active managers is worthwhile, where they can add value after allowing for additional fees and costs.

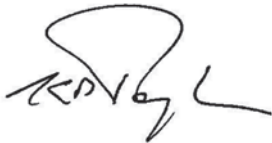
The Authority's investment strategy is benchmarked against a Reference Portfolio, which is a simple, notional portfolio that would be expected to achieve the investment objective by investing only in major, liquid, public markets at low cost. This helps define the strategy's risk and is used to assess the contribution to the

Fund's performance of decisions by the Fund's active managers. Active investment management has been employed broadly by the Fund since 2008 and has added value net of incremental fees.

A key initiative in the forecast four year period is the completion of construction and implementation of a new business system which will be used to administer the Schemes.

The Authority reports on how it has performed relative to its objective in the Annual Reports of the Authority and the Fund.

More information on the Authority and its policies and operations is available on our website at www.gsfa.govt.nz.



K B Taylor
Chairman



A K Kerr
Chairman, Audit & Risk Review Committee

May 2014

The Authority

Nature and Scope

The Authority was established in 2001 to manage and administer the assets of the Fund and the Schemes in accordance with the Act.

A Board, established by the Act and appointed by the Minister, governs the Authority and determines its business either directly or by delegation.

The Authority oversees the management of the Fund and the Schemes but has outsourced the key activities of Schemes administration and investment management, including custody of the Fund's assets.

The Authority's organisational structure is set out in Diagram 1 on the next page.

Functions and Operations

The Authority's functions are to manage and administer the Fund and the Schemes in accordance with the Act. All decisions relating to the business of the Authority are made under the authority of the Board, in accordance with section 25 of the Crown Entities Act.

The Minister has the power to add to the Authority's functions and may issue formal directions to the Authority on Government policy relating to its objectives and activities. The Minister may also issue formal directions to the Authority on the Government's expectations as to the Fund's performance, including the Government's expectations for risk and return, or not to invest in a specified investment or class of investments to which the Crown already has a direct or indirect exposure, for the purpose of limiting that exposure. No directions have been received from the Minister in terms of these powers.

The key activities of the Authority fall into the following two broad categories:

Investment

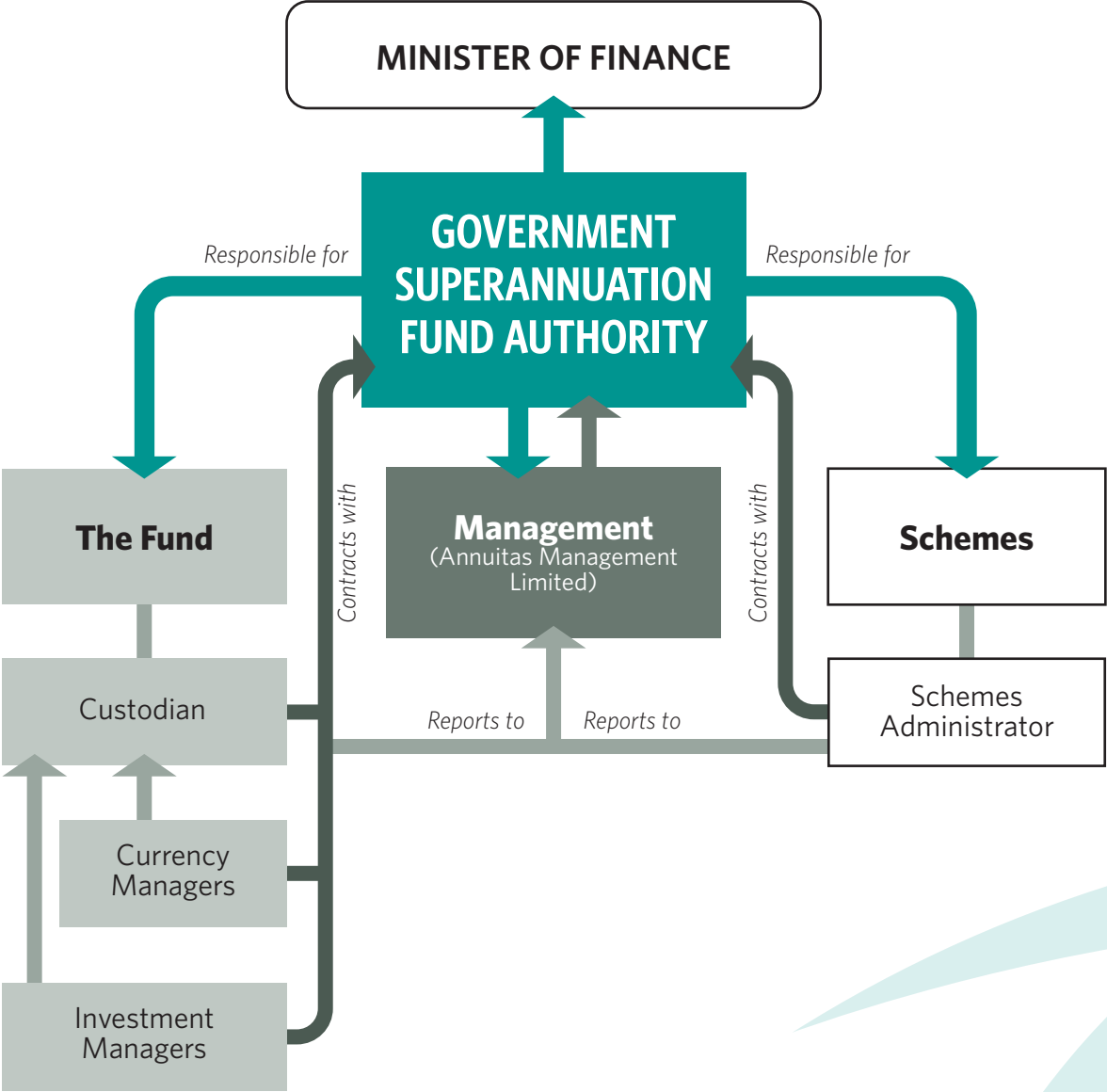
- Management of the investment assets of the GSF.

Schemes

- Management and administration of the Schemes, including the agreement between the Authority and the Schemes Administrator.
- Interpretation of the provisions in the Act and exercise of discretionary powers (set out in the Act).

Details on the outputs and performance measures for these activities can be found on pages 5 - 15 (**Investment**) and 16 - 19 (**Schemes**).

Diagram 1: Structure of the Government Superannuation Fund Authority and its operations



Investment

Objectives and strategy

The Authority's investment responsibilities under the Act are to:

- invest the Fund on a prudent, commercial basis, in a manner consistent with best practice portfolio management;
- maximise returns without undue risk to the Fund as a whole; and
- avoid prejudice to New Zealand's reputation as a responsible member of the world community.

