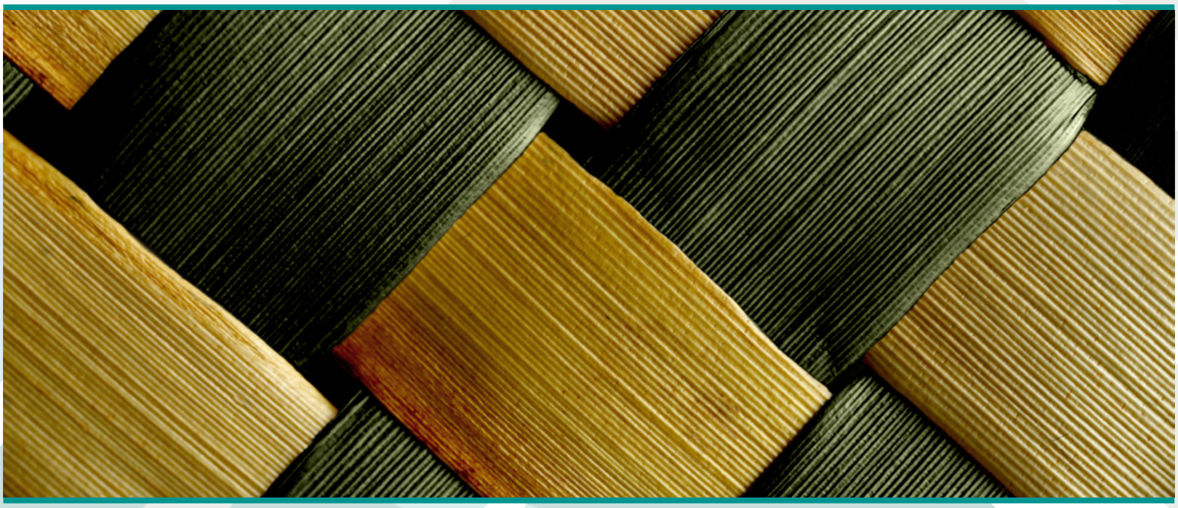
Reports and Financial Statements

for the year ended 30 June 2016



GOVERNMENT SUPERANNUATION FUND AUTHORITY

GOVERNMENT SUPERANNUATION FUND
Te Pūtea Penihana Kāwanatanga

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

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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 2016.

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 2005.

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 2016 Year

- Below average return on investments for the year of 2.1% before tax and after investment fees. This was 0.2% behind the Reference Portfolio and well below the 8.0% return on New Zealand (**NZ**) Government Stock.
- Over the last 3 years the Fund investment return averaged 9.8% per annum (pa), 0.3% pa ahead of the Reference Portfolio and 3.5% pa above NZ Government Stock.
- Over the last 10 years, which spans the global financial crisis, the Fund investment return was 5.9% pa, the same as the Reference Portfolio and behind 6.5% pa for NZ Government Stock.
- During the fiscal year $871 million was paid out to members of the GSF Schemes.
- Progress on the new Business System for the administration of the GSF Schemes has been slower than planned. However significant progress has been made in 2015/16 and the new Business System is on track to be functional in late 2016 . The Authority is fully committed to have a fit for purpose system into the future which will enable the GSF Schemes to continue to operate efficiently and accurately.

Investment Activity

The Fund's objective is to maximise the excess return above NZ Government Stock subject to limiting the chance of under-performing Government Stock by more than 10% over a rolling ten year period to 25%. The Fund switched to a before NZ tax investment objective in 2015.

The Fund relies largely on equities to provide the excess return over NZ Government Stock returns but is always looking for more efficient ways to capture alternative return sources. 90% of the Fund is invested internationally. Almost 20% is invested in alternative asset classes such as insurance-linked assets, private equity and real estate funds and skill-based trading strategies. Insurance-based investments have provided worthwhile diversification of fixed interest investments. Considerable attention is paid to the cost of active management relative to the extra risk and expected enhancement.

During the year the Board approved an investment in a fund that provides exposure to a basket of risk factors that offer a distinct set of return sources from various asset classes. Each return source is volatile, like the return from equities, but they are uncorrelated with equities returns and with each other, providing a more robust combined return stream. The investment was funded partly from global equities and partly from exiting a global tactical asset allocation strategy.

As noted last year, the Fund's private equity investments are now well into their 8 - 10 year lifecycles and have started to produce very good returns both in NZ and offshore. The Board is investigating ways to increase its commitment to global private equity where we believe additional returns are available to compensate for the greater risk and reduced liquidity.

Collaboration with other Crown Financial Institutions (**CFIs**) continued, notably with the Guardians of New Zealand Superannuation (**NZ Super**). As well as discussing common investment issues, the Authority shares a global engagement service company to co-ordinate engagements with global companies that have serious issues around environment, human rights and corruption. The Authority and other CFIs are members of the NZ Corporate Governance Forum to promote good governance among listed NZ companies.

Schemes

Datacom Employer Services Limited continues as the scheme administrator.

Good progress on the development of a new and more sustainable Business System for use in the administration of the GSF Schemes has been made in the last 12 months. The project is on track to become operational in late 2016.

Further comment on GSF Schemes' activity can be found on page 13.

Statutory Review

The GSF Act provides for a review to be conducted every 5 years of how effectively and efficiently the Authority is performing its functions. The first 2 reviews were undertaken in 2006 and 2011.

In February 2016 the Minister of Finance appointed PricewaterhouseCoopers Securities Limited (PwC) to undertake the third 5 yearly review.

The review was completed towards the end of the financial year and the report on the review was tabled in Parliament in July.

The report can be viewed *http://www.treasury.govt.nz/publications/reviews-consultation/gsfa*

The scope of PwC's assessment included a review of all relevant documentation and policies related to the investment governance and operations undertaken within the GSFA.

In the review, they assessed the Investment Governance Framework in terms of strategy, people, conflict of interest management, assessment of risks, reporting, decision making, documentation, compliance and outcomes. The review also took into consideration the reviews performed in the past (i.e. the 2011 Statutory

Review and the 2015 Independent Review undertaken by Mark Burgess, the former CEO of the Australian Future Fund).

Overall, PwC stated that they believe the Authority is a sound operation, run by experienced and capable people with an appropriate investment governance framework. The key strengths PwC highlighted in the review were:

- The Board and Management are experienced and have an appropriate level of expertise in investments. The Board and Management are clearly aware of the investment strategy and can accurately articulate the Authority's investment principles and beliefs.
- Manager selection has made a positive contribution to performance within the NZ equities and global equities portfolios. This reflects the experience and expertise of the key investment staff. The Management team attends a large number of investment manager meetings and these meetings are documented in the Board papers. In addition, the team supplements their internal research with the Mercer GIMD software and seeks the advice of Russell Investments consultants on an ad-hoc basis. PwC believes the Authority is well covered in the manager research space.
- There are defined delegations, roles and responsibilities between the Board and/or the Investment Committee and Management. The investment team is fully responsible for the day-to-day monitoring of the Fund. Any proposed changes to the Fund are put forward as a recommendation from the investment team. The investment team may use ad-hoc advice from external advisors and/or collaborate with other CFIs. As a result, the investment team is aware that they are fully accountable for the performance outcomes of the Fund.
- There is evidence of collaboration with other CFIs to gain insights in the development of the Fund's investment approach and operations. There is a regular formal collaboration forum with the investment teams across the CFIs. Some of the tangible outcomes include research into Responsible Investments and the sharing of the costs associated with this research.
- There are defined delegations within Management to sign off on any security transactions or execution of documents considered necessary or expedient in the conduct of the investment arrangements. Specifically, any two of the Chief Executive, General Manager (Investments), General Manager (Schemes) or the Chief Financial Officer is required to approve these instructions.
- Comprehensive reporting of risk metrics and the stress testing results are included in the quarterly reports. The level and quality of the risk reporting framework is strong. Regular reporting provided to the Board includes a comprehensive attribution analysis, which clearly articulates the reasons for performance.
- Performance and compliance reporting is undertaken by JP Morgan (the Fund's custodian). In addition, attribution analysis is also undertaken by JP Morgan, which is directly transferred to the Board's investment papers. We believe this is a good approach for an operationally independent organisation to calculate performance returns.

In addition to noting the strengths of the Authority, PwC also made a number of recommendations and areas of development for the Authority in the Statutory Review which will assist in improving its operations. The Authority will consider all of these recommendations and develop action plans where appropriate to implement these recommendations. Once these action plans are finalised they will be published onto the Authority's website.

Outlook

The global outlook is for continued slow growth, very low inflation, low interest rates and heightened risk from both struggling economies and geopolitical uncertainties.

The global economy remains fragile and uneven. Geopolitical risks are heightened with social divisions in many countries, notably in Europe, exemplified by the Brexit referendum in the UK, the Middle East, and even in the US, as evidenced in the presidential campaign. These tensions threaten to push policies against trade and growth.

Low and, in some cases, negative government bond yields provide very low or negative returns.

After last year's set back, global equity markets are not over-priced relative to company earnings and interest rates in a low inflation world but future earnings will be under pressure from low revenue growth and low productivity growth. Disruptive industry change is prevalent. Overall returns are likely to remain modest.

Commodity prices remain near their multi-year lows and emerging markets are still relatively cheap despite some recovery in recent months. On the other hand, global listed real estate and infrastructure are expensive compared to equities in general.

The NZ dollar has remained above most estimates of long term fundamental value, especially against the currencies of Europe, Japan and Australia. The NZ share market, which is dominated by lower risk yield stocks, is very fully valued and likely to lag if the outlook for major equity markets improves.

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 annual investment results, as well as any changes the Authority makes to its policies, Fund investment strategy and personnel.

The Board

The Board has worked effectively and efficiently in 2015/16 with seven full Board meetings being held during the financial year. The Board has two permanent committees, an Investment Committee chaired by Craig Ansley and an Audit and Risk Review Committee chaired by Cecilia Tarrant. The Board has also established a committee to provide governance oversight to the project developing the new Business System for the administration of the GSF Schemes. This Committee is chaired by Michelle van Gaalen.

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 Taylor
Chairman
Government Superannuation Fund Authority Board

7 September 2016

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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 Authority defines this objective as being to maximise the Fund's excess return relative to NZ Government Stock (before NZ tax) with a one in four chance of under-performing NZ Government Stock by a cumulative 10% measured over rolling ten year periods.

In addition to the investment objective's long term return and risk measures, the Authority established a notional Reference Portfolio in 2010 to define and monitor the Fund's relative risk and return performance over shorter, interim periods. The Reference Portfolio is a simple, globally diversified asset allocation that is expected to meet the long term investment objective by investing passively in liquid public markets at low cost.

The Fund relies largely on equities to provide the excess return over NZ Government Stock returns but is always looking for more efficient ways to capture alternative return sources. Almost 20% of the Fund is invested in alternative asset classes such as catastrophe insurance, life settlements, private equity and real estate funds, and now a basket of risk factors that is expected to provide an independent source of returns. Insurance-based investments have provided worthwhile diversification of fixed interest investments.

Global equities, bonds and most of these alternative assets are managed actively as we believe there are additional returns from skilled management. All active investment decisions are benchmarked against the Reference Portfolio to assess whether they add value in terms of higher returns for equivalent 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.

90% of the Fund is invested internationally to avoid concentration risk in NZ assets. Hedging limits the foreign currency exposure to 20% on average, however.

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.

The Authority last reviewed its Reference Portfolio in 2013. The current Reference Portfolio effective from 1 July 2014 has 60% international equities, 10% NZ equities and 30% global fixed interest.

Table 1 sets out the Fund's asset allocation, as at 30 June 2016 and 2015, compared with the Reference Portfolio.

Investment Returns

Investment returns were somewhat under par in the 2016 financial year. Although global bond returns exceeded normal levels international equities had negative returns. The economic backdrop to these returns was characterised by weak global growth and repeated attempts by monetary authorities to forestall a recession. Markets fluctuated sharply at times and investors' risk aversion mounted as these attempts appeared to be unsuccessful in lifting global growth. Investors sought safety in government bonds and equities with stable yields, benefiting the NZ share market in particular. NZ equities had a very strong year, standing out from the global pack.

The Fund return on investments for the June year was a below average 2.1% (before tax and after investment fees). Over the last 3 years the Fund returned 9.8% per annum net of investment fees. The comparative return for the same period for the Reference Portfolio is 9.5% per annum and for NZ Government Stock is 6.3% per annum.

The key driver of poor returns this year was the decline in global equity markets, the Fund's largest exposure. Global equity returns were -3.2% in local currency terms but -8.7% if not hedged into NZ dollars. In contrast, NZ Government Stock returned 8.0% as investors deserted equities in favour of the safety of government bonds.

Table 2 compares the Fund's investment return before tax and after fees against the Reference Portfolio and NZ Government Stock over periods ended 30 June 2016.

Table 1[1]

Asset Class	Investment Assets at 30 June 2016		Investment Assets at 30 June 2015		Reference Portfolio
	$m	%	$m	%	%
Global fixed interest	**539**	**13.7**	581	14.6	30
Global equities	**2,093**	**53.0**	2,458	61.6	60
NZ equities	**421**	**10.7**	385	9.7	10
Commodity futures	**80**	**2.0**	84	2.1	-
Catastrophe insurance	**268**	**6.8**	268	6.7	-
Life settlements	**123**	**3.1**	96	2.4	-
Multi-asset class[2]	**189**	**4.8**	270	6.8	-
Global tactical asset allocation	**127**	**3.2**	118	3.0	-
Currency overlay[3]	**107**	**2.7**	(270)	(6.8)	
Total	**3,947**	**100.0**	3,990	100.0	100.0

1 The numbers in the table may differ from the numbers in the Statement of Net Assets for the Fund (on page 34) because of different disclosure requirements for financial reporting purposes.

