B.20 SOI (2011)

# GOVERNMENT SUPERANNUATION FUND AUTHORITY

## STATEMENT OF INTENT
1ST JULY 2011

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# 1. STATEMENT FROM THE BOARD

The Government Superannuation Fund Authority (**the Authority**) is an autonomous Crown Entity established under the Government Superannuation Fund Act 1956 (**the Act**).

The functions of the Authority are to manage and administer the Government Superannuation Fund (**GSF** or **the Fund**) and the GSF superannuation schemes (**the Schemes**) in terms of the Act.

In carrying out its functions, the Authority has established two outcomes:

1. Contribute to an improvement in the Crown's overall economic position by endeavouring to minimise the Crown's contributions to the Fund.
2. Meet the needs and reasonable expectations of stakeholders.

The Fund has an actuarial deficit in that its assets are significantly less than the gross liabilities of the Schemes. The deficit exists primarily because, over the years, successive governments have elected not to pay employer contributions on behalf of their staff. Instead, governments provided funding as entitlements were paid. The Authority places reliance on the provisions in the Act for the Minister of Finance (**Minister**) to ensure that sufficient funds are available, or will be available, to the Fund to pay entitlements as they fall due. Achieving the outcome of endeavouring to minimise the Crown's contributions to the Fund governs the Authority's management and investment of the Fund.

Stakeholders are the members of the Schemes, the employer contributors to the Schemes and the Crown. The Authority has determined the needs and reasonable expectations of:

- The members - for entitlements to be calculated correctly, consistent with the Act and the policies maintained by the Authority, and to be paid on time. Meeting this need and reasonable expectation is a key factor in the Authority's management and administration of the Schemes.
- The employers - for contributions to be minimised.

Outputs, that will assist in achieving the outcomes, and measures put in place to assess performance against the outputs are set out in Sections 3 and 4. The Authority places particular emphasis on ensuring the Fund's investment portfolio is efficiently constructed to meet its Investment Performance Measure and Risk Parameter (see page 7) and closely monitors investment returns relative to the assessed returns from its Reference Portfolio (see page 7). Investment management fees are also monitored against returns and the added value from active management strategies.

The Fund is expected to pay entitlements for the next 60 years or so. Therefore, the Authority takes a long term view when developing its investment strategy and investment performance is measured over rolling ten year periods. The Authority reviews its investment strategy regularly and believes the current strategy and risk profile are appropriate to achieve the Investment Objective over the Fund's long term horizon.

The second statutory review of the Authority will be undertaken, during the first half of 2011, by an independent consultant appointed by the Minister. Details of the matters to be covered by the review are set out on page 24.

Any recommendations arising from that review will be considered by the Board and, where appropriate, action plans developed for implementation in the year ended 30 June 2012.

If you are interested to learn more about the Authority, and its policies and operations, we invite you to visit our website at *www.gsfa.govt.nz*.

Tim McGuinness
**Chairman**

David May
**Deputy Chairman**

**May 2011**

# 2. THE AUTHORITY

## OPERATING ENVIRONMENT

*(section 141 (1)(a) of the Crown Entities Act)*

The Authority was established in 2001 to manage and administer the assets of the Fund and the Schemes in accordance with the Act.

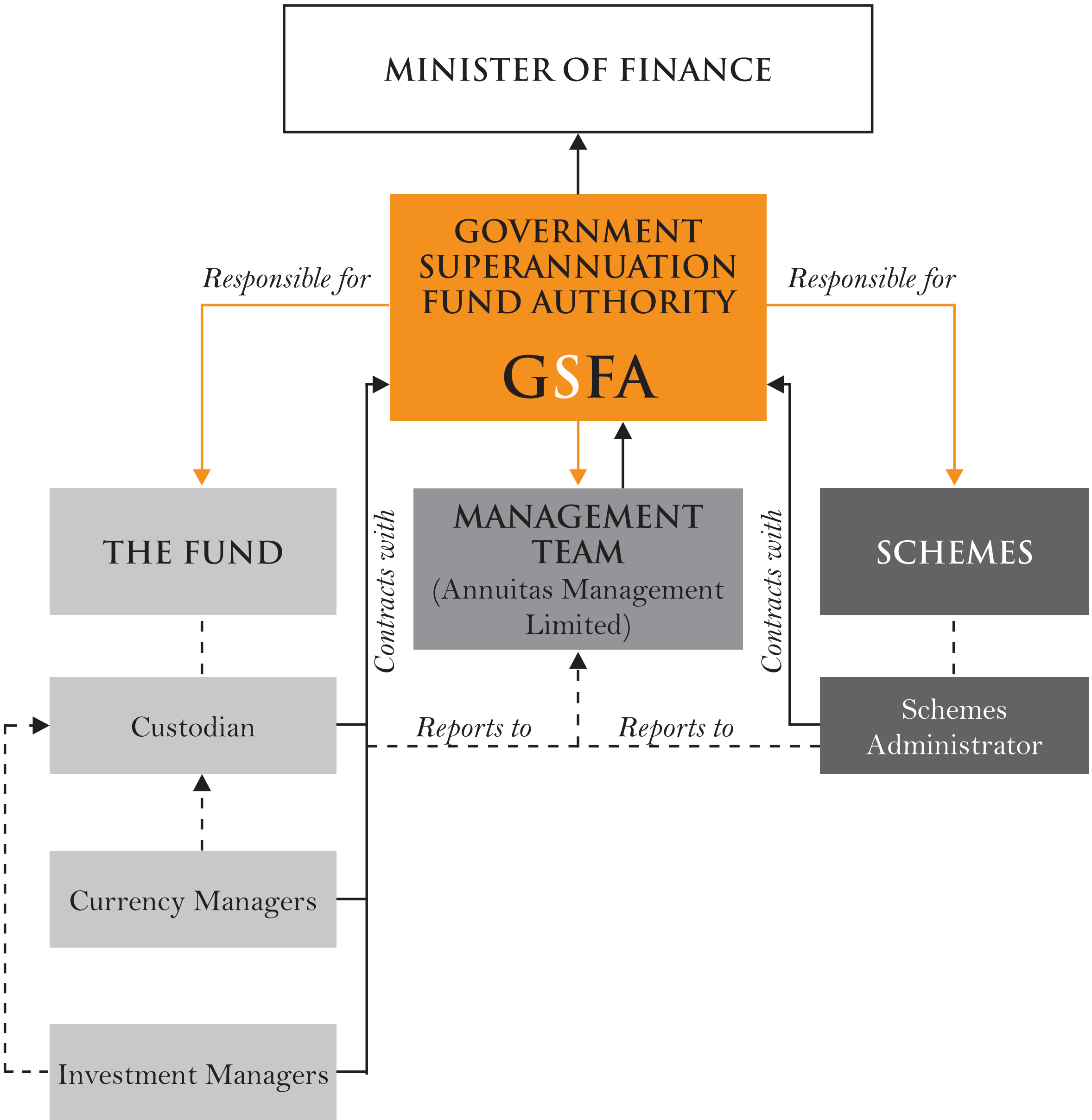
A Board, established by the Act and appointed by the Minister, governs the Authority and determines its business either directly or by delegation.

The Authority oversees the management of the Fund and the Schemes but has outsourced the key activities of scheme administration and investment management, including custody of the Fund's assets.

The Authority's organisational structure is set out in Diagram 1 on the next page. Further information on organisational structure is set out on page 21.

This Statement of Intent (**SOI**) is prepared pursuant to part 4 of the Crown Entities Act 2004 (**Crown Entities Act**). In addition, Section 15N of the Act requires the Authority to include in its SOI specific comments on the expected performance of investment assets of the Fund and the Schemes over the next financial year, as well as the risks to that performance and the steps taken to manage those risks. See pages 10 and 26.

**Diagram 1: Structure of the Government Superannuation Fund Authority and its operations**



# NATURE AND SCOPE OF FUNCTIONS

*(section 141(1)(b) of the Crown Entities Act)*

The Authority's functions are to manage and administer the Fund and the Schemes in accordance with the Act. All decisions relating to the business of the Authority are made under the authority of the Board, in accordance with section 25 of the Crown Entities Act.

The Minister has the power to add to the Authority's functions and may direct the Authority to have regard to Government policy relating to its objectives and activities. The Minister may also direct the Authority to meet the Government's expectations as to the Fund's performance, including the Government's expectations for risk and return, or not to invest in a specified investment or class of investments to which the Crown already has a direct or indirect exposure, for the purpose of limiting that exposure. No directions have been received from the Minister in terms of these powers.

The key activities of the Authority fall into the following two broad categories:

## Investment

- Management of the investment assets of the GSF (the Fund).

