Reports and Financial Statements

for the year ended 30 June 2017

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 2017.

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 2017 Year

- A good year for investments with a return of 13.9% before tax and after investment management fees. This was 1.4% ahead of its benchmark Reference Portfolio and well above the 0.2% return on New Zealand (**NZ**) Government Stock.
- Over the last 5 years, the Fund investment return has averaged 12.1% per annum net of fees, 0.8% per annum ahead of its Reference Portfolio and 8.3% per annum above NZ Government Stock.
- Over the last 10 years, which spans the global financial crisis, the Fund investment return was 5.7% per annum net of fees, 0.1% ahead of its Reference Portfolio and 0.6% behind NZ Government Stock.
- During the financial year to 30 June 2017, $874 million was paid out to members of the GSF Schemes.
- The new Business System for the administration of the GSF Schemes successfully went live on 28 November 2016. The transition from the old outdated system to the new Business System has gone seamlessly with no disruptions to key stakeholders. ClearPoint Limited has been appointed to provide enhancement, operational and cloud support for the new Business System.

Investment Activity

The Fund's objective is to maximise the excess return above NZ Government Stock while limiting to 25% the chance of under-performing NZ Government Stock by more than 10% over rolling ten year periods. 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, private real estate funds and risk factors. These alternative sources of return diversify the Fund's risk, enabling higher total returns to be achieved at similar levels of risk. Active management is also used where there is a strong likelihood of added value net of any incremental costs. Nevertheless, global equity market risk remains by far the biggest investment risk to the Fund.

During year the Board approved an increase in the Fund's commitments to global private equity. The increase will occur over the next few years and will include commitments to primary buyout and growth funds, some venture capital and secondary stakes in more mature private equity funds. The Fund's existing private equity investments are now well into their 8 - 10 year lifecycles and are producing the expected higher returns both in NZ and offshore. The Board believes better quality private equity funds will generally provide higher returns than the public markets sufficient 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 the services of a global engagement service company to co-ordinate engagements with global companies that have serious issues around damage to the environment, human rights abuse and bribery and corruption. The Authority and other CFIs are members of the NZ Corporate Governance Forum which promotes good governance among listed NZ companies.

Schemes

The highlight of the year was the successful transition to the new Business System on 28 November 2016. Datacom continues to be the Authority's schemes administrator and ClearPoint Limited has been appointed to provide enhancement, operational and cloud support for the new system.

Further comment on GSF Schemes' activity can be found on page 12.

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 two reviews were undertaken in 2006 and 2011. The third review was completed in June 2016 by PricewaterhouseCoopers Securities Limited (**PwC**).

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

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

Overall, PwC stated they believe the Authority is a sound operation, run by experienced and capable people with an appropriate investment governance framework. PwC also made some recommendations in the review, noting some areas of development for the Authority, which will assist in continually improving its operations.

The Authority has considered the recommendations and developed action plans where appropriate to implement the recommendations. The action plans have been completed and are now part of the Authority's work programme. The recommendations and the Authority's responses have been published on the Authority's website.

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

Keith Taylor retired as Chairman of the Board at the end of April 2017. Keith joined the Board in August 2008 and became Chairman on 1 August 2011. The Authority and the Fund benefitted from his wide experience in investment, actuarial and governance matters. I succeeded Keith as Chairman from 1 May 2017 and I, and my fellow Board members, express our appreciation and thanks for the very significant contribution made by Keith during his time on the Board and wish him well in the future.

Dr Alison O'Connell joined the Board on 1 May 2017. Alison is also on the Board of the Education Benevolent Society Inc. and the Earthquake Commission. She is a Governor and former Director of the Pensions Policy Institute in the United Kingdom. Her background is in the financial services industry, mainly in strategic management roles including at Swiss Re and McKinsey. Alison's PhD is from Victoria University, Wellington. She has a Master of Arts in Mathematics from the University of Cambridge and a Master of Science in Gerontology from the University of London. Alison is a Fellow of the Institute of Actuaries in the United Kingdom and of the New Zealand Society of Actuaries.

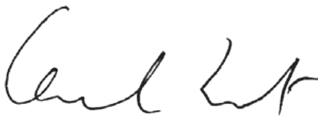
The Board has worked effectively and efficiently in 2016/17 with seven full Board meetings being held during the financial year.

The Board has two permanent committees - an Investment Committee chaired by Dr Craig Ansley and an Audit and Risk Review Committee chaired by myself until 30 April 2017. Shelley Cave became the Chairman of the Audit and Risk Review Committee following my appointment as Chairman of the Board. The Board had also established a committee to provide governance oversight to the new Business System project. This committee was chaired by Michelle van Gaalen and dis-established in June 2017 following the successful implementation and transition to the new Business System and the completion of the project. I would like to thank all of the committee chairs for the work they have undertaken during the year.

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.



Cecilia Tarrant
Chairman
Government Superannuation Fund Authority Board

6 September 2017

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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 assets 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 2017 and 2016, compared with the Reference Portfolio.

Table 1[1]: Asset Allocation

Asset Class	Investment Assets at 30 June 2017		Investment Assets at 30 June 2016		Reference Portfolio
	$m	%	$m	%	%
Global fixed interest	**537**	**12.6**	539	13.7	30
Global equities	**2,365**	**55.5**	2,054	52.0	60
Global private equity	**192**	**4.5**	228	5.8	-
NZ equities	**326**	**7.7**	368	9.4	10
NZ private equity	**86**	**2.0**	53	1.3	-
Commodity futures	**76**	**1.8**	80	2.0	-
Catastrophe insurance	**251**	**5.9**	268	6.8	-
Life settlements	**104**	**2.4**	123	3.1	-
Style premia[2]	**211**	**4.9**	127	3.2	-
Currency overlay[3]	**114**	**2.7**	107	2.7	
Total	**4,261**	**100.0**	3,947	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 32) because of different disclosure requirements for financial reporting purposes.*

[2] *Style premia comprises a mix of securities and derivatives across different asset classes structured to provide exposure to a blend of style premia or risk premia. This investment replaced a Global Tactical Asset Allocation strategy during the year.*

[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 2017 but may vary during the year.*

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

Investment Returns

Investment returns were strong in the 2017 financial year. The Fund return on investments for the year ended 30 June 2017 was 13.9% (before tax and after investment fees), outperforming the Reference Portfolio by 1.4%. Global equities returns of 16.3% were the big driver as global growth recovered. For the same reason global bonds suffered small capital losses that almost offset their low running yields. NZ equities performed in line with global markets. The Fund's alternative investments had a disappointing year but were comparable to the low returns on bonds.

Returns from global financial assets, especially equities, have been strong over the last 5 years. The risks from the global financial crisis in 2008 have receded and the global economy has returned towards more normal growth rates, which has been reflected in improving asset values.

The Fund's gross investment return of 13.9% last year exceeded the Reference Portfolio return by 1.4% and has averaged similar excess return for the last 3 years. This significant added value reflects strong contributions from the Fund's active global equities and bond managers. Over the last 5 years the Fund has returned 12.1% per annum net of investment fees. The comparative return for the same period for the Reference Portfolio is 11.3% per annum and for NZ Government Stock is 3.8% per annum.

Measured over the last 10 years, the Fund's return matches the Reference Portfolio but is 0.7% below NZ Government Stock as that period includes poor global equity market returns in the 2008 global financial crisis.

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 2017.

Table 2: Total Fund Return Summary

Return per annum to 30 June 2017	1 Year	3 Years	5 Years	10 Years	SI
Fund Net of Fees	**13.9**	9.6	12.1	5.7	7.2
Reference Portfolio	**12.5**	8.4	11.3	5.6	7.1
NZ Government Stock	**0.2**	5.5	3.8	6.3	6.0

Return comprises gross of fees returns prior to 30 June 2009 and net of fees thereafter.

