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REPORTS AND FINANCIAL STATEMENTS

GOVERNMENT SUPERANNUATION FUND AUTHORITY

for the year ended 30 June 2012

GOVERNMENT SUPERANNUATION FUND
Te Pūtea Penihana Kāwanatanga

for the year ended 30 June 2012

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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 reports on the activities of the Government Superannuation Fund Authority (**the Authority**) and the Government Superannuation Fund (**GSF** or **the Fund**) for the year ended 30 June 2012.

The Authority was established in October 2001 as a Crown entity by section 15A of the Government Superannuation Fund Act 1956 (**GSF Act**) and became an autonomous Crown entity under the Crown Entities Act 2004 (**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 2012 Year

- After two strong years, the return in the financial year to 30 June 2012 was disappointing.
- Despite a small surplus of $25 million before tax there was an overall loss of $17 million for the 2012 financial year after deduction of tax of $42 million.
- Allocations to alternative strategies added value, however allocations to emerging markets and foreign currency did not.
- The continued high New Zealand dollar (**NZD**) impacted on the returns from the Fund's unhedged foreign assets.
- Increased new investment in insurance-linked assets with the addition of life settlements.
- Good progress has been made on the new business system for the administration of the schemes. Construction is due to be completed in 2013 and planning for the final transition phase has commenced.

Investment Markets

Almost four years on from the global financial crisis (**GFC**), its effects continued to reverberate through the financial year to June 2012. The large United States (**US**) economy suffered a credit downgrade and its recovery from recession remained below par owing to the overhang of household and public sector debt. The European debt crisis escalated with successively larger financial rescue packages being required to avoid defaults. Meanwhile Europe rolled into recession with outright depression in the peripheral countries. The developing countries, notably China, also experienced slowing growth. Asset prices were only being kept from negative territory in this environment by repeated doses of monetary stimulus supported by explicit and implicit government guarantees that will ultimately be a cost to taxpayers and the productive sector.

Markets were volatile and weak over the financial year as a whole. Global share markets returned -3% on average. Only the US market among the majors achieved a positive return. Global sovereign bonds provided above average returns of almost 10% (hedged into NZD), despite their low yields, as investors sought safety in the credits of countries perceived to be least exposed to the debt crisis. European markets fared worst, especially the periphery.

New Zealand (**NZ**) and Australia continued to be seen as relatively safe havens in this context. NZ Government bonds and NZ shares outperformed global market averages and the NZD remained firm over the year. Although NZ's private sector external debt is high and public sector debt is rising, the country's external terms of trade are still quite buoyant and growth is moderate. NZ is increasingly linked to Asia, one of the world's faster growing regions as opposed to Europe, and the stimulus provided by the re-build of Christchurch is increasingly significant.

Investment Activity

No significant changes were made to the Fund's investment strategy during the year. The investment in insurance-linked assets was increased in February 2012 with a modest investment in life settlements, a portfolio of life insurance policies on American lives selected according to strict criteria. The Fund entered into a swap agreement with an investment bank which, in turn, acquired the policies at a discount to the sum assured and accepts the obligation to pay remaining premiums in exchange for collecting the eventual death benefits. This market has become investible in recent years in response to tighter regulation. The Fund expects to earn a high return over the 30 year life of the investment but its market value is sensitive to changes in long term interest rates and actual mortality experience.

Shortly after the end of the financial year the Fund made commitments to additional global and NZ private equity investments which will be funded from international equities as the capital is drawn down over the next few years. It was also decided to exit the global property because this market had become increasingly volatile and highly correlated with the broader equity market. This change is expected to be completed by 1 October 2012.

Investment Performance

The Fund's return for the year ended 30 June 2012 was disappointing after two strong years following the GFC. The Fund's return after fees and tax of -0.5% (gross 0.8%) compares to 11.6% (gross 14.8%) in 2011. The gross return was 0.2% ahead of the Reference Portfolio and the return (after fees) was 0.4% behind the Reference Portfolio. Allocations to alternative strategies outside the Reference Portfolio contributed positively in the weak market environment but this was more than offset by allocations to emerging markets and foreign currency, which did not add value. External managers had a neutral overall impact on the Fund's investment return, earning sufficient added value to cover their fees. 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 after tax and expenses against the long term expected return on NZ Government Stock after tax for periods ended 30 June 2012.

Returns to 30 June 2012 (%pa)	1 year	5 years	10 years
Fund return (after tax and expenses)	-0.5	-1.1	3.5
NZ Government Stock (after tax)	7.8	6.3	5.0
NZ Government Stock (after tax) plus 2.5%	10.3	8.8	7.5

The Fund has an Investment Performance Measure (**IPM**) which is the return on NZ Government Stock plus 2.5% after tax meausured over a rolling 10 year period.

The Fund return was behind the IPM return by 4.0% per annum at 30 June 2012. This is explained by the negative impact of historically poor global equity market returns over the last decade or more and, in contrast, the historically high returns from NZ Government Stock.

The five years annualised return includes the impact of the GFC on investment markets. The 10 year return annualised includes the impact of the GFC and the decline in equity markets in 2002/03.

Full details of the Fund's Investment Strategy and returns can be found in the Investment Commentary on page 6.

Schemes

Datacom Employer Services Limited 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 completed in December 2010. The construction phase has been delayed and is now scheduled to be completed in 2013 (previously scheduled for around June 2012). Planning for transition from the old system to the new system is underway.

The role of the Government Actuary was disestablished on 30 September 2011 and on 1 October 2011 Russell Employee Benefits Pty Limited (**Russell**) was appointed to provide actuarial services to the Authority. The Authority's current Actuary at Russell is Emma Brodie.

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

Statutory Review

The Act provides for a review to be conducted every five years of how effectively and efficiently the Authority is performing its functions under the Act. The first review was undertaken in 2006 and in March 2011 the Minister of Finance appointed JANA Investment Advisers (JANA) to undertake the second five yearly review. The review was tabled in Parliament in July 2011 and 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 made some suggestions to improve the operation of GSFA and significant progress has been made on a number of these recommendations. These can be viewed at *www.gsfa.govt.nz/content/default.html*. Select Authority Reports / Statutory Review then download: Stat Review 2012 08 24.pdf.

Outlook

Global bond yields are now barely sufficient to match expected inflation, and cash yields in most markets are negative in real terms. Thus the bond market is anticipating an extended period of slow global economic growth and continued easy monetary conditions. Significant risk remains of a disorderly global deleveraging triggered by a breakup of the European Union in some form and a more severe global recession. Risk premiums are high in Europe and this is depressing asset prices and currencies in that region.

Elsewhere, in North America and Asia, the risks emanating from the GFC have eased while corporate profit margins are high but growth is sub-par and fragile owing to the high debt levels in developed countries. Increasingly, global growth and NZ's performance will be influenced by China and broader Asia where economic prospects are brightest.

Absolute returns are likely to be persistently low in this environment however equities and other risky assets should provide positive premiums over government bonds over the next few years in contrast to the negative premiums of the recent past.

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 access to our quarterly investment results, as well as any changes the Authority makes to its policies, investment strategy and personnel.

Tributes

Mark Verbiest resigned as a member of the Board at the end of May 2012. Mr Verbiest contributed to both the Board's effectiveness and the Authority's achievements. The Board expresses its appreciation and thanks to Mr Verbiest for his contribution and wishes him well for the future.

David May retired as Deputy Chairman of the Board at the end of May 2012. Mr May was a member of the Government Superannuation Fund Establishment Board and was appointed Deputy Chairman when the Authority was established in 2001. During his almost 11 years of service, the Board benefitted from Mr May's wide experience in superannuation, his actuarial background and his valuable contribution to the current investment structure and management arrangements for GSF. The Board thanks Mr May for the significant contribution he has made.

Alan Langford retired as Chief Executive at the end of June 2012. Mr Langford had made an outstanding contribution as the Authority's Chief Executive since his appointment in 2001. He managed the business through several major restructurings and his wide knowledge of superannuation and investment markets has proved invaluable. The Board thanks Mr Langford and wishes him all the best for the future.

Welcome

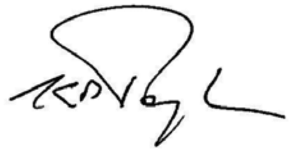
Simon Tyler was appointed Chief Executive of the Board from 1 July 2012. Mr Tyler was previously Head of Financial Markets at the Reserve Bank and, prior to that, held a number of senior positions at The National Bank. The Board looks forward to working with Mr Tyler in the future.

The Authority also welcomes Dr Craig Ansley as a new member of the Board with effect from mid July 2012. Dr Ansley is an Adjunct Professor of Finance at the University of Auckland and a member of the Guardians of New Zealand Superannuation. Dr Ansley was founder of the New Zealand office of Russell Investment Group, and spent several years in senior roles in that organisation.

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

5 September 2012

INVESTMENT COMMENTARY

Investment Strategy

The Authority is required to invest the Fund on a prudent, commercial basis. In so doing, its investment objective is 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 objective (Investment Performance Measure or IPM) of the Fund is defined in terms of expected return and risk. The long term after tax return of the Fund is expected to average the return of NZ Government Stock plus 2.5% after tax. We measure this over rolling ten year periods. The Fund's risk tolerance, or "Risk Paremeter" is defined as 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. These measures are reviewed regularly, taking into account the investment and tax environment in which the Authority operates. There were no changes in the current 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 the Fund's relative 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 investment objective 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 2012 compared with the Reference Portfolio that became effective on 1 July 2010.