2 The Fund invests in a multi-asset class fund which is a diversified portfolio comprising global private equity, global property and absolute return hedge funds.

3 Currency overlay comprises unrealised profits or losses (shown in brackets) on currency hedges and is generally made up of cash equivalents or short term liabilities to banks (when there are accrued losses). The Reference Portfolio is hedged so that there is 20% exposure to foreign currency. The actual portfolio also had a 20% exposure to Foreign Currency at 30 June 2016 but may vary during the year.

All table figures are rounded and so may not appear to add exactly.

Table 2: Total Fund Return Summary

Returns per annum to 30 June 2016	1 year	3 years	10 years
Fund Investment Return (before tax and after fees)	2.1	9.8	5.9
Reference Portfolio	2.3	9.5	5.9
NZ Government Stock	8.0	6.3	6.5

The Fund's gross investment return exceeded the Reference Portfolio return by 0.5%. This modest added value was not enough to cover additional investment fees, however, resulting in 0.2% underperformance net of fees. Although significant value was added in equities and tactical asset allocation over the financial year, it was more than offset by the Fund's insurance-linked assets and emerging market bonds under-performing the strongly rallying core global bonds. These exposures are expected to out-perform core global bonds going forward.

Returns from global financial assets, especially equities, have been volatile in the last year on account of feeble global growth, large debt overhangs in major countries and fluctuating belief in global policymakers' ability to rejuvenate flagging economies, notably in Europe, Japan and China. The Brexit vote also unnerved markets just prior to the June 30 close to the financial year.

The Fund's investment return exceeded its Reference Portfolio and was also ahead of NZ Government Stock in the last 3 and 5 years. Measured over the last 10 years, the Fund's return matches the Reference Portfolio but is 0.6% below NZ Government Stock as that period includes poor global equity market returns in the 2008 global financial crisis (GFC).

Returns by Asset Class

Table 3 shows the investment returns by major asset class compared to the relevant asset class benchmark. (All returns in NZ dollars before NZ tax and after fees.)

Table 3

Asset Class	Year to June 2016		3 Years to June 2016 pa	
	Actual	Benchmark	Actual	Benchmark
Total fund	**2.1**	**2.3**[4]	9.8	9.5
Global fixed interest	**8.0**	**9.9**	7.3	8.1
Global equities[5]	**-7.3**	**-8.7**	10.0	8.8
NZ equities	**22.5**	**21.7**	19.0	17.1
Multi-asset class[5]	**-6.9**	**-2.6**	8.3	9.3
Global tactical asset allocation	**7.7**	**-4.6**	3.7	3.0
Catastrophe insurance	**0.0**	**-0.1**	8.2	8.0
Life settlements	**-8.3**	**-8.3**	4.4	4.4
Currency Overlay	**5.4**	**5.3**	-0.9	-0.8

4 The benchmark for the total Fund is the Reference Portfolio.

5 Returns are unhedged. All other asset class returns are hedged to NZ dollars.

Outlook

The outlook is for continued slow growth, very low inflation, low interest rates and heightened risk from both struggling economies and geopolitical uncertainties.

The global economy remains fragile and uneven. The US economy is growing moderately but Japan and Europe remain under clouds. China's growth has slowed as it shifts from investment-led to more balanced growth and a more open financial market. Other developing economies face mixed outlooks depending on their reliance on commodity exports. Geopolitical risks are heightened with social divisions in many countries, notably in Europe, exemplified by the Brexit referendum in the UK, the Middle-East, and even in the US, as evidenced in the presidential campaign. These tensions threaten to push policies against trade and growth.

Low and, in some cases, negative government bond yields provide very low or negative returns. Traditionally the safe asset class, government bonds provide less protection than usual on account of the large amount of public debt and increased risks of either rising inflation and interest rates on one hand or value erosion through negative yields and currency depreciation on the other.

After last year's set back, global equity markets are not over-priced relative to company earnings and interest rates in a low inflation world but future earnings will be under pressure from low revenue growth and low productivity growth. Persistent low global interest rates, stable oil prices and gradually improving global growth should support valuations for the next year or so but future returns will depend more on sustained dividends and earnings growth. Meanwhile disruptive industry change is prevalent. Overall returns are likely to remain low.

Commodity prices remain near their multi-year lows and emerging markets are still relatively cheap despite some recovery in recent months. On the other hand, global listed real estate and infrastructure are expensive compared to equities in general. The extremely low interest rates on offer have encouraged investors to chase other sources of yield, notably in lower risk equities with stable and high dividend yields, real estate and infrastructure trusts.

The NZ dollar has remained above most estimates of long term fundamental value, especially against the currencies of Europe, Japan and Australia. The NZ share market, which is dominated by lower risk yield stocks, is very fully valued and likely to lag if the outlook for major equity markets improves.

Responsible Investment

The Act requires the Authority to manage and administer the Fund in a manner consistent with avoiding prejudice to NZ'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 NZ is a party.

The Authority has joined with other CFIs in hiring a global engagement firm to co-ordinate engagement on our behalf with global companies that have significant RI issues. The Authority has participated in engagements with several companies with other CFIs and, in some cases, with global peer funds linked through the United Nations Principles for Responsible Investment (**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 behaviour the Board will consider excluding them from our portfolio and has done so. Excluded companies are listed on the website. 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.

The Authority invests in a number of collective investment vehicles (**CIVs**). These are a practical and cost effective way to get exposure to some markets and managers. The Authority cannot influence directly 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 CFIs have similar RI obligations and all are signatories to the UNPRI. The CFIs work together to implement their RI Policies using consistent information and research gathered initially by the RI unit of NZ Super.

Schemes Commentary

Schemes administration

Datacom Employer Services Limited continues 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 specific in terms of required turn-around times.

New Business System

Work on development of a new and more sustainable Business System to be used in the administration of the GSF Schemes continues. The current Business System is more than fifteen years old and incorporates technology that is no longer in common use in NZ.

The detailed requirements for the project were completed in December 2010. The construction phase was originally scheduled for completion around June 2012.

Implementation of the new Business System for schemes administration has been delayed. The Authority was not satisfied with results from pre-implementation system tests and work continues to ensure the system delivered is fit-for-purpose. The new Business System is expected to be operational by the end of 2016.

Statement of Governance and Accountability

The Authority was established in October 2001 as a Crown entity under section 15A of the GSF Act and became an autonomous Crown entity under the Crown Entities Act in January 2005. 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 the Board is responsible for the business of the Authority.

Government Superannuation Fund Authority Board - as at 7 September 2016

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

Keith Taylor. Appointed as a Board member 10 August 2008 and appointed as Chairman from 1 August 2011. Mr Taylor is Chair of Gough Holdings Limited, Chair of Butlands Management Services Limited and Auckland Council Investments Limited. He is Deputy Chair of the Reserve Bank of New Zealand. He is a director of Southern Cross Medical Care Society, Port Marlborough New Zealand Limited and Annuitas Management Limited. He was previously Group Managing Director and Chief Executive Officer of Tower Limited and, prior to that, held a number of senior management roles in Tower and its predecessor, Government Life.

Cecilia Tarrant. Appointed as a Board member 25 August 2011 and as Deputy Chair as at 1 July 2013. She is a director of Fletcher Building Limited, Payments NZ Limited and Annuitas Management Limited. She is a trustee of the University of Auckland Foundation and an Executive-in-Residence at the University of Auckland Business School. She previously held a number of senior management positions with Credit Suisse First Boston and Morgan Stanley in New York and London.

Craig Ansley. Appointed 16 July 2012. Dr Ansley is a member of the Board of NZ Super and he is an external member of the BNZ Wealth & Private Banking Review Committee. He was founder of the NZ office of Russell Investment Group, and spent several years in senior roles in that organisation.

Michelle van Gaalen. Appointed 1 November 2012. Ms van Gaalen is currently Chief Executive of Pinnacle Life Limited and has previously held various roles including Director of Strategy and Business Performance for the BNZ.

Shelley Cave. Appointed 1 July 2014. Ms Cave is a Board Member of the Financial Markets Authority and she was formerly a partner of the law firm Simpson Grierson specialising in capital markets transactions.

Ainsley McLaren. Appointed 1 July 2015. Ms McLaren is a Director of Hohepa Auckland Regional Board. She has previously held various executive roles including Head of Investment Management at ASB Group Investments and Executive Director at First State Investments (NZ) Limited.

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 permanent committees with specific responsibilities for Audit and Risk Review and Investments. In addition the Board has established a New Business System committee. The Chairman is an ex officio member of all three 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.

Auditor

The Auditor-General is the auditor of the Authority. The Auditor-General has appointed David J Shadwell of Deloitte to act on her behalf.

Our People

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 schemes 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.

Annuitas has 13 staff and strives to be a good employer. It is committed to offering equal employment opportunities (**EEO**) to prospective and existing staff.

Annuitas has a Health and Safety Policy and a Health and Safety Plan. There are regular meetings held with all staff to help achieve its aim of providing a healthy and safe workplace.

Workplace flexibility and investment in professional development are core to its employment offering and whilst none of the staff have serious disabilities Annuitas strives to be a good EEO employer.

Diversity of Staff

Ethnicity	Pakeha 11	Asian 2	Maori 0	Pacifica 0
Sex	Male 5	Female 8		
Age	Under 35 1	35-55 5	Over 55 7	

Staff participated in a range of educational development programmes during the year.

The activities of Annuitas compared with seven key elements (as per Human Rights Commission) of being a good employer are summarised in the table below.

Elements	Annuitas Activity
Leadership, accountability and culture	• Alignment between strategic plan objectives, individual objectives and performance measures.
Recruitment, selection and induction	• Robust recruitment and selection process. • Orientation and induction for all staff.
Employee development, promotion and exit	• Professional development opportunities identified and sourced. • Any vacancies advertised internally. • Exit interview process.
Flexibility and work design	• IT systems facilitate working from home. • Flexible Working Arrangements Policy.
Remuneration, recognition and conditions	• Transparent, equitable and gender-neutral job evaluation practices. • Remuneration benchmarked against third-party NZ data. • Discretionary performance incentive scheme.
Harassment and bullying prevention	• Acceptable Conduct Policy for Employees and Contractors signed annually by all employees and available at all times. • Relevant other policies available at all times.
Safe and healthy environment	• Robust Health and Safety Policy. • Strong focus on employee health, safety and well-being.

All Annuitas policies are regularly reviewed and/or updated, many on an annual basis.

The workforce profile of Annuitas has remained stable and there were no changes during the year.

The Management team is:

- Simon Tyler Chief Executive
- Euan Wright Chief Financial Officer
- Fiona Morgan Manager, Finance
- Philippa Drury General Manager, Schemes
- Janet Shirley Manager, Schemes
- Paul Bevin General Manager, Investments
- Peter McCaffrey Manager, Portfolio Strategy and Risk
- 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 members, 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
- is criminal liability that the Authority has determined, in its absolute discretion, should be excluded from the indemnity.

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

Insurance

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

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

The scope of the directors' and officers' insurance cover and the company reimbursement insurance cover is consistent with the limitations imposed by the Crown Entities Act.

Statement of Service Performance

Output Class 01 – Management of the Government Superannuation Fund

This output class provides investment and schemes 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 measures are set out in the Authority's Statement of Intent for the period commencing 1 July 2015.

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 compared to the expected return over rolling 10 year periods.	Partially Achieved • The Fund matched the NZ Government Stock return over the last 10 years compared to an expected excess return of 2.5% pa. This period encompasses the GFC when equities crashed.
• Actual performance (returns and assessed risk) compared to the Reference Portfolio over rolling 3 years to determine the added value of alternative asset exposures and active management (net of additional fees and costs).	• Over the last 3 years the Fund returned 3.5% pa ahead of NZ Government Stock. • The Fund's net of fees return was 0.2% behind the Reference Portfolio for the year but 0.3% pa ahead over the last 3 years.
• Volatility and loss of value of Fund returns versus expected levels.	• The Fund's risk over the last 3 years (measured as volatility of returns) was 5.6%, which was lower than the Reference Portfolio's 6.4% and within the long term risk measure.
• All measured with reference to independent market valuations by the custodian and assessed by the Authority's investment management staff	• Performance is calculated independently by the Custodian and verified by Management.

Performance Measure	Performance Achievement
Endeavour to achieve competitive investment costs justified by value added.	
• 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.	Achieved • Active management subtracted 0.2% in the last year and added 0.3% pa over the last 3 years (net of fees). • Alternative strategies lagged the Reference Portfolio this year and lagged in the last 3 years owing to the strong returns from public equity and bond markets. • Active management, including the addition of alternative assets, lowered Fund risk, contributing to an improved reward for risk compared to the Reference Portfolio. • The Fund is benchmarked annually against global peers. Latest available results to calendar 2015 indicated: - The Fund's 5 year return was 1.5%pa above peers due to a larger policy allocation to equities. - Total fund risk was also higher than peers owing to a larger equities allocation. - Alternative asset classes reduced risk. The Fund's active risk was similar to peers. - 5 year value added from active management was slightly behind global peers.
• Comparison of expected and actual value added, in terms of excess return (net of additional costs) and/or reduced risk, versus the Reference Portfolio. • Annual comparison of the Fund's performance and cost structure with those of similar organisations, prepared by independent party.	• Costs were similar to peers as greater use of external, active management was offset by lower manager fees.
• Independent statutory review every 5 years.	• The last statutory review was completed in 2016 and concluded inter alia that 'the GSFA is effectively and efficiently performing its designated functions'.