Returns by Asset Class

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

Table 3

Asset Class	Year to June 2017		3 Years to June 2017	
	Actual	Benchmark	Actual	Benchmark
Total fund	**13.9**	**12.5**[4]	9.6	8.4
Global fixed interest	**4.6**	**0.8**	6.1	5.8
Global equities[5]	**16.3**	**15.4**	12.3	11.1
NZ equities	**13.5**	**11.6**	16.2	15.3
Catastrophe insurance	**1.2**	**1.5**	10.3	10.7
Life settlements	**-4.2**	**-4.4**	4.5	6.0
Currency Overlay	**3.3**	**3.1**	-3.3	-4.2

[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 economic outlook over the next year is for a modest rise in global growth and inflation. Consumption is being supported by continued gains in employment, some confidence has returned to the business sector which is lifting investment, while government finances have generally been put on a more sustainable footing allowing more expansionary policies to be pursued.

After almost a decade since the start of the global financial crisis many economies, most notably the US, are finally looking healthier. As a result, some of the extraordinary monetary stimuli that have been deployed are starting to be gradually unwound. This has begun in the US, with other regions such as Europe expected to follow suit over the coming year.

Financial markets are currently characterised by low volatility and low yields on financial assets. This is partly due to the unprecedented monetary stimulus and the lower macro-economic volatility this has engendered. Low yields on financial assets point to low returns in the future, both for equities and bonds. While expected returns for are low for both, the difference between the two is near the long-term average which implies equity investors are being compensated for higher risk.

Of course, to the extent policy stimulus has lowered economic and financial market volatility, its removal could heighten volatility in the short term. If the removal of stimulus is the result of an improving global economy, policy makers and longer term investors should 'look through' this volatility.

Political uncertainty and a potential slowdown in growth in China are the other main risks on the horizon. Given China's rising economic influence, a material slowdown could have consequences for global growth and asset returns. China's remarkable transition from an agrarian society to an industrial one in just a few decades has so far been relatively smooth. While some confidence in the China's economic management is justified, , the future path might be a bit bumpier.

Furthermore, asset valuations may not be fully reflecting all risks. Global bond yields appear low given the outlook for growth and inflation, so do global commodity prices notwithstanding some recent gains. As well as regional differences in risks, there are also some regional differences in valuations. Prices of NZ and US shares are high relative to earnings compared to other regions, such as Europe, and Japan reflecting their better relative growth. Similarly, the NZ dollar and US dollar are both high relative to long-term real exchange rates, so there may be some adjustment relative to other major currencies over the next year or so.

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 Policies (**RI** and **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 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 response times.

New Business System

The new Schemes administration Business System went live on 28 November 2016. The old system was more than fifteen years old and incorporated old technology that is no longer in common use in NZ. Whilst the overall project took longer than planned, the Authority is very pleased with the final outcome. The transition from the old system to the new Business System went seamlessly with no disruption to service or issues for key stakeholders, including the contributors, annuitants and employers. The new Business System has now been operating effectively for 10 months and there have been no unexpected issues.

The Authority has appointed ClearPoint Limited to provide enhancement, operational and cloud support for the new Business System.

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 6 September 2017

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

Cecilia Tarrant. Appointed as a Board member 25 August 2011, as Deputy Chairman as at 1 July 2013 and as Chairman from 1 May 2017. She is a director of Fletcher Building Limited, Seeka Limited, Payments NZ Limited and Annuitas Management Limited. She is a member of the University of Auckland investment committee and 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 as a Board member 1 November 2012 and as Deputy Chairman from 1 September 2017. Ms van Gaalen is currently Chief Executive of Pinnacle Life Limited and is a director of FlexiCard (and associated companies). She has previously held various executive roles including Director of Strategy and Business Performance for the BNZ.

Shelley Cave. Appointed 1 July 2014. Ms Cave is a director of Delegat Group Limited and 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 board member of the Financial Markets Authority, a director of Hohepa Auckland Regional Board and an Executive Director at Harbour Asset Management Limited. 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.

Alison O'Connell. Appointed 1 May 2017. Dr O'Connell is also on the Board of the Education Benevolent Society Inc. and the Earthquake Commission. She is a Fellow of the Institute of Actuaries in the UK and the New Zealand Society of Actuaries and formerly held executive roles at the Pensions Policy Institute, Swiss Re and McKinsey.

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 two permanent committees with specific responsibilities for Audit and Risk Review and Investments. The Chairman is an ex officio member of both committees.

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

- the power of delegation;
- the power to grant a power of attorney; and
- the power to appoint the scheme administration manager, investment managers, other service providers and the custodian.

Auditor

The Auditor-General is the auditor of the Authority. The Auditor-General has appointed Michael Wilkes of Deloitte Limited to act on his 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.

Annuitas has 14 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 equal employment opportunity employer.

Diversity of Staff

Ethnicity	Pakeha 12	Asian 2	Maori 0	Pacifika 0
Gender	Male 6	Female 8		
Age	Under 35 1	35-55 4	Over 55 9	

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 Management team is:

- Simon Tyler — Chief Executive
- 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
- Keith Poore — Manager, Asset Allocation

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 O1 – 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 assets of 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 2014.

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 return was below the NZ Government Stock return over the last 10 years compared to an expected excess return of 2.5% per annum. This period encompasses the global financial crisis when equities crashed. • Over the last 5 years the Fund returned 8.3% per annum ahead of NZ Government Stock.
• 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).	• The Fund's return net of investment costs and fees return was 1.4% ahead of the Reference Portfolio for the year and 1.2% per annum 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 5.5%, which was lower than the Reference Portfolio's 6.3% 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 added 1.4% in the last year and added 1.2% per annum over the last 3 years (net of fees). • Alternative strategies lagged the Reference Portfolio this year but matched it 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 similar to GSF. In calendar year 2016: – The Fund's 5 year return was 2.5%per annum above the peer median due mainly to greater risk arising from its larger policy allocation to equities. – 5 year value added from active management of 0.7% per annum net of fees was ahead of 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 by the Fund was offset by its lower manager fees.
• Independent statutory review every 5 years.	• The last statutory review was completed in 2016 and concluded, inter alia, 'the Authority 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 2016, global fixed interest management in 2017, NZ equities and global tactical asset allocation in 2016. • The Managers' overall returns, net of fees, were 1.5% ahead of benchmarks this financial year and 0.7% per annum 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 with independent advice and in the 5 yearly statutory review. The statutory review completed in 2016 concluded that the Authority'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.
• Review of custodian's performance against key performance indicators quarterly to determine that it meets its Service Level Agreement.	• 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.
• No direct investments that breach the RI Policies set out in the SIPSP.	• No breaches of RI Policies occurred.

Performance Measure	Performance Achievement
Comply with the SIPSP (continued)	
• All investments in CIVs in accordance with RI Policies in the SIPSP. • CIVs notified of the Board's RI Policies. • Measured by internal and external review.	• Investment in all CIVs complied with the SIPSP. This is reviewed both internally and by an external reviewer. • All CIVs are notified of the RI Policies.
Put in place a sound investment strategy consistent with the SIPSP and the Authority's Beliefs.	
• Board review of the investment strategy, including the key investment and taxation assumptions, at least annually that confirms the strategy is consistent with the SIPSP and the Authority's Beliefs.	• Achieved The SIPSP was reviewed by PwC as part of the 2016 statutory review and it is also reviewed annually by the Authority's investment adviser. • 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 2016 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.
*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 2016 the Fund maintained an 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 other 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 scheme 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 against KPIs is measured through monthly reporting by the scheme 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 and annual 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 new Business System has been operational since 28 November 2016 and supports the requirements of the Schemes administration team. • There has been no major loss or corruption of data or functionality during the year. A Business Continuity Plan is in place. • Data has been successfully extracted as required.