Table 1

Asset Class	Actual Asset Allocation* at 30 June 2012	Reference Portfolio
	%	%
Global Fixed Interest	20.6	30
International Equities	47.2	55
NZ Equities	9.0	10
Commodity Futures	3.7	5
Global Property	4.7	-
Insurance-linked Assets	7.1	-
Absolute Return**	5.7	-
Currency Overlay***	2.0	-
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 2012 and 30 June 2011.

Table 2

Asset Class	**Investment Assets Actual at 30 June 2012**		**Investment Assets Actual at 30 June 2011**	
	$000	*%*	*$000*	*%*
Global Fixed Interest	626,255	20.0	711,149	22.4
New Zealand Equities	268,905	9.0	345,633	10.9
International Equities	1,275,453	42.8	1,397,708	44.1
Commodity Futures	108,937	3.7	104,422	3.3
Global Property	140,083	4.7	153,204	4.8
Insurance-Linked Assets	210,712	7.1	108,176	3.4
Multi-Asset Class	215,657	7.2	219,156	6.9
Global Tactical Asset Allocation	104,388	3.5	101,189	3.2
Currency Overlay	59,800	2.0	65,787	2.1
TOTAL	**2,979,903**	**100.0**	**3,170,988**	**100.0**

The numbers in the table are from the Custodian and are pre tax gross of fees. The assets are 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

After two years of strong returns recovering from the GFC, the Fund return was disappointing in fiscal 2012.

Table 3 compares the Fund's investment returns after tax against the expected long term return over periods ended 30 June.

Table 3

Returns	**1 year to 30 June 2012**	**5 years Annualised**	**10 years Annualised**
	%pa	%	%
Fund return (after tax)	-0.5	-1.1	3.5
NZ Government Stock (after tax)	7.8	6.3	5.0
NZ Government Stock (after tax) plus 2.5%	10.3	8.8	7.5

The Fund return is behind its IPM by 4.0% per annum. This is explained by the negative impact of historically poor global equity market returns over the last decade or more and, in contrast, the historically high returns from Government Stock.

Almost four years on from the GFC, its effects continued to reverberate through the fiscal year to June 2012. The large United States economy suffered a credit downgrade and its recovery from recession remained below par owing to the overhang of household and public sector debt. Through the year the European debt crisis escalated with successively larger financial rescue packages being required to avoid defaults. Meanwhile Europe rolled into recession with outright depression in the peripheral countries. The developing countries, notably China, also experienced slowing growth. Asset prices were only kept from more negative territory in this environment by repeated doses of monetary stimulus. While these buy time to allow a more gradual deleveraging they are supported by explicit and implicit government guarantees that will ultimately be a cost to taxpayers and the productive sector.

Markets were volatile and weak over the financial year as a whole. Global share markets returned -3% on average. Only the US market among the majors achieved a positive return. Global sovereign bonds provided above average returns of almost 10% (hedged into NZ dollars) despite their low yields, as investors sought safety in the credits of countries perceived to be least exposed to the debt crisis. European markets fared worst, especially the periphery.

New Zealand and Australia continued to be seen as relatively safe havens in this context. NZ Government bonds and NZ shares outperformed global market averages and the NZ dollar remained firm over the year. Although NZ's private sector external debt is high and public sector debt is rising, the country's external terms of trade are still quite buoyant and growth is moderate. NZ is increasingly linked to Asia, one of the world's faster growing regions as opposed to Europe, and the stimulus provided by the re-build of Christchurch is increasingly significant.

The Fund's return before tax of 1.1% in 2012 compares with the Reference Portfolio return of 0.9%, a small gain of 0.2%. We measure the performance of active management net of fees and expenses, however, which resulted in a small relative shortfall of 0.4%. Allocations to alternative strategies outside the Reference Portfolio contributed positively in the weak market environment but this was more than offset by allocations to emerging markets and foreign currency, which did not add value. External managers had a neutral overall impact, earning sufficient added value to cover their fees.

Returns by Asset Class

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

Asset Class	Year to June 2012		3 Years to June 2012 (pa)	
	Actual	Benchmark	Actual	Benchmark
	%	%	%	%
Total Fund	**1.1**	**0.9**	**9.8**	**9.7**
Global Fixed Interest (hedged)	10.9	9.8	9.9	7.8
International Equities	-5.0	-3.9	4.1	3.1
NZ Equities	-0.8	0.1	7.4	6.4
Global Property	5.9	5.2	7.5	9.2
Commodity Futures	-9.9	-12.0	-2.3	-4.0
Multi-Asset Class (USD)	0.8	-2.1	10.7	9.7
GTAA (USD)	1.8	0.4	9.6	0.4
Insurance-Linked Assets (USD)*	6.6	8.2	n/a	n/a
Currency Overlay	-1.9	-1.4	6.3	8.0

* *Includes castrophe insurance but not life settlements which were owned for only five months of the year.*

Global Fixed Interest

Actual Return 10.9%, Benchmark Return 9.8%
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).

Fixed income investments proved to be something of a white knight in the Fund, supported by strong investor demand for safe-haven assets. Despite already-low yields, bonds gained in value as investors sought exposure to the bonds of financially stronger governments and drove yields lower. That favoured US bonds, notwithstanding its credit downgrade, Australia, NZ and Germany relative to the rest of Europe.

The Fund's global fixed interest managers added 1.1% for the year. This reflected a bias toward higher quality issues at the expense of yield, notably non-European governments, investment grade corporate credit and US agency mortgages.

International Equities

Actual Return -5.0%, Benchmark return -3.9%
Benchmark - MSCI All Countries World Index

Given the uncertain economic and financial environment, it is not surprising that global equity markets declined in the year to June, except for the US market. The main driver of the poor global returns was faltering investor risk appetites, unnerved by the rolling European debt crisis and fears that global monetary stimulus was becoming progressively less effective in supporting growth. European and emerging markets fared worst amid the global flight from risk.

Better returns in US shares were underpinned by strong earnings growth despite a poor economic recovery. Much of the earnings growth came through an increase in margins, i.e. improving productivity, while revenue and sales growth was less supportive.

Global shares were also shaken, directly and indirectly, by the high levels of inflation reported in emerging markets. This spurred authorities in countries like China and India to implement aggressive moves to combat inflation and slow down their overheating economies. Share price performance suffered as a result in both emerging and developed markets, with developed market companies now generating an increasing share of their earnings from developing economies.

The Fund's international equities managers under-performed by 1.1% collectively during the year. That is their first year of under-performance since they were engaged in late 2007 and reflected strong relative performance of defensive stocks with stable earnings prospects, i.e. a flight to quality. The appointed managers are under continuous review and currently comprise six 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 earnings momentum factors. 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 managers cover the global market while two others focus on high growth and deep value opportunities respectively. Five of the seven managers are ahead of their benchmarks since inception. Two managers are currently under review on account of significant changes in their senior personnel.

NZ Equities

Actual Return -0.8%, Benchmark Return 0.1%
Benchmark - NZX50 Gross Index including imputation credits

The New Zealand share market, as measured by the NZX 50 index, was flat year-on-year, slightly ahead of the weak share market performance around the globe.

The New Zealand economic recovery gathered momentum from the Rugby World Cup and, later in the financial year, from the prospective rebuild of Christchurch following last year's earthquake.

The Fund has two managers for NZ public equities and a commitment to a private equity fund initiated in mid-2009. The public equity managers subtracted 0.9% relative to the index largely on account of one manager's exposure to Australian stocks which under-performed the NZ market significantly.

The NZ private equity fund, 3 years into a 10 year programme, provided value gains well ahead of the public market index for the second year running.

Global Property

Actual Return 5.9%, Benchmark Return 5.2%
Benchmark - FTSE EPRA NAREIT Developed Real Estate Index hedged into NZD

A corner of the share market that stood out was global listed property. Global listed property shares outperformed the broader share market by 9.1%, led by US real estate investment trusts. Part of the relatively strong performance of global listed property reflected recovering real estate fundamentals especially in the US. In part, however, it reflected the defensive qualities of Real Estate Investment Trusts (**REITs**) compared to riskier share market sectors in these times of risk aversion, coupled with extremely low interest rates resulting from massive monetary stimulus. The Fund's global listed property manager added 1.0% relative to the benchmark and is 1.6%pa ahead since inception in 2005.

Despite the strong recent market performance, the Authority has decided to exit the global REIT market. The exit is expected to be completed by 1 October. Compared to inception in 2005, global REITs are now more volatile than the broad equity market and more correlated with it, i.e. they have become relatively more risky. As REITs offer lower expected returns than equities in general and little diversification benefit, it has been decided that sufficient similar exposures to underlying property are being accessed through a mix of the broader equities markets and global bonds.

The Fund also has exposure to less liquid opportunities to add value in global real estate 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 still in the early stage of investing, its performance to date reflects mainly fees charged on committed capital not yet invested and this reduced overall returns slightly relative to the benchmark.

Commodity Futures

Actual Return -9.9%, Benchmark Return -12.0%
Benchmark - Dow Jones UBS Commodity Index (Total Return)

The Fund invests about 3% of its assets in commodity futures. Commodity prices are highly volatile and tend to reflect economic cycles. Commodity futures 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 2.0% in financial 2012 and 4.0% per annum since inception in July 2009.

Multi-Asset Class (in US dollars)

Actual Return 0.8%, Benchmark Return -2.1%
Benchmark - Reference Portfolio

7% 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 volatility. One-third of the multi-asset class fund is invested in public markets - global equities and bonds. The other two-thirds have absolute return (hedge) funds, global private equity and private real estate investments. Therefore, it represents an alternative way of getting exposure to equities and credit together with skill-based strategies. It is benchmarked against the same Reference Portfolio as the total Fund.