## Schemes

- Management and administration of the Schemes, including the agreement between the Authority and the scheme administrator.
- Interpretation of the provisions in the Act and exercise of discretionary powers (set out in the Act).

Details on the outputs and performance measures for these activities can be found on pages 6 –15 (Investment) and 16 - 19 (Schemes).

# 3. INVESTMENT

## OBJECTIVES AND STRATEGY

*(section 141(1)(c) and (d) of the Crown Entities Act)*

The Authority's responsibilities under the Act, with respect to investment, are to invest the Fund on a prudent, commercial basis, in a manner consistent with best practice portfolio management, whilst at the same time maximising returns without undue risk to the Fund as a whole and avoiding prejudice to New Zealand's reputation as a responsible member of the world community (**avoid prejudice**).

The Authority does this through:

- Developing and implementing principles for best practice portfolio management.
- Maximising return without undue risk to the Fund as a whole by careful management of the Fund, and by implementing an investment strategy designed to deliver returns over time in excess of the after tax returns from New Zealand Government Stock (a proxy for the rate at which the Crown could otherwise borrow money to pay entitlements), and which meets a risk parameter.
- Developing and implementing responsible investment policies to meet the requirement to avoid prejudice.

## BEST PRACTICE PORTFOLIO MANAGEMENT

The Authority interprets best practice portfolio management to encompass:

- Defining a clear investment objective that reflects its statutory responsibilities and outcomes.
- Maintaining a sound investment strategy consistent with that objective and the Authority's Investment Beliefs (**Beliefs**).
- Ensuring cost-effective management of investments measured through robust monitoring of performance.
- Having strong governance through clear assignment of responsibilities that promotes accountability, clear and transparent reporting, and effective communication with the Fund's stakeholders.
- Encouraging the sharing of relevant knowledge and resources with other Crown Financial Institutions (**CFIs**), peer funds and experts.

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

The Authority has established a set of Beliefs to provide a robust foundation for its investment strategy, and to communicate shared values about investment. The Beliefs comprise the Authority's views with regard to the sources of investment return and risk, and how these can be captured cost effectively. The Beliefs are published on the Authority's website *www.gsfa.govt.nz* and are reviewed annually.

The Authority seeks to achieve additional returns, above the returns that would be gained solely in Government Stock, by accepting a level of investment risk. Most of this risk is systematic or market risk, derived from owning equities and other growth assets whose values may fluctuate. There are also risks that the investment returns, generated by the experienced active investment managers engaged by the Authority, may be below their respective benchmarks.

The Authority has established a Statement of Investment Policies, Standards and Procedures (**SIPSP**) that sets out how these risks are managed. The SIPSP is reviewed and updated at least annually. The current version of the SIPSP is published on the Authority's website.

## MAXIMISING RETURN WITHOUT UNDUE RISK TO THE FUND AS A WHOLE

The Authority seeks to develop and maintain a diversified and efficient investment portfolio that will meet the Investment Objective (see below). It is implemented by allocating the Fund's assets, across a mix of exposures, to broad categories of market risk and return, and supplementing this with active, skill-based sources of return.

### Investment Objective (output)

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

In seeking to achieve this objective, the Authority balances the level of investment risk of the Fund and the expected excess return over New Zealand Government Stock. The Risk Parameter and Investment Performance Measure define this balance of risk and return.

### Risk Parameter

To have no more than a one in ten chance in any one year of a loss after tax greater than 9% of the total Fund.

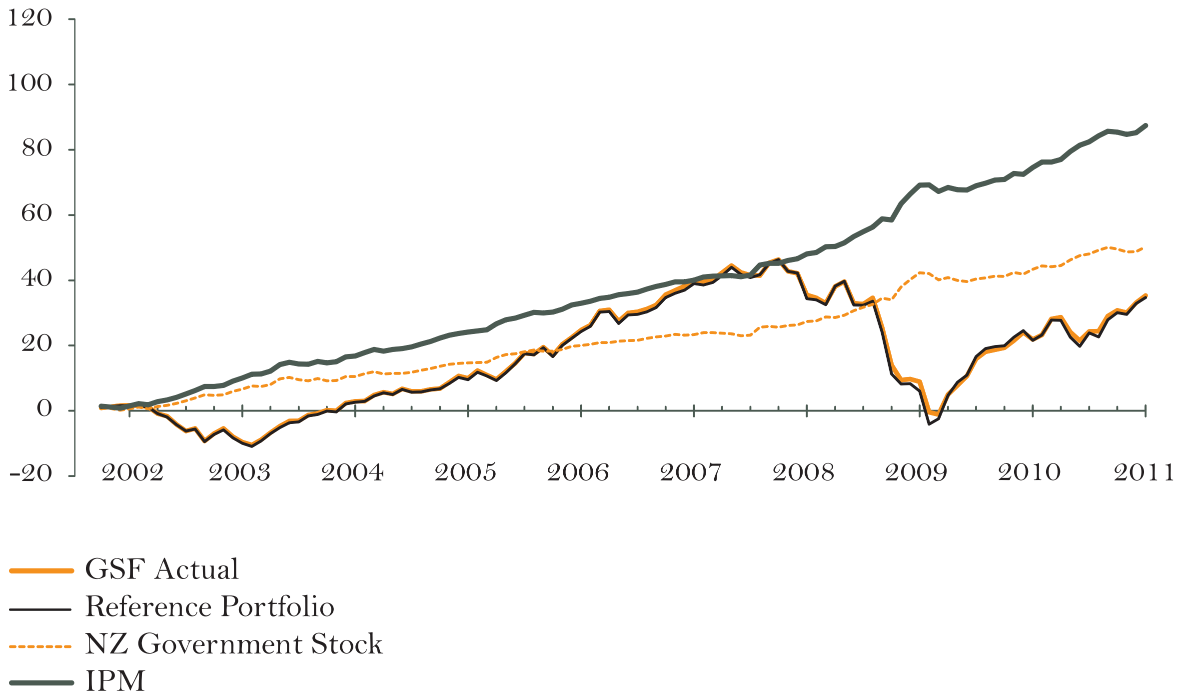
### Investment Performance Measure (IPM)

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

Since 2009 the Authority has also benchmarked its investment performance against a Reference Portfolio, which is a simple, passively managed, notional portfolio that could meet the Risk Parameter and the IPM by investing only in major, liquid public markets at low cost. Most of the Fund's performance is expected to be attributable to the market risk factors captured in the Reference Portfolio. However, the Authority believes certain alternative market exposures and active management can add value to the Fund, by improving returns and/or lowering risk, and also reflect best practice portfolio management. The extra cost and the potential added value are considered carefully before investing. The added value (net of any additional investment management fees) is measured against the Reference Portfolio.

The Fund's overall performance, since October 2001 when the Authority assumed responsibility for managing the Fund, is assessed by comparing its investment return with the IPM as illustrated in Graph 1 below. (Graph 1 is before investment management fees as data after investment management fees is not available prior to 1 July 2009).

### Graph 1: GSF Cumulative Returns since Inception (after tax, before fees)




Notwithstanding good returns in the last two years, the Fund has not achieved its IPM over the full period since inception in 2001. This reflects poor returns from global equities over this period, notably in 2000-02 and again in 2007-08.

It is important to recognise that the Fund will pay entitlements for the next 60 years or so and that the Authority takes a long term view in setting the investment strategy. Investment performance is measured over rolling ten year periods. Although returns have been below expectations in the almost ten years since inception, they were within the risk parameter set.

The Authority reviews its investment strategy regularly and believes the current strategy and risk profile are appropriate to achieve the Investment Objective over the Fund's long term horizon.

## AVOID PREJUDICE

The Authority has Responsible Investment Policies, which can be viewed on its website *www.gsfa.govt.nz*. In addition, it has developed programmes to monitor the risk of investments to New Zealand's reputation, exclude prejudicial investments (where practicable) engage companies on environmental, social and governance (**ESG**) issues and generally support greater integration into investment processes of material ESG issues.

The Authority is a signatory to the United Nations Principles for Responsible Investment (**UNPRI**). Where they are consistent with each signatory's fiduciary duties, signatories seek to address six aspirational principles established by UNPRI. The principles can be viewed on *unpri.org/principles*.

The Authority has entered into a resource sharing agreement with other CFIs to help the Authority meet its avoid prejudice obligations, including its UNPRI commitments, while minimising cost and duplication of effort.

## FORECAST SERVICE PERFORMANCE FOR 2011/2012

*(Sections 141(1)(c) and (d) and sections 142(2)(a) and (b) of the Crown Entities Act, and section 15N of the Act)*

The two outcomes established by the Authority for investment are to:

- Contribute to an improvement in the Crown's overall economic position by endeavouring to minimise the Crown's contribution to the Fund.
- Meet the needs and reasonable expectations of stakeholders – employer contributions to be minimised.