The Authority meets these responsibilities by developing and implementing:

- principles for best practice portfolio management;
- an investment strategy centred on a defined return objective over the long term and within a defined risk limit; and
- responsible investment policies to meet the requirement to avoid prejudice.

Best practice portfolio management

The Authority interprets best practice portfolio management as:

- having a clear investment objective that reflects its statutory responsibilities and desired outcomes;
- maintaining a sound investment strategy consistent with that objective and the Authority's Investment Beliefs (**Beliefs**);
- having strong governance with clear assignment of responsibilities that promotes accountability, clear reporting and effective communication with the Fund's stakeholders;
- engaging external managers with the requisite skills to implement desired investment strategies on terms that align with the Authority's goals;
- ensuring cost-effective management of investments by robust monitoring of performance; and
- encouraging the sharing of relevant knowledge and resources with other Crown Financial Institutions (**CFIs**), peer funds and experts.

The Authority's outputs and performance measures for investment are designed to achieve these elements and measure success.

The Authority has established a set of Beliefs to provide a robust foundation for its investment strategy and to communicate shared values about investment. The Beliefs comprise the Authority's views with regard to the sources of investment return and risk and how these can be captured cost effectively. The Beliefs are set out below.

- a. Because the Crown guarantees the Schemes' pension obligations and meets the major share of them, the Fund can adopt a higher risk profile than otherwise to improve returns and the Crown's economic position.
- b. The Fund expects to earn higher returns for investing in markets or assets with higher risks of loss.
- c. The aggregate degree of exposure to higher risk sources of return is the most important investment decision as it creates the majority of the Fund's additional risk and return.

- d. Diversification among various uncorrelated return sources improves the Fund's reward-to-risk ratio. Conversely, concentration of risk requires sufficient additional return to compensate.
- e. Although closed to new investors, the Fund's long horizon means it can afford to invest in some illiquid assets when the expected return is attractive.
- f. A large proportion of most return sources can be captured by investing passively in low-cost, market-representative baskets of securities.
- g. Some investment markets are more efficient than others and their relative efficiency varies over time and it is possible to exploit this using skilled managers.
- h. Moderate market timing is appropriate because risk premia vary over time and there is some evidence they are mean-reverting.
- i. Investment opportunities should be considered net of all costs and taxes and having regard to their contribution to total fund risk and return.
- j. Costs and principal-agent risks should be controlled carefully, especially where managers are engaged to add value through their skill.
- k. Responsible Investment encompasses not only maximising return for risk, but also broadly accepted global standards of ethical conduct in relation to business governance, environmental and social risks.

The Authority seeks to achieve returns in excess of the returns from New Zealand Government Stock by accepting additional investment risk. Most of this additional return is the expected reward for bearing systematic or market risk from owning equities and other assets whose values may fluctuate significantly. Additional risk arises from the pursuit of active investment strategies that may produce returns that vary from market benchmarks from time to time.

The Authority's SIPSP sets out how these risks are managed. The SIPSP is reviewed and updated at least annually by the Board.

Maximising return without undue risk to the Fund as a whole

The Authority seeks to develop and maintain a diversified and efficient investment portfolio that will meet the Investment Objective (described below). It is implemented by allocating the Fund's assets across a mix of exposures to broad categories of market risk and return and supplementing this with active, skill-based sources of return.

Investment Objective (output)

Maximise the return on the assets of the Fund over the long term, without undue risk to the Fund as a whole, in a manner consistent with best practice portfolio management.

Following a review in 2013, the Authority has defined this objective as follows:

The Authority aims to

"Maximise the Fund's excess return relative to New Zealand Government Stock (before New Zealand tax) with a one in four chance of under-performing New Zealand Government Stock by a cumulative 10% measured over rolling ten year periods."

Under current assumptions, this level of risk is consistent with an expected excess return of 2.5% per annum over the next 10 years.

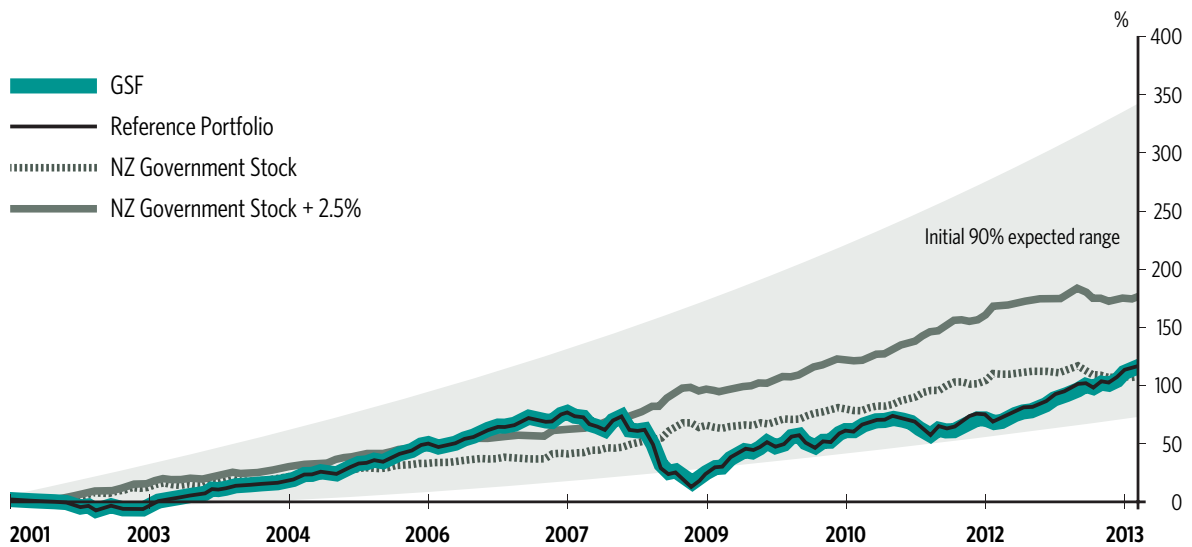
There are two changes from the previous expression. Both return and risk are now measured over a consistent ten year period and the objective is now cast in pre-tax terms. The second change recognises that the Crown guarantees the scheme's pension obligations, funds a large share of them and receives any New Zealand taxes paid. Maximising the Fund's returns before New Zealand taxes therefore also maximises the Crown's position.