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 – timeframes being met. • Regular updating of website information on Schemes and Investment, sending the annual Chairman's letter to members by the end of September each year and sending member and employer updates. • Achieving consistently good satisfaction scores in the major aspects of the biennial survey of members and employers and positive feedback from other stakeholders. • Timely processing of appeals. On receipt of an appeal, complete papers are provided to the Appeals Board at least 14 days before each scheduled hearing.	Achieved: • Data required by the Actuary for reporting to Treasury was sent to the Actuary 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 2016, a member update in September 2016, an employer update in April 2017 and an annuitant update in March 2017. • The Authority carries out a biennial survey on a random sample of members (600) and employers (76). In the 2017 survey, satisfaction with information provided by the Authority to members and employers remained high and reasonably stable (83% and 74% respectively). Satisfaction with services and information provided by the scheme administrator to members and employers remained high and reasonably stable (87% and 84% respectively). • Overall satisfaction by members with the Authority's management of the schemes remains high at 86%. • Employer satisfaction with decisions made by the Authority increased significantly to 78%, the highest since the survey began in 2002. • Employer confidence in the Fund's investment arrangements remained stable while the numbers not that confident remained low. • Employer satisfaction with communications provided by the Authority and services provided by the scheme administrator remained consistently high and stable. • In the year to 30 June 2017, three 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 am pleased to present this report on the Government Superannuation Fund (**GSF** or the **Fund**) for the year ended 30 June 2017. 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 2017, the gross return was 14.6% before tax and expenses (2016: 2.6% before tax and expenses).

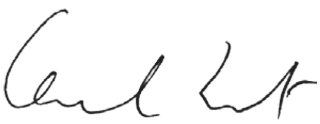
This annual report includes information on membership, and other matters required by the GSF Act. Commentary on the investment performance of the Fund starts on page 7 of the Authority's Annual Report.

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 26-27.



Cecilia Tarrant
Chairman
Government Superannuation Fund Authority Board

6 September 2017

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 2017:

- 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 $8,663 million (2016: $8,874 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.

Cecilia Tarrant
Chairman
Government Superannuation Fund Authority Board

6 September 2017

GOVERNMENT SUPERANNUATION FUND

Membership Commentary

Movement in contributors during the past five years:

Year ended 30 June	Total	Change Contributors	% Change
2013	11,464	(989)	(7.94)
2014	10,580	(884)	(7.71)
2015	9,767	(813)	(7.68)
2016	9,060	(707)	(7.24)
2017	**8,356**	**(704)**	**(7.77)**

Number of contributors, by scheme:

GSF Scheme	2017	% of Total	2016
General Scheme	**7,950**	95.14	8,624
Armed Forces	**124**	1.48	130
Police	**239**	2.86	257
Prisons Service	**35**	0.42	40
Judges and Solicitor-General	**3**	0.04	4
Parliamentary	**5**	0.06	5
Total contributors at end of year	**8,356**	100.00	9,060

Movement in the number of contributors during the year:

	2017	2016
Contributors at beginning of year	**9,060**	9,767
Cessation of employment before retirement	**(25)**	(36)
Death before retirement	**(51)**	(15)
Retirements	**(619)**	(651)
Transfer to other schemes	**(8)**	(5)
Withdrawals	**(1)**	(0)
Total contributors at end of year	**8,356**	9,060

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

Year ended 30 June	Total Annuitants	Change	% Change
2013	46,568	(70)	(0.15)
2014	46,359	(209)	(0.44)
2015	45,967	(392)	(0.85)
2016	45,635	(332)	(0.72)
2017	**45,279**	**(356)**	**(0.78)**

Movement in number of annuitants during the year:

	2017	2016
Annuitants at beginning of year	**45,635**	45,967
New retiring allowances	**619**	651
New allowances to spouses	**683**	738
Deferred pensions now in payment	**393**	319
Discontinued allowances	**(2,051)**	(2,040)
Total annuitants at end of year	**45,279**	45,635

There were 4,115 deferred pensions at 30 June 2017 (2016: 4,508).

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
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)
2017	**8,356**	**45,279**	**4,115**	**57,750**	**(1,453)**

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

	2017	%	2016	%
Contributors	**8,356**	**16**	9,060	17
Annuitants	**45,279**	**84**	45,635	83
	53,635	**100**	**54,695**	**100**

Granting a charge over contributions

In the year to 30 June 2017, 8 charges (2016: 13) were registered by the Fund in favour of charge holders as security over individual contributor's contributions.

Financial Statements

GOVERNMENT SUPERANNUATION FUND

Statement of Responsibility

The Financial Statements of the Fund for the year ended 30 June 2017 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 87, 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 2017, and the changes in net assets and the cash flows of the Fund, for the year ended 30 June 2017.

Cecilia Tarrant
Chairman
Government Superannuation Fund Authority Board

Simon R Tyler
Chief Executive

6 September 2017

GOVERNMENT SUPERANNUATION FUND

Statement of Changes in Net Assets

For the year ended 30 June 2017

	Note	2017 $000 Actual	2017 $000 Forecast	2016 $000 Actual
Change in assets from				
Investing activities				
Interest, dividends and other income	1	**103,399**	85,225	112,015
Changes in fair value of investment assets through profit or loss	2	**458,114**	170,455	2,939
		561,513	255,680	114,954
Operating activities				
Operating expenses	3			
Funding for the Authority	14	**(41,281)**	(40,444)	(43,388)
Impairment of the Business System	8	**-**	-	(10,721)
Surplus before tax and membership activities		**520,232**	215,236	60,845
Income tax (expense)	4	**(71,741)**	(49,668)	(73,540)
Surplus/(deficit) after tax and before membership activities		**448,491**	165,568	(12,695)
Membership activities				
Contributions				
Government	5	**690,457**	714,399	706,331
Members		**27,420**	27,000	32,670
Other employers		**17,758**	17,000	17,998
Total contributions		**735,635**	758,399	756,999
Benefits paid	6	**(873,825)**	(905,000)	(870,887)
Net membership activities		**(138,190)**	(146,601)	(113,888)
Net increase/(decrease) in net assets		**310,301**	18,967	(126,583)
Opening net assets available to pay benefits		**3,960,879**	3,952,249	4,087,462
Net assets available to pay benefits		**4,271,180**	3,971,216	3,960,879

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 2017

	Note	2017 $000 Actual	2017 $000 Forecast	2016 $000 Actual
Current assets				
Cash and cash equivalents		**191,848**	71,710	308,943
Derivative assets	13e	**106,727**	2,497	107,557
Trade and other receivables	7	**74,756**	21,470	45,189
Total current assets		**373,331**	95,677	461,689
Non-current assets				
Investments				
Commodities		**75,715**	70,188	80,413
Derivative assets	13e	**23,485**	1,450	19,381
Equities - NZ		**396,164**	410,000	399,572
Equities - International		**2,242,130**	2,054,423	1,826,838
Global fixed interest		**517,353**	581,526	524,286
Insurance-linked assets		**355,709**	438,103	391,872
Multi-asset and Style Premia Funds		**357,972**	393,262	311,521
Property – NZ		**6,439**	5,086	7,466
Other investments		**27,998**	2,406	38,990
Total investments	13e	**4,002,965**	3,956,444	3,600,339
Deferred tax asset	4	**293**	-	3,001
Business System	8	**22,984**	34,502	18,427
Total non-current assets		**4,026,242**	3,990,946	3,621,767
Total assets		**4,399,573**	4,086,623	4,083,456

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 2017

	Note	2017 $000 Actual	2017 $000 Forecast	2016 $000 Actual
Less liabilities				
Current liabilities				
Trade and other payables	9	**84,434**	31,266	78,301
Income tax payable		**27,134**	-	22,626
Derivative liabilities	13h	**14,664**	64,411	14,367
Total current liabilities		**126,232**	95,677	115,294
Non-current liabilities				
Derivative liabilities	13h	**2,161**	19,730	7,283
Total non-current liabilities		**2,161**	19,730	7,283
Total liabilities		**128,393**	115,407	122,577
Net assets available to pay benefits		**4,271,180**	3,971,216	3,960,879
Promised retirement benefits				
Gross liability for promised retirement benefits	12	**12,934,000**	12,299,000	12,835,000
Deficit		**8,662,820**	8,327,784	8,874,121
Net assets available to pay benefits		**4,271,180**	3,971,216	3,960,879

The Financial Statements were approved by the Authority Board on 6 September 2017.

