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REPORTS OF THE

GOVERNMENT SUPERANNUATION FUND AUTHORITY

FOR THE YEAR ENDED
30 JUNE 2010

GOVERNMENT SUPERANNUATION FUND
Te Pūtea Penihana Kāwanatanga

FOR THE YEAR ENDED
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2010

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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 2010.

A separate annual report has been prepared by the Authority on the Government Superannuation Fund (**GSF** or **the Fund**), beginning on page 23.

The Authority was established in October 2001 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**) in January 2004.

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, appointed by the Board, carries out these functions under delegation from the Board.

Features of the 2010 Year

- Solid investment returns in the recovery from the Global Financial Crisis (**GFC**).
- Surplus after-tax of $285 million (10.4% of net assets).
- Significant added value from active management of most asset classes.
- Further progress in diversifying the Fund's investment market exposures and investment manager appointments.
- Tender undertaken to identify an organisation to undertake the development of a new and more sustainable system to be used in the administration of the GSF Schemes. Work undertaken on the first phase of the project.

Investments

Investment markets remained very unsettled throughout the last year in the aftermath of the worst GFC in at least 50 years. Markets rallied strongly through most of the financial year but petered out toward the end, becoming highly volatile reflecting conflicting assessments of global financial risk and return.

The threat of a global banking collapse was averted by massive, concerted government stimulus. Nevertheless, a lot of uncertainty remains about the durability of the economic recovery and the capacity of governments to manage their economies out of the huge debt overhang that has been built up. History suggests no easy or painless path for over-indebted economies, only tough political choices about how the burden is shared.

The New Zealand economy was somewhat insulated from the GFC partly due to its relatively sound banking system and partly through its exposure to Australia and Asia, which grew more strongly than the US and European economies. This was reflected in a strong recovery of the NZ dollar. Nevertheless, New Zealand has a high level of external debt and continued dependence on foreign investment, which makes it vulnerable to global financial shocks.

The Board continues to focus on the longer term with an investment strategy appropriate for a Fund that is expected to pay pensions for the next 60 years or so. This is achieved by diversifying the Fund's exposures to growth assets and by engaging investment managers considered to be capable of adding value. The Board is constantly seeking to enhance the management of the Fund to meet the statutory requirements of best practice portfolio management and maximising return without undue risk to the Fund as a whole.

Recent initiatives to diversify the Fund's market exposures away from equities include small allocations to managed portfolios of emerging market government debt, high yield corporate debt and natural catastrophe insurance securities. In addition, the Board is managing its foreign currency exposure more actively and considering dynamic allocation among its major risk exposures more generally. It has also moved to active management of its commodities' exposures.

During the year the Authority modified the way it defines and monitors its investment strategy. It has developed a Reference Portfolio, which is a simple portfolio which could meet the Risk Parameter (see page 5) and the Investment Performance Measure (**IPM**) (see page 5) by investing passively in liquid public markets at low cost. The Authority believes that, although the Reference Portfolio meets the risk and performance measures, it is not the most efficient portfolio. It is of the view that further diversification and active management can make meaningful improvements to the overall risk/return trade-off. The diversification and active management decisions are reflected in a 'Target Portfolio'. This portfolio is benchmarked against the Reference Portfolio to assess whether the diversification and active management decisions have added value net of costs.

Investment Returns

The investment performance of the Fund during the year was heartening as solid returns across most asset classes were augmented by significant value added by the Fund's investment managers.

The Fund's surplus before-tax of $383 million was 14.3% of net assets. The surplus after-tax of $285 million was 10.4% of net assets, (ahead of the Fund's IPM of 8.2%). These were welcome results after two years of negative returns.

The return from the Fund's international equities portfolio outperformed the broad global market benchmark by 3.0% before-tax in 2010. The return from this asset class is 2.2%pa ahead since 2007, when the Fund switched from passive investment of international equities to a selection of active managers using various strategies aimed at achieving better performance than the market. Active management also enhanced returns in most other asset classes. Overall, active management contributed 2.0% before-tax to the Fund's before-tax return of 14.3%. This translated into a 1.3% return net of investment management fees.

The strong recovery in the NZ dollar was a feature of the year, and this detracted significantly from the performance of unhedged offshore investments. The NZ dollar rose 9% in trade-weighted terms. Although offshore investments represent about 90% of the Fund's assets, all but 20% were hedged back to NZ dollars through most of the year, effectively recouping currency losses on the underlying investments.

The table below compares the Fund's investment returns against the IPM for periods ended 30 June 2010.

	1 year %	5 years Annualised %	Since October 2001 Annualised %
Fund return	10.4	1.2	2.3
IPM	8.2	7.2	7.0

The five years annualised return includes the impact of the GFC on investment markets. The since October 2001 return includes the impact of the GFC and the decline in equity markets in 2000-2003.

Full details of the Fund's Investment Strategy and returns can be found in the Investment Commentary on page 5.

Schemes

Datacom Employer Services continues to perform well as the schemes' administrator.

Following a tender, the Authority appointed Datacom Systems (Wellington) Limited to undertake the development of a new and more sustainable system to be used in the administration of the GSF Schemes. The project is being planned in three phases: Elaboration, Construction and Transition, using a development approach known as Rational Unified Process.

The Elaboration phase commenced early in 2010 and has proceeded on time and to budget. This phase will be completed towards the end of 2010 at which time Datacom will move on to the Construction and Transition phases.

Further comment on GSF Scheme's activity can be found on page 13 of this report.

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. It explains how the Authority operates and gives all stakeholders immediate access to our latest quarterly investment results, as well as any changes the Authority makes to its policies, Investment Strategy and personnel.

Tributes

During the year three Board members, Helen Bowie, Susie Weaver and Ralph Stockdill retired when their terms of appointment came to an end.

Ms Bowie was a member of the inaugural Board, appointed when the Authority took over responsibility for managing the Fund and administering the Schemes in 2001. She was previously a member of the GSF Establishment Board. Ms Bowie's legal background and skills provided valuable insights and a strong governance focus across the full range of the Board's activities and discussions.

Ms Weaver was appointed in December 2001, soon after the establishment of the Board, and was a member of the Board's Investment Committee. The Authority and the Fund benefitted from Ms Weaver's wide experience in investment matters.

Mr Stockdill was appointed as a member of the Board in July 2002, following his retirement from senior management positions with the Department of Labour. His background and experience proved particularly relevant in the management of the GSF Schemes and the development and implementation of the Authority's Responsible Investment Policies.

The Board expresses its appreciation and thanks for the significant contributions made by Ms Bowie, Ms Weaver and Mr Stockdill and wishes them well for the future.

The Authority welcomed Toni Kerr and Mark Verbiest as new members of the Board.

Conclusion

The Board thanks the Minister of Finance and government officials for their support, and the Management team and staff for their high level of work and commitment to meeting the Authority's objectives.

I also thank my fellow Board members for their expertise and commitment during the year.

Tim McGuinness
Chairman
Government Superannuation Fund Authority Board

GOVERNMENT SUPERANNUATION FUND AUTHORITY
INVESTMENT COMMENTARY

Investment Strategy

The Authority is required to invest the Fund on a prudent commercial basis. In so doing, it aims to maximise returns without undue risk to the Fund as a whole, while managing and administering the Fund in a manner consistent with best practice portfolio management.

The investment strategy of the Fund is defined in terms of its Investment Objective, Investment Performance Measure 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 is assessed by comparing the after-tax return with the NZX New Zealand Government Stock Gross Index return (after-tax) plus at least 2.5% per annum measured over rolling 10 year periods.

Risk Parameter

Having no more than a 1 in 10 chance in any one year of a loss after-tax greater than 9.0% of the total Fund.

The IPM and Risk Parameter are reviewed at least annually, taking into account the investment and tax environment in which the Authority operates. The Authority modified the investment strategy slightly during the year. The Risk Parameter was increased to a 1 in 10 chance of an annual loss larger than 9% (previously 6%) in view of an increase in expected market risk levels. The IPM was also changed by increasing the margin over Government Stock to 'at least' 2.5% to reflect a corresponding increase in expected return for the higher level of risk.

Asset Allocation

The Authority reviews the asset allocation of the Fund regularly to ensure it remains consistent with the Investment Objective, legislative requirements and best practice.

During the year the Authority changed the way it defines and monitors its asset allocation. A Reference Portfolio replaced the Strategic Asset Allocation (**SAA**) from 1 July 2010. The Reference Portfolio is a globally diversified asset allocation that could meet the Investment Objective by investing passively in liquid public markets at low cost. The Reference Portfolio reflects a practical, low cost strategy against which all active investment decisions will be benchmarked to assess whether they have added value, in terms of either higher returns, or reduced risk, net of costs. Active decisions will be reflected in a Target Portfolio. These decisions will include the addition of asset classes that provide uncorrelated sources of return as well as skill-based active management strategies.

Table 1 sets out the SAA that applied as at 30 June 2010 and 30 June 2009. This table continues to refer to the SAA because the Reference Portfolio became effective on 1 July 2010.

Table 1

Asset Class	**Strategic Asset Allocation at 30 June 2010**	**Strategic Asset Allocation at 30 June 2009**	**Actual Economic Exposures at 30 June 2010***
	%	%	%
Global fixed interest	24.0	24.0	25.4
New Zealand equities	10.0	10.0	10.1
International equities	49.5	49.5	47.7
Commodity futures	3.0	3.0	3.5
Real estate	8.0	8.0	6.5
Absolute return**	5.5	5.5	6.8
TOTAL	**100.0**	**100.0**	**100.0**

* The Fund also invests in a multi-asset class which is a diversified portfolio comprising listed equities, private equities, real estate and hedge funds. The economic exposures, held indirectly through the investment in the multi-asset class, have been reallocated to the other asset classes held by the Fund.

** Absolute return comprises part of the investment in the multi-asset class strategy and global tactical asset allocation (GTAA). The GTAA manager invests tactically in a range of liquid public market securities, including developed and emerging market equities, bonds, currencies and commodities.

Table 2 compares the actual asset allocation, as at 30 June 2010, and 30 June 2009.

Table 2

Asset Class	**Investment Assets Actual at 30 June 2010**		**Investment Assets Actual at 30 June 2009**	
	$000	%	$000	%
Global fixed interest	703,737	24.0	515,386	19.4
New Zealand equities	294,688	10.0	262,071	9.9
International equities	1,333,348	45.4	1,248,203	47.1
Commodity futures	82,765	2.8	64,378	2.4
Real estate	171,745	5.9	166,092	6.3
Multi-asset	236,379	8.1	230,014	8.7
Global tactical asset allocation	111,800	3.8	163,106	6.2
TOTAL	**2,934,462**	**100.0**	**2,649,250**	**100.0**

The numbers in the table are based on the assets managed by the investment managers for each asset class. They differ from the investments numbers set out in the Statement of Net Assets for the Fund (see page 30) because of differing disclosure requirements for financial reporting purposes.

Table 3 sets out the Reference Portfolio and the Target Portfolio to apply from 1 July 2010.

Table 3

Asset Class	Reference Portfolio %	Target Portfolio %
Global fixed interest	30.0	26.5
New Zealand equities	10.0	9.3
International equities	55.0	45.0
Commodity futures	5.0	4.2
Real estate	–	5.0
Multi-asset class	–	7.0
Global tactical asset allocation	–	3.0
TOTAL	**100.0**	**100.0**

Investment Returns

The Fund made a welcome recovery in 2010 following two years of negative returns during the global financial crisis.

The Fund's surplus before-tax of $383 million was 14.3% (2009: -19.9%) of net assets. The surplus after-tax of $285 million was 10.4% (2009: -16.8%) of net assets, (ahead of the Fund's IPM of 8.2%).

Table 4 compares the Fund's after-tax investment returns against the IPM over periods ended 30 June.

Table 4

	1 year to 30 June 2010 %	5 years Annualised %	Since October 2001 Annualised %
Fund return	10.4	1.2	2.3
IPM	8.2	7.2	7.0

The negative investment returns in the 2008 and 2009 financial years and the effects of the 2000-03 crash mean the Fund's annualised annual return since October 2001 remains 4.7% below the IPM.

Active management added 2.0% overall to the Fund's before-tax return in 2010, equivalent to 1.3% net of investment management expenses. Significant excess returns were generated by the Authority's equities and global fixed interest managers and the commodities manager. In addition, the multi-asset class strategies added value through a focus on credit and emerging markets exposures. Only the return from real estate was behind benchmark.

The challenge of maintaining an effective currency hedge, when international equities and the NZ dollar were both rising, acted as a slight drag on total performance. In May the Authority increased the proportion of the Fund unhedged to 33% as the NZ dollar was seen to be over-valued from a medium term perspective. The hedging position will continue to be managed actively pursuant to a framework approved by the Board.

The revival in returns from growth assets in 2009/10 reflected relief that unprecedented and co-ordinated government stimulus would avert possible global deflation and depression following the global financial crisis (**GFC**). The very strong rebound in share prices that started in March 2009 petered out, however, in the June quarter of 2010. The initial relief gave way to the realisation that excessive accumulated debts still remained to be worked through and that future economic growth will be saddled with this burden for some time. By the close of the 2010 financial year, markets were challenged by heightened uncertainty about the strength and durability of the global economic recovery and the capacity of public policy to restore confidence.

It is important to take a long term view of investment returns, as the Fund is expected to pay annuities for another 60 years. To earn at least 2.5% after-tax, over and above the after-tax returns from Government stock over the long term, means the Fund has to invest with above average risk and the Risk Parameter recognises this. Any losses are expected to be more than offset over time by years of high returns. The losses experienced in 2009 and 2008 were a reflection of the severity of the GFC. Despite this unusually volatile period the Board is confident that its current investment strategy is appropriate.

Returns by Asset Class

Table 5 compares the before-tax investment returns by asset class and for the total Fund for the financial years ended 30 June 2010 and 2009.

Table 5

Before-tax Investment Returns for each Asset Class, and for the Fund, for 2010 and 2009

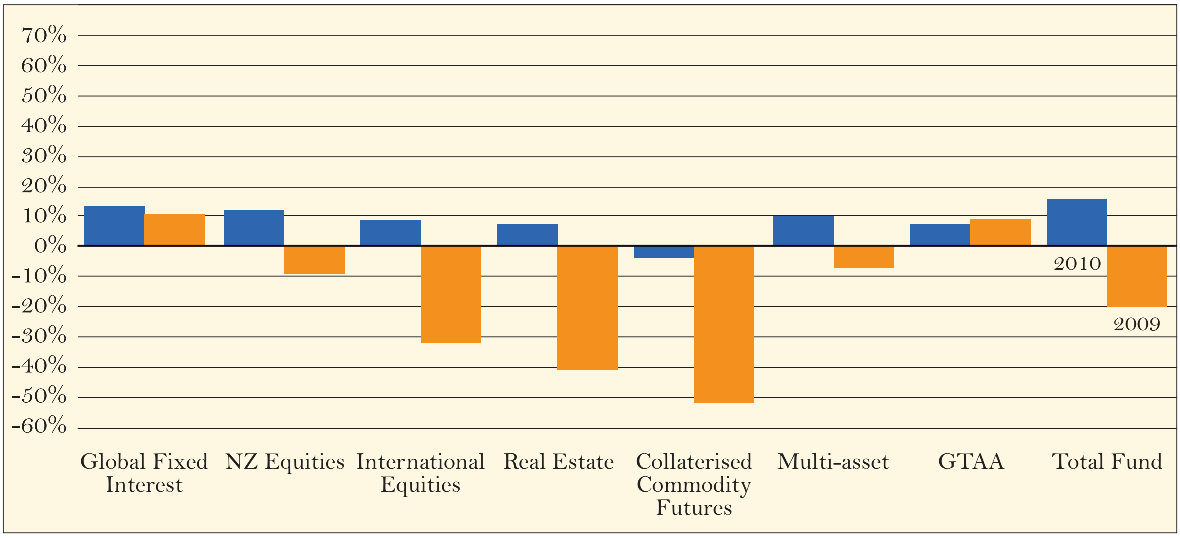
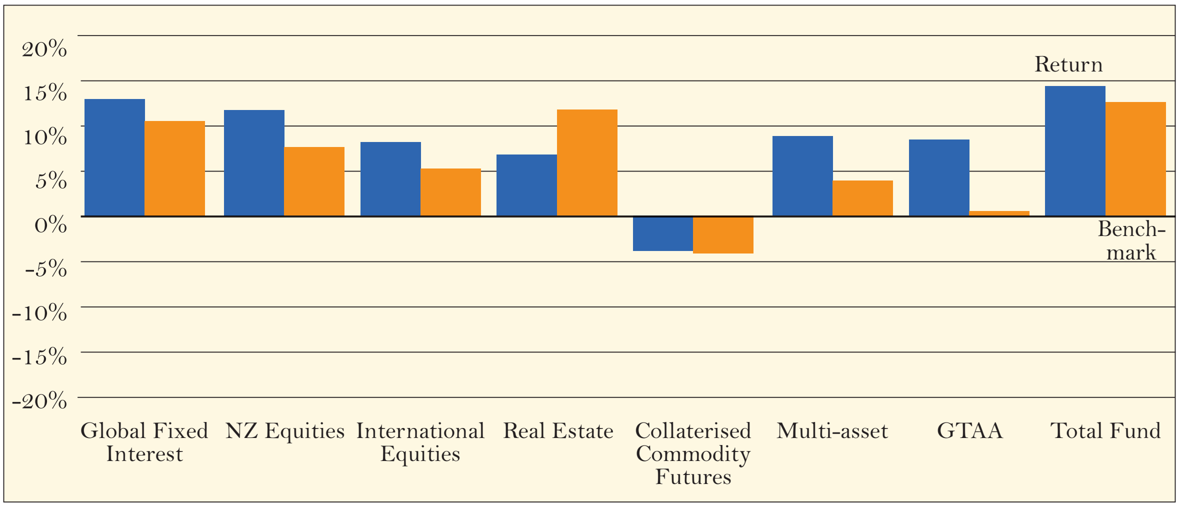


Table 6 compares the before-tax investment returns for each asset class with its benchmark index.

