Guardians of New Zealand Superannuation

ANNUAL REPORT 2007

NEW ZEALAND
SUPERANNUATION
FUND

2007

CONTENTS

New Zealand faces an ageing of its population over the first half of this century and one way to alleviate the financial pressure on future governments is to move from a complete reliance on the 'pay-as-you-go' system to a partially pre-funded system. This is what New Zealand has done with the creation of the New Zealand Superannuation Fund.

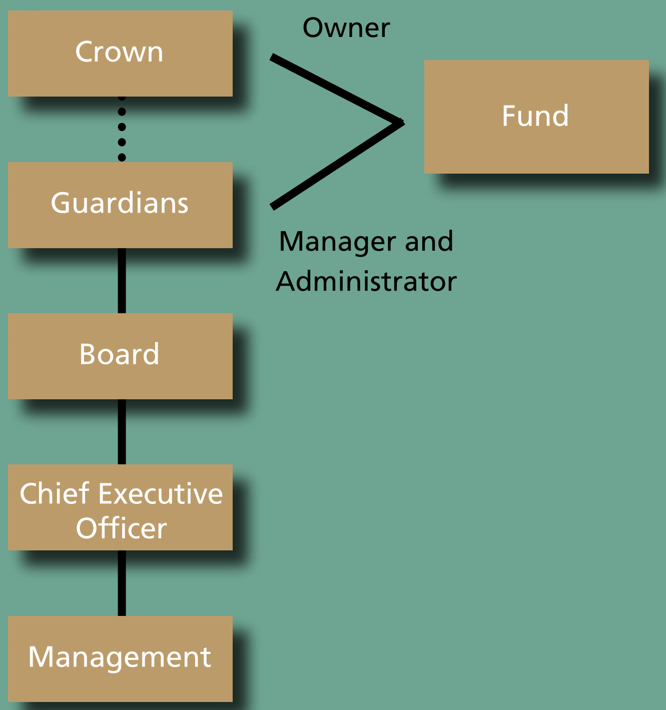
New Zealand Superannuation and Retirement Income Act 2001 (Act): This Act defines current entitlements to New Zealand Superannuation; establishes the New Zealand Superannuation Fund with sufficient resources to meet the present and future cost of New Zealand superannuation; provides for Crown contributions to the Fund; establishes a Crown entity to manage and administer the Fund called the Guardians of New Zealand Superannuation; establishes a process for signalling political agreement on parameters for New Zealand superannuation entitlements and fundings; and brings together in one Act all of the provisions for each of those matters.

Crown entity: A type of organisation that forms part of New Zealand's state sector, which is managed consistent with the requirements of the Crown Entities Act 2004.

Guardians of New Zealand Superannuation (Guardians): An autonomous Crown entity which manages, administers, and invests the New Zealand Superannuation Fund (established under the Act).

Board of the Guardians of New Zealand Superannuation (Board): A body responsible for setting the investment policies of the New Zealand Superannuation Fund and for overseeing its operations. The Board must consist of at least five, but not more than seven, members appointed by the Governor-General on the recommendations of the Minister of Finance (established under the Act).

New Zealand Superannuation Fund (Fund): A Crown-owned fund financed by capital contributions from the Crown, to assist future governments to meet the cost of providing retirement income to New Zealanders (established under the Act).



1. MILESTONES

2007

April	Chief Operating Officer appointed
March	First securities lending programme awarded
January	New custodian appointed Chief Executive Officer appointed

2006

November	Second global equity market neutral mandate awarded
October	Minority interest acquired in Kaingaroa Forest
August	Institutional Shareholder Services appointed to assist with proxy voting
June	Third multi-strategy mandate awarded
May	Second multi-strategy mandate awarded
March	Second global infrastructure mandate awarded

2005

November	Second New Zealand timber purchase announced First US timber purchase announced First equity only multi-strategy mandate awarded First global tactical asset allocation mandate awarded
October	First New Zealand timber purchase announced First investment in commodity futures announced First Reference Group meeting held
September	Second commitment to New Zealand private equity announced
August	Fourth New Zealand equities mandate awarded
July	Passive currency overlay mandate awarded Third global emerging markets mandate awarded
June	First commitment to New Zealand private equity announced First New Zealand unlisted property mandate awarded
March	First review of strategic asset allocation completed First global infrastructure mandate awarded Alternative assets advisory firm appointed
February	First global listed property mandate awarded First global equities (large cap) mandate awarded Second global emerging markets mandate awarded

2004

November	First independent review of the Guardians conducted
October	Second US equities (small cap) mandate awarded
July	Additional global equities (large cap) mandate awarded First US equities (small cap) mandate awarded First non-US equities (small cap) mandate awarded First global emerging markets mandate awarded
May	First three global equities (small cap) mandates awarded
March	Further two global equities (large cap) mandates awarded
January	Additional New Zealand equities mandate awarded

2003

November	First global fixed interest mandate awarded DMO currency execution agent appointed
September and October	First New Zealand fixed interest mandate awarded Transition manager appointed Fund commenced investing with $2.4 billion in cash First global equities (large cap) mandate awarded First two New Zealand equities mandates awarded Custodian appointed
August	Initial strategic asset allocation announced
March	Chief Executive Officer, legal advisor, and tax advisor appointed
February	Advisor for initial strategic asset allocation appointed

2002

November	Board strategy planning undertaken
August	Guardians' Board appointed

2001

October	Minister of Finance appointed independent committee to nominate persons for the Guardians of New Zealand Superannuation Board New Zealand Superannuation Fund created by an Act of Parliament (New Zealand Superannuation and Retirement Income Act 2001)

2000

November	New Zealand Superannuation Bill introduced into Parliament

2. 2007 HIGHLIGHTS

Business Performance Overview

- Growth of the organisation in terms of staff numbers and capabilities
- Continued Fund growth and diversification
- Custodian review and transition to a new custodian
- Implementation of a revised responsible investment framework.

Financial Overview

- Fund assets grew from $10,108.7 million to $13,149.5 million*
- Net contributions from the Crown of $2,049.0 million
- Return on investments of $1,590.7 million (after costs, but before New Zealand tax)**.

Investment Performance

- Rate of return of 14.58%, against risk-free rate of return of 7.21%
- Annualised rate of return since inception of the Fund of 14.81% p.a. against risk-free rate of return of 6.47% p.a.***.

* Net assets after adjustment for deferred tax liabilities and tax receivables/payables.

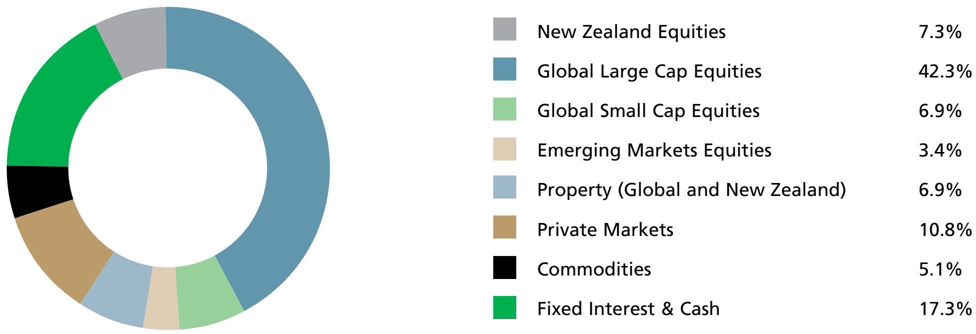
** The equivalent return, post-New Zealand tax, is $1,079.4 million (refer to Section 5).

