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REPORTS OF THE

GOVERNMENT SUPERANNUATION FUND AUTHORITY

FOR THE YEAR ENDED
30 JUNE 2011

GOVERNMENT SUPERANNUATION FUND
Te Pūtea Penihana Kāwanatanga

FOR THE YEAR ENDED
30 JUNE 2011

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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 2011.

A separate annual report has been prepared by the Authority on the Government Superannuation Fund (**GSF** or **the Fund**), beginning on page 25.

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 2011 Year

- A second year of strong returns following the global financial crisis of 2008/09.
- Surplus after tax of $335.6 million (return after tax of 11.6%).
- Continued added value in most asset classes.
- Sharply rising NZ dollar (**NZD**) impacted on the returns from the Fund's overseas assets.
- New investments in New Zealand insurance-linked assets and commercial property.
- Requirements for the new schemes administration system project largely completed in December 2010. Work on the construction phase underway.
- 5 year Statutory Review found the Authority meets best practice in all essential areas, has effective board and management oversight, appropriate policies and practices, strong risk management and effective decision making.

Investment Markets

Growth investments continued to recover strongly for the second year since the global financial crisis (**GFC**). International equity and commodity markets were up strongly and New Zealand equities returned 17.5%. These outcomes reflected low starting points and huge fiscal and monetary stimulus from governments trying to avert a global depression. Perhaps the most surprising feature was the big rise in the NZD, 20% against the US dollar (**USD**) and 12% against the basket of currencies in which the Fund invests. The rises reflected New Zealand's peripheral position in the GFC and strong export commodity prices. To the extent overseas assets were not hedged the NZD's rise eroded returns in NZD terms significantly.

Near the end of the financial year signs re-emerged that the massive debt over-hang, built up before the GFC, was not being addressed credibly by governments and central banks.

First, Europe managed to negotiate only interim measures to avoid possible defaults by peripheral Eurozone countries and major bank failures: secondly, in the United States, debt ceilings became political issues with the government unable to agree on a credible debt reduction programmes. Debt reduction programmes are necessary but will mean slower future growth in developed economies, possibly higher inflation and declines in living standards that will be hard to sustain politically. These risks haunted financial markets at the close of the financial year.

Investment Activity

During the year the Authority continued to diversify the Fund's sources of return and risk. In addition to existing investments in global property, commodities and absolute return strategies, established over the last few years, new investments were made in insurance-linked assets and New Zealand commercial property.

Insurance-linked assets are relatively new areas for institutional investors and offer a return for taking on insurance risks that are not closely related to the returns and risk from international equities.

The New Zealand commercial property investment is in a private fund managed by Willis Bond and Company Management Limited, a successful Wellington developer, that seeks opportunities to acquire properties on favourable terms, in the current debt-stressed market, and re-develop them to add value.

Investment Performance

The Fund's return was strong for the second year in a row since the negative returns of the GFC. The return after tax of 11.6% compares to 10.4% in 2010 and the Investment Performance Measure (**IPM**) (see page 6) of 7.2%.

The Fund's surplus before tax of $420 million represents a return of 14.8%. This return lagged the return from the Reference Portfolio (see page 6) of 17.3% by 2.5%.
The under-performance was due to an increase in the Fund's exposure to foreign currencies during the year, from the benchmark level of 20% to 36%, when the NZD rose strongly.

The exposure to foreign currencies remained higher than benchmark at 30 June as the NZD was still seen as over-valued and linked to the fortunes of international equity markets, which is the Fund's largest risk.

Active management added value in most asset classes, and to the Fund as a whole, apart from the currency impact. The Authority monitors its managers continuously and is pleased with the value they have added since the transition from passive international equities management in 2007/08.

The table below compares the Fund's investment returns against the IPM for periods ended 30 June 2011.

	1 year to 30 June 2011 %	5 years Annualised %	Since October 2001 Annualised %
Fund return (after tax)	11.6	0.8	3.2
IPM	7.2	7.4	7.1

Not withstanding improved results in the last two years, the Fund return is behind its IPM since October 2001 by 3.9% per annum.

The five years annualised return includes the impact of the GFC on investment markets. The return since October 2001 includes the impact of the GFC and the large 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 6.

Schemes

Datacom Employer Services continues to perform well as the scheme administrator.

Work continues on the development of a new and more sustainable business system for use in the administration of the GSF Schemes. The detailed requirements for the project were largely completed in December 2010 and the construction phase is scheduled to be completed around June 2012. Initial planning for transition from the old system to the new system has also commenced.

Further comment on GSF Schemes' activity can be found on page 14 of this report.

Statutory Review

The GSF Act provides for a review to be conducted every 5 years of how effectively and efficiently the Authority is performing its functions. The first review was undertaken in 2006.

In early March 2011 the Minister of Finance appointed JANA Investment Advisers (JANA) to undertake the second 5 yearly review. The review was completed towards the end of the financial year and the report on the review was tabled in Parliament in July. The report can be viewed at *http://treasury.govt.nz/releases/2011-07-28*

In tabling the report the Minister stated "The reviewers found the GSFA (the Authority) meets best practice in all essential areas, has effective board and management oversight, appropriate policies and practices, strong risk management and effective decision making."

JANA stated in the report:

- The Fund's investment objectives and strategy have been developed based on sound principles using a logical and consistent approach. In our view, the policies, standards and procedures developed by the Authority in determining the investment objectives and strategy are appropriate for the Fund.
- The policies, standards and procedures used by the Authority to establish the asset allocation mix of the Fund and the approach to portfolio construction for the Fund's investment portfolio and within asset classes are considered and robust. The establishment of a Reference Portfolio as a benchmark makes the Authority's strategy, implemented through the Target Portfolio, quite transparent.
- The investment performance of the Fund to date has been satisfactory. The Target (actual) Portfolio has struggled to out-perform the Reference Portfolio over time, but its return profile has been less volatile and has exhibited downside protection characteristics. The Fund's performance in listed asset classes relative to passive market benchmarks has been strong. Whilst the inclusion of 'alternative' investments appears to have detracted value during the strong rebound in equity markets over the past two years, the portfolio construction approach pursued by the Authority has resulted in a reduction in the risk profile of the Fund's returns.

- The Fund's overall investment cost level is consistent with meeting the Fund's investment objectives and is in line with that of similarly sized funds with a broadly similar asset allocation mix in the Australian and New Zealand market place.

In respect of organisation and governance, schemes administration and information and financial management, JANA concluded that the Authority is well structured and well managed with appropriate systems in place or under development.

In the report JANA made a number of recommendations and suggested enhancements to practices and policies, which have been largely accepted by the Board and action plans put in place.

The Authority's responses to the comments made by JANA in the Executive Summary of the report, and on the recommendations and suggested enhancements to policies and practices, can be viewed on the Authority's website.

Outlook

The investment outlook is more uncertain than usual. This was evidenced by the decline in global equity prices and the NZD, early in the new financial year. The declines were a reaction to weakening growth in the US and Europe coupled with a loss of confidence in policymakers' capacity to fix the debt crisis overhanging the developed economies. Continuing to 'kick the can down the road', by transferring debts and creating excess liquidity, erodes confidence but decisive action to write off or pay down debts involves material cuts in living standards until debt burdens can be restored to sustainable levels. In the meantime, investors are preferring increased exposure to creditor countries, including emerging economies, as a major shift in global economic power unfolds. Interestingly, New Zealand sits somewhere in the middle as an exporter of commodities with increasing demand from emerging economies, but with a large external debt burden and rising government debt. The risks are higher than usual and the investment outlook will not improve significantly until the debt problem is addressed credibly.

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.

Tribute

Tim McGuinness retired as Chairman of the Board at the end of May 2011. Mr McGuinness was a member of the inaugural Board, appointed when the Authority took over responsibility for managing the Fund and administering the Schemes in 2001. He was previously a member of the GSF Establishment Board. Mr McGuinness was appointed Chairman in 2008 and, up until that time, was Chairman of the Investment Committee. The Authority and the Fund benefitted from his wide experience in investment and governance matters.

The Board expresses its appreciation and thanks for the very significant contribution made by Mr McGuinness and wishes him well for the future.

Mr McGuinness is succeeded the writer, Keith Taylor. My term of appointment as Chairman commenced on 1 August 2011.

Welcome

The Authority welcomes Cecilia Tarrant as a new member 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.

Keith B Taylor
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

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

Investment Performance Measure (IPM)

The performance of the Fund is assessed by comparing the return after tax 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 IPM and the Risk Parameter remained unchanged over the year.

Asset Allocation and Reference Portfolio

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

In 2010 the Authority established a Reference Portfolio to define and monitor its risk and return performance, in addition to the absolute benchmarks of the IPM and Risk Parameter. The Reference Portfolio is a simple, globally diversified asset allocation that could meet the IPM by investing passively in liquid public markets at low cost. All active investment decisions are benchmarked against the Reference Portfolio to assess whether they have added value in terms of higher returns or reduced risk, net of costs. These decisions include the addition of asset classes, that diversify the Fund's sources of return, as well as skill-based active management strategies.

Table 1 sets out the actual asset allocation, as at 30 June 2011 compared with the Reference Portfolio that became effective on 1 July 2010.

Table 1

Asset Class	Actual Asset Allocation* at 30 June 2011	Reference Portfolio
	%	%
Global Fixed Interest	22.2	30
International Equities	47.2	55
NZ Equities	10.9	10
Global Property	5.5	
Commodity Futures	3.3	5
Insurance-Linked Assets	3.4	-
Absolute Return**	5.4	
Currency Overlay***	2.1	-
TOTAL	**100.0**	**100.0**

* *The Fund invests in a multi-asset class fund which is a diversified portfolio comprising listed equities, private equities, global property and hedge funds. The exposures, held indirectly through the multi-asset class fund, have been reallocated to the other asset classes.*
** *Absolute return comprises part of the investment in the multi-asset class fund 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.*
*** *Currency overlay comprises unrealised profits on currency hedges, and is generally made up of cash equivalents.*

Table 2 compares the actual asset allocation as at 30 June 2011 and 30 June 2010.

Table 2

Asset Class	Investment Assets Actual at 30 June 2011		Investment Assets Actual at 30 June 2010	
	$000	%	$000	%
Global Fixed Interest	711,149	21.3	703,737	24.0
New Zealand Equities	345,633	10.9	294,688	10.0
International Equities	1,397,708	44.1	1,333,348	45.4
Commodity Futures	104,422	3.3	82,765	2.8
Global Property	153,204	4.8	171,745	5.9
Insurance-Linked Assets	108,176	3.4	-	-
Multi-Asset Class	219,156	6.9	236,379	8.1
Global Tactical Asset Allocation	101,189	3.2	111,800	3.8
Currency Overlay	65,787	2.1	-	-
TOTAL	**3,170,988**	**100.0**	**2,934,462**	**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 32) because of differing disclosure requirements for financial reporting purposes.