Table 6

Before-tax Investment Returns v Benchmark, year ended 30 June 2010



Global Fixed interest 12.9%

Barclays Capital Global Aggregate Index, hedged to New Zealand dollars 10.4%

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).

Returns from government bonds around the world were solid. In the context of sharply rebounding share prices through most of the financial year, bond yields remained relatively stable on account of subdued inflationary pressure and easy monetary policy. Declining credit spreads provided a yield enhancement in this period. In the June quarter, however, government bond yields fell and spreads widened in a flight to quality, due to concerns that fiscal austerity plans in Europe would derail world growth. US 10 year bond yields fell 60 basis points (bps) over the year as a whole to 2.93%, while the New Zealand 10 year bond yield also ended the year 60 bps lower at 5.34%.

The fixed interest managers added 2.3% of return net of fees above the benchmark.

International equities 8.3%

MSCI All Countries World Index 5.3%

Global share markets represent the discounted value of future corporate earnings and dividends over the long term. In the short term, however, they act as the barometer of risk in the global economy. For example, global share prices fell 55% from a peak in October 2007 to a basement level in March 2009, in the midst of the worst financial crisis in at least 50 years. From there they rebounded to a peak in April 2010 of almost 80% of the previous high, in response to concerted government policy stimulus. Then the recovery petered out and high volatility persisted in the June quarter owing to heightened uncertainty about the robustness of economic growth and the ability of governments to withdraw the earlier stimulus.

This nervousness about potentially negative outcomes, whether deflationary or inflationary, is unlikely to go away soon. Debt burdens and sub-par global growth will also keep earnings growth in check for the next few years. Share prices will continue to reflect these risks accordingly.

For the June financial year, the global share market index return was a solid 11.5% in local currency terms. In NZ dollars, however, the return was 5.3%.

The Authority's international equities managers had an excellent year, adding 2.4% of return (net of fees) above the benchmark. Since moving to active management in late 2007, the Authority's managers have added 2.2%pa net of fees.

New Zealand equities 11.7%

NZX50 Gross Index including imputation credits 7.6%

The New Zealand share market lagged global markets in financial 2010 in local currency terms but was ahead in NZ dollar terms owing to the strong NZ dollar. The New Zealand market tends to underperform global markets during rallies and outperform during sell-offs. The New Zealand Equities' managers added 3.3% of return (net of fees) above the benchmark.

Real Estate 6.7%

Composite UBS Warburg Global Real Estate Investors Index, FTSE EPRA NAREIT Index hedged into New Zealand dollars and US NCREIF Index 11.6%

As for global equities in general, listed property securities rebounded strongly this year, both globally and in New Zealand. The global listed property benchmark returned 25.8% in local currency terms. In contrast, direct property returned -14.8% as underlying property values remained soft despite the rally in listed Real Estate Investment Trust (REIT) prices. This reversed the relative returns during the 2008/09 crisis period when property values were slow to decline while REIT prices plummeted.

This is the one asset class where the Authority's managers under-performed. The Fund is in the process of withdrawing from US direct real estate and reallocating that exposure to a value adding strategy in New Zealand instead.

Collateralised Commodity Futures -3.8%

Dow Jones-UBS Commodities Total Return Index hedged into New Zealand dollars -4.1%

The Fund has a small allocation to commodities that is expected to generate a return uncorrelated to the rest of the Fund, but which is quite volatile. Exposures are maintained to a diversified basket of liquid commodity futures fully collateralised with cash equivalents. The manager actively manages the exposure. In 2010 commodity prices weakened overall. While the manager added 1.5% net of fees, the Fund lost ground in transitioning to an active manager from the passive commodities index swap held previously.

Multi-asset class 8.2%

Composite index comprising 70% of the MSCI All Countries World Equities Index and 30% of the Lehman Brothers Global Aggregate Bond Index 4.4%

About 8% of the Fund is invested in an endowment-like global fund. In addition to public equity and bond market investments, the fund invests globally in private equity, real estate, natural resources and absolute return strategies. This multi-asset strategy aims to earn equity-like returns over the long term with about half the volatility of listed equities. It is benchmarked against a simple 30/70 bond/equities portfolio with similar risk profile to the total Fund.

The multi-asset class fund out-performed its benchmark by 3.8% gross and 3.3% net of fees. After trailing the strong rise in equity markets through to February 2010, the fund avoided much of the slump in May and June. Key factors contributing to the added value included this defensive positioning, an emphasis on credit rather than equities, and a strong bias toward emerging markets. The fund is progressively making investments in global private equity and real estate.

Global tactical asset allocation 8.4%

USD 3 month LIBOR plus 6% pa hedged into New Zealand dollars 0.5%

The Fund is invested in a global tactical asset allocation strategy. The manager invests tactically in a range of liquid public market securities including developed and emerging market equities, bonds, currencies and commodities. The strategy is benchmarked against a target of 6% per annum above cash, hedged into NZ dollars. In 2010 the manager exceeded the target by 7.9% gross and 5.0% net of fees. Most of this value was added in the early part of the financial year as the manager captured momentum in its asset allocation and currency strategies.

Responsible Investing

The GSF Act requires the Authority to manage and administer the Fund (among other requirements) in a manner consistent with avoiding prejudice to New Zealand's reputation as a responsible member of the world community. The Authority must also have an ethical investment policy. These matters are addressed in the Authority's Responsible Investment (**RI**) Policies, which also cover:

- Environmental, social and governance considerations.
- The retention, exercise and delegation of voting policies.

In terms of its RI Policies the Authority excludes direct investment in securities issued by a number of companies that are involved in manufacture of tobacco, anti-personnel mines, cluster munitions and nuclear weapons. These activities are inconsistent with the Authority's RI Policies and with international conventions to which New Zealand is a party.

The Authority invests in a number of collective investment vehicles (**CIVs**). These are a practical and cost effective way to achieve exposure to some markets and managers, but the Authority has little influence over the securities held by the CIVs, or their individual voting decisions. In such cases, the managers of the CIVs have been made aware of the Authority's RI Policies and its decisions with respect to them. The managers are encouraged to consider whether the RI Policies are appropriate for the CIVs.

The Authority and other Crown Financial Institutions (**CFIs**) have similar RI obligations and all are signatories to the United Nations Principles for Responsible Investment (**UNPRI**). As a result the CFI's work closely together to ensure their RI policies are implemented consistently and economically. Much of the necessary work is undertaken for the group by the New Zealand Superannuation Fund's Responsible Investing Unit. The Authority has also participated in collaborative engagements, both directly with the NZ Superannuation Fund and through the UNPRI, with companies believed to infringe the RI Policies, to encourage them to change their practices. New investments are also evaluated in terms of the RI Policies as well as normal commercial criteria.

SCHEMES COMMENTARY

New business system

Following a tender, the Authority appointed Datacom Systems (Wellington) Limited (**Datacom Systems**) to undertake the development of a new and more sustainable system to be used in the administration of the GSF Schemes. The Authority is satisfied that Datacom Systems has the resources, experience and capability to undertake the work.

The project is being planned in three phases: Elaboration, Construction and Transition using an approach known as Rational Unified Process. The objectives of the Elaboration phase are to further refine the scope and technology for the new system and to give the Authority greater certainty as to the total cost of the project. The Elaboration phase commenced early in 2010, has proceeded on time and to budget, and is already achieving the objectives. This phase will be completed towards the end of 2010 at which time Datacom will move on to the Construction and Transition phases.

Schemes administration

Datacom Employer Services Limited continues to perform well as the scheme administrator of the GSF Schemes and has met the new performance standards that applied from 1 July 2009. These new performance standards reflect current best practice in schemes administration and are more specific in terms of required turn-around times.

Additional payment to members in receipt of CPI adjusted annuities

As part of Budget 2010, a legislative change was made whereby members, in receipt of a consumer price index (**CPI**) adjusted annuities, will receive an additional payment equivalent to 2.02% of their annuity payments between 1 October 2010 and 27 April 2011. The additional payment is intended to provide compensation to members for the increase in goods and services tax (**GST**) on 1 October 2010. After 27 April 2011 the impact of the increase in GST will be reflected through the annual CPI adjustment applied to annuity payments from 28 April 2011.

GOVERNMENT SUPERANNUATION FUND AUTHORITY
STATEMENT OF GOVERNANCE AND ACCOUNTABILITY

The Authority was established in October 2001 as a Crown entity by section 15A of the GSF Act and became an autonomous Crown entity under the Crown Entities Act in January 2004. 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 - as at 1 September 2010

The Minister of Finance has appointed the following six members to the Board:

Tim McGuinness. Chairman. Appointed as a Board member in 2001 and reappointed in 2004 and 2007. Appointed as Chairman in 2008. Mr McGuinness is a trustee of the Police Superannuation Scheme, NZ Fire Service 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.

David May. Deputy Chairman. Appointed in 2001 and reappointed in 2004, 2007 and 2009. Mr May 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, a director of Southern Cross Medical Care Society and a trustee of Southern Cross Healthcare Trust.

Toni Kerr. Appointed in 2009. Ms Kerr is Head of Treasury Operations at Kiwibank Limited. She previously held a number of senior management roles in BNP Paribas based in Hong Kong, and has considerable experience in banking and wealth management.

Steve Napier. Appointed in 2008. Mr Napier is a Whakatane based financial advisor. He previously held senior investment management positions with Colonial First State Investments.

Keith Taylor. Appointed in 2008. Mr Taylor is Deputy Chair of the Earthquake Commission and a Board member of the Takeovers Panel and the New Zealand Qualifications Authority. He is a director of the Reserve Bank of New Zealand, Gough, Gough and Hamer Limited, Catalyst Risk Management Limited, Port Marlborough New Zealand Limited and Butlands Management Services Limited. He was previously Group Managing Director and Chief Executive Officer of Tower Limited and, prior to that, held a number of senior management roles in Tower and its predecessor, Government Life.

Mark Verbiest. Appointed in 2009. Mr Verbiest was a member of Telecom's senior executive team between 2000 and 2008. He is also a director of AMP Haumi Management Limited (manager of the AMP NZ Office Trust), Freightways Limited, Southern Cross Medical Care Society, Transpower New Zealand Limited and Willis Bond Capital Partners Limited, Chairman of Aptimize Limited and a trustee of Southern Cross Healthcare Trust. He is also a member of the Securities Commission and a consultant to national law firm Simpson Grierson.

Retired Board Members

Helen Bowie, Susie Weaver and Ralph Stockdill retired from the Authority Board when their terms of appointment ended in 2009.

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 two committees with specific responsibilities for Audit and Risk Review and Investments. 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 Ian Marshall of Deloitte to act on her 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 schemes management, the delegation includes interpretation of the provisions of the GSF Schemes and exercise of discretionary powers in accordance with the Provisions, Policies and Procedures of the Government Superannuation Fund, 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
- Janet Shirley — Manager, Schemes
- Paul Bevin — General Manager, Investments
- Peter McCaffrey — Manager, Special Projects
- Nicky Rumsey — Manager, Investments

Indemnity

The Authority has:

- 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 members of Management, who exercise delegations on behalf of the Board in terms of the MSA, whereby it agreed to indemnify the members of Management (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 indemnities provided by the Authority to Board members and the members of Management do not protect the Board member, or the members of Management, 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 indemnities. 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 Management 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 Management, 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 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 (the Fund),
- management of the GSF Schemes, including the agreement between the Authority and the scheme administrator, and
- interpretation of the provisions of the GSF Act and exercising discretionary powers (as 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 2009.

Investment Management

Performance Measure	Performance Achievement
Maximise investment returns (without undue risk)	
Over the long term, the Fund return meets the Investment Performance Measure (**IPM**) and Risk Parameter, by maintaining a diversified portfolio of assets (Strategic Asset Allocation (**SAA**)), measured: • through independent advice and assessment; and • by internal investment management with monthly management reporting and quarterly reporting to the Board.	The Fund's return of 10.4% after-tax for the June year 2010 exceeded its Investment Performance Measure (IPM) (see page 5) by 2.2%, reflecting a rebound in equity markets after the Global Financial Crisis (**GFC**). Since October 2001, when the diversification of the Fund's investment portfolio commenced, the Fund's annualised return of 2.3%pa lags the IPM by 4.7%pa on account of market crashes in 2000-03 and 2008-09. The Fund's risk for the year, measured by the volatility of annual returns, was within its Risk Parameter (see page 5). Collectively, active management added 2.0% to this year's return before-tax (1.3% net of fees). Performance against the IPM and the Risk Parameter is assessed monthly by internal investment management and reported quarterly to the Board.

Performance Measure	Performance Achievement
	The Authority reviewed the investment assumptions underlying the Fund's investment strategy in 2009, following the GFC. Risk estimates were increased, and there was an associated increase in expected returns but there was no significant change in the asset allocation. As a result, the IPM and the Risk Parameter were changed. The Authority approved a more flexible approach to managing the Fund's net foreign currency exposure to limit the risk of losses from associated declines in both global equity markets and the NZ dollar.
Assessment of investment manager performance against agreed mandates and benchmarks measured through: • independent assessments by investment adviser; and • internal investment management with monthly management reporting and quarterly reporting to the Board.	The investment managers (retained by the Authority) are highly rated by independent advisers. The investment managers are reviewed on a regular basis by the investment advisors and reports are provided to internal investment management. Internal investment management also carries out its own review of the investment managers. Any matters of concern are followed up by management with the investment manager and reported to the Board as appropriate. Monthly reports are received from each of the investment managers and from the custodian. The custodian's report compares each manager's performance against benchmark and compliance against mandate. Only minor breaches of mandates were identified during the year. Detailed reports are provided by internal investment management to the Board using an upgraded performance measurement and analysis system

Performance Measure	Performance Achievement
Fully compliant with policies and procedures, in particular: • no unauthorised variations from the Statement of Investment Policies Standards and Procedures (**SIPSP**) (which may be varied by the Board from time to time) identified on annual review; • actual allocations rebalanced to within SAA rebalancing tolerances, monthly; • investment manager risk remains in line with expectation through comparing investment managers' risk profile' against assessed risk; and • custodian performance is in line with their Service Level Agreement. Comparison of Fund performance and cost structure with similar organisations at least annually.	The Fund remained fully compliant with the SIPSP throughout the year. Rebalancing was undertaken monthly to within SAA rebalancing tolerances. Each Investment manager's risk profile is analysed monthly by management, supported by monthly compliance certificates from the manager. Custodial service is monitored against Service Level Agreement standards quarterly. Custodial service is benchmarked regularly against peers. Action is taken by management if the level of service provided by the custodian is below the level of peers. The Fund participates in an annual review of performance and costs benchmarked against global peer funds. The 2009 review showed the Fund was in line with its peers.
Meet the needs and reasonable expectations of stakeholders	
No significant negative feedback from stakeholders.	No significant negative feedback was received from stakeholders. As a key stakeholder, the Minister has asked the Authority to pay particular attention to the cost of external investment managers undertaking active management.