Performance Measure	Performance Achievement
Monitor individual investment managers to ensure compliance with contracted mandates and, where appropriate, out-performance against benchmarks.	
• External review by independent adviser and regular reviews by the Authority's investment management staff.	Achieved • Reviews of external investment managers are obtained regularly from independent investment advisers. • Compliance and performance is monitored monthly by the Authority's staff against mandates and independent benchmarks. • Global equities management was reviewed in 2014, global fixed interest management in 2015 and global tactical asset allocation in 2016. • The Managers' overall returns, net of fees, were in line with benchmarks this financial year and 0.5% pa ahead over the last 3 years.
Maintain a Statement of Investment Polices, Standards and Procedures (SIPSP) that meets best practice.	
• Periodic review by independent adviser to assess whether the SIPSP meets best practice and is relevant.	Achieved • The SIPSP is reviewed annually by the Board and in the 5 yearly statutory review. The statutory review completed in 2016 concluded that GSFA's governance and policies, including the SIPSP are 'fit for purpose' and have been complied with in all material respects.
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.	Achieved • The Fund remained fully compliant throughout the year.
• Actual asset allocation 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 at least quarterly and there were no significant breaches that required further action, during the year.

<table>
<tr><th>Performance Measure</th><th>Performance Achievement</th></tr>
<tr><td colspan="2">Comply with the SIPSP. (continued)</td></tr>
<tr><td>Review of custodian’s performance against key performance indicators quarterly to determine that it meets its Service Level Agreement.</td><td>A full tender for custody services was completed in 2016 with the reappointment of the incumbent custodian.
The custodian is monitored against KPIs contained in the Service Level Agreement and service issues are addressed with the custodian quarterly.</td></tr>
<tr><td>No direct investments that breach the Responsible Investment policies set out in the SIPSP.</td><td>No breaches of Responsible Investment policies occurred.</td></tr>
<tr><td>All investments in CIVs in accordance with Responsible Investment policies in the SIPSP.
CIVs notified of the Board’s Responsible Investment policies.
Measured by internal and external review.</td><td>Investment in all CIVs complied with the SIPSP.
All CIVs are notified of the Responsible Investment policies.</td></tr>
<tr><td colspan="2">Put in place a sound investment strategy consistent with the SIPSP and the Authority’s Beliefs</td></tr>
<tr><td>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.</td><td>Achieved
The Statutory Reviewer reviewed the SIPSP in 2016 and it is to be reviewed by an independent adviser annually in future.
The investment strategy is reviewed annually by the Board to ensure it continues to meet the Investment Objective and Investment Beliefs contained in the SIPSP.
The 5-yearly independent Statutory Review of the investment programme was completed in 2016. The review endorsed the programme and suggested some enhancements to risk monitoring and process improvements.</td></tr>
</table>

Performance Measure	Performance Achievement
*Collaborate with other CFIs to monitor environmental, social and governance (**ESG**) risks of investments, engage with companies with negative ESG issues, encourage integration of ESG issues into investment arrangements where consistent with financial objectives, and maintain a list of excluded investments.*	
• Avoidance of negative ESG issues. • Advice to investment managers on policies and exclusions. • Updated exclusion list. • Participation in engagements with companies that lead to positive change in behaviour.	Achieved • In 2015 the Fund maintained its A ranking for application of the United Nations Principles of Responsible Investments (**UNPRI**) principles. • The list of excluded investments has been maintained up to date. External managers are advised of the Authority's policies and exclusions. • The Authority, in conjunction with CFIs, engages with companies with significant RI issues.
Ensure the Authority complies with the GSF Act.	
• Conclusions of in-house legal compliance programme developed with advice from the Authority's legal adviser.	Achieved: • The Authority complied fully with the Act throughout the year with the advice from the Authority's legal adviser.

Schemes Administration

Performance Measure	Performance Achievement
Accurately calculate and pay entitlements, process contributions correctly and on time.	
• Performance is in line with the KPIs set out in the Management Agreement between the Authority and Schemes Administrator.	Achieved: • 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.
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.	• All KPIs have been met.

Performance Measure	Performance Achievement
Accurately calculate and pay entitlements, process contributions correctly and on time. (continued)	
Performance against KPIs is measured through monthly reporting by the Schemes Administrator, monitored by Management.	• Detailed monthly reports are provided by Datacom on performance against KPIs. The reports are reviewed in detail by Management and summary information included in the papers for consideration by the Board at its regular meetings. Quarterly compliance certificates are received from Datacom and reviewed by Management.
- The Business System is relevant and supportive of the requirements of the Schemes. Assessed by: - no major loss or corruption of data or functionality; - having an appropriate Business Continuity Plan in place; - the ability to access required data from both the current and new Business Systems; and - the new Business System commencing in 2016	• 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. Objective not yet achieved. • Development continues on the new Business System, with focus on delivering a system that will be fit-for purpose.

Performance Measure	Performance Achievement
Respond appropriately to stakeholders' inquiries and provide relevant information.	
• Timely responses to all requests for information from Treasury and meeting deadlines measured by: – no requests being received for missing or incomplete information; and – time frames being met. • Regular updating of website information on Schemes and Investment, sending the annual Chairman's letter to members by the end of September each year and sending member and employer updates. • Achieving consistently good satisfaction scores in the major aspects of the biennial survey of members and employers and positive feedback from other stakeholders. • Timely processing of appeals. On receipt of an appeal, complete papers are provided to the Appeals Board at least 14 days before each scheduled hearing.	Achieved: • Data required by the Actuary for reporting to Treasury was sent within the required timeframes. • All information provided was complete. • The Authority's website has been regularly updated during the year. An annual letter was sent by the Chairman to all GSF members in September 2015, a member update in September 2015 and an employer update in June 2016. • The Authority carries out a biennial survey on a random sample of members (600) and employers (80). In the 2015 survey, satisfaction with decisions made by, and information provided by, the Authority to members and employers remained high and reasonably stable (82% and 78% respectively). Similarly, satisfaction with services and information provided by the scheme administrator to members remained high and reasonably stable (85% and 80% respectively). • Employer satisfaction with decisions made by the Authority and confidence in investment arrangements whilst lower than levels in 2013 were consistent with 2012 levels. The numbers who were dissatisfied, or not at all confident remained low. • Employer satisfaction with communication provided by the Authority and services provided by the scheme administrator remained consistently high and stable. • In the year to 30 June 2016, two appeals were heard by the Appeals Board. The papers were provided to the Appeals Board at least 14 days before the scheduled hearing date. There are no outstanding issues.

GOVERNMENT
SUPERANNUATION
FUND

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 2016. The report is made in accordance with section 93B of the Government Superannuation Fund Act 1956 (**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 Actuary, at the amount necessary to fund the balance of their employees' entitlements. The Government 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 under the Act to manage the Fund's assets and administer the GSF Schemes.

The Act provides for interest to be paid into or out of the Fund in respect of members' contributions or benefits. In respect of interest charged by the Fund, the rate is equivalent to the gross return on the Fund for the year. For the year ended 30 June 2016, the gross return was 2.6% before tax and expenses (2015: 13.8% before tax and expenses).

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 7 of the Authority's Annual Report.

Information on the Authority can be found commencing on page 3.

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 28-29.

Keith B Taylor
Chairman
Government Superannuation Fund Authority Board

7 September 2016

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 2016:

- On the basis of evidence available, all contributions required to be made to the Fund, in accordance with 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 fell short of the accrued benefit liability of the Fund by $8,874 million (2015: $8,592 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.

Keith B Taylor
Chairman
Government Superannuation Fund Authority Board
2 September 2016

GOVERNMENT SUPERANNUATION FUND

Membership Commentary

Movement in contributors during the past five years:

Year ended 30 June	Total	Change Contributors	% Change
2012	12,453	(980)	(7.30)
2013	11,464	(989)	(7.94)
2014	10,580	(884)	(7.71)
2015	9,767	(813)	(7.68)
2016	**9,060**	**(707)**	**(7.24)**

Number of contributors, by scheme:

GSF Scheme	2016	% of Total	2015
General Scheme	8,624	95.19	9,298
Armed Forces	130	1.43	133
Police	257	2.84	280
Prisons Service	40	0.44	46
Judges and Solicitor-General	4	0.04	5
Parliamentary	5	0.06	5
Total contributors at end of year	**9,060**	**100.00**	**9,767**

Movement in the number of contributors during the year:

	2016	2015
Contributors at beginning of year	9,767	10,580
Cessation of employment before retirement	(36)	(54)
Death before retirement	(15)	(16)
Retirements	(651)	(738)
Transfer to other schemes	(5)	(0)
Withdrawals	(0)	(5)
Total contributors at end of year	**9,060**	**9,767**

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

Year ended 30 June	Total Annuitants	Change	% Change
2012	46,638	(201)	(0.43)
2013	46,568	(70)	(0.15)
2014	46,359	(209)	(0.44)
2015	45,967	(392)	(0.85)
2016	**45,635**	**(332)**	**(0.72)**

Movement in number of annuitants during the year:

	2016	2015
Annuitants at beginning of year	**45,967**	46,359
New retiring allowances	**651**	738
New allowances to spouses	**738**	735
Allowances deferred	**319**	395
Discontinued allowances	**(2,040)**	(2,160)
Total annuitants at end of year	**45,635**	45,967

There were 4,508 deferred pensions at 30 June 2016 (2015: 4,827).

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
2012	12,453	46,638	5,677	64,768	(1,379)
2013	11,464	46,568	5,390	63,422	(1,346)
2014	10,580	46,359	5,122	62,061	(1,361)
2015	9,767	45,967	4,827	60,561	(1,500)
2016	**9,060**	**45,635**	**4,508**	**59,203**	**(1,358)**

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

	2016	%	2015	%
Contributors	**9,060**	17	9,767	19
Annuitants	**45,635**	83	45,967	81
	54,695	100	55,734	100

Granting a charge over contributions

In the year to 30 June 2016, 13 charges (2015: 7) were registered by the Fund in favour of charge holders as security over individual contributor's contributions.

Financial Statements

Statement of Responsibility

The Financial Statements of the Fund for the year ended 30 June 2016 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 85, 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 2016, and the changes in net assets and the cash flows of the Fund, for the year ended 30 June 2016.

Keith B Taylor
Chairman
Government Superannuation Fund Authority Board

Simon R Tyler
Chief Executive

7 September 2016

GOVERNMENT SUPERANNUATION FUND

Statement of Changes in Net Assets

For the year ended 30 June 2016

	Note	2016 $000 Actual	2016 $000 Forecast	2015 $000 Actual
Change in assets from				
Investing activities				
Interest, dividends and other income	1	**112,015**	91,500	120,301
Changes in fair value of investment assets through profit or loss	2	**2,939**	213,500	380,188
		114,954	305,000	500,489
Operating activities				
Operating expenses	3			
Funding for the Authority	14	**(43,388)**	(39,214)	(31,249)
Impairment of the Business System	8	**(10,721)**	-	-
Surplus before tax and membership activities		**60,845**	265,786	469,240
Income tax (expense)/benefit	4	**(73,540)**	(58,919)	41,311
(Deficit)/surplus after tax and before membership activities		**(12,695)**	206,867	510,551
Membership activities				
Contributions				
Government	5	**706,331**	732,900	717,673
Members		**32,670**	31,000	37,307
Other employers		**17,998**	20,000	21,532
Total contributions		**756,999**	783,900	776,512
Benefits paid	6	**(870,887)**	(913,000)	(876,500)
Net membership activities		**(113,888)**	(129,100)	(99,988)
Net (decrease)/increase in net assets		**(126,583)**	77,767	410,563
Opening net assets available to pay benefits		**4,087,462**	3,976,773	3,676,899
Net assets available to pay benefits		**3,960,879**	4,054,540	4,087,462

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 2016

	Note	2016 $000 Actual	2016 $000 Forecast	2015 $000 Actual
Current assets				
Cash and cash equivalents		**308,943**	171,710	305,836
Derivative assets	13e	**107,557**	3,108	11,591
Income tax receivable		-	-	19,608
Trade and other receivables	7	**45,189**	22,470	40,620
Total current assets		**461,689**	197,288	377,655
Non current assets				
Investments				
Commodities		**80,413**	86,440	83,565
Derivative assets	13e	**19,381**	1,050	2,988
Equities - NZ		**399,572**	400,000	371,834
Equities - International		**1,826,838**	2,260,697	2,189,325
Global fixed interest		**524,286**	584,874	589,441
Insurance-linked assets		**391,872**	369,649	363,993
Multi-asset and Global tactical asset allocation		**311,521**	321,366	387,076
Property – NZ		**7,466**	7,982	6,537
Other investments		**38,990**	2,406	1,034
Total investments	13e	**3,600,339**	4,034,464	3,995,793
Deferred tax asset	4	**3,001**	-	45,067
Work in progress – Business System	8	**18,427**	29,400	19,059
Total non current assets		**3,621,767**	4,063,864	4,059,919
Total assets		**4,083,456**	4,261,152	4,437,574

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

Statement of Net Assets (continued)

As at 30 June 2016

	Note	2016 $000 Actual	2016 $000 Forecast	2015 $000 Actual
Less liabilities				
Current liabilities				
Trade and other payables	9	**78,301**	32,266	69,259
Income tax payable		**22,626**	6,433	-
Derivative liabilities	13h	**14,367**	162,716	254,312
Total current liabilities		**115,294**	201,415	323,571
Non current liabilities				
Derivative liabilities	13h	**7,283**	5,197	26,541
Total non current liabilities		**7,283**	5,197	26,541
Total liabilities		**122,577**	206,612	350,112
Net assets available to pay benefits		**3,960,879**	4,054,540	4,087,462
Promised retirement benefits				
Gross liability for promised retirement benefits	12	**12,835,000**	12,602,000	12,679,000
Deficit		**8,874,121**	8,547,460	8,591,538
Net assets available to pay benefits		**3,960,879**	4,054,540	4,087,462

The Financial Statements were approved by the Authority Board on 7 September 2016.