Since 2009, the Authority has benchmarked its investment performance against a Reference Portfolio as well as against the Investment Objective. The Reference Portfolio is a simple, notional portfolio that would be expected to achieve the Investment Objective by investing only in major, liquid, public markets at low cost. Most of the Fund's performance will be attributable to the market risk factors captured in the Reference Portfolio. However, the Authority believes certain alternative market exposures and active management can add value to the Fund by improving returns and/or lowering risk, consistent with best practice portfolio management. The extra cost and the potential added value are considered carefully before investing.

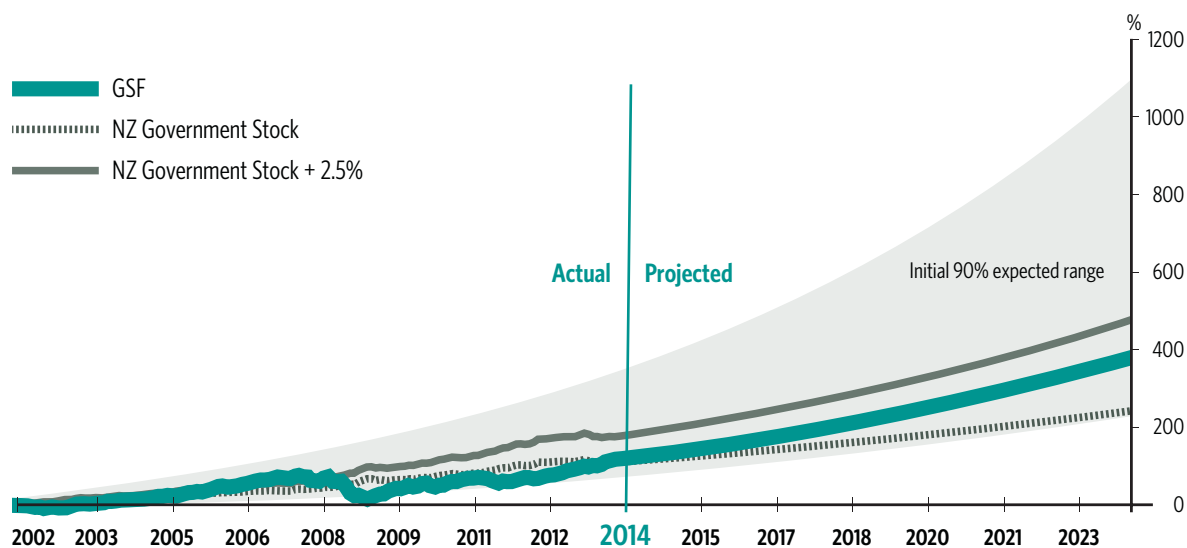
The Fund's investment return since October 2001, when the Authority assumed responsibility for managing the Fund, is compared with the Investment Objective and Reference Portfolio in Graph 1 below. The projected return for the next ten years and the expected range of outcomes are illustrated in Graph 2.

(Both graphs are after investment management fees. The data for fees is not available prior to 1 July 2009 but the Fund was run passively during that period.)

Graph 1: GSF Cumulative Returns since Inception (before tax and after fees)



Graph 2: GSF Returns Projection (before tax and after fees)



Because the Fund will pay entitlements for the next 50 years, the Authority takes a long term view in setting the investment strategy. Investment performance is measured over rolling ten year periods. Although market returns were below target since inception, they were within the expected range.

The Authority reviews its investment strategy regularly and believes the current strategy and risk profile are appropriate to achieve the Investment Objective over the Fund's long term horizon.

Avoid prejudice

The Authority has developed programmes to monitor the risk of investments to New Zealand's reputation, exclude prejudicial investments where practicable, engage companies on environmental, social and governance (ESG) issues and generally support greater integration of material ESG issues into investment processes. The Authority's Responsible Investment Policies can be viewed on our website www.gsfa.govt.nz.

The Authority is a signatory to the United Nations Principles for Responsible Investment (UNPRI). Signatories seek to address six aspirational principles established by UNPRI where they are consistent with each signatory's fiduciary duties. The principles can be viewed on www.unpri.org/principles.

The Authority has entered into a resource sharing agreement with other CFIs to help it meet its 'avoid prejudice' obligations and implement its policies, including its UNPRI commitments, efficiently.

Forecast Service Performance for 2014/2015

The two outcomes established by the Authority for investment are to:

- contribute to an improvement in the Crown's overall economic position by endeavouring to minimise the Crown's contribution to the Fund; and
- meet the needs and reasonable expectations of stakeholders - employer contributions to be minimised.

Investment Performance Expectations for 2014-18

The Board's forecast investment return is based on expected average ten year returns for each asset class held (see Significant Assumptions used in the Forecast of the Fund on page 13). The volatility of market prices for risky assets like equities, however, means that the actual return in any given year may vary widely

from the ten year average. The range of potential annual returns over rolling ten year periods is also much narrower than for any single year.

The Board's forecast return for the Fund for the year ended 30 June 2015 is 8.8% before tax and investment costs (see Table 1 on the next page). This translates to forecast investment income, including valuation changes, of \$308 million¹.

The Reference Portfolio is forecast to have a 25% chance of returning 10% less than Government Stock over the next 10 years, after allowing for larger-than-normal losses in some years.

The forecast includes added value from alternative market exposures and active management strategies. These increase the Fund's expected return compared with the Reference Portfolio and lower the probability of significant loss. The Target Portfolio is forecast to return 1.3% (\$40 million) more than the Reference Portfolio, before tax and investment costs.

¹The \$223 million shown in the Forecast Income Statement on page 22 is after deducting taxation and Schemes expenses.

Table 1: Projected Investment Performance and Risk for the year ended 30 June 2015

	Target Portfolio		Reference Portfolio	
	<i>\$m</i>	<i>Return % pa</i>	<i>\$m</i>	<i>Return % pa</i>
Investment Performance				
Gross Investment Income	308	8.7	268	7.4
NZ Government Stock		5.0		5.0
Total Investment Costs	29	0.8	8	0.2
Net Investment Income	278	7.9	260	7.2
Tax	50	1.4	48	1.3
Forecast Investment Income after Tax	228	6.5	212	5.9
Investment Costs				
Investment Management Fees	25	0.68	5	0.13
Custody Expenses	2	0.04	1	0.03
Overheads (share of Authority's operating expenses)	3	0.07	2	0.06
Total Investment Costs	29	0.80	8	0.21

- The Authority manages the Fund to a 'Target Portfolio', which includes investment activities aimed at improving risk-adjusted return compared to the Reference Portfolio.
- Table 2, on page 13, shows the assumed asset allocations for the Target Portfolio and the Reference Portfolio.
- The assumed returns from each asset class are set out in Table 3 on page 14 and include, where appropriate, half of the added value expected from active management of the asset class.
- Total investment costs include the projected investment management fees and custody expenses and 70% of the Authority's projected operating expenses. The other 30% of the Authority's expenses is allocated to Schemes. For the Reference Portfolio assumptions, the Authority's expenses are allocated 50:50 between the Reference Portfolio and the Schemes.