Performance Measure	Performance Achievement
Compliant with Responsible Investment Policies (including the Board's policies on ethical investment and the aspirational principles established by UNPRI).	The Authority has complied with the Responsible Investment Policies (including the Board's policies on ethical investment and the aspirational principles established by UNPRI). The Authority excludes direct investment in certain companies, involved with tobacco, nuclear weapons, cluster bombs and anti-personnel mines. It is working with The Guardians of the New Zealand Superannuation Fund and other Crown Financial Institutions to monitor other companies that may be infringing the ethical standards and is participating in collaborative engagement to encourage such companies to modify their practices. The Authority subscribes to the UNPRI and participates in some co-operative engagements through the UNPRI.
Overall expected cost $20.8 million.	Actual cost for the year ended 30 June 2010 was $24.3 million. The actual cost reflects higher than expected investment manager fees, caused by the value of investment assets being higher than forecast. Investment managers' fees are generally set as a percentage of funds under management. In addition, some managers, who added value above benchmarks during the year, were paid performance fees under contracted arrangements.

Schemes Administration

<table>
<tr><th>Performance Measure</th><th>Performance Achievement</th></tr>
<tr><td colspan="2">Pay entitlements and process contributions, correctly and on time and respond appropriately to stakeholders' inquiries</td></tr>
<tr><td>Performance is in line with (the performance standards set out in) the Management Agreement between the Authority and the Scheme Administrator, specifically:
• 100% of all annuities are paid on time;
• all contributions are banked on receipt and allocated as soon 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 measured through monthly reporting, with overall performance measured by monitoring the performance of the Administrator, with monthly reports and follow up.</td><td>The scheme administrator met the performance standards for the year.

Detailed monthly reports are provided by the Scheme Administrator reporting on performance against standards. This report is reviewed in detail by management and included in the papers considered by the Board at its regular meetings. Quarterly compliance certificates are received from Datacom Employer Services and are reviewed by management.

There was a batch processing error by the bank, that processes the payment of pensions, that resulted in a delay of up to 2 business days in the payment of one 4 weekly instalment of annuities to 217 overseas annuitants in Australia and the United Kingdom. Additional procedures have been put in place to reduce the risk of this error from recurring.</td></tr>
<tr><td>The Business System is relevant and supportive of the Schemes' requirements demonstrated through:
• no major loss or corruption of data or functionality; and
• the ability to access required data, assessed by periodic review.</td><td>The Business System continues to support the requirements of the schemes administration team. There has been no major loss or corruption of data or functionality. During the year the business system was unavailable for 12 business hours with no direct impact on members. Data has been successfully extracted as required.</td></tr>
</table>

Performance Measure	**Performance Achievement**
Complete papers are provided to the Appeals Board at least 14 days before each scheduled hearing, measured by: • the timely and efficient resolution of the appeals. Data required by Government Actuary and Treasury sent within agreed timescales, measured through: • minimal requests for missing, or incomplete information.	In the twelve months to 30 June 2010, three appeals were heard by the Appeals Board. Papers were provided to the Appeals Board at least 14 days before each scheduled hearing date. Data required by the Government Actuary and reporting to Treasury was sent within the required timescales. There were minimal requests for missing or incomplete information.
Meet the needs and reasonable expectations of stakeholders	
Regular updating of website, with information on schemes and investments, and sending annual Chairman's letter to members, measured through: • good results from an annual survey of members and employers; and • minimal adverse comments regarding communications.	The Authority's website has been regularly updated during the year with information on schemes and investments. Survey results indicate the majority of members and employers surveyed are happy with the level of information provided. This result was assessed as good by the Authority Board. The annual Chairman's letter was sent out as usual. In 2009 all contributors were sent a Member Update similar to the Employer Updates that are sent regularly to employers. The Member Update is intended as an annual publication.
Overall expected cost (Schemes) $4.1 million	Actual cost for the year ended 30 June 2010 was $3.7 million.

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 (**GSF** or **the Fund**) for the year ending 30 June 2010. 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 includes information on membership, and other matters required by the GSF Act. Commentary on the investment performance of the Fund starts on page 5 of the Authority's Annual Report.

Information on the Authority can be found commencing on page 1.

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.

Details of the membership of the GSF Schemes is set out on pages 25-26.

Mortgage Finance

As at 30 June 2010, there are no mortgages outstanding (30 June 2009: two mortgages totalling $8,000).

Tim McGuinness
Chairman
Government Superannuation Fund Authority Board

GOVERNMENT SUPERANNUATION FUND

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 2010:

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

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

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 $9,397 million (2009: $9,298 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.

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

Tim McGuinness
Chairman
Government Superannuation Fund Authority Board

GOVERNMENT SUPERANNUATION FUND
MEMBERSHIP COMMENTARY

The movement in contributors during the past five years was:

Year ended 30 June	Total	Change	% Change Contributors
2006	20,240	(2,001)	(9.00)
2007	18,718	(1,522)	(7.52)
2008	17,031	(1,687)	(9.00)
2009	15,683	(1,348)	(7.91)
2010	14,587	(1,096)	(6.98)

The number of contributors by scheme were:

GSF Scheme	2010	% of Total	2009
General Scheme	13,574	93.06	14,465
Armed Forces	438	3.00	607
Police	446	3.06	469
Prisons Service	98	0.67	109
Judges and Solicitor-General	18	0.12	24
Parliamentary	13	0.09	13
Total contributors at end of year	**14,587**	**100.00**	**15,683**

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

	2010	2009
Contributors at beginning of year	15,683	17,031
Retirements	(1,007)	(1,023)
Withdrawals	(10)	(8)
Death before retirement	(12)	(24)
Cessation of employment before retirement	(49)	(79)
Transfer to other schemes	(18)	(214)
Total contributors at end of year	**14,587**	**15,683**

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

Year ended 30 June	Total Annuitants	Change	% Change
2006	47,523	(64)	(0.13)
2007	47,237	(286)	(0.60)
2008	47,158	(79)	(0.17)
2009	46,963	(195)	(0.41)
2010	46,855	(108)	(0.23)

The movement in number of annuitants during the year was:

	2010	2009
Annuitants at beginning of year	46,963	47,158
New retiring allowances	999	1,034
New allowances to spouses	769	785
Allowances deferred	103	16
Discontinued allowances	(1,979)	(2,030)
Total annuitants at end of year	**46,855**	**46,963**

There were 5,949 deferred pensions at 30 June 2010 (2009: 6,052)

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

Year ended 30 June	Total Contributors	Total Annuitants	Total Deferred Pensions	Total Members	Decrease During Year
2006	20,240	47,523	6,019	73,782	(1,941)
2007	18,718	47,237	6,025	71,980	(1,802)
2008	17,031	47,158	6,068	70,257	(1,723)
2009	15,683	46,963	6,052	68,698	(1,559)
2010	14,587	46,855	5,949	67,391	(1,307)

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

	2010	%	2009	%
Contributors	14,587	24	15,683	25
Annuitants	46,855	76	46,963	75
	61,442	**100**	**62,646**	**100**

Granting a charge over contributions

In the year to 30 June 2010, 27 charges (2009: 31) were registered by the Fund in favour of chargeholders as security over individual contributor's contributions.

FINANCIAL STATEMENTS

GOVERNMENT SUPERANNUATION FUND

STATEMENT OF RESPONSIBILITY

The Financial Statements of the Fund for the year ended 30 June 2010 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 78, have been complied with.

In our opinion, the attached Financial Statements present a true and fair view of the net assets, as at 30 June 2010, and the changes in net assets and the cash flows of the Fund, for the year ended 30 June 2010.

Tim McGuinness
Chairman
Government Superannuation Fund Authority Board

Alan Langford
Chief Executive

1 September 2010

GOVERNMENT SUPERANNUATION FUND
STATEMENT OF CHANGES IN NET ASSETS

FOR THE YEAR ENDED 30 JUNE 2010

	Note	2010 $000 Actual	2009 $000 Actual	2010 $000 Forecast
Change in assets from:				
Investing activities				
Investment revenue				
Interest, dividend and other income	1	**86,464**	116,002	66,241
Increase/(decrease) in fair values of investment assets through profit or loss	2	**296,855**	(788,742)	130,057
		383,319	(672,740)	196,298
Operating activities				
Operating revenue	3			
Government		**22,160**	19,181	19,678
Other employers		**5,784**	4,499	5,137
		27,944	23,680	24,815
Operating expenses	3			
Funding for the Authority		**(27,944)**	(23,680)	(24,815)
Surplus/(deficit) before-tax and membership activities		**383,319**	(672,740)	196,298
Income tax (expense)/benefit	4	**(98,670)**	89,429	(34,908)
Surplus/(deficit) after-tax and before membership activities		**284,649**	(583,311)	161,390
Membership activities				
Contributions				
Government	5	**610,528**	618,286	619,816
Members		**60,011**	63,902	50,955
Other employers		**13,448**	12,704	13,870
		683,987	694,892	684,641
Benefits paid	6	**(826,143)**	(881,650)	(838,830)
Net benefits paid		**(142,156)**	(186,758)	(154,189)
Net increase/(decrease) in net assets		**142,493**	(770,069)	7,201
Opening net assets available to pay benefits		**2,804,083**	3,574,152	2,683,574
Net assets available to pay benefits		**2,946,576**	2,804,083	2,690,775

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 2010

	Note	2010 $000 Actual	2009 $000 Actual	2010 $000 Forecast
Current assets				
Cash and cash equivalents		**128,393**	317,008	160,745
Trade and other receivables	7	**96,288**	83,232	77,322
Income tax receivables		**10,080**	36,319	178,353
Total current assets		**234,761**	436,559	416,420
Non-current assets				
Investments				
Fixed interest - International		**775,623**	510,270	558,546
Equities - New Zealand		**284,838**	252,902	235,194
Equities - International		**1,266,387**	955,094	1,031,710
Real estate		**168,426**	161,186	173,036
Commodity futures		**82,767**	44,033	74,158
Multi-asset and Global tactical asset allocation		**348,349**	380,503	367,297
Mortgages	8	**–**	8	5
Derivative assets held for trading		**95,839**	148,163	84,371
Short term investments		**3,143**	600	35,365
Total investments		**3,025,372**	2,452,759	2,559,682
Non-current tax receivables				
Deferred tax asset	4	**–**	87,536	–
Total non current tax receivables		**–**	87,536	–
Total non-current assets		**–**	2,540,295	–
Total assets		**3,260,133**	2,976,854	2,976,102

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 (CONTINUED)

AS AT 30 JUNE 2010

	Note	2010 $000 Actual	2009 $000 Actual	2010 $000 Forecast
Less liabilities				
Current liabilities				
Trade and other payables	9	**174,171**	132,540	101,628
Income tax payable		**–**	11,494	–
Benefits payable		**3,829**	1,456	2,394
Derivative liabilities held for trading		**135,557**	27,281	181,305
Total current liabilities		**313,557**	172,771	285,327
Total liabilities		**313,557**	172,771	285,327
Net assets available to pay benefits		**2,946,576**	2,804,083	2,690,775
promised retirement benefits				
Gross liability for promised retirement benefits	12	**12,344,000**	12,102,000	11,956,000
Deficit		**9,397,424**	9,297,917	9,265,225
Net assets available to pay benefits		**2,946,576**	2,804,083	2,690,775

The Financial Statements were approved by the Authority Board on 1 September 2010.

Tim McGuinness
Chairman
Government Superannuation Fund Authority Board

Keith Taylor
Chairman
Audit & 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

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 30 JUNE 2010

	Note	2010 $000 Actual	2009 $000 Actual	2010 $000 Forecast
Cash flows from operating activities				
Cash was provided from:				
Government contributions		**641,521**	638,277	638,992
Members' contributions		**60,302**	64,351	50,984
Other employers' contributions		**21,665**	18,498	19,143
Interest and dividends		**84,120**	119,229	68,519
Cash was disbursed to:				
Benefit payments		**(822,618)**	(886,849)	(843,304)
Income tax		**3,609**	(11,942)	(11,942)
Operating expenses		**(32,956)**	(22,136)	(25,480)
Net cash flows from operating activities		**(44,357)**	(80,572)	(103,098)
Cash flows from investing activities				
Cash was provided from:				
Maturities and sales of investment assets		**6,321,016**	7,929,115	4,296,994
Mortgage repayments		**8**	14	5
Cash was disbursed to:				
Purchase of investments		**(6,465,282)**	(7,821,383)	(4,183,002)
Net cash flows from investing activities		**(144,258)**	107,746	113,997
Net (decrease)/increase in cash held		**(188,615)**	27,174	10,899
Opening cash and cash equivalents		**317,008**	289,834	149,846
Closing cash and cash equivalents		**128,393**	317,008	160,745

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

GOVERNMENT SUPERANNUATION FUND

RECONCILIATION OF NET CHANGE IN NET ASSETS TO NET OPERATING CASH FLOWS

FOR THE YEAR ENDED 30 JUNE 2010

	2010 $000	2009 $000
Net increase/(decrease) in net assets	**142,493**	(770,069)
Add changes in non-cash items		
Deferred tax asset	**87,536**	(87,536)
Non-current tax payables	–	(11,942)
Capitalised interest	–	1
	87,536	(99,477)
Movements in working capital items		
Receivables and prepayments	**2,304**	1,862
Investment receivables	**(15,360)**	143,614
Income tax receivable	**26,239**	(15,660)
Government contributions received in advance	**9,884**	1,519
Investment payables	**(35,723)**	(208,404)
Trade and other payables	**(3,976)**	1,831
Income tax payable	**(11,494)**	11,494
Benefits payable	**2,373**	(5,449)
	(25,753)	(69,193)
Changes in items classified as investing activities		
Accrued interest portion of bonds	**(2,861)**	4,635
Change in fair value of investment assets	**(296,855)**	788,742
Investment settlement receivables	**15,360**	(143,614)
Investment settlement payables	**35,723**	208,404
	(248,633)	858,167
Net cash out flows from operating activities	**(44,357)**	(80,572)

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

GOVERNMENT SUPERANNUATION FUND

JUDGES AND SOLICITOR-GENERAL SUPERANNUATION

Statement of Changes in Net Assets

FOR THE YEAR ENDED 30 JUNE 2010

	2010 $000	2009 $000
Income from operations*		
Government contributions	**14,257**	14,007
Members contributions	**–**	–
	14,257	14,007
Expenditure*		
Benefits paid:		
Retirements	**11,496**	11,062
Allowances capitalised	**930**	1,228
Spouses and children	**1,831**	1,717
	14,257	14,007
Net changes in net assets	**–**	**–**

* 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

GOVERNMENT SUPERANNUATION FUND
PARLIAMENTARY SUPERANNUATION

Statement of Changes in Net Assets

FOR THE YEAR ENDED 30 JUNE 2010

	2010 $000	2009 $000
Income from operations*		
Government contributions	**3,694**	3,680
Members contributions	**159**	156
	3,853	3,836
Expenditure*		
Benefits paid:		
Retirements	**3,284**	3,117
Allowances capitalised	**–**	165
Spouses and children	**569**	554
	3,853	3,836
Net changes in net assets	**–**	–

* 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

GOVERNMENT SUPERANNUATION FUND
STATEMENT OF ACCOUNTING POLICIES

The following significant policies have been applied in the preparation of the Financial Statements:

(i) Reporting entity and statutory base

The Financial Statements of the Government Superannuation Fund (**the Fund**) are prepared pursuant to section 93 of the Government Superannuation Fund Act 1956 (**GSF Act**) and incorporate the Judges and Solicitor-General Superannuation Account and the Parliamentary Superannuation Account.

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 (**GSF Schemes**). Pursuant to section 19H of the GSF Act, the GSF Schemes are registered under the Superannuation Schemes Act 1989.

Reporting requirements

The Financial Statements have been prepared in accordance with NZ IAS 26: *Accounting and Reporting by Retirement Benefit Plans*, and with the provisions of relevant legislative requirements.

The Fund is a profit-oriented entity domiciled in New Zealand.

(ii) Statement of compliance

The Financial Statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (**NZ GAAP**), applying the New Zealand equivalents to International Financial Reporting Standards, and its interpretations (**NZ IFRS**), as appropriate for profit-oriented entities. The Financial Statements comply with International Financial Reporting Standards (**IFRS**).

The preparation of financial statements, in conformity with NZ IFRS, requires judgements, estimates and assumptions to be made that affect the application of policies and the reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions made are based on historical experience and other factors that are believed to be reasonable under the circumstances. The results of the estimates and associated assumptions form the basis of making the judgements about the carrying value of assets and liabilities, which are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and associated assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised, if the revision affects only that period, or in the period of the revision and future periods, if the revisions affect both current and future periods.

Judgements are made in the application of NZ IFRS, that have a significant effect on the Financial Statements, and estimates with a significant risk of material adjustment in the next year are discussed in Notes 10, 11, 12 and 13.

(iii) Measurement base

The measurement base adopted is that of historical cost modified by the revaluation of investment assets, which are measured at fair value.

(iv) Presentation and functional currency

The Fund is located within New Zealand, and the performance of the Fund is measured and reported in New Zealand Dollars (**NZD**), rounded to thousands ($000). Therefore, these Financial Statements are presented in NZD as that is the currency of the primary economic environment in which the Fund operates. The Fund's presentational and functional currency is NZD.