Investment Returns

The Fund return was strong for the second year in a row since the negative returns of the GFC.

The surplus before tax of $420 million corresponds to a return of 14.8% (2010: 14.3%) of net assets. The surplus after tax of $336 million was 11.6% (2010: 10.4%) of net assets compared to the IPM of 7.2%.

Table 3 compares the Fund's investment returns after tax against the IPM over periods ended 30 June.

Table 3

	1 year to 30 June 2011 %	5 years Annualised %	Since October 2001 Annualised %
Fund return (after tax)	11.6	0.8	3.2
IPM	7.2	7.4	7.1

Notwithstanding improved results in the last two years, the Fund return is behind its IPM since October 2001 by 3.9% per annum. This is explained by the negative impact of historically poor global equity market returns over the last decade.

The Fund's return before tax of 14.8% in 2011 compares with the Reference Portfolio return of 17.3%, a shortfall of 2.5% (3.3% after investment fees).

The Fund's active equity and fixed interest managers continued to add value during the year, out-performing their aggregate benchmarks by 1.6% (1.3% net of investment management fees). Currency hedges into NZD returned 13.4% compared to the benchmark of 18.3%. The Fund's total exposure to foreign currencies is normally 20%, but was increased for most of the year to as high as 36% on account of the NZD's perceived over-valuation and link to international equity markets. As a result, the Fund did not gain as much as it could have if foreign currency exposures had been maintained at normal levels.

The global economy experienced its second year of recovery following the GFC. In large part the recovery was a response to massive fiscal and monetary stimulus in the developed economies. These economies are weighed down by huge over-hanging debts and the threat of debt deflation. Towards the end of the year growth in the major markets appeared to be petering out as stimulus faded and the long term effects of deleveraging took hold.

After two years of strongly rebounding share prices and profit margins, especially in areas linked to global commodity prices, equity markets were starting to show concern at year end about the sustainability of revenue and margin growth, despite historically undemanding share valuations. Although 12-month returns were strong, markets were characterised by alternating bouts of optimism and pessimism according to views about the imminence or not of European debt defaults.

New Zealand was seen as a relatively safe haven in this context, being somewhat less debt-burdened than the United States and Europe while receiving a substantial economic boost from rising farm-based commodity prices. In addition, significant government stimulus was provided in response to two earthquakes in Christchurch, whose estimated damage was equivalent to 8% of GDP. The New Zealand equity market produced a good return, despite a challenging economic environment.

Returns by Asset Class

Table 4 below shows the returns before tax, by major asset class compared to the relevant asset class benchmark. (All returns in NZD unless otherwise specified.)

Table 4

Asset Class	**Year to June 2011**		**3 Years to June 2011 (pa)**	
	Actual	Benchmark	Actual	Benchmark
Total Fund	14.8	17.3	1.6	2.1
Global Fixed Interest	6.0	3.5	9.7	8.3
International Equities	9.8	8.4	0.5	-1.8
NZ Equities	19.8	17.5	6.7	4.0
Global Property	10.1	11.0	-6.8	-2.0
Commodity Futures	10.0	4.8	-20.1	-27.1
Multi-Asset Class (in USD)	17.6	21.8	2.3	3.0
GTAA* (in USD)	12.4	6.3	11.6	6.8
Insurance-Linked Assets (in USD)	-5.3	-0.9	n/a	n/a
Currency Overlay	13.4	18.3	n/a	n/a

* *Global Tactical Asset Allocation*

Global Fixed Interest

Actual Return 6.0%, Benchmark Return 3.5%

Benchmark - Citigroup World Government Bond Index hedged to NZD

Returns from fixed interest investments (such as government and corporate bonds) comprise interest income and capital gains (when market yields decline) or losses (when yields rise).

Market returns over the year were somewhat below longer term norms. This reflected fairly low initial yields and volatile markets dealing alternately with optimism then pessimism about whether governments could reschedule debts in Europe, recapitalise insolvent banks and prevent an economic slump. By year end there was a degree of consensus that future growth would be below average and long term bonds were at risk, not only from defaults and rescheduling, but also from other forms of yield repression and inflation.

The Fund's global fixed interest managers added 2.5% for the year. 1.5% of this can be attributed to allowing them to invest in lower quality credits (than government risk) including high grade corporate and mortgage securities. The managers added a further 1.0% through their active management. The Fund gained from its small exposure to an emerging market debt fund, which outperformed global government bonds by 8.9% plus active management returns of a further 8.9%.

International Equities

Actual Return 9.8%, Benchmark Return 8.4%

Benchmark - MSCI All Countries World Index

The global share market index returned an outstanding 21.8% in local currency terms for the June year, although the average returns for the last 5 years and decade are barely positive. In NZD the index return for 2011 was a much more modest 8.4%.

The Fund's international equities managers added 1.4% collectively during the year and have added 2.0% per annum since they were engaged in late 2007. The appointed managers are under continuous review and currently comprise 6 global managers and an emerging markets specialist. There is a mix of approaches to avoid over-exposure to a single strategy. Two quantitative managers aim to add value by holding risk balanced portfolios that exploit temporary relative valuation spreads and momentum factors very efficiently. The other four global managers focus on fundamental company valuations with a longer horizon and generally have slower turnover of shares in their portfolios. Two cover the global broad market while two others focus on high growth and deep value opportunities respectively. All but one of the managers are ahead of their benchmarks since inception.

NZ Equities

Actual Return 19.8%, Benchmark Return 17.5%

Benchmark - NZX50 Gross Index including imputation credits

Both of the Fund's listed New Zealand equities managers out-performed the benchmark index for the year. A number of key positions added value, including Ryman Healthcare, Mainfreight, New Zealand Exchange and Ramsay Healthcare. These companies were able to grow earnings despite the difficult economic environment. The Fund was underweight Contact Energy, which under-performed the market significantly, and had minimal exposure to Pike River or NZ Oil & Gas, index stocks that were badly affected by the tragic events at Pike.

In addition, an investment in a New Zealand private equity fund, initiated in mid-2009, provided value gains well ahead of the index.

Global Property

Actual Return 10.1%, Benchmark Return 11.0%

Benchmark - FTSE EPRA NAREIT Developed Real Estate Index hedged into NZD

The global property investment comprises mainly a portfolio of global Real Estate Investment Trusts and companies that invest exclusively in property. They provide a very liquid, core exposure to well-managed, higher quality, income yielding properties. The global listed portfolio returned 11.3% in financial 2011, slightly ahead of the benchmark.

The Fund also has exposure to less liquid opportunities to add value in global property through its investment in the global multi-asset class fund (see below) and in New Zealand opportunities through a fund managed by Willis Bond and Company

Management. As the Willis Bond Fund is at the initial stage of investing, its performance to date reflects mainly fees charged on committed capital, not yet invested, and this reduced overall returns relative to the benchmark.

Commodity Futures

Actual Return 10.0%, Benchmark Return 4.8%

Benchmark - Dow Jones UBS Commodity Index (Total Return)

The Fund invests about 3% of its assets in commodity futures. These are fully collateralised with cash and provide diversification from the large equity risk exposure of the Fund. The portfolio comprises a basket of commodity futures covering energy, industrial and precious metals and agricultural commodities. It is managed to capture a premium from rebalancing to fixed weights and actively exploit the term pricing structure of commodity futures, rather than selecting which commodities will perform best. The manager added 5.2% in 2011 and has added 3.6% per annum since inception in July 2009.

Multi-Asset Class (in USD)

Actual Return 17.6%, Benchmark Return 21.8%

Benchmark - Composite index comprising 55% International Equities, 10% NZ Equities, 30% Global Fixed Interest and 5% Collateralised Commodity Futures

Seven per cent of the Fund is invested in an endowment-like global multi-asset class fund. The multi-asset class fund aims to produce equity-like returns with half the risk. One-third of the multi-asset class fund is invested in public markets - global equities and bonds. The other two-thirds provide exposure to alternative investments (ie other than public equities and bonds). Therefore, it represents an alternative, diversifying, way of achieving similar outcomes to those of the Fund as a whole.

Since inception the multi-asset class return is 0.4% pa ahead of its benchmark despite lagging 4.2% in the current year. This year's underperformance reflects defensive positioning when global equities and other risky assets performed well. For example, the multi-asset class fund was underweight equities and overweight credit. Over the whole investment period, it has performed in line with the Fund's actual returns before tax. The private equity and private real estate strategies are now substantially through their initial investment phases and are expected to show an increasing contribution to the Fund's performance. The public portfolios have also performed well relative to peers and benchmarks since inception.

Global Tactical Asset Allocation (GTAA) (in USD)

Actual Return 12.4%, Benchmark Return 6.3%

Benchmark - USD 3 month LIBOR plus 6%

Three per cent of the Fund is invested in an overlay fund that invests across global bond, credit, equity, currency and commodity markets using only liquid derivative contracts.

Its aim is to earn profits from relative value and momentum factors affecting markets and out-perform an absolute target of LIBOR plus 6%. The strategy is expected to provide an alternative diversifying source of return to international equities.

Since inception GTAA has returned 10.5% per annum above LIBOR (7% net of fees). In the current year the manager's excess return was 12.4% less 2% related to the currency hedging to NZD, ie 10.1% (7% net of fees). The excess return was generated largely from spread (ie long-short) trades based on relative value among commodities, currencies and equity versus bond positions, rather than relying on market direction.

Insurance-Linked Assets (in USD)

Actual Return -5.3%, Benchmark Return -0.9%

Benchmark - Swiss Re Catastrophe Bond Index (Total Return)

Insurance-linked assets are a new investment for the Fund, initiated in December 2010. The asset class comprises catastrophe bonds, industry loss warranties and reinsurance contracts, and is managed by an external specialist manager.

The Fund takes on the risk of large scale losses from major catastrophes, such as hurricanes and earthquakes, which are borne primarily by insurers and reinsurers. The Fund receives premiums to accept part of the risk and effectively spread the risks more widely when the insurance industry's capacity is stretched, as it was after Hurricane Katrina in 2005 and after the GFC.

Early returns have been impacted by exposure to the Japanese Tohoku earthquake and nuclear power disaster, and a small exposure to the second Christchurch earthquake.

Currency Overlay

Actual Return 13.4%, Benchmark Return 18.3%

Benchmark - Composite Index representing the currencies comprising underlying asset classes

The Fund's currency exposure is managed at a total Fund level. The Fund fully hedges foreign currency exposures of all asset classes except global equities and the Multi-Asset Class. These asset classes are partially hedged to leave the desired percentage of the total Fund unhedged. The Fund's benchmark currency exposure is 20%.

Since June 2010 currency exposure has been actively managed to reflect the Fund's risk relating to extreme valuation of the NZD compared to long term norms. The NZD is linked to international equity markets, which is the Fund's largest risk exposure, and this exposes the Fund to simultaneous downward shifts in both international equities and the NZD. To reduce this risk, the foreign currency exposure is increased when the NZD is perceived to be extremely over-valued and vice versa.