Keith Taylor
Chairman
Government Superannuation Fund Authority Board

Cecillia Tarrant
Chairman
Audit & Risk Review Committee
Government Superannuation Fund Authority Board

7 September 2016

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 2016

	2016 $000 Actual	2016 $000 Forecast	2015 $000 Actual
Cash flows from operating activities			
Cash was provided from:			
Government contributions - members	**665,931**	698,236	695,045
Government contributions - expenses	**35,100**	35,025	27,932
Members' contributions	**33,150**	31,050	37,167
Other employers' contributions - members	**13,496**	15,450	17,772
Other employers' contributions - expenses	**4,814**	4,500	3,730
Interest and dividends	**111,625**	92,491	114,291
Cash was disbursed to:			
Benefit payments	**(871,230)**	(913,000)	(876,644)
Income tax	**10,303**	(57,138)	(52,800)
Operating expenses	**(41,729)**	(39,324)	(31,150)
Net cash flows from operating activities	**(38,540)**	(132,710)	(64,657)
Cash flows from investing activities			
Cash was provided from:			
Maturities and sales of investment assets	**3,186,272**	2,554,230	4,588,882
Cash was disbursed to:			
Purchase of investment assets	**(3,134,306)**	(2,410,764)	(4,472,436)
Business System	**(10,319)**	(10,341)	(9,600)
Net cash flows from investing activities	**41,647**	133,125	106,846
Net increase in cash held	**3,107**	415	42,189
Opening cash and cash equivalents	**305,836**	171,295	263,647
Closing cash and cash equivalents	**308,943**	171,710	305,836

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

Statement of Changes in Deficit

For the year ended 30 June 2016

	2016 $000 Actual	2016 $000 Forecast	2015 $000 Actual
Opening deficit at the beginning of the year	**(8,591,538)**	(8,742,227)	(9,149,101)
Change in liabilities amount	**(156,000)**	117,000	147,000
Change in Net Assets	**(126,583)**	77,767	410,563
Closing deficit at the end of the year	**(8,874,121)**	(8,547,460)	(8,591,538)

Note – Deficit

- The estimated actuarial present value of Promised Retirement Benefits (Gross Liability) – refer note 12 - is the present value of the expected payments by the Fund to existing and past members, attributable to the services rendered. The present value was calculated by the Authority's Actuary, as at 30 June 2016, under NZ IAS 26, using a net discount rate.
- The Deficit is the value of the Gross Liability less the value of the Net Assets of the Fund.
- There is no requirement on the Crown to fully fund the Deficit in relation to the GSF Schemes. The Crown meets its obligation to pay members entitlements on a cash flow (pay as you go) basis.
- Reliance is placed by the Authority on the provisions of section 95 of the Act which requires the Minister to appropriate funds from public money to ensure that sufficient funds are available, or will be available, to pay entitlements as they fall due.

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

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

For the year ended 30 June 2016

	2016 $000	2015 $000
Net (decrease)/increase in net assets	**(126,583)**	410,563
Non - cash items		
Deferred tax receivable/(payable)	**42,064**	(45,067)
Impairment of the Business System	**10,721**	-
Total non - cash items	**52,785**	(45,067)
Movements in working capital items		
Benefits payable	**360**	-
Government contributions received in advance	**(1,877)**	1,877
Income tax payable	**22,626**	(32,712)
Income tax receivable	**19,608**	(19,608)
Investment payables	**9,784**	(44,900)
Investment receivables	**558**	2,052
Receivables and prepayments	**(5,126)**	785
Trade and other payables	**775**	764
Total movement in working capital items	**46,708**	(91,742)
Changes in items classified as investing activities		
Accrued interest portion of bonds	**1,601**	(175)
Accrued payments for Business System	**230**	(896)
Change in fair value of investment assets	**(2,939)**	(380,188)
Investment settlement receivables	**(558)**	(2,052)
Investment settlement payables	**(9,784)**	44,900
Total movement in investing activities	**(11,450)**	(338,411)
Net cash out flows from operating activities	**(38,540)**	(64,657)

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

Judges and Solicitor-General Superannuation

Statement of Changes in Net Assets

For the year ended 30 June 2016

	2016 $000	2015 $000
Income from operations*		
Government contributions	**14,985**	16,282
Total contributions	**14,985**	16,282
Expenditure*		
Benefits paid:		
Retirements	**12,059**	12,469
Allowances capitalised	**603**	1,705
Spouses and children	**2,323**	2,108
Total Benefits paid	**14,985**	16,282
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 2016

	2016 $000	2015 $000
Income from operations*		
Government contributions	4,354	4,933
Members' contributions	65	66
Total contributions	4,419	4,999
Expenditure*		
Benefits paid:		
Retirements	3,746	3,738
Allowances capitalised	-	618
Spouses and children	673	643
Total Benefits paid	4,419	4,999
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* 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 on a going concern basis in accordance with Generally Accepted Accounting Practice in New Zealand (**NZ GAAP**), applying the NZ 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**).

(iii) Critical accounting estimates and judgements

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 reported amounts of assets and liabilities, income and expenses. Judgement has been applied in selecting the accounting policy to designate assets at fair value through profit or loss upon initial recognition. This policy has a significant impact on the amounts disclosed in the financial statements. Further detail on the material assumptions or major sources of estimation uncertainty that have a significant risk of causing material adjustments to the carrying amounts of assets are discussed in Note 13. However as with all investments their value is subject to variation due to market fluctuations. Judgement has also been applied in assessing the capitalisation costs and valuation (potential for impairment) of the Business System (see Note 8).

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.

(iv) Measurement base

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

(v) Presentation and functional currency

The Fund is located in NZ, 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 therefore NZD.

(vi) Accounting policies

The following particular accounting policies, which materially affect the measurement of changes in net assets, net assets 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, 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 taxation purposes, the Fund is classified as a portfolio investment entity (**PIE**). The income tax expense represents the sum of the tax liability for the year and includes deferred tax (if any). The taxation 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 never taxable or deductible, and it further excludes items that are taxable or deductible in other years.

Gains and losses on equities are non-taxable to the Fund. Taxable profit also requires that the Fair Dividend Rate (**FDR**) calculation method be applied to investments in overseas equities, which deems taxable income to arise regardless of the increase or decline in value of the investments. 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 balance sheet 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 exit 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, (less an allowance for impairment), for the Government Superannuation Fund Business System (**Business System**) have been capitalised and classified as work in progress. These work in progress costs will be amortised on completion of the project.

Securities lending

Securities lending transactions are collateralised by securities or cash. The transfer of the securities to counterparties is only reflected in the Statement of Net Assets if the risks and rewards of ownership are also transferred. Collateral advanced by the borrower in the form of readily marketable securities (non-cash) is held in escrow by a third-party agent. Recourse of those securities is only available in the event of default by the borrower and, as such, the non - cash collateral is not recognised in the Statement of Net Assets. Collateral advanced by the borrower in the form of cash is recognised in the Statement of Net Assets as an asset, along with a corresponding liability to repay the cash collateral to the borrower, once the securities have been returned.

Impairment

All assets, including any assets under construction, 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 recoverable amount.

The Business System, referred to in Note 8 to the financial statements, has been reviewed for impairment against *NZ IAS 36: Impairment of Assets* and an allowance for impairment was made. This is discussed further on page 49.

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 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 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.

The Fund does not adopt hedge accounting.

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 NZ 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 a 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 (excluding investing activities).

(vii) Forecast figures

The forecast figures are those presented in the Fund's 2015 Statement of Performance Expectations, being for the period 1 July 2015 to 30 June 2019. The forecast figures were prepared in accordance with the accounting policies adopted by the Fund for the preparation of the Financial Statements.

(viii) Standards issued but not yet effective

Various standards, interpretations and amendments have been issued by the External Reporting Board but have not been adopted by the Fund because they are not yet effective. The Fund expects to adopt the applicable standards and interpretations in the period in which they become mandatory.

The standard which has not yet been adopted because it is not yet effective is: *NZ IFRS 9: Financial Instruments*. This standard is effective for annual reporting periods beginning at or after 1 January 2017.

(ix) Consistency in presentation

The same presentation and methods of computation have been followed in these financial statements as were applied in the preparation of the Fund's Financial Statements for the year ended 30 June 2015.

(x) 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 2016

1. Interest, dividends and other income

	2016 $000	2015 $000
Equities - International	**41,419**	46,747
Equities - NZ	**13,994**	15,176
Global fixed interest	**27,987**	35,041
Insurance linked assets	**3**	4,322
Multi-asset and Global tactical asset allocation	**3,858**	901
Property - NZ	**1,874**	7,452
Short term and call deposits	**608**	871
Other income	**22,272**	9,791
Total interest, dividends and other income	**112,015**	120,301

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

	2016 $000	2015 $000
Commodities	**(7,069)**	3,559
Equities - International	**(83,218)**	272,118
Equities - NZ	**64,262**	23,167
Global fixed interest	**16,214**	2,835
Insurance-linked assets (net)	**11,088**	2,669
Multi-asset and Global tactical asset allocation	**2,493**	80,093
Property - NZ	**(1,167)**	(4,080)
Short term investments	**336**	(173)
Total changes in fair values of investment assets through profit or loss	**2,939**	380,188

* Includes changes resulting from hedging (where applicable)

3. Operating 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 Actuary, the Government contributed 89% (2015: 88%) of the Authority's administrative expenses reimbursed by the Fund. Other employers contributed the balance of 11% (2015: 12%).

4. Income tax

	2016 $000	2015 $000
Reconciliation to statement of changes in net assets		
Surplus before tax and membership activities	**60,845**	469,240
Add imputation credits	**3,587**	4,595
Net taxable income	**64,432**	473,835
Tax expense at 28%	**18,041**	132,674
Tax effect:		
Non deductible loss/(gain)	**22,727**	(207,873)
Foreign Investment Fund income	**35,295**	35,671
Prior period adjustment	**1,067**	(44)
Imputation credits	**(3,587)**	(4,595)
Withholding tax credits	**(3)**	-
Forfeited withholding tax credits	**-**	2,856
Income tax expense/(benefit)	**73,540**	(41,311)
Income tax expense/(benefit) comprises:		
Current tax	**75,474**	3,800
Deferred tax	**(3,001)**	(45,067)
Prior period adjustment	**1,067**	(44)
Income tax expense/(benefit)	**73,540**	(41,311)
Movement in deferred taxation		
Opening balance	**45,067**	-
Prior period adjustment	**(983)**	-
Current year movement	**(41,083)**	45,067
Deferred tax asset*	**3,001**	45,067

*The deferred tax asset in 2016 relates to the impairment expense. The deferred tax asset in 2015 relates to unused tax losses and tax credits.

5. Government and Employer contributions

	2016 $000	2015 $000
Government service superannuation contributions	**648,377**	668,958
Government Superannuation Fund Authority expenses	**38,615**	27,500
Judges and Solicitor-General superannuation contributions	**14,985**	16,282
Parliamentary superannuation contributions	**4,354**	4,933
Total Government contributions	**706,331**	717,673

5. Government contributions *(continued)*

Funding arrangements

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

GSF Scheme	Member Contribution %	Employer Contribution for year ended 30 June 2016 %
General Scheme:		
- Non-funding employers*	6.5	10.7
- Funding except Islands**	6.5	between 11.1 and 14.1
- Islands	6.5	13.0
Armed Forces	7.6	16.2
Police	7.5	13.8
Prisons Service	8.5	Nil

* Not receipted by the Fund, paid to the Crown.

** 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 2015. As a result some changes to employer contribution rates were implemented with effect from 1 July 2016 (see Note 11).

6. Benefits and refunds paid

	2016 $000	2015 $000
Benefits:		
Allowances capitalised	**19,970**	25,299
Pension entitlements	**733,552**	730,603
Spouses and children	**112,219**	111,911
Refunds:		
Cessation of membership	**2,205**	5,239
Death	**1,823**	1,261
Transfers to other schemes	**1,118**	2,187
Total benefits and refunds paid	**870,887**	876,500

7. Trade and other receivables

	2016 $000	2015 $000
Government contributions - benefits	**108**	-
Government contributions - expenses	**3,315**	-
Interest and dividends	**8,868**	6,934
Investment settlements receivable	**28,989**	29,547
Members' contributions	**844**	1,026
Other employers' contributions - benefits	**1,316**	1,587
Other employers' contributions - expenses	**-**	19
Past service contributions	**881**	1,131
Pension entitlements	**191**	240
Prepaid benefits	**677**	136
Total trade and other receivables	**45,189**	40,620

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

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. Development of the new system has taken longer and cost more than originally planned. It has been reviewed against NZ IAS 36: Impairment of Assets which has resulted in a provision for impairment being made. The provision of $10.721 million (2015: Nil) was made because work completed in the early stages of the development was found, as a result of testing, to be of no ongoing value. As at 30 June 2016 $18.427 million* (2015: $19.059 million) of capital costs for the new system were allocated as Work in Progress on the Statement of Net Assets.

It is expected the Authority will commence amortisation during the 2017 calendar year.

* $61,956 of this was paid to Deloitte for non audit related services (2015: $89,182).