(v) Accounting policies

The following particular accounting policies, which materially affect the measurement of changes in net assets, financial position and cash flows have been consistently applied in the preparation of the Financial Statements.

Investment income

Interest income is recognised using the effective interest rate of the instruments. Realised and unrealised gains or losses on financial instruments are recognised in the Statement of Changes in Net Assets. Interest income on assets, designated at fair value through profit or loss, is accrued at balance date. Dividend income is recognised in the Statement of Changes in Net Assets on the ex dividend date.

Foreign currencies

Transactions in currencies, other than NZD, are recorded in NZD at the rates of exchange prevailing on the dates of the transactions. At each balance date, assets and liabilities, that are denominated in foreign currencies, are retranslated at the rates prevailing on the balance date. Gains and losses arising on retranslation are included in the Statement of Changes in Net Assets for the period.

Expenses

All expenses, recognised in the Statement of Changes in Net Assets, are accounted for on an accruals basis.

Tax

The tax expense represents the sum of the tax liability for the year and includes deferred tax (if any). The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit before-tax, as reported in the Statement of Changes in Net Assets, because it excludes items of income or expense that are taxable or deductible in other years, and it further excludes items that are never taxable or deductible. The Fair Dividend Rate (**FDR**) method is applied to investments in most overseas equities, which deems taxable income to arise regardless of the increase or decline in value of the investments.

The liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the Financial Statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the Statement of Financial Position liability method. Deferred tax liabilities are recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

The carrying amount of the deferred tax asset is reviewed at each balance date and reduced to the extent that it is no longer probable that sufficient taxable profits will be earned to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled, or the asset is realised. Deferred tax is charged or credited in the Statement of Changes in Net Assets.

Financial instruments

Financial assets and financial liabilities are recognised in the Statement of Net Assets when the Fund becomes a party to the contractual provisions of the instruments. The Fund offsets financial assets and financial liabilities if the Fund has a legally enforceable right to set off the recognised amounts and interests, and intends to settle on a net basis. The Fund derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire. A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled, or expires.

Investments

Investments are recognised and derecognised on the trade date where a purchase or sale is under a contract, whose terms require delivery within the timeframe established by the market concerned, and are initially measured at fair value.

Investments are designated at fair value through profit or loss. Transaction costs are expensed immediately. As the Fund's business is investing in financial assets, with a view to profiting from their total return in the form of interest, dividends or increases in fair value, investments are designated at fair value through profit or loss on initial recognition. Fair values are determined after taking into account accrued interest on all applicable securities.

Fair value is an estimate of the amount of consideration that would be agreed upon in an arms' length transaction between knowledgeable willing parties, who are under no compulsion to act.

Financial assets, designated at fair value through profit or loss, are measured at subsequent reporting dates at fair value, which is the bid price on the exchange on which the investment is quoted without any deduction for future selling costs. If a quoted market price is not available on a recognised stock exchange, the fair value of the instrument is estimated using accepted valuation techniques.

Investments in units of collective investment vehicles (**CIVs**) are valued at the closing price, or the value advised by the relevant investment manager.

Short term investments are discountable securities that have not been classified as cash equivalents and are expected to be realised within 12 months.

Impairment

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

Trade and other receivables

Trade and other receivables are carried at amortised cost. Trade and other receivables may include sales of securities and investments that are unsettled at balance date and may also include dividends and interest. Dividends and distributions are accrued when the right to receive payment is established. Interest is accrued at the balance date from the time of last payment.

Trade and other payables

Trade and other payables are not interest-bearing and are carried at amortised cost. Any outstanding trades are recorded on trade date and are normally settled within three business days. Purchases of securities and investments, that are unsettled at balance date, are included in payables.

Derivative financial instruments and hedge accounting

Derivative financial instruments are contracts whose values are derived from changes in one or more underlying financial instruments or indices. The Fund's activities expose it primarily to the financial risks of changes in foreign currency rates, commodity prices and interest rates. The Fund may use foreign exchange forward contracts, commodity swaps and interest rate swap contracts to hedge these exposures. The Fund does not use derivative financial instruments for speculative purposes.

Derivative instruments are initially recognised at fair value through profit or loss on the date on which a derivative contract is entered into. They are subsequently re-measured at each balance date using either quoted sales prices or appropriate valuation techniques. Any gains or losses are taken to the Statement of Changes in Net Assets in the period in which they occur. Transaction costs are expensed on initial recognition. The fair value of commodity futures swaps is determined using broker quotations.

Derivatives are carried as assets when their fair value is positive, and as liabilities when their fair value is negative. The Fund does not undertake any form of hedge accounting. The use of financial derivatives is governed by a Statement of Investment Policies, Standards and Procedures (**SIPSP**), approved by the Government Superannuation Fund Authority Board (**the Board**), which includes written policies on the use of financial derivatives.

Goods and Services Tax

The Fund is not registered for Goods and Services Tax (**GST**). All components of the Financial Statements are stated inclusive of GST where appropriate.

Statement of Cash Flows

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

- *Cash and cash equivalents*
  These comprise cash balances held with banks in New Zealand and overseas. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash, are subject to insignificant risk of changes in value, and are held for the purpose of meeting short-term cash commitments. Only items that have an original maturity of three months or less are classified as cash.
- *Investing activities*
  These comprise acquisition and disposal of investments. Investments include securities not falling within the definition of cash.

  Sales, purchases and maturities of investments are disclosed net, in line with the manner in which the investments are managed.
- *Operating activities*
  These include any activities that are the result of normal business activities.
- *Forecast figures*
  The forecast figures are those presented in the Fund's 2009/10 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 Fund for the preparation of the Financial Statements.

- *Standards issued but not yet effective*
  Various standards, interpretations and amendments have been issued by the Accounting Standards Review Board but have not been adopted by the Fund because they are not yet effective. The Fund expects to adopt the standards and interpretations in the period in which they become mandatory. The Fund anticipates that the standards and interpretations will have no material impact on the historical statements of the Fund in the period of initial application, except for NZ IFRS 9: Financial Instruments, the impact of which is currently unknown.
- *Standards and Interpretations effective in the current period*
  The same accounting policies, presentation and methods of computation have been followed in these financial statements as were applied in the preparation of the Fund's financial statements for the period ended 30 June 2009, except for the impact of the adoption of the NZ IFRS 7 Amendments. The amendments to NZ IFRS 7 expand the disclosures required in respect of fair value measurements and have resulted in additional disclosures in Note 13(e). No comparative information has been presented in accordance with the transitional relief provisions offered in these amendments.

(vi) Changes in accounting policies

There were no changes to accounting policies during the year.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2010

1. Interest, dividends, and other income

	2010 $000	2009 $000
NZ Government stock	–	526
NZ Government owned/guaranteed securities	–	212
Local Authority bonds	–	123
Other bonds and securities	–	1,587
Fixed interest – International	**21,428**	27,282
Short term and call deposits, including treasury bills	**101**	1,858
Equities – New Zealand	**11,625**	11,631
Equities – International	**21,947**	46,506
Real Estate – International listed securities	**3,488**	3,455
Real Estate – International unlisted securities	**1,853**	5,228
Multi-asset and Global tactical asset allocation	**11,600**	–
Mortgages to members	–	1
Other sources	**14,422**	17,593
Total interest, dividends, and other income	**86,464**	116,002

2. Changes in fair values of investment assets through profit or loss

	2010 $000	2009 $000
NZ Government stock	–	2,076
NZ Government owned/guaranteed securities	–	359
Local Authority bonds	–	176
Other bonds and securities	–	615
Fixed interest – International (including hedging)	**52,679**	21,096
Short term investments	**1,411**	1,738
Equities – New Zealand	**15,867**	(43,324)
Equities – International (including hedging)	**184,943**	(574,016)
Real Estate – International listed securities (including hedging)	**29,666**	(68,428)
Real Estate – International unlisted securities (including hedging)	**(6,687)**	(36,480)
Commodity futures (including hedging)	**(151)**	(90,396)
Multi-asset and Global tactical asset allocation (including hedging)	**19,127**	(2,158)
Total changes in fair values of investment assets through profit or loss	**296,855**	(788,742)

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 Government 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 Government contributed 79.3% of the Authority's administrative expenses reimbursed by the Fund. Other employers contributed the balance of 20.7%.

4. Income tax expense

	2010 $000	2009 $000
Reconciliation to statement of changes in net assets		
Surplus/(deficit) before-tax and membership activities	**383,319**	(672,740)
Add imputation credits	**2,159**	2,796
Net taxable income/(loss)	**385,478**	(669,944)
Tax (expense)/credit at 30%	**(115,643)**	200,983
Tax effect:		
Non-assessable/deductible investment gain/(losses)	**43,595**	(89,234)
Fair dividend rate (FDR) income	**(28,318)**	(27,009)
Prior period adjustment	**(2,442)**	1,893
Imputation credits	**2,108**	2,796
Withholding tax credits	**2,030**	–
Income tax (expense)/benefit	**(98,670)**	89,429
Income tax (expense)/benefit comprises:		
Current tax	**(96,228)**	–
Deferred tax	**–**	87,536
Prior period adjustment	**(2,442)**	1,893
Income tax (expense)/benefit	**(98,670)**	89,429

	2010 $000	2009 $000
Movement in deferred taxation		
Opening balance	**87,536**	–
Prior period adjustment	**(2,442)**	–
Transfer (to)/from current tax	**(85,094)**	87,536
Closing balance	**–**	87,536
Non current tax payables		
Opening balance	**–**	(11,942)
Non current tax prior period adjustment	**–**	448
Transfer to current tax	**–**	11,494
Closing balance	**–**	–

With effect from 1 October 2007 the Fund qualified as, and elected to be, a Portfolio Investment Entity (PIE) for taxation purposes. Under the PIE tax rules any gains or losses on New Zealand and certain Australian listed shares are non-taxable, whereas those gains or losses had previously been taxable or deductible to the Fund.

5. Government contributions

	2010 $000	2009 $000
Government service superannuation contributions	**592,577**	600,599
Judges and Solicitor-General superannuation contributions	**14,257**	14,007
Parliamentary superannuation contributions	**3,694**	3,680
Total Government contributions	**610,528**	618,286

Funding arrangements

There is no requirement on the Government 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 Government to ensure that sufficient funds are available, or will be available, to pay benefits as they fall due.

Member Contribution %	GSF Scheme	Employer Contribution for year ending 30 June 2010 %
	General Scheme:	
6.5	Non-funding employers	6
6.5	Funding except Islands*	Between 6 and 10
6.5	Islands	6
7.6	Armed Forces	15.4
7.5	Police	16.1
8.5	Prisons Service	Nil

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

The employer contribution rates were reviewed and, in most cases, increased from 1 July 2010 (see Note 12).

6. Benefits paid

	2010 $000	2009 $000
Pension entitlements	**643,564**	621,233
Allowances capitalised	**73,195**	75,092
Spouses and children	**102,228**	100,130
Refunds:		
Transfers to other schemes	**1,952**	82,106
Cessation of membership	**4,670**	2,168
Death	**534**	921
Total Benefits paid	**826,143**	881,650

7. Trade and other receivables

	2010 $000	2009 $000
Government contributions – operating	**5,334**	4,284
Members' contributions	**571**	402
Other employers' contributions	**997**	3,045
Interest and dividends	**3,069**	2,702
Investment settlements receivable	**39,965**	24,605
Prepaid benefits	**43,459**	44,647
Past service contributions	**2,658**	3,292
Pension entitlements	**235**	255
Total Trade and other receivables	**96,288**	83,232

8. Mortgages

The Housing New Zealand Corporation managed mortgages previously granted to members of the Fund. As at 30 June 2010 there are no mortgages outstanding (2009: two mortgages).

9. Trade and other payables

	2010 $000	2009 $000
Government receipts	**195**	197
Unallocated contributions	**21**	29
Government Superannuation Fund Authority	**1,947**	6,298
Other employers' contributions – operating	**385**	–
Government contributions in advance - benefits	**43,257**	33,373
Investment settlements payable	**128,366**	92,643
Total Trade and other payables	**174,171**	132,540

10. Actuarial Valuations of the Fund

Statutory 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 statutory valuation was undertaken by the Government Actuary, Mr David Benison, B.Sc. (Econ), FIA, FNZSA, as at 30 June 2009, and the report, dated November 2009, was tabled in Parliament on 25 May 2010. More information on the results of the valuation is provided in Note 11 below.

New Zealand International Accounting Standards (NZ IAS)-26 actuarial valuation

In addition to the statutory valuation discussed above, the Government Actuary values the promised retirement benefits, in accordance with NZ IAS-26, for the Financial Statements of the Fund. The most recent valuation was undertaken as at 30 June 2010 – refer Note 12.

11. Statutory actuarial valuation as at 30 June 2009

Significant assumptions, used in the statutory valuation, as at 30 June 2009, were:

- Discount rate 6.00% per annum
- Consumer Price Index 2.25% per annum
- Salary increases 3.00% per annum

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

The results of the 30 June 2009 statutory valuation are:

	2009 $million	**2008 $million**
Past service liabilities		
Armed Forces contributors	148	187
General Scheme contributors (excluding Islands)	2,930	2,874
General Scheme contributors (Islands only)	38	31
Police contributors	231	289
Prisons Service contributors	26	29
Judges and Solicitor-General	29	32
Parliamentary	8	13
Pensioners	8,073	7,887
Deferred pensioners	619	612
Total past service liabilities	12,102	11,954
Value of Fund assets	2,804	3,574
Unfunded past service liability	**9,298**	8,380

The above figures are rounded and so may not appear to add exactly.

Vested benefits are calculated as the amount payable in the event that all contributors ceased membership as at the valuation date. The vested benefit values are shown in the following table, where contributors include the inactive members. The ratio of vested benefits to past service liabilities is also shown.

	As a percentage of past service liability	2009 $million	2008 $million
Vested benefits			
Contributors:			
Armed Forces	29%	43	59
General Scheme (excl Islands)	112%	3,282	3,257
Islands	108%	41	34
Police	92%	213	259
Prisons Service	104%	27	29
Judges and Solicitor-General	141%	41	47
Parliamentary	137%	11	17
Total Contributors	107%	3,658	3,703
Pensioners:			
Pensioners	100%	8,073	7,887
Deferred Pensioners	100%	619	611
Total Pensioners	100%	8,691	8,498
Grand total		12,349	12,202
Less net assets		2,804	3,574
Shortfall		**9,545**	8,628

The above figures are rounded and so may not appear to add exactly.

The Fund has been closed to new entrants since 1992. Members with 10 or more years' service are eligible to take an immediate or deferred pension on leaving the Fund. As a result, almost all members in the Fund can take either an immediate pension or a deferred pension. The total value of this pension for all members, as at the valuation date, is the vested benefits.

Members will, however, retire at dates later than 30 June 2010. The pension they receive at their actual retirement date can be split into that part accrued at the valuation date and that part which will accrue after the valuation date.

The net asset value was used as the actuarial value of the assets.

The valuation revealed that the Fund was in deficit at the date of the valuation. The benefits payable from the Fund are underwritten by the Government. The Government Actuary recommended that from 30 June 2010, the Government pays 79% of each benefit paid (previously 75%).

The rate of contribution, including employer superannuation contribution tax at 33%, that is required to be paid by funding employers (employers of those contributors who are paid from money that is not public money) has been determined under a notional funding approach, and:

- for employers that are the Public Services of the Cook Islands, Niue or Tokelau, is certified as 8.0% of contributor salaries; and
- for employers other than the Public Services of the Cook Islands, Niue or Tokelau, is certified as the average rate of contributor salaries obtained by applying the percentage rates to the contributors of the employer, by reference to gender and age nearest as at 30 June 2009 given in the following table:

Age range	Males	Females
Up to age 51	10.9%	11.3%
Age 52 to age 56	12.9%	13.6%
Age 57 to age 61	14.2%	15.0%
Age 62 to age 66	15.3%	16.1%
Age 65 and over	0.0%	0.0%

The rate of contribution, including employer superannuation contribution tax at 33%, applicable to non-funding employers (the employers of those contributors who are paid from money that is public money) is recommended by reference to the notional funding approach to be set at the following levels:

- for the Armed Forces Scheme: a rate of 25.1% of contributor salaries;
- for the General Scheme: a rate of 10.7% of contributor salaries;
- for the Police Scheme: a rate of 19.1% of contributor salaries;
- for the Prisons Service Scheme: a rate of 0% of contributor salaries;
- for the Judges and Solicitor-General Scheme: an amount equal to the benefits payable; and
- for the Parliamentary Scheme: an amount equal to the benefits payable.