Foreign currency exposure has varied during the year, but for much of the period, has been a maximum 36% in response to the very strong NZD. As a result the reduced currency hedge returned 13.4% whereas the benchmark hedge would have returned 18.3%. Therefore the Fund has forgone additional returns of 4.9% compared to the Reference Portfolio. Although disappointing, the forgone return coincided with a period of strong international equity market returns, as envisaged. At year end the Fund was positioned for weaker equity markets and NZD.

Responsible Investment

The Act requires the Authority to manage and administer the Fund 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. The Authority addresses these matters through its Responsible Investment (**RI**) Policies, which cover the exercise of voting rights, with respect to shares owned by the Authority, and governance, environmental and social issues relating to its investments.

In terms of its RI Policies, the Authority excludes direct investment in securities issued by a number of companies involved in the manufacture of tobacco, anti-personnel mines, cluster munitions and nuclear weapons. These activities are inconsistent with Government policy, or 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. However, the Authority has little influence over the securities held by the CIVs, or their individual voting decisions. A CIV's ability to comply with the RI Policies is considered as part of the investment evaluation and, if an investment is made in the CIV, the manager of the CIV is advised of the RI Policies and associated decisions and encouraged to reflect them in their own policies.

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**). The CFIs work together to implement their RI Policies using consistent information and research gathered initially by the New Zealand Superannuation Fund's RI unit.

During the year to June the Authority participated in several company engagements with other CFIs and, in some cases global peer funds linked through the UNPRI. These companies were believed to be damaging the environment severely, infringing human rights or engaged in bribery and corruption. We participated with other investors in agitating successfully for changes in the board of directors and corporate strategy of GPG, a New Zealand listed company. The Authority has also encouraged its investment managers to consider the UNPRI and ensure that governance, environmental and social risks are analysed adequately as part of their investment processes.

Schemes Administration

Datacom Employer Services Limited continues to perform well as the scheme administrator of the GSF Schemes and has met the performance standards that have applied since 1 July 2009. These 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, received an additional payment equivalent to 2.02% of their annuity payments between 1 October 2010 and 27 April 2011.
The additional payment provided 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 was reflected through the annual CPI adjustment applied to annuity payments from 28 April 2011.

New Business System

Good progress is being made on the development of a new and more sustainable business system to be used in the administration of the GSF Schemes. The current business system is more than fifteen years old and incorporates technology that is no longer in common use in New Zealand.

The detailed requirements for the project were largely completed in December 2010 and the developer, Datacom Systems (Wellington) Limited, is now working on the construction phase. This is scheduled to be completed around June 2012. Initial planning for the next phase, transition, has already commenced.

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 7 September 2011

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

Keith Taylor. Appointed as a Board member in 2008. Appointed as Chairman from 1 August 2011. Mr Taylor is Deputy Chairman 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, Southern Cross Medical Care Society, Gough, Gough and Hamer Limited, Port Marlborough New Zealand Limited and Butlands Management Services Limited, and trustee of the Southern Cross Healthcare Trust and New Zealand Fire Service Superannuation Scheme. 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.

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.

Toni Kerr. Appointed in 2009. Ms Kerr is Head of Treasury Operations at Kiwibank Limited. She previously held a number of senior management positions 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 trustee of the Hepatitis Foundation. He was previously a Whakatane based share broker and, prior to that, held senior investment management positions with Colonial First State Investments.

Cecilia Tarrant. Appointed 25 August 2011. Ms Tarrant is an Executive in Residence at the University of Auckland Business School and is a trustee of the University of Auckland Foundation. She previously held a number of senior management positions with Morgan Stanley and Credit Suisse First Boston in New York and London.

Mark Verbiest. Appointed in 2009. Mr Verbiest is a director of AMP NZ Office Limited, Freightways Limited and Southern Cross Medical Care Society, and Chairman of Willis Bond Capital Partners Limited, Willis Bond General Partner Limited and Transpower New Zealand Limited. He is also a trustee of Southern Cross Healthcare Trust, a board member of the Financial Markets Authority and a consultant to national law firm Simpson Grierson. Mr Verbiest was a member of Telecom's senior executive team between 2000 and 2008 and, prior to 2000, a partner of Simpson Grierson.

Retired Board Members

Tim McGuinness retired from the Authority Board when his term of appointment ended on 31 May 2011.

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 both committees.

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

- the power of delegation;
- the power to grant a 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 2010.

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, measured through: • Independent assessments by external investment advisers; and • Assessment by internal investment management, with monthly management reporting and quarterly reporting to the Board.	Despite outperforming the IPM by 4.4% in the year ended 30 June 2011, the Fund remains behind the IPM over the last 5 years and since inception in 2001, due to the very poor returns from global equities over those periods. The Fund increased its diversification during the year by adding global emerging market debt, opportunistic New Zealand commercial property and insurance-linked assets, and by increasing its foreign currency exposure significantly. A key outcome of the diversification was a reduction in total portfolio risk to a level less than the Risk Parameter. The 5 Year Statutory Review of the Authority noted that "the portfolio construction approach pursued by the Authority has resulted in a reduction in the risk profile of the Fund's returns".

Performance Measure	Performance Achievement
	Investment performance by manager and asset class is reported to the Board at each meeting. Every quarter a detailed investment report is presented to the Board which assesses, amongst other things, the Fund's performance against the IPM and Risk Parameter.
Comparison of actual performance (returns and assessed risk) against the Reference Portfolio (see page 6) to determine the added value of alternative strategies.	The Fund under-performed the Reference Portfolio by 2.5% before tax (3.3% after fees) in the year ended 30 June 2011. Although active managers added value (net of fees) relative to benchmarks, this was offset by the currency hedges into NZD which returned 4.9% less than the benchmark. During the year, the Fund's total exposure to foreign currencies was increased to as high as 36%, compared with the benchmark of 20%, on account of the NZD's perceived over-valuation and link to international equity markets.
Comparison of individual investment managers' actual performance against contracted mandates and return benchmarks, measured through: • independent assessments by external investment advisers; and • assessment by internal investment management, with monthly reporting and quarterly reporting to the Board.	In total, the Fund's investment managers outperformed their benchmarks net of fees in the year ended 30 June 2011. By asset class, the managers of global fixed interest, international and New Zealand equities, commodity futures and global tactical asset allocation out-performed while the managers of global property, insurance-linked assets and the multi-asset class under-performed. Regular reports are received from external investment advisors on their ratings of the managers appointed by the Authority. Internal investment management has a structured review programme for all managers. Investment performance by manager and asset class is reported to the Board at each meeting. Every quarter a detailed report is presented to the Board.

Performance Measure	Performance Achievement
Compliance with policies and procedures, in particular: • no unauthorised variations from the SIPSP (which may be varied by the Board from time to time) identified on annual review; • actual asset allocation rebalanced monthly to within rebalancing tolerances monthly; • investment manager risk remains in line with expectation by comparing investment managers' risk profiles against assessed risk; and • review of quarterly scorecards to determine that custodian performance meets their Service Level Agreement.	The Fund remained fully compliant with the SIPSP throughout the year. The 5 year Statutory Review identified two possible incidences of non-compliance in prior years but the Board is satisfied these were not material. Rebalancing was undertaken monthly to within SAA rebalancing tolerances. Each investment manager's risk profile is analysed quarterly. Custodial service is monitored against Service Level Agreement (**SLA**) standards quarterly and is benchmarked regularly against peers. Action is taken by Management if the level of service provided by the custodian breaches the SLA or is below the level of peers.
Annual comparison of Fund performance and cost structure with similar organisations, prepared by an external party.	The Fund participates in an annual review of performance and costs benchmarked against global peer funds. The 2010 review showed the Fund's performance and costs were in line with its peers. A conclusion of the 5 year Statutory Review of the Authority was that the Fund's overall investment cost level is in line with that of similarly sized funds with a broadly similar asset allocation mix in the Australian and New Zealand market place.

Performance Measure	Performance Achievement
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 of Finance has repeated the request that the Authority pay particular attention to the cost of external investment managers undertaking active management. These matters receive close attention by the Board.
Compliance 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 (**RI**) Policies (including the Board's policies on ethical investment and the aspirational principles established by UNPRI) with respect to directly held investments. The Authority excludes direct investment in certain companies, involved with tobacco, nuclear weapons, cluster bombs and anti-personnel mines. Some collective investment vehicles (**CIVs**), in which the Authority has invested, may hold securities in some of the companies excluded under the RI policies. The CIVs are a practical and cost effective way to achieve exposure to some markets and managers, and the Authority has little influence over the securities held by the CIVs. The Authority is working with the Guardians of New Zealand Superannuation and other Crown Financial Institutions to monitor companies that may be infringing the RI policies and is participating in collaborative engagements to encourage these companies to modify their practices. The Authority subscribes to the UNPRI and participates in some cooperative engagements through the UNPRI.

Performance Measure	Performance Achievement
Overall expected investment management cost	
$20.8 million which includes the expected investment management expenses and 70% of the Authority's expected general operating expenses.	$28.8 million. The $8 million excess was due to investment management and custody fees being above forecast on account of several factors: • the introduction of new active investment strategies, such as private equity, that have higher management fees; • higher than forecast asset values upon which management fees are generally based; and • payment of contracted performance fees to some managers that exceeded performance targets.

Schemes Administration

Performance Measure	Performance Achievement
Pay entitlements and process contributions, correctly and on time and respond appropriately to stakeholders' inquiries	
Performance is in line with 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 as verified as being correct; • All transactions are processed correctly; • All routine correspondence is responded to within 5 working days; and • All non-routine correspondence is responded to within 7 working days.	The Scheme Administrator (Datacom) met the performance standards (set out in the Management Agreement between the Authority and the Scheme Administrator) during the year. Detailed monthly reports are provided by the Scheme Administrator on performance against standards. The reports are 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 and are reviewed by Management.

Performance Measure	Performance Achievement
Measured through monthly reporting, with overall performance measured by monitoring the performance of the Administrator, with monthly reports and follow up.	During the year, Datacom identified an error in a program change made to the business system in February 2010 which resulted in overpayment to 33 spouses between April 2010 and December 2010. Datacom wrote to each member affected, explained the error and that the overpaid amount would not be recovered from the member. The software and the ongoing 4 weekly annuities were corrected. Datacom reimbursed the Fund for the overpaid amounts.
The business system is relevant and supportive of the Schemes' requirements demonstrated through; • No major loss or corruption of data of functionality; and • The ability to access required data, assessed by periodic review.	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. There were no outages during business hours and no loss of data during the year. Data has been successfully extracted as required.
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 2011, 6 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 for reporting to Treasury was sent within the required timescales, which enabled the Government Actuary to complete, on time, the information required for the Crown Financial Statements in August, November and February. There were minimal requests for missing or incomplete information.