## Investment Performance Expectations for 2011/2012

The Board's forecast is based on long term average returns from each asset class held by the Fund (see Significant Assumptions used in the Forecast of the Fund on page 13.) The volatility of markets for growth assets like equities means that the forecast increase in assets from investing activities in any given year, included in the Forecast Income Statement for the Fund, is subject to a wide margin of error. Greater volatility and uncertainty exists about returns over 1 year than over 10 year periods. As a result, returns in any particular year are not necessarily indicative of the long term investment performance of the Fund. Actual returns from each asset class in the year may vary significantly from the long term return assumptions, which represent a mean or mid-point of the range of expected returns.

Table 1, on the next page, compares the forecast investment performance and risk of the Fund (the Projected Portfolio) with the Reference Portfolio.

Recognising the range of possible returns, the Board's forecast return for the Fund for the year ended 30 June 2012 is 8.0% after tax and before total investment costs (equivalent to the assumed return on the NZX New Zealand Government Stock Gross Return Index after tax of 4.6% per annum for the same period, plus 3.4%). The forecast return translates to a surplus after tax of $248 million for the Fund ($223.3 million after tax and total investment costs). The forecast includes an allowance for added value from active management strategies. By comparison, the Reference Portfolio is forecast to return 6.9% ($214 million) after tax and total investment costs.

The forecast return for the Fund is consistent with a 1 in 16 chance of a loss after tax greater than 9% of the total Fund. The forecast return for the Reference Portfolio is consistent with a 1 in 10 chance of a loss greater than 9%.

The risk of a loss greater than 9% of the total Fund is significantly less for the Projected Portfolio than for the Reference Portfolio. By including alternative market exposures and active management strategies in the Projected Portfolio, the Fund's risk is reduced significantly compared with investing in the Reference Portfolio. This is considered appropriate by the Authority given investment markets may be more volatile than usual in the medium term. If these enhancements were used instead solely to boost return rather than reduce risk, the Fund could earn an extra 1.9% after tax with the same level of risk as the Reference Portfolio, ie an estimated surplus of 9.0% after tax instead of 8.0% from the Projected Portfolio and 7.1% from the Reference Portfolio.

In addition, the surplus *after tax and before total investment costs* increases by 90 (798 – 708) basis points for the Projected Portfolio (compared with the Reference Portfolio).

These improvements are offset partly by a 56 (79 – 23) basis points increase in total investment costs. The surplus after tax and after total investment costs increases by 34 (719 – 685) basis points.

**Table 1: Projected Investment Performance and Risk for the Projected Portfolio and the Reference Portfolio for the year ended 30 June 2012**

| | PROJECTED PORTFOLIO[1] | | REFERENCE PORTFOLIO | |
|---|---|---|---|---|
| | $m | Basis points pa[2] | $m | Basis points pa[2] |
| **Investment performance** | | | | |
| Increase in assets from investing activities (*before tax and total investment costs*) | 293 | 942 | 266 | 853 |
| Surplus (*after tax and before total investment costs*) | 248 | **798** | 221 | **708** |
| Investment Performance Measure | | 690 | | 690 |
| Surplus (*after tax and total investment costs*) | 223.3 | **719** | 214 | **685** |
| **Investment risk** | | | | |
| Risk (*chance of loss after tax >9% of total Fund*) | | 600 (1 in 16) | | 1,000 (1 in 10) |
| **Investment costs** | | | | |
| Direct investment management fees | 19.9 | 64 | 4.5 | 15 |
| Custody expenses | 2 | 6 | 1 | 3 |
| Overheads (*share of Authority's operating expenses*) | 2.8 | 9 | 1.5 | 5 |
| **Total investment costs**[3] | **24.7** | **79** | **7** | **23** |

*Notes:*

1. *The Projected Portfolio is the portfolio used as the basis for projecting the increase in assets from investment activities (IA) as shown in the forecast Income Statement for the Fund.*
2. *One basis point equals 0.01%. Calculation of basis points use a divisor (a + b – i) based on the Fund's projected net assets available to pay benefits, as at 30 June 2011 for the Projected Portfolio and the Reference Portfolio (a) and 2012 (b), and the surplus after tax for the year ended 30 June 2012 (i) .*
3. *Total investment costs include the projected direct investment management fees and custody expenses and 70% (50% for the Reference Portfolio) of the Authority's projected operating expenses (see page 32). Investment costs are not deductible for tax.*
4. *Table 2 on page 14 shows the assumed asset allocations for the Projected Portfolio and the Reference Portfolio.*
5. *The IA assumes that active investment managers achieve only part of their performance targets. If all active managers achieved their performance targets the IA for the Projected Portfolio would increase by $25 million, less additional investment management (performance) fees of $1.4 million.*

## Outputs and Performance Measures

In addition to setting the Investment Objective and the IPM the Authority sets specific outputs and performance measures for investment. These will assist the Authority achieve the investment outcomes it has established.

Some outputs are ongoing, while others reflect specific projects that may be completed over a period beyond one year.

For the 2011/2012 year the Authority has identified the following service performance outputs and performance measures for investment:

| OUTPUTS | MEASURES |
|---|---|
| Manage investments to maximise returns over the long term, without undue risk to the Fund as a whole. | • Fund return versus the IPM.<br>• Actual performance (returns and assessed risk) compared to the performance of the Reference Portfolio to determine the added value of alternative asset classes and active management (net of additional fees and costs).<br>• Expected and actual volatility of Fund returns versus the Risk Parameter.<br>• Comparison of additional investment expenses to relevant global benchmarks and the Reference Portfolio and expected and actual value added, in terms of excess return and/or reduced risk, versus Reference Portfolio.<br>All measured by assessments by independent external investment advisors and by internal investment management. |
| Competitive investment costs justified by value added. | • Comparison of investment managers' actual performance against contracted mandates and return benchmarks, measured through independent reporting by the custodian and assessment by internal investment management, with monthly management reporting and quarterly reporting to the Board.<br>• Annual comparison of the Fund's performance and cost structure with those of similar organisations, prepared by independent party.<br>• Independent statutory review every 5 years. |
| Individual investment managers comply with contracted mandates and, where appropriate, out perform benchmarks. | • External review by independent adviser and periodic reviews by internal investment management. |
| SIPSP meets best practice. | • Periodic review by independent adviser that confirms the SIPSP meets best practice. |

| OUTPUTS | MEASURES |
|---|---|
| Compliance with SIPSP. | • No unauthorised variations from the SIPSP (which may be varied by the Board from time to time) identified on annual review.<br>• Actual asset allocation rebalanced monthly to within rebalancing tolerances set out in the SIPSP.<br>• Investment manager risk remains in line with expectation by comparing investment managers' actual risk profiles against expected risk.<br>• Review of quarterly key performance indicators to determine that the custodian's performance meets its Service Level Agreement. |
| Sound investment strategy consistent with the SIPSP and the Authority's Beliefs. | • At least an annual review of the investment strategy, including the key investment and taxation assumptions, that confirms the strategy is consistent with the SIPSP and the Authority's Beliefs. |
| Compliance with Responsible Investment Policies, including the Board's policies on ethical investment. | • No investments that breach the Responsible Investment Policies and the Board's policies on ethical investment.<br>Measured by internal and external review. |
| Collaborating with other CFIs to increase the extent to which the Authority meets the aspirational principles established by UNPRI consistent with its other investment responsibilities. | • Improved ratings on the implementation of the aspirational principles established by UNPRI, assessed by UNPRI review. |
| Sharing of relevant knowledge and resources with other CFIs, peer funds and experts. | • Endorsement of collaboration initiatives by key stakeholders. |
| The Authority complies with the Act. | Measured by external input that confirms compliance. |

## SIGNIFICANT ASSUMPTIONS USED IN THE FORECAST OF THE FUND

*(Sections 142(1)(d) and (e) of the Crown Entities Act)*

- Table 2 sets out the assumptions made for the asset allocations for the Projected Portfolio and the Reference Portfolio. The Authority seeks to enhance the Fund's performance by investing in certain alternative market and active management strategies, such as real estate, insurance linked assets, private equity (part of New Zealand equities) and global tactical asset allocation. These strategies are expected to result in a reduction in investment risk and/or an increase in returns, compared to the Reference Portfolio, after allowing for incremental costs.