12. Gross liability for promised retirement benefits

The Government Actuary has valued the promised retirement benefits in accordance with NZIAS-26, as at 30 June 2010, for the purposes of the Fund's Financial Statements.

Significant assumptions, used in the valuation, were:

- Discount rate 6.00% per annum
- Consumer Price Index 2.50% per annum (long-term)
- Salary increases 3.00% per annum

Movement in promised retirement/past service benefit liability

	2010 $million	2009 $million
Opening gross promised retirement/ past service benefit liability	12,102	11,954
Movements in liability		
Expected changes	4	54
Experience (losses)/gains	(13)	68
Assumption changes:		
Change in discount rate and Consumer Price Index	573	26
Change in demographic assumption	(322)	–
Closing gross promised retirement/ past service benefit liability	**12,344**	12,102

Vested benefits – 30 June 2010

Vested benefits are calculated as the amount payable in the event that all contributors ceased membership as at the valuation date. The vested benefit values, as at 30 June 2010, are shown in the following table, where contributors include the inactive members.

Vested benefits	2010 $million	2009 $million
Contributors	3,681	3,658
Pensioners:		
Current pensioners	8,607	8,073
Deferred pensioners	672	619
Total pensioners	9,280	8,691
Total vested benefits	12,961	12,349
Less net assets	(2,947)	(2,804)
Shortfall	**10,014**	9,545

The above figures are rounded so may not appear to add exactly.

13. Financial instruments

a) Management of financial instruments

The investments of the Fund are managed on behalf of the Authority by specialist investment managers, which are required to invest the assets allocated for management in accordance with the terms of written investment management agreements. The Authority has determined that the appointment of these managers is appropriate for the Fund and is in accordance with the Authority's SIPSP.

JP Morgan Chase acts as master custodian on behalf of the Authority and provides services including physical custody and safekeeping of assets, settlement of trades, collection of dividends and other investment income and accounting for investment transactions.

b) Significant accounting policies

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which revenues and expenses are recognised in respect of each class of financial asset and financial liability, are disclosed in the Statement of Accounting Policies.

c) Capital risk management

The Investment Strategy and the Strategic Asset Allocation (**SAA**) of the Fund are reviewed regularly by the Authority, in conjunction with its advisors. From 1 July 2010 the SAA will be replaced by the Reference Portfolio and the Target Portfolio (see page 5). The Authority reviews the cash requirements and funding of the GSF Schemes, each month, in the context of maintaining the SAA (and in future the Target Portfolio) and redeems or invests funds as appropriate.

d) Categories of financial instruments

The Fund recognises all investment financial assets and liabilities at fair value through the Statement of Changes in Net Assets, as detailed in the Statement of Accounting Policies, and other financial assets and liabilities at amortised cost.

	2010 $000	2009 $000
Financial investment assets at fair value	**3,025,372**	2,452,759
Financial investment liabilities at fair value	**135,557**	27,281
Financial assets at amortised cost	**224,681**	400,240
Financial liabilities at amortised cost	**178,000**	133,996

e) Fair value measurements recognised in the Statement of Financial Position

The following table provides an analysis of the financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable.

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets to identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly (ie. as prices) or indirectly (ie. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

2010	Level 1 $000	Level 2 $000	Level 3 $000	Total $000
Financial assets at fair value through profit or loss				
Derivative financial assets	–	95,839	–	**95,839**
Available for sale financial assets				
Investments in cash funds – New Zealand (**NZ**)	3,143	–	–	**3,143**
Investments in Fixed interest - International	745,850	29,773	–	**775,623**
Equities – NZ	284,838	–	–	**284,838**
Equities – International	988,939	277,448	–	**1,266,387**
Real estate – International	129,934	38,492	–	**168,426**
Commodity futures	–	82,767	–	**82,767**
Multi asset and Global tactical asset allocation	–	348,349	–	**348,349**
	2,152,704	872,668	–	**3,025,372**
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities	–	135,557	–	**135,557**
	–	135,557	–	**135,557**

There were no transfers between Level 1 and 2 in the period.

f) Financial risk management objectives

The Fund is exposed to a variety of financial risks as a result of its activities. These risks include market risk (including currency risk, fair value interest rate risk and price risk), credit risk, liquidity risk and cash flow interest rate risk. The Fund's risk management and investment policies, approved by the Authority, seek to minimise the potential adverse effects of these risks on the Fund's financial performance, within the context of the Risk Parameter (See page 5). These policies may include the use of certain financial derivative instruments to manage risk to within the approved limits.

The Authority outsources the investment management to specialist managers, which provide services to the Fund, co-ordinate access to domestic and international investment markets, and manage the financial risks relating to the operations of the Fund in accordance with investment mandates set by the Authority. The Fund invests principally in a portfolio of equities and fixed interest securities. Exposure to market risks is diversified by direct investment in commodity futures, private equity, real estate, a multi-asset fund and global tactical asset allocation. It may also invest in derivative instruments such as futures and options.

The Fund does not enter into or trade derivative financial instruments for speculative purposes. The use of financial derivatives is governed by the Authority's SIPSP, which provides written policies on the use of financial derivatives. These policies permit the use of derivatives to change the Fund's exposure to particular assets. Derivatives cannot be used directly to leverage the Fund and the Fund's effective market exposure should not exceed the market value of its assets. Compliance with policies and exposure limits is reviewed by the Authority on a continuous basis.

g) Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations, resulting in financial loss to the Fund. The Authority has adopted the policy of only dealing with creditworthy counterparties and obtaining sufficient collateral, or other security where appropriate, as a means of mitigating the risk of financial loss from default. The Authority measures credit risk on a fair value basis. The Fund's exposure and the credit ratings of its counterparties are continuously monitored by the Authority.

Credit risk, arising on investments, is mitigated by investing in rated instruments or instruments issued by rated counterparties with credit ratings for the portfolio as a whole of at least a weighted average of A, or better, as determined by Standard and Poor's. Credit risk associated with receivables is considered minimal. The main receivables balance is in relation to investments sold, which are settled within three days of trade date, and for which the counterparties are mainly large financial institutions. Other receivables balances are largely immaterial.

The Fund does not have any significant credit risk exposure to any single counterparty, or any group of counterparties having similar characteristics. It is the opinion of the Authority that the carrying amounts of the financial assets represent the maximum credit risk exposure at the Statement of Net Assets date.

As at 30 June 2010, the Fund does not have any single investment exceeding 5% of the net assets (2009: nil).

h) Liquidity risk

The Authority's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities. The Fund is therefore exposed to the liquidity risk of meeting benefit payments. The Authority's listed equities and fixed interest securities are considered to be realisable over a reasonable period of time, although with a market risk.

The Fund's liquidity risk is managed in accordance with the Authority's investment strategy. The Fund has a level of net outward cash flows. The Authority manages liquidity risk by maintaining cash, cash equivalents and short term investments, and through the continuous monitoring of forecast and actual cash flows and by matching the maturity profiles of financial assets and liabilities. The Authority's overall strategy to liquidity risk remains unchanged from 2009.

All the Fund's financial liabilities are expected to be paid within the next three months. The breakdown of the financial liabilities is as follows:

	2010 $000	2009 $000
Unsettled purchases	**128,366**	92,642
Derivative liabilities	**135,557**	27,281
Other financial liabilities	**49,634**	41,354
Total financial liabilities	**313,557**	161,277

i) Market risk

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: market interest rates (interest rate risk), foreign exchange (currency risk) and market prices (price risk).

The Fund invests principally in a portfolio of equities and fixed interest securities. Exposure to market risks is diversified by direct investment in commodity futures, private equity, real estate, a multi-asset fund and global tactical asset allocation. It may also invest in derivative instruments such as futures and options.

The Authority outsources to investment managers who manage the market risk in accordance with investment mandates.

Interest rate risk management

The Fund's activities expose it to the financial risk of changes in interest rates. Floating rate instruments expose the Fund to cash flow risk, whereas fixed interest rate instruments expose the Fund to fair value interest rate risk. The Authority monitors the Fund's exposure to interest rate risk.

The following tables detail the Fund's exposure to interest rate risk at the balance date by the earlier of contractual maturities or re-pricing. Interest rate risk is managed by the investment managers within mandates prescribed by the Authority.

Financial assets: Variable interest rate instruments

	Weighted average interest rate %	Less than 12 months $000	1-5 years $000	5+ years $000	Total $000
2010					
Cash and cash equivalents	0.49	128,393	–	–	**128,393**
Fixed interest securities	2.47	161,601	202,911	414,254	**778,766**
Receivables for securities	n/a	39,965	–	–	**39,965**
Mortgages	–	–	–	–	**–**
Total		**329,959**	**202,911**	**414,254**	**947,124**
2009					
Cash and cash equivalents	0.52	317,008	–	–	317,008
Fixed interest securities	4.40	9,558	162,037	260,761	432,356
Receivables for securities	n/a	24,605	–	–	24,605
Mortgages	8.00	–	8	–	8
Total		351,171	162,045	260,761	773,977

Interest rate sensitivity

The sensitivity analysis below has been determined based on the Fund's exposure to floating interest rates in cash and cash equivalents at the reporting date. A 1% or 100 basis point increase or decrease is used when reporting interest rate risk internally.

The following table illustrates the effect on the operating surplus and net assets from possible changes in interest rate risk, that were reasonably possible based on the risk the Fund was exposed to at reporting date:

Changes in variable	+/-	Effect on (deficit)/surplus after-tax and before membership activities 2010 $000	2009 $000
Interest rate risk	**1%**	**1,554**	4,078

The methods and assumptions used to prepare the sensitivity analysis have not changed during the year.

Foreign currency risk management

Foreign currency risk is the risk that the market value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The Fund undertakes certain transactions and holds investment assets denominated in foreign currencies, hence it is exposed to the effects of exchange rate fluctuations.

Exchange rate exposures are managed within approved policy limits and parameters. The Fund enters into foreign currency contracts designed to hedge some or all of its exposure to foreign currencies. This exchange rate exposure is managed in line with the Authority's SIPSP.

The Authority's overall objective is to have an exposure to foreign currencies of 20% of the total Fund (2009: 20%). To achieve that objective the Authority hedges its foreign currency exposures from the Fund's asset classes as set out as follows:

Asset Class	Before-tax (After-tax) Strategic Hedging Ratio	Range (Before-tax)
International equities	103% (72%)	93% to 113%
Real estate	143% (100%)	138% to 148%
Fixed interest	100% (100%)	90% to 110%
Commodities	143% (100%)	138% to 148%
Absolute return strategies	143% (100%)	138% to 148%

The Fund's total unhedged exposure to foreign currency exchange at the reporting date was $574,678,000 (2009: $208,006,000). The Fund's total hedged foreign currency exposure at the reporting date was $2,610,470,000 (2009: $2,088,306,000).

Foreign currency sensitivity

The Fund is mainly exposed to the United States dollar (**USD**), Australian dollar, British Pound, Japanese Yen and Euro currencies.

The fixed interest managers are responsible for managing the exposure to other currencies back to the USD, within the terms of their individual investment mandates. Another manager hedges the USD exposure to the NZD. For international equities the foreign currency exposure is hedged by a specialist manager back to the NZD within the limits approved by the Authority.

The following table details the Fund's sensitivity to a 5 percent increase or decrease in the NZD on the unhedged exposure to foreign currencies. This represents the Authority's assessment of the possible change in foreign exchange rates.

Changes in variable	+/-	Effect on (deficit)/surplus after-tax and before membership activities 2010 $000	2009 $000
Interest rate risk	**5%**	**20,113**	7,280

A positive impact results in an increase in the surplus after-tax (and before membership activities), where the NZD weakens against other currencies. For a strengthening of the NZD against other currencies there would be an equal and opposite impact on the surplus, and the amounts above would be negative.

There have been no changes in the methods and assumptions used to prepare the foreign currency sensitivity analysis from the prior year.

Other market risk

Other market risk is the risk that the total value of investments will fluctuate as a result of changes in market prices, whether caused by factors specific to an individual investment or its issuer, or to factors affecting all instruments traded in the market. The Fund has investments in equity instruments, fixed interest instruments and derivative financial instruments, which exposes it to price risk. The investment managers manage the other market risk in accordance with the Authority's SIPSP and their mandates.

As the Fund's financial instruments are carried at fair value, with changes in fair value recognised in the Statement of Changes in Net Assets, all changes in market conditions will directly affect investment income.

The following table illustrates the effect on the operating revenue and net assets from possible changes in market price risk, that were reasonably possible based on the risk that the Fund was exposed to at reporting date:

Changes in variable	**+/-**	**Effect on (deficit)/surplus after-tax and before membership activities**	
		2010	**2009**
		$000	**$000**
Interest rate risk	**5%**	**53,454**	39,786

The Authority does not believe there are any financial assets past due at balance date.

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 had business transactions with the Government, Crown Entities, and State Owned Enterprises, together with a number of other public sector entities.

The Authority managed the Fund's assets and administered the GSF Schemes. For the year ended 30 June 2010, the Fund paid the Authority $27,944,000 (2009: $23,680,000) for operating expenses, as detailed in the Statement of Changes in Net Assets. In turn, the Fund was reimbursed by the Government and other employers, as set out in Note 3. As at 30 June 2010 $1,947,000 was payable to the Authority for expenses incurred (2009: $6,298,000).

One member of the Board receives an annuity from the Fund.

15. Actual versus forecasts

Investment revenues are subject to the volatile nature of investment markets, this being the principle reason for the variance between the forecast and actual changes in fair value of investment assets.

Funding for the Authority for operating expenses was above that forecast. This was caused by higher than expected investment manager fees, as a result of the value of investment assets being greater than forecast. Investment managers' fees are generally set as a percentage of funds under management. In addition, some managers, who added value above benchmarks during the year, were paid performance fees under contracted arrangements.

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. Contingent assets, liabilities and capital commitments

There are no contingent assets, liabilities and capital commitments. (2009: Nil).

17. Subsequent Events

There have been no material events after balance date that require adjustments to, or disclosure in, the Financial Statements. (2009: Nil).

On 20 May 2010 the Government announced a decrease in the tax rate applying to the Fund from 30% to 28%. This will become effective from 1 July 2011.

Deloitte.

AUDIT REPORT

TO THE READERS OF THE GOVERNMENT SUPERANNUATION FUND'S FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2010

The Auditor-General is the auditor of the Government Superannuation Fund (the Fund). The Auditor-General has appointed me, Ian Marshall, using the staff and resources of Deloitte, to carry out the audit of the financial statements of the Fund, on her behalf, for the year ended 30 June 2010.

Unqualified Opinion

In my opinion the financial statements of the Fund on pages 29 to 56:

- comply with generally accepted accounting practice in New Zealand;
- comply with International Financial Reporting Standards; and
- present a true and fair view:
  - the Fund's net assets as at 30 June 2010; and
  - the changes in net assets and cash flows for the year ended on that date.

The audit was completed on 1 September 2010, 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 Government Superannuation Fund Authority Board (the 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 the 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 mis-statements 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 our 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 our opinion above.

Responsibilities of the Board and the Auditor

The Board is responsible for preparing the financial statements in accordance with generally accepted accounting practice in New Zealand. The financial statements must present a true and fair view of the net assets of the Fund as at 30 June 2010 and 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 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 and other probity services, we have no relationship with or interests in the Fund.

Ian Marshall
On behalf of the Auditor-General

DELOITTE
WELLINGTON, NEW ZEALAND

GOVERNMENT SUPERANNUATION FUND AUTHORITY
STATEMENT OF RESPONSIBILITY

The Financial Statements of the Authority, for the year ended 30 June 2010, 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 Statement of Service Performance set out on pages 17 to 22, and the attached Financial Statements for the financial year fairly reflect the financial position, as at 30 June 2010, and the operations of the Authority for the year ended 30 June 2010.

Tim McGuinness
Chairman
Government Superannuation Fund Authority Board

Keith Taylor
Chairman
Audit & Risk Review Committee
Government Superannuation Fund Authority Board

1 September 2010

GOVERNMENT SUPERANNUATION FUND AUTHORITY

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 30 JUNE 2010

	Note	2010 $000 Actual	2009 $000 Actual	2010 $000 Forecast
Revenue				
Interest received		**7**	10	14
Other revenue		**17**	586	13
Transfer from the Government Superannuation Fund	1	**27,944**	23,680	24,815
Total revenue		**27,968**	24,276	24,842
Expenses				
Scheme administration		**2,660**	2,696	2,666
Investment management and custody	2	**22,171**	16,981	17,910
Operating	3	**3,137**	4,599	4,266
Total expenses		**27,968**	24,276	24,842
Net profit for the year		**–**	–	–
Other comprehensive income		**–**	–	–
Total comprehensive income for the year		**–**	–	–

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

FOR THE YEAR ENDED 30 JUNE 2010

	Note	2010 $000 Actual	2009 $000 Actual	2010 $000 Forecast
Public equity				
General fund		**–**	–	–
Total public equity		**–**	–	–
Represented by:				
Current assets				
Cash and cash equivalents		**215**	339	170
Trade and other receivables	4	**2,130**	6,451	2,170
Total current assets		**2,345**	6,790	2,340
Non - current assets				
Trade and other receivables	4	**1,143**	13	–
Total non - current assets		**1,143**	13	–
Total assets		**3,488**	6,803	2,340
Current liabilities				
Trade and other payables	5	**3,488**	6,803	2,340
Total current liabilities		**3,488**	6,803	2,340
Net assets		**–**	–	–

The Financial Statements were approved by the Government Superannuation Fund Authority Board on 1 September 2010.