9. Trade and other payables

	2016 $000	2015 $000
Benefits payable	**360**	-
Government contributions in advance - benefits	**-**	1,677
Government contributions in advance - expenses	**-**	200
Government Superannuation Fund Authority	**4,819**	4,076
Investment settlements payable	**72,749**	62,965
Members' contributions in advance	**352**	341
Other employers' contributions - expenses	**21**	-
Total trade and other payables	**78,301**	69,259

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 Authority's actuary, Matthew Burgess, (FNZSA, FIAA), Director, Russell Actuarial, Russell Employee Benefits Pty Limited as at 30 June 2015. The report was tabled in Parliament on 18 February 2016. More information on the results of the valuation is provided in Note 11.

New Zealand International Accounting Standards NZ IAS 26 actuarial valuation

An actuarial valuation of the Fund was undertaken by the Authority's Actuary, Matthew Burgess, (FNZSA, FIAA), Director, Russell Actuarial, Russell Employee Benefits Pty Limited as at 30 June 2016 to determine the value of the promised retirement benefits, in accordance with NZ IAS 26, for the Financial Statements of the Fund – refer Note 12.

11. Statutory actuarial valuation as at 30 June 2015

Details of the statutory actuarial valuation, as at 30 June 2015, 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.

Significant assumptions, used in the statutory valuation were:

Discount rate	6.0% per annum (2014:6.0%)
Consumer Price Index (long term)	2.5% per annum (2014:2.5%)
Salary growth	3.0% per annum (2014:3.0%)

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 2015 statutory valuation are:

	2015 $ million	**2014 $ million**
Past service liabilities		
Armed Forces contributors	4	6
General Scheme contributors (excluding Islands)	2,236	2,345
General Scheme contributors (Islands only)	64	58
Police contributors	198	204
Prisons Service contributors	15	17
Judges and Solicitor-General	11	17
Parliamentary	6	8
Pensioners	9,469	9,335
Deferred pensioners	821	823
Total past service liabilities*	12,824	13,813
Less value of Fund assets	4,087	3,677
Unfunded past service liability*	8,737	9,136

* Total may not add up due to rounding.

11. Statutory actuarial valuation as at 30 June 2014 *(continued)*

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	2015 As a percentage of past service liability	2015 $ million	2014 $ million
Vested Benefits			
Contributors:			
Armed Forces	100%	4	8
General Scheme-excluding Islands	109%	2,432	2,620
General Scheme-Islands	102%	65	61
Police	96%	190	198
Prisons Service	100%	15	17
Judges and Solicitor-General	109%	12	19
Parliamentary	100%	6	8
Total Contributors	108%	2,725	2,930
Pensioners:			
Pensioners	100%	9,469	9,335
Deferred pensioners	100%	821	823
Total Pensioners	100%	10,290	10,158
Grand total		13,015	13,088
Less net assets		4,087	3,677
Shortfall		8,928	9,411

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 ten 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 retire at dates later than 30 June 2015. 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 the Fund was in deficit at the date of the valuation. The benefits payable from the Fund are underwritten by the Government. The Actuary recommended that from 1 July 2015, the Government pays 75.7% of each benefit paid (2014: 77.7%).

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 calculated on an employer by employer basis, based solely on the members employed by each employer;

11. Statutory actuarial valuation as at 30 June 2014 *(continued)*

- for employers that are the Public Services of the Cook Islands, Niue or Tokelau, the employer contribution rate is certified as 14.0% of contributor salaries; and
- for funding employers other than the Public Services of the Cook Islands, Niue or Tokelau, contributions are calculated on an employer by employer basis only on the contributors employed by that employer. Contribution rates include employer superannuation contribution tax (**ESCT**) and an allowance for expenses. A sample of average contribution rates at selected ages is set out in the follow table by age and gender:

Age	Males	Females
50	14.7%	14.8%
55	14.8%	14.9%
57	14.6%	14.7%
59	14.3%	14.4%
61	13.9%	14.1%
63	13.0%	13.2%
65	11.3%	11.4%
67	11.5%	11.7%

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 2015 are as follows:

- for the Armed Forces Scheme: a rate of 14.4% of contributor salaries;
- for the General Scheme: a rate of 11.5% of contributor salaries;
- for the Police Scheme: a rate of 15.4% 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 2016

The Actuary has valued the promised retirement benefits in accordance with NZ IAS 26, as at 30 June 2016, for the purposes of the Fund's Financial Statements.

Significant assumptions, used in the valuation, were:

Discount rate	5.0% per annum
Consumer Price Index (long term)	2.0% per annum
Salary growth	2.5% per annum

12. Gross liability for promised retirement benefits as at 30 June 2015 *(continued)*

Movement in promised retirement/past service benefit liability	2016 $ million	2015 $ million
Opening gross promised retirement/past service benefit liability	**12,679**	12,826
Movements in liability		
Expected changes	**(187)**	(107)
Experience (gains)/losses	**(97)**	(101)
Assumption changes:		
Change in discount rate, Consumer Price Index and salary assumption	**317**	61
Change in demographic assumption (including mortalityimprovement)	**123**	-
Closing gross promised retirement/past service benefit liability	**12,835**	12,679

Vested benefits – 30 June 2016

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 2016, are shown in the following table, where contributors include the inactive members.

Vested benefits	2016 $ million	2015 $ million
Contributors	**2,572**	2,676
Pensioners:		
Current pensioners	**9,632**	9,401
Deferred pensioners	**813**	800
Total pensioners	**10,444**	10,210
Total vested benefits	**13,016**	12,877
Less net assets	**(3,961)**	(4,087)
Shortfall*	**9,055**	8,790

* Total may not add up due to rounding.

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 the global custodian on behalf of the Authority. They provide services including safekeeping of assets, settlement of trades, collection of 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

13. Financial instruments *(continued)*

in respect of each class of financial asset and financial liability, are disclosed in the Statement of Accounting Policies.

c) Capital risk management

The investment strategy, Reference Portfolio and Target Portfolio are reviewed regularly by the Authority, in conjunction with its advisors (see page 7). 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 financial assets and liabilities at fair value through profit or loss, or at amortised cost, as detailed in the Statement of Accounting Policies.

	2016 $000	**2015 $000**
Financial assets at fair value	**3,707,896**	4,007,384
Financial liabilities at fair value	**21,650**	280,853
Financial assets at amortised cost	**354,132**	346,456
Financial liabilities at amortised cost	**78,301**	69,259

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).

13. Financial instruments *(continued)*

2016	Level 1 $000	Level 2 $000	Level 3 $000	Total $000
Financial assets at fair value through profit or loss				
Derivative financial assets	**-**	**126,938**	**-**	**126,938**
Insurance-linked assets				
NZ & Australia	**-**	**56,318**	**-**	**56,318**
North America	**-**	**-**	**123,746**	**123,746**
Rest of the world	**-**	**-**	**211,808**	**211,808**
Investments in cash				
Asia	**25,055**	**-**	**-**	**25,055**
NZ & Australia	**13,935**	**-**	**-**	**13,935**
Investments in commodities				
NZ	**-**	**80,413**	**-**	**80,413**
Investments in equities				
NZ & Australia	**381,572**	**-**	**46,597**	**428,169**
North America	**793,901**	**474,971**	**39,443**	**1,308,315**
Asia	**170,756**	**-**	**-**	**170,756**
Europe	**306,564**	**-**	**-**	**306,564**
Rest of the world	**12,606**	**-**	**-**	**12,606**
Investments in fixed interest				
Asia	**45,787**	**-**	**-**	**45,787**
Europe	**119,666**	**-**	**-**	**119,666**
NZ & Australia	**24,901**	**-**	**-**	**24,901**
North America	**284,746**	**33,720**	**-**	**318,466**
Rest of the world	**15,466**	**-**	**-**	**15,466**
Investments in property				
NZ	**-**	**-**	**7,466**	**7,466**
Multi-asset and Global tactical asset allocation				
North America	**-**	**311,521**	**-**	**311,521**
	2,194,955	**1,083,881**	**429,060**	**3,707,896**
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities	**-**	**21,650**	**-**	**21,650**
	-	**21,650**	**-**	**21,650**

13. Financial instruments *(continued)*

2015	Level 1 $000	Level 2 $000	Level 3 $000	Total $000
Financial assets at fair value through profit or loss				
Derivative financial assets	-	14,579	-	14,579
Insurance-linked assets				
NZ & Australia	-	57,088	-	57,088
North America	-	-	95,783	95,783
Rest of the world	-	-	211,122	211,122
Investments in cash				
North America	1,034	-	-	1,034
Investments in commodities				
NZ	-	83,565	-	83,565
Investments in equities				
Asia	274,237	-	-	274,237
Europe	460,213	-	-	460,213
NZ & Australia	367,038	-	43,942	410,980
North America	852,994	508,017	34,352	1,395,363
Rest of the world	20,366	-	-	20,366
Investments in fixed interest				
Asia	39,125	-	-	39,125
Europe	153,070	-	-	153,070
NZ & Australia	29,735	-	-	29,735
North America	317,121	33,300	-	350,421
Rest of the world	17,090	-	-	17,090
Investments in property				
NZ	-	-	6,537	6,537
Multi-asset and Global tactical asset allocation				
North America	-	387,076	-	387,076
	2,532,023	1,083,625	391,736	4,007,384
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities	-	280,853	-	280,853
	-	280,853	-	280,853

13. Financial instruments *(continued)*

Movement of assets

There were no transfers of assets between level 2 and 3 during the 2016 year.

Transactions during the year, within level 3 investments are outlined in the table below.

2016 Level 3 Investments	Insurance Linked Assets	Property	Private Equity
Opening balance Level 3	**306,905**	**6,537**	**78,294**
Purchases during the year	**22,779**	**2,096**	**17,966**
Gains/(losses) for the year*	**7,656**	**(1,167)**	**11,720**
Less return of capital	**-**	**-**	**(21,940)**
Less (sales) during the year	**(1,786)**	**-**	**-**
Closing balance at 30 June 2016	**335,554**	**7,466**	**86,040**

2015 Level 3 Investments	Insurance Linked Assets	Property	Private Equity
Opening balance Level 3	236,430	15,261	57,396
Purchases during the year	3,618	-	16,041
Gains/(losses) for the year*	84,905	(4,080)	13,838
Less (sales) during the year	(18,048)	(4,644)	(8,981)
Closing balance at 30 June 2015	306,905	6,537	78,294

* Income and dividends for these investments are shown within the interest, dividends and other income category on the Statement of Changes in Net Assets. The changes in fair value are shown within the increase in fair values of investment assets through profit or loss on the Statement of Changes in Net Assets.

Valuation techniques and inputs

For fair value measurements categorised within Level 2 and 3 of the fair value hierarchy, an entity is required to disclose a description of the valuation technique and the inputs used in the fair value measurement. These are disclosed below.

Financial Asset	Fair Value as at 30 June 2015		Fair Value as at 30 June 2014		Valuation technique	Significant unobservable input(s)	Relationship of unobservable inputs to Fair Value
	Level 2 $000	Level 3 $000	Level 2 $000	Level 3 $000			
Derivative assets	**126,938**	**-**	14,579	-	Valuation is derived using the Discounted cash flow techniques based on market exchange rates and interest rates	Not applicable	Not applicable
Multi-asset and Global technical asset allocation	**311,521**	**-**	387,076	-	Discounted cash flow techniques using broker quotes, forward contracts and spot rates	Not applicable	Not applicable

13. Financial instruments *(continued)*

International equities	**474,971**	**-**	508,017	-	Discounted cash flow techniques using account comparable markets and advice from specialised advisors	Not applicable	Not applicable
Fixed interest	**33,720**	**-**	33,300	-	Discounted cash flow techniques using forward interest rates and trading spreads	Not applicable	Not applicable
Insurance linked assets	**56,318**	**-**	57,088	-	Discounted cash flow techniques and option pricing models with reference to the current Fair Value of similar instruments	Not applicable	Not applicable
	-	**123,746**	-	95,783	Discounted cash flow techniques	Mortality multiples and market rates for life settlement practices	The lower the mortality multiple the higher the Fair Value
	-	**211,808**	-	211,122	Internal Valuation Committee pricing through the utilisation of Broker dealer pricing sheets	Seasonality curves provided through independent third party modelling software	The higher the curve the greater the Fair Value (and greater the risk)
Property	**-**	**7,466**	-	6,537	Use of independent qualified valuer assessments taking into account market trends and yields	Local market conditions	The higher the latest sale returns the higher the Fair Value
Private equity	**-**	**86,040**	-	78,294	Discounted cash flow and earnings multiple techniques	Revenue, earnings and associated valuation multiples	The higher the latest sale returns and quotes of similar products the higher the Fair Value
						Local market conditions	
						Indicative quotes	
Commodities	**80,413**	**-**	83,565	-	Discounted cashflow techniques using broker quotes	Not applicable	Not applicable
	1,083,881	**429,060**	1,083,625	391,736			

13. Financial instruments *(continued)*

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.

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 75% of its value in a portfolio of equities and fixed interest securities (2015: 71%). Exposure to market risks is diversified by direct investment in private equity, 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-, or better, as determined by Standard and Poor's. There is a limit in the amount that can be invested below BBB- with a minimum of CCC. Credit risk associated with receivables is considered minimal. The largest receivables balance is in relation to investments sold, which are settled normally 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 2016, the Fund does not have any single underlying investment exceeding 5% of the net assets (2015: nil).