The multi-asset fund added 0.8% in the current year and is 2.9% pa ahead of its benchmark since inception. This year's outperformance reflects defensive positioning when global equities and other risky assets performed poorly. For example, the multi-asset class fund was underweight equities and overweight credit. 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 going forward. The public market portfolios have also performed well relative to peers and benchmarks since inception.

Global Tactical Asset Allocation (GTAA) (in US dollars)

Actual Return 1.8%, Benchmark Return 0.4%
*Benchmark - US dollar 3 month London interbank offered rate (**LIBOR**) plus 6%*

3% of the Fund is invested in a 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 that is derived largely from skill-based trades.

In the current year the manager's excess return was 1.3%, which is below expectations. The excess return was generated largely from spread (i.e. long-short) trades based on relative value among commodities, currencies and equity versus bond positions, rather than relying on market direction. Since inception GTAA has returned 8.2% pa above LIBOR (3.8% net of fees).

Catastrophe Insurance (in US dollars)

Actual Return 6.6%, Benchmark Return 8.2%
Benchmark - Swiss Re Catastrophe Bond Index (Total Return)

Insurance-linked investments were 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 large risks more widely when the insurance industry's capacity is stretched, as it was after Hurricane Katrina in 2005 and after the GFC. These returns have very low correlation to the rest of the total Fund, as evidenced by the benchmark's 8.2% return this year when the total Fund earned 1.1%.

Over the current year the manager's returns were behind the index owing to a mix of exposures to smaller perils whereas the index comprises only bonds covering the peak perils of US hurricane and earthquake, Japanese quake and European storms.

Life Settlements (in US dollars)

Actual Return 0.3%, Benchmark Return 5.1%

Benchmark – Absolute return of 1% per month

On 1 February a new investment was made in a life settlements swap. A life settlement is the sale of an existing life policy to a third party who takes over outstanding premiums and collects the benefit on maturity. This market exists only in the US where elderly people with health impairments who do not need their policies any longer sell them to investors at a discount to the sum assured but for more than the surrender value offered by the insurer. Regulation has made it safer for investment after some initial questionable practices.

The Fund has invested $45m in a swap with an investment bank that provides exposure to a portfolio of 400 lives with diverse characteristics to limit risk. It has an expected return significantly greater than equities over its 30 year horizon but is subject to market valuation changes that are sensitive to long term interest rates.

Currency Overlay

Actual Return -1.9%, Benchmark Return -1.4%

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 global equity markets, which is the Fund's largest risk exposure, and this exposes the Fund to simultaneous downward shifts in both global 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. The reduced currency hedge subtracted 0.3% compared to the Reference Portfolio in addition to 0.2% of uncontrolled drift due to minor timing effects. At year end the Fund was positioned for a weaker NZD.

Outlook

Global bond yields are now barely sufficient to match expected inflation and cash yields in most markets are negative in real terms. Thus the bond market is anticipating an extended period of slow global economic growth and continued easy monetary conditions. Significant risk remains of a disorderly global deleveraging triggered by a breakup of the European Union in some form and a more severe global recession. Risk premiums are high in Europe as a result depressing asset prices and currencies in that region.

Elsewhere, in North America and Asia, the risks emanating from the GFC have eased and corporate profit margins are high but growth is sub-par and fragile owing to the high debt levels in developed countries. Increasingly, global growth and NZ's performance will be influenced by China and broader Asia where economic prospects are brightest.

Absolute returns are likely to be persistently low in this environment but equities and other risky assets should provide positive premiums over government bonds over the next few years in contrast to the negative premiums of the recent past.

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 consideration of 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. 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.

The Authority participated in engagements with several companies with other CFIs and, in some cases, with 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. If companies materially breach our RI standards and engagement is unlikely to change their behavior the Board will consider excluding them from our portfolio. 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 COMMENTARY

Schemes administration

Datacom Employer Services Limited continues to perform well as the 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.

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 completed in December 2010 and the developer, Datacom Systems (Wellington) Limited, is currently working on construction. Construction was originally scheduled for completion around June 2012. The complexity of the requirements of the GSF Schemes has resulted in additional time being required to complete construction. The construction phase is now scheduled for completion in calendar year 2013. Planning for the final phase, transition, has also 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 5 September 2012

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

Keith Taylor. Appointed as a Board member in 2008. Appointed as Chairman from 1 August 2011. Mr Taylor is Deputy Chair of the Earthquake Commission and a Board member of the Takeovers Panel. He is Chair of Speirs Group Limited and a director of the Reserve Bank of New Zealand, Southern Cross Medical Care Society, Gough, Gough and Hamer Limited, Port Marlborough New Zealand Limited, 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.

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

Steve Napier. Appointed in 2008. Mr Napier is a director of Steve Napier Limited, Eden Agri Capital GP Limited and 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 is a director of Fletcher Building Limited and Javan Cream Company Limited and a trustee of Tere Waitomo Community Trust. She previously held a number of senior management positions with Morgan Stanley and Credit Suisse First Boston in New York and London.

Craig Ansley. Appointed 16 July 2012. Craig Ansley was appointed to the Board of the Government Superannuation Fund Authority in July 2012. He is an Adjunct Professor of Finance at the University of Auckland and a member of the Guardians of New Zealand Superannuation. Craig was founder of the New Zealand office of Russell Investment Group, and spent several years in senior roles in that organisation. He was a member of the Savings Working Group, a trustee of the National Provident Fund and has been a director of a number of companies in the private sector.

Retired Board Members

Mark Verbiest resigned from the Authority Board on 31 May 2012.

David May retired from the Authority Board when his term of appointment ended on 31 May 2012.

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 GSF, subject to appropriate consultation with the Board. The Management team is:

- Alan Langford — Chief Executive (retired 30 June 2012)
- Simon Tyler — Chief Executive (appointed 1 July 2012)
- 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.

GOVERNMENT SUPERANNUATION FUND AUTHORITY
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 2012.

Investment Management

Performance Measure	Performance Achievement
Manage investments to maximise returns over the long term, without undue risk to the Fund as a whole, in accordance with best practice portfolio management	
• Fund return versus the IPM. • Actual performance (returns and assessed risk) compared to the Reference Portfolio to determine the added value of alternative asset exposures and active management (net of additional fees and costs). • Expected and actual volatility of Fund returns versus the Risk Parameter. All measured with reference to independent market valuations by the custodian and by the Authority's investment management staff.	Over the last 10 years it is 4.0% pa behind the IPM. This reflects the high returns on government stock compared to global equities over the last 1 and 10 years relative to the Fund's asset allocation. The Fund's net of fees return was 0.5% behind the Reference Portfolio for the year and 0.6%pa behind over three years. The Fund's risk (measured as volatility) was 7.9% before tax over the last 3 years, which was lower than the 8.9%pa for the Reference Portfolio and within the Risk Parameter. Performance is calculated by the custodian.

<table>
<tr><th>Performance Measure</th><th>Performance Achievement</th></tr>
<tr><td colspan="2">Endeavour to achieve competitive investment costs justified by value added</td></tr>
<tr><td>

Comparison of investment managers' actual performance against contracted mandates and representative benchmarks measured independently by the custodian and assessed by the Authority's investment management staff, with monthly management reporting and quarterly reporting to the Board.
Comparison of expected and actual value added, in terms of excess return (net of additional expenses) and/or reduced risk, versus the Reference Portfolio.
Annual comparison of the Fund's performance and cost structure with those of similar organisations, prepared by independent party.
Independent statutory review every 5 years.

</td><td>
External managers have added value over the last 1 and 3 years in excess of their fees.
Performance is calculated by the custodian, monitored monthly by Management and reported quarterly to the Board.
External managers added 0.1% net of fees in 2012 and an average 0.9%pa net of fees over the last 3 years. This was offset by the effect of an active tilt against the NZ dollar which was considered over-valued.
The Fund is benchmarked annually against global peers. Although the calendar 2011 surveyed results are not yet available, the 2010 results indicated:

The Fund's 3 year returns to 2010 were lower than peers on account of differences in policy allocations to equities;
Active management had a similar, negligible, impact on returns as peers
The Fund's management fees were slightly higher than peers because a larger percentage of the Fund is managed externally and actively whereas the peer average has some internal and passive management.

JANA completed its Statutory Review in 2011. It concluded inter alia '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 similar asset allocation mix in the Australian and NZ market.'
</td></tr>
<tr><td colspan="2">Monitor individual investment managers to ensure compliance with contracted mandates and, where appropriate, out performance against benchmarks</td></tr>
<tr><td>

External review by independent adviser and regular reviews by the Authority's investment management staff.

</td><td>Reviews of investment managers are obtained regularly from independent advisers. Compliance and performance is monitored monthly by Management against independent benchmarks and mandates.</td></tr>
</table>

Performance Measure	Performance Achievement
Maintain a SIPSP that meets best practice	
• Periodic review by independent adviser to assess whether the SIPSP meets best practice and is relevant.	Periodic reviews are undertaken by an independent adviser to ensure the SIPSP meets best practice and is relevant.
Comply with the SIPSP	
• No unauthorised variations from the SIPSP (which may be varied by the Board from time to time) identified on annual review.	The Fund remained fully compliant with the SIPSP throughout the year.
• Actual asset allocations rebalanced monthly to within rebalancing tolerances set out in the SIPSP.	Rebalancing was completed monthly to within predetermined policy ranges.
• Investment manager risk remains in line with expectation by comparing investment managers' actual risk profiles against expected risk.	Each manager's risk is monitored quarterly and there were no significant breaches during the year.
• Review of quarterly key performance indicators to determine that the custodian's performance meets its Service Level Agreement.	The custodian is monitored against KPIs quarterly and performance issues addressed with the custodian.
Put in place a sound investment strategy consistent with the SIPSP and the Authority's Beliefs	
• Board review of the investment strategy, including the key investment and taxation assumptions, at least annually that confirms the strategy is consistent with the SIPSP and the Authority's Beliefs.	The Board reviews the investment strategy annually to ensure it meets the Investment Objective and Investment Beliefs contained in the SIPSP.
Ensure compliance with Responsible Investment Policies, including the Board's policies on ethical investment	
• No investments that breach the Responsible Investment Policies and the Board's policies on ethical investment.	There were no investments that breached policies.
• Measured by internal and external review.	Excluded investments are updated quarterly with external research assistance, notified to external managers and published on the Authority's website.