Cecilia Tarrant
Chairman
Government Superannuation Fund Authority Board

Shelley Cave
Chairman
Audit & Risk Review Committee
Government Superannuation Fund Authority Board

6 September 2017

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

Statement of Cash Flows

For the year ended 30 June 2017

	2017 $000 Actual	2017 $000 Forecast	2016 $000 Actual
Cash flows from operating activities			
Cash was provided from:			
Government contributions - members	**653,913**	678,236	665,931
Government contributions - expenses	**36,731**	36,524	35,100
Members' contributions	**27,192**	27,135	33,150
Other employers' contributions - members	**16,060**	12,886	13,496
Other employers' contributions - expenses	**4,090**	4,064	4,814
Interest and dividends	**107,031**	86,218	111,625
Cash was disbursed to:			
Benefit payments	**(873,594)**	(905,000)	(871,230)
Income tax	**(64,526)**	(30,429)	10,303
Operating expenses	**(38,657)**	(40,554)	(41,729)
Net cash outflows from operating activities	**(131,760)**	(130,920)	(38,540)
Cash flows from investing activities			
Cash was provided from:			
Maturities and sales of investment assets	**3,950,794**	2,530,198	3,186,272
Cash was disbursed to:			
Purchase of investment assets	**(3,929,210)**	(2,405,631)	(3,134,306)
Business System	**(6,919)**	(8,143)	(10,319)
Net cash inflows from investing activities	**14,665**	116,424	41,647
Net (decrease)/increase in cash held	**(117,095)**	(14,496)	3,107
Opening cash and cash equivalents	**308,943**	86,206	305,836
Closing cash and cash equivalents	**191,848**	71,710	308,943

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 Changes in Deficit

For the year ended 30 June 2017

	2017 $000 Actual	2017 $000 Forecast	2016 $000 Actual
Opening deficit at the beginning of the year	**(8,874,121)**	(8,539,751)	(8,591,538)
Change in liabilities amount	**(99,000)**	193,000	(156,000)
Change in Net Assets	**310,301**	18,967	(126,583)
Closing deficit at the end of the year	**(8,662,820)**	(8,327,784)	(8,874,121)

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 2017, 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 2017

	2017 $000	2016 $000
Net increase/(decrease) in net assets	**310,301**	(126,583)
Non–cash items		
Deferred tax receivable/(payable)	**2,708**	42,064
Impairment of the Business System	**-**	10,721
Amortisation of the Business System	**1,641**	-
Total non–cash items	**4,349**	52,785
Movements in working capital items		
Benefits payable	**40**	360
Government contributions received in advance - benefits	**501**	(1,877)
Income tax payable	**4,508**	22,626
Income tax receivable	**-**	19,608
Investment expense payable	**949**	-
Investment payables	**3,497**	9,784
Investment receivables	**(32,605)**	558
Other employers' contributions received in advance – benefits	**1,834**	-
Other employers' contributions received in advance – expenses	**(21)**	-
Receivables and prepayments	**3,038**	(5,126)
Trade and other payables	**(667)**	775
Total movement in working capital items	**(18,926)**	46,708
Changes in items classified as investing activities		
Accrued interest portion of bonds	**800**	1,601
Accrued payments for Business System	**722**	230
Change in fair value of investment assets	**(458,114)**	(2,939)
Investment settlement receivables	**32,605**	(558)
Investment settlement payables	**(3,497)**	(9,784)
Total movement in investing activities	**(427,484)**	(11,450)
Net cash out flows from operating activities	**(131,760)**	(38,540)

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 2017

	2017 $000	2016 $000
Income from operations*		
Government contributions	**14,705**	14,985
Total contributions	**14,705**	14,985
Expenditure*		
Benefits paid:		
Retirements	**12,220**	12,059
Allowances capitalised	**-**	603
Spouses and children	**2,485**	2,323
Total Benefits paid	**14,705**	14,985
Net changes in net assets	**-**	-

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

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

Parliamentary Superannuation

Statement of Changes in Net Assets

For the year ended 30 June 2017

	2017 $000	2016 $000
Income from operations*		
Government contributions	**4,254**	4,354
Members' contributions	**64**	65
Total contributions	**4,318**	4,419
Expenditure*		
Benefits paid:		
Retirements	**3,580**	3,746
Spouses and children	**738**	673
Total Benefits paid	**4,318**	4,419
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.

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 treated as being registered on the managed investment schemes register under the Financial Markets Conduct Act 2013.

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 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 NZ 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 a previous allowance for impairment), for the Government Superannuation Fund Business System (**Business System**) have been capitalised.
The Business System went live in November 2016. Amortisation of the capital costs began at that time.

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 no allowance for impairment was made in the current year. This is discussed further on page 47.

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, from balance date, 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 2016 Statement of Performance Expectations, being for the period 1 July 2016 to 30 June 2017. 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.

(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 2016.

(x) Changes in accounting policies

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

Notes to the Financial Statements

For the year ended 30 June 2017

1. Interest, dividends and other income

	2017 $000	2016 $000
Equities – International	**45,932**	41,419
Equities – NZ	**14,956**	13,994
Global fixed interest	**20,651**	27,987
Insurance linked assets	**1,981**	3
Multi-asset and Style Premia Funds	**945**	3,858
Property – NZ	**775**	1,874
Short term and call deposits	**178**	608
Other income	**17,981**	22,272
Total interest, dividends and other income	**103,399**	112,015

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

	2017 $000	2016 $000
Commodities	**(2,518)**	(7,069)
Equities – International	**395,647**	(83,218)
Equities – NZ	**34,436**	64,262
Global fixed interest	**6,148**	16,214
Insurance-linked assets (net)	**7,293**	11,088
Multi-asset and Style Premia Funds	**18,240**	2,493
Property – NZ	**(1,027)**	(1,167)
Short term investments	**(105)**	336
Total changes in fair values of investment assets through profit or loss	**458,114**	2,939

** 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 90% (2016: 89%) of the Authority's administrative expenses reimbursed by the Fund. Other employers contributed the balance of 10% (2016: 11%).

4. Income tax

	2017 $000	2016 $000
Reconciliation to statement of changes in net assets		
Surplus before tax and membership activities	**520,232**	60,845
Add imputation credits	**3,723**	3,587
Net taxable income	**523,955**	64,432
Tax expense at 28%	**146,707**	18,041
Tax effect:		
Non-deductible (gain)/loss	**(109,508)**	22,727
Foreign Investment Fund income	**39,030**	35,295
Prior period adjustment	**(765)**	1,067
Imputation credits	**(3,723)**	(3,587)
Withholding tax credits	**-**	(3)
Income tax expense	**71,741**	73,540
Income tax expense comprises:		
Current tax	**69,798**	75,474
Deferred tax	**2,708**	(3,001)
Prior period adjustment	**(765)**	1,067
Income tax expense	**71,741**	73,540
Movement in deferred taxation		
Opening balance	**3,001**	45,067
Prior period adjustment	**-**	(983)
Current year movement	**(2,708)**	(41,083)
Deferred tax asset	**293**	3,001

5. Government and Employer contributions

	2017 $000	2016 $000
Government service superannuation contributions	**634,345**	648,377
Government Superannuation Fund Authority expenses	**37,153**	38,615
Judges and Solicitor-General superannuation contributions	**14,705**	14,985
Parliamentary superannuation contributions	**4,254**	4,354
Total Government contributions	**690,457**	706,331

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.