Outputs and Performance Measures

In addition to setting the Investment Objective, the Authority sets specific outputs and performance measures for investment. These will assist the Authority to achieve the investment outcomes it has established. Some outputs are ongoing, while others reflect specific projects that may be completed over a period beyond one year.

For the 2014/2015 year the Authority has identified the following service performance outputs and performance measures for investment:

Outputs	Measures
<p>Manage investments to maximise returns over the long term, without undue risk to the Fund as a whole, in accordance with best practice portfolio management.</p>	<ul style="list-style-type: none"> ▪ Fund return compared to the expected return over rolling 10 year periods. ▪ Volatility and drawdown of Fund returns versus expected levels. ▪ Actual performance (returns and assessed risk) compared to the Reference Portfolio over rolling 3 years to determine the added value of alternative asset exposures and active management (net of additional fees and costs). ▪ All measured with reference to independent market valuations by the custodian and assessed by the Authority's investment management staff.
<p>Endeavour to achieve competitive investment costs justified by value added.</p>	<ul style="list-style-type: none"> ▪ Comparison of investment managers' actual performance against contracted mandates and representative benchmarks, measured independently by the custodian and assessed by the Authority's investment management staff, with monthly management reporting and quarterly reporting to the Board. ▪ Comparison of expected and actual value added, in terms of excess return (net of additional costs) and/or reduced risk, versus the Reference Portfolio. ▪ Annual comparison of the Fund's performance and cost structure with those of similar organisations, prepared by independent party. ▪ Independent statutory review every 5 years.
<p>Monitor individual investment managers to ensure compliance with contracted mandates and, where appropriate, out-performance against benchmarks.</p>	<ul style="list-style-type: none"> ▪ External review by independent adviser and regular reviews by the Authority's investment management staff.

Outputs	Measures
Maintain a SIPSP that meets best practice.	<ul style="list-style-type: none"> Periodic review by independent adviser to assess whether the SIPSP meets best practice and is relevant.
Comply with the SIPSP.	<ul style="list-style-type: none"> No unauthorised variations from the SIPSP (which may be varied by the Board from time to time) identified on annual review. Actual asset allocation rebalanced monthly to within rebalancing tolerances set out in the SIPSP. Investment manager risk remains in line with expectation by comparing investment managers' actual risk profiles against expected risk. Review of custodian's performance against key performance indicators quarterly to determine that it meets its Service Level Agreement. No direct investments that breach the Responsible Investment policies set out in the SIPSP. All investments in collective investment vehicles (CIVs) in accordance with Responsible Investment policies in the SIPSP. CIVs notified of the Board's Responsible Investment policies. Measured by internal and external review.
Put in place a sound investment strategy consistent with the SIPSP and the Authority's Beliefs.	<ul style="list-style-type: none"> Board review of the investment strategy, including the key investment and taxation assumptions, at least annually that confirms the strategy is consistent with the SIPSP and the Authority's Beliefs.
Collaborate with other CFIs to monitor environmental, social and governance (ESG) risks of investments, engage with companies with negative ESG issues, encourage integration of ESG issues into investment arrangements where consistent with financial objectives, and maintain a list of excluded investments.	<ul style="list-style-type: none"> Avoidance of any negative ESG issues. Advice to investment managers on policies and exclusions. Updated exclusion list. Participation in engagements with companies that lead to positive change in behaviour.
Ensure the Authority complies with the GSF Act.	<ul style="list-style-type: none"> Conclusions of in-house legal compliance programme developed with advice from the Authority's legal firm.

Significant Assumptions used in the Forecast of the Fund

Table 2 sets out the assumptions made for the asset allocations for the Target Portfolio and the Reference Portfolio. The Authority seeks to enhance the Fund's performance by investing in certain alternative market exposures, such as opportunistic real estate, insurance linked assets, private equity, global tactical asset allocation, and active management strategies. These exposures and strategies are reflected in the Target Portfolio and expected to increase returns and/or reduce investment risk compared to the Reference Portfolio, after allowing for incremental costs.

Table 2: Assumed Asset Allocations (%) of the Target Portfolio and the Reference Portfolio as at 30 June 2014

Asset Class	Target Portfolio	Reference Portfolio
International Equities	54.7	60.0
New Zealand Equities	9.3	10.0
Global Fixed Interest	16.3	30.0
Multi-Asset Class	7.0	n/a
Catastrophe Risk	6.0	n/a
Life Settlements	3.7	n/a
Global Tactical Asset Allocation	3.0	n/a
Foreign Currency Exposure	(36.0)	(20.0)
Total	100.0	100.0

- The Reference Portfolio is a simple, notional portfolio, invested passively in liquid public markets only.
- The actual asset allocation for the Fund is rebalanced if required to the Target Portfolio.
- The Board's forecast of the performance of the Fund depends on assumptions with respect to the returns (before tax) from each asset class in the Target Portfolio. Actual returns from each asset class over the next year may vary significantly from the long term return assumptions used.

Table 3: Assumed Returns (%) and Risk (%) for each Asset Class (before tax and before fees)

Asset Class	Target Portfolio	Reference Portfolio	Risk
International Equities	9.5	8.5	20.7
New Zealand Equities	10.1	8.6	20.4
Global Fixed Interest	5.4	4.9	4.4
Multi-Asset Class	8.4	n/a	8.0
Catastrophe Risk	7.4	n/a	n/a
Life Settlements	12.0	n/a	n/a
Global Tactical Asset Allocation	7.6	n/a	13.0
Total Portfolio	8.7	7.4	12.7

- The assumed returns for the Reference Portfolio have been provided by Russell Investment Group Limited (Russell) based on simulation modeling that is globally integrated, sensitive to market conditions and allows for extreme outcomes.
- The assumed returns for the Target Portfolio are adjusted by the Authority for risk and/or added value by active investment managers as appropriate.
- The risk measure is the assumed annual volatility of return for each asset class. The annual volatility is not an appropriate risk measure for Catastrophe Risk and Life Settlements.
- The assumed returns for the Target Portfolio are higher in general than those used in the 2013 Statement of Intent.
- Actual investment management fees may vary significantly from those projected. Actual returns from each asset class in the year may vary significantly from expected returns. In addition, performance fees are paid to some managers if agreed performance targets are exceeded.
- The assumed returns for each asset class in the Target Portfolio include, where appropriate, half of the added value expected from active management of the asset class.
- Currency hedging to New Zealand dollars is in place for all international assets while leaving an overall level of foreign currency exposure the Board considers is prudent. The net currency exposure benchmark is currently 20% of the Fund's assets, which is used for the Target Portfolio. The Fund is allowed to have foreign currency exposure anywhere between 0% - 40%.
- Asset values, as at 1 July 2014, are projected from actual 31 January 2014 asset values.
- Projected entitlement payments from the Fund are \$12 million per month.
- Taxation assumptions are summarised in Table 4 (see next page).