*** Investing began in September 2003.

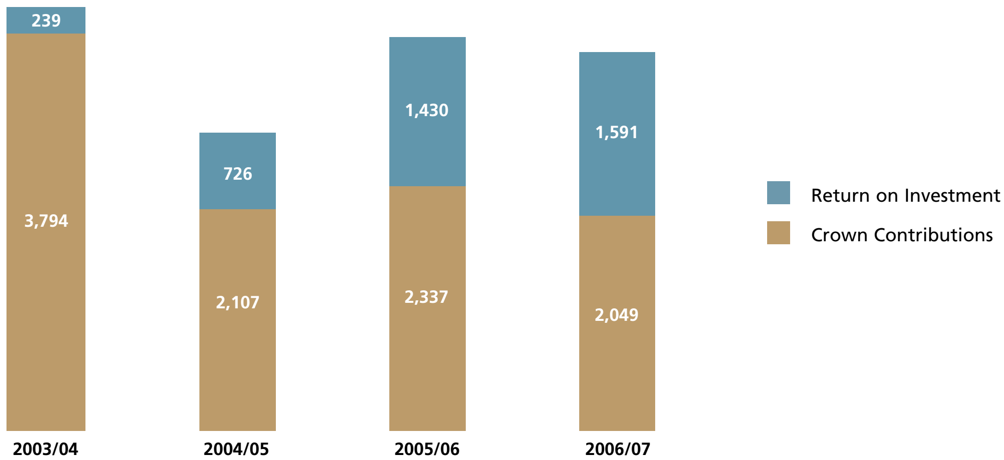
Notes:

- *All references to Dollars are New Zealand dollars ($ or NZD), unless otherwise indicated*
- *All references to returns are post-overseas tax, and pre-New Zealand income tax expenses.*

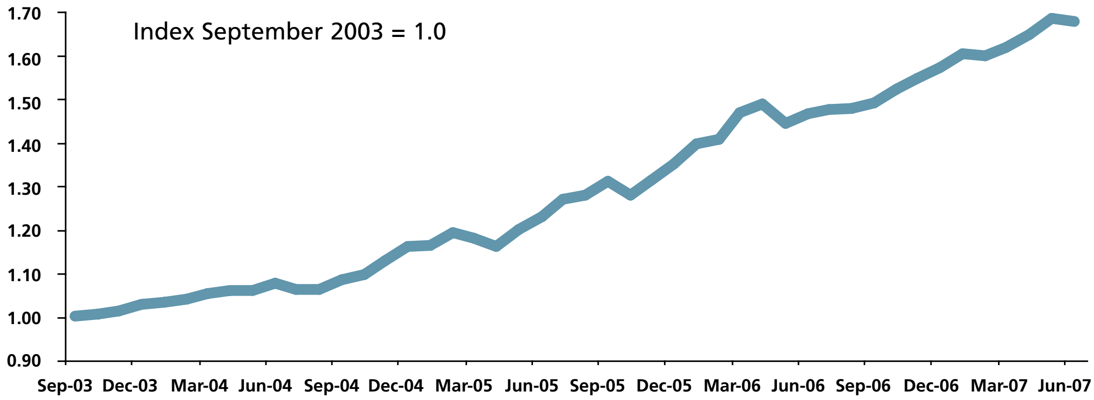
FUND ASSET MIX AS AT 30 JUNE 2007



GROWTH IN FUND SIZE (NZD MILLIONS)



CUMULATIVE ANNUALISED FUND RETURN SINCE INVESTMENT COMMENCED



3. STATEMENT FROM THE BOARD OF THE GUARDIANS OF NEW ZEALAND SUPERANNUATION

David May, Chairman

Sir Douglas Graham, Deputy Chairman

On behalf of the Guardians of New Zealand Superannuation we are pleased to present the Annual Report for the financial year ended 30 June 2007. This report outlines the Guardians' activities and Fund performance for the financial year.

As reported last year, the dominant theme for the Guardians has been the management of the sustained growth in funds under management. This growth has continued (the Fund grew $3.0 billion excluding net tax liabilities and reached $13.1 billion at financial year-end) as has the range and complexity of the investments. The key focus for this year has been on the development of the Guardians as an organisation, to ensure they develop their capability, build and maintain robust processes, and provide a solid platform on which to continue to widen their investment portfolio.

Investment Strategy

Our investment objective is to maximise returns without undue risk and with a clear focus on the long term.

The investment strategy adopted by the Guardians is outlined in the Strategic Asset Allocation detailed in Section 6 of this Annual Report. The investment strategy takes into account the long-term nature of the liabilities for which the Fund acts as a buffer, the financial assets (and their risk-return characteristics) that are available for investment, the tax implications of investment in various jurisdictions, and the funding allocations from the Crown.

Over the past year the Fund has continued its diversification into private markets in line with its objectives. Diversification is the best means by which overall portfolio returns can be maintained while reducing financial risk. The growth in the private market investments portfolio and continued diversification in public markets are both positive developments which are expected to benefit the Fund over the long term.

The Fund remains heavily oriented towards growth assets and, despite the growth in private market investments, heavily invested in publicly listed international equities. This asset choice is deliberate, as while it brings vulnerability to short-term volatility in asset prices, over the long term a growth-oriented investment portfolio is expected to outperform a portfolio invested in fixed income assets. The Guardians believe it is appropriate to accept this short-term volatility in order to achieve the long-term goal. This strategy will need revision in the longer term, as the Fund matures and cash withdrawals commence.

Performance

The long-term performance expectation of the Fund is to exceed, before tax, the risk-free rate of return (measured as the yield on 90-day Treasury Bills) by an average of at least 2.5% p.a.

Over the 2006/07 financial year, the Fund generated a return of 14.58% on funds invested compared with a risk-free rate of 7.21%.

Since September 2003, when the Guardians' investment programme began, the annualised return of the Fund has been 14.81% against the risk-free rate of 6.47%. Such a strong performance reflects just how positive financial markets have performed over this period. While the Guardians have deliberately invested in growth assets with the expectation of outperforming risk-free investments, this extended period of such exceptional return outperformance is unusual.

As emphasized in earlier Annual Reports, this strong performance cannot be sustained every year. Periods of significant underperformance can be expected. The challenge will be to accept these less favourable periods, when they happen, and to remain calmly focused on the long-term goal.

Institutional Growth

In a short period of time the Fund has grown to become New Zealand's largest managed fund with investments across a wide range of public and private assets. This growth is expected to continue and bring with it increased investment complexity.

The Guardians' focus has been balanced between continuing to seek new investment opportunities that enhance the returns of the Fund, and investing in their business operations, including their people, systems, and processes, to facilitate and support investment growth.

Following the resignation of the inaugural Chief Executive Officer, Paul Costello, the Board appointed Adrian Orr as Chief Executive Officer in February of this year. Adrian was previously the Deputy Governor and Head of Financial Stability at the Reserve Bank of New Zealand. In the six months that Adrian has been in this role, the Board has supported the introduction of a number of initiatives designed to strengthen the organisation so that it is well placed to support the growth of the Fund. In particular, there has been a renewed focus on ensuring the organisational structure, delegations, decision-making committees, and policies and procedures are appropriate to ensure the Guardians continue to make quality decisions, and manage business risks.

In terms of establishing robust and scaleable operating systems, a key appointment during the year was Northern Trust Company as custodian of the Fund. Northern Trust was selected after an extensive search and, based on the wide range of support and services it provides, it was considered an excellent partner to assist the Guardians with the growing complexity of the Fund.

The Board also introduced a bonus scheme that aims to better enable the Guardians to attract, motivate, and retain high calibre employees, and to align their incentives with the performance results of the Fund.

Responsible Investment

Responsible investment continues to be an evolving and complex part of best-practice portfolio management, and the key means of meeting the Fund's statutory obligation to avoid prejudice to New Zealand's reputation internationally.

The Guardians' responsible investment activities during the year included a revision of the Statement of Investment Policy, Standards and Procedures, and in doing so, the Guardians worked closely with other organisations in New Zealand. The Guardians continue to monitor their investments within their responsible investment framework. As part of the monitoring of investment managers, decisions were taken during the year to engage with, exclude, and divest from some stocks.

Where responsible investment issues are identified, it is the Guardians' preference to engage with companies, along with like-minded shareholders, so as to influence preferred responsible investment outcomes.

Looking Ahead

A significant part of the financial success of the Fund to date has been the positive financial market conditions since the inception of the Fund. However, this 'fair weather' will not continue indefinitely. The financial returns for assuming investment risk have declined.

At the same time the challenge to diversify requires more complex investment decisions to be made and a need for more in-house skills to assess opportunities.

> *'The Board will continue to balance its efforts between developing the institutional capacity of the Guardians while ensuring that the Fund is meeting its investment objectives. Our focus will remain on adding value in all of our activities.'*

The Board will continue to balance its efforts between developing the institutional capacity of the Guardians while ensuring that the Fund is meeting its investment objectives. Our focus will remain on adding value in all of our activities.