During the year the Fund continued securities lending as a means of earning additional income from its investments. As at 30 June 2016, the Fund had approximately $148 million (2015: $165 million)

13. Financial instruments *(continued)*

lent out to counterparties. These assets have remained in the name of the Fund and were lent out against specific collateral, including cash, provided by the borrower with loans collateralised to a minimum of 99% (2015: 102%) at the borrower level. The Fund has direct access to the collateral in the event of default.

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 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 the previous year.

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 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
2016				
Unsettled purchases	**72,749**	**-**	**-**	**72,749**
Derivative liabilities	**14,366**	**1,533**	**5,751**	**21,650**
Other financial liabilities	**5,552**	**-**	**-**	**5,552**
Total	**92,667**	**1,533**	**5,751**	**99,951**
2015				
Unsettled purchases	62,965	-	-	62,965
Derivative liabilities	254,312	25,696	845	280,853
Other financial liabilities	6,294	-	-	6,294
Total	323,571	25,696	845	350,112

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 private equity, insurance-linked assets, a multi-asset fund and global tactical asset allocation.

13. Financial instruments *(continued)*

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
2016					
Cash and cash equivalents	**0.51**	**308,943**	**-**	**-**	**308,943**
Fixed interest securities	**3.18**	**30,286**	**160,632**	**333,368**	**524,286**
Receivables for securities	**n/a**	**28,989**	**-**	**-**	**28,989**
Total		**368,218**	**160,632**	**333,368**	**862,218**
2015					
Cash and cash equivalents	0.55	305,836	-	-	305,836
Fixed interest securities	3.44	23,244	200,843	365,354	589,441
Receivables for securities	n/a	29,547	-	-	29,547
Total		358,627	200,843	365,354	924,824

Interest rate sensitivity

A significant change to interest rates will have a significant effect on the value and income of many of the assets within the Fund. It is difficult to quantify the effect of a change in interest rates in many of the asset classes such as the equity portfolios. The assets directly affected by a change in interest rates would be the Global Fixed Interest assets, Insurance linked assets and the Fund's currency hedging portfolio.

The Global Fixed Interest portfolio has benchmark duration of 6.89 years (2015: 6.5 years) and at the end of the year the portfolio was valued at $524 million (2015: $589 million). A 1% rise in interest rates would devalue the portfolio in the order of $36 million (2015: $38 million) (before tax) and conversely a 1% fall would increase the value by a similar amount.

The Fund hedges the foreign currency risk of its foreign assets back to NZD and has a benchmark of having 20% of the Fund in Foreign Currency. The Fund uses 3 month forward contracts and longer term (maximum 10 year) swaps to hedge the foreign assets. These swaps are sensitive to the spread between 90 day interest rates in NZ and other foreign currencies. A 1% change in the spread will change the accrual of income in the order of $26 million (2015: $29 million) (before tax) over a year.

13. Financial instruments *(continued)*

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 on a before tax basis. The Authority adjusts the Fund's foreign currency exposure in accordance with its limits set in 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 NZD. The Strategy is implemented by adjusting hedge ratio on the International equities' portfolio.

Foreign currency risk management

Asset Class	After-tax Benchmark Hedge Ratio
Absolute return*	100%
Catastrophe risk	100%
Commodities	100%
Global fixed interest	100%
International equities	76%
Life settlements	100%
Multi asset class	0%

* Absolute return comprises global tactical asset allocation. The global tactical asset allocation 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) before tax was $754 million (2015: $6 million). On an after tax basis the total exposure to foreign currencies was equivalent to 20% of the Fund (2015: 20%). The Fund's foreign exchange exposure, before taking into account hedging was $2,808 million (2015: $2,886 million).

Foreign currency sensitivity

The Fund is mainly exposed to the Australian Dollar, United States Dollar (**USD**), 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 decrease in the NZD on the unhedged exposure to foreign currencies.

13. Financial instruments *(continued)*

	Changes in NZD	Effect on surplus/(deficit) after-tax and before membership activities 2015 $000	2014 $000
Exchange rate risk	- 5%	38,534	40,875

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.

Market price risk

Market price 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 expose it to price risk. The investment managers manage the other market risk in accordance with the Authority's SIPSP and their mandates.

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

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

	Changes in variable	Effect on surplus/(deficit) after-tax and before membership activities 2015 $000	2014 $000
Market price risk	+ 5%	108,367	122,248

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 administers the GSF Schemes. For the year ended 30 June 2016, the Fund paid the Authority $43,388,000 (2015: $31,249,000) for operating expenses, as detailed in the Statement of Changes in Net Assets. In turn, the Fund was reimbursed by the Government for 89% being $38,615,000 (2015: 88% being $27,932,000) and other employers for 11% being $4,773,000 (2015: 12% being $3,730,000). (Refer also Notes 3 and 15 and achievements for the year detailed on pages 18-24). As at 30 June 2016 $4,854,000 was payable by the Fund to the Authority for expenses incurred but not yet paid (2015: $4,076,000). 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 principal reason for the variance between the forecast and actual changes in fair value of investment assets.

Funding for the Authority for operating expenses was above that forecast. This was the result of higher manager fees and operating costs.

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 inflation, early retirements, redundancies, unexpected salary changes, or transfers to other superannuation schemes.

16. Contingent assets, liabilities and capital commitments

As at 30 June 2016 capital commitments were in place for the building of a new Business System and to several Investment Managers. These are summarised as follows:

	2016 $000	2015 $000
Non-cancellable contractual commitments		
Less than one year	**67,558**	34,485
Between one and two years	**61,105**	34,455
Total non-cancellable contractual commitments	**128,663**	68,940

There are no contingent assets or liabilities (2015: Nil).

17. Subsequent events

There have been no material events after balance date that require adjustments to, or disclosure in, the Financial Statements (2015: Nil).

Deloitte.

INDEPENDENT AUDITOR'S REPORT

TO THE READERS OF THE GOVERNMENT SUPERANNUATION FUND'S FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2016

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

Opinion on the financial statements

We have audited:

- the financial statements of the Fund on pages 32 to 64, that comprise the statement of net assets as at 30 June 2016, 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.

In our opinion:

- the financial statements of the Fund:
  - give a true and fair view of the Fund's:
    - financial position as at 30 June 2016; and
    - financial performance and cash flows for the year then ended; and
  - comply with generally accepted accounting practice in New Zealand and have been prepared in accordance with New Zealand equivalents to International Financial Reporting Standards.

Our audit was completed on 7 September 2016. 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 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, in our judgement, are likely to influence readers' 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 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 the 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. Also, we did not evaluate the security and controls over the electronic publication of the financial statements.

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
- give a true and fair view of the Fund's financial position, financial performance and cash flows.

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

The Board is 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 is also responsible for the publication of the financial statements, whether in printed or electronic form.

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.

Independence

When carrying out the audit, we followed the independence requirements of the Auditor-General, which incorporate the independence requirements of the External Reporting Board.

Other than the audit and the provision of advisory services in relation to the Business System Refresh project, we have no relationship with or interests in the Fund.

David J Shadwell

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 2016, have been prepared in accordance with section 154 of the Crown Entities Act.

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

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

In our opinion, the Statement of Service Performance set out on pages 18-24 clearly reflects the objectives of the Authority. The attached Financial Statements for the financial year fairly presents the financial position, as at 30 June 2016, and the operations and cash flows of the Authority for the year ended 30 June 2016.

Keith Taylor
Chairman
Government Superannuation Fund Authority Board

Cecillia Tarrant
Chairman
Audit & Risk Review Committee
Government Superannuation Fund Authority Board

7 September 2016

Statement of Comprehensive Revenue and Expense

For the year ended 30 June 2016

	Note	2016 $000 Actual	2016 $000 Forecast	2015 $000 Actual
Revenue				
Interest received		**39**	20	43
Transfer from the Government Superannuation Fund	1	**43,388**	39,214	31,249
Total revenue		**43,427**	39,234	31,292
Expenses				
Scheme administration		**3,187**	6,822	3,175
Investment management and custody	2	**36,506**	28,504	24,476
Operating	3	**3,734**	3,908	3,641
Total expenses		**43,427**	39,234	31,292
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 2016

	Note	2016 $000 Actual	2016 $000 Forecast	2015 $000 Actual
Equity				
General fund		**-**	-	-
Total equity		**-**	-	-
Represented by:				
Current assets				
Cash and cash equivalents		**459**	660	250
Trade and other receivables	4	**4,851**	3,196	4,212
Total current assets		**5,310**	3,856	4,462
Total assets		**5,310**	3,856	4,462
Current liabilities				
Trade and other payables	5	**5,310**	3,856	4,462
Total current liabilities		**5,310**	3,856	4,462
Net assets		-	-	-

The Financial Statements were approved by the Government Superannuation Fund Authority Board on 7 September 2016.

Keith Taylor
Chairman
Government Superannuation Fund Authority Board

Cecillia Tarrant
Chairman
Audit & Risk Review Committee
Government Superannuation Fund Authority Board

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

GOVERNMENT SUPERANNUATION FUND AUTHORITY

Statement of Cash Flows

For the year ended 30 June 2016

	Note	2016 $000 Actual	2016 $000 Forecast	2015 $000 Actual
Cash flows from operating activities				
Cash was provided from:				
Government Superannuation Fund	1	**42,645**	39,324	30,497
Interest		**39**	20	43
		42,684	39,344	30,540
Cash was disbursed to:				
Total expenses		**(42,475)**	(39,428)	(30,696)
Net cash flows from operating activities		**209**	(84)	(156)
Net increase/(decrease) in cash held		**209**	(84)	(156)
Opening cash and cash equivalents		**250**	744	406
Closing cash and cash equivalents		**459**	660	250

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

	2016 $000 Actual	2016 $000 Forecast	2015 $000 Actual
Net operating result	**-**	-	-
Movements in working capital items:			
Trade and other receivables	**(639)**	2,187	(845)
Trade and other payables	**848**	(2,271)	689
Net cash flows from operating activities	**209**	(84)	(156)

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

Statement of Changes in Equity

For the year ended 30 June 2016

	2016 $000 Actual	2016 $000 Forecast	2015 $000 Actual
Equity at beginning of the year	-	-	-
Total comprehensive income for the year	-	-	-
Equity at end of the year	-	-	-

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

Statement of Accounting Policies

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

(i) Reporting entity

The Government Superannuation Fund Authority (the **Authority**) was established in October 2001, as a Crown entity by section 15A of the Government Superannuation Act 1956 (**GSF Act**) (and subsequent amendments) and became an autonomous Crown entity under the Crown Entities Act 2004 in January 2005.

The Authority's primary function is to manage the Government Superannuation Fund (the **Fund**) and administer the GSF Schemes. The Authority does not operate to make a financial return and is domiciled in NZ.

The Authority has designated itself as a public benefit entity (**PBE**) for financial reporting purposes.

Separate Financial Statements have been prepared for the Fund in terms of section 93 of the GSF Act.

(ii) Basis of preparation

The financial statements have been prepared on a going concern basis, and all accounting policies, have been applied consistently to all periods presented in these financial statements.

Statement of compliance

The financial statements of the Authority have been prepared in accordance with the requirements of the Crown Entities Act 2004, which includes the requirement to comply with generally accepted accounting practice in New Zealand (**NZ GAAP**).

The financial statements have been prepared in accordance with Tier 1 PBE accounting standards, and comply with those standards.

Presentation currency and rounding

The financial statements are presented in New Zealand dollars (**NZD**) and all values are rounded to the nearest thousand (**$000**).

Standards issued but not yet effective and not early adopted

In 2015, the External Reporting Board issued *Disclosure Initiative (Amendments to PBE IPSAS 1), 2015 Omnibus Amendments to PBE Standards, and Amendments to PBE Standards and Authoritative Notice as a Consequence of XRB A1 and Other Amendments.* These amendments apply to PBEs with reporting periods beginning on or after 1 January 2016. The Authority will apply these amendments in preparing its 30 June 2017 financial statements. The Authority expects there will be no effect in applying these amendments.

(iii) Measurement base

The measurement base adopted is that of historical cost.

(iv) Accounting policies

The following particular accounting policies, which materially affect the measurement of revenue and expense, 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 Revenue and Expense are accounted for on an accruals basis.

Foreign currencies

Transactions in overseas currencies are recorded in NZD at the rates of exchange prevailing on the dates of the transactions with any currency gain or loss included in the Statement of Comprehensive Revenue and Expense.

Tax

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 include bank term deposits (if applicable), 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 payable on certain overseas fees that would otherwise be subject to GST if received in NZ. GST on these items is included within operating expenditure on the Statement of Comprehensive Revenue and Expense.

Impairment

Financial assets 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 Revenue and Expense 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.
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 NZ, 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.

(v) 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 2015. 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.

(vi) Changes in accounting policies

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

Notes to the Financial Statements

For the year ended 30 June 2016

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.

2. Investment management and custody expenses

	2016 $000	2015 $000
Custody expenses	**1,474**	1,496
Investment management expenses	**35,032**	22,980
Total investment management and custody expenses	**36,506**	24,476

3. Operating expenses

	2016 $000	2015 $000
Audit of financial statements	**207**	207
Board fees and expenses	**220**	213
Management fees - Annuitas	**2,359**	2,284
Other expenses	**948**	937*
Total operating expenses	**3,734**	3,641

* This includes $12,000 paid to Deloitte for a review of the Births, deaths and marriages data transfer assignment.

4. Trade and other receivables

	2016 $000	2015 $000
Annuitas Management Limited	**27**	126
Government Superannuation Fund	**4,819**	4,076
Other receivables and prepayments	**5**	10
Total trade and other receivables	**4,851**	4,212

5. Trade and other payables

	2016 $000	2015 $000
Business System related costs	**933**	1,163
Investment management fees	**3,949**	2,769
Professional services and operating expenses	**414**	494
Other creditors	**14**	36
Total trade and other payables	**5,310**	4,462

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. Given that transactions in overseas currencies are recorded in NZD at the rates of exchange prevailing on the date of payment the total exposure to currency risk is minimal.