**Table 2: Assumed Asset Allocations of the Projected Portfolio and the Reference Portfolio**

| ASSET CLASS | PROJECTED PORTFOLIO % | REFERENCE PORTFOLIO % |
|---|---|---|
| Global Equities | 42.1 | 55.0 |
| New Zealand Equities | 9.4 | 10.0 |
| Fixed Interest | 21.2 | 30.0 |
| Commodity Futures | 4.2 | 5.0 |
| Property | 5.0 | |
| Multi-Asset Class | 7.1 | |
| Catastrophe Risk | 4.0 | |
| Life Settlements | 4.0 | |
| Global Tactical Asset Allocation | 3.0 | |
| **Total** | **100.0** | **100.0** |

- The forecast assumes the projected asset allocation is rebalanced periodically.
- The Board's forecast of the performance of the Fund depends on assumptions with respect to the returns (before tax) from each asset class in the asset allocation. These assumptions are long term (see Table 3) and actual returns from each asset class over the next year may vary significantly from the long term return assumptions used.

**Table 3: Assumed Returns for each Asset Class (before tax)**

| ASSET CLASS | ASSUMED RETURN (BEFORE TAX) % |
|---|---|
| **Assets in the Projected Portfolio and the Reference Portfolio** | |
| International Equities | 10.4 |
| New Zealand Equities | 10.5 |
| Global Fixed Interest | 6.4 |
| Collateralised Commodities Futures | 7.2 |
| **Assets in the Projected Portfolio only** | |
| Real Estate | 7.8 |
| Multi – Asset Class | 10.0 |
| Catastrophe Risk | 9.0 |
| Life Settlements | 9.0 |
| Global Tactical Asset Allocation | 7.0 |

- Investment management agreements with managers contain return expectations and the methodology for calculating fees, based primarily on assets under management. Actual returns from each asset class in the year may vary significantly from expected returns. In addition, in projecting its expenses, the Authority allows for the payment of performance fees to some managers if agreed performance targets are exceeded. Consequently actual fees may vary from those projected.
- Currency hedging is in place for all international assets while leaving an overall level of foreign currency exposure the Board considers is prudent. The net currency exposure benchmark is currently 20% of the Fund's assets. The projections make no allowance for changes in the value of the New Zealand dollar against other currencies, which could affect the value of the unhedged portion of the Fund.
- Asset values, as at 1 July 2011, are projected from actual 31 January 2011 asset values.
- Projected entitlement payments from the Fund are $12 million per month.
- Taxation assumptions are summarised in Table 4 below.

### Table 4: Taxation Assumptions

| ASSET CLASS | TAX TREATMENT |
|---|---|
| Global equities, including real estate investment trusts and commingled funds that invest in diversified assets, collateralised commodity futures, catastrophe insurance linked securities. | • Tax at 28% on 5% of the opening value of the asset classes on a monthly basis, plus, in respect of "quick sales" during the year, tax on the lesser of the gain on sale (including dividends) or 5% of cost. |
| New Zealand equities. | • 0% on gains and all dividends fully imputed. |
| Selected Australian equities. | • 0% on gains, 28% on income. |
| Fixed interest and derivatives (including currency hedges and life settlements swaps). | • 28% on gains and income. |

# 4. SCHEMES

## BACKGROUND

The Schemes were established in 1948 to provide a way for public sector employees to save for their retirement.

The Schemes were closed to new members from 1 July 1992, except for people who were eligible for membership through their employment with certain Pacific Island governments. Membership was closed to these people in 1995.

There are seven Schemes, each of which is registered as a superannuation scheme under the Superannuation Schemes Act 1989.

Currently the Schemes have just over 67,000 members, made up of around 20,000 contributory members and deferred annuitants (ie members who have elected to receive their entitlements from a future date), and around 47,000 annuitants. It is expected entitlements will continue to be paid by the Fund for the next 60 years or so.

Members contribute a defined percentage of their superable salaries (which may be different to their total remuneration) to the Fund on a regular basis. In return, they receive a retiring entitlement based on their average superable salary for the last five years of contributory service, years of service and age at retirement.

Certain non Government employers contribute the balance of the accruing cost of their employees' retirement entitlements to the Fund. The Government, as an employer, meets its share of members' retirement entitlements as they fall due for payment. Therefore, the Schemes are only partially funded, with the accumulated employee contributions, investment returns and employer contributions (from non Government employers) being deemed by the Government Actuary to be sufficient to meet 21% of the entitlements at present (20% from 1 July 2011).

The actual and projected present values of the Unfunded Past Service Liabilities of the Fund have been calculated by the Government Actuary in his actuarial valuation, as at 30 June 2010, dated August 2010. The results are set out in Table 5. The Unfunded Past Service Liabilities are estimates of the Crown contributions required to meet the past service liabilities of the Fund.

**Table 5: Actual and Projected Unfunded Past Service Liabilities**

| | ACTUAL 30 JUN 10 $M | PROJECTED 30 JUN 11 $M | PROJECTED 30 JUN 12 $M |
|---|---|---|---|
| Past Service Liabilities | 12,344 | 12,318 | 12,237 |
| Net Assets[1] | 2,947 | 2,996 | 3,035 |
| Unfunded Past Service Liabilities[2] | 9,398 | 9,322 | 9,202 |

1. *It should be noted that investment markets have risen slightly since the Government Actuary carried out his valuation. The Board projects net assets to be $3,175 million, as at 30 June 2011, and $3,300 million, as at 30 June 2012.*
2. *The Unfunded Past Service Liabilities have been calculated by the Government Actuary using a net of tax discount rate. The Unfunded Past Service Liabilities, calculated using a gross discount rate, are recorded in the Crown's financial statements.*

The Authority is responsible for managing and administering the Schemes in accordance with the Act. The day to day administration of the Schemes is outsourced to Datacom Employer Services Limited (**Datacom**).

## OBJECTIVES AND STRATEGY

*(sections 141(1)(c) and (d) of the Crown Entities Act)*

The Authority aims to ensure sustainable, cost effective management of the Schemes to enable accurate calculation, payment and reporting of members' entitlements. The Authority does this by ensuring:

- contributions are collected and entitlements are calculated and paid correctly, in terms of the Act and the policies maintained by the Authority (**Policies**), and in a cost effective and timely manner; and
- service levels are met.

The sustainability of the Business System, used for administration of the Schemes, is fundamental to achievement of this strategy. The Business System is more than 15 years old and incorporates technology that is no longer in common use in New Zealand. People with relevant technology skills are becoming scarce. While the current Business System is stable, and the Authority is confident it will perform adequately in the short term, the Authority is developing a new Business System, which will be more relevant and sustainable over the longer term.

Also key in achieving the Schemes' outcome (see next page) is the performance of the scheme administrator, Datacom. The Authority has established and maintains a partnering relationship style with Datacom to ensure all issues relating to the administration of the Schemes are communicated early to the Authority and are managed and resolved in an open manner, taking into account the interests of the members and the Crown.

The Authority reports to the Crown on the value of the liabilities of the Fund. In this regard, section 94 of the Act requires the Government Actuary to undertake actuarial examinations of the Fund on a regular basis. A legislative change is proposed that will result in the position of Government Actuary being disestablished. Under the proposed change the role of the Government Actuary in the Act will be removed and replaced with an Actuary appointed by the Authority. It is envisaged the legislative change will come into effect from 1 October 2011. In 2011 a tender will be carried out by the Authority for the role of Actuary.

In communicating with members and employers, the Authority seeks to ensure information provided is both of a high standard and timely. This includes information on member entitlements and on the activities of the Authority.

The Authority interprets the provisions of the Act and the Policies, and exercises its discretionary powers, in relation to matters raised by members. The Authority seeks to achieve equity and consistency in its application of the provisions of the Act and the Policies.

## FORECAST SERVICE PERFORMANCE FOR 2011/2012

*(sections 142(1)(c) and (d) of the Crown Entities Act)*

The Authority's key activities in relation to the Schemes are:

- the management and administration of the Schemes, including the agreement between the Authority and the scheme administrator, Datacom; and
- interpretation of the provisions in the Act and the Policies and exercising discretionary powers (set out in the Act).

The outcome established by the Authority for Schemes is to meet the needs and reasonable expectations of stakeholders.