Performance Measure	Performance Achievement
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 achieving consistently good satisfaction scores in the annual survey of members and employers.	The Authority's website has been regularly updated during the year with information on schemes and investments. Survey results indicate satisfaction levels with all forms of communication are high - 81% of respondents confirmed they were satisfied with the information they received from the Authority. The desire for additional information from the Authority was low with 20% of respondents requiring further information. The annual Chairman's letter was sent out in September 2010 as scheduled. In 2010 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) $3.8 million	Actual cost for the year ended 30 June 2011 was $3.9 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 2011. 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 6 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 27-28.

Keith B Taylor
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 2011:

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 $9,096 million (2010: $9, 397 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.

Keith B Taylor
Chairman
Government Superannuation Fund Authority Board

MEMBERSHIP COMMENTARY

Movement in contributors during the past five years:

Year ended 30 June	Total	Change	% Change Contributors
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)
2011	**13,433**	**(1,154)**	**(7.91)**

Number of contributors, by scheme:

GSF Scheme	2011	% of Total	2010
General Scheme	12,685	94.43	13,574
Armed Forces	221	1.65	438
Police	408	3.04	446
Prisons Service	91	0.68	98
Judges and Solicitor-General	15	0.11	18
Parliamentary	13	0.10	13
Total contributors at end of year	**13,433**	**100.00**	**14,587**

Movement in the number of contributors during the year:

	2011	2010
Contributors at beginning of year	14,587	15,683
Retirements	(1,079)	(1,007)
Withdrawals	(9)	(10)
Death before retirement	(7)	(12)
Cessation of employment before retirement	(41)	(49)
Transfer to other schemes	(18)	(18)
Total contributors at end of year	**13,433**	**14,587**

Movement in the number of annuitants during the past five years:

Year ended 30 June	Total Annuitants	Change	% Change
2007	47,237	(286)	(0.60)
2008	47,158	(79)	(0.17)
2009	46,963	(195)	(0.41)
2010	46,855	(108)	(0.23)
2011	**46,839**	**(16)**	**(0.03)**

Movement in number of annuitants during the year:

	2011	**2010**
Annuitants at beginning of year	46,855	46,963
New retiring allowances	1,079	999
New allowances to spouses	823	769
Allowances deferred	74	103
Discontinued allowances	(1,992)	(1,979)
Total annuitants at end of year	**46,839**	**46,855**

There were 5,875 deferred pensions at 30 June 2011 (2010: 5,949)

Movement in total number of members during the past five years:

Year ended 30 June	Total Contributors	Total Annuitants	Total Deferred Pensions	Total Members	Decrease During Year
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)
2011	**13,433**	**46,839**	**5,875**	**66,147**	**(1,244)**

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

	2011	**%**	**2010**	**%**
Contributors	**13,433**	22	14,587	24
Annuitants	**46,839**	78	46,855	76
Total	**60,272**	**100**	**61,422**	**100**

Granting a charge over contributions

In the year to 30 June 2011, 16 charges (2010: 27) 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 2011 have been prepared in accordance with Section 93 of the GSF Act.

The Government Superannuation Fund Authority (**the Authority**) is responsible for the preparation of the Financial Statements and the judgements 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 79, 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 2011, and the changes in net assets and the cash flows of the Fund, for the year ended 30 June 2011.

Keith B Taylor
Chairman
Government Superannuation Fund Authority Board

Alan Langford
Chief Executive

7 September 2011

GOVERNMENT SUPERANNUATION FUND

STATEMENT OF CHANGES IN NET ASSETS

For the year ended 30 June 2011

	Note	2011 $000 Actual	2011 $000 Forecast	2010 $000 Actual
Change in assets from:				
Investing activities				
Interest, dividends and other income	1	**89,843**	82,432	86,464
Increase in fair values of investment assets through profit or loss	2	**329,977**	165,112	296,855
		419,820	247,544	383,319
Operating activities				
Operating revenue	3			
Government		**25,771**	19,432	22,160
Other employers		**6,850**	5,166	5,784
		32,621	24,598	27,944
Operating expenses	3			
Funding for the Authority		**(32,621)**	(24,598)	(27,944)
Surplus before tax and membership activities		**419,820**	247,544	383,319
Income tax expense	4	**(84,242)**	(39,578)	(98,670)
Surplus after tax and before membership activities		**335,578**	207,966	284,649
Membership activities **Contributions**				
Government	5	**662,613**	678,809	610,528
Members		**54,508**	47,339	60,011
Other employers		**23,086**	13,132	13,448
		740,207	739,280	683,987
Benefits paid	6	**(863,203)**	(870,674)	(826,143)
Net benefits paid		**(122,996)**	(131,394)	(142,156)
Net increase in net assets		**212,582**	76,572	142,493
Opening net assets available to pay benefits		**2,946,576**	3,029,503	2,804,083
Net assets available to pay benefits		**3,159,158**	3,106,075	2,946,576

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 2011

	Note	2011 $000 Actual	2011 $000 Forecast	2010 $000 Actual
Current assets				
Cash and cash equivalents		**161,686**	170,645	128,393
Derivative assets		**96,553**	61,157	95,839
Trade and other receivables	7	**112,192**	106,017	96,288
Income tax receivables		**–**	–	10,080
Total current assets		**370,431**	337,819	330,600
Non current assets				
Investments				
Derivative assets		**31,195**	19,759	-
Global Fixed Interest		**706,555**	689,477	775,623
Equities - NZ		**340,210**	299,772	284,838
Equities - International		**1,246,519**	1,408,930	1,266,387
Global Property – NZ and International		**150,398**	209,841	168,426
Commodity Futures		**104,425**	89,932	82,767
Multi-Asset and Global Tactical Asset Allocation		**320,352**	299,772	348,349
Insurance-Linked Assets		**108,182**	–	–
Other investments		**8,252**	2,406	3,143
Total investments		**3,016,088**	3,019,889	2,929,533
Work in progress – Business System	8	**4,442**	–	1,143
Total non current assets		**3,020,530**	3,019,889	2,930,676
Total assets		**3,390,961**	3,357,708	3,261,276

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 2011

	Note	2011 $000 Actual	2011 $000 Forecast	2010 $000 Actual
Less liabilities				
Current liabilities				
Trade and other payables	9	**162,483**	103,092	175,314
Income tax payable		**27,530**	–	–
Benefits payable		**2,428**	2,488	3,829
Derivative liabilities	13	**7,124**	26,433	135,557
Total current liabilities		**199,565**	132,013	314,700
Non current liabilities				
Derivative liabilities	13	**32,238**	119,620	-
Total non current liabilities		**32,238**	119,620	-
Total liabilities		**231,803**	251,633	314,700
Net assets available to pay benefits		**3,159,158**	3,106,075	2,946,576
Promised retirement benefits				
Gross liability for promised retirement benefits	12	**12,255,000**	12,003,000	12,344,000
Deficit		**9,095,842**	8,896,925	9,397,424
Net assets available to pay benefits		**3,159,158**	3,106,075	2,946,576

The Financial Statements were approved by the Authority Board on 7 September 2011.

Keith B Taylor
Chairman
Government Superannuation Fund Authority Board

A K Kerr

Chair
Audit & Risk Review Committee

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 2011

	Note	2011 $000 Actual	2011 $000 Forecast	2010 $000 Actual
Cash flows from operating activities				
Cash was provided from:				
Government contributions-members		**671,263**	679,250	620,412
Government contributions-expenses		**24,162**	19,859	21,109
Members' contributions		**55,508**	48,188	60,302
Other employers' contributions-members		**30,031**	18,424	21,665
Interest and dividends		**92,180**	81,833	84,120
Cash was disbursed to:				
Benefit payments		**(864,187)**	(868,352)	(822,618)
Income tax		**(47,100)**	(39,638)	3,609
Operating expenses		**(32,968)**	(25,138)	(32,029)
Net cash flows from operating activities		**(71,111)**	(85,574)	(43,430)
Cash flows from investing activities				
Cash was provided from:				
Maturities and sales of investment assets		**5,796,865**	4,237,574	6,321,016
Mortgage repayments		**–**	–	8
Cash was disbursed to:				
Purchase of investments		**(5,689,602)**	(4,173,002)	(6,465,282)
Business System		**(2,859)**	–	(927)
Net cash flows from investing activities		**104,404**	64,572	(145,185)
Net increase/(decrease) in cash held		**33,293**	(21,002)	(188,615)
Opening cash and cash equivalents		**128,393**	191,647	317,008
Closing cash and cash equivalents		**161,686**	170,645	128,393

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 2011

	2011 $000	2010 $000
Net increase in net assets	**212,582**	142,493
Add changes in non-cash items		
Deferred tax asset	**–**	87,536
	–	87,536
Movements in working capital items		
Receivables and prepayments	**(895)**	2,304
Investment receivables	**(15,009)**	(15,360)
Income tax receivable	**10,080**	26,239
Government contributions received in advance	**8,650**	9,884
Investment payables	**(22,247)**	(35,723)
Trade and other payables	**766**	(2,833)
Income tax payable	**27,530**	(11,494)
Benefits payable	**(1,401)**	2,373
	7,474	(24,610)
Changes in items classified as investing activities		
Accrued interest portion of bonds	**1,994**	(2,861)
Accrued payments for Business System	**(440)**	(216)
Change in fair value of investment assets	**(329,977)**	(296,855)
Investment settlement receivables	**15,009**	15,360
Investment settlement payables	**22,247**	35,723
	(291,167)	(248,849)
Net cash out flows from operating activities	**(71,111)**	(43,430)

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 2011

	2011 $000	2010 $000
Income from operations*		
Government contributions	**14,750**	14,257
Members' contributions	**–**	–
	14,750	14,257
Expenditure*		
Benefits paid:		
Retirements	**12,011**	11,496
Allowances capitalised	**808**	930
Spouses and children	**1,931**	1,831
	14,750	14,257
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

PARLIAMENTARY SUPERANNUATION

Statement of Changes in Net Assets

For the year ended 30 June 2011

	2011 $000	2010 $000
Income from operations*		
Government contributions	**3,777**	3,694
Members' contributions	**154**	159
	3,931	3,853
Expenditure*		
Benefits paid:		
Retirements	**3,378**	3,284
Spouses and children	**553**	569
	3,931	3,853
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 (**GSF Schemes**), as prescribed in the GSF Act. Pursuant to section 19H of the GSF Act, the GSF Schemes are registered under the Superannuation Schemes Act 1989.

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 (**NZ**).

(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 year in which the estimate is revised, if the revision affects only that year, or in the year of the revision and future years, if the revisions affect both current and future years.

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 Note 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**). 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 instrument. The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset or, where appropriate, a shorter period.

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 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 translated at the rates prevailing on balance date. Gains and losses arising on translation are included in the Statement of Changes in Net Assets for the year.

Expenses

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

Tax

For tax purposes, the Fund is classified as a portfolio investment entity. 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 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.

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.