Table 4: Taxation Assumptions

Asset Class	Tax Treatment
International Equities Catastrophe Risk Life Settlements Multi-Asset Class	<ul style="list-style-type: none">▪ 28% on 5% of the average value of the portfolios during the year.
New Zealand Equities	<ul style="list-style-type: none">▪ 28% on dividends, allowing for 20% imputation credits.
Global Fixed Interest Global Tactical Asset Allocation	<ul style="list-style-type: none">▪ 28% on accounting profit or loss.

Schemes

Background

The Schemes were established in 1948 to provide a way for public sector employees to save for their retirement.

The Schemes were closed to new members from 1 July 1992, except for people who were eligible for membership through their employment with certain Pacific Island governments. Membership was closed to these people in 1995.

There are seven Schemes, each of which is registered as a superannuation scheme under the Superannuation Schemes Act 1989.

At 30 June 2013, the Schemes had 63,422 members, made up of 16,854 contributory members and deferred annuitants (eg. members who have elected to receive their entitlements from a future date) and 46,568 annuitants. It is expected that entitlements will continue to be paid by the Fund for the next 50 years or so.

Contributory members contribute a defined percentage of their superable salaries (which may be different to their total remuneration) to the Fund on a regular basis.

In return, they receive a retiring entitlement based on their average superable salary for the last five years of contributory service, years of service and age at retirement.

Certain non Government employers contribute the balance of the accruing cost of their employees' retirement entitlements to the Fund. The Government, as an employer, meets its share of members' retirement entitlements as they fall due for payment. Therefore the Schemes are only partially funded, with the accumulated employee contributions, investment returns and employer contributions (from non Government employers) being deemed by the Authority's Actuary to be sufficient to meet 16.7% of the entitlements at present (19.7% from 1 July 2014).

The actual and projected present values of the Unfunded Past Service Liabilities (**UPSL**) of the Fund have been calculated by the Authority's Actuary in the actuarial valuation, as at 30 June 2013. The results are set out in Table 5. The UPSL values are estimates of the Crown contributions required to meet the past service liabilities of the Fund.

Table 5: Actual and Projected Unfunded Past Service Liabilities

	Actual 30 June 2013 \$m	Projected 30 June 2014 \$m	Projected 30 June 2015 \$m
Past Service Liabilities	13,858	13,759	13,651
Net Assets	3,382	3,451	3,521
Unfunded Past Service Liabilities	10,476	10,308	10,131

- The actual and projected unfunded past service liabilities were calculated by the Authority's Actuary using a net of tax investment rate. The UPSL, calculated using a gross discount rate, are recorded in the Crown's financial statements. In estimating the future net assets, the Actuary has assumed there will be no added value from active investment management.
- Investment markets have improved since the Authority's Actuary carried out the valuation. The Board projects net assets to be \$3,614 million, as at 30 June 2014, and \$3,728 million, as at 30 June 2015.

In all actuarial valuations since 30 June 2012, the Authority's Actuary has made allowance for continued improvements in mortality (i.e. for annuitants living longer) which has increased the past service liabilities and consequently the UPSL.

The Authority is responsible for managing and administering the Schemes in accordance with the Act. The day to day administration of the Schemes is outsourced to Datacom Employer Services Limited (**Datacom**).

The overall expected costs (**Schemes**) of \$5.50 million include the expected Schemes administration expenses, estimated actuarial costs and approximately 30% of the Authority's projected operating expenses (see page 24).

Objectives and strategy

The Authority aims to ensure sustainable, cost effective management of the Schemes to enable accurate calculation, payment and reporting of members' entitlements. The Authority does this by ensuring:

- contributions are collected and entitlements are calculated and paid correctly in terms of the Act and the policies maintained by the Authority (**Policies**), and in a cost effective and timely manner; and
- service levels agreed with the Schemes Administrator are met.

The sustainability of the Business System, used for administration of the Schemes, is fundamental to achievement of this strategy. The Business System is more than 19 years old and incorporates technology that is no longer in common use in New Zealand. People with relevant technology skills are becoming scarce. While the current Business System is stable, and the Authority is confident it will perform adequately in the short term, the Authority is developing a new Business System, which will be more comprehensive and sustainable over the longer term.

Also key in achieving the Schemes' outcome (see below) is the performance of the Schemes Administrator, Datacom. The Authority has established and maintains a partnering relationship style with Datacom to ensure all issues relating to the administration of the Schemes are communicated early to the Authority and are managed and resolved in an open collaborative manner, taking into account the interests of the members of the Schemes and the Crown.

The Actuary appointed by the Authority undertakes actuarial examinations of the Fund on a regular basis. Based on these examinations, the Authority reports to the Crown on the value of the liabilities of the Fund, as required by section 94 of the Act.

In communicating with members and employers, the Authority seeks to ensure information provided is both of a high standard and timely. This includes information on member entitlements and on the activities of the Authority.

The Authority interprets the provisions of the Act and the Policies, and exercises its discretionary powers, in relation to matters raised by members. The Authority seeks to achieve equity and consistency in its application of the provisions of the Act and the Policies.

Forecast Service Performance for 2014/2015

The Authority's key activities in relation to the Schemes are:

- the management and administration of the Schemes, including the agreement between the Authority and the Schemes Administrator; and
- interpretation of the provisions in the Act and the Policies and exercising discretionary powers (set out in the Act).

For 2014/2015 the Authority has identified the following outputs and performance measures to assist in achieving the Schemes' outcome:

- To meet the needs and reasonable expectations of the members and employers as stakeholders.