For 2011/2012 the Authority has identified the following outputs and performance measures to assist in achieving the Schemes outcome:

| OUTPUTS | MEASURES |
|---|---|
| Accurately calculate and pay entitlements, and process contributions correctly and on time, and respond appropriately to stakeholders' inquiries. | • Performance is in line with the key performance indicators (**KPIs**) set out in the Management Agreement between the Authority and scheme administrator.<br>KPIs are:<br>- 100% of all annuities are paid on time;<br>- all contributions are banked on receipt and allocated as soon as verified as being correct;<br>- all transactions are processed correctly;<br>- all routine correspondence is responded to within 5 working days; and<br>- all non-routine correspondence is responded to within 7 working days.<br>Performance against KPIs is measured through monthly reporting, with overall performance measured by monitoring the performance of the scheme administrator.<br>• The Business System is relevant and supportive of the requirements of the Schemes assessed by:<br>- no major loss or corruption of data or functionality;<br>- the ability to access required data from the current and new Business System; and<br>- the new Business System being completed on budget by 30 June 2012. |
| Responding appropriately to stakeholders' inquiries and providing relevant information. | • Timely responses to all requests from Treasury and the Government Actuary (and the Actuary to be appointed by the Authority) and meeting deadlines measured by:<br>- no requests being received for missing or incomplete information; and<br>- timeframes being met.<br>• Regular updating of website information, information on Schemes and Investment, sending annual Chairman's letter to members, sending member and employer updates.<br>• Achieving consistently good satisfaction scores in the annual survey of members and employers and positive feedback from other stakeholders.<br>• 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. |

Overall expected cost (Schemes) $4.4 million

*Note: Overall expected costs (Schemes) include the expected scheme administration expenses, estimated actuarial costs and 30% of the Authority's projected operating expenses (see page 32).*

# 5. ORGANISATIONAL HEALTH AND CAPABILITY

*(required under section 141(1)(e) of the Crown Entities Act)*

## GOVERNANCE

The Board is the governing body of the Authority and is responsible for making all decisions relating to the Fund and the Schemes. The Board has all the powers necessary for managing, and for directing or supervising the management of, the business of GSF.

The Minister appoints the members of the Board. The members have a wide range of experience and expertise in the investment, financial and business sectors.

The Authority has established a Corporate Governance Statement, which incorporates legislative and regulatory requirements as well as the policies and practices developed by the Board. This statement is available on the Authority's website *www.gsfa.govt.nz*.

The key policies and practices developed by the Authority are set out below:

- The Authority's obligations with respect to the Fund and the Schemes are supported by business planning, business risk assessment, management reporting, and arrangements for audit, internal control and compliance, all conducted on a regular basis.
- The Authority regularly reviews its own activities and the activities of Management, to ensure that clear and proper sets of accountabilities remain in effect, delegations are properly implemented, and reporting is comprehensive.
- The Board reviews its own performance annually and, at all times, aims to achieve best practice.
- The Board has established two committees:
  - Audit and Risk Review; and
  - Investment

  to perform and exercise the functions and powers of the Board delegated to each committee, as applicable. Committees have written terms of reference and ensure their activities remain consistent with the Crown Entities Act. Each committee reviews its performance annually and is also reviewed by the Board.
- The Board meets at least nine times per annum and ensures that it receives appropriate and reliable reporting on the Fund and the Schemes, and on the actions of its Management and other service providers.
- The Board regularly considers the resources required for the effective and proper management of the Fund and the administration of the Schemes and acts to ensure that resources available to the Authority, both internally and externally, align with these requirements. The Board aims to use resources of appropriate quality and capacity for its needs, at a reasonable cost. The Board ensures that comprehensive service level agreements are entered into with the major external service providers, which specify reporting and compliance standards.
- The Board has a systematic compliance programme with its service providers and any breaches of compliance are reported to the Board.
- The Board has established a risk management programme, which is implemented and reviewed quarterly by Management. The Audit and Risk Review Committee monitors matters of risk management and reports to the Board.

## ORGANISATIONAL STRUCTURE

The Authority has adopted an outsourced model for the key activities of scheme administration and investment management (including custody of the Fund's assets).

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 management and secretarial roles on behalf of the Authority and NPF. The MSA between the Authority and Annuitas contains delegations of authority to enable Management to carry out the day to day management of the Authority's investment, custody and scheme administration arrangements. At each meeting the Board receives reports from Management on all decisions made and matters determined under the delegations of authority.

The joint venture with NPF is seen to be the most appropriate way of providing the management and support required by the Board. The Schemes and the NPF schemes are closed to new members and both organisations have adopted an outsourced model for the major activities of investment, custody and scheme administration. Annuitas allows economies of scale and higher quality resourcing than could be justified if each organisation operated on a stand-alone basis.

The Authority has appointed:

- Datacom as the administrator of the Schemes. Datacom is responsible for the collection and processing of contributions to the Schemes, maintenance of member records, calculating, notifying, processing and paying of all entitlements under the Schemes, maintaining toll free lines and a help desk to log and process all oral and written enquiries, and maintaining the financial records of the Schemes. All interpretation issues and determinations, arising under the Act and the Policies, must be referred by Datacom to the Authority for decision;
- JP Morgan Chase Bank as the global custodian for the Fund. The custodian is responsible for the safekeeping of the assets of the Fund, settling transactions, and reporting on the performance and compliance of the investment managers appointed by the Authority; and
- specialist management organisations to undertake day to day investment decisions and trading, currency hedging and investment advice. The managers are listed on the Authority's website *www.gsfa.govt.nz*.

# ORGANISATIONAL DEVELOPMENT

Board members are appointed for three years and often serve two terms. The Board, through the Chairman, advises the Minister to help ensure an appropriate balance of skills and experience is maintained in the membership of the Board.

The Board generally sets aside one day per year for strategic planning and one day every second year for an investment workshop. During the strategic planning day the Board reviews its outcomes, outputs and performance measures (**Objectives**) in the context of the investment and superannuation environment. It assesses whether its strategies remain appropriate and the capabilities of the organisation to achieve its Objectives. In particular, the Board reviews the robustness and sustainability of systems and technology and assesses whether appropriate resources and skills are in place for the Authority and Management to achieve their accountabilities and responsibilities.

The investment workshop provides an opportunity for the Board and Management to receive presentations and discuss contemporary issues and new approaches relating to investment management, or other parts of the Authority's business. Board members are also encouraged to take advantage of training and development opportunities available in superannuation and investment.

The Authority maintains close working relationships with other CFIs. A formal collaboration process is in place to facilitate sharing of information and strategies with other CFIs where appropriate, including joint evaluation of investments.

Management of the Fund's assets and scheme administration will continue to be outsourced to specialist organisations. A key element of an outsourced model is to ensure each contracted manager, where appropriate, has in place a well planned and tested business continuity plan, including a disaster recovery programme (**DRP**). This is particularly important in the key areas of custody and scheme administration. The DRPs for the custodian and the scheme administrator are tested on a regular basis and reported to the Board.

A small Management team, reporting to the Chief Executive, is responsible for overseeing the key functions – investment, schemes administration and finance. Back up support is maintained to reduce key person risk. Management is responsible for identifying and implementing appropriate strategies for the Authority to meet its obligations under the Act and to meet the Objectives.

Each year performance objectives and standards are set for each of the key management functions and for senior Management, and progress is monitored regularly by the Board.

The Annuitas Board has a key role to resolve any conflicts or priority issues that may arise between the Authority and NPF. It has not been necessary for the Annuitas Board to exercise this function as Management has been able to manage the workloads, achieve the Objectives and meet deadlines to the satisfaction of both Boards.

# 6. CONSULTATION AND REPORTING TO THE MINISTER

*(required under section 141(1)(g) of the Crown Entities Act)*

## MATTERS REQUIRING CONSULTATION WITH THE MINISTER

The Authority is required to consult with the Minister on the following matters:

- The method for calculating interest on contributors' contributions, where the contributor is discharged or released from the regular forces in circumstances where no retiring allowance is payable (section 71K(b) of the Act).
- Approval of any class of transactions which involve:
  - borrowing money;
  - mortgaging or charging any of the real property of the Fund, whether present or in the future, as security; or
  - entering into a derivative transaction, or amending the terms of that transaction (where derivative transaction includes swaps, options, futures and any combination of those things).
- Approval to operate bank accounts outside the provisions set out in section 158 of the Crown Entities Act.

Approvals have been sought and granted for some of the matters outlined above. With regard to derivative transactions, the Minister has given approval for the Authority to enter into such transactions where the use is consistent with the SIPSP.

No approvals from the Minister have been necessary with respect to section 71K(b), or to borrow money and mortgage real property.

## REPORTING TO THE MINISTER

The financial statements of the Authority and the Fund are maintained and reported in accordance with the Act and the Crown Entities Act. The Act requires the Authority to report to the Minister on the Fund at intervals and include any information that the Minister requires. In addition to the annual reports of the Authority and the Fund, information is provided to the Minister for inclusion in the Crown's budget and economic updates. The Government Actuary calculates the Unfunded Past Service Liabilities for inclusion in the Crown's financial statements.