5. Government and Employer contributions *(continued)*

GSF Scheme	Member Contribution % of salary	Employer Contribution for year ended 30 June 2017 % of salary
General Scheme:		
- Non-funding employers*	6.5	11.5
- Funding except Islands**	6.5	between 11.3 and 14.9
- Islands	6.5	14.0
Armed Forces	7.6	14.4
Police	7.5	15.4
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 2016. As a result some changes to employer contribution rates were implemented with effect from 1 July 2017 (see Note 11).

6. Benefits and refunds paid

	2017 $000	2016 $000
Benefits:		
Allowances capitalised	**19,312**	19,970
Pension entitlements	**727,720**	733,552
Spouses and children	**120,070**	112,219
Refunds:		
Cessation of membership	**2,739**	2,205
Death	**1,547**	1,823
Transfers to other schemes	**2,437**	1,118
Total benefits and refunds paid	**873,825**	870,887

7. Trade and other receivables

	2017 $000	2016 $000
Government contributions - benefits	**-**	108
Government contributions - expenses	**3,737**	3,315
Government Superannuation Fund Authority	**81**	-
Interest and dividends	**6,004**	8,868
Investment settlements receivable	**61,594**	28,989
Members' contributions	**985**	844
Other employers' contributions - benefits	**721**	1,316
Other employers' contributions – expenses	**17**	-
Past service contributions	**907**	881
Pension entitlements	**323**	191
Prepaid benefits	**387**	677
Total trade and other receivables	**74,756**	45,189

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 went live with the new Business System on 28 November 2016. Amortisation of the asset began on that date resulting in $1.641 million being included within the operating expenses of the Fund. At year end it was reviewed against NZ IAS 36: Impairment of Assets which resulted in no provision for impairment being made (2016: $10.721 million).

9. Trade and other payables

	2017 $000	2016 $000
Benefits payable	**400**	360
Government contributions in advance - benefits	**501**	-
Government Superannuation Fund Authority	**4,149**	4,819
Investment expenses	**949**	-
Investment settlements payable	**76,246**	72,749
Members' contributions in advance	**355**	352
Other employers' contributions – benefits	**1,834**	-
Other employers' contributions - expenses	**-**	21
Total trade and other payables	**84,434**	78,301

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 2016. The report was tabled in Parliament on 20 March 2017. 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), Senior Consultant, Willis Towers Watson as at 30 June 2017 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 2016

Details of the statutory actuarial valuation, as at 30 June 2016, 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	5.0% per annum (2015:6.0%)
Consumer Price Index (long term)	2.5% per annum (2015:2.5%)
Salary growth	2.5% per annum (2015:3.0%)

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 2016 statutory valuation are:

	2016 $ million	**2015 $ million**
Past service liabilities		
Armed Forces contributors	4	4
General Scheme contributors (excluding Islands)	2,101	2,236
General Scheme contributors (Islands only)	63	64
Police contributors	193	198
Prisons Service contributors	14	15
Judges and Solicitor-General	9	11
Parliamentary	7	6
Pensioners	9,632	9,469
Deferred pensioners	813	821
Total past service liabilities*	12,835	12,824
Less value of Fund assets	3,961	4,087
Unfunded past service liability*	8,874	8,737

** Total may not add up due to rounding.*

11. Statutory actuarial valuation as at 30 June 2016 *(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	**2016 As a percentage of past service liability**	**2016 $ million**	**2015 $ million**
Vested Benefits			
Contributors:			
Armed Forces	100%	4	4
General Scheme-excluding Islands	109%	2,286	2,432
General Scheme-Islands	105%	66	65
Police	97%	187	190
Prisons Service	100%	14	15
Judges and Solicitor-General	100%	9	12
Parliamentary	100%	7	6
Total Contributors	108%	2,572	2,725
Pensioners:			
Pensioners	100%	9,632	9,469
Deferred pensioners	100%	813	821
Total Pensioners	100%	10,444	10,290
Grand total		13,016	13,015
Less net assets		3,961	4,087
Shortfall		9,055	8,928

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 2016. 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 2016, the Government pays 77.6% of each benefit paid (2015: 75.7%).

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. Statistical actuarial valuation as at 30 June 2016 *(continued)*

- for employers that are the Public Services of the Cook Islands, Niue or Tokelau, the employer contribution rate is certified as 15.0% 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. The resulting employer rates are then smoothed to reduce the immediate impact of a change in valuation methodology. Contribution rates include employer superannuation contribution tax **(ESCT)** and an allowance for expenses. A sample of average contribution rates at selected ages, before smoothing, is set out in the following table by age and gender:

Age	Males	Females
50	16.3%	16.4%
55	16.8%	17.0%
57	17.0%	17.2%
59	17.1%	17.3%
61	17.2%	17.3%
63	17.1%	17.2%
65	16.7%	16.9%
67	16.5%	16.6%

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 2016, after smoothing, are as follows:

- for the Armed Forces Scheme: a rate of 14.2% of contributor salaries;
- for the General Scheme: a rate of 12.4% of contributor salaries;
- for the Police Scheme: a rate of 16.0% 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 2017

The Actuary has valued the promised retirement benefits in accordance with NZ IAS 26, as at 30 June 2017, 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 2017 *(continued)*

Movement in promised retirement/past service benefit liability	**2017 $ million**	**2016 $ million**
Opening gross promised retirement/past service benefit liability	**12,835**	12,679
Movements in liability		
Expected changes	**(240)**	(187)
Experience (gains)/losses	**102**	(97)
Assumption changes:		
Change in discount rate, Consumer Price Index and salary assumption	**237**	317
Change in demographic assumption (including mortality improvement)	**-**	123
Closing gross promised retirement/past service benefit liability	**12,934**	12,835

Vested benefits – 30 June 2017

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 2017, are shown in the following table, where contributors include the inactive members.

Vested benefits	**2017 $ million**	**2016 $ million**
Contributors	**2,409**	2,572
Pensioners:		
Current pensioners	**9,860**	9,632
Deferred pensioners	**796**	813
Total pensioners	**10,656**	10,444
Total vested benefits	**13,064**	13,016
Less net assets	**(4,271)**	(3,961)
Shortfall*	**8,793**	9,055

** 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.

13. Financial instruments *(continued)*

b) Significant accounting policies

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

c) Capital risk management

The investment strategy, Reference Portfolio and Target Portfolio are reviewed regularly by the Authority, in conjunction with its advisors (see page 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.

	2017 $000	**2016 $000**
Financial assets at fair value	**4,109,692**	3,707,896
Financial liabilities at fair value	**16,825**	21,650
Financial assets at amortised cost	**266,604**	354,132
Financial liabilities at amortised cost	**84,434**	78,301

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)*

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

2017	Level 1 $000	Level 2 $000	Level 3 $000	Total $000
Financial assets at fair value through profit or loss				
Derivative financial assets	-	130,212	-	130,212
Insurance-linked assets				
NZ & Australia	-	59,749	-	59,749
North America	-	-	104,790	104,790
Rest of the world	-	-	191,170	191,170
Investments in cash				
Asia	26,622	-	-	26,622
Europe	856	-	-	856
North America	520	-	-	520
Investments in commodities				
NZ	-	75,715	-	75,715
Investments in equities				
Asia	330,026	-	-	330,026
Europe	362,018	-	-	362,018
NZ & Australia	349,308	-	79,766	429,074
North America	882,031	576,902	47,395	1,506,328
Rest of the world	10,848	-	-	10,848
Investments in fixed interest				
Asia	43,898	-	-	43,898
Europe	121,744	-	-	121,744
NZ & Australia	14,973	-	-	14,973
North America	285,063	36,412	-	321,475
Rest of the world	15,263	-	-	15,263
Investments in property				
NZ	-	-	6,439	6,439
Multi-asset and Style Premia Funds				
North America	-	357,972	-	357,972
	2,443,170	1,236,962	429,560	4,109,692
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities	-	16,825	-	16,825
	-	16,825	-	16,825

13. Financial instruments *(continued)*

e) Fair value measurements recognised in the Statement of Net Assets *(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				
Asia	170,756	-	-	170,756
Europe	306,564	-	-	306,564
NZ & Australia	381,572	-	46,597	428,169
North America	793,901	474,971	39,443	1,308,315
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 Style Premia Funds				
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)*

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

Movement of assets

There were no transfers of assets between level 2 and 3 during the 2017 year.