Outputs	Measures
<p>Accurately calculate and pay entitlements, process contributions correctly and on time.</p>	<ul style="list-style-type: none"> ▪ Performance is in line with the key performance indicators (KPIs) set out in the Management Agreement between the Authority and Schemes Administrator. <p>KPIs are:</p> <ul style="list-style-type: none"> - 100% of all annuities are paid on time; - all contributions are banked on receipt and allocated as soon as verified as being correct; - all transactions are processed correctly; - all routine correspondence is responded to within 5 working days; and - all non-routine correspondence is responded to within 7 working days. <p>Performance against KPIs is measured through monthly reporting by the Schemes Administrator, monitored by Management.</p> <ul style="list-style-type: none"> ▪ The Business System is relevant and supportive of the requirements of the Schemes. <p>Assessed by:</p> <ul style="list-style-type: none"> - no major loss or corruption of data or functionality; - having an appropriate Business Continuity Plan in place; - the ability to access required data from both the current and new Business Systems; and - the new Business System being operational by 1 July 2015.
<p>Respond appropriately to stakeholders' inquiries and provide relevant information.</p>	<ul style="list-style-type: none"> ▪ Timely responses to all requests for information from Treasury and meeting deadlines measured by: <ul style="list-style-type: none"> - no requests being received for missing or incomplete information; and - timeframes being met. ▪ Regular updating of website information on Schemes and Investment, sending the annual Chairman's letter to members by the end of September each year and sending member and employer updates. ▪ Achieving consistently good satisfaction scores in the major aspects of the biennial survey of members and employers and positive feedback from other stakeholders. ▪ Timely processing of appeals. On receipt of an appeal, complete papers are provided to the Appeals Board at least 14 days before each scheduled hearing.



Forecast Financial Statements

Forecast Financial Statements for the five years ending 30 June 2018

The Fund

- Forecast Income Statement
- Forecast Balance Sheet
- Forecast Statement of Cash Flows
- Forecast Reconciliation of Changes in Net Assets to Net Operating Cash Flows
- Statement of Accounting Policies.

The Authority

- Forecast Income Statement
- Forecast Balance Sheet
- Forecast Statement of Cash Flows
- Forecast Reconciliation of Net Operating Result to Net Operating Cash Flows
- Statement of Accounting Policies.

Government Superannuation Fund

Forecast Income Statement

Estimate 2013/14 \$000		Forecast 2014/15 \$000	Forecast 2015/16 \$000	Forecast 2016/17 \$000	Forecast 2017/18 \$000
	Increase in assets from:				
418,009	Investing activities	308,000	316,000	325,000	335,000
	Operating activities				
(35,669)	Funding the Authority*	(35,024)	(37,177)	(38,229)	(39,641)
382,340	Surplus before tax and membership activities	272,976	278,823	286,771	295,359
(70,719)	Tax	(49,653)	(50,952)	(52,344)	(53,857)
311,621	Surplus after tax and before membership activities	223,323	227,871	234,427	241,502
	Membership activities				
765,000	Contributions - Crown	748,000	761,000	772,000	783,000
41,000	Contributions - members	35,000	31,000	28,000	25,000
22,000	Contributions - other entities	23,000	21,000	19,000	17,000
(907,000)	Benefits paid	(915,000)	(928,000)	(940,000)	(951,000)
(79,000)	Net membership activities	(109,000)	(115,000)	(121,000)	(126,000)
232,621	Surplus after tax and after membership activities	114,323	112,871	113,427	115,502
3,381,595	Opening assets available to pay benefits	3,614,216	3,728,539	3,841,410	3,954,837
3,614,216	Net assets available to pay benefits	3,728,539	3,841,410	3,954,837	4,070,339

* This amount is transferred from the Fund to the Authority to meet the expenses of the Authority (see page 29).

Government Superannuation Fund

Forecast Balance Sheet

Estimate as at 30 June 2014 \$000		Forecast as at 30 June 2015 \$000	Forecast as at 30 June 2016 \$000	Forecast as at 30 June 2017 \$000	Forecast as at 30 June 2018 \$000
3,609,029	Investments	3,701,501	3,797,734	3,904,454	4,028,825
	Other assets				
61,295	Cash and cash equivalents	55,521	51,518	54,157	66,213
73,838	Receivables, prepayments and other assets	90,143	109,747	122,989	143,786
135,133		145,664	161,265	177,146	209,999
3,744,162	Total assets	3,847,165	3,958,999	4,081,600	4,238,824
	Less				
129,946	Other payables	118,626	117,589	126,763	168,485
3,614,216	Net assets available to pay benefits	3,728,539	3,841,410	3,954,837	4,070,339
13,759,000	Estimated actuarial present value of Promised Retirement Benefits	13,651,000	13,515,000	13,352,000	13,160,000
10,144,784	Deficit	9,922,461	9,673,590	9,397,163	9,089,661
3,614,216	Net assets available to pay benefits	3,728,539	3,841,410	3,954,837	4,070,339

Note - Deficit

- The estimated actuarial present value of Promised Retirement Benefits (Gross Liability) is the present value of the expected payments by the Fund to existing and past members, attributable to the services rendered. The present value was calculated by the Authority's Actuary using a net discount rate.
- The Deficit shown in the Forecast Balance Sheet differs slightly from that calculated by the Authority's Actuary in their actuarial valuation of the Fund, as at 30 June 2013, under NZ IAS 26, dated August 2013. The Authority's Actuary projected a lower value for the assets of the Fund compared with the forecast made by the Authority.
- There is no requirement on the Crown to fully fund the Deficit in relation to the Schemes.
- The Crown pays its share of the Deficit on a cashflow (pay as you go) basis.
- Reliance is placed by the Authority on the provisions of section 95 of the Act which requires the Minister to appropriate funds from public money to ensure that sufficient funds are available, or will be available, to pay entitlements as they fall due.
- The surplus in the forecast income statement is lower than the projected surplus in the performance objectives (Table 1) as the Forecast Income Statement includes all the costs for the Schemes administration.

Government Superannuation Fund

Forecast Statement of Cash Flows

Estimate 2013/14 \$000		Forecast 2014/15 \$000	Forecast 2015/16 \$000	Forecast 2016/17 \$000	Forecast 2017/18 \$000
	Cash flows from operating activities				
	<i>Cash was provided from</i>				
774,359	Contributions - Crown	746,891	761,739	770,610	771,771
39,895	Contributions - members	35,084	30,633	27,982	29,288
23,003	Contributions - other entities	23,032	21,079	19,074	19,071
86,660	Interest	90,692	83,100	77,192	78,486
	<i>Cash was disbursed to</i>				
(908,805)	Benefit payments	(914,980)	(928,000)	(940,050)	(950,994)
(58,115)	Income tax	(49,271)	(48,581)	(51,673)	(49,739)
(36,747)	Operating expenses	(36,124)	(35,768)	(37,435)	(39,012)
(79,750)	Net cash outflows from operating activities	(104,676)	(115,798)	(134,300)	(141,129)
	Cash flows from investing activities				
	<i>Cash was provided from</i>				
2,496,061	Maturities and sales of investment assets	2,230,554	2,301,470	2,301,636	2,301,173
	<i>Cash was disbursed to</i>				
(2,549,853)	Purchase of investment assets	(2,131,652)	(2,189,675)	(2,164,697)	(2,147,988)
(53,792)	Net cash inflows from investing activities	98,902	111,795	136,939	153,185
(133,542)	Net (decrease)/increase in cash held	(5,774)	(4,003)	2,639	12,056
194,837	Opening cash brought forward	61,295	55,521	51,518	54,157
61,295	Closing cash balance	55,521	51,518	54,157	66,213