Treasury, through the Crown Ownership Monitoring Unit (**COMU**), also reports to the Minister on a quarterly basis, following consultation with the Authority, on the Fund's investment performance and on key operational issues. COMU will be consulting with the Authority on improving the reporting to the Minister. Commentary on the investment activities of the Authority is also included in the Crown's annual Investment Statement.

The Authority has introduced a Reference Portfolio (see page 7) against which the added value (before, and after, tax and investment management fees) of implementing alternative investment market exposures and the performance of active managers can be measured and reported quarterly. This assists the Authority in ensuring that investment management fees represent the optimal level of fees to meet the Investment Objective, as noted in the Minister's Letter of Expectation received in February 2011.

The Act requires that there must be conducted every five years a (independent) review of how effectively and efficiently the Authority is performing its functions under the Act. The second review will be undertaken in the year ended 30 June 2011 by an independent consultant appointed by the Minister. The review will consider:

- Whether or not, and how effectively and efficiently the Authority is performing its functions under section 15D of the Act.
- Whether or not the investment policies, standards, and procedures established by the Authority are appropriate to the Fund; and whether or not the investment policies, standards, and procedures established by the Authority have been complied with in all material respects.
- Whether the Authority's operations across all aspects of its organisation are consistent with best practice, in particular whether the level of investment management fees represents the optimal level of fees to meet the Fund's investment objectives and strategies.
- The investment performance of the Fund to date, including an assessment of how the Fund has performed against a passive fund management benchmark.

One of the Board's key tasks under this SOI is to consider any recommendations arising from the review and, where appropriate, developing action plans for implementation in the year ended 30 June 2012.

# 7. PROCESSES IN RELATION TO ACQUISITIONS

*(required under section 141(1)(h) of the Crown Entities Act)*

Section 141 of the Crown Entities Act requires the Authority to report on any processes to be followed for the purpose of section 100 (Acquisitions of shares or interests in companies, trusts and partnerships).

The Authority believes the intention of section 100 is to cover situations where the Authority buys shares to facilitate an acquisition strategy. The Authority has no plans to acquire shares for this purpose.

# 8. RISK MANAGEMENT

*(required under section 141(1)(i) of the Crown Entities Act and section 15N of the Act)*

A summary of the Authority's assessment of the key risks to the business, including the key risks to the performance of the Fund, and actions being taken to manage those risks is set out below.

## INVESTMENT RISKS

| RISK | ACTION TO MANAGE |
|---|---|
| Investment strategy and asset allocation are inappropriate. | • Diversify the assets and management techniques of the Fund.<br>• Seek professional advice on the investment strategy and asset allocation.<br>• Peer reviews of advice, and regular consultation with other CFIs and large investment funds.<br>• Review annually the SIPSP, as required by section 15L of the Act. |
| Poor performance of active investment managers. | • Robust selection process for all investment managers, based on demonstrated ability.<br>• Diversification among managers.<br>• Avoiding investment in strategies with low likelihood of adding value.<br>• Mandates for active investment managers based on best practice portfolio management.<br>• Regular monitoring and review of manager performance, especially in relatively new investment classes.<br>• Management agreements, which provide for dismissal at the discretion of the Authority. |

| RISK | ACTION TO MANAGE |
|---|---|
| Overall investment management risk. | • Specific mandate for each investment manager, based on best practice portfolio management.<br>• Constraints to govern credit and liquidity risks.<br>• Regular rebalancing of the Fund to approved risk exposure limits, and use of strategic tilts.<br>• Use of a custodian to hold securities, settle and record transactions, report on performance and monitor compliance of investment managers with mandates.<br>• Operational risk review of commingled investment vehicles, including robust due diligence of managers, and monitoring of their prior and ongoing contractual obligations.<br>• A comprehensive SIPSP developed and enforced by the Authority.<br>• Clear separation of functions between investment management, custody, and overall supervision.<br>• Appropriate resourcing of the Management team to conduct the oversight function. |
| Currency risk, for example the risk that the Fund will lose value through adverse exchange rate movements. | • Maintaining an overall level of foreign currency risk that is prudent in the context of the total Fund.<br>• Fully hedging currency exposures across the Fund's fixed interest and real estate portfolios and partly hedging the currency exposure in the other portfolios. |
| The assumed gross pre tax investment returns for each asset class are not achieved. | • Adoption of a diversified asset allocation for the Fund and appointment of investment managers, based on demonstrated ability, with benchmarks relevant to total portfolio risk. However, the volatility of investment markets means that the projected return from each asset class and the Fund is inherently uncertain. |
| Major structural changes to investment markets and/or taxation environment. | • Neither of these risks is within the control of the Authority. However, the Authority takes into account changes in these risks in its reviews of the investment strategy and asset allocation. |

## REPUTATION RISK

| RISK | ACTION TO MANAGE |
| --- | --- |
| Avoiding prejudice to New Zealand's reputation. | • Assessment of evolving practices in portfolio management, including review of their applicability to the Authority's business.<br>• Implementing a Responsible Investment programme in collaboration with other CFIs and with support services from the Guardians of New Zealand Superannuation.<br>• Determination of authorised investments (which may include authorised markets) in investment mandates.<br>• Exclusion of direct investment in tobacco, nuclear weapons, landmines and cluster bombs. |
| The Authority's reputation risk. | • Robust selection process for contracted managers.<br>• Comprehensive management and service level agreements and clearly defined and agreed mandates and reporting standards.<br>• Maintenance of an internal governance framework for appropriate fiduciary oversight, performance management and control of functions carried out by the Board and Management.<br>• Implementation of a comprehensive risk management programme.<br>• Sustainable management of the Schemes to enable accurate calculation, payment and reporting of members' entitlements.<br>• Clear communication with stakeholders. |

## SCHEMES RISKS

### Liabilities

The Fund's liabilities arise from the defined benefit schemes specified in the Act. Risks that may affect the liabilities include:

- Movements in the consumer price index (**CPI**) (all retiring allowances and spousal annuities are CPI indexed).
- The rate of increase in contributors' salaries, especially as it affects the last five years of contributory service.
- The discount rate used to value the liabilities.
- Factors affecting retirement or cessation of contributors, including state sector restructuring and privatisations.
- Patterns of entitlement selection on retirement.
- Mortality rates.

None of the above risks is within the control of the Authority. The Authority will, however, ensure that accurate and timely information is provided to the Government Actuary (and the Actuary to be appointed by the Authority) to enable preparation of actuarial projections of the liabilities in accordance with the provisions of the Act.

| RISK | ACTION TO MANAGE |
|---|---|
| The provisions of the Act, relating to the Schemes are not complied with and discretions relating to the Schemes are inappropriately applied. | • Monitoring the performance of Datacom and resolving any issues of interpretation of the Act.<br>• Ensuring all discretionary decisions are exercised in accordance with the Act and the Policies.<br>• Ensuring any changes to the Policies are made only after taking into account the interests of relevant persons, including the Crown, in accordance with the Act. |

## Administration

The Authority is responsible for the management and administration of the Schemes. Day to day administration duties are carried out by Datacom in accordance with an agreement that expires on 25 April 2013. In administering the Schemes, heavy reliance is placed on the Business System owned by the Authority.

| RISK | ACTION TO MANAGE |
|---|---|
| Poor performance by Datacom. | • Having a detailed scheme administration management agreement in place with Datacom, backed by a parent company guarantee.<br>• Maintaining a close liaison with Datacom.<br>• Monitoring Datacom's performance against the KPIs.<br>• Carrying out an annual survey that assesses, amongst other things, the level of satisfaction of members and employers with the service provided by Datacom.<br>• Taking remedial action on any issues identified in the survey. |
| Serious information technology problems. | • Ensuring any system modifications to the existing Business System are approved by the Authority and that the system is well maintained.<br>• Developing a new and more sustainable Business System (see comment below).<br>• Ensuring that Datacom has in place back up systems and a fully tested business continuity plan and disaster recovery plan and that systems reliability is regularly monitored. |
| *The Authority is undertaking the development of a new Business System, used for administering the Schemes. It is expected the project will be completed by June 2012.* | |
| Transition of data from the old to the new Business System. | • Development of a comprehensive transition plan.<br>• Contingency provided in the overall budget. |

# 9. FORECAST FINANCIAL STATEMENTS

## FORECAST FINANCIAL STATEMENTS FOR THE YEAR ENDING 30 JUNE 2012

### THE AUTHORITY

*(required under section 142(1)(a) of the Crown Entities Act)*

- Forecast income statement
- Forecast balance sheet
- Forecast statement of cash flows
- Forecast reconciliation of net operating result to net operating cash flows
- Statement of accounting policies

### THE FUND

*(required under section 15N of the Act)*

- Forecast income statement
- Forecast balance sheet
- Forecast statement of cash flows
- Forecast reconciliation of income statement to net operating cash flows
- Statement of accounting policies