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 pooled investment vehicles are valued at the closing price, or the value advised by the relevant investment manager.

Government Superannuation Fund Business System

All directly attributable costs for the Government Superannuation Fund Business System (**Business System**) have been capitalised and classified as work in progress. These costs will be amortised on completion of the project.

Impairment

All 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 and may include sales of securities and investments that are unsettled at balance date, and also include dividends and interest. Dividends and distributions are accrued when the right to receive payment is established. Interest is accrued at 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 directly 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.

Intangible Assets

Intangible assets are stated at cost less accumulated amortisation (if applicable) less any accumulated impairment.

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 and cash equivalents.
- *Investing activities*
  These comprise acquisition and disposal of investments. Investments include securities not falling within the definition of cash.
- *Operating activities*
  These include any activities that are the result of normal business activities.

(vi) Forecast figures

The forecast figures are those presented in the 2010/11 Statement of Intent for the Government Superannuation Fund Authority (**the Authority**). The forecast figures were prepared in accordance with the accounting policies adopted by the Fund for the preparation of the Financial Statements.

(vii) 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 Authority expects to adopt the standards and interpretations in the period in which they become mandatory. The Authority anticipates that the standards and interpretations will have no material impact on the historical statements of the Fund in the period of initial application.

(viii) Consistency in presentation

The same 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 year ended 30 June 2010.

(ix) Prior year comparatives

Prior year comparatives have been reclassified, where appropriate, to facilitate comparison with the current year.

(x) Changes in accounting policies

There have been no material changes to accounting policies during the year.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2011

1. Interest, dividends, and other income

	2011 $000	2010 $000
Global Fixed Interest	**24,593**	21,428
Short term and call deposits	**98**	101
Equities – NZ	**11,504**	11,625
Equities – International	**23,448**	21,947
Global Property – International listed securities	**4,183**	3,488
Global Property – International unlisted securities	**965**	1,853
Multi-Asset and Global Tactical Asset Allocation	**11,682**	11,600
Other income	**13,370**	14,422
Total interest, dividends, and other income	**89,843**	**86,464**

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

	2011 $000	2010 $000
Global Fixed Interest	**22,822**	52,679
Short term investments	**1,101**	1,411
Equities – NZ	**43,429**	15,867
Equities – International	**178,624**	184,943
Global Property – International listed securities	**40,044**	29,666
Global Property – International unlisted securities	**4,417**	(6,687)
Commodity Futures	**38,454**	(151)
Multi-Asset and Global Tactical Asset Allocation	**4,638**	19,127
Insurance-Linked Assets	**(3,552)**	–
Total changes in fair values of investment assets through profit or loss	**329,977**	**296,855**

* *Includes changes resulting from hedging (where applicable)*

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% (2010:79.3%) of the Authority's administrative expenses reimbursed by the Fund. Other employers contributed the balance of 21% (2010:20.7%).

4. Income tax expense

	2011 $000	**2010 $000**
*Reconciliation to statement of changes in net assets**		
Surplus before tax and membership activities	**419,820**	383,319
Add imputation credits	**2,610**	2,159
Add withholding tax credits	**6**	–
Net taxable income	**422,436**	385,478
Tax expense at 30%	**126,731**	115,643
Tax effect:		
Non-assessable/deductible investment (losses)	**(59,488)**	(43,595)
Fair dividend rate (**FDR**) income	**26,208**	28,318
Prior period adjustment	**(3,699)**	2,442
Imputation credits	**(2,610)**	(2,108)
Withholding tax credits	**(2,900)**	(2,030)
Income tax expense	**84,242**	98,670
Income tax expense comprises:		
Current tax	**87,941**	96,228
Prior period adjustment	**(3,699)**	2,442
Income tax expense	**84,242**	98,670

* *At balance date there is no deferred taxation*

5. Government contributions

	2011 $000	2010 $000
Government service superannuation contributions	**644,086**	592,577
Judges and Solicitor-General superannuation contributions	**14,750**	14,257
Parliamentary superannuation contributions	**3,777**	3,694
Total Government contributions	**662,613**	610,528

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 ended 30 June 2011 %
	General Scheme:	
6.5	Non-funding employers	10.7
6.5	Funding except Islands*	Between 10.9 and 16.1
6.5	Islands	8
7.6	Armed Forces	25.1
7.5	Police	19.1
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 11).

6. Benefits and refunds paid

	2011 $000	2010 $000
Benefits:		
Pension entitlements	**667,900**	643,564
Allowances capitalised	**81,608**	73,195
Spouses and children	**106,097**	102,228
Refunds:		
Transfers to other schemes	**2,199**	1,952
Cessation of membership	**4,646**	4,670
Death	**753**	534
Total benefits and refunds paid	**863,203**	**826,143**

7. Trade and other receivables

	2011 $000	2010 $000
Government contributions - expenses	**6,943**	5,334
Members' contributions	**544**	571
Other employers' contributions - benefits	**720**	997
Interest and dividends	**3,818**	3,069
Investment settlements receivable	**54,973**	39,965
Prepaid benefits	**43,009**	43,459
Past service contributions	**1,982**	2,658
Pension entitlements	**203**	235
Total trade and other receivables	**112,192**	96,288

8. Business System

The Business System is used for the administration of the GSF Schemes. It supports the core business functions of the GSF Schemes including contributions management, benefit calculation and payment, scheme administration, financial accounting and scheme reporting. The Authority is undertaking the development of a new system. As at 30 June 2011 $4.442 million (2010:$1.143 million) of capital costs for the new system were allocated as Work in Progress on the Statement of Net Assets. The project is due to be amortised commencing in the financial year ending 30 June 2013.

9. Trade and other payables

	2011 $000	2010 $000
Members' contributions	**280**	195
Unallocated contributions	**-**	21
Government Superannuation Fund Authority	**3,974**	3,090
Other employers' contributions - expenses	**203**	385
Government contributions in advance - benefits	**51,907**	43,257
Investment settlements payable	**106,119**	128,366
Total trade and other payables	**162,483**	175,314

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 2010, and the report, dated October 2010, was tabled in Parliament on 11 November 2010. More information on the results of the valuation is provided in Note 11.

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

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 2011 – refer Note 12.

11. Statutory actuarial valuation as at 30 June 2010

Details of the statutory actuarial valuation, as at 30 June 2010 are included for information only. The statutory valuation is used to determine the employer subsidy rates and to apportion entitlements between the Fund and Government. (see below).

Significant assumptions, used in the statutory valuation were:

- Discount rate 6.00% per annum
- Consumer Price Index 2.50% 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 2010 statutory valuation are *:

	2010 $million	2009 $million
Past service liabilities		
Armed Forces contributors	104	148
General Scheme contributors (excluding Islands)	2,623	2,930
General Scheme contributors (Islands only)	39	38
Police contributors	236	231
Prisons Service contributors	25	26
Judges and Solicitor-General	28	29
Parliamentary	9	8
Pensioners	8,607	8,073
Deferred pensioners	672	619
Total past service liabilities	**12,344**	12,102
Value of Fund net assets	2,947	2,804
Unfunded past service liability	**9,398**	**9,298**

* *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	2010 $ million	2009 $ million
Vested benefits			
Contributors:			
Armed Forces	27%	29	43
General Scheme - excl Islands	126%	3,314	3,282
General Scheme - Islands	110%	42	41
Police	93%	221	213
Prisons Service	102%	25	27
Judges and Solicitor-General	135%	38	41
Parliamentary	139%	12	11
Total Contributors	120%	3,681	3,658
Pensioners:			
Pensioners	100%	8,607	8,073
Deferred Pensioners	100%	673	619
Total Pensioners	100%	9,280	8,691
Grand total		**12,961**	12,349
Less net assets		2,947	2,804
Shortfall		**10,014**	**9,545**

* *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 these pensions 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 of the Fund 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 2011, the Government pays 80% of each benefit paid (2010: 79%).

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 2010 given in the following table:

Age range	Males	Females
Up to age 52	10.9%	11.3%
Age 53 to age 57	12.9%	13.6%
Age 58 to age 62	14.2%	15.0%
Age 63 to age 67	15.3%	16.1%
Age 68 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 NZ IAS:26, as at 30 June 2011, for the purposes of the Fund's Financial Statements.

Significant assumptions, used in the valuation, were:

- Discount rate 6.25% 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	**2011 $million**	**2010 $million**
Opening gross promised retirement/ past service benefit liability	**12,344**	12,102
Movements in liability		
Expected changes	**34**	4
Experience (losses)	**(174)**	(13)
Assumption changes:		
Change in discount rate and Consumer Price Index	**(274)**	573
Change in demographic assumption	**-**	(322)
Provision for mortality improvement	**325**	-
Closing gross promised retirement/ past service benefit liability	**12,255**	**12,344**

Vested benefits – 30 June 2011

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 2011, are shown in the following table, where contributors include the inactive members.

Vested benefits	**2011 $million**	**2010 $million**
Contributors	**3,465**	3,681
Pensioners:		
Current pensioners	**8,736**	8,607
Deferred pensioners	**658**	672
Total pensioners	**9,394**	9,280
Total vested benefits	**12,859**	12,961
Less net assets	**(3,159)**	(2,947)
Shortfall	**9,700**	**10,014**

* *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, Reference Portfolio and Target Portfolio are reviewed regularly by the Authority, in conjunction with its advisors (see page 6).
The Authority reviews the cash requirements and funding of the GSF Schemes, each month, in the context of maintaining 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 profit or loss as detailed in the Statement of Accounting Policies, and other financial assets and liabilities at amortised cost.

	2011 $000	2010 $000
Financial investment assets at fair value	**3,112,641**	3,025,372
Financial investment liabilities at fair value	**39,362**	135,557
Financial assets at amortised cost	**273,878**	224,681
Financial liabilities at amortised cost	**164,911**	179,143

e) Fair value measurements recognised in the Statement of Net Assets

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 (i.e. as prices) or indirectly (i.e. 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).

2011	Level 1 $000	Level 2 $000	Level 3 $000	Total $000
Financial assets at fair value through profit or loss				
Derivative financial assets	–	**127,748**	–	**127,748**
Cash funds – NZ	**8,252**	–	–	**8,252**
Global Fixed Interest	**670,932**	**35,623**	–	**706,555**
Equities – NZ	**329,879**	**10,331**	–	**340,210**
Equities – International	**940,106**	**306,413**	–	**1,246,519**
Global Property	**145,424**	**4,974**	–	**150,398**
Commodity Futures	–	**104,425**	–	**104,425**
Multi Asset and Global Tactical Asset Allocation	–	**320,352**	–	**320,352**
Insurance-Linked Assets	–	**108,182**	–	**108,182**
	2,094,593	**1,018,048**	–	**3,112,641**
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities	–	**39,362**	–	**39,362**
	–	**39,362**	–	**39,362**

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
Cash funds – NZ	3,143	–	–	3,143
Global Fixed Interest	745,850	29,773	–	775,623
Equities – NZ	284,838	–	–	284,838
Equities – International	988,939	277,448	–	1,266,387
Global Property	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, interest rate risk and price risk), credit risk and liquidity 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 6). 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, global property, insurance linked assets, a multi-asset fund and global tactical asset allocation. The Fund may also invest in derivative instruments such as futures and options.