Tim McGuinness
Chairman
Government Superannuation Fund Authority Board

Keith Taylor
Chairman
Audit & 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 2010

	Note	2010 $000 Actual	2009 $000 Actual	2010 $000 Forecast
Cash flows from operating activities				
Cash was provided from:				
Government Superannuation Fund	1	**32,311**	21,801	25,490
Interest		**7**	10	14
Other		**17**	406	13
		32,335	22,217	25,517
Cash was disbursed to: Total expenses		**(32,459)**	(21,934)	(25,477)
Net cash flows from operating activities		**(124)**	283	40
Net (decrease)/increase in cash held		**(124)**	283	40
Opening cash and cash equivalents		**339**	56	130
Closing cash and cash equivalents		**215**	339	170

Reconciliation of net operating result to net cash flows from operating activities

	2010 $000 Actual	2009 $000 Actual	2010 $000 Forecast
Net operating result	**–**	–	–
Movements in working capital items:			
Trade and other receivables	**3,191**	(1,902)	675
Trade and other payables	**(3,315)**	2,185	(635)
Net cash flows from operating activities	**(124)**	283	40

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

STATEMENT OF MOVEMENTS IN PUBLIC EQUITY

FOR THE YEAR ENDED 30 JUNE 2010

	Note	2010 $000 Actual	2009 $000 Actual	2010 $000 Forecast
Public equity at beginning of the period		–	–	–
Total comprehensive income for the year		–	–	–
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 ACCOUNTING POLICIES

The following significant policies have been applied in the preparation of the Financial Statements:

(i) Reporting entity, basis of preparation and statutory base

The Authority was established in October 2001 as a Crown entity by section 15A of the Government Superannuation Act 1956 (**GSF Act**) and became an autonomous Crown entity under the Crown Entities Act in January 2004. The core business of the Authority is to manage the Government Superannuation Fund (**the Fund**) and administer the GSF Schemes. The Authority is an autonomous Crown Entity for legislative purposes and a Public Benefit Entity for financial reporting purposes.

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) Statement of compliance

The Financial Statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (**NZ GAAP**), applying the New Zealand equivalents to International Financial Reporting Standards and its interpretations (**NZ IFRS**), as appropriate, for Public Benefit Entities. The Authority is a public benefit entity, which is domiciled in New Zealand.

The preparation of Financial Statements, in conformity with NZ IFRS, requires judgements, estimates and assumptions to be made that affect the application of policies and the reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions made are based on historical experience and other factors that are believed to be reasonable under the circumstances. The results of the estimates and associated assumptions form the basis of making the judgements about the carrying value of assets and liabilities, which are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and associated assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which an estimate is revised, if the revision affects only that period, or in the period of the revision and future periods, if the revisions affect both current and future periods.

The accounting policies set out below have been applied consistently to all periods presented in these Financial Statements.

(iii) Measurement base

The measurement base adopted is that of historical cost.

(iv) Presentational and functional currency

The Financial Statements are presented in New Zealand dollars (**NZD**), rounded to thousands (**$000**), which is also the Authority's functional currency.

(v) 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:

Forecast figures

The forecast figures are those approved by the Authority Board (**the Board**) at the beginning of the period and presented in the Authority's 2009/10 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.

Goods and Services Tax

The Authority makes principally exempt supplies for Goods and Services Tax (**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 (terminated February 2009), which was recoverable as input tax, GST is included in expenditure.

Tax

As a public authority, in terms of section CW 31(2) of the Income Tax Act 2004, the Authority is exempt from income tax.

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 in New Zealand, used in the day to day cash management of the activities of the Authority.
- *Operating activities*
  Operating activities include all receipts of revenues and investment income, and payments of expenses.
- *Investing activities*
  These comprise acquisition and disposal of investments. Investments include securities not falling within the definition of cash.
- *Financing activities*
  Financing activities relate to changes in equity capital structure.
- *Financial instruments*
  The categories of financial assets and financial liabilities comprise:
  - Financial assets that are classified as loans and receivables. These include various bank term deposits, receivables from related parties and other receivables.
  - Financial liabilities that are classified as other liabilities and measured at amortised cost. These include trade and other payables.

Recognition

The Authority recognises a financial asset or a financial liability on the date the Authority becomes a party to the contractual provisions of the instrument.

Measurement

Financial assets, classified as receivables, and other financial liabilities are initially measured at fair value and subsequently carried at amortised cost using the effective interest rate method, less impairment losses, if any.

Accounting judgments and major sources of estimation certainty

In the application of the Authority's accounting policies the Board is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant.

The estimates and underlying assumptions are reviewed on an ongoing basis.

Impairment

Financial assets, that are stated at amortised cost, are reviewed at each balance date to determine whether there is objective evidence of impairment. If any such indication exists, an impairment loss is recognised in the Statement of Comprehensive Income as the difference between the asset's carrying amount and the present value of estimated future cash flows.

Derecognition

The Authority derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the financial asset and the transfer qualifies for derecognition in accordance with NZ IAS 39 Financial Instruments: Recognition and Measurement. A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired.

Foreign currencies

The Authority, from time to time, pays the managers of international equities and international fixed interest for management fees in currencies other than NZD. Transactions in overseas currencies are recorded in NZD at the rates of exchange prevailing on the dates of the transactions. Due to the nature of this payment there are no currency gains or losses.

Revenue

Revenue is recognised on an accrual basis. Interest income is accrued at balance date using the effective interest method.

Expenses

All expenses recognised in the Statement of Comprehensive Income are accounted for on an accrual basis.

Accounting for Joint Ventures

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 with Annuitas. The main function of Annuitas is to provide staff (**Management**) who act in management and secretarial roles on behalf of the Authority and the NPF. 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.

Standards issued but not yet effective

Various standards, interpretations and amendments have been issued by the Accounting Standards Review Board but have not been adopted by the Authority because they are not yet effective. The Authority expects to adopt the standards and interpretations in the period in which they become mandatory. The Board anticipates that the standards and interpretations will have no material impact on the historical statements of the Authority in the period of initial application except for NZ IFRS 9: Financial Instruments, the impact of which is currently unknown.

Standards and Interpretations effective in the current period

The same accounting policies, presentation and methods of computation have been followed in these financial statements as were applied in the preparation of the Authority financial statements for the period ended 30 June 2009, except for the impact of the adoption of NZ IAS 1. The revision to NZ IAS 1 has introduced minor terminology changes including revised titles for the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2010

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 Government 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 Government contributed 79.3% of the Authority's administrative expenses, including investment management and custody expenses, reimbursed by the Fund. Other employers contributed the balance of 20.7%.

2. Investment management and custody

	2010 $000	2009 $000
Investment management expenses	**21,004**	15,539
Custody expenses	**1,167**	1,442
Total Investment management and custody	**22,171**	16,981

3. Operating expenses

	2010 $000	2009 $000
Operating expenses include (but are not limited to):		
Audit	**156**	148
Other assurance fees paid to Auditor – Probity	**5**	9
Board fees and expenses	**209**	220
Gross rental and outgoings – Bowen space	**–**	489
Make good – Bowen space	**2**	343
Annuitas Management Limited	**1,714**	1,762

4. Trade and other receivables

	2010 $000	2009 $000
Government Superannuation Fund	**3,090**	6,314
Other receivables and prepayments	**127**	144
Annuitas Management Limited	**56**	6
Total trade and other receivables	**3,273**	6,464
Current	2,130	6,451
Non current	1,143	13

5. Trade and other payables

	2010 $000	2009 $000
Investment management	**2,892**	6,445
Professional services	**548**	334
Other creditors	**48**	24
Total Trade and other payables	**3,488**	6,803

6. Financial instruments

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, cash equivalents and receivables. The Authority has a minimal credit risk in its holdings of cash, cash equivalents, 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 amounts due from the Fund, which is an obligation of the Government in terms of section 15E of the Act.

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

Currency risk

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

The Authority has United States dollars (USD) 1,227,000 (2009: USD 740,000) and Australian dollars (AUD) 38,000 (2009: AUD 64,000) management fees owing in foreign currency at balance date to two international fixed interest and four international equity managers. This is the total exposure to currency risk.

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.

Liquidity risk

The Authority manages liquidity risk by maintaining cash and cash equivalents and through the continuous monitoring of forecast and actual cash flows. The Authority's overall strategy to liquidity risk remains unchanged from 2009.

All the Authority's financial liabilities are expected to be paid within the next 12 months.

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 the Authority and NPF.

During the year Annuitas employed 14 staff (including 2 part time) (2009: 14 (including 2 part time)). Total remuneration was $2,262,452 (2009: $2,269,697) and the Authority reimbursed $1,312,222 (2009: $1,361,818), or 58% (2009: 60%) of the total.

8. **Board fees**

Board members were paid the following fees during the period

	2010 $000	**2009 $000**
Chairman		
Tim McGuinness	**46,400**	46,400
Deputy Chairman		
David May	**29,000**	29,000
Members		
Helen Bowie (retired 30 November 2009)	**9,667**	23,200
Ralph Stockdill (retired 31 October 2009)	**7,732**	23,200
Susie Weaver (retired 19 December 2010)	**11,600**	23,200
Steve Napier	**23,200**	21,267
Keith Taylor	**23,200**	21,267
Mark Verbiest (appointed 1 November 2009)	**15,467**	–
Toni Kerr (appointed 1 December 2009)	**13,533**	–

The Authority also met Board members' travel and other expenses, where applicable, to attend Board meetings, and for travel on matters directly related to the business of the Authority. Travel and other expenses totalled $7,491 in 2010 (2009: $12,250).

The Authority continued with Directors' and Officers' insurance cover for Board members and members of Management, and Company Reimbursement insurance in respect of any claims made by Board members, or members of Management, under indemnities provided by the Authority. The total cost of the insurance was $19,125 (2009: $19,125) per annum.

9. **Related party information**

The Authority is an autonomous Crown entity.

The Authority has entered into various transactions with Government entities on an arm's length basis in the normal course of business. During the year the Authority entered into a resource sharing agreement with the Guardians of New Zealand Superannuation (**the Guardians**) to work jointly with the Guardians on the Authority's Responsible Investing Policies. David May (Deputy Chairman) is Chairman of the Guardians. Other Crown Financial Institutions, including the Earthquake Commission (**EC**), are also involved in this resource sharing agreement with the Guardians. Keith Taylor (Board member) is the Deputy Chair of the EC Board.

The Authority has appointed Board members, Tim McGuinness and David May, as directors of Annuitas. The costs of running Annuitas are shared between the Authority and the NPF on an equitable basis, as agreed between the two parties. The Authority paid fees for this service during the year amounting to $1,714,000 (2009 : $1,762,000). The amount owing by Annuitas to the Authority at year end was $56,359 (2009: $6,279).

The Board, through Management, monitors the performance of the managers, appointed by the Authority to provide services to the Authority, and their adherence to the terms of their contracts, and co-ordinates actuarial, accounting, taxation, legal and communication services for the Authority.

There were no transactions between the Board members as individuals and the Authority, other than the payment of fees or expenses. There were no individual transactions with Management. One member of the Board receives an annuity from the Fund.

10. Actual versus forecast

Investment revenues are subject to the volatile nature of investment markets, this being the principle reason for the variance between the forecast and actual changes in fair value of investment assets.

Investment management and custody expenses were above those forecast. This was caused by higher than expected investment manager fees, as a result of the value of investment assets being greater than forecast. Investment managers' fees are generally set as a percentage of funds under management. In addition, some managers who added value above benchmarks during the year, were paid performance fees under contracted arrangements.

11. Contingent assets and liabilities

There are no contingent assets or liabilities at 30 June 2010 (2009: Nil).

12. Capital commitments

Section 22 of the Government Superannuation Fund Amendment Act 2001 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 terminated on 17 February 2009.

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

	2010 $000	**2009 $000**
Non-cancellable contractual commitments		
Scheme administration not later than one year	**2,697**	2,660
Scheme administration later than one year and not later than two years	**2,697**	2,210
Scheme administration later than two years and not later than five years	**2,210**	–
Total non-cancellable contractual commitments payable	**7,604**	4,870

As at balance date, the Authority had committed $1,400,000 for ongoing expenditure on the upgrade of the GSF business system used in the administration of the GSF Schemes.

On 1 December 2007 the Authority entered into a new Management Services Agreement (**MSA**) with Annuitas.

Estimated commitments under the MSA are:

	2010 $000	2009 $000
Management services not later than one year	2,050	1,950
Management services later than one year and not later than two years	1,025	2,050
Management services later than two years and not later than five years	–	1,025
Total Estimated Commitments	**3,075**	5,025

13. Subsequent Events

There have been no material events after balance date that require adjustments to, or disclosure in, the Financial Statements. (2009: Nil).

Since balance date the Authority Board has approved further expenditure of up to $7,500,000 on the upgrade of the GSF business system used in the administration of the GSF Schemes.

Deloitte.

AUDIT REPORT

TO THE READERS OF GOVERNMENT SUPERANNUATION FUND AUTHORITY'S FINANCIAL STATEMENTS AND STATEMENTOF SERVICE PERFORMANCE FOR THE YEAR ENDED 30 JUNE 2010

The Auditor-General is the auditor of Government Superannuation Fund Authority (the Authority). The Auditor-General has appointed me, Ian Marshall, using the staff and resources of Deloitte, to carry out the audit on her 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 2010.

Unqualified opinion

In my opinion:

i) The financial statements of the Authority on pages 60 to 72:
- comply with generally accepted accounting practice in New Zealand; and
- fairly reflect:
  - the Authority's financial position as at 30 June 2010; and
  - the results of its operations and cash flows for the year ended on that date.

ii) The statement of service performance of the Authority on pages 17 to 22:
- complies with generally accepted accounting practice in New Zealand; and
- fairly reflects for each class of outputs:
  - the performance achieved, as compared with the forecast measures outlined in the statement of forecast service performance adopted at the start of the financial year; and
  - the output expenses incurred, as compared with the forecast output expenses outlined in the statement of forecast service performance adopted at the start of the financial year.

The audit was completed on 1 September 2010, 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 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 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 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 and 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 the financial statements and 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 2010 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 Board'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, we have no relationship with or interests in the Authority.

Ian Marshall
On behalf of the Auditor-General

DELOITTE
WELLINGTON, NEW ZEALAND

GOVERNMENT SUPERANNUATION FUND AUTHORITY
DIRECTORY

AS AT 1 SEPTEMBER 2010

Government Superannuation Fund Authority Board

Tim McGuinness (Chairman)
David May (Deputy Chairman)
Toni Kerr
Steve Napier
Keith Taylor
Mark Verbiest

Executive office

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

Scheme administrator

Datacom Employer Services Limited
Level 4, Sovereign House
34 Manners Street
PO Box 3614
Wellington 6140

Custodian

JP Morgan Chase Bank NA

Investment adviser

Russell Investment Group Limited

Tax adviser

PricewaterhouseCoopers

Actuary

Government Actuary

Auditor

Ian Marshall
Deloitte
on behalf of the Auditor-General

Bankers

Bank of New Zealand (Authority)
National Bank of New Zealand Limited (Fund)

Solicitors

DLA Phillips Fox
Crown Law

GOVERNMENT SUPERANNUATION FUND AUTHORITY DIRECTORY (CONTINUED)

Investment managers

Global fixed interest

Ashmore Management Company Limited (*from May 2010*)
Pacific Investment Management Company LLC
Wellington Management Company LLP

New Zealand equities

Direct Capital IV GP Limited (*from July 2009*)
Harbour Asset Management Limited (*from January 2010*)
AllianceBernstein New Zealand Limited (*to January 2010*)
ING (NZ) Limited

International equities

Altrinsic Global Advisers, LLC
Arrowstreet Capital Limited Partnership
AXA Rosenberg Investment Management Asia Pacific Ltd (*to May 2010*)
Genesis Emerging Markets Investment Company
Marathon Asset Management LLP
PanAgora Asset Management, Inc
Pzena Investment Management LLC
T. Rowe Price Global Investment Services Limited

Real estate

AMP Capital Investors New Zealand Limited
(*previously AMP Capital Redding Investors Limited*)
LaSalle Investment Management (Securities) L.P. (*to November 2009*)
RREEF America REIT II, Inc
Willis Bond and Company Management Limited (*from July 2010*)

Collateralised commodity futures

Gresham Investment Management LLC

Multi-asset

Makena Capital Management (Cayman), LLC

Global tactical asset allocation

AQR Capital Management, LLC

Currency Management

International equities and real estate
State Street Global Advisors, Australia, Limited
International fixed interest, Collateralised commodity futures and Global tactical asset allocation
ANZ National Bank Limited

GOVERNMENT SUPERANNUATION FUND AUTHORITY DIRECTORY (CONTINUED)

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

Datacom Employer Services Ltd
GSF Scheme Administration
Level 4, Sovereign House
34 Manners Street
PO Box 3614
Wellington 6140

or

Chief Executive
Government Superannuation Fund Authority
PO Box 3390
Wellington 6140

GOVERNMENT SUPERANNUATION FUND AUTHORITY

STATEMENT OF INVESTMENT POLICIES, STANDARDS AND PROCEDURES

This document is titled Statement of Investment Policies, Standards and Procedures (**SIPSP**) and is dated 31 August 2010. An electronic copy is available via website *www.gsfa.co.nz*

This document is the intellectual property of the Government Superannuation Fund Authority (**the Authority**). You must not use or disseminate any of the information contained in it without the prior written consent of the Authority.