Performance Measure	Performance Achievement
Collaborate with other CFIs to increase the extent to which the Authority meets the aspirational principles established by UNPRI consistent with its other investment responsibilities	
• Above average ratings on the implementation of the aspirational principles established by UNPRI, assessed by UNPRI review.	The Authority's ratings in the UNPRI survey improved each year since 2009 and ranked first or second quartile among respondents for all but one of the UNPRI principles.
Ensure the Authority complies with the GSF Act	
• Conclusions of in-house legal compliance programme developed with advice from the Authority's legal firm.	The Authority complied fully with the Act throughout the year.

Schemes Administration

Performance Measure	Performance Achievement
Accurately calculate and pay entitlements, and process contributions correctly and on time, and respond appropriately to stakeholders' inquiries	
• Performance is in line with the key performance indicators (**KPIs**) set out in the Management Agreement between the Authority and the scheme administrator. KPIs are: - 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. Performance against KPIs is measured through monthly reporting, with overall performance measured by monitoring the performance of the scheme administrator.	The scheme administrator, Datacom Employer Services Limited (**Datacom**), met the performance standards (set out in the Management Agreement between the Authority and Datacom) during the year. Detailed monthly reports are provided by Datacom on performance against KPIs. 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
• The business system is relevant and supportive of the requirements of the Schemes assessed by: - no major loss or corruption of data or functionality; - the ability to access required data from the current and new business system; and - the new business system being completed on budget by 30 June 2012.	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. Completion of construction of the new business system has been delayed and is currently scheduled for completion in 2013. Planning for transition from the old to the new business system has commenced.

Responding appropriately to stakeholders' inquiries and providing relevant information.	
• Timely responses to all requests from Treasury and the Government Actuary (and the Actuary to be appointed by the Authority) and meeting deadlines measured by: - no requests being received for missing or incomplete information; and - timeframes being met.	Data required by the Government Actuary and the Authority's Actuary for reporting to Treasury was sent within the required timescales, which enabled the Government Actuary and the Authority's Actuary to complete on time, the information required for the Crown Financial Statements as at 30 June, 30 September and 28 February. All information provided was complete. Two requests for additional information were received from the Authority's Actuary and responded to by Datacom.
• Regular updating of website information, information on Schemes and Investment, and sending annual Chairman's letter to members, sending member and employer updates. • Achieving consistently good satisfaction scores in the annual survey of members and employers and positive feedback from other stakeholders.	The Authority's website has been regularly updated during the year. An annual letter was sent by the Chairman to all GSF members, and two employer updates and two member updates were sent out. The Authority carries out an annual survey on a random sample of members (600) and employers (80). Satisfaction with decisions made by, and information provided by, the Authority to members remains high and reasonably stable (83% and 79% respectively). Similarly, satisfaction with services and information provided by the scheme administrator to members remains high and reasonably stable (87% and 85% respectively). Employer satisfaction with decisions made by the Authority and confidence in investment arrangements both fell significantly, with more employers being "unsure". The numbers, who were dissatisfied, or not at all confident, remains very low. The Authority will monitor this on an ongoing basis.
• Timely processing of appeals. On receipt of an appeal, complete papers are provided to the Appeals Board at least 14 days before each scheduled hearing. • The timely and efficient resolution of the appeals.	Employer satisfaction with information provided by the Authority and services provided by the scheme administrator remains high. In the year to 30 June 2012, 26 appeals were heard by the Appeals Board. All papers were provided to the Appeals Board at least 14 days before the scheduled hearing dates. There are no outstanding issues.
Overall expected cost (Schemes) $4.4 million.	Actual cost for the year ended 30 June 2012 was $4.2 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 ended 30 June 2012. 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 are set out on pages 26-27.

Keith B Taylor

Chairman
Government Superannuation Fund Authority Board

5 September 2012

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 2012:

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 $11,062 million (2011: $9,096 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

5 September 2012

GOVERNMENT SUPERANNUATION FUND
MEMBERSHIP COMMENTARY

Movement in contributors during the past five years:

Year ended 30 June	Total	Change	% Change Contributors
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)
2012*	**12,453**	**(980)**	**(7.30)**

Number of contributors, by scheme:

GSF Scheme	2012	% of Total	2011
General Scheme	11,824	94.95	12,685
Armed Forces	145	1.16	221
Police	379	3.04	408
Prisons Service	83	0.67	91
Judges and Solicitor-General	13	0.11	15
Parliamentary	9	0.07	13
Total contributors at end of year*	**12,453**	**100.00**	**13,433**

Movement in the number of contributors during the year:

	2012	2011
Contributors at beginning of year	13,433	14,587
Retirements	(888)	(1,079)
Withdrawals	(3)	(9)
Death before retirement	(14)	(7)
Cessation of employment before retirement	(64)	(41)
Transfer to other schemes	(12)	(18)
Reinstatement	1	-
Total contributors at end of year*	**12,453**	**13,433**

** There is one reinstated General Scheme contributor in the 2012 data who was not included in the 2011 data.*

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

Year ended 30 June	Total Annuitants	Change	% Change
2008	47,158	(79)	(0.17)
2009	46,963	(195)	(0.41)
2010	46,855	(108)	(0.23)
2011	46,839	(16)	(0.03)
2012	**46,638**	**(201)**	**(0.43)**

Movement in number of annuitants during the year:

	2012	2011
Annuitants at beginning of year	46,839	46,855
New retiring allowances	888	1,079
New allowances to spouses	742	823
Allowances deferred	198	74
Discontinued allowances	(2,029)	(1,992)
Total annuitants at end of year	**46,638**	**46,839**

There were 5,677 deferred pensions at 30 June 2012 (2011: 5,875).

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
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)
2012	**12,453**	**46,638**	**5,677**	**64,768**	**(1,379)**

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

	2012	%	2011	%
Contributors	12,453	21	13,433	22
Annuitants	46,638	79	46,839	78
	59,091	**100**	**60,272**	**100**

Granting a charge over contributions

In the year to 30 June 2012, 17 charges (2011: 16) 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 2012 have been prepared in accordance with Section 93 of the GSF Act.

The Authority is responsible for the preparation of the Financial Statements and the 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 2012, and the changes in net assets and the cash flows of the Fund, for the year ended 30 June 2012.

Keith B Taylor

Chairman
Government Superannuation Fund Authority Board

Simon R Tyler

Chief Executive

5 September 2012

GOVERNMENT SUPERANNUATION FUND
STATEMENT OF CHANGES IN NET ASSETS

For the year ended 30 June 2012

	Note	2012 $000 Actual	2012 $000 Forecast	2011 $000 Actual
Change in assets from:				
Investing activities				
Interest, dividends and other income	1	**88,403**	79,300	89,843
(Decrease)/increase in fair values of investment assets through profit or loss	2	**(63,226)**	214,194	329,977
		25,177	293,494	419,820
Operating activities				
Operating revenue	3			
Government		**21,633**	23,219	25,771
Other employers		**5,408**	5,805	6,850
		27,041	29,024	32,621
Operating expenses	3			
Funding for the Authority		**(27,041)**	(29,024)	(32,621)
Surplus before tax and membership activities		**25,177**	293,494	419,820
Income tax expense	4	**(41,936)**	(44,871)	(84,242)
(Deficit)/surplus after tax and before membership activities		**(16,759)**	248,623	335,578
Membership activities				
Contributions				
Government	5	**699,108**	684,472	662,613
Members		**49,931**	46,033	54,508
Other employers		**22,611**	13,094	23,086
		771,650	743,599	740,207
Benefits paid	6	**(897,060)**	(866,842)	(863,203)
Net benefits paid		**(125,410)**	(123,243)	(122,996)
Net (decrease)/increase in net assets		**(142,169)**	125,380	212,582
Opening net assets available to pay benefits		**3,159,158**	3,174,609	2,946,576
Net assets available to pay benefits		**3,016,989**	3,299,989	3,159,158

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 2012

	Note	2012 $000 Actual	2012 $000 Forecast	2011 $000 Actual
Current assets				
Cash and cash equivalents		**135,278**	170,645	161,686
Derivative assets		**93,498**	76,298	96,553
Trade and other receivables	7	**69,715**	102,654	112,192
Total current assets		**298,491**	349,597	370,431
Non current assets				
Investments				
Derivative assets		**17,136**	–	31,195
Global Fixed Interest		**689,899**	683,379	706,555
Equities - NZ		**266,072**	311,540	340,210
Equities - International		**1,175,435**	1,440,455	1,246,519
Global Property – NZ and International		**137,437**	167,495	150,398
Commodity Futures		**108,941**	140,695	104,425
Multi-Asset and Global Tactical Asset Allocation		**320,052**	374,706	320,352
Insurance-Linked assets		**210,722**	280,907	108,182
Other investments		**3,855**	2,406	8,252
Total investments		**2,929,549**	3,401,583	3,016,088
Work in progress – Business System	8	**6,904**	–	4,442
Total non current assets		**2,936,453**	3,401,583	3,020,530
Total assets		**3,234,944**	3,751,180	3,390,961

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 2012

	Note	2012 $000 Actual	2012 $000 Forecast	2011 $000 Actual
Less liabilities				
Current liabilities				
Trade and other payables	9	**158,805**	249,387	162,483
Income tax payable		**9,298**	2,987	27,530
Benefits payable		**5,249**	2,488	2,428
Derivative liabilities	13	**26,121**	196,329	7,124
Total current liabilities		**199,473**	451,191	199,565
Non current liabilities				
Derivative liabilities	13	**18,482**	–	32,238
Total non current liabilities		**18,482**	–	32,238
Total liabilities		**217,955**	451,191	231,803
Net assets available to pay benefits		**3,016,989**	3,299,989	3,159,158
Promised retirement benefits				
Gross liability for promised retirement benefits	12	**14,079,000**	12,237,000	12,255,000
Deficit		**11,062,011**	8,937,011	9,095,842
Net assets available to pay benefits		**3,016,989**	3,299,989	3,159,158

The Financial Statements were approved by the Authority Board on 5 September 2012.