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

2017 Level 3 Investments	Insurance Linked Assets	Property	Private Equity
Opening balance Level 3	**335,554**	**7,466**	**86,040**
Purchases during the year	**-**	**-**	**39,730**
Gains/(losses) for the year*	**2,578**	**(1,027)**	**6,795**
Less return of capital	**(42,172)**	**-**	**(4,872)**
Less (sales) during the year	**-**	**-**	**(532)**
Closing balance at 30 June 2017	**295,960**	**6,439**	**127,161**

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

* *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 2017		Fair Value as at 30 June 2016		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	**130,212**	**-**	126,938	-	Valuation is derived using the Discounted cash flow techniques based on market exchange rates and interest rates	Not applicable	Not applicable
Multi-asset and Style Premia Funds	**357,972**	**-**	311,521	-	Discounted cash flow techniques using broker quotes, forward contracts and spot rates	Not applicable	Not applicable

13. Financial instruments *(continued)*

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

Financial Asset	Fair Value as at 30 June 2017		Fair Value as at 30 June 2016		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			
International equities	**576,902**	**-**	474,971	-	Discounted cash flow techniques using account comparable markets and advice from specialised advisors	Not applicable	Not applicable
Fixed interest	**36,412**	**-**	33,720	-	Discounted cash flow techniques using forward interest rates and trading spreads	Not applicable	Not applicable
Insurance linked assets NZ and Australia	**59,749**	**-**	56,318	-	Discounted cash flow techniques and option pricing models with reference to the current Fair Value of similar instruments	Not applicable	Not applicable
Insurance Linked North America	**-**	**104,790**	-	123,746	Discounted cash flow techniques	Mortality multiples and market rates for life settlement practices	The lower the mortality multiple the higher the Fair Value
Insurance Linked Rest of World	**-**	**191,170**	-	211,808	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	**-**	**6,439**	-	7,466	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

13. Financial instruments *(continued)*

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

Financial Asset	Fair Value as at 30 June 2017		Fair Value as at 30 June 2016		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			
Private equity	**-**	**127,161**	-	86,040	Discounted cash flow and earnings multiple techniques	Revenue, earnings and associated valuation multiples Local market conditions Indicative quotes	The higher the latest sale returns and quotes of similar products the higher the Fair Value
Commodities	**75,715**	**-**	80,413	-	Discounted cashflow techniques using broker quotes	Not applicable	Not applicable
	1,236,962	**429,560**	1,083,881	429,060			

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 70% of its value in a portfolio of equities and fixed interest securities (2016: 75%). Exposure to market risks is diversified by direct investment in private equity, insurance linked assets, a multi-asset fund and style-premia fund. 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.

13. Financial instruments *(continued)*

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 2017, the Fund does not have any single underlying investment exceeding 5% of the net assets (2016: nil).

During the year the Fund continued securities lending as a means of earning additional income from its investments. As at 30 June 2017, the Fund had approximately $117 million (2016: $209 million) 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 101% (2016: 99%) 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.

13. Financial instruments *(continued)*

h) Liquidity risk *(continued)*

	Less than 12 months $000	1-5 years $000	5+ years $000	Total $000
2017				
Unsettled purchases	**76,246**	**-**	**-**	**76,246**
Derivative liabilities	**14,664**	**758**	**1,403**	**16,825**
Other financial liabilities	**7,188**	**-**	**-**	**7,188**
Total	**98,098**	**758**	**1,403**	**100,259**
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

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 the style-premia fund.

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
2017					
Cash and cash equivalents	**0.38**	**191,848**	**-**	**-**	**191,848**
Fixed interest securities	**2.91**	**19,106**	**195,056**	**303,191**	**517,353**
Receivables for securities	**n/a**	**61,594**	**-**	**-**	**61,594**
Total		**272,548**	**195,056**	**303,191**	**770,795**

13. Financial instruments *(continued)*

i) Market risk *(continued)*

	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

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 a benchmark duration of 7 years (2016: 6.89 years) and at the end of the year the portfolio was valued at $517 million (2016: $524 million). A 1% rise in interest rates would devalue the portfolio in the order of $36 million (2016: $36 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 $29 million (2016: $26 million) (before tax) over a year.

Foreign currency risk management

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

The Fund undertakes certain transactions and holds investment assets denominated in foreign currencies, hence it is exposed to the effects of exchange rate fluctuations. Foreign currency exposures are managed within approved policy limits and parameters set out in the SIPSP. The Fund enters into contracts designed to hedge some or all of its exposure to foreign currencies.

The Authority has a benchmark exposure to foreign currencies of 20% of the total Fund on a before tax basis. The Authority adjusts the Fund's foreign currency exposure in accordance with defined tilting rules that reflect the prevailing valuation of the NZD. The Strategy is implemented by adjusting the hedge ratio on the International equities' portfolio.

13. Financial instruments *(continued)*

i) Market risk *(continued)*

Foreign currency risk management

Asset Class	After-tax Benchmark Hedge Ratio
Style Premia Fund	100%
Catastrophe Insurance	100%
Commodity Futures	100%
Global fixed interest	100%
International equities	69%
Life settlements	100%
Global Private Equity	0%

The Fund's total exposure to foreign currencies at the reporting date (after hedging) before tax was $981 million (2016: $754 million). On an after tax basis the total exposure to foreign currencies was equivalent to 20% of the Fund (2016: 20%). The Fund's foreign exchange exposure, before taking into account hedging was $3,279 million (2016: $2,808 million).

Foreign currency sensitivity

The Fund is mainly exposed to the Australian Dollar, US dollar (**USD**), Great Britain pound 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.

	Changes in NZD	Effect on surplus/(deficit) after-tax and before membership activities	
		2017 $000	**2016 $000**
Exchange rate risk	- 5%	**35,335**	38,534

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

13. Financial instruments *(continued)*

i) Market risk *(continued)*

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**	
		2017 $000	**2016 $000**
Market price risk	+ 5%	**107,865**	91,365

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 2017, the Fund paid the Authority $41,281,000 (2016: $43,388,000) for operating expenses, as detailed in the Statement of Changes in Net Assets. In turn, the Fund was reimbursed by the Government for 90% being $37,153,000 (2016: 89% being $38,615,000) and other employers for 10% being $4,128,000 (2016: 11% being $4,773,000). As at 30 June 2017 $4,149,000 was payable by the Fund to the Authority for expenses incurred but not yet paid (2016: $4,854,000).

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 2017 capital commitments were in place for multiple Investment Managers. These are summarised as follows:

	2017 $000	2016 $000
Non-cancellable contractual commitments		
Less than one year	**163,228**	67,558
Between one and two years	**159,513**	61,105
Total non-cancellable contractual commitments	**322,741**	128,663

There are no contingent assets or liabilities (2016: Nil).

17. Subsequent events

There have been no material events after balance date that require adjustments to, or disclosure in, the Financial Statements (2016: Nil).

Deloitte.

INDEPENDENT AUDITOR'S REPORT

TO THE READERS OF THE GOVERNMENT SUPERANNUATION FUND'S FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2017

The Auditor-General is the auditor of the Government Superannuation Fund (the Fund). The Auditor-General has appointed me, Michael Wilkes, using the staff and resources of Deloitte Limited, to carry out the audit of the financial statements of the Fund on his behalf.

Opinion

We have audited the financial statements of the Fund on pages 31 to 63 that comprise the statement of net assets as at 30 June 2017, 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 on pages 31 to 63:

- present fairly, in all material respects:
  - its financial position as at 30 June 2017; and
  - its financial performance and cash flows for the year then ended; and
- comply with generally accepted accounting practice in New Zealand in accordance with New Zealand equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

Our audit was completed on 6 September 2017. This is the date at which our opinion is expressed.