Acknowledgements

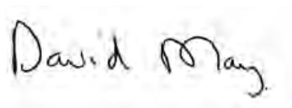
We take this opportunity to thank Board Members for their support throughout the year. Oversight and governance of the Fund have demanded a significant amount of skill and energy, to ensure we focus on the key issues underlying a wide range of investment decisions and associated process.

In December 2006 a new Board member, Professor John Evans, was appointed to the Board. John has an extensive technical knowledge of investment issues, which will be a valuable addition to the mix of skills and expertise of the Board.

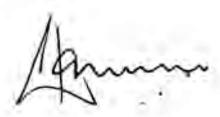
The Guardians have achieved a significant number of milestones in the relatively short period they have been in existence. The organisation has come through a period of rapid growth, and our focus for the next financial year will be on managing the growth of the Fund and the organisational development to support it. Changes in the skills and expertise of the organisation have and will continue to result in a strong team that is well placed for the future growth.

The Board looks forward to working together with the Chief Executive Officer and the management team to further develop the internal structure of the organisation to meet the challenges of the year ahead.

Many thanks also to all staff, who have at times worked long hours, to ensure the application of comprehensive and robust analysis of investment opportunities, and in the running of our growing operations, particularly the enormous amount of work undertaken to ensure the smooth transition from our previous custodian to Northern Trust.



DAVID MAY
Chairman



SIR DOUGLAS GRAHAM
Deputy Chairman

4. STATEMENT FROM THE CHIEF EXECUTIVE OFFICER

Adrian Orr,
Chief Executive Officer

On behalf of management I have pleasure in presenting our Annual Report for the 2006/07 financial year.

When I joined the Guardians in February 2007, it was apparent that a lot had been achieved in the short history of the Fund, and that there are exciting challenges ahead for the organisation.

As an organisation, our efforts are focused on managing growth in both the portfolio and the organisation. Both are equally important to our success. Over recent months we have put considerable effort into ensuring that the organisational structure, internal processes and committees, and policies and procedures, are sufficient to ensure ongoing robust decision making. We have also put effort into developing a human resources framework that will best attract, retain, and motivate our people. At the same time, we have continued our momentum in investment, expanding and diversifying the portfolio.

"As an organisation, our efforts are focused on managing growth in both the portfolio and the organisation. Both are equally important to our success."

Staff numbers have increased from 15 at the end of the last financial year to 27 at the end of this financial year (these numbers exclude contractors and part-time employees). This number is expected to increase to around 40 by the end of the 2007/08 financial year.

In an operational context a significant project for management this year was the transition to our recently appointed custodian – Northern Trust. In December last year the Board decided it was necessary to change custodian, and in the period December 2006 to July 2007 a number of staff have worked diligently on the operational systems to effect a smooth transition to the new custodian. Improvements in reporting and analysis of Fund investments should soon start to flow through to the organisation. We look forward to working with Northern Trust to identify new opportunities for business efficiencies.

Through the performance of the Fund, we want to make all New Zealanders feel confident in our ability to safeguard and manage the Fund. We aim to develop the Fund into the country's most respected institutional investor, an employer of choice in the sector, and to be regarded as a centre of excellence internationally for sovereign wealth management.

Some of the areas of focus for management in the next period are development and implementation of a knowledge management framework, a review of our vision and values, ongoing development of our communications, enhancement of management and financial reporting systems, together with an overall assessment of the responsiveness of our investment activities to changing markets and new opportunities.

We adopt a transparent approach to our organisation, and I invite all of our readers to visit our website where additional information on the Guardians' and Fund's history, management team, governance and legislation, and investment strategy and performance can be found (www.nzsuperfund.co.nz).

Finally, I would like to express my gratitude to my staff who contribute with their talent and passion to make this organisation successful. While much has been achieved to date, there remains much more to do. I look forward to updating you on progress in our next Annual Report.

ADRIAN ORR
Chief Executive Officer

www.nzsuperfund.co.nz

5. INVESTMENT PERFORMANCE OF THE NEW ZEALAND SUPERANNUATION FUND

Asset Growth

In 2006/07, total assets grew from $10,108.7 million to $13,149.5 million (net of current and deferred tax). The growth comprised $2,049.0 million in Crown contributions and a return on investments of $1,590.7 million (after costs but before New Zealand tax).

Since September 2003, when the investment programme commenced, $10,287.1 million has been received in Crown contributions. During the same period, around $3,986.0 million in pre-tax investment income has been generated.

Overall Performance

The Fund's objective is to maximise returns without undue risk. The Guardians' expectation is to exceed, before tax, the risk-free rate of return (measured as the yield on 90-day New Zealand Treasury Bills) by an average of at least 2.5% p.a. over a rolling 20-year period.

The Fund's rate of return for the year to 30 June 2007 was 14.58% (after costs and foreign withholding tax, but before New Zealand tax). This return exceeded the risk-free rate of return of 7.21% by 7.37%. The composition of the return for the year to 30 June 2007 is set out in the following table.

The Fund is treated as a body corporate for New Zealand tax purposes, and is subject to New Zealand tax on any income derived from the Fund's investments. The Fund's earnings before tax to 30 June 2007 was $1,590.7 million, and post-tax $1,079.4 million.

For investments outside of New Zealand, currency movements can have a substantial impact upon returns. The Guardians' current policy is to hold 82.5% of the Fund's investments in NZD, with the remaining 17.5% spread across a range of foreign currencies. This currency mix reflects the Fund's purpose. Superannuation entitlements are paid by the Crown in NZD. Holding foreign currency therefore creates a mismatch between the Fund's assets and the Crown's liabilities. This mismatch needs to be weighed against the diversification benefits of holding additional currencies, together with the persistently high level of New Zealand's interest rates. Further, over the long timeframes considered by the Guardians, currency fluctuations tend to have a lesser influence on returns. The policy adopted reflects these various considerations.

Currency policy is implemented by currency hedging of foreign assets, either in whole or in part. At 30 June 2007 the foreign currency policy was to hedge 72.5% of the Fund's exposure in the global growth assets sector (equities, and property assets), and 100% of infrastructure, global fixed interest, and timber assets. The table shows actual returns to each portfolio. In order to make the impact of currency movements transparent, for those asset classes which consist of foreign assets and which have benchmarks, returns are also shown both on a fully hedged and fully unhedged basis.

INVESTMENT PERFORMANCE FOR THE YEAR TO 30 JUNE 2007

Sector	Proportion of Fund (30/06/07)	Portfolio Return* (After Fees)	Benchmark Index Return*	Return from Active Management	Unhedged Benchmark Return	Fully Hedged Benchmark Return
New Zealand Equities *Weighted average of NZSX 50/ NZSX mid cap/small cap*	7.30%	22.65%	20.35%	2.30%	-	-
Global Large Cap Equities *MSCI World in NZD*	42.30%	17.03%	17.09%	(0.06%)	(2.39%)	25.29%
Global Small Cap Equities *Weighted average of Russell 2000/ Citigroup Extended Markets (ex US) in NZD*	6.90%	18.95%	15.55%	3.40%	(3.93%)	23.76%
Emerging Markets Equities *MSCI Emerging Markets in NZD*	3.40%	41.85%	36.72%	5.13%	14.51%	46.01%
Property *No Benchmark*	6.90%	16.77%	-	-	-	-
Private Markets *No Benchmark*	10.80%	25.15%	-	-	-	-
Commodities *S&P GSCI + 90 day NZD T Bill*	5.10%	(11.43%)	(12.15%)	0.72%	-	-
Fixed Interest *(Includes Cash)*	17.30%	2.27%	4.85%	(2.58%)	-	-
Total Fund	**100.00%**	**14.58%**	**14.81%**	**(0.23%)**		

**At 30 June 2007 the policy for managing foreign currency exposure was to hedge 72.5% of the Fund's exposure in the global growth assets sector (equities, and property assets), and 100% of infrastructure, global fixed interest, and timber assets. Private Markets include timber, infrastructure, private equities, and other non-listed investments. Return on investments in Private Markets and Property are not usually benchmarked against a securities index. These investments have absolute return objectives. Their investment performance is monitored against risk-free returns plus a margin for the investment risks incurred.*

Overall Performance - continued

Since 30 September 2003, when investing began, the Fund's annualised return has been 14.81% p.a. This compares with the risk-free rate for the period of 6.47% p.a. The composition of returns since inception is shown below.