Keith B Taylor

Chairman
Government Superannuation Fund Authority Board

A.K. Kerr

A K Kerr

Chair, Audit & Risk Review Committee
Government Superannuation Fund Authority Board

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

GOVERNMENT SUPERANNUATION FUND
STATEMENT OF CASH FLOWS

For the year ended 30 June 2012

	2012 $000 Actual	2012 $000 Forecast	2011 $000 Actual
Cash flows from operating activities			
Cash was provided from:			
Government contributions - members	**629,944**	684,255	671,263
Government contributions - expenses	**22,557**	24,303	24,162
Members' contributions	**50,167**	46,885	55,508
Other employers' contributions - members	**26,904**	18,989	30,031
Interest and dividends	**89,078**	78,239	92,180
Cash was disbursed to:			
Benefit payments	**(851,508)**	(869,727)	(864,187)
Income tax	**(59,576)**	(44,197)	(47,100)
Operating expenses	**(28,656)**	(29,564)	(32,968)
Net cash flows from operating activities	**(121,090)**	(90,817)	(71,111)
Cash flows from investing activities			
Cash was provided from:			
Maturities and sales of investment assets	**5,005,172**	4,237,558	5,796,865
Cash was disbursed to:			
Purchase of investments	**(4,907,585)**	(4,167,743)	(5,689,602)
Business System	**(2,905)**	–	(2,859)
Net cash flows from investing activities	**94,682**	69,815	104,404
Net (decrease)/increase in cash held	**(26,408)**	(21,002)	33,293
Opening cash and cash equivalents	**161,686**	191,647	128,393
Closing cash and cash equivalents	**135,278**	170,645	161,686

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 CHANGES IN NET ASSETS TO NET OPERATING CASH FLOWS

For the year ended 30 June 2012

	2012 $000	2011 $000
Net (decrease)/increase in net assets	**(142,169)**	212,582
Movements in working capital items		
Receivables and prepayments	**25,576**	(895)
Investment receivables	**16,901**	(15,009)
Income tax receivable	**–**	10,080
Government contributions received in advance	**(51,907)**	8,650
Investment payables	**49,136**	(22,247)
Trade and other payables	**(907)**	766
Income tax payable	**(18,232)**	27,530
Benefits payable	**2,821**	(1,401)
	23,388	7,474
Changes in items classified as investing activities		
Accrued interest portion of bonds	**59**	1,994
Accrued payments for Business System	**443**	(440)
Change in fair value of investment assets	**63,226**	(329,977)
Investment settlement receivables	**(16,901)**	15,009
Investment settlement payables	**(49,136)**	22,247
	(2,309)	(291,167)
Net cash out flows from operating activities	**(121,090)**	(71,111)

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 2012

	2012 $000	2011 $000
Income from operations*		
Government contributions	**15,963**	14,750
Members' contributions	**–**	–
	15,963	14,750
Expenditure*		
Benefits paid:		
Retirements	**12,939**	12,011
Allowances capitalised	**1,008**	808
Spouses and children	**2,016**	1,931
	15,963	14,750
Net changes in net assets	**–**	–

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

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

GOVERNMENT SUPERANNUATION FUND
PARLIAMENTARY SUPERANNUATION

STATEMENT OF CHANGES IN NET ASSETS

For the year ended 30 June 2012

	2012 $000	2011 $000
Income from operations*		
Government contributions	**4,867**	3,777
Members' contributions	**116**	154
	4,983	3,931
Expenditure*		
Benefits paid:		
Retirements	**3,762**	3,378
Allowances capitalised	**625**	–
Spouses and children	**596**	553
	4,983	3,931
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 incorporated the requirements of 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. Estimates with a significant risk of material adjustment in the next year are discussed in Notes 11, 12 and 13.

(iii) Measurement base

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

(iv) Presentation and functional currency

The Fund is located within New Zealand, and the performance of the Fund is measured and reported in New Zealand Dollars (**NZD**), rounded to thousands (**$000**) except as indicated. 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 adopted 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.

Benefits

Benefits are recognised in the Statement of Changes in Net Assets when they become payable.

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 retranslated 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 other than benefits, 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 (**PIE**). 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.

Taxable profit also requires that the Fair Dividend Rate (**FDR**) calculation method applying to investments in overseas equities, which deems taxable income to arise regardless of the increase or decline in value of the investments, be applied. The Fund's 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 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 funds 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 evidence 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 may 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.

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 Fund's 2011 Statement of Intent. 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 Fund expects to adopt the standards and interpretations in the period in which they become mandatory. The Fund anticipates that the standards and interpretations will have no material impact on the historical statements of the Fund in the period of initial application.

(viii) Consistency in presentation

The same presentation and methods of computation, except for the recognition of benefits, 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 2011.

(ix) Changes in accounting policies

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

GOVERNMENT SUPERANNUATION FUND
NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

1. Interest, dividends and other income

	2012 $000	2011 $000
Global Fixed Interest	**27,654**	24,593
Short term and call deposits	**991**	98
Equities – NZ	**13,961**	11,504
Equities – International	**22,969**	23,448
Global Property – International listed securities	**4,532**	4,183
Global Property – International unlisted securities	**–**	965
Multi-Asset and Global Tactical Asset Allocation	**10,792**	11,682
Other income	**7,504**	13,370
Total interest, dividends, and other income	**88,403**	89,843

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

	2012 $000	2011 $000
Global Fixed Interest	**39,109**	22,822
Short term investments	**1,576**	1,101
Equities – NZ	**(21,606)**	43,429
Equities – International	**(83,642)**	178,624
Global Property – International listed securities	**2,214**	40,044
Global Property – International unlisted securities	**183**	4,417
Commodity Futures	**(12,655)**	38,454
Multi-Asset and Global Tactical Asset Allocation	**(171)**	4,638
Insurance-Linked Assets	**11,766**	(3,552)
Total changes in fair values of investment assets through profit or loss	**(63,226)**	329,977

** 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 80% (2011:79%) of the Authority's administrative expenses reimbursed by the Fund. Other employers contributed the balance of 20% (2011: 21%).

4. Income tax expense

	2012 $000	2011 $000
Reconciliation to statement of changes in net assets*		
Surplus before tax and membership activities	**25,177**	419,820
Add imputation credits	**3,534**	2,616
Net taxable income	**28,711**	422,436
Tax expense at 28% (2011: 30%)	**8,039**	126,731
Tax effect:		
Non deductible loss/(gain)	**16,733**	(59,488)
FDR income	**23,555**	26,208
Prior period adjustment	**(100)**	(3,699)
Imputation credits	**(3,429)**	(2,610)
Withholding tax credits	**(2,862)**	(2,900)
Income tax expense	**41,936**	84,242
Income tax expense comprises:		
Current tax	**42,036**	87,941
Prior period adjustment	**(100)**	(3,699)
Income tax expense	**41,936**	84,242

** At balance date there is no deferred taxation*

5. Government contributions

	2012 $000	2011 $000
Government service superannuation contributions	**678,278**	644,086
Judges and Solicitor-General superannuation contributions	**15,963**	14,750
Parliamentary superannuation contributions	**4,867**	3,777
Total Government contributions	**699,108**	662,613

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 (if applicable), 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.

5. Government contributions *(continued)*

Member Contribution %	GSF Scheme	Employer Contribution for year ended 30 June 2012 %
	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 as part of the Statutory Actuarial Valuation of the Fund as at 30 June 2011. As a result some increases to employer contribution rates were implemented with effect from 1 July 2012 (see Note 11).

6. Benefits and refunds paid

	2012 $000	2011 $000
Benefits:		
Pension entitlements	**725,068**	667,900
Allowances capitalised	**47,561**	81,608
Spouses and children	**114,356**	106,097
Refunds:		
Transfers to other schemes	**3,599**	2,199
Cessation of membership	**5,997**	4,646
Death	**479**	753
Total benefits and refunds paid	**897,060**	863,203

7. Trade and other receivables

	2012 $000	2011 $000
Government contributions - expenses	**6,019**	6,943
Government contributions - benefits	**17,257**	–
Members' contributions	**900**	544
Other employers' contributions	**2,078**	720
Interest and dividends	**3,598**	3,818
Investment settlements receivable	**38,072**	54,973
Prepaid benefits	**–**	43,009
Past service contributions	**1,554**	1,982
Pension entitlements	**237**	203
Total trade and other receivables	**69,715**	112,192

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 currently developing a new business system. As at 30 June 2012 $6.904 million (2011: $4.442 million) of capital costs for the new system were allocated as Work in Progress on the Statement of Net Assets. Included within this capital amount are fees of $28k paid to Deloitte for assurance related costs). It is expected the Authority will commence amortising the capital costs during the financial year ending 30 June 2014.