The basis for our opinion is explained below. In addition, we outline the responsibilities of the Government Superannuation Fund Authority Board (the Board) and our responsibilities relating to the financial statements, we comment on other information, and we explain our independence.

Basis for opinion

We carried out our audit in accordance with the Auditor-General's Auditing Standards, which incorporate the Professional and Ethical Standards and the International Standards on Auditing (New Zealand) issued by the New Zealand Auditing and Assurance Standards Board. Our responsibilities under those standards are further described in the Responsibilities of the auditor section of our report.

We have fulfilled our responsibilities in accordance with the Auditor-General's Auditing Standards.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of the Board for the financial statements

The Board is responsible on behalf of the Fund for preparing financial statements that are fairly presented and that comply with generally accepted accounting practice in New Zealand.

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

In preparing the financial statements, the Board is responsible on behalf of the Fund for assessing the Fund's ability to continue as a going concern. The Board is also responsible for disclosing, as applicable, matters related to going concern and using the going concern basis of accounting, unless the Board intends to liquidate the Fund or to cease operations, or has no realistic alternative but to do so.

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

Responsibilities of the auditor for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements, as a whole, are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit carried out in accordance with the Auditor-General's Auditing Standards will always detect a material misstatement when it exists. Misstatements are differences or omissions of amounts or disclosures, and can arise from fraud or error. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decisions of readers taken on the basis of these financial statements.

For the forecast information reported in the financial statements, our procedures were limited to checking that the information agreed to the Fund's statement of performance expectations.

We did not evaluate the security and controls over the electronic publication of the financial statements.

As part of an audit in accordance with the Auditor-General's Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit. Also:

- We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- We obtain an understanding of internal control relevant to the audit 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.
- We evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board.
- We conclude on the appropriateness of the use of the going concern basis of accounting by the Board and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Fund's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Fund to cease to continue as a going concern.
- We evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Our responsibilities arise from the Public Audit Act 2001.

Other Information

The Board is responsible for the other information. The other information comprises the information in the Reports, but does not include the financial statements, and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of audit opinion or assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information. In doing so, we consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on our work, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Independence

We are independent of the Fund in accordance with the independence requirements of the Auditor-General's Auditing Standards, which incorporate the independence requirements of Professional and Ethical Standard 1(Revised): *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards 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.

Michael Wilkes, Partner

for Deloitte Limited

On behalf of the Auditor-General
Christchurch, New Zealand

Statement of Responsibility

The Financial Statements of the Authority, for the year ended 30 June 2017, 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 17-22 clearly reflects the objectives of the Authority. The attached Financial Statements for the financial year fairly presents the financial position, as at 30 June 2017, and the operations and cash flows of the Authority for the year ended 30 June 2017.

Cecilia Tarrant
Chairman
Government Superannuation Fund Authority Board

Shelley Cave
Chairman
Audit & Risk Review Committee
Government Superannuation Fund Authority Board

6 September 2017

Statement of Comprehensive Revenue and Expense

For the year ended 30 June 2017

	Note	2017 $000 Actual	2017 $000 Forecast	2016 $000 Actual
Revenue				
Interest received		**29**	20	39
Transfer from the Government Superannuation Fund	1	**41,281**	40,444	43,388
Total revenue		**41,310**	40,464	43,427
Expenses				
Scheme administration		**5,656**	7,784	3,187
Investment management and custody	2	**31,544**	28,752	36,506
Operating	3	**4,110**	3,928	3,734
Total expenses		**41,310**	40,464	43,427
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 2017

	Note	2017 $000 Actual	2017 $000 Forecast	2016 $000 Actual
Equity				
General fund		**-**	-	-
Total equity		**-**	-	-
Represented by:				
Current assets				
Cash and cash equivalents		**41**	284	459
Trade and other receivables	4	**4,186**	4,230	4,851
Total current assets		**4,227**	4,514	5,310
Total assets		**4,227**	4,514	5,310
Current liabilities				
Trade and other payables	5	**4,227**	4,514	5,310
Total current liabilities		**4,227**	4,514	5,310
Net assets		**-**	-	-

The Financial Statements were approved by the Government Superannuation Fund Authority Board on 6 September 2017.

Cecilia Tarrant
Chairman
Government Superannuation Fund Authority Board

Shelley Cave
Chairman
Audit & Risk Review Committee
Government Superannuation Fund Authority Board

6 September 2017

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 2017

	Note	2017 $000 Actual	2017 $000 Forecast	2016 $000 Actual
Cash flows from operating activities				
Cash was provided from:				
Government Superannuation Fund	1	**41,234**	40,554	42,645
Interest		**29**	19	39
		41,263	40,573	42,684
Cash was disbursed to:				
Total expenses		**(41,681)**	(40,577)	(42,475)
Net cash flows from operating activities		**(418)**	(4)	209
Net (decrease)/increase in cash held		**(418)**	(4)	209
Opening cash and cash equivalents		**459**	288	250
Closing cash and cash equivalents		**41**	284	459

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

	2017 $000 Actual	2017 $000 Forecast	2016 $000 Actual
Net operating result	**-**	-	-
Movements in working capital items:			
Trade and other receivables	**665**	110	(639)
Trade and other payables	**(1,083)**	(114)	848
Net cash flows from operating activities	**(418)**	(4)	209

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 2017

	2017 $000 Actual	2017 $000 Forecast	2016 $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.

GOVERNMENT SUPERANNUATION FUND AUTHORITY

Statement of Accounting Policies

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

(i) Reporting entity

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 Public Sector PBE accounting standards, and comply with those standards.

Presentation currency and rounding

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

Standards issued but not effective

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

(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 largely 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 2016.
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 2017

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

	2017 $000	2016 $000
Custody expenses	**1,082**	1,474
Investment management expenses	**30,462**	35,032
Total investment management and custody expenses	**31,544**	36,506

3. Operating expenses

	2017 $000	2016 $000
Audit of financial statements	**206**	207
Board fees and expenses	**233**	220
Management fees – Annuitas	**2,587**	2,359
Other expenses	**1,084**	948
Total operating expenses	**4,110**	3,734

4. Trade and other receivables

	2017 $000	2016 $000
Annuitas Management Limited	**-**	27
Government Superannuation Fund	**4,149**	4,819
Other receivables and prepayments	**37**	5
Total trade and other receivables	**4,186**	4,851

5. Trade and other payables

	2017 $000	2016 $000
Business System related costs	**183**	933
Government Superannuation Fund	**81**	-
Investment management fees	**3,363**	3,949
Professional services and operating expenses	**567**	414
Other creditors	**33**	14
Total trade and other payables	**4,227**	5,310

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:

	2017 $	2016 $
Keith Taylor – (Chairman until retired on 30 April 2017)	**38,667**	46,400
Cecilia Tarrant – (Deputy Chairman until 30 April 2017, Chairman from 1 May 2017)	**34,433**	29,000
Craig Ansley	**26,913**	25,520
Shelley Cave	**24,467**	23,200
Ainsley McLaren	**24,467**	23,200
Alison O'Connell	**5,133**	-
Michelle van Gaalen	**26,913**	27,840
Total Board fees	**180,993**	175,160

The Authority also met Board members' travel and other expenses, including continuing education, where applicable, to attend Board meetings, and for travel on matters directly related to the business of the Authority. Travel and other expenses totalled $39,910 in 2017 (2016: $27,165).

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 $10,012 (2016: $15,559).

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 2017, the Authority received $41,281,000 (2016: $43,388,000) for operating expenses as detailed in the Statement of Comprehensive Revenue and Expense. As at 30 June 2017, $4,149,000 was due from GSF for expenses incurred (2016: $4,819,000).

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.