INVESTMENT PERFORMANCE FROM INCEPTION OF THE FUND TO 30 JUNE 2007

Sector	Portfolio Return (After Fees)	Benchmark Index Return	Return from Active Management	Unhedged Benchmark Return	Fully Hedged Benchmark Return
New Zealand Equities *Weighted average of NZSX 50/NZSX mid cap/small cap*	23.60%	20.24%	3.36%	-	-
Global Large Cap Equities *MSCI World in NZD*	18.85%	17.52%	1.33%	10.86%	20.10%
Global Small Cap Equities *Weighted average of Russell 2000/ Citigroup Extended Markets (ex US) in NZD*	23.83%	21.86%	1.97%	13.06%	25.55%
Emerging Markets Equities *MSCI Emerging Markets in NZD*	37.76%	38.94%	(1.18%)	29.58%	42.47%
Property *No Benchmark*	20.55%	-	-	-	-
Private Markets *No Benchmark*	21.57%	-	-	-	-
Commodities *S&P GSCI + 90 day NZD T Bill*	(7.97%)	(9.28%)	1.31%	-	-
Fixed Interest *(Includes Cash)*	5.30%	6.10%	(0.80%)	-	-
Total Fund	**14.81%**	**13.98%**	**0.83%**		

Fund Composition and Performance

Public Equities

Approximately 60% of the Fund is invested in public equity markets. Publicly traded equity comprises a large portion of assets available to investors, and is a core holding. Global holdings are distributed between large cap, small cap and emerging market mandates, in proportions that approximately reflect market capitalisation. In other words, the Fund holds these exposures without any predetermined tilts towards particular areas. The portfolio is largely neutral with respect to factors such as value and growth, firm size and geography. A total of 16 mandates were operating within the total global equity portfolio as at 30 June 2007. All global mandates are actively managed.

Investment in New Zealand shares remains at 7.3% of the total portfolio. This allocation balances the advantages that the Fund possesses when investing locally, including being indifferent to local taxation plus access to good quality managers, against the limited size of the local market. Four mandates presently comprise this portfolio.

The year to 30 June 2007 saw strong performance in all equity markets. The large cap and small cap global equity portfolios returned 17.0% and 19.0% respectively. Emerging markets returns were particularly strong, with the portfolio returning 41.9%. New Zealand equities returned 22.7%.

Property

Property assets comprised close to 7% of the Fund at year end. The majority is held via a passive allocation to listed global property securities. This comprises stocks whose primary revenue source is rental income. In addition, a direct exposure to the New Zealand property market is held via AMP Capital.

The property portfolio returned 16.8% for the year. This comprised a 13.1% return to global property, and a 23.8% return in New Zealand property.

Private Markets

Private Markets is a generic title for investments not made through public securities markets. At present this includes holdings in infrastructure, private equity and timber assets. It is likely that further types of assets will be added to this group in the future. As at 30 June 2007 this group comprised about 11% of total assets.

Private market returns were 25.2% for the year. The major contributors were strong infrastructure returns, reinforced by steady returns from the timber portfolio. The private equity programme is in its early stages. The few investments made to date mostly continue to be held at cost.

Commodities

The Fund continues to target an exposure to commodity markets of around 5% of total assets. This is obtained through holdings of baskets of commodity derivatives (futures), through three separate mandates. These holdings are fully collateralised, i.e. the face value of the contracts is matched by a similar amount of NZD cash. The total return includes both the gain and loss on the commodity and derivatives, and the return on the cash held as collateral.

Commodity returns were poor for the year to 30 June 2007. The Fund's commodity portfolio returned -11.4%.

Fund Composition and Performance - continued

Fixed Interest

Fixed interest comprises about 17% of total assets. These presently include a mix of New Zealand and global sovereign debt. The majority of this exposure is held passively, tracking sovereign debt bond indices. A minority portion is held synthetically, via a mix of derivative exposures.

The year to 30 June 2007 produced moderate fixed interest returns. Globally, the Citigroup World Government Bond Index returned 6.7% in NZD (on a fully hedged basis). In New Zealand fixed interest, rising yields dampened returns, producing a weighted average index return of 2.4%.

Active Management

In aggregate, the year to 30 June 2007 was a disappointing one for the Fund's active managers. For the first year since inception active management detracted from performance, with a return of -0.23% net of fees. On the positive side, more than half of the Fund's active managers outperformed their benchmarks. Solid gains were made by New Zealand equity managers (+2.3%), global small cap managers (+3.4%) and emerging market managers (+5.1%). Global large cap managers were close to neutral for the year. However, these gains were more than offset by some other poor performances, particularly those who operated against fixed interest benchmarks (-2.6%). The gains from active decisions taken by private market asset managers were substantial. This was particularly the case for the Fund's infrastructure managers. Private market managers account for a significant portion of the performance fees accrued during the year.

Operating Costs

A key focus for the Board when controlling operating costs is to ensure expenditure is appropriate with the active management strategy of the Fund. The Guardians recognise that skill in investment management commands a premium, and the Fund is prepared to reward investment managers for delivering superior performance. The Guardians' decision to introduce performance-based fees is an example of their commitment to this principle.

The management expense ratio (MER) of the Fund was 1.01% of average assets in 2006/07 and is detailed below.

Expense	2006/07	2005/06	Increase/(Decrease)
Manager Fees	0.75%	0.54%	0.21%
Custody Fees	0.09%	0.09%	-
Internal Operating Costs (i.e. Board and Staff Costs)	0.06%	0.05%	0.01%
Use of Money Interest	0.06%	-	0.06%
Professional Advisors, Auditors, and Other Costs	0.05%	0.03%	0.02%
Total	**1.01%**	**0.71%**	**0.30%**

The increase is in the management expense ratio which is due to a combination of factors:

- **Manager Fees:** The Fund places emphasis on paying performance fees to investment managers for delivering superior results. Around 44% (2005/06: 28%) of the total fees paid to managers were for generating risk adjusted performance above an agreed benchmark. The high levels of manager fees in 2006/07 reflect the excess returns delivered by the investment managers. This particularly applied to the Fund's private market managers, who collectively made a significant contribution to the strong returns produced by the Fund. The liability to pay performance-based fees is accrued in full at balance date. However, the payout of these fees is spread over future years, based on a multiple of the manager's base fees and is also contingent on future market performance;
- **Use of Money Interest:** The volatility of returns experienced during the year led to an underpayment in New Zealand provisional income tax and consequentially a Use of Money Interest charge; and
- **Professional Advisors, Auditors, and Other Costs:** The Fund continued to diversify its asset base during the year. There were higher transactional and ongoing costs associated with accessing some of these assets. During the year, the Fund also introduced a securities lending programme, which generated additional income for the Fund (which is not reflected in the table on page 18), but which also incurred additional operating costs (which are reflected in the table).

New Investments During the Year

The Fund's investment mix continued to broaden over the year. To a degree the pace at which new mandates were established slackened relative to the initial years of operation. This was partly because a solid platform of mandates already exists. Funding is increasingly directed towards existing mandate channels. During the year, a number of mandates were deepened to include a broader range of investments. In addition, the Guardians' attention is increasingly turning to monitoring existing investments. No manager relationships were terminated during the year.

Public Markets

Over the past financial year the Guardians awarded one new mandate within public securities mandates, and identified a number of others that are 'in the pipeline'.

The new mandate was awarded to an existing investment manager, AXA Rosenberg, who also manages global small capitalisation equities for the Fund. The new mandate is a global equity market neutral strategy, where excess returns are designed to come entirely from AXA Rosenberg's stock selection skills rather than equity market movements. The Guardians overlay market exposure to this mandate synthetically, using derivatives.

Elsewhere, the public market portfolio was comparatively stable. In part this was because most managers have performed satisfactorily, and reflects the desire by the Guardians to be a genuine long-term business partner. Managers are carefully selected. All managers are monitored to ensure that both their process and level of risk taking remain as expected, and that their personnel and style are not changing unexpectedly.

There was little change to the Fund's fixed interest mandates during the year. Investments within these mandates grew in line with total Fund size.

New Investments During the Year - continued

Private Markets

Timber

The major addition to the timber portfolio was the acquisition of a minority share in the Kaingaroa Forest estate. In October 2006 the Fund announced that it had entered into an agreement with Harvard Management Company to acquire this interest for approximately $300 million. Harvard retained ownership of the majority of the estate. Forest management continues to be undertaken by Timberlands Limited, based in Rotorua. Kaingaroa Forest is an estate of approximately 170,000 hectares of cutting rights to plantation forest located in the Central North Island of New Zealand. The bulk of the forest is Radiata Pine, with a small quantity of Douglas Fir.