9. Trade and other payables

	2012 $000	2011 $000
Members' contributions	**240**	280
Government Superannuation Fund Authority	**2,864**	3,974
Other employers' contributions – expenses	**446**	203
Government contributions in advance - benefits	**–**	51,907
Investment settlements payable	**155,255**	106,119
Total trade and other payables	**158,805**	162,483

10. Actuarial valuations of the Fund

Statutory actuarial valuation

Section 94 of the GSF Act requires that the Authority must obtain a report from an actuary that examines the financial position of the Fund as at dates determined by the Minister of Finance, being dates that are no more than 3 years apart. On 22 August 1999, the Minister directed annual valuations 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 2011, and the report, dated September 2011, was tabled in Parliament on 14 October 2011. More information on the results of the valuation is provided in Note 11.

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

The Authority's 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 2012 – refer Note 12.

11. Statutory actuarial valuation as at 30 June 2011

Details of the statutory actuarial valuation, as at 30 June 2011 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	6.25% 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 2011 statutory valuation are *:

	2011 $ million	2010 $ million
Past service liabilities		
Armed Forces contributors	34	104
General Scheme contributors (excluding Islands)	2,511	2,623
General Scheme contributors (Islands only)	38	39
Police contributors	219	236
Prisons Service contributors	23	25
Judges and Solicitor-General	26	28
Parliamentary	10	9
Pensioners	8,736	8,607
Deferred pensioners	658	672
Total past service liabilities	12,255	12,344
Less value of Fund assets	3,159	2,947
Unfunded past service liability	**9,096**	9,398

** 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.

Scheme/Group	As a percentage of past service liability	2011 $ million	2010 $ million
Vested Benefits			
Contributors:			
Armed Forces	27%	9	29
General Scheme-excl Islands	125%	3,141	3,314
General Scheme-Islands	109%	42	42
Police	93%	204	221
Prisons Service	102%	24	25
Judges and Solicitor-General	128%	34	38
Parliamentary	129%	12	12
Total Contributors	**121%**	**3,465**	**3,681**
Pensioners:			
Pensioners	100%	8,736	8,607
Deferred pensioners	100%	658	673
Total Pensioners	**100%**	**9,394**	**9,280**
Grand total		**12,859**	12,961
Less net assets		3,159	2,947
Shortfall		**9,700**	10,014

** 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 2011. 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 2012, the Government pays 78.9% of each benefit paid (2011: 80%).

Employer contribution rates, including employer superannuation contribution tax at 33% (if applicable), are as follows:

- For funding employers (employers of those contributors who are paid from money that is not public money) the employer contribution rate has been determined under a notional funding approach;
- For employers that are the Public Services of the Cook Islands, Niue or Tokelau, the employer contribution rate is certified as 8.0% of contributor salaries; and
- For employers other than the Public Services of the Cook Islands, Niue or Tokelau, the employer contribution rate 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 2011 given in the following table:

Age range	Males	Females
Up to age 53	10.9%	11.3%
Age 54 to age 58	12.9%	13.6%
Age 59 to age 63	14.2%	15.0%
Age 64 to age 68	15.3%	16.1%
Age 69 and over	0.0%	0.0%

- For non funding employers (employers of those contributors who are paid from money that is public money) the employer contribution rate has been determined under a notional funding approach. The employer contribution rates recommended in the statutory actuarial valuation report as at 30 June 2009 and subsequently maintained for the financial years commencing 1 July 2010 and 1 July 2011 are as follows:
  - 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 as at 30 June 2012

The Authority's Actuary, Emma Brodie FNZSA, FIAA, has valued the promised retirement benefits in accordance with NZ IAS-26, as at 30 June 2012, for the purposes of the Fund's Financial Statements.

Significant assumptions, used in the valuation, were:

Discount rate	5.50% 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	**2012 $ million**	**2011 $ million**
Opening gross promised retirement/ past service benefit liability	**12,255**	12,344
Movements in liability		
Expected changes	**(68)**	34
Experience losses/(gains)	**30**	(174)
Assumption changes:		
Change in discount rate and Consumer Price Index 1,060	**(274)**	
Change in demographic assumption (including mortality improvement)	**802**	325
Closing gross promised retirement/ past service benefit liability	**14,079**	12,255

Vested benefits – 30 June 2012

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 2012, are shown in the following table, where contributors include the inactive members.

Vested benefits	**2012 $ million**	**2011 $ million**
Contributors	**3,776**	3,465
Pensioners:		
Current pensioners	**9,872**	8,736
Deferred pensioners	**752**	658
Total pensioners	**10,624**	9,394
Total vested benefits	**14,400**	12,859
Less net assets	**(3,017)**	(3,159)
Shortfall	**11,383**	9,700

** 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. 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, or at amortised cost, as detailed in the Statement of Accounting Policies, and other financial assets and liabilities at amortised cost.

	2012 $000	**2011 $000**
Financial investment assets at fair value	**3,023,047**	3,112,641
Financial investment liabilities at fair value	**44,603**	39,362
Financial assets at amortised cost	**204,993**	273,878
Financial liabilities at amortised cost	**164,054**	164,911

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).

2012	Level 1 $000	Level 2 $000	Level 3 $000	Total $000
Financial assets at fair value through profit or loss				
Derivative financial assets	**–**	**110,634**	**–**	**110,634**
Investments in cash funds – New Zealand (NZ)	**3,855**	**–**	**–**	**3,855**
Investments in Fixed interest - International	**657,320**	**32,579**	**–**	**689,899**
Equities – NZ	**246,709**	**19,363**	**–**	**266,072**
Equities – International	**885,819**	**289,616**	**–**	**1,175,435**
Global Property	**128,365**	**9,072**	**–**	**137,437**
Commodity Futures	**–**	**108,941**	**–**	**108,941**
Multi-asset and Global Tactical Asset Allocation	**–**	**320,052**	**–**	**320,052**
Insurance-Linked Assets	**–**	**210,722**	**–**	**210,722**
	1,922,068	**1,100,979**	**–**	**3,023,047**
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities	**–**	**44,603**	**–**	**44,603**
	–	**44,603**	**–**	**44,603**

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
Investments in cash funds – NZ	8,252	–	–	8,252
Investments in Fixed interest - International	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

f) **Financial risk management objectives**

The Fund is exposed to a variety of financial risks as a result of its activities. These risks include credit risk, liquidity risk and market risk (including currency risk, interest rate risk and price 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 and monitored 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 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- (with all individual instruments at a minimum of investment grade BBB-), 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 2012, the Fund does not have any single underlying investment exceeding 5% of the net assets (2011: 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 outward cash flows. The Authority manages liquidity risk by maintaining cash, cash equivalents and short term investments, and through the continuous monitoring of forecast and actual cash flows and by seeking to match the maturity profiles of financial assets and liabilities. The Authority's overall strategy to manage liquidity risk remains unchanged from 2010.

The following tables summarise the maturity profiles of the Fund's financial liabilities based on contractual maturities. 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
2012				
Unsettled purchases	**155,255**	**–**	**–**	**155,255**
Derivative liabilities	**26,121**	**10,170**	**8,312**	**44,603**
Other financial liabilities	**8,799**	**–**	**–**	**8,799**
Total	**190,175**	**10,170**	**8,312**	**208,657**
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

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: Interest rate instruments

	Weighted average interest rate %	Less than 12 months $000	1-5 years $000	5+ years $000	Total $000
2012					
Cash and cash equivalents	0.97	**135,278**	**–**	**–**	**135,278**
Fixed interest securities	3.37	**88,397**	**195,369**	**406,133**	**689,899**
Receivables for securities	n/a	**38,072**	**–**	**–**	**38,072**
Total		**261,747**	**195,369**	**406,133**	**863,249**
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

Interest rate sensitivity

The sensitivity analysis below has been determined based on the Fund's exposure to interest rates at the reporting date. The table illustrates the post tax effect of an increase in interest rates of 1%. For a decrease in interest rates there would be an equal and opposite impact on the surplus after tax, and before membership activities.

	Changes in variable	Effect on surplus/(deficit) after-tax and before membership activities 2012 ($000)	2011 ($000)
Floating interest rate risk	+1%	**1,136**	1,229
Fixed interest rate risk	+1%	**(4,772)**	(4,857)
Total interest rate risk		**3,636**	3,628

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 (2011: 20%). The Authority adjusts the Fund's foreign currency exposure between 0 and 40% 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 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. The benchmark foreign currency hedge ratios for the Fund's asset classes are set out below:

Foreign currency risk management

Asset Class	**Before-tax (After-tax) Benchmark Hedge Ratio**	**Range (Before-tax)**
International Equities	97% (70%)	87% to 97%
Global Property	143% (100%)	138% to 148%
Global Fixed Interest	100% (100%)	90% to 110%
Commodity Futures	143% (100%)	138% to 148%
Multi Asset Class	0%	0%
Absolute Return*	143% (100%)	138% to 148%

* *Absolute return comprises 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 $774 million before tax (2011: $674 million). The Fund's foreign exchange exposure, before taking into account hedging was $2,662 million (2011: $2,774 million).

Foreign currency sensitivity

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

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

The following table details the Fund's sensitivity to a 5 per cent increase in the NZD on the unhedged exposure to foreign currencies.

	Changes in NZD	**Effect on surplus/(deficit) after-tax and before membership activities** 2012 $000	2011 $000
Exchange rate risk	**+ 5%**	**27,870**	23,584

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 2012 $000	2011 $000
Market price risk	+ 5%	**55,259**	56,385

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 2012, the Fund paid the Authority $27,041,000 (2011: $32,621,000) 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 2012 $2,864,000 was payable to the Authority for expenses incurred (2011: $3,974,000).