# GOVERNMENT SUPERANNUATION FUND AUTHORITY

## FORECAST INCOME STATEMENT

| Estimate 2010/11 $000 | | Forecast 2011/12 $000 |
|---|---|---|
| 30,349 | Transfer from the Fund | 29,024 |
| 23 | Other revenue | 21 |
| **30,372** | **Total revenue** | **29,045** |
| 2,806 | Schemes administration | 3,167 |
| 23,812 | Investment management | 21,850 |
| 3,754 | Operating expenses | 4,028 |
| **30,372** | **Total expenses** | **29,045** |
| **-** | **Net operating result** | **-** |

## FORECAST BALANCE SHEET

| Estimate as at 30 June 2011 $000 | | Forecast as at 30 June 2012 $000 |
|---|---|---|
| | **Tax payers' equity** | |
| - | General funds | - |
| **-** | **Total tax payers' equity** | **-** |
| | Represented by | |
| | **Current assets** | |
| 110 | Cash | 150 |
| 2,584 | Receivables and prepayments | 2,320 |
| **2,694** | **Total assets** | **2,470** |
| | **Current liabilities** | |
| 2,694 | Payables and accruals | 2,470 |
| **2,694** | **Total liabilities** | **2,470** |
| **-** | **Net assets** | **-** |

# GOVERNMENT SUPERANNUATION FUND AUTHORITY

## FORECAST STATEMENT OF CASH FLOWS

| Estimate 2010/11 $000 | | Forecast 2011/12 $000 |
|---|---|---|
| | **Cash flows from operating activities** | |
| | *Cash was provided from* | |
| 29,712 | Government Superannuation Fund | 29,564 |
| 7 | Interest | 8 |
| 16 | Other | 13 |
| | *Cash was disbursed to* | |
| (29,840) | Operating expenses | (29,545) |
| (105) | **Net cash flows from operating activities** | **40** |
| (105) | Net (decrease)/increase in cash held | 40 |
| 215 | Opening cash brought forward | 110 |
| **110** | **Closing cash balance** | **150** |

## FORECAST RECONCILIATION OF NET OPERATING RESULT TO NET OPERATING CASH FLOWS

| Estimate 2010/11 $000 | | Forecast 2011/12 $000 |
|---|---|---|
| - | **Net operating result** | - |
| | *Add/(less) movements in working capital items* | |
| 3,828 | Decrease in receivables and prepayments | 264 |
| (3,933) | Increase in payables and accruals | (224) |
| **(105)** | **Net cash flows from operating activities** | **40** |

GSFA

# GOVERNMENT SUPERANNUATION FUND AUTHORITY

## STATEMENT OF ACCOUNTING POLICIES AND SIGNIFICANT ASSUMPTIONS

### Reporting entity and statutory base

The Authority was established as a Crown entity by section 15A of the Act as amended. The core business of the Authority is to manage and administer the Fund and the Schemes (see below).

The Fund was established by section 13 of the Act. It consists of various defined benefit superannuation schemes as prescribed in the Act. A separate financial forecast has been prepared for the Fund. Pursuant to section 19H of the Act, the Schemes are registered under the Superannuation Schemes Act 1989.

The forecast financial statements have been prepared on the basis that the Authority is a going concern. The Authority is an Autonomous Crown Entity for legislative purposes and, as the primary objective is not to make a financial return, the Authority has designated itself a Public Benefit Entity for the purposes of New Zealand Equivalents to International Financial Reporting Standards (**NZ IFRS**).

### Basis of preparation

#### Statement of compliance

The forecast financial statements have been prepared in accordance with section 142 of the Crown Entities Act 2004, which includes the requirement to comply with New Zealand Generally Accepted Accounting Practice (**NZ GAAP**). The forecast financial statements comply with other applicable Financial Reporting Standards, as appropriate for Public Benefit Entities.

These forecast financial statements have been prepared for the Statement of Intent of the Authority commencing on 1 July 2011 and for the Minister. They are not prepared for any other purpose and should not be relied upon for any other purpose.

Actual financial results achieved for the period are likely to vary from the information presented.

#### Measurement base

The forecast financial statements are prepared on the historical cost basis.

#### Functional and presentation currency

The reporting currency of the Authority forecast financial statements is New Zealand dollars and all values are rounded to the nearest thousand dollars ($000). The functional currency of the Authority is New Zealand dollars.

## Particular accounting policies

The following particular accounting policies, which significantly affect the measurement of financial performance, financial position, and cash flows, have been consistently applied:

### a. Forecast figures

The forecast figures have been prepared in accordance with generally accepted accounting practice, and are consistent with the accounting policies adopted by the Authority for the preparation of the financial statements.

### b. Revenue and expenses

Revenue and expenses are recognised on an accrual basis.

Revenue is measured at the fair value of consideration received/or receivable.

Revenue from the Fund is recognised as earned and reported in the financial period to which it relates.

### c. Goods and Services Tax

The Authority is principally an exempt supplier in respect of Goods and Services Tax (**GST**), as it manages superannuation schemes. GST is imposed on imported services if those services would be a taxable supply in New Zealand. The affected transactions for the Authority are fees incurred in relation to the custody of assets and investment reports undertaken overseas. GST on services is not reclaimable and GST is therefore included in expenditure.

### d. Statement of Cash Flows

The Forecast Statement of Cash Flows has been prepared using the direct approach.

### e. Taxation

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

### f. Accounting for associates

The Authority has a 50% ownership in Annuitas. Staff employed by Annuitas act in management roles on behalf of the Authority. Reimbursement of Annuitas costs, calculated on a time basis, are included in the operating expenses of the Authority. The Authority does not equity account for Annuitas as this is deemed to be immaterial.

## Changes in accounting policies

All policies have been applied on bases consistent with those used in the year ended 30 June 2010.

## Investment management expenses

Investment management fees (including custody costs) are forecast to reduce from $23.81 million in 2011 to $21.85 million in 2012. This is primarily due to a reduction in projected investment performance fees.

## Operating expenses

The forecast operating expenses does not include any expenditure on the Business System project. The cost of the project will be capitalised and amortised over 7 years from completion of the project. As the project is not projected to be completed until 30 June 2012, amortisation will not start until the next financial year.

## Recovery of expenses

The forecast expenses of the Authority, for the management and administration of the Fund and the Schemes for the 2011/2012 year, are $29.04 million. These expenses, net of other revenue of $0.02 million are recovered from the Fund in accordance with section 15E of the Act.

The Fund then recovers payments made to the Authority (forecast $29.02 million) partly from the Crown, under a Permanent Legislative Authority (**PLA**), and partly from non Government employer contributions.

The payments to the Authority by the Fund are recovered from the Crown and from non Government employer contributions in proportions determined by the Government Actuary. The Fund currently recovers 79.0% of the payments to the Authority from the Crown and 21.0% from non Government employer contributions. The Government Actuary has determined that, from 1 July 2011, the Crown's share will be 80.0% (forecast $23.22 million) and the share to be met from the non Government employer contributions 20.0% (forecast $5.80 million).

**The expenses of the Authority include:**

- Management of the GSF assets (the Fund).
- Expenses related to investment management, custodial arrangements and fees for implementing processes for avoiding prejudice to New Zealand's reputation as a responsible member of the world community.
- Management of the Schemes, including the agreement between the Authority and the scheme administrator.
- Interpretation of the provisions of the Act and the exercising of discretionary powers (set out in the Act).
- The fee paid to Annuitas under the management services agreement between the Authority and Annuitas.