Private Equity

The past year has seen a significant acceleration of the Fund's private equity programme. A total of six commitments have been made, with total committed capital of almost $400 million. Three of the commitments made to date have been to fund of funds, and these vehicles will likely play a core role in the portfolio for some time. Because of the nature of the dealflow, new private equity investors face considerable delays in becoming invested. To date draw downs total about $70 million, or less than 20% of committed capital. The amount invested is around 0.5% of the total Fund. Private equity is viewed as an extension of the Fund's other equity investments. Many firms move freely between public and private ownership. The source of equity capital is viewed as secondary to the investment merits of each enterprise.

The Guardians are mindful of the wide spread of returns achieved by private equity investors, and the tendency for a few successful investors to far outperform the average. The objective therefore remains to seek relationships with a small number of leading private equity managers.

At the beginning of the financial year, the Fund had commitments to the AMP Pencarrow Private Equity Fund, and the Direct Capital Partners (DCP III) Fund. Over the past financial year the Fund has made commitments to four global private equity funds:

- the Adams Street Partnership Fund – 2007 Non US Fund, L.P., which invests in non-US private equity opportunities;
- the Apax Europe VII-A (Feeder) L.P., which invests in large European buyouts;
- the Coller International Partners V-B , L.P., which invests in global private equity secondaries; and
- the HarbourVest International Private Equity Partners V – Partnership Fund L.P., which invests in non-US private equity opportunities.

Investment Managers and Custodians

Section 68(g) of the Act requires that the Fund reports a schedule of external investment managers and custodians used during the year. This schedule is contained in section 11 of the Annual Report.

The Fund also maintains relationships with a number of other counterparties in order to manage exposure to equity, fixed income, currency, and commodity markets.

During the year, the Guardians also reviewed and appointed a new custodian for the Fund (please refer to box Custodian Review and Transition).

Custodian Review and Transition

A major initiative during the year was the review and appointment of a new custodian for the Fund. The key aim in carrying out the review was to re-examine the best available custody services in light of the Fund's planned growth and development, and to ensure the continuing contestability of this key service role. The review process considered custody, reporting and accounting services, pricing, and the strength of the custody team and technology platform supporting those services.

Following the review, the Guardians appointed Northern Trust (a global provider of investment management, asset, and fund administration for institutions worldwide) as the Fund's new custodian. Northern Trust assumed custodial responsibility for the Fund's assets in July 2007 following a successful implementation and transition from the previous custodian.

Risk Management

The investment activities and transactions the Guardians undertake expose the Fund to a broad range of risks. The Board is responsible for ensuring that management has identified the principal risks of the business and has established the appropriate control environment. Management is also charged with ensuring that the organisation has adequate resources to manage the risk inherent in day-to-day operations. During the year, the Board identified the top five risks facing the Guardians, and established a reporting framework (please refer to table Risks for the Performance of the Fund). These risks are being directly managed through the key priorities for the organisation.

Much of the daily work of managing risk is done at the business unit level, as close to the source of those risks as possible. The Guardians' internal and external auditors, in executing their audit plans, provide input to management and the Board on the effectiveness of the organisation's risk management practices.

As the Fund grows in size and complexity, the risks the Guardians manage also change. In the coming year the Guardians plan to strengthen their risk management framework and in particular will process map key business processes and internal controls. At an operational level they will also refine and test their business continuity plans.

Risk Management - continued

Risks for the Performance of the Fund

The Guardians operate a holistic approach to risk management that identifies inherent and current risks.

The **inherent** risks which face the organisation include:

- the systemic collapse of financial market returns;
- inappropriate Strategic Asset Allocation or investment execution;
- activities that may prejudice New Zealand's reputation; and
- inadequate performance or failure of the custodian.

During the financial year 2006/07, the Board reviewed the risk controls in place, and assessed the **current** risks. Five potential current risks that the Guardians face when managing the Fund's growth were identified:

- inadequate resource planning for the execution of the investment strategy;
- inadequate growth management practices;
- an inability to attract and retain capable staff;
- inadequate long-term investment performance; and
- ineffective processes and project management controls.

These current risks could directly impact the Guardians' performance if not managed appropriately. Key Priorities and Performance Indicators mentioned in the Guardians' 2007 Statement of Intent will directly address these current risks.

6. INVESTMENT STRATEGY OF THE GUARDIANS

Objectives and Investment Strategy

The Guardians' governing legislation requires them to invest the Fund on a prudent, commercial basis in a manner consistent with:

(a) best-practice portfolio management;

(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.

The liability for providing New Zealand Superannuation payments lies with the Crown. The primary function of the Fund is to act as a smoothing mechanism for the Crown to meet these payments. New Zealand's population will progressively age through the next few decades. Accordingly, the cost of superannuation entitlements will roughly double as a percentage of GDP. The establishment of the Fund means that the fiscal cost of these entitlements will be borne more evenly through time, as opposed to being an increasing burden for future taxpayers. Current projections suggest that the Crown will make contributions to the Fund for approximately the next 20 years. Thereafter, withdrawals will help finance the entitlements of retirees (The Treasury's Funding Model can be found on the Fund's website).

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The Guardians' approach is to invest in higher-risk assets only where the additional returns justify the additional risk. For this reason, all returns are assessed relative to the risk-free rate, usually measured as the return on New Zealand 90-day Treasury Bills. Acceptance of each investment into the Fund depends on whether the incremental returns over and above a lower-risk alternative justify the incremental risk.

Investment risk is viewed from a total Fund perspective. The Fund's investments cover a wide spectrum of assets, from low-risk sovereign debt to relatively high-risk assets such as private and emerging markets equity. While many investments will be risky in their own right, when combined with a broader portfolio they may contribute only marginally to total Fund risk.

Risk is measured against the time horizon over which the Fund invests. The Fund's governing legislation uses a 40-year horizon when calculating contributions. As a consequence, this long-term perspective means that the Fund can be more tolerant of short-term fluctuations than can most investors.

Objectives and Investment Strategy - continued

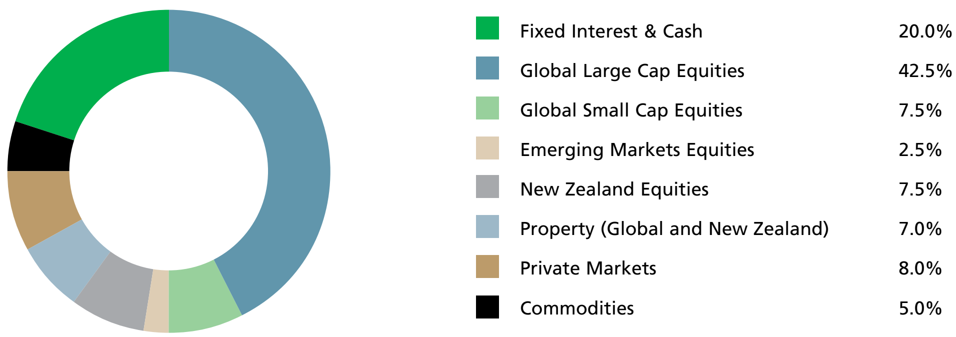
The Fund is taxed as a corporate. However, the Crown is indifferent between receiving returns via tax revenue or through accumulation within the Fund. By contrast, tax paid to foreign jurisdictions is a loss to New Zealand. For these reasons, the Guardians' focus is on maximising returns before New Zealand tax, but after all foreign taxes and expenses. Returns of the Fund are reported on this basis.

Strategic Asset Allocation

A key part of the Guardians' approach to investing is their Strategic Asset Allocation (SAA) strategy. The SAA determines the proportions of the total Fund invested in the various broad asset classes, such as global large cap shares, emerging market shares, and property. Over time the SAA is likely to be the main determinant of risk and return for the Fund, although returns achieved within each asset class are also important.

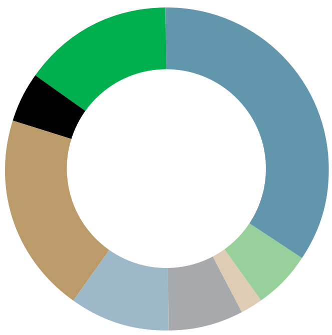
The Fund's current SAA objective, as of 30 June 2007, is summarised below. This is the target allocation established by the Board for the period to 30 June 2007. This allocation has a higher weighting towards public market investments than the long-term SAA. It recognised that several of the Fund's investment programmes, including those in private markets, property, and commodities, are in their establishment phase, and will require time to become fully effective.