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 the previous year.

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. Board fees

Board members were paid the following fees during the year:

	2016 $	**2015 $**
Keith Taylor - Chairman	**46,400**	46,400
Cecilia Tarrant - Deputy Chairman	**29,000**	29,000
Craig Ansley	**25,520**	25,520
Shelley Cave	**23,200**	23,200
Toni Kerr	**-**	25,520
Ainsley McLaren (appointed 1 July 2015)	**23,200**	-
Michelle van Gaalen	**27,840**	23,200
Total Board Fees	**175,160**	172,840

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 $27,165 in 2016 (2015: $22,096).

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 $15,559 (2015: $15,218).

8. Related party information

The Authority is an autonomous Crown entity.

The principal function of the Authority is to manage and administer the Government Superannuation Fund (GSF) and the associated Schemes. For the year ended 30 June 2016, the Authority received $43,388,000 (2015: $31,249,000) for operating expenses as detailed in the Statement of Comprehensive Revenue and Expense. As at 30 June 2016, $4,819,000 was due from GSF for expenses incurred (2015: $4,076,000).

The Authority also 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 NZ Super to work jointly, on Responsible Investing Policies. Craig Ansley is a member of the NZ Super Board.

The Authority has appointed Board members, Keith Taylor and Cecilia Tarrant as directors of Annuitas. The costs of running Annuitas are shared between the Authority and the NPF on an equitable basis, as agreed between the two parties. The Authority paid fees for this service during the year amounting to $2,359,000 (2015: $2,284,000). The amount owed by Annuitas to the Authority at year end was $27,000 (2015: $126,000).

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.

9. Actual versus forecast

Investment revenues are subject to the volatile nature of investment markets, this being the main reason for the variance between the forecast and actual changes in fair value of investment assets (within the Fund). Funding for the Authority for operating expenses was over that forecast. This was the result of higher than anticipated investment management expenses (see Note 2).

10. Contingent assets and liabilities

There are no contingent assets or liabilities at 30 June 2016 (2015: Nil).

11. 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:

	2016 $000	2015 $000
Non-cancellable contractual commitments		
Less than one year	**5,253**	5,244
Between one and two years	**4,729**	4,969
Between two and five years	**2,050**	2,132
Total non-cancellable contractual commitments	**12,032**	12,345

In terms of section 15E (1) of the GSF Act, the administrative expenses of the Authority are reimbursed by the Fund. The expenses referred to in the above table are therefore reimbursed by the Fund as they are incurred.

12. Subsequent events

There have been no material events after balance date that require adjustments to, or disclosure in, the financial statements (2015: Nil).

INDEPENDENT AUDITOR'S REPORT

TO THE READERS OF GOVERNMENT SUPERANNUATION FUND AUTHORITY'S FINANCIAL STATEMENTS AND THE PERFORMANCE INFORMATION FOR THE YEAR ENDED 30 JUNE 2016

The Auditor-General is the auditor of the Government Superannuation Fund Authority (the Authority). The Auditor-General has appointed me, David J Shadwell, using the staff and resources of Deloitte, to carry out the audit of the financial statements and the performance information of the Authority on her behalf.

Opinion on the financial statements and the performance information

We have audited:

- the financial statements of the Authority on pages 68 to 78, that comprise the statement of financial position as at 30 June 2016, the statement of comprehensive revenue and expense, statement of changes in equity 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; and
- the performance information of the Authority on pages 18 to 24.

In our opinion:

- the financial statements of the Authority:
  - present fairly, in all material respects:
    - its financial position as at 30 June 2016; and
    - its financial performance and cash flows for the year then ended; and
  - comply with generally accepted accounting practice in New Zealand and have been prepared in accordance with Public Benefit Entity International Public Sector Accounting Standards.
- the performance information:
  - presents fairly, in all material respects, the Authority's performance for the year ended 30 June 2016, including:
    - for each class of reportable outputs:
      - its standards of performance achieved as compared with forecasts included in the statement of performance expectations for the financial year;
      - its actual revenue and output expenses as compared with the forecasts included in the statement of performance expectations for the financial year; and
    - the actual expenses or capital expenditure incurred compared with the appropriated or forecast expenses or capital expenditure.
  - complies with generally accepted accounting practice in New Zealand.

Our audit was completed on 7 September 2016. 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 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 the performance information are free from material misstatement.

Material misstatements are differences or omissions of amounts and disclosures that, in our judgement, are likely to influence readers' overall understanding of the financial statements and the 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 the performance information. The procedures selected depend on our judgement, including our assessment of risks of material misstatement of the financial statements and the 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 performance information 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 performance information within the Authority's framework for reporting performance;
- the adequacy of the disclosures in the financial statements and the performance information; and
- the overall presentation of the financial statements and the performance information.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements and the performance information. Also, we did not evaluate the security and controls over the electronic publication of the financial statements and the performance information.

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 performance information that:

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

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

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

Responsibilities of the Auditor

We are responsible for expressing an independent opinion on the financial statements and the performance information and reporting that opinion to you based on our audit. Our responsibility arises from section 15 of the Public Audit Act 2001.

Independence

When carrying out the audit, we followed the independence requirements of the Auditor-General, which incorporate the independence requirements of the External Reporting Board.

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

DJShadwell

David J Shadwell

Deloitte

On behalf of the Auditor-General, Wellington, New Zealand

Directory

AS AT 7 SEPTEMBER 2016

Government Superannuation Fund Authority Board

Craig Ansley
Shelley Cave
Ainsley McLaren
Cecilia Tarrant *(Deputy Chair)*
Keith Taylor *(Chairman)*
Michelle van Gaalen

Management

Annuitas Management Limited

Simon Tyler	Chief Executive
Euan Wright	Chief Financial Officer
Philippa Drury	General Manager, Schemes
Paul Bevin	General Manager, Investments
Fiona Morgan	Manager Finance

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

Matthew Burgess, Russell Employee Benefits Pty Ltd

Auditor

David J Shadwell,
Deloitte, on behalf of the Auditor-General

Directory *(continued)*

Bankers

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

Legal Adviser

DLA Piper New Zealand

INVESTMENT MANAGERS

Commodities

AMP Capital Investors (NZ) Limited

Global Fixed Interest

Ashmore Investment Management Limited
Brandywine Global Investment Management, LLC
Pacific Investment Management Company, LLC
Wellington Management Australia Pty Ltd

Global Tactical Asset Allocation

AQR Capital Management, LLC

Insurance-Linked Assets

Apollo Global Management, LLC
Credit Suisse Securities (Europe) Limited
Fermat Capital Management, LLC
Nephila Capital Limited

International Equities

Arrowstreet Capital Limited Partnership
Genesis Emerging Markets Investment Company
Lazard Asset Management, LLC
Marathon Asset Management, LLP
PanAgora Asset Management, Inc
Pzena Investment Management, LLC
Russell Investment Management Ltd *(terminated 01 October 2015)*

Multi-Asset Class and Global Private Equity

Makena Capital Management (Cayman), LLC

New Zealand Equities

ANZ Investments Limited
Harbour Asset Management Limited

Directory (continued)

New Zealand Private Equity

Direct Capital IV GP Limited
HRL Morrison and Company
Pencarrow Private Equity Management Limited
Pioneer Capital Management Limited

New Zealand Unlisted Property

Willis Bond and Company Management Limited

Foreign Exchange Hedging

ANZ Bank New Zealand Limited
State Street Global Advisors, Australia, Limited

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

GOVERNMENT SUPERANNUATION FUND AUTHORITY

Statement of Investment Policies, Standards and Procedures

GOVERNMENT SUPERANNUATION FUND AUTHORITY

Statement of Investment Policies, Standards and Procedures

This document is titled Statement of Investment Policies, Standards and Procedures (**SIPSP**) and is dated 1 September 2016 and supersedes all previous versions. An electronic copy is available via website *www.gsfa.co.nz*.

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No liability
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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 Statement is reviewed and approved at least annually by the Board. Only the Board can approve material changes to it. A version control document is maintained.

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, directing and supervising the management of the business of the Authority and the Fund. The Authority's key governance document is its **Corporate Governance Statement**, incorporating the requirements set out in the Act, the Crown Entities Act, other relevant law, 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 which certain functions and powers are delegated. The Investment Committee has written terms of reference and its performance is reviewed annually.

The Authority and the Board of Trustees of the National Provident Fund have formed a joint venture company, Annuitas Management Limited (**Annuitas**), to engage staff (**Management**) to provide management services to each organisation. The Management Services Agreement between the Authority and Annuitas delegates authority to Management to enable it to carry out the day to day activity of the Authority and the Fund. This includes the management of functions contracted out to third parties for investment management, custody, scheme administration, legal, tax and advisory services.

In relation to investments, Management is responsible for the identification and implementation of appropriate strategies for the Authority to meet its obligations and objectives under the GSF Act. The Board retains the power of appointment of investment managers, custodians and external investment advisers. Management is delegated discretion to vary the Fund's asset allocation according to prescribed criteria and within prescribed limits pursuant to a dynamic asset allocation programme.

2.2 Standards

a) A custodian is appointed to separate investment decision-making (undertaken by the investment managers) from the holding of assets and securities, 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 in custody unless specifically authorised by the Board.

b) Cash required for operational liquidity purposes is managed by 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*

2.3 Procedures

Selection of managers is made in accordance with the Authority's Policy on Procurement of Services. It takes into account, among other criteria specific to the role:

- best-practice portfolio management;
- the skills and experience of the manager compared to peers;

- 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 procedures.

Selection of investment managers will be contestable and conducted through a request for proposal and interview process unless specific circumstances require a different approach.

Investment mandates shall include guidelines setting out eligible investments, performance criteria, constraints and exposure limits, including 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 Philosophy

3.1 Policies

The Authority meets its responsibilities under the Act by developing and implementing:

- principles for best practice portfolio management;
- an investment strategy centred on maximising return over the long term subject to a defined risk limit; and
- responsible investment policies to meet the requirement to avoid prejudice to New Zealand's (**NZ**) reputation as a responsible member of the world community.

3.2 Standards

The Authority interprets best practice portfolio management as:

- having a clear investment objective that reflects its statutory responsibilities and desired outcomes;
- maintaining a sound investment strategy consistent with that objective and the Authority's investment philosophy;
- having strong governance with clear assignment of responsibilities that promotes accountability, clear reporting and effective communication with the Fund's stakeholders;
- ensuring cost-effective management of investments by engaging an external custodian of its assets and managers with the requisite skills and alignment of interests with the Authority and monitoring their performance closely; and
- sharing relevant knowledge and resources with other Crown Financial Institutions, peer funds and experts.

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

The Authority's investment philosophy provides a foundation for its investment strategy. It represents the Authority's views with regard to the sources of investment return and risk and how these can be captured cost effectively, having regard to the Authority's attributes:

- The nature of the GSF's pension obligations allows the Fund to take a long term view for its investment strategy and tolerate short term volatility in market prices and a degree of illiquidity;
- To promote the Crown's interests, the Fund's investments focus on returns after foreign taxes but before NZ taxes;
- Implementation of the investment strategy is out-sourced to third parties. The Authority determines investment strategy, selects and monitors external managers. Investment operational risk is managed by robust contractual arrangements with an independent custodian and the out-sourced managers.

The Authority's Investment Philosophy is set out below. It is reviewed at least every four years.

	Investment Beliefs	**Investment Strategy**
a)	Risk and return are strongly related. Investment returns in excess of the risk-free rate are derived primarily from accepting risks of capital loss.	The Authority seeks returns in excess of the returns from NZ Government Stock by accepting additional investment risk.
b)	An easily accessed source of additional return is the expected reward for bearing risk from owning equities whose values fluctuate and may decline significantly.	Because the Fund has a long horizon and meets only part of the GSF's pension obligations it can tolerate the volatility associated with a high level of equity risk
c)	There are other investment risks that provide return as compensation independent of equity risk. These include, for example: the risk of inflation shocks, real interest rate shocks, and currency shocks, credit default, insurance risks and risks arising from investor aversion to heavily discounted assets, going against the crowd and illiquidity.	The Authority seeks exposure to these other risks to the extent it can instead of relying solely on equity risk. For example, the Fund has significant investments in private, i.e. illiquid, markets and insurance-linked assets.
d)	Diversification among various uncorrelated risks and return sources improves the overall reward-to-risk ratio.	The Authority aims to maximize reward for risk by capturing diversification benefits across and within asset classes.
e)	Broad market exposure is the main source of risk and return and can often be obtained cheaply. Isolating additional return sources is more costly.	Attention is paid to ensure costs are appropriate for the incremental value added and managers' incentives align with the Fund's interests.
f)	Asset prices do not always reflect all available information immediately. Although this provides opportunity to enhance returns with active management, real skill is rare and it is difficult to find active managers that can capture excess returns, net of their incremental fees and costs.	Active management is used where there is a high conviction that it offers a prospective return above passive investment in the broad market after allowing for incremental costs and risks. Multiple active managers are avoided where their active exposures compound total risk unduly.
g)	Returns are partly predictable over the long term but vary unpredictably in the short term. Extreme discrepancies between price and value provide opportunities occasionally to enhance risk-adjusted returns.	The Authority reviews the Fund's Reference Portfolio periodically to ensure its risk and return align with the objectives and adjusts the Fund's risk exposures in the interim in response to extreme price-value discrepancies.
h)	Responsible Investment encompasses not only maximising return for risk, but also acting in accordance with broadly accepted global standards of ethical conduct in relation to business governance, environmental and social risks.	The Authority does not invest in entities acting contrary to NZ's laws or international agreements and excludes direct tobacco investments. It is a member of the UNPRI and collaborates with other investors to avoid investing directly in companies that breach its standards of environmental and social behaviour and with whom engagement is unlikely to improve outcomes.