The Fund does not enter into or trade derivative financial instruments directly 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 direct debt 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 largest 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.

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 balance date.

As at 30 June 2011, the Fund does not have any single underlying investment exceeding 5% of the net assets (2010: nil).

h) Liquidity risk

The Authority's approach to managing liquidity for the Fund is to ensure that it will always have sufficient liquidity to meet the Fund's liabilities as they fall due. The Fund is therefore exposed to the liquidity risk of meeting its share of the benefit payments. The Fund'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 inward 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 seeking to match the maturity profiles of financial assets and liabilities. The Authority's overall strategy to liquidity risk remains unchanged from 2010.

The following tables summarise the maturity profiles of the Fund's financial liabilities based on contractual maturities. The 2010 derivative liabilities are not split across maturity dates as this information was not available. The tables have been drawn up based on the undiscounted cash flows of financial liabilities and based on the earliest date on which the Fund can be required to pay. The tables include both interest and principal cash flows.

	Less than 12 months $000	1-5 years $000	5+ years $000	Total $000
2011				
Unsettled purchases	**106,119**	**-**	**-**	**106,119**
Derivative liabilities	**7,124**	**24,376**	**7,862**	**39,362**
Other financial liabilities	**58,792**	**-**	**-**	**58,792**
Total	**172,035**	**24,376**	**7,862**	**204,273**
2010				
Unsettled purchases	128,366	-	-	128,366
Derivative liabilities	135,557	-	-	135,557
Other financial liabilities	50,777	-	-	50,777
Total	314,700	-	-	314,700

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 manages market risk by outsourcing its investment management; the investment managers manage the market risk in accordance with investment mandates.

The Fund's investment strategy is to invest in a diversified portfolio of equities and fixed interest securities and it may also invest in derivative instruments such as futures and options. Exposure to market risks is diversified by direct investment in commodity futures, private equity, global property, insurance linked assets, a multi-asset fund and global tactical asset allocation.

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 on financial assets, based on contractual maturities, at the financial statement date. Interest rate risk is managed by the investment managers.

Financial assets: Variable interest rate instruments

	Weighted average interest rate %	Less than 12 months $000	1-5 years $000	5+ years $000	Total $000
2011					
Cash and cash equivalents	0.23	**161,686**	**–**	**–**	**161,686**
Fixed interest securities	3.81	**83,346**	**229,237**	**402,224**	**714,807**
Receivables for securities	n/a	**54,973**	**–**	**–**	**54,973**
Total		**300,005**	**229,237**	**402,224**	**931,466**
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
Total		329,959	202,911	414,254	947,124

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 the reporting date:

Changes in variable	+/-	Effect on surplus/(deficit) after-tax and before membership activities 2011 $000	2010 $000
Interest rate risk	**1%**	**1,229**	1,554

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 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. Foreign currency exposures are managed within approved policy limits and parameters set out in the SIPSP. The Fund enters into contracts designed to hedge some or all of its exposure to foreign currencies.

The Authority has a benchmark exposure to foreign currencies of 20% of the total Fund (2010: 20%). From time to time the exposure may be greater or less than 20%. The benchmark foreign currency hedge ratios for the Fund's asset classes are set out below:

Asset Class	Before-tax (After-tax) Benchmark Hedge Ratio	Range (Before-tax)
International Equities	103% (72%)	93% to 113%
Global Property	143% (100%)	138% to 148%
Global Fixed Interest	100% (100%)	90% to 110%
Commodity Futures	143% (100%)	138% to 148%
Absolute Return*	143% (100%)	138% to 148%

* *Absolute return comprises part of the investment in the multi-asset class fund 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.*

The Fund's total exposure to foreign currencies at the reporting date (after hedging) was $674 million (2010: $575 million). The Fund's foreign exchange exposure, before taking into account hedging was $2,774 million (2010: $2,610 million).

Foreign currency sensitivity

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

The global 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 long term change in foreign exchange rates.

Changes in variable	+/-	Effect on surplus/(deficit) after-tax and before membership activities 2011 $000	2010 $000
Exchange rate risk	**5%**	**23,584**	20,113

When the NZD weakens against other currencies there is an increase in the surplus after tax (and before membership activities). 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 income from investing activities.

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

Changes in variable	+/-	Effect on surplus/(deficit) after-tax and before membership activities 2011 $000	2010 $000
Market price risk	**5%**	**56,385**	53,454

The Authority does not believe there are any financial assets past due at balance date and, therefore, there is no impairment.

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. During the year 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 manages the Fund's assets and administered the GSF Schemes. For the year ended 30 June 2011, the Fund paid the Authority $32,621,000 (2010: $27,944,000) 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 2011 $3,974,000 was payable to the Authority for expenses incurred (2010: $1,947,000).

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

Mark Verbiest (Board member) is Chairman of Willis Bond General Partners Limited (WBGP), the general partner of a property investment fund (**PIF**) in which the Authority has invested. Mr Verbiest is also Chairman of, and an investor in, Willis Bond Capital Partner Limited, a related property investment fund, which co-invests with WBGP in property developments. Mr Verbiest took no part in the decision by the Board to invest in PIF and takes no part in the Board's discussions on the investment.

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 management fees due to a number of factors: introduction of new active investment strategies, such as private equity, that have higher management fees; higher than forecast asset values upon which manager fees are generally based; and payment of contracted performance fees to some managers that exceeded performance targets.

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

As at 30 June 2011 capital commitments were in place for the building of the new Business System and to a New Zealand Equity Manager and a Global Property Investment Manager. These are summarised as follows:

	2011 $000	2010 $000
Non-cancellable contractual commitments		
Less than one year	**33,341**	1,400
Between one and two years	**31,847**	-
Total non-cancellable contractual commitments	**65,188**	1,400

There are no contingent assets or liabilities (2010: Nil).

17. Subsequent Events

There have been no material events after balance date that require adjustments to, or disclosure in, the Financial Statements. (2010: Nil).

A change in the tax rate for superannuation funds from 30% to 28% was enacted in the Taxation (Budget Measures) Act on 27 May 2010. The lower rate applies to the Fund from 1 July 2011.

Deloitte.

AUDIT REPORT

INDEPENDENT AUDITOR'S REPORT

TO THE READERS OF THE GOVERNMENT SUPERANNUATION FUND'S FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011

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

We have audited the financial statements of the Fund on pages 31 to 58 that comprise the statement of net assets as at 30 June 2011, the statement of changes in net assets and statement of cash flows for the year ended on that date, and a summary of significant accounting policies and other explanatory information.

Opinion

In our opinion the financial statements of the Fund on pages 31 to 58:

- comply with generally accepted accounting practice in New Zealand; and
- present a true and fair view of the Fund's:
    - financial position as at 30 June 2011; and
    - financial performance and cash flows for the year ended on that date.

Our audit was completed on 7 September 2011. This 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 our responsibilities, and we explain our independence.

Basis of opinion

We carried out our audit in accordance with the Auditor-General's Auditing Standards, which incorporate the International Standards on Auditing (New Zealand). Those standards require that we comply with ethical requirements and plan and carry out our audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

An audit involves carrying out procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgement, including our assessment of risks of material misstatement of the financial statements whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Fund's preparation of the financial statements that present a true and fair view of the matters to which they relate. We consider internal control in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control.

An audit also involves evaluating:

- the appropriateness of accounting policies used and whether they have been consistently applied;
- the reasonableness of the significant accounting estimates and judgements made by the Board;
- the adequacy of all disclosures in the financial statements; and
- the overall presentation of the financial statements.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements. We have obtained all the information and explanations we have required and we believe we have obtained sufficient and appropriate audit evidence to provide a basis for our audit opinion.

Responsibilities of the Board

The Board is responsible for preparing financial statements that:

- comply with generally accepted accounting practice in New Zealand; and
- present a true and fair view of the Fund's financial position, financial performance and cash flows.

The Board is also responsible for such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Board's responsibilities arise from the Government Superannuation Fund Act 1956.

Responsibilities of the Auditor

We are responsible for expressing an independent opinion on the financial statements and reporting that opinion to you based on our audit. Our 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, we have no relationship with or interests in the Fund.

Ian C 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 2011, 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 judgements 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 18 - 24, and the attached Financial Statements for the financial year fairly reflect the financial position, as at 30 June 2011, and the operations and cashflows of the Authority for the year ended 30 June 2011.

Keith B Taylor
Chairman
Government Superannuation Fund Authority Board

A K Kerr

Chair
Audit & Risk Review Committee

7 September 2011

GOVERNMENT SUPERANNUATION FUND AUTHORITY

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 30 June 2011

	Note	2011 $000 Actual	2011 $000 Forecast	2010 $000 Actual
Revenue				
Interest received		**7**	8	7
Other revenue		**20**	13	17
Transfer from the Government Superannuation Fund	1	**32,621**	24,598	27,944
Total revenue		**32,648**	24,619	27,968
Expenses				
Scheme administration		**2,706**	2,700	2,660
Investment management and custody	2	**26,428**	18,111	22,171
Operating	3	**3,514**	3,808	3,137
Total expenses		**32,648**	24,619	27,968
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

As at 30 June 2011

	Note	2011 $000 Actual	2011 $000 Forecast	2010 $000 Actual
Public equity				
General fund		**–**	–	–
Total public equity		**–**	–	–
Represented by:				
Current assets				
Cash and cash equivalents		**184**	150	215
Trade and other receivables	**4**	**4,066**	2,320	3,273
Total current assets		**4,250**	2,470	3,488
Total assets		**4,250**	2,470	3,488
Current liabilities				
Trade and other payables	5	**4,250**	2,470	3,488
Total current liabilities		**4,250**	2,470	3,488
Net assets		**–**	–	–

The Financial Statements were approved by the Government Superannuation Fund Authority Board on 7 September 2011.

Keith B Taylor
Chairman
Government Superannuation Fund Authority Board

a.K. Kerr

A K Kerr

Chair
Audit & Risk Review Committee

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 2011

	Note	2011 $000 Actual	2011 $000 Forecast	2010 $000 Actual
Cash flows from operating activities				
Cash was provided from:				
Government Superannuation Fund	1	**31,737**	25,138	32,311
Interest		**7**	8	7
Other		**20**	13	17
		31,764	25,159	32,335
Cash was disbursed to:				
Total expenses		**(31,765)**	(25,119)	(32,459)
Net cash flows from operating activities		**(31)**	40	(124)
Net (decrease)/increase in cash held		**(31)**	40	(124)
Opening cash and cash equivalents		**215**	110	339
Closing cash and cash equivalents		**184**	150	215

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

	2011 $000 Actual	2011 $000 Forecast	2010 $000 Actual
Net operating result	–	–	–
Movements in working capital items:			
Trade and other receivables	**(793)**	540	3,191
Trade and other payables	**762**	(500)	(3,315)
Net cash flows from operating activities	**(31)**	40	(124)

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 2011

	Note	2011 $000 Actual	2011 $000 Forecast	2010 $000 Actual
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, including forecast information.