No liability

While the Authority has made every effort to ensure that the information provided in this document is accurate, neither the Authority nor its advisors will be liable whether in contract or in tort (including negligence), equity or any other cause of action to any persons or person who rely on the information without the prior agreement of the Authority.

Change without notice

The Authority may change the information in this document at any time and without providing any notice to any party of any changes.

CONTENTS

1 INTRODUCTION

1.1 The Authority

The Government Superannuation Fund Authority (**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**).

1.2 Purpose

This Statement of Investment Policies, Standards and Procedures (**SIPSP**) records the arrangements set by the Authority's Board (**the Board**) for the governance and management of the investment assets held by the Fund. The Board's governance defines fiduciary roles and responsibilities, establishes the decision-making processes and the policies and procedures for management of the investment assets of the Fund.

1.3 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) 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 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 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."*

1.4 Review

This document is dated 31 August 2010 and supersedes all previous versions. This document is subject to regular review and amendment as the Fund's investment strategy evolves. A version control document is maintained by the Board.

2 THE FUND MANAGEMENT STRUCTURE AND GOVERNANCE

Required under section 15M (f) - the Fund management structure.

2.1 Policies

The Board is the governing body of the Authority and is responsible for making all decisions relating to the Fund. The Board has all the powers necessary for managing, and for directing or supervising the management of, the business of the Authority and the Fund. The Authority's key governance document its **Corporate Governance Statement**, incorporating the requirements set out in the Act, the Crown Entities Act 2004, other legislation and regulation, and policies and practices developed by the Board. A copy of the Authority's Corporate Governance Statement can be found on the website *www.gsfa.govt.nz*

The Board has established an Investment Committee to perform and exercise the functions and powers of the Board delegated to the committee. The committee has written terms of reference and ensures that its activities remain consistent with the Crown Entities Act. The committee review its performance annually and is also reviewed by the Board;

The Board is supported by a Management team (employed by Annuitas Management Limited (**Annuitas**) – see below) who act in management, operational and secretarial roles on behalf of the Authority. Clear separation of the governance and operational functions is maintained. The Board retains the power of appointment of investment managers and custodians.

The Authority has outsourced the key activities of scheme administration and investment management (including custody of the Fund's assets) as well as legal, tax and investment advisory functions and communication services.

In terms of the GSF Act, the Government Actuary is the actuary for the Fund and the Auditor-General is the auditor.

2.2 Standards

a) A global custodian is appointed 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).

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

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

c) Third party investment managers have been engaged to invest the assets of the Fund. Details of the current investment managers can be found on the website *www.gsfa.govt.nz*

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

The MSA between the Authority and Annuitas contains delegations of authority to enable Management to carry out the day to day management of the Authority's investment, custody and scheme administration arrangements. In relation to investments, Management is primarily responsible for the identification and implementation of appropriate strategies for the Authority to meet its obligations under the GSF Act and its objectives. This includes the management of contracted services, including investment management, custodial and external advisers, maintaining financial accounting and performance calculations and contract and compliance monitoring.

2.3 Procedures

Selection of managers is made in accordance with the Authority's Policy on Procurement of Services.

Selection of investment managers 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 investment 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 ongoing suitability for their role.

3 STATEMENT OF INVESTMENT BELIEFS

3.1 Policies

The Board believes that it is essential to have a clear set of investment beliefs to communicate its values and to provide a basis for its investment actions. Accordingly the Board has adopted the following set of Investment Beliefs.

3.2 Standards

a) **Higher returns generally require acceptance of higher risks and diversification reduces total risk.**

Investors generally demand a return premium to compensate them for investing in risky assets. Total investment risk can be reduced for any given return target by investing in a diversified range of asset classes. Risk is reduced by exposure to different sources of return that are complementary or not closely related and, within an asset class, by investing across a range of industries, countries and entities. Diversification reduces risk but has a proportionately lesser effect on returns. A portfolio that is well-diversified, both across and within asset classes, will deliver more consistent returns over time than a less diversified portfolio.

b) **Setting a strategic asset allocation appropriate to the Fund's long term objectives is the most important investment decision as it creates the majority of the Fund's risk and return.**

Setting, managing and monitoring the appropriateness of the asset allocation and exposures to major market risks are the key investment management functions. Although active management may be engaged to seek additional sources of return to the underlying asset class returns, the additional impact on the risk and return characteristics of the portfolio is secondary compared to the risks and returns of the underlying markets themselves.

c) **Markets vary in their efficiency, and market inefficiencies offer skilful 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 inefficiencies. It is possible to identify skilful managers by thorough research. The higher expected returns from active management should be weighed against the higher costs and any tax implications arising from active management. Rewards from active management will be maximised by engaging skilful managers with diversified investment approaches.

d) **Market timing is not a reliable source of return in the short term because of the unpredictability of returns over short periods, but account should be taken of unusual asset price behaviour with respect to longer term indicators of relative reward for risk.**

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. Returns are affected in the short term as new information is incorporated into asset prices and by uncertainty, temporary influences and sentiment. 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.

Asset prices deviate significantly from normal relationships from time to time increasing the risk of abnormal future returns (i.e. 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. Over longer periods, the more stable components of return become more evident.

e) **Investment opportunities should be considered net of all costs and taxes and having regard to their contribution to total fund risk and return.**

Investment returns should be considered net of all costs and taxes. Costs can be incurred in the form of fees, commissions, transaction expenses, and the impact of transactions on market prices. Costs can also arise from deviations from the strategic asset allocation and unduly constraining investment managers' ability to add value.

In addition to considering the characteristics of an investment opportunity in its own right it is important to take into account its contribution to the total risk and return of the Fund. Investments, whose risks are less correlated with the fund as a whole, generally have a lower return threshold for inclusion in the portfolio.

f) **Costs and principal-agent risks should be controlled carefully, especially where managers are engaged to add value through their skill.**

Active management requires an investment in research and skill or experience and is therefore more expensive than passive management, such as index tracking. When active managers are engaged to add value through their skill it is important to ensure the additional fees and costs are reasonable. Most importantly, where fees are related to performance, the manager's interests must be aligned strongly with those of the Fund in terms of returns, risks and investment horizon.

3.3 Procedures

The Investment Beliefs are reviewed formally as part of the annual statutory review of the SIPSP and updated at other times as determined by the Board.

4 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.

4.1 Introduction

Investments can be divided into broad asset classes that share common return and risk characteristics. Each asset class differs materially from the others in its characteristics. These differences and the interaction among asset classes, when combined in a total portfolio, provide diversification that improves the total expected return available for any given level of risk.

4.2 Policies

The asset classes in which the Fund may invest are:

a) **Equities** comprising equity securities and securities convertible into equities and includes partly paid ordinary and preference shares. The asset class includes large, mid and small capitalisation equities, emerging market and unlisted equity investments.

b) **Real Estate** comprising land and premises built on land and holdings in entities that invest principally in land and premises.

c) **Fixed Interest** comprising securities issued by sovereign and non-sovereign issuers and investments in various sub-sectors such as mortgage-backed and asset-backed securities and inflation linked bonds or products. The asset class includes government guaranteed debt securities (or guaranteed by an agency thereof) and non-sovereign debt, including deposits debentures, bonds, notes, promissory notes and other securities not convertible into equity at the issuers option.

d) **Cash and short term securities** comprising New Zealand and foreign currency cash holdings, as specifically provided for in the relevant investment management. agreements for liquidity purposes or held as collateral against derivative transactions.

e) **Commodities** comprising tangible products, such as metals, energy and agricultural products.

f) **Insurance-linked assets**, including securities providing exposure to natural catastrophe insurance and reinsurance markets.

The Fund may invest in these asset classes through direct ownership of the assets or through investing in collective investment vehicles that hold the assets or through derivative securities, such as futures, forward contracts, options and swaps.

The Fund's investments may be traded on recognised public exchanges, or may be traded on private markets.

Private market assets and securities are generally less liquid than their public market counterparts. They include collective investment vehicles, that hold eligible assets and securities, such as unit trusts, hedge funds and fund-of-funds that engage in active strategies trading among various asset classes and securities. Private market assets are generally valued by appraisal.

The selection of individual investments within the various asset classes is delegated by the Authority to professional investment managers selected for their expertise in particular investment disciplines. Each manager is mandated contractually to invest in a defined range of eligible investments which may cover one or more of the asset classes above and is subject to defined limits of investment risk.

5 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.

5.1 Policies

a) Investment Objective

The Authority's investment objective is 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 to the Fund as a whole, within a best practice framework.

In seeking to achieve this objective over the long term, the Authority determines a level of investment risk the Fund can accept that is consistent with an expected excess return over New Zealand Government Stock. The Risk Parameter defines this level of risk and the Investment Performance Measure is the expected return.

b) Risk Parameter

The Risk Parameter is to have no more than a one in ten chance in any one year of a loss after-tax greater than 9% of the total Fund.

c) Investment Performance Measure (IPM)

The Authority considers that the Risk Parameter is consistent with an expected after-tax return equivalent to the NZX New Zealand Government Stock Gross Return Index (after-tax), plus at least 2.5% per annum, measured over rolling 10 year periods.

5.2 Standards

a) Reference Portfolio

The Board has adopted a Reference Portfolio for accountability and performance measurement purposes. The Reference Portfolio is a simple portfolio that could be managed at low-cost and meet the Fund's return and risk objectives. The Reference Portfolio also provides a benchmark to measure the Authority's performance in generating value-added returns. The Board reviews the composition of Reference Portfolio at least every three years.

The current Reference Portfolio comprises:

Table 1: Reference Portfolio and Benchmarks

Asset Class	Weight (%)	Benchmark
International equities	55	MSCI All Country World Index
New Zealand equities	10	NZX50 Gross including Imputation Credits
Commodities	5	UBS DJ Total Return Commodities index
Fixed interest	30	Citigroup World Government Bond Index
Total Assets	**100**	
Foreign currency exposure (after-tax)	20	

b) Target Portfolio and rebalancing ranges

The Authority seeks to out-perform the Reference Portfolio on a net of fees basis in two main ways:

- By taking on exposure to sources of return that are considered to be systematic reward for bearing risk of loss and are not represented in the Reference Portfolio. These 'better beta' sources of return include real estate, private equity and insurance-related risks for example; and
- By capturing returns, attributable to manager skill rather than systematic risk bearing, ie 'alpha'. Alpha does not add materially to systematic risk.

The Authority manages the Fund to a Target Portfolio that incorporates better beta and alpha strategies and is expected to be a more efficient portfolio than the Reference Portfolio, ie improve risk-adjusted returns after fees and tax. The Target Portfolio is also expected to deliver the Fund's IPM within the Fund's Risk Parameter.

The current Target Portfolio and the rebalancing ranges are set out in Table 2.

The ranges indicate the percentage the capital allocation is permitted to deviate from the target allocation before rebalancing trades are required.

Table 2: Target Portfolio Allocation and Rebalancing Ranges

Asset Class/Strategy	Target Allocation (%)	Rebalancing Ranges (%)
International equities	45.0	37.5 to 52.5
New Zealand equities	9.3	6.3 to 12.3
Real estate	5.0	1.0 to 9.0
Fixed interest	26.5	20.5 to 32.5
Commodities	4.2	1.2 to 7.2
Global tactical asset allocation	3.0	1.0 to 5.0
Multi-asset class	7.0	3.0 to 11.0
Total Assets	**100.0**	
Foreign currency exposure (after-tax)	20.0	0 to 40[1]

The actual weightings of the asset classes/strategies are based on the valuations of those assets/strategies determined using the policies, standards and procedures set out in Section 12.

[1]See Section (d) 'Foreign Currency Tilting Strategy'.

c) **Foreign exchange exposure and hedging policies**

The Authority addresses its foreign currency exposures in a total portfolio context. The Authority's overall objective is to have an after-tax exposure to foreign currencies of 20% of the total Fund. The Fund's required foreign currency exposure is achieved by hedging all asset classes, with the exception of the International equities and the Multi-asset class portfolios, to the hedge ratios shown in Table 3.

The hedge ratio for International equities is varied to deliver the desired total Fund foreign currency exposure as discussed further below in Section 5.3 (d). The Multi-asset class portfolio is not hedged.

Table 3: Foreign Exchange Hedging Strategies

Asset Class	Before-tax (After-tax) Strategic Hedging Ratio	Range (Before-tax)
International equities	Variable	Variable
Real estate	143% (100%)	138% to 148%
Fixed interest	100% (100%)	90% to 110%
Commodities	143% (100%)	138% to 148%
Global tactical asset allocation	143% (100%)	138% to 148%
Multi-asset class	Unhedged	Unhedged
Total Fund (after-tax)	20%	0% to 40%

5.3 Procedures

a) **Review of Objectives and Reference Portfolio**

The IPM and the Risk Parameter are reviewed at least annually, taking into account the investment and taxation environment in which the Authority operates. The trade-off between risk and return is reviewed based on analysis of the prospective risk and return characteristics of each asset class in which the

Fund might invest and their combinations. The Reference Portfolio is reviewed at least every three years.

b) Rebalancing

Rebalancing takes place monthly to ensure the Fund remains aligned with the Target Portfolio taking into account known cash flows for the following month. The asset exposure ranges are set as a trade-off between the costs of being exactly at the Target Portfolio against the risk that variations in exposures will compromise the Fund's investment objectives. Rebalancing takes into account investments that are relatively illiquid, such as equity interests in collective investment vehicles that are not traded and have contractual restrictions on redemptions.

c) 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.

d) Foreign Currency Tilting Strategy

The Authority adjusts the Fund's foreign currency exposure periodically in accordance with its Foreign Currency Tilting Strategy. This Strategy moves the Fund's foreign exchange exposure according to defined tilting rules that reflect the prevailing valuation and momentum of the New Zealand dollar. The Strategy is implemented by adjusting the before-tax hedge ratio on the International equities' portfolio so that the total Fund foreign currency exposure is at the required after-tax level.

6 BENCHMARKS

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.

6.1 Policies

The benchmark for the Fund as a whole (and for individual asset classes) is selected to be consistent with the risk and return assumptions that underpinned determination of the Reference Portfolio and Target Portfolio for the Fund.

The Fund's performance is assessed by comparing its investment return with the IPM, Risk Parameter and individual asset class or strategy benchmarks (see sections 5.1 and 5.2).

6.2 Standards

a) Investment Objective

The Authority's investment objective is 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 to the Fund as a whole, within a best practice framework.

b) Investment Performance Measure (IPM)

The IPM is an expected after-tax return equivalent to the NZX New Zealand Government Stock Gross Return Index (after-tax), plus at least 2.5% per annum, measured over rolling 10 year periods.

c) Risk Parameter

The Risk Parameter is to have no more than a one in ten chance in any one year of a loss after-tax greater than 9% of the total Fund.

d) Asset Class and Strategy Benchmarks

For the purposes of assessing asset class or strategy performance, the benchmarks set out in Table 4 are adopted.