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

15. Actual versus forecasts

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

Funding for the Authority for operating expenses was below that forecast. This was caused by lower manager fees which were the result of lower than forecast asset values upon which manager fees are based.

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 2012 capital commitments were in place for the building of a new Business System and to a New Zealand Equity Manager and a Global Property Investment Manager. These are summarised as follows:

	2012 $000	2011 $000
Non-cancellable contractual commitments		
Less than one year	**24,813**	33,341
Between one and two years	**24,134**	31,847
Total non-cancellable contractual commitments	**48,947**	65,188

There are no contingent assets or liabilities (2011: Nil).

17. Subsequent events

There have been no material events after balance date that require adjustments to, or disclosure in, the Financial Statements (2011: Nil).

AUDIT REPORT

INDEPENDENT AUDITOR'S REPORT

TO THE READERS OF THE GOVERNMENT SUPERANNUATION FUND'S FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2012

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 57, that comprise the statement of net assets as at 30 June 2012, the statement of changes in net assets and statement of cash flows for the year ended on that date and the notes to the financial statements that include accounting policies and other explanatory information.

Opinion

In our opinion the financial statements of the Fund on pages 31 to 57:

- comply with generally accepted accounting practice in New Zealand; and
- fairly reflect the Fund's:
  - financial position as at 30 June 2012; and
  - financial performance and cash flows for the year ended on that date.

Our audit was completed on 5 September 2012. 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 preparation of the Fund's financial statements 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 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
- fairly reflect 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 and assurance related services, we have no relationship with or interests in the Fund.

Ian C Marshall

Deloitte

On behalf of the Auditor-General

Wellington, New Zealand

GOVERNMENT SUPERANNUATION FUND AUTHORITY
STATEMENT OF RESPONSIBILITY

The Financial Statements of the Authority, for the year ended 30 June 2012, 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 18-23, and the attached Financial Statements for the financial year fairly reflect the financial position, as at 30 June 2012, and the operations and cashflows of the Authority for the year ended 30 June 2012.

Keith B Taylor

Chairman
Government Superannuation Fund Authority Board

A.K. Kerr

A K Kerr

Chair
Audit & Risk Review Committee
Government Superannuation Fund Authority Board

5 September 2012

GOVERNMENT SUPERANNUATION FUND AUTHORITY
STATEMENT OF COMPREHENSIVE INCOME

For the year ended 30 June 2012

	Note	2012 $000 Actual	2012 $000 Forecast	2011 $000 Actual
Revenue				
Interest received		**5**	8	7
Other revenue		**20**	13	20
Transfer from the Government Superannuation Fund	1	**27,041**	29,024	32,621
Total revenue		**27,066**	29,045	32,648
Expenses				
Scheme administration		**2,759**	3,167	2,706
Investment management and custody	2	**20,405**	21,850	26,428
Operating	3	**3,902**	4,028	3,514
Total expenses		**27,066**	29,045	32,648
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 2012

	Note	2012 $000 Actual	2012 $000 Forecast	2011 $000 Actual
Public equity				
General fund		**–**	–	–
Total public equity		**–**	–	–
Represented by:				
Current assets				
Cash and cash equivalents		**344**	150	184
Trade and other receivables	4	**3,016**	2,320	4,066
Total current assets		**3,360**	2,470	4,250
Total assets		**3,360**	2,470	4,250
Current liabilities				
Trade and other payables	5	**3,360**	2,470	4,250
Total current liabilities		**3,360**	2,470	4,250
Net assets		**–**	–	–

The Financial Statements were approved by the Government Superannuation Fund Authority Board on 5 September 2012.

Keith B Taylor

Chairman
Government Superannuation Fund Authority Board

A K Kerr

Chair
Audit & Risk Review Committee
Government Superannuation Fund Authority Board

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

GOVERNMENT SUPERANNUATION FUND AUTHORITY

STATEMENT OF CASH FLOWS

For the year ended 30 June 2012

	Note	2012 $000 Actual	2012 $000 Forecast	2011 $000 Actual
Cash flows from operating activities				
Cash was provided from:				
Government Superannuation Fund	1	**28,154**	29,564	31,737
Interest		**5**	8	7
Other		**26**	13	20
		28,185	29,585	31,764
Cash was disbursed to:				
Total expenses		**(28,025)**	(29,545)	(31,795)
Net cash flows from operating activities		**160**	40	(31)
Net increase/(decrease) in cash held		**160**	40	(31)
Opening cash and cash equivalents		**184**	110	215
Closing cash and cash equivalents		**344**	150	184

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

	2012 $000 Actual	2012 $000 Forecast	2011 $000 Actual
Net operating result	–	–	–
Movements in working capital items:			
Trade and other receivables	**1,050**	264	(793)
Trade and other payables	**(890)**	(224)	762
Net cash flows from operating activities	**160**	40	(31)

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 MOVEMENTS IN PUBLIC EQUITY

For the year ended 30 June 2012

	2012 $000 Actual	2012 $000 Forecast	2011 $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 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 also 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 international fixed interest for management fees in currencies other than NZD. Transactions in overseas currencies are recorded in NZD at the rates of exchange prevailing on the dates of the transactions. Due to the nature of this payment there are no currency gains or losses.

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

As the Authority manages superannuation schemes, its supplies are principally exempt for Goods and Services Tax (**GST**) purposes. GST is however payable on certain overseas fees that would be subject to GST if received in New Zealand. GST on these items is included within operating expenditure.

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 Statement of Intent for the year commencing 1 July 2011. 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) Changes in accounting policies

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

GOVERNMENT SUPERANNUATION FUND AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

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 80% (2011: 79%) of the Authority's administrative expenses, including investment management and custody expenses, reimbursed by the Fund. Other employers contributed the balance of 20% (2011: 21%).

2. Investment management and custody expenses

	2012 $000	2011 $000
Investment management expenses	**18,672**	24,738
Custody expenses	**1,733**	1,690
Total investment management and custody expenses	**20,405**	26,428

3. Operating expenses

	2012 $000	2011 $000
Audit	**181**	175
Board fees and expenses	**202**	197
Other expenses	**1,368**	1,100
Management fees –Annuitas	**2,151**	2,042
Total operating expenses	**3,902**	3,514

4. Trade and other receivables

	2012 $000	2011 $000
Annuitas	**63**	–
Government Superannuation Fund	**2,864**	3,974
Other receivables and prepayments	**89**	92
Total trade and other receivables	**3,016**	4,066

5. Trade and other payables

	2012 $000	2011 $000
Investment management	**2,721**	3,234
Professional services	**571**	997
Other creditors	**68**	19
Total trade and other payables	**3,360**	4,250

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 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**) 1,417,215 (2011: USD1,793,388) and Australian dollars (**AUD**) 26,176 (2011: AUD 27,555) 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 2011.

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) (2011: 13 (including 3 part time)). Total remuneration was $2,407,287 (2011: $2,337,947) and the Authority reimbursed $1,588,809 (2011: $1,566,424), or 66% (2011: 67%) of the total.

8. Board fees

Board members were paid the following fees during the year:

	2012 $	2011 $
Chairman		
Keith Taylor (Chairman effective 1 August 2011)	44,467	23,200
Tim McGuinness (retired 31 May 2011)	–	42,533
Deputy Chairman		
David May (retired 31 May 2012)	28,033	30,450
Members		
Steve Napier	23,200	23,200
Mark Verbiest (retired 31 May 2012)	21,267	23,200
Toni Kerr	23,200	23,200
Cecilia Tarrant (appointed 25 August 2011)	19,333	–

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 $11,868 in 2012 (2011: $8,375).

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 $27,025 (2011: $19,550).

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 Investing Policies. Craig Ansley is a member of the Guardians Board.

The Authority has appointed Board member, Keith Taylor as a director 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 $2,151,143 (2011: $2,042,000). The amount owed by Annuitas to the Authority at year end was $62,857 (2011: owed to Annuitas $6,000).

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.

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.

11. Contingent assets and liabilities

There are no contingent assets or liabilities at 30 June 2012 (2011: 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:

	2012 $000	2011 $000
Non-cancellable contractual commitments		
Less than one year	**5,128**	5,134
Between one and two years	**5,184**	4,600
Between two and five years	**15,399**	6,419
Greater than five years	**7,462**	854
Total non-cancellable contractual commitments	**33,173**	17,007

13. Subsequent events

There have been no material events after balance date that require adjustments to, or disclosure in, the Financial Statements (2011: Nil).

Deloitte.

AUDIT REPORT

INDEPENDENT AUDITOR'S REPORT

TO THE READERS OF GOVERNMENT SUPERANNUATION FUND AUTHORITY'S FINANCIAL STATEMENTS AND NON-FINANCIAL PERFORMANCE INFORMATION FOR THE YEAR ENDED 30 JUNE 2012

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 non-financial performance information of the Authority on her behalf.

We have audited:

- the financial statements of the Authority on pages 62 to 72, that comprise the statement of financial position as at 30 June 2012, the statement of comprehensive income, statement of movements in public equity and statement of cash flows for the year ended on that date and notes to the financial statements that include accounting policies and other explanatory information; and
- the non-financial performance information of the Authority on pages 18 to 23 that comprises the statement of service performance, and which includes outcomes.