CURRENT STRATEGIC ASSET ALLOCATION



The Fund's long-term SAA is outlined below. This is the asset mix the Guardians expect to move to over the next three to five years.

LONGER TERM STRATEGIC ASSET ALLOCATION



Fixed Interest & Cash (15.0%)*	15.0%
Global Large Cap Equities (42.5%)*	34.5%
Global Small Cap Equities (N/A)*	6.0%
Emerging Markets Equities (N/A)*	2.0%
New Zealand Equities (7.5%)*	7.5%
Property (Global and New Zealand) (10.0%)*	10.0%
Private Markets (20.0%)*	20.0%
Commodities (5.0%)*	5.0%

** as published in the 2006 Statement of Intent*

Opportunities to Add Value

The Guardians aim to enhance returns relative to those implied by the SAA in a number of ways:

- Active management within securities markets. This is normally implemented by engaging managers whose performance is expected to exceed a benchmark.
- Operating a private market investment programme. The Guardians seek to acquire private market assets and engage managers who produce superior returns to their public market equivalents, net of fees, and after adjustment for risk.
- Use of the Fund's balance sheet. The securities lending programme is an example of return enhancements available to a large, long-term investor.
- Operational efficiencies. All operating costs lower Fund returns. The Guardians accordingly seek to maximise added value net of these costs and ensure they are cost-effective. The boundary between cost reductions and return enhancements is often fluid. For example, efficient execution of derivative positions can provide useful increments to returns. In some cases this allows market exposure to be obtained at effectively zero fees.

The Guardians' Core Investment Beliefs

When undertaking investments, the Guardians hold certain beliefs:

- The Fund's return objectives, risk tolerance, and the timeframe over which the Guardians will measure results, are an important consideration.
- Risk and return are strongly related, and diversification reduces total risk.
- Risk and return characteristics vary over time, and include both a random component and a partly predictable component based on current pricing compared to long-term averages. The longer the time horizon, the greater the predictable component.
- The Fund's long-term investment horizon, combined with the fact that no outflows are required until at least after 2020, means that the organisation is extremely well positioned to capture illiquidity premium.
- Different types of risks can be unbundled to make the portfolio more efficient. Examples include the separation of market risk (beta) and active risk (alpha), and the decoupling of foreign currency exposure and international assets.
- Investment opportunities must be examined on a risk-adjusted basis, post-expenses and foreign taxation, and excluding any benefit from leverage. Individual investments will be assessed on their expected impact upon the total portfolio, rather than the characteristics of the particular sector of transaction.
- There is value in pursuing excess returns in public markets. The Guardians will focus on the expected after-cost benefit on an investment.
- Principal-agent conflicts must be minimised in the Fund's relationship with investment managers. This can be done using financial incentives, transparency around related party transactions, and appropriate governance to promote investors' interests.
- Long-term financial performance can be affected by environmental, social, and governance issues. The Guardians have encouraged and will continue to encourage the companies they invest in to meet international standards in these areas.

The Investment Outlook

Investment markets have delivered strong returns since the Fund began investing in 2003. However, returns during this period have been above both historic averages and those likely to be sustained in future. The Guardians' 2007/08 Statement of Intent projects returns for the next 10 years of 8.1%. This assumes an excess return above the risk-free rate of 2.9%. By contrast, between 2003 and 30 June 2007, the Fund achieved an annualised return of 14.81%. This was a premium of 8.34% above the return on New Zealand Treasury Bills, the risk-free of rate of return. During the past four years, market volatility has been lower than historic experience.

At least some of the strong returns in recent years have reflected falling yields within asset markets. This is apparent across virtually every market in which the Fund invests. However, declining yields cannot be a permanent source of stronger returns. Whether the yield declines witnessed to date turn out to be permanent or temporary remains to be seen. The returns projected by the Guardians are based on an assumption of unchanged future yields.

Another uncertainty is the Fund's ability to access investments within private markets. The Fund's long-term SAA envisages an increase in the private market allocation to 20% of Fund assets. However, the Guardians will only undertake this expansion where there is a compelling investment case. For these reasons, the private market investment programmes are deliberately flexible in size. The Fund's broad mandate allows it to consider lumpy opportunities as they arise. Conversely, where no such opportunities arise, the Fund is not compelled to invest in any particular area.

Volatile investment market movements are inevitable. However, the Fund, with its long-term focus, strong cash inflows, and investment disciplines is well placed to deal with those challenges.

7. RESPONSIBLE INVESTMENT

The Guardians have a policy, standards, and procedures which encompass the Guardians' ethical investment and voting requirements.

Considerable progress was made during the year to build on the early foundations of the Responsible Investment Policy (RI Policy). The RI Policy was revised during the year in conjunction with the Responsible Investment Committee and the Board. The RI Policy is a key factor in investment decisions.

The Guardians are founding signatories to the United Nations Principles for Responsible Investment (UN PRI), and with a representative Board member on the UN PRI Board, they have continued to actively participate in national and international forums in the development of best practice in the area of responsible investment.

Investments are monitored against internationally agreed standards for responsible corporate behaviour, in particular, the UN Global Compact principles. This process facilitates the identification of companies that may be in breach of standards on human rights, environmental protection, anti-corruption, or labour conditions.

In some cases the Guardians may seek to influence the activities of companies they invest in through engagement or voting, but recognise it is not the role of shareholders to interfere with day-to-day management. During the year, the Guardians engaged with certain companies on issues ranging from executive remuneration, environmental management, human rights issues, and labour conditions. The Board elected to exclude from the Fund's portfolio a number of investments in companies that were involved in landmine manufacture. The Guardians are currently analysing several other issues, including investment in tobacco companies and companies involved in nuclear weapons production.

The appointment last year of a specialist proxy voting agency, Institutional Shareholder Services, has enabled the Guardians to exercise their voting rights on international holdings consistently across the portfolio. During the year, the Guardians also worked closely with their New Zealand investment managers and corporate governance advisor in order to play an active role in voting in the New Zealand market.

The Guardians participated in collaborative engagement activities including becoming a signatory in 2007 to the Carbon Disclosure Project (CDP). The CDP is the world's largest institutional investor initiative, addressing the business implications of climate change. These joint initiatives provide an effective means for shareholders to raise concerns with the companies they invest in.

The focus going forward will be to further integrate and embed the RI Policy into the investment operations of the Fund. This will require working more closely with the Fund's investment managers, applying RI Policy considerations across all asset classes, working collaboratively with other investors, and continuing to develop a benchmarking process. Key themes for the engagement programme will be underpinned by the principles of the UN Global Compact.

8. GOVERNANCE

Legislation and Structure of the Guardians

Effective governance is essential in order to safeguard the assets entrusted to the Guardians, and to ensure that appropriate objectives are pursued and outcomes achieved in line with the Guardians' legislated mandate.

This section of the Annual Report details the Guardians' mandate, the Board and Board committees, the separation of responsibility between the Board and management, and key policies designed to guide activities and behaviour.

Operational Environment

While accountable to the Crown, the Guardians operate at arm's length from the Crown. The Board is required to report on the Fund to the Minister of Finance at those intervals that the Minister may require and currently the Guardians provide a quarterly written report to the Minister on the Fund's progress.

Under the governing legislation, the Minister of Finance may give directions regarding the Crown's expectations as to the Fund's performance, including its expectations as to risk and return. However, the Minister may not give any direction that is inconsistent with the duty to invest the Fund on a prudent, commercial basis. The Guardians must have regard to any such direction and must notify the Minister how they propose to do this, as well as report any direction in the Annual Report. Directions given by the Minister must be tabled in Parliament. No directions from the Minister have been received to date.

Board of the Guardians

The Board of the Guardians is the governing body of the Fund: it has the authority to "undertake any activity … or enter into any transaction" in order "to manage and administer the Fund". The Board has the power to delegate any of the functions or powers it has to a committee of the Board, or any person, but may not delegate the power to grant a power of attorney or the power to appoint investment managers and custodians.