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 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.

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

c) **Fixed interest** comprising interest-bearing securities issued or guaranteed by sovereign governments and agencies and issued by non-sovereign issuers.

d) **Cash and short term securities** comprising NZ and foreign currency cash and interest-bearing securities with less than one year to maturity.

e) **Commodities** futures contracts traded on recognised public exchanges.

f) **Insurance-linked** securities providing exposure to natural catastrophe risks and longevity risks.

4.2 Standards

The Fund may invest in these asset classes through direct ownership of the assets, through collective investment vehicles that hold the assets (subject to section 15K which prohibits the Fund having a controlling interest) 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, subject to prudent limits approved by the Board.

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, limited partnerships, hedge funds and fund-of-funds. Private market assets are generally valued by appraisal, as described in section 12 'Valuation'.

4.3 Procedures

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 of 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

Investment Objective

Maximise the Fund's excess return relative to NZ Government Stock (before NZ tax) with a one in four chance of under-performing NZ Government Stock by 10% cumulatively measured over rolling ten 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, notional portfolio that could be managed at low-cost and return more than NZ Government Stock while meeting the Fund's risk objectives. The long term expected excess return of the Reference Portfolio varies somewhat over time. The Reference Portfolio also provides a benchmark to measure the Authority's performance in generating value-added returns. The current Reference Portfolio is set out in Table 1.

Table 1: Reference Portfolio and Benchmarks

Asset Class	Weight (%)	Benchmark
International equities	60	MSCI All Country World Index
NZ equities	10	S&P/NZX50 Gross Index including imputation credits
Fixed interest	30	Barclays GlobalAggregate Index
Total Assets	**100**	
Foreign currency exposure	20	

b) Target Portfolio

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

- taking exposure to sources of return not represented in the Reference Portfolio that are considered to be systematic reward for bearing risk of loss. These 'alternative beta' sources of return include illiquidity, style premia and insurance-linked risks for example; and
- capturing returns attributable to manager skill rather than systematic risk bearing, i.e. 'alpha'.

The Authority manages the Fund to a Target Portfolio that incorporates alternative risk premia and skill-based strategies and is expected to be a more efficient portfolio than the Reference Portfolio, i.e. improve risk-adjusted returns after fees and foreign tax. The current Target Portfolio is set out in Table 2.

Table 2: Target Portfolio

Asset Class	Weight (%)
International equities	55.0
NZ equities	9.6
Fixed interest	16.5
Style premia	5.0
Multi-asset class[1]	4.2
Natural catastrophe risks	6.0
Longevity risks	3.7
Total Assets	**100.0**
Foreign currency exposure	20.0

1 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.

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

c) Dynamic Asset Allocation (DAA)

From time to time the Authority may take temporary positions away from the Target Portfolio allocations in response to relative valuation signals. Those positions are expected to add returns as relative valuation returns to normal levels. The limits that each asset class may be tilted away from its Target Portfolio allocation are shown in Table 3.

Table 3: DAA Limits

Asset Class	Limit versus Target Portfolio Allocation (%)[1]
Cash vs equities vs fixed interest	+/-10
Developed market equities vs emerging market equities	+/- 5
NZ equities vs International equities	+/- 2
Developed market fixed interest vs emerging market fixed interest	+/- 5
Foreign currency exposure	+/-15
Foreign currency majors vs NZD[2]	+/- 10
High yield credit vs governments vs investment grade credit	+/- 5
Commodities and/or Property	+/- 5

1 Although the ranges have been expressed as symmetric, short exposures are not permitted.

2 Major currencies include USD, EUR, GBP, JPY, CHF, AUD.

d) Rebalancing Limits

Rebalancing limits define the extent to which the allocation to an asset class is permitted to deviate from the intended allocation (the Target Portfolio allocation set out in Table 2 plus any temporary changes in the allocation as a result of DAA decisions) before rebalancing trades are required. Rebalancing limits are expressed as deviations around the intended allocation. Asset classes are generally rebalanced once the rebalancing limits are breached.

Asset classes or components of asset classes that are not able to be readily traded are not subject to formal rebalancing limits but are monitored to ensure their exposure does not become excessive relative to their intended exposure.

The rebalancing and reset limits (relative to the intended allocation) are shown in Table 4.

Table 4: Rebalancing and Reset Ranges

Asset Class	Rebalancing Limits (%)
International equities	+/- 5
NZ equities	+/- 2
Fixed Interest	+/- 4
Natural catastrophe risks	+/- 4

5.3 Procedures

a) Review of Reference Portfolio

The Reference Portfolio is reviewed at least every four years taking into account the investment 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.

b) Review of Target Portfolio

The Target Portfolio is reviewed at least annually.

c) Rebalancing

Rebalancing takes place monthly to ensure the Fund remains aligned with the intended allocation 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 intended allocation 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.

d) Foreign exchange exposure and hedging policies

The Authority expresses its desired foreign currency exposures relative to the total portfolio. The hedge ratio for international equities is varied to deliver the desired total Fund foreign currency exposure taking into account any hedging within other asset classes and any DAA tilts.

e) Significant Asset Allocation Changes

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

f) Dynamic Asset Allocation

DAA tilts are generally implemented by the physical movement of assets (selling the asset to be under-weighted and buying the asset to be over-weighted). In the case of currency tilts, where there is a well-developed derivatives market, forward currency contracts and basis swaps are used.

DAA decisions within limits approved by the Board are determined by Management. Those decisions and their investment performance impact are reported to the Investment Committee and to subsequent Board meetings.

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 is the Reference Portfolio. The Fund's performance is also assessed by comparing the Reference Portfolio's investment return to NZ Government Stock, before NZ tax and after fees. The performance of individual asset classes or strategies is assessed by comparing their pre-tax performance with their respective benchmarks.

6.2 Standards

a) Actual Portfolio

The investment performance of the actual portfolio is monitored relative to the Reference Portfolio. The expected excess return of the Reference Portfolio above NZ Government Stock over rolling 10 year periods is reviewed regularly.

b) Asset Class and Strategy Benchmarks

For the purposes of assessing asset class or strategy performance, the benchmarks set out in Table 5 are adopted.

Table 5: Benchmarks

Asset Class	Benchmark
International equities	MSCI All Country World Index
NZ equities	S&P/NZX 50 Gross Index including imputation credits
Fixed interest	Barclays Global Aggregate Index
Style premia	US 3 month Treasury Bills + 6%
Multi-asset class[1]	Reference Portfolio (unhedged)
Natural catastrophe risks	Swiss Reinsurance Catastrophe Bond Total Return Index
Longevity risk	N/A[2]
Dynamic asset allocation	N/A[3]

1 A single portfolio comprising a diversified range of both public and private market assets including global equities, fixed interest, property, private equity, and absolute return strategies.

2 No benchmark is specified for the longevity risk (life settlements) investments because there is no single reliable measure of market performance. Instead it is monitored relative to initial return expectations and general market returns for life settlements.

3 The return attributable to DAA is determined based on the relative asset class benchmark returns.

Managers within an asset class may have specific benchmarks depending on their specific mandates. For example, in the case of international equities the MSCI All Country World Investible Markets Index, MSCI All Country World Index, 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 return before NZ tax with the Reference Portfolio and the NZ Government Stock index return. The Authority recognises that, from year to year, investment returns may not meet the expected excess return over Government Stock.

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 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 any fees due to the investment managers; and
- after transaction costs (but before custodian costs).

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

For the Fund's investments as a whole, for each asset class and for each investment manager, the custodian provides monthly reports to enable monitoring and review of the Fund and managers' performances. Those reports include:

- the cash 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;
- tax reclaims; 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 performances 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 Performance Expectations.

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 each 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's service level agreement.

Management reports to the Board on monthly rebalancing and DAA decisions.

8 Responsible Investment

Required under section 15M (d) – Ethical Investment, including policies, standards, or procedures for avoiding prejudice to NZ'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 Policies

As noted in the Authority's Investment Philosophy (Section 3.2) Responsible Investment encompasses more than maximising return for risk.

The Authority's RI Policies encompass:

a) avoiding prejudice to NZ'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.

Where an investment is found to contravene the Authority's RI Policies, the Board may engage with the issuer, exercise its voting discretion, or exclude or divest it from the Fund. Exclusion or divestment decisions may be reversed where subsequent advice indicates that the investment complies with the RI Policies.

In addition to the application of its RI Policies to the investments held in the Fund, the Authority:

- encourages the adoption of good corporate governance practices, including exercising voting entitlements consistent with maximising shareholder value and RI policies where possible;
- encourages investment managers to consider its RI policies and to integrate environmental, social and governance (ESG) factors into their investment analysis and/or engage with corporate entities as part of their investment process; and
- works with similar investors to enhance the effectiveness of its RI policies, which may include supporting collaborative initiatives.

8.2 Standards

Standards encompass direct investment in corporate securities (equity and debt), public debt and collective investment vehicles (**CIVs**).

The Authority excludes from the Fund direct interests in companies that are involved in the:

- manufacture of cluster munitions
- testing of nuclear explosive devices
- manufacture of anti-personnel mines
- manufacture of tobacco; and
- processing of whale meat.

These activities either contravene NZ law or international agreements to which NZ is a signatory or are clearly inconsistent with Government policy.

The Authority may also engage with or exclude investment in entities believed, on the basis of credible evidence from publicly available sources, to have participated in serious infringements of relevant international standards relating to human rights, labour and employment, severe environmental damage, bribery and corruption or infringements of international security and disarmament accords.

The Authority may also exclude companies for breaches of the Fund's RI standards where engagement was unlikely to be effective due to the context of the company's operations or to a lack of responsiveness from the company to the issue.

Investment in CIVs may be a practicable and cost effective way of achieving exposure to some investment opportunities. The Authority is prohibited by section 15K of the Act from owning controlling interests in CIVs, however, and usually has little influence over the structure of the CIV, the individual securities it holds or its individual voting decisions. In applying the RI Policies to a CIV the Authority assesses value to the Fund of the CIV as a whole rather than each security it may hold. The Authority communicates its RI policies to managers of CIVs in which it invests and encourages them to consider whether its policies are appropriate for the CIV. In addition, the Authority will review its investment if there is a material change in its mandate or strategy.

Investment managers are delegated responsibility to exercise voting rights on behalf of the Authority but the Authority retains the ultimate voting right. Managers are required to vote in the interests of the Fund and their voting record is monitored. NZ managers are required to advise the Authority of their voting intent where the issue is likely to be publicly contentious, against the recommendation of an approved proxy voting service or give rise to a conflict of interest. In such cases, Management may direct the manager's votes under delegation from the Board. Managers' voting record is summarised on the website every six months.

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

8.3 Procedures

The Board is accountable for the Authority's RI Policies. The Authority has a collaborative agreement with NZ Super and the Accident Compensation Corporation, which have similar RI obligations and are signatories to the United Nations Principles for Responsible Investment[2]. The agreement encompasses policy development, identification and analysis of high RI risks, co-ordination of engagement and exclusion activities, engagement of research providers, research sharing and communications.
The parties to the agreement meet regularly to review current engagements and exclusions, high risk securities, research and policy development.

[2] The UN principles for Responsible Investment can be viewed at *www.unpri.org*

With the assistance of NZ Super, the Authority implements its RI policies by:

- monitoring high risk issues and securities;
- monitoring portfolio investments against the RI policies;
- analysing RI issues and appropriate responses;
- excluding securities as appropriate;
- communicating the Authority's policies and decisions to investment managers;
- participating in collaborative engagements with other investors;
- monitoring managers' voting records; and
- publishing its RI policies and exclusion decisions (individual company engagements may be confidential).

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 Investment Objective 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, DAA and asset class 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 Investment Objective. Particular investments or strategies within collective investment vehicles may be leveraged or include leverage or be invested 'short' provided the overall risk of the CIV is acceptable. (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 at current and prospective market prices to ensure the Fund remains within permitted risk limits at all times.

c) Manager risk
The Authority retains external 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 less than the last 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 Investment Objective 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;
- 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 concentration of exposure to any single issuer of securities; and
  - 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 managers (including managers of collective investment vehicles) have adequate policies and procedures relating to leverage and derivative counterparties and monitoring managers' adherence 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 Target Portfolio and rebalancing procedures described in Section 5. In addition, liquidity risk is managed by:

- monitoring the Fund's liquidity monthly against prescribed levels approved by the Board;
- requiring managers to invest only in securities listed on recognised exchanges, except as specifically authorised by the Board;
- 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 a specific mandate for each investment manager, based on best practice portfolio management, except for investments in CIVs;
- separation of functions between investment management, custody, and specifying limits to the authority delegated to Management for dynamic asset allocation decisions;
- ensuring Management has sufficient resources to conduct the oversight function as part of its overall responsibilities;
- requiring fund transactions to be authorised by at least two persons; 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.

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

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.

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 standalone 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 NZ, or in countries with which NZ 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 vehicle; and

d) exposures outside the rebalancing range for each asset class, including ranges permitted pursuant to the dynamic asset allocation policy, (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 5, Table 4.

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 the most recent 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 SUPERANNUATION FUND AUTHORITY

GOVERNMENT SUPERANNUATION FUND
Te Pūtea Penihana Kāwanatanga