As at 30 June 2017, the Authority had appointed the Board chairman Cecilia Tarrant as a director of Annuitas. The costs of running Annuitas are shared between the Authority and the NPF on an equitable basis, as agreed between the two parties. The Authority paid fees for this service during the year amounting to $2,587,000 (2016: $2,359,000). No amount was owed to/by Annuitas at year end (2016: $27,000).

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.

8. Related party information *(continued)*

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.

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 investment management and custody, and operating expenses was over that forecast. This was the result of higher than anticipated investment management expenses (which are dependent on the value of the investment assets) and higher operating costs (see Note 3).

10. Contingent assets and liabilities

There are no contingent assets or liabilities at 30 June 2017 (2016: Nil).

11. Commitments

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

	2017 $000	**2016 $000**
Non-cancellable contractual commitments		
Less than one year	**2,827**	5,253
Between one and two years	**2,383**	4,729
Between two and five years	**2,476**	2,050
Total non-cancellable contractual commitments	**7,686**	12,032

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 (2016: Nil).

Deloitte.

INDEPENDENT AUDITOR'S REPORT

TO THE READERS OF GOVERNMENT SUPERANNUATION FUND AUTHORITY'S FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION FOR THE YEAR ENDED 30 JUNE 2017

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

Opinion

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 2017, 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 including a summary of significant accounting policies; and
- the performance information of the Authority on pages 17 to 22.

In our opinion:

- the financial statements of the Authority on pages 68 to 78:
  - present fairly, in all material respects:
    - its financial position as at 30 June 2017; and
    - its financial performance and cash flows for the year then ended; and
  - comply with generally accepted accounting practice in New Zealand in accordance with Public Benefit Entity Reporting Standards.
- the performance information on pages 17 to 22:
  - presents fairly, in all material respects, the Authority's performance for the year ended 30 June 2017, including:
    - for each class of reportable outputs:
    - its standards of delivery performance achieved as compared with forecasts included in the statement of performance expectations for the financial year; and
    - its actual revenue and output expenses as compared with the forecasts included in the statement of performance expectations for the financial year; and
  - complies with generally accepted accounting practice in New Zealand.

Our audit was completed on 6 September 2017. This is the date at which our opinion is expressed.

The basis for our opinion is explained below. In addition, we outline the responsibilities of the Government Superannuation Fund Authority Board (the Board) and our responsibilities relating to the financial statements and the performance information, we comment on other information, and we explain our independence.

Basis for our opinion

We carried out our audit in accordance with the Auditor-General's Auditing Standards, which incorporate the Professional and Ethical Standards and the International Standards on Auditing (New Zealand) issued by the New Zealand Auditing and Assurance Standards Board. Our responsibilities under those standards are further described in the Responsibilities of the auditor section of our report.

We have fulfilled our responsibilities in accordance with the Auditor-General's Auditing Standards.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of the Board for the financial statements and the performance information

The Board is responsible on behalf of the Authority for preparing financial statements and performance information that are fairly presented and comply with generally accepted accounting practice in New Zealand. The Board is responsible for such internal control as it determines is necessary to enable it to prepare financial statements and performance information that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements and the performance information, the Board is responsible on behalf of the Authority for assessing the Authority's ability to continue as a going concern. The Board is also responsible for disclosing, as applicable, matters related to going concern and using the going concern basis of accounting, unless there is an intention to merge or to terminate the activities of the Authority, or there is no realistic alternative but to do so.

The Board's responsibilities arise from the Crown Entities Act 2004, the Public Finance Act 1989 and the Government Superannuation Fund Act 1956.

Responsibilities of the auditor for the audit of the financial statements and the performance information

Our objectives are to obtain reasonable assurance about whether the financial statements and the performance information, as a whole, are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit carried out in accordance with the Auditor-General's Auditing Standards will always detect a material misstatement when it exists. Misstatements are differences or omissions of amounts or disclosures, and can arise from fraud or error. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decisions of readers, taken on the basis of these financial statements and the performance information.

For the forecast information reported in the financial statements and the performance information, our procedures were limited to checking that the information agreed to the Authority's statement of performance expectations.

We did not evaluate the security and controls over the electronic publication of the financial statements and the performance information.

As part of an audit in accordance with the Auditor-General's Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit. Also:

- We identify and assess the risks of material misstatement of the financial statements and the performance information, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- We obtain an understanding of internal control relevant to the audit 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.
- We evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board.

- We evaluate the appropriateness of the reported performance information within the Authority's framework for reporting its performance.
- We conclude on the appropriateness of the use of the going concern basis of accounting by the Board and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Authority's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements and the performance information or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Authority to cease to continue as a going concern.
- We evaluate the overall presentation, structure and content of the financial statements and the performance information, including the disclosures, and whether the financial statements and the performance information represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Our responsibilities arise from the Public Audit Act 2001.

Other information

The Board is responsible for the other information. The other information comprises the information in the Reports, but does not include the financial statements, and our auditor's report thereon.

Our opinion on the financial statements and the performance information does not cover the other information and we do not express any form of audit opinion or assurance conclusion thereon.

In connection with our audit of the financial statements and the performance information, our responsibility is to read the other information. In doing so, we consider whether the other information is materially inconsistent with the financial statements and the performance information or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on our work, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Independence

We are independent of the Authority in accordance with the independence requirements of the Auditor-General's Auditing Standards, which incorporate the independence requirements of Professional and Ethical Standard 1 (Revised): *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards 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 Authority.

Michael Wilkes, Partner

for Deloitte Limited

On behalf of the Auditor-General
Christchurch, New Zealand

Directory

AS AT 6 SEPTEMBER 2017

Government Superannuation Fund Authority Board

Craig Ansley
Shelley Cave
Ainsley McLaren
Alison O'Connell
Cecilia Tarrant *(Chairman)*
Michelle van Gaalen *(Deputy Chairman)*

Management

Annuitas Management Limited

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

Executive Office

Level 12, The Todd Building
95 Customhouse Quay
P O 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, Willis Towers Watson

Auditor

Michael Wilkes, Deloitte Limited, 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

Style Premia

AQR Capital Management, LLC

Insurance-Life Settlements

Apollo Global Management, LLC

Credit Suisse Securities (Europe) Limited

Insurance – Catastrophe

Fermat Capital Management, LLC

Nephila Capital Limited

Global Equities

Arrowstreet Capital Limited Partnership

Genesis Emerging Markets Investment Company *(terminated 31 July 2017)*

Lazard Asset Management, LLC

Marathon Asset Management, LLP

PanAgora Asset Management, Inc

Pzena Investment Management, LLC

Global Private Equity

Makena Capital Management (Cayman), LLC

StepStone Group, LP *(appointed 29 June 2017)*

Directory *(continued)*

New Zealand Equities

ANZ Investments Limited *(terminated 9 November 2016)*

Devon Funds Management *(appointed 9 November 2016)*

Harbour Asset Management Limited

New Zealand Private Equity

Direct Capital Management Limited

HRL Morrison and Company

Pencarrow Private Equity Management Limited

Pioneer Capital Management Limited

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

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	54.0
NZ equities	9.6
Fixed interest	16.5
Style premia	5.0
Global private equity	5.2
Natural catastrophe risks	6.0
Longevity risks	3.7
Total Assets	**100.0**
Foreign currency exposure	20.0

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%
Global private equity	MSCI All Country World Index + 3%
Natural catastrophe risks	Swiss Reinsurance Catastrophe Bond Total Return Index
Longevity risk	N/A[1]
Dynamic asset allocation	N/A[2]

[1]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.

[2]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 annually 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[1]. 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.

[1]*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 quarterly 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 is managed using forward foreign exchange contracts or basis swaps relating to the currencies in which the securities that comprise the portfolio are denominated, or their close proxies.

The investment management agreements for those managers actively using forward foreign exchange contracts include limits for the maximum exposure per counterparty. For other types of derivatives, there are dollar limits for the maximum exposure before collateral is required.

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