Table 4: Asset Class and Strategy Benchmarks

Asset Class/Strategy	Benchmark
International equities	MSCI All Countries Index
New Zealand equities	NZX 50 gross index including imputation credits
Global listed real estate – collective portfolio	FTSE EPRA / NAREIT Global Property Index
US unlisted real estate	NCREIF Property Index
Fixed interest	Barclays Global Aggregate Index
Commodities (Collateralised commodities futures)	Dow Jones UBS Total Return Commodity Index
Global tactical asset allocation	US 3 month Libor + 6%
Multi-asset class[2]	70% MSCI World Index and 30% Barclays Global Aggregate Index

[2]A single portfolio comprising a diversified range of both public markets' and private markets' assets including global equities, fixed interest, property and private equity, and absolute return strategies.

Generally, managers within an asset class have the same benchmark as the asset class. Managers may have specific benchmarks depending on their specific mandates, for example in the case of International equities the MSCI All Country World Index Investible Markets Index, MSCI ACWI, the MSCI World Index and the MSCI Emerging Markets Index are used.

6.3 Procedures

a) The Fund's performance is assessed by comparing its after-tax investment return with the IPM over rolling 10 year periods and with the Risk Parameter. The Authority recognises that, from year to year, investment returns may not meet the IPM and may be outside the Risk Parameter.

   The Board also monitors the before-tax after-fees return of the Fund's Target Portfolio relative to the Reference Portfolio, and the before-tax after-fees return of the Fund's actual portfolio relative to the Target Portfolio.

b) The performance against the Risk Parameter is monitored by comparing the variance of the Fund's actual after-tax return with the variance consistent with a loss of 9% occurring not more than one year in ten.

c) The performance of asset classes or strategies is assessed by comparing the actual performance of the investment managers with the benchmarks relevant to their respective mandates, plus any excess return target expected for active managers. Investment managers' performances are generally considered over periods not less than three years.

   Investment performance is generally measured:

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

Investment managers are evaluated after taking into account their investment management fees and the degree of risk incurred to achieve expected return targets. Investment managers are also compared to other managers in the same asset class or strategy.

7 STANDARDS FOR REPORTING

Required under section 15M (c) – standards for reporting the investment performance of the Fund.

7.1 Policies

A comprehensive and timely reporting framework enables the Board to analyse the performance of the Fund, asset classes and investment managers.

7.2 Standards

a) **Reporting by the custodian to the Board**

For the Fund's investments as a whole, for each asset class and for each investment manager, the custodian provides the reports required by the Authority to enable monitoring and review of the Fund and managers' performance. Those reports 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 and comparisons with benchmarks;
- taxation matters; and
- reports of compliance with mandate specific restrictions on separately managed portfolios.

b) **Reporting by investment managers**

Reports from investment managers each month may cover (where applicable):

- details of securities held;
- a review of the performance and an analysis of performance factors;
- investment philosophy and strategy;
- 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 the custodian;
- a statement of any voting rights issues;
- annual external audit report; and
- compliance with responsible investment policies

The Board reviews the managers' investment performance quarterly and investment managers are required to meet with Management, on behalf of the Authority, on at least an annual basis.

c) **Reporting by Management to the Board**

Management reports on investment performance quarterly to the Board including aggregate returns and returns analysed by asset class and by manager. In each case actual returns are compared to benchmarks, expected risk measures, any active return targets and, in appropriate cases, peer returns. Summary reports are provided monthly of aggregate and asset class returns. Management also reports on responsible investment developments.

Management liaises regularly with the Treasury which represents the Minster of Finance.

d) Public Reporting

The Fund's investment performance is reported quarterly on the Authority's website *www.gsfa.govt.nz* and published each year in the Fund's Annual Report, which is tabled in the House of Representatives. Forecasts for investment performance are published each year in the Authority's Statement of Intent.

The Treasury also reports to the Minister quarterly, following consultation with the Authority, on the Fund's investment performance and on key operational issues.

7.3 Procedures

The investment management agreements contain reporting provisions to enable the Board to determine a manager's compliance with the agreement and mandate, and success in meeting investment targets set for the manager. Similarly, the reporting functions provided by the custodian, including standards for timeliness, are described in the custodian contract.

8 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 of voting rights acquired through investments.

8.1 Responsible Investment Policies, Standards and Procedures (RI Policies)

The Authority has developed RI Policies for:

a) ethical investment, including avoiding prejudice to New Zealand's reputation as a responsible member of the world community;

b) environmental, social, and governance considerations; and

c) the retention, exercise, or delegation of voting rights acquired through investments.

The Authority may take other factors into account in its investment processes, provided they do not conflict with its responsibilities under the GSF Act and can be implemented in a practicable and cost effective way. The Authority takes a broad range of other factors into account in its investment processes including:

- information or advice that a corporate entity or country, on the basis of credible evidence from publicly available sources, has participated in serious infringements of relevant international standards relating to human rights, labour and employment, the environment or international security and disarmament;
- any action by the corporate entity or country which 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.

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

8.2 Procedures

The Board is accountable for, and maintains oversight of, the Authority's RI Policies. The Investment Committee oversees the development of the RI Policies, monitors their implementation, and makes recommendations to the Board, as required.

The Authority has signed a collaborative agreement with the Guardians of New Zealand Superannuation (**GNZS**), the Accident Compensation Commission and the Earthquake Commission as all parties have similar RI obligations and all are signatories to the United Nations Principles for Responsible Investment. The purpose of the agreement is to minimise costs and duplication of research effort for all parties.

The Board has delegated the implementation of the RI Policies to the General Manager - Investments, the Chief Executive and the Investment Committee depending on the level of action required.

A copy of the Authority's RI Policies and the delegated authorities for their implementation can be found on the website *www.gsfa.govt.nz*

9 RISK MANAGEMENT

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

9.1 Policies

The Authority has developed comprehensive risk management policies for the management of various investment, operational and financial risks. The Audit and Risk Review Committee assists the Board in fulfilling its responsibilities with respect to internal controls, accounting policies, financial statements approval and risk management. Risk management is further supported by the Corporate Governance Statement, acceptable conduct policies for Board members and Management, Board expenditure policies and procedures, defined roles and responsibilities, performance accountability processes and timely disclosure and communication.

The level of investment risk in the Fund is defined by the Risk Parameter and the Authority's risk management procedures described in section 9.3. A description of the major risk categories are set out below.

9.2 Standards

a) Market risk

Market risk is the risk of adverse movements in investment markets (including asset prices, volatility, changes in the yield curve or other market related variables) that affect the value or income of the portfolio. Market risk is outside the control of the Authority. The volatility of investment markets means that the return from the Fund is inherently uncertain. Actual returns from each asset class may vary significantly each year from the mean returns assumed in determining the investment strategy appropriate to the long term.

Major structural changes to investment markets and/or taxation environment are not within the control of the Authority. However, the Authority takes into account changes in these risks in its reviews of the Reference Portfolio, Target Portfolio and investment strategy.

b) Borrowing or leverage risk

The Fund is not permitted to borrow money or charge any of the property of the Fund, directly or through financial instruments, without the Minister of Finance's consent. The Authority has sought and obtained the Minister's consent to enter into financial instruments, where the use of those is consistent with the Authority's SIPSP. The Authority has also obtained the Minister's consent to enter into temporary overdrafts with its banks.

Collective investment vehicles

The Fund may own equity securities or invest in collective investment vehicles that borrow or grant charges on their own assets provided that owning these equity securities does not cause undue risk to the Fund as a whole, as expressed in the Risk Parameter. Particular investments or strategies within collective investment vehicles may be leveraged or include leverage or be invested 'short'. (Short positions arise when securities are sold while not yet owned, in anticipation of being bought after the price falls. Short positions may be created physically by borrowing the securities and selling them or through derivative contracts.)

Derivatives held directly by the Fund

To avoid undue risk to the Fund as a whole, derivative positions held directly by the Fund are required to be collateralised. In general this means the Fund must hold sufficient cash or securities corresponding to the derivatives to be able to meet any obligations arising from closing out the derivative transaction at current market prices.

c) **Manager risk**

The Authority retains professional managers to implement its investment strategy and, in many cases, deliver superior returns through skilled active management. Managers' returns may vary from expected levels.

d) **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.

e) **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.

f) **Operational risk**

Operational risk is the risk of financial loss due to mismanagement, error, fraud or unauthorised transactions.

g) **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.

9.3 Procedures

a) **Market risk** is managed by:

- specifying the total risk budget of the Fund and its various major exposures consistent with the Risk Parameter and best practice assumptions in relation to exposure risks and correlations among them;
- diversifying the asset classes in which the Fund invests by adopting the Reference Portfolio and Target Portfolio described in section 5 and a range of investment management techniques for the Fund;
- seeking professional advice on the investment strategy, the Reference Portfolio and the Target Portfolio;
- carrying out peer reviews of advice, and consulting with other Crown Financial Institutions and large investment funds;
- requiring investment managers to manage their portfolios within defined market exposure limits for each asset class held; and
- setting limits to which managers are required contractually to manage their portfolios which may include:
  - limits on the expected volatility of their total portfolio or their portfolio relative to the benchmark;
  - limits on exposure to any single issuer of securities;
  - limits on particular exposures in the manager's benchmark; and exposures not represented in the benchmark.

b) **Borrowing or leverage risk** is managed by

- requiring any derivative transactions held directly by the Fund to be adequately collateralised with cash or corresponding securities, valued at current market prices;
- entering into commercial arrangements for any charges against the Fund in accordance with industry best practice, such as the use of agreed counterparty settlement limits and temporary overdrafts for forward currency contracts, swaps and other contracts for difference;
- requiring settlement of amounts outstanding from any derivative transactions due to short term price fluctuations that exceed levels agreed in advance with counterparties;
- the Authority satisfying itself that potential managers (including managers of collective investment vehicles) have adequate policies and procedures relating to derivative counterparties and, if selected, monitoring that managers adhere to their policies; and
- using appropriate industry standard documentation.

c) **Manager risk** is managed by:

- robust selection process for investment managers based on demonstrated ability and independent expert opinion;
- diversification among managers;
- setting mandates for active managers based on best practice portfolio management that prescribe acceptable risk limits;
- regular assessment and review of manager performance against the benchmark and peers; and
- putting in place management agreements or other satisfactory contractual terms that separate Fund assets from managers and protect against manager errors, omissions and wrongful actions.

d) **Credit risk** is managed by requiring that managers of the Fund's credit investments:

- maintain the credit quality of their portfolios within agreed contractual guidelines and specified according to approved independent credit ratings;
- limit exposure to individual issuers to prescribed limits; and
- maintain appropriate policies and procedures relating to derivative counterparty selection and management and appropriate industry standard documentation.

e) **Liquidity risk** is controlled by implementing the Fund's Reference Portfolio and Target Portfolio and rebalancing procedures described in section 4. In addition, liquidity risk is managed by:

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

f) **Operational risk** is managed by:

- engaging an independent custodian to record transactions, report on performance and monitor compliance of investment managers with mandates;
- having in place a specific mandate for each investment manager, based on best practice portfolio management;
- clear separation of functions between investment management, custody, and overall supervision;
- ensuring the Management team has sufficient resources to conduct the oversight function as part of its overall responsibilities; and
- requiring investment managers and the custodian to:
  - provide the Authority with third party covenants or assurances against operational risk 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
  - provide compliance reporting, and
  - reconcile the Fund's recorded positions regularly.

g) **Currency risk** is managed by:

- maintaining a foreign currency hedging policy for the Fund and individual asset classes;
- engaging currency managers to manage the various hedging programmes;
- specifying the bounds within which investment managers may take on currency exposures relative to their benchmarks; and
- specifying the instruments that managers may use and the credit worthiness of the counterparties in the investment management agreement with each manager.

10 THE USE OF DERIVATIVES

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

10.1 Introduction

Derivatives are financial instruments whose value and characteristics are derived from underlying assets, indices or reference rates. Derivatives cover a broad range of financial instruments and include futures contracts, forward currency contracts, swaps, forward interest rate contracts, options and credit default swaps.

There is a variety of purposes for which it may be appropriate for the Fund to use derivatives. These include risk management, value adding investment strategies and transactional efficiency.

Derivatives provide another means for an investment manager to obtain market exposures and can be more liquid than the assets from which their value is derived.

10.2 Policies

Derivatives may be entered into by the Authority or its managers and custodians on behalf of the Fund. Their use must be entered into as specified in each investment management agreement, or where consistent with the terms governing collective investment vehicles.

Section 15C of the Act requires the consent of the Minister of Finance to enter into derivative transactions. Accordingly the Authority has sought and obtained the Minister's approval to use derivatives subject to certain conditions.

The use of derivatives is permitted only where it results in market exposures appropriate to the Fund as a whole; the resulting counterparty exposures are adequately controlled and the Fund can meet any liquidity requirements arising from their use.

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.

10.3 Standards

Derivative instruments may be traded on recognised exchanges or issued by a counterparty over-the-counter. Each such counterparty must meet the Fund's general requirements in terms of credit rating and contractual arrangements.

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 for the asset class. If required, appropriate parameters for hedging using proxy currency will be established with the currency managers as well as appropriate operational ranges.

The effective exposures to underlying securities or assets arising from any derivatives are taken into account for the purposes of determining compliance with the prescribed exposure limits of portfolios.

10.4 Procedures

All investment managers are required to provide the Authority with a copy of their policies relating to derivative securities trading and counterparty risk and to manage their derivative exposures in accordance with those policies. The Authority recognises that, where it invests in collective investment vehicles offered by investment managers, those vehicles may be investing in derivatives and takes that into account in determining the appropriate level of investment for the Fund.

The risk of derivatives is measured by their effective exposure to underlying assets as well as on a stand alone basis. The value of derivatives is measured according to generally accepted industry best practice.

Over-the-counter foreign exchange hedging derivative 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.

The currency exposure associated with international investing will be managed using forward foreign exchange contracts relating to the currencies in which the securities that comprise the portfolio are denominated, or their close proxies.

Derivative policies and practices, including foreign exchange hedging are in accordance with any selected manager's derivatives policies, set out in their offer documents, or as otherwise specified in an investment management agreement. Selected managers are required to maintain policies and procedures relating to derivative counterparty selection and management accordingly and use appropriate industry standard documentation.

11 INVESTMENT CONSTRAINTS

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

11.1 Policies

Prohibitions and constraints imposed by the Authority can be categorised as follows:

a) asset classes or strategies which do not form part of the asset allocation;

b) investments excluded under the Authority's RI Policies;

c) investments outside the permitted investments of any investment mandate, or not included in the offer document of a collective investment; and

d) exposures outside the rebalancing range for each investment class (to ensure the investment objective of the Fund is not compromised by excessive deviation from the Fund's Reference Portfolio and Target Portfolio).

In addition, 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

11.2 Standards

The Authority has developed constraints and limits in respect of each asset class or strategy to control risks. Each investment management agreement specifies those investments that constitute authorised investments and managers may not invest other than in those permitted investments.

Limits on the maximum holding that can be held in each issuer address section 15K of the GSF Act and rebalancing ranges for each asset class or strategy are recorded in Section 5.2.

11.3 Procedures

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.

Procedures for rebalancing are set out in section Table 2, page 91.

12 VALUATION

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

12.1 Policies

Many of the investments of the Fund are securities regularly traded on recognised exchanges and are valued independently and reported publicly. These investments are valued at current market value by the custodian in accordance with accepted industry best practice.

Where investments are not traded on recognised exchanges but can be independently priced by the custodian, the Authority, in conjunction with the custodian, determines fair valuation on these investments through an objective or independent process where possible. Examples of investments that are not traded on recognised exchanges but that can be independently priced are: some collective investment vehicles, some non-sovereign bonds and over-the-counter derivative transactions.

Where a valuation discrepancy arises between an investment manager and the custodian, the Authority generally accepts the custodian's valuation.

For private market investments, that are either:

- not able to be independently priced by the custodian; or
- can be priced independently by the custodian but at a cost, determined by the Authority to be unreasonable, the Authority relies on the valuation provided by the investment manager that has either:
  - been undertaken by a reputable, suitably qualified professional valuer who is independent of the investment manager; or
  - been determined by reference to observable market variables obtained from sources independent of the manager.

12.2 Standards

In the case of listed assets, fair value is determined by reference to prices traded on recognised exchanges. For unlisted securities, where quoted market prices are not available, fair value will be determined on the basis of independent valuation. Investments in collective investment vehicles will be subject to external valuation processes and valued according to accepted market practice. In the case of over-the-counter derivatives, the mark-to-market method for determining the value is independently verified.

12.3 Procedures

Wherever possible, independent pricing measured at subsequent reporting dates will form the basis of the Board's fair value estimate, using the Standards in 12.2. In cases where an independent valuation is unable to be obtained, the Authority uses the closing price released by the relevant investment manager. Investments in collective investment vehicles, where underlying assets are not publicly traded, are subject to the Board being satisfied that there are adequate and timely independent valuations and audit procedures to validate underlying valuations.

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