Members of the Board are appointed by the Governor-General on the recommendation of the Minister of Finance. The Minister's recommendation follows nominations from an independent nominating committee. On receiving those nominations, the Minister must consult with representatives of other political parties in Parliament before recommending the Governor-General appoint a person to the Board.

Board Members are chosen for their experience, training, and expertise in the management of financial assets, as well as their mix of complementary skills and commitment to the Fund's goals.

The Board must comprise at least five, but no more than seven, Members. Each Board Member is appointed for a term of up to five years and is eligible to be reappointed.

Board of the Guardians - continued

At 30 June 2007, the Board consisted of seven members. Full biographical information on each Board Member is available on the Fund's website.

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Board Committees

The Board operates four Board Committees to assist in the fulfilment of its obligations. These are:

- **Audit and Risk Committee:** Oversees the financial reporting of the Fund, internal and external audit of the Fund, the internal risk management framework and its application, compliance (including tax compliance), the accuracy of key financial statements, and other governance systems;
- **Responsible Investment Committee:** Oversees the implementation of the ethical investment policy (under s61(d) of the Act) and the policy for the exercise of voting rights (under s61(i) of the Act);
- **Employee Policy and Remuneration Committee:** Oversees the development and operations of employment and remuneration policies; and
- **Private Markets Committee:** Considers private equity opportunities on an 'as required' basis. This Board committee was established in May 2007 and has not yet met. It replaced the former management committee known as the Private Equity Review Committee that also included several Board Members.

Assessment of Board Performance

A formal independent review of how effectively and efficiently the Board is performing its function is carried out every five years. The Minister of Finance sets the terms of reference for the review, which is conducted by an independent person appointed by the Minister. The report is then presented to Parliament. The first review was conducted in July 2004 and is available on the Fund's website. This year, a Board performance review was conducted and facilitated by an external specialist. The results of that process will form part of a wider review of the Board governance and Board reporting which is being developed during the next year.

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BOARD OF THE GUARDIANS OF NEW ZEALAND SUPERANNUATION

DAVID MAY

SIR DOUGLAS GRAHAM

BRIDGET LIDDELL

DAVID NEWMAN

DAVID MAY, CHAIRMAN: Chairman of the Guardians' Employee Policy and Remuneration Committee, and member of the Responsible Investment Committee. Currently Deputy Chairman of the Government Superannuation Fund Authority, established in 2001, and Director of Southern Cross Medical Care Society. David has 35 years experience in the financial services, superannuation and insurance industries, including 27 years with Colonial Group, most recently as Managing Director of Colonial Life NZ Limited (1995–2000).

SIR DOUGLAS GRAHAM, DEPUTY CHAIRMAN: Chairman of the Guardians' Audit and Risk Committee, member of the Responsible Investment Committee, and the Employee Policy and Remuneration Committee. Currently Chairman of the Lombard Group, Director of Watercare Services Limited, Director of OTPP NZ Forest Investments Limited and the Commonwealth Special Envoy to the Kingdom of Tonga. Sir Douglas was a Member of Parliament from 1984 until his retirement from politics in 1999. Sir Douglas was Minister of Justice from 1990–1998, and prior to his distinguished political career, practised law from 1965–1984.

BRIDGET LIDDELL, CFA: Chairman of the Guardians' Responsible Investment Committee, and member of the Private Markets Committee. Currently Chairman of the US Beachhead Programme, a programme run by New Zealand Trade and Enterprise to assist New Zealand companies with entry to the US market, and a Director of The New Zealand Institute, a privately funded non-partisan think-tank, and of Biovittoria, a New Zealand biotechnology company. Before moving to the US in 2003, Bridget was Chief Executive Officer of University of Auckland Development Limited. Bridget has been a Director of several New Zealand companies, including Sky City Entertainment Group, Fisher & Paykel Appliances Holdings Limited and Uniservices Limited. Bridget has held senior executive positions at Carter Holt Harvey and was a Director of CS First Boston NZ Limited.

DAVID NEWMAN: Chairman of the Guardians' Private Markets Committee, and member of the Audit and Risk Committee. Currently Chairman of Infratil Limited and its subsidiary Wellington International Airport Limited and a Director of Infratil Airports Europe Limited. David is also Chairman of Loyalty New Zealand Limited, operator of Fly Buys loyalty card programme, of Austral Pacific Energy Limited, and of the Centre for Biodiversity and Restoration Ecology at Victoria University of Wellington. He was previously Chief Executive Officer of the Institute of Directors in New Zealand. Prior to this, David spent 22 years with BP, culminating in four years as Chief Executive and Managing Director of BP New Zealand Limited.

BOARD OF THE GUARDIANS OF NEW ZEALAND SUPERANNUATION - CONTINUED

GLEN SAUNDERS

MARK TUME

JOHN EVANS

GLEN SAUNDERS: Member of the Guardians' Responsible Investment Committee, and the Employee Policy and Remuneration Committee. A consultant, investment banker, and qualified accountant, Glen is a Board member of the United Nations Principles for Responsible Investment, and a Director of Prometheus Finance Limited. He was previously UK Managing Director of Netherlands-based bank, Triodos. Glen is a former Director of the Wind Fund plc and the Local Investment Fund, a public-private partnership funding community-based initiatives in the UK. He has also served as Non-Executive Director of the Western Partnership for Sustainable Development and the Earth Centre Advisory Board.

MARK TUME: Member of the Guardians' Audit and Risk Committee, and the Private Markets Committee. Currently Managing Director of Lake Taupo Capital Limited, Director of Transpower New Zealand Limited, and of Ngai Tahu Holdings Corporation. Over his 20-year career, Mark has held a variety of senior roles within the finance sector, in areas such as investment banking, capital markets, asset and liability management, and risk control. He was a former President of the New Zealand Financial Markets Association.

JOHN EVANS[5]: Member of the Guardians' Audit and Risk Committee, and the Private Markets Committee. Currently Managing Director of PGE Australasia Pty, an actuarial company specialising in the application of quantitative techniques to investment business. John is also Associate Professor in Actuarial Studies at the University of South Wales and Deputy Director of the Centre for Pensions and Superannuation. He holds a number of directorships, including Emerging Leaders Investment Limited, and is actively involved with various Committees at Fiducian Portfolio Services, a specialist financial services organisation.

Board Meeting Attendance

The Board met eight times during 2006/07, and its committee held 17 meetings. The table below details the number of meetings attended by each Board member relative to the total meetings that Board member could have attended.

Meeting type / Attendees	Board meeting	Audit and Risk Committee (ARC)	Responsible Investment Committee (RIC)	Employee Policy and Remuneration Committee (ERC)
Number of meetings	8	4	8	5
David May[1]	8	3	4	5
Sir Douglas Graham	8	4	7	5
Bridget Liddell	8		8	
Dr Michaela Anderson[2]	1		1	
David Newman	7	4		
Mark Tume[3]	8	1		
Glen Saunders[4]	8		8	4
John Evans[5]	4	1		

[1] Joined the RIC in February 2007.
[2] Left the Guardians in August 2006.
[3] Joined the ARC in April 2007.
[4] Joined the ERC in April 2007.
[5] Appointed to the Board in December 2006, and joined the ARC in April 2007.

Remuneration

The remuneration paid to Board Members during 2006/07 is summarised in Note 16 to the Guardians' financial statements. Further information on the fees framework for members of statutory and other bodies appointed by the Crown is available on the Fund's website. The total remuneration of the Guardians' employees earning more than $100,000 p.a. is detailed in Note 15 to the Guardians' financial statements.

Code of Conduct

The Board has reviewed the Guardians' Code of Conduct (Code) for both itself and management. The Code sets out standards for appropriate ethical and professional conduct, and procedures for dealing with conflicts of interest. There is also a commitment to professional development for Board and staff members to ensure the organisation keeps up with emerging best-practice trends.

The Audit and Risk Committee is responsible for the implementation and enforcement of the Code. A copy of the Code is available on the Fund's website.

Conflict of Interest Procedures

The Conflict of Interest procedures for Board Members and employees are intended to provide a process for identifying, minimising and resolving potential conflicts of interest.

Equal Employment Opportunities

The Guardians have an Equal Employment Opportunities (EEO) policy and programme in place to address equal employment opportunities for all employees and recognise the benefits of diversity of skills and experience of employees.

Initiatives in this area during year include:

- development of cross-functional and multi-functional teams within the organisation;
- appointment of a General Manager Human Resources;
- development of human resource policies and procedures in line with the EEO policy; and
- support of a good work-life balance with flexible work arrangements.