Opinion

In our opinion:

- the financial statements of the Authority on pages 62 to 72:
  - comply with generally accepted accounting practice in New Zealand; and
  - fairly reflect the Authority's:
    - financial position as at 30 June 2012; and
    - financial performance and cash flows for the year ended on that date.
- the non-financial performance information of the Authority on pages 18 to 23:
  - complies with generally accepted accounting practice in New Zealand; and
  - fairly reflects the Authority's service performance and outcomes for the year ended 30 June 2012, including for each class of outputs:
    - its service performance compared with forecasts in the statement of forecast service performance at the start of the financial year; and
    - its 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 5 September. 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 non-financial performance information 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 non-financial performance information. 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 non-financial performance information. The procedures selected depend on our judgement, including our assessment of risks of material misstatement of the financial statements and non-financial performance information, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the preparation of the Authority's financial statements and non-financial performance information 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 appropriateness of the reported non-financial performance information within the Authority's framework for reporting performance;
- the adequacy of all disclosures in the financial statements and non-financial performance information; and
- the overall presentation of the financial statements and non-financial performance information.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements and non-financial performance information. 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 non-financial performance information 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 and outcomes.

The Board is also responsible for such internal control as is determined necessary to enable the preparation of financial statements and non-financial performance information 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 non-financial performance information 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
Deloitte

On behalf of the Auditor-General
Wellington, New Zealand

GOVERNMENT SUPERANNUATION FUND AUTHORITY
DIRECTORY

AS AT 5 SEPTEMBER 2012

Government Superannuation Fund Authority Board

Keith Taylor (Chairman)
Craig Ansley
Toni Kerr
Steve Napier
Cecilia Tarrant

Executive Office

Level 12, The Todd Building
95 Customhouse Quay
PO Box 3390
Wellington 6140

Scheme Administrator

Datacom Employer Services Limited

Custodian

JP Morgan Chase Bank NA

Investment Adviser

Russell Investment Group Limited

Tax Adviser

PricewaterhouseCoopers

Actuary

Emma Brodie
Russell Employee Benefits Pty Ltd

Auditor

Ian C Marshall
Deloitte
on behalf of the Auditor-General

Bankers

Bank of New Zealand (Authority)

National Bank of New Zealand Limited (Fund)

Solicitors

DLA Phillips Fox

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, LLC

Credit Suisse Securities (Europe) Limited (from 1 January 2012)

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 Management Limited
Harbour Asset Management Limited
One Path (NZ) Limited

Global Property

AMP Capital Investors New Zealand Limited
Willis Bond and Company Management Limited

Foreign Exchange Hedging

State Street Global Advisors, Australia, Limited
ANZ National Bank Limited

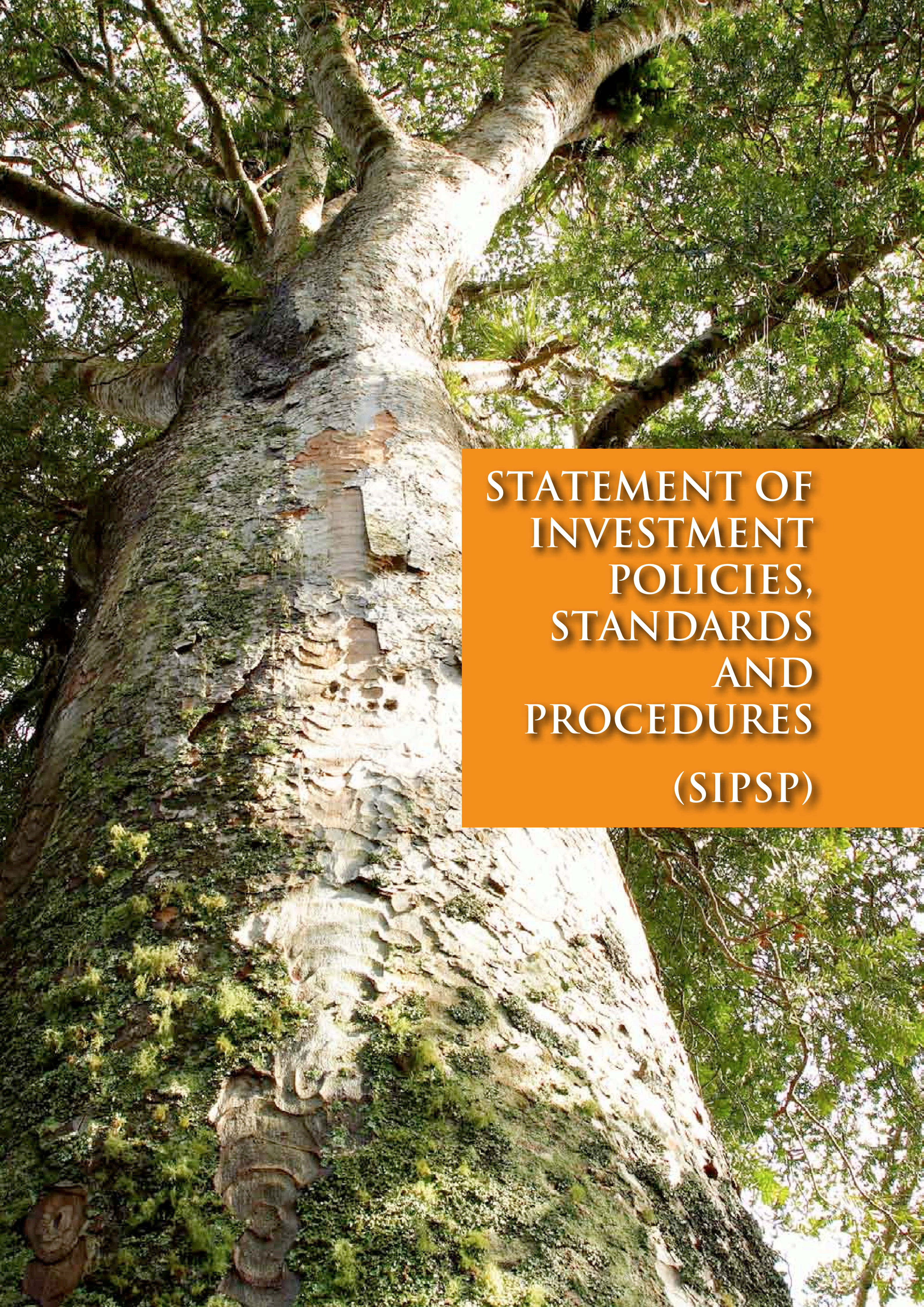
GOVERNMENT SUPERANNUATION FUND AUTHORITY DIRECTORY (CONTINUED)

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

Datacom Employer Services Ltd
GSF Schemes Administration
PO Box 3614
Wellington 6140

or

Chief Executive
Government Superannuation Fund Authority
PO Box 3390
Wellington 6140



STATEMENT OF INVESTMENT POLICIES, STANDARDS AND PROCEDURES

(SIPSP)

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 08 August 2012. 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 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 are 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 about the sources of investment risk and return in order to communicate its values and 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. Risk premia are higher for assets or factors that fare poorly in bad times. While historical returns can provide a guide to the range and likelihood of future potential returns, investment decisions should be based on forward looking expectations of return and risk having regard to all relevant information.

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 drivers. A portfolio that is well-diversified across asset classes, style factors and risk factors will deliver more consistent and, therefore, higher compound returns over time than a less diversified portfolio with the same average expected return. Within an asset class, this can be achieved by investing across a range of industries, countries and entities. Diversification should not ignore valuation, however, especially if many assets are over-priced in good times. Concentration of risk, the opposite of diversification, is only worthwhile where there is the strong likelihood of higher incremental returns.

c) **Investors should take into account their relative strengths and weaknesses.**

Having a long investment horizon means the Fund can afford to own some illiquid assets where the expected return premium is attractive, sell insurance against financial and natural catastrophes, engage in contrarian asset allocation and market timing, and achieved better alignment when contracting with delegated managers.

Being a moderate sized fund means the Fund can exploit opportunities in smaller markets without market impact or capacity constraints and be less tied to market cap weighted strategies.

d) **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.

e) **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.

f) **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' and 'slumps' 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. Moderate shifts in exposure to markets, factors or strategies are appropriate, with particular regard to valuations.

g) **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 holding illiquid assets and from deviations from the Reference Portfolio and unduly constraining investment managers' ability to add value. Illiquid assets should be acquired only when the expected return is sufficient to compensate for their inflexibility, ie when there is an opportunity to buy from weak sellers initially and/or to add value during the holding period and/or to sell to eager buyers at some time in the future.

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.

h) **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.

i) **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

The Authority's investment objective is to 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

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

c) Investment Performance Measure (IPM)

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

5.2 Standards

a) Reference Portfolio

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

The current Reference Portfolio comprises:

Table 1: Reference Portfolio and Benchmarks

Asset Class	Weight (%)	Benchmark
International equities	55	MSCI All Country World Index
New Zealand equities	10	NZX50 Gross Increase 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	50.5
New Zealand equities	9.3
Property	0.0
Fixed interest	20.0
Commodities	4.2
Global tactical asset allocation	3.0
Multi-asset class	7.0
Insurance-linked assets	6.0
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 (for example, the multi-asset class) or components of asset classes (e.g. 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	45.5 to 55.5	48.5 to 52.5
New Zealand equities	7.3 to 11.3	8.3 to 10.3
Property	0.0 to 1.0	0.0 to 1.0
Fixed Interest	16.0 to 24.0	18.0 to 22.0
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 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:

   1) The Fund's actual portfolio relative to the Reference Portfolio;
   2) the Fund's Target Portfolio relative to the Reference Portfolio; and
   3) 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 section Table 3, page 94.

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. Investments that are not regularly traded at a public exchange are valued according to the policies, standards and procedures in this section 12 at least annually.

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 using generally accepted industry standards 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.

The Authority may seek independent advice from a suitably qualified professional valuer to verify or confirm the reasonableness of any valuation provided by an investment manager.

12.2 Standards

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 generally accepted industry standards. 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.

GOVERNMENT
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Te Pūtea Penihana Kāwanatanga