Government Superannuation Fund

Forecast Reconciliation of Changes in Net Assets to Net Operating Cash Flows

Estimate 2013/14 \$000		Forecast 2014/15 \$000	Forecast 2015/16 \$000	Forecast 2016/17 \$000	Forecast 2017/18 \$000
232,621	Net increase in net assets	114,323	112,871	113,427	115,502
	<i>Add/(less) movements in working capital items</i>				
12,889	Movement in receivables and prepayments	(17,006)	(19,632)	(13,362)	(19,581)
(43,330)	Movement in other payables	(11,320)	(1,037)	9,174	41,722
(30,441)		(28,326)	(20,669)	(4,188)	22,141
	<i>Add/(less) items classified as investing activities</i>				
(182)	Movement in accrued interest portion of fixed interest securities	793	529	1,339	(1,388)
(333,437)	Movement in net investment assets	(218,000)	(234,000)	(248,000)	(255,000)
3,548	Movement in investment receivables	17,041	19,515	12,961	21,280
48,141	Movement in investment payables	9,493	5,956	(9,839)	(43,664)
(281,930)		(190,673)	(208,000)	(243,539)	(278,772)
(79,750)	Net cash outflows from operating activities	(104,676)	(115,798)	(134,300)	(141,129)

Government Superannuation Fund

Statement of Accounting Policies

Reporting entity and statutory base

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

The Fund is managed by the Authority. The Authority was established as a Crown entity by section 15A of the Act and became an autonomous Crown entity under the Crown Entities Act 2004.

As the primary objective of the Fund is to make a financial return, the Authority has determined the Fund is a profit oriented entity for the purposes of New Zealand equivalents to International Financial Reporting Standards (**NZ IFRS**).

Basis of preparation

Statement of Compliance

The forecast financial statements meet the requirements of section 15N of the Act and comply with New Zealand Generally Accepted Accounting Practice (**NZ GAAP**).

The forecast financial statements also comply with New Zealand equivalents to NZ IFRS, and other applicable Financial Reporting Standards, as appropriate for profit oriented entities. Compliance with NZ IFRS ensures that the financial statements comply with International Financial Reporting Standards (**IFRS**).

These forecast financial statements have been prepared for the Statement of Intent of the Authority commencing on 1 July 2014 and for the Minister. They are not prepared for any other purpose and should not be relied upon for any other purpose.

Actual financial results achieved for the period covered are likely to vary from the information presented, and the variations may be material.

Measurement Base

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

Functional and presentation currency

The reporting currency of the Fund is New Zealand dollars. All values are rounded to the nearest thousand dollars (**\$000**). The functional currency of the Fund is New Zealand dollars.

Particular accounting policies

The following particular accounting policies, which significantly affect the measurement of changes in net assets, net assets and cash flows, have been consistently applied:

a. Reporting requirements

The forecast financial statements have been drawn up in accordance with NZ IAS 26: Accounting and Reporting by Retirement Benefit Plans, and with the provisions of relevant legislative requirements.

b. Investments

Investments are recorded on a trade date basis and are stated at fair value.

c. Promised retirement benefits

The actuarial present value of promised retirement benefits is the present value of the expected payments by the Fund to existing and past members, attributable to the services rendered.

d. Financial instruments

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

All financial instruments are recognised in the Balance Sheet and all revenues and expenses in relation to financial instruments are recognised in the Income Statement.

Investments are recorded at fair value and all other financial instruments are shown at their estimated fair value.

e. Receivables

Receivables are carried at amortised cost.

Assets that are stated at amortised cost, are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such indication exists, an impairment loss is recognised as the difference between the asset's carrying amount and the present value of the recoverable amount.

f. Other assets

Other assets include capitalised expenditure on the Business System. The Business System will be amortised over ten years from completion (expected to be in the year ended 30 June 2015). Amortisation will be recovered from the Authority as the user of the Business System.

g. Investment income and expenses

Dividend income is recorded on the ex-dividend date. Interest is recorded on an accrual basis.

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 (including those arising on translation of foreign currencies), are included in the Income Statement.

Costs of administration of the Fund, including investment management and custodian fees, are paid out of the Fund and recovered in accordance with section 15E of the Act.

h. Operating revenue

In terms of section 15E(1) of the Act, the administration expenses of the Authority, including investment management and custody expenses, are reimbursed by the Fund. The employer subsidy payments made to the Fund by the Crown and other employers includes a share of the expenses.

i. Contributions and benefits

Contributions are recognised in the Income Statement, when they become receivable, resulting in a financial asset for amounts receivable from both members and employers.

Entitlements are recognised in the Income Statement when they become payable.

j. Taxation

For tax purposes, the Fund is classified as a portfolio investment entity (**PIE**). Income taxation expense includes both the current year's provision and the income tax effects of temporary differences (if any).

Since the Fund became a PIE there have been no temporary differences. The Fund is not registered for Goods and Services Tax.

k. Statement of Cash Flows

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

- Cash and other cash equivalents includes cash balances on hand, held in bank accounts, demand deposits and other highly liquid investments in which the Fund and its managers invest as part of its day to day cash management. All balances have an original maturity of less than three months.
- Investing activities are those activities relating to the acquisition, holding and disposal of investments. Investments include securities not falling within the definition of cash, including cash flows from the settlement of forward foreign exchange contracts.
- Operating activities include all transactions and other events that are not investing or financing activities.

l. Consolidation

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

Changes in accounting policies

There are no significant changes in accounting policies.