(iii) Measurement base

The measurement base adopted is that of historical cost.

(iv) Presentation and functional currency

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

(v) Accounting policies

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

Revenue

Revenue is recognised on an accrual basis. Interest income is accrued at balance date using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period.

Expenses

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

Foreign currencies

The Authority, from time to time, pays the managers of international equities and global 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.

Tax

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

Financial instruments

Financial instruments include both financial assets and financial liabilities. 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.

Financial assets, classified as loans and receivables include various bank term deposits, receivables from related parties and other receivables. Financial liabilities, measured at amortised cost, include trade and other payables.

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.

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 fees paid for certain services supplied from outside New Zealand, mainly fees incurred in relation to the custody of assets and the provision of investment reports. GST on these items is included within operating expenditure.

Accounting judgements and major sources of estimation certainty

In the application of the Authority's accounting policies the Government Superannuation Fund Authority Board (**the Board**) is required to make judgements, 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 expires.

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.

Statement of Cash Flows

The Statement of Cash Flows has been prepared using the direct approach. The following are definitions of the terms used in the Statement of Cash Flows.

- *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 interest 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.

(vi) Forecast figures

The forecast figures are those approved by the Board at the beginning of the period and presented in the Authority's 2010/11 Statement of Intent. The forecast figures were prepared in accordance with NZ GAAP, and are consistent with the accounting policies adopted by the Board for the preparation of the Financial Statements.

(vii) 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 financial statements of the Authority in the period of initial application.

(viii) Prior year comparatives

Prior year comparatives have been reclassified, where appropriate, to facilitate comparison with the current year.

(ix) Changes in accounting policies

There have been no changes to accounting policies during the year.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2011

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% (2010:79.3%) of the Authority's administrative expenses, including investment management and custody expenses, reimbursed by the Fund. Other employers contributed the balance of 21% (2010:21.7%).

2. Investment management and custody expenses

	2011 $000	2010 $000
Investment management expenses	**24,738**	21,004
Custody expenses	**1,690**	1,167
Total investment management and custody expenses	**26,428**	**22,171**

3. Operating expenses

	2011 $000	2010 $000
Audit	**175**	156
Board fees and expenses	**197**	209
Other assurance fees paid to Auditor – Probity	**–**	5
Other expenses	**1,100**	1,053
Management fees –Annuitas	**2,042**	1,714
Total operating expenses	**3,514**	**3,137**

4. Trade and other receivables

	2011 $000	2010 $000
Annuitas	**–**	56
Government Superannuation Fund	**3,974**	3,090
Other receivables and prepayments	**92**	127
Total trade and other receivables	**4,066**	**3,273**

5. Trade and other payables

	2011 $000	2010 $000
Investment management	**3,234**	2,892
Professional services	**997**	548
Other creditors	**19**	48
Total trade and other payables	**4,250**	**3,488**

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 in turn is mainly funded by 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**) 1,793,388 (2010: USD 1,227,000) and Australian dollars (**AUD**) 27,555 (2010: AUD 38,000) owing in management fees at balance date. 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 2010.

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 13 staff (including 3 part time) (2010: 13 (including 2 part time)). Total remuneration was $2,337,947 (2010: $2,262,452) and the Authority reimbursed $1,566,424 (2010: $1,312,222), or 67% (2010: 58%) of the total.

8. Board fees

Board members were paid the following fees during the period:

	2011 $	2010 $
Chairman		
Tim McGuinness (retired 31 May 2011)	**42,533**	46,400
Deputy Chairman		
David May *	**30,450**	29,000
Members		
Steve Napier	**23,200**	23,200
Keith Taylor	**23,200**	23,200
Mark Verbiest	**23,200**	15,467
Toni Kerr	**23,200**	13,533

* *Includes payment for acting as Chairman from 1 to 30 June 2011.*

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 $8,375 in 2011 (2010: $7,491).

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 for the year was $19,550 (2010: $19,125).

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. The Authority continued with the resource sharing agreement with the Guardians of New Zealand Superannuation (the Guardians) to work jointly, on Responsible Investment Policies. David May (Deputy Chairman) is Chairman of the Guardians. Other Crown Financial Institutions, including the Earthquake Commission, are also involved in this resource sharing agreement with the Guardians. Keith Taylor (Chairman) from 1 August 2011 is the Deputy Chairman of the Earthquake Commission Board.

The Authority has appointed Keith Taylor 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 $2,042,000 (2010 : $1,714,000). The amount owed to Annuitas by the Authority at year end was $6,000 (2010: owed by Annuitas $56,359).

The Board, through Management, monitors the performance of the external 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.

Mark Verbiest (Board member) is Chairman of Willis Bond General Partners Limited (**WBGP**), the general partner of a property investment fund (**PIF**) in which the Authority has invested. Mr Verbiest is also Chairman of, and an investor in, Willis Bond Capital Partner Limited, a related property investment fund, which co-invests with WBGP in property developments. Mr Verbiest took no part in the decision by the Board to invest in PIF and takes no part in the Board's discussions on the investment.

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 that forecast on account of several factors: introduction of new active investment strategies, such as private equity, that have higher management fees; higher than forecast asset values upon which manager fees are generally based; and payment of contracted performance fees to some managers that exceeded performance targets.

11. Contingent assets and liabilities

There are no contingent assets or liabilities at 30 June 2011 (2010: Nil).

12. Commitments

The Authority has commitments for the administration of the GSF schemes, the provision of actuarial services and for the provision of Management services from Annuitas. These commitments are summarised as follows:

	2011 $000	**2010 $000**
Non-cancellable contractual commitments		
Less than one year	**5,134**	4,747
Between one and two years	**4,600**	3,722
Between two and five years	**6,419**	2,210
Greater than five years	**–**	854
Total non-cancellable contractual commitments	**17,007**	**10,679**

13. Subsequent Events

There have been no material events after balance date that require adjustments to, or disclosure in, the Financial Statements. (2010: Nil).

The Financial Markets Authority Act 2011 disestablished the office of the Government Actuary from 1 May 2011. However, it extended the term of the then Government Actuary to 30 September 2011 to perform duties and functions relating to the Government Superannuation Fund. The Authority Board has appointed Russell Employee Benefits Pty Ltd as actuary to the Authority for a period of three years from 1 October 2011.

Deloitte.

INDEPENDENT AUDITOR'S REPORT

TO THE READERS OF THE GOVERNMENT SUPERANNUATION FUND AUTHORITY'S FINANCIAL STATEMENTS AND STATEMENT OF SERVICE PERFORMANCE FOR THE YEAR ENDED 30 JUNE 2011

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

We have audited:

- The financial statements of the Authority on pages 62 to 73, that comprise the statement of financial position as at 30 June 2011, the statement of comprehensive income, statement of movements in public equity and statement of cash flows for the year ended on that date, and a summary of significant accounting policies and other explanatory information; and
- The statement of service performance of the Authority on pages 18 to 24.

Opinion

In our opinion:

- the financial statements of the Authority on pages 62 to 73:
  - comply with generally accepted accounting practice in New Zealand; and
  - fairly reflect the Authority's:
    - financial position as at 30 June 2011; and
    - financial performance and cash flows for the year ended on that date.
- the statement of service performance of the Authority on pages 18 to 24:
  - complies with generally accepted accounting practice in New Zealand; and
  - fairly reflects, for each class of outputs for the year ended 30 June 2011, the Authority's
    - service performance compared with the forecasts in the statement of forecast service performance for the financial year; and
    - actual revenue and output expenses compared with the forecasts in the statement of forecast service performance at the start of the financial year.

Our audit was completed on 7 September 2011. This 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 our responsibilities, and we explain our independence.

Basis of opinion

We carried out our audit in accordance with the Auditor-General's Auditing Standards, which incorporate the International Standards on Auditing (New Zealand). Those standards require that we comply with ethical requirements and plan and carry out our audit to obtain reasonable assurance about whether the financial statements and statement of service performance are free from material misstatement.

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.

An audit involves carrying out procedures to obtain audit evidence about the amounts and disclosures in the financial statements and statement of service performance. The procedures selected depend on our judgement, including our assessment of risks of material misstatement of the financial statements and statement of service performance, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Authority's preparation of the financial statements and statement of service performance that fairly reflect the matters to which they relate. We consider internal control in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control.

An audit also involves evaluating:

- the appropriateness of accounting policies used and whether they have been consistently applied;
- the reasonableness of the significant accounting estimates and judgements made by the Board;
- the adequacy of all disclosures in the financial statements and statement of service performance; and
- the overall presentation of the financial statements and statement of service performance.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements and statement of service performance. We have obtained all the information and explanations we have required and we believe we have obtained sufficient and appropriate audit evidence to provide a basis for our audit opinion.

Responsibilities of the Board

The Board is responsible for preparing financial statements and a statement of service performance that:

- comply with generally accepted accounting practice in New Zealand;
- fairly reflect the Authority's financial position, financial performance and cash flows; and
- fairly reflect its service performance.

The Board is also responsible for such internal control as is determined necessary to enable the preparation of financial statements and a statement of service performance that are free from material misstatement, whether due to fraud or error.

The Board's responsibilities arise from the Crown Entities Act 2004 and the Public Finance Act 1989.