## FORECAST INCOME STATEMENT

| Estimate 2010/11 $000 | | Forecast 2011/12 $000 |
|---:|---|---:|
| | **Increase in assets from:** | |
| 439,547 | **Investing activities** | **293,494** |
| | **Operating activities** | |
| 30,349 | Operating revenue | 29,024 |
| (30,349) | Funding the Authority | (29,024) |
| **439,547** | **Surplus before tax and membership activities** | **293,494** |
| (87,531) | Tax | (44,871) |
| **352,016** | **Surplus after tax and before membership activities** | **248,623** |
| | **Membership activities** | |
| 663,703 | Contributions - Crown | 684,472 |
| 51,926 | Contributions - members | 46,033 |
| 17,716 | Contributions - other entities | 13,094 |
| (857,328) | Benefits paid | (866,842) |
| **(123,983)** | **Net benefits paid** | **(123,243)** |
| **228,033** | **Surplus after tax and after membership activities** | **125,380** |
| 2,946,576 | Opening assets available to pay benefits | 3,174,609 |
| **3,174,609** | **Net assets available to pay benefits** | **3,299,989** |

# GOVERNMENT SUPERANNUATION FUND

## FORECAST BALANCE SHEET

| Estimate as at 30 June 2011 $000 | | Forecast as at 30 June 2012 $000 |
|---|---|---|
| 3,407,322 | **Investments** | 3,477,881 |
| | **Other assets** | |
| 191,647 | Cash and cash equivalents | 170,645 |
| 63,555 | Receivables and prepayments | 102,654 |
| 255,202 | | 273,299 |
| **3,662,524** | **Total assets** | **3,751,180** |
| | **Less** | |
| 484,981 | Other payables | 448,703 |
| 2,934 | Benefits accrued | 2,488 |
| 487,915 | | 451,191 |
| **3,174,609** | **Net assets available to pay benefits** | **3,299,989** |
| | **Estimated actuarial present value of Promised Retirement Benefits** | |
| 12,318,000 | Gross liability | 12,237,000 |
| 9,143,391 | Deficit | 8,937,011 |
| **3,174,609** | **Net assets available to pay benefits** | **3,299,989** |

*Note – Deficit*

*The estimated actuarial present value of Promised Retirement Benefits (Gross Liability) is the present value of the expected payments by the Fund to existing and past members, attributable to the services rendered. The present value has been calculated by the Government Actuary using a net discount rate.*

*The Deficit shown in the Forecast Balance Sheet differs slightly from that calculated by the Government Actuary in his actuarial valuation of the Fund, as at 30 June 2010, under NZ IAS 26, dated August 2010. The Government Actuary projected a lower value for the assets of the Fund compared with the forecast made by the Authority.*

*There is no requirement on the Crown to fully fund the Deficit in relation to the Schemes. 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.*

## FORECAST STATEMENT OF CASH FLOWS

| Estimate 2010/11 $000 | | Forecast 2011/12 $000 |
|---|---|---|
| | **Cash flows from operating activities** | |
| | *Cash was provided from* | |
| 680,679 | Contributions - Crown | 708,558 |
| 48,791 | Contributions - members | 46,885 |
| 25,355 | Contributions - other entities | 18,989 |
| 63,667 | Interest | 78,239 |
| | *Cash was disbursed to* | |
| (858,769) | Benefits payments | (869,727) |
| (75,151) | Income tax | (44,197) |
| (29,712) | Operating expenses | (29,564) |
| **(145,140)** | **Net cash outflows from operating activities** | **(90,817)** |
| | **Cash flows from investing activities** | |
| | *Cash was provided from* | |
| 5,492,396 | Maturities and sales of investment assets | 4,237,558 |
| | *Cash was disbursed to* | |
| (5,284,002) | Purchase of investment assets | (4,167,743) |
| **208,394** | **Net cash inflows from investing activities** | **69,815** |
| 63,254 | Net increase/(decrease) in cash held | (21,002) |
| 128,393 | Opening cash brought forward | 191,647 |
| **191,647** | **Closing cash balance** | **170,645** |

## FORECAST RECONCILIATION OF NET CHANGES IN NET ASSETS TO NET OPERATING CASH FLOWS

| Estimate 2009/10 $000 | | Forecast 2010/11 $000 |
|---|---|---|
| 228,033 | **Net increase in net assets** | 125,380 |
| | *Add/(less) movements in working capital items* | |
| 42,813 | (Decrease)/increase in receivables and prepayments | (39,099) |
| 112,663 | Increase/(decrease) in other payables | (36,278) |
| (895) | (Decrease) in benefits accrued | (446) |
| 154,581 | | (75,823) |
| | *Add/(less) items classified as investing activities* | |
| (1,968) | (Increase) in accrued interest portion of fixed interest securities | (1,783) |
| (378,685) | (Increase) in net market values of investment assets | (214,194) |
| (31,226) | (Decrease)/increase in investment receivables | 41,333 |
| (115,875) | (Increase)/decrease in investment payables | 34,270 |
| (527,754) | | (140,374) |
| **(145,140)** | **Net cash outflows from operating activities** | **(90,817)** |

# STATEMENT OF ACCOUNTING POLICIES

## Reporting entity and statutory base

The Fund was established by section 13 of the Act. It consists of the assets held in respect of various defined benefit superannuation schemes prescribed in the Act. Pursuant to section 19H of the Act, the Schemes are registered under the Superannuation Schemes Act 1989.

The Fund is managed by the Authority. The Authority was established as a Crown entity by section 15A of the Act and became an autonomous Crown entity under the Crown Entities Act 2004.

As the primary objective of the Fund is to make a financial return, the Authority has determined the Fund is a profit oriented entity for the purposes of New Zealand equivalents to International Financial Reporting Standards (**NZ IFRS**).

## Basis of preparation

### Statement of Compliance

The forecast financial statements meet the requirements of section 15N of the Act and comply with New Zealand Generally Accepted Accounting Practice (**NZ GAAP**).

The forecast financial statements also comply with New Zealand equivalents to NZ IFRS, and other applicable Financial Reporting Standards, as appropriate for profit oriented entities. Compliance with NZ IFRS ensures that the financial statements comply with International Financial Reporting Standards (**IFRS**).

These forecast financial statements have been prepared for the Statement of Intent of the Authority commencing on 1 July 2011 and for the Minister. They are not prepared for any other purpose and should not be relied upon for any other purpose.

Actual financial results achieved for the period covered are likely to vary from the information presented, and the variations may be material.

*Measurement Base*

The forecast financial statements have been prepared on the basis of historical cost with the exception that certain assets and liabilities are measured at fair value.

*Functional and presentation currency*

The reporting currency of the Fund is New Zealand dollars. All values are rounded to the nearest thousand dollars ($000). The functional currency of the Fund is New Zealand dollars.

## Particular accounting policies

The following particular accounting policies, which significantly affect the measurement of changes in net assets, net assets and cash flows, have been consistently applied:

**a. Reporting requirements**

The forecast financial statements have been drawn up in accordance with NZ IAS 26: *Accounting and Reporting by Retirement Benefit Plans*, and with the provisions of relevant legislative requirements.

**b. Investments**

Investments are recorded on a trade date basis and are stated at fair value.

**c. Actuarial valuation**

The actuarial present value of promised retirement benefits is the present value of the expected payments by the Fund to existing and past members, attributable to the services rendered.

**d. Financial instruments**

The Fund is party to financial instruments as part of its normal operations. These financial instruments include bank accounts, investments, receivables and payables. Financial instruments, including derivatives that are hedges of specific assets, are recognised on the same basis as their underlying hedged assets. All financial instruments are recognised in the Balance Sheet and all revenues and expenses in relation to financial instruments are recognised in the Income Statement.

Investments are recorded at fair value and all other financial instruments are shown at their estimated fair value.

**e. Receivables**

Receivables are carried at amortised cost.

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

**f. Investment income and expenses**

Dividend income is recorded on the ex-dividend date. Interest is recorded on an accrual basis.

Gains and losses on the sale of equities are determined by using the average cost of equities sold and are recorded on the settlement date.

All realised and unrealised gains and losses, at the end of the year, are included in the Income Statement.

Costs of administration of the Fund, including investment management and custodian fees, are paid out of the Fund and recovered in accordance with section 15E of the Act.

**g. Operating revenue**

In terms of section 15E(1) of the Act, the administration expenses of the Authority, including investment management and custody expenses, are reimbursed by the Fund. Both the Crown and other employers reimburse the Fund under section 95 of the Act for the Authority's expenses.

**h. Contributions and benefits**

Contributions are recognised in the Income Statement, when they become receivable, resulting in a financial asset for amounts receivable from both employees and employers.

Entitlements are recognised in the Income Statement when they become payable, resulting in a financial liability for current payments owing.

**i. Taxation**

Income taxation expense includes both the current year's provision and the income tax effects of temporary differences, calculated using the liability method.

Tax effect accounting is applied on a comprehensive basis to all temporary differences. A balance in the deferred tax account, arising from temporary differences or income tax benefits from income tax losses, is only recognised where there is virtual certainty of realisation.

**j. Statement of Cash Flows**

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

- Cash and other cash equivalents includes cash balances on hand, held in bank accounts, demand deposits and other highly liquid investments in which the Fund and its managers invest as part of its day to day cash management.
- Investing activities are those activities relating to the acquisition, holding and disposal of investments. Investments include securities not falling within the definition of cash, including cash flows from the settlement of forward foreign exchange contracts.
- Operating activities include all transactions and other events that are not investing or financing activities.

**k. Consolidation**

The Fund's financial statements include the Judges' Superannuation Account and the Parliamentary Superannuation Account.

## Changes in accounting policies

There are no significant changes in accounting policies.