Government Superannuation Fund Authority

Forecast Income Statement

Estimate 2013/14 \$000		Forecast 2014/15 \$000	Forecast 2015/16 \$000	Forecast 2016/17 \$000	Forecast 2017/18 \$000
35,669	Transfer from the Fund	35,024	37,177	38,229	39,641
9	Other revenue	8	8	8	8
35,678	Total revenue	35,032	37,185	38,237	39,649
3,307	Schemes administration	4,290	5,282	5,282	5,282
28,656	Investment management	26,700	27,775	28,739	30,061
3,715	Operating expenses	4,042	4,128	4,216	4,305
35,678	Total expenses	35,032	37,185	38,237	39,648
-	Net operating result	-	-	-	-

Forecast Balance Sheet

Estimate as at 30 June 2014 \$000		Forecast as at 30 June 2015 \$000	Forecast as at 30 June 2016 \$000	Forecast as at 30 June 2017 \$000	Forecast as at 30 June 2018 \$000
	Tax payers' equity				
-	General funds	-	-	-	-
-	Total tax payers' equity	-	-	-	-
	Represented by				
	Current assets				
280	Cash	160	154	192	183
3,584	Receivables and prepayments	3,196	3,607	4,401	5,265
3,864	Total assets	3,356	3,761	4,593	5,448
	Current liabilities				
3,864	Payables and accruals	3,356	3,761	4,593	5,448
3,864	Total liabilities	3,356	3,761	4,593	5,448
-	Net assets	-	-	-	-

Government Superannuation Fund Authority

Forecast Statement of Cash Flows

Estimate 2013/14 \$000		Forecast 2014/15 \$000	Forecast 2015/16 \$000	Forecast 2016/17 \$000	Forecast 2017/18 \$000
	Cash flows from operating activities				
	<i>Cash was provided from</i>				
36,747	Government Superannuation Fund	36,124	35,768	37,435	39,012
8	Interest	8	8	8	8
	Other				
	<i>Cash was disbursed to</i>				
(36,635)	Operating expenses	(36,252)	(35,782)	(37,405)	(39,029)
120	Net cash flows from operating activities	(120)	(6)	38	(9)
120	Net (decrease)/increase in cash held	(120)	(6)	38	(9)
160	Opening cash brought forward	280	160	154	192
280	Closing cash balance	160	154	192	183

Forecast Reconciliation of Net Operating Result to Net Operating Cash Flows

Estimate 2013/14 \$000		Forecast 2014/15 \$000	Forecast 2015/16 \$000	Forecast 2016/17 \$000	Forecast 2017/18 \$000
-	Net operating result	-	-	-	-
	<i>Add/(less) movements in working capital items</i>				
1,058	Decrease/(increase) in receivables and prepayments	388	(411)	(794)	(864)
(938)	(Decrease)/increase in payables and accruals	(508)	405	832	855
120	Net cash flows from operating activities	(120)	(6)	38	(9)

Government Superannuation Fund Authority

Statement of Accounting Policies and Significant Assumptions

Reporting entity and statutory base

The Authority was established as a Crown entity by section 15A of the Act. The core business of the Authority is to manage and administer the Fund and the Schemes (see below).

The Fund was established by section 13 of the Act. It consists of various defined benefit superannuation schemes as prescribed in the Act. A separate financial forecast has been prepared for the Fund. Pursuant to section 19H of the Act, the Schemes are registered under the Superannuation Schemes Act 1989.

The forecast financial statements have been prepared on the basis that the Authority is a going concern. The Authority is an Autonomous Crown Entity for legislative purposes and, as the primary objective is not to make a financial return, the Authority has designated itself a Public Benefit Entity for the purposes of New Zealand Equivalents to International Financial Reporting Standards (**NZ IFRS**).

Basis of preparation

Statement of compliance

The forecast financial statements have been prepared in accordance with section 142 of the Crown Entities Act 2004, which includes the requirement to comply with New Zealand Generally Accepted Accounting Practice (**NZ GAAP**). The forecast financial statements comply with other applicable Financial Reporting Standards, as appropriate for Public Benefit Entities.

These forecast financial statements have been prepared for the Statement of Intent of the Authority commencing on 1 July 2014 and for the Minister. They are not prepared for any other purpose and should not be relied upon for any other purpose.

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

Measurement base

The forecast financial statements are prepared on the historical cost basis.

Functional and presentation currency

The reporting currency of the Authority forecast financial statements is New Zealand dollars and all values are rounded to the nearest thousand dollars (**\$000**). The functional currency of the Authority is New Zealand dollars.

Particular accounting policies

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

a. Forecast figures

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

b. Revenue and expenses

Revenue and expenses are recognised on an accrual basis.

Revenue is measured at the fair value of consideration received/or receivable. Revenue from the Fund is recognised as earned and reported in the financial period to which it relates.

Expenses paid in foreign currency are recorded at the rates of exchange prevailing at the date of the transactions and there are no currency gains or losses.

c. Goods and Services Tax

The Authority makes principally exempt supplies for Goods and Services Tax (GST), as it manages superannuation schemes. GST is imposed on imported services if those services would be a taxable supply in New Zealand. The affected transactions for the Authority are fees incurred in relation to the custody of assets and investment reports undertaken overseas. GST on services is not reclaimable and GST is therefore included in expenditure.

d. Statement of Cash Flows

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

e. Taxation

As a Public Authority, in terms of section CW 38(2) of the Income Tax Act 2007, the Authority is exempt from income tax.

f. Accounting for Joint Ventures

The Authority has a 50% ownership in Annuitas. Staff employed by Annuitas act in management roles on behalf of the Authority. Reimbursement of Annuitas costs, calculated on a time basis, are included in the operating expenses of the Authority. The Authority does not equity account for Annuitas as this is deemed to be immaterial.

Changes in accounting policies

All policies have been applied on bases consistent with those used in the year ended 30 June 2013.

Investment management expenses

Investment management fees (including custody costs) are forecast to decrease from the estimate of \$28.562 million in 2014 to a forecast of \$26.550 million in 2015. This is primarily due to an decrease in forecast investment performance fees.

Schemes administration expenses

The forecast Schemes administration expenses include reimbursement to the Fund for amortised expenditure on the Business System owned by the Fund.

Recovery of expenses

The forecast expenses of the Authority, for the management and administration of the Fund and the Schemes for the 2014/2015 year, are \$35.032 million. These expenses, net of other revenue of \$0.008 million are recovered from the Fund in accordance with section 15E of the Act.

The Fund then recovers payments made to the Authority (forecast \$35.024 million), partly from the Crown, under a Permanent Legislative Authority (**PLA**), and partly from non Government employer contributions.

The payments to the Authority by the Fund are recovered from the Crown and from non Government employer contributions in proportions determined by the Appointed Actuary. The Authority's appointed Actuary has determined that, from 1 July 2014, the Crown's share will be 88% (forecast \$30.821 million) and the share to be met from the non Government employer contributions 12% (forecast \$4.203 million).

The expenses of the Authority include:

- Management of the GSF assets (**the Fund**).
- Expenses related to investment management, custodial arrangements and fees for implementing processes for avoiding prejudice to New Zealand's reputation as a responsible member of the world community.
- Management of the Schemes, including the agreement between the Authority and the Schemes Administrator.
- Interpretation of the provisions of the Act and the Policies and the exercising of discretionary powers (set out in the Act).
- The fee paid to Annuitas under the management services agreement between the Authority and Annuitas.



**Statement of Performance Expectations
(SPE)**