Responsibilities of the Auditor

We are responsible for expressing an independent opinion on the financial statements and statement of service performance and reporting that opinion to you based on our audit. Our 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 C Marshall
On behalf of the Auditor-General

DELOITTE
WELLINGTON, NEW ZEALAND

GOVERNMENT SUPERANNUATION FUND AUTHORITY
DIRECTORY

AS AT 7 SEPTEMBER 2011

Government Superannuation Fund Authority Board

Keith Taylor (Chairman)
David May (Deputy Chairman)
Toni Kerr
Steve Napier
Cecilia Tarrant
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 (to 30 September 2011)
Russell Employee Benefits Pty Ltd (from 1 October 2011)

Auditor

Ian C Marshall
Deloitte
on behalf of the Auditor-General

Bankers

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

Solicitors

DLA Phillips Fox

GOVERNMENT SUPERANNUATION FUND AUTHORITY DIRECTORY (CONTINUED)

Investment Managers

Commodity Futures
Gresham Investment Management LLC

Global Fixed Interest
Ashmore Management Company Limited
Pacific Investment Management Company LLC
Wellington Management Company LLP

Global Tactical Asset Allocation
AQR Capital Management, LLC

Insurance-Linked Assets
Nephila Capital Ltd (from December 2010)

International Equities
Altrinsic Global Advisers, LLC
Arrowstreet Capital Limited Partnership
Genesis Emerging Markets Investment Company
Marathon Asset Management LLP
PanAgora Asset Management, Inc
Pzena Investment Management, LLC
T. Rowe Price Global Investment Services Limited

Multi-Asset Class
Makena Capital Management (Cayman), LLC

New Zealand Equities
Direct Capital IV GP Limited
Harbour Asset Management Limited
One Path (NZ) Limited (formerly ING (NZ) Limited)

Global Property
AMP Capital Investors, New Zealand Limited
Willis Bond and Company Management Limited (from July 2010)

Foreign Exchange Hedging
State Street Global Advisors, Australia, Limited
ANZ National Bank Limited

GOVERNMENT SUPERANNUATION FUND AUTHORITY DIRECTORY (CONTINUED)

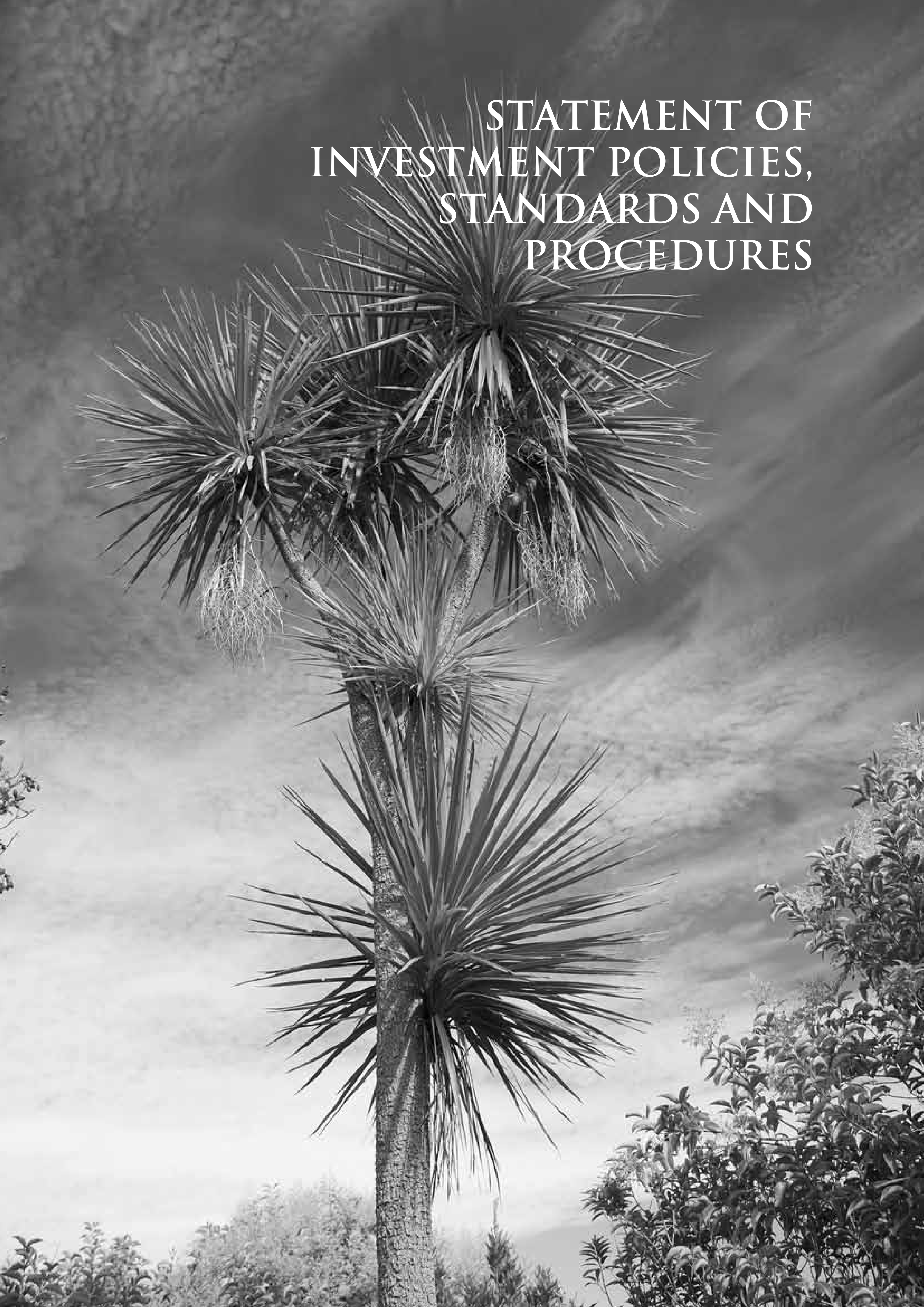
All correspondence relating to the GSF Schemes should be addressed to –

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

STATEMENT OF INVESTMENT POLICIES, STANDARDS AND PROCEDURES



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 7 September 2011. An electronic copy is available via website *www.gsfa.co.nz*.

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 7 September 2011 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, 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 until 30 September 2011 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.**

Investors generally demand a return premium to compensate them for investing in risky assets. These risk premia represent the compensation for accepting the risk of loss and are the primary and major source of investment returns. Equity market risk is the most well-known risk premium. It is the compensation for accepting the residual risk of a commercial venture, typically through corporate equity shares. There are other premia for accepting different types of risk.

b) **Diversification reduces total risk.**

Total investment risk can be reduced for any given return target by investing in a diversified range of sources of return that have different fundamental economic and financial determinants. A portfolio, that is well-diversified, both across and within asset classes, will deliver more consistent and, therefore, higher compound returns over time than a less diversified portfolio. Within an asset class, this can be achieved by investing across a range of industries, countries and entities. Concentration of risk, the opposite of diversification, is only worthwhile where there is the strong likelihood of higher incremental returns.

c) **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. The Board has adopted a simple Reference Portfolio that is consistent with the Fund's long term objectives, captures the major sources of systematic market risk and return, and which could be managed passively at low cost. The Reference Portfolio provides a benchmark against which Management's discretionary actions can be monitored, in addition to the explicit performance objectives. The Fund's performance may be enhanced in risk-adjusted terms by investing in other sources of systematic return not in the Reference Portfolio and/or engaging active managers with trading skill. The impact of Management's discretionary actions on the risk and return characteristics of the portfolio is secondary compared to the risks and returns of the major underlying markets captured in the Reference Portfolio.

d) **Some investment markets are more efficient than others and their relative efficiency varies over time. Greater market inefficiencies offer skilful managers more opportunity to add value through superior information and trading skill.**

The more inefficient the market (which may vary over time), the greater the opportunity 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 relatively inefficient markets and skilful managers by thorough research. The higher expected returns from active management should be weighed against the higher costs and any tax implications that result. Rewards from active management will be maximised by focusing on relatively inefficient markets and by engaging skilful managers with diversified investment approaches.

e) **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, however, 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.

f) **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 Reference Portfolio 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, justify a lower return threshold for inclusion in the portfolio.

g) **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.

h) **Responsible Investment encompasses more than maximising return for risk.**

Responsible asset owners recognise the obligations and interests of their sponsors and apply broadly accepted global standards of ethical conduct in relation to environmental risks, social issues and business governance, acknowledging that these may not always be consistent with maximising risk-adjusted returns.

In general, however, firms that follow good governance practices enhance their value and performance and reduce the risk of serious loss of value in adverse circumstances. Similarly, firms that recognise and manage environmental and social risks in their sphere of operation are likely to do better than those that do not.

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) **Property** 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 risks and longevity risks.

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

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

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

Having no more than a 1 in 10 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 Index 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**

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 property, private equity and insurance-linked 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 is set out in Table 2.

Table 2: Target Portfolio Allocation

Asset Class/Strategy	Target Allocation (%)
International equities	43.0
New Zealand equities	9.3
Property	5.0
Fixed interest	24.5
Commodities	4.2
Global tactical asset allocation	3.0
Multi-asset class	7.0
Insurance-linked assets	4.0
Total Assets	**100.0**
Foreign currency exposure (after-tax)	20.0

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.

c) **Rebalancing and Reset Ranges**

Rebalancing ranges define the extent to which the capital allocation to an asset class is permitted to deviate from the target allocation (set out in Table 2) before rebalancing trades are required.

Reset ranges show the extent to which an asset class is rebalanced having breached the rebalancing ranges.

Some asset classes (eg. the multi-asset class) or components of asset classes (eg. private equity within New Zealand equities and private property within property) are not able to be readily traded. Those assets are not subject to formal rebalancing ranges but are monitored to ensure the exposure does not become unacceptable.

The rebalancing and reset ranges are shown in Table 3.

Table 3: Rebalancing and Reset Ranges

Asset Class	Rebalancing Range (%)	Reset Range (%)
International equities	38.0 to 48.0	41.0 to 45.0
New Zealand equities	7.3 to 11.3	8.3 to 10.3
Property	4.0 to 6.0	4.5 to 5.5
Fixed Interest	20.5 to 28.5	22.5 to 26.5
Commodities	3.2 to 5.2	3.5 to 4.5

d) **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 hedge ratio for International equities is varied to deliver the desired total Fund foreign currency exposure and takes into account any foreign currency tilting as discussed further below in Section 5.3 (d). Before tax hedge ratios depend on the tax treatment of the currency hedge and is determined by the tax treatment of the underlying assets, which may be on a comparative value or fair dividend rate basis.

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 rebalancing 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 after-tax investment return with the IPM and its risk with the Risk Parameter. The performance of individual asset classes or strategies is assessed by comparing their pre-tax performance with their respective benchmarks (see sections 5.1 and 5.2).

6.2 Standards

a) Investment Objective

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

b) Investment Performance Measure (IPM)

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

Having 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 World Index
New Zealand equities	NZX 50 Gross Index Including imputation credits
Global listed property – collective portfolio	FTSE EPRA / NAREIT Global Property Index
US unlisted property	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]	Reference Portfolio (unhedged)
Insurance linked assets	Swiss Reinsurance Catastrophe Bond Total Return 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 its risk with the Risk Parameter. The Authority recognises that, from year to year, investment returns may not meet the IPM and risk may be outside the Risk Parameter.

b) The Board monitors the before-tax after-fees return of:

- The Fund's actual portfolio relative to the Reference Portfolio;
- The Fund's Target Portfolio relative to the Reference Portfolio; and
- The Fund's actual portfolio relative to the Target Portfolio.

c) 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.

d) 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 Board 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 Minister 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. A forecast for investment performance is 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 service level agreement.

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.

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*.

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 may exclude investments, which are not consistent with the factors listed above, or may engage with entities to improve their conduct. 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.

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. Where managers or custodians use derivatives, their use must be specified in each investment management agreement, or be consistent with the terms governing collective investment vehicles. Where the Authority is a counter-party to a derivative, the terms and conditions of the derivative must be specified in appropriate industry standard documentation.

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.

Rebalancing ranges are set out in Table 3, page 92.

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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