Management Team

At 30 June 2007, there were 27 employees. Recruitment of an additional 10 employees is planned during 2007/08 in order to effectively respond to the investment opportunities available to the Fund, and to manage the associated implementation challenges.

One of the Guardians' key priorities in the next year is to maximise their ability to attract, retain, motivate, and manage their team; and to review the Guardians' vision and values. Both key priorities aim to position the Guardians as an employer of choice.

The Guardians operate through a series of internal executive committees. These committees include the:

- **Management Committee:** dealing with the business operations of the Guardians;
- **Investment Committee:** advising on the investment decisions of the Guardians;
- **Portfolio Committee:** advising on the performance, compliance, and risk metrics of the portfolio, investment managers and custodian, and the allocation of cash to the portfolio; and
- **Communications Committee:** advising on all internal and external communication issues.

The role of the committees is to ensure high-quality decision-making for the Management Team to support the Chief Executive Officer.

The Chief Executive Officer however is fully accountable to the Board for all aspects of the Fund's investment and business performance, and for compliance and control.

In planning for growth during the year, the Guardians have refined their organisational structure to support the overall business strategy. The chart below details the organisation structure, along with brief profiles of Senior Managers. Full profiles can be found on the Fund's website.

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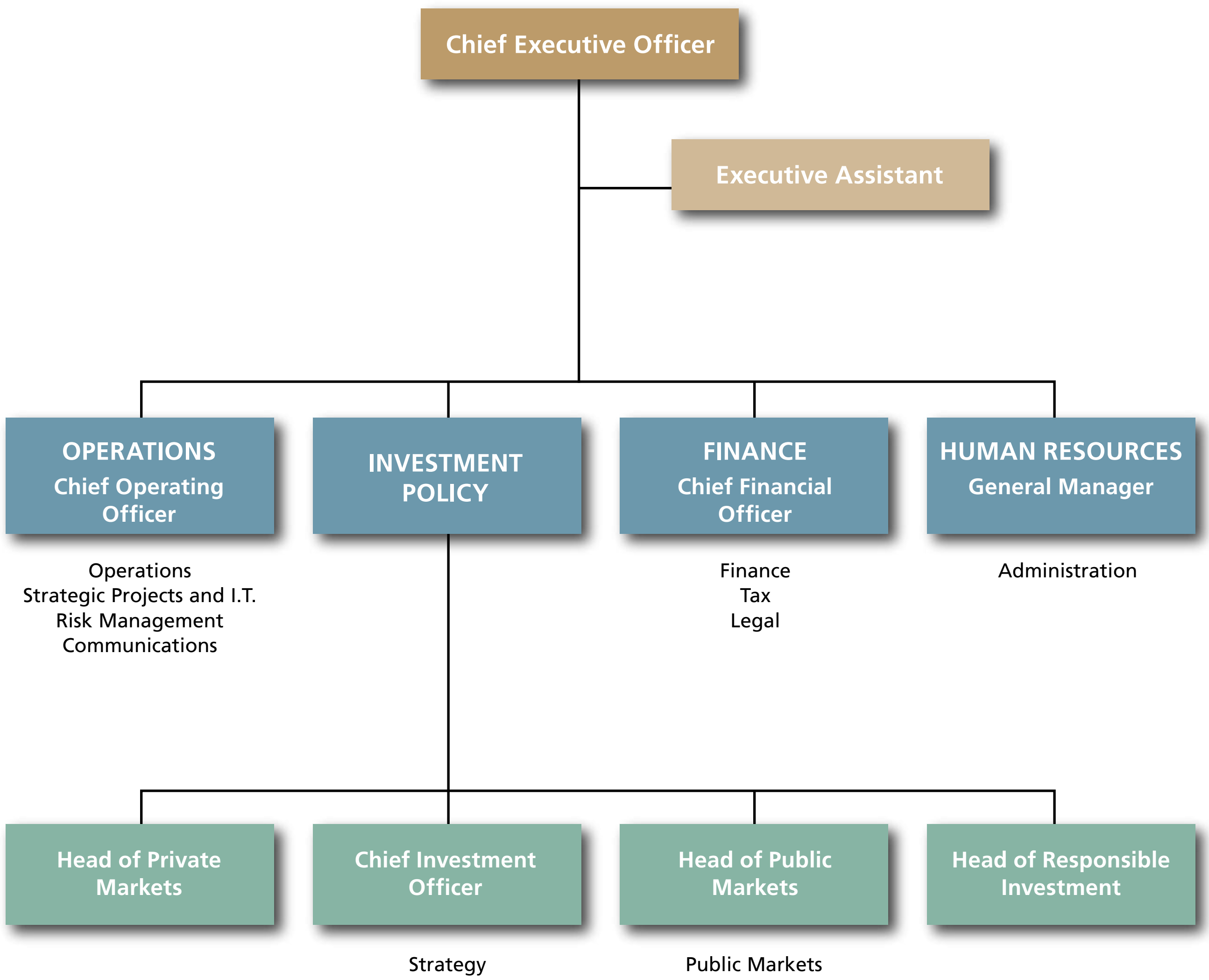

SENIOR MANAGEMENT TEAM

ADRIAN ORR

ANNE-MAREE O'CONNOR

JANET GALLAGHER

MARK FENNELL

Adrian Orr, Chief Executive Officer: Responsible for general management of the Guardians and of the Fund under delegation from the Board. Adrian joined the Guardians in February 2007 from the Reserve Bank of New Zealand where he was Deputy Governor and Head of Financial Stability. Adrian has held the position of Chief Economist at Westpac Banking Corporation, Chief Manager of the Economics Department of the Reserve Bank of New Zealand and Chief Economist at The National Bank of New Zealand. He also worked at The Treasury and at the OECD.

Anne-Maree O'Connor, Head of Responsible Investment: Responsible for developing and implementing the Guardians' policy, standards and procedures for responsible investment and corporate governance. Anne-Maree joined the Guardians in November 2006. She was the Managing Director of CoreRatings, a leading European rating agency for independent investment analyses of corporate responsibility risks. Anne-Maree moved back to New Zealand after 20 years in Europe. She held various positions in the field of corporate responsibility and governance including Associate Director, Socially Responsible Investment (SRI) at Morley Fund Management, Head of SRI Research at Henderson Global Investors, and Head of Corporate Responsibility Ratings at Det Norske Veritas.

Janet Gallagher, General Manager Human Resources: Responsible for staff management and human resources (HR) framework. Janet joined the Guardians in May 2007 after eight years managing her own HR consultancy business. Previously Janet held senior HR positions with Lion Nathan, NZI Life, and New Zealand Dairy Foods.

Mark Fennell, Chief Operating Officer: Responsible for developing and overseeing investment operations, information technology, strategy projects, risk management, and communications. Mark joined the Guardians in July 2007 from The Warehouse Group where he was the Company Secretary and Chief Risk Manager. Mark also has significant public sector experience, working in a senior finance position for the Ministry of External Relations and Trade and state owned enterprises (Forestry Corporation and New Zealand Railways Corporation).

SENIOR MANAGEMENT TEAM (CONTINUED)

PAUL DYER

STEWART BROOKS

TIM MITCHELL

Paul Dyer, Chief Investment Officer: Responsible for overseeing the development and implementation of investment policy. Paul joined the Guardians in April 2004 after eight years with AMP Capital Investors (NZ Ltd), most recently as Chief Investment Officer. Prior to AMP Capital, he was Director, Strategy at SBC Warburg (Australia). Paul has also held positions as Chief Economist with Buttle Wilson and economist with The Treasury.

Stewart Brooks, Chief Financial Officer: Responsible for financial control, tax, legal, and external audit. Stewart joined the Guardians in August 2003 from Sterling Grace Portfolio Management Group, where he was Group Company Secretary. Stewart was previously Financial Controller for Motorola Cellular and worked in private equities for seven years. Prior to this he worked for a computer multinational in the UK.

Tim Mitchell, Head of Public Markets: Responsible for the appointment of investment managers in public markets. Tim joined the Guardians in April 2003. He was previously a consultant to the Board with responsibility for establishing the Guardians' infrastructure. Prior to that, Tim was a principal advisor at The Treasury. Before moving into the public sector, he spent seven years with Colonial First State Investment, most recently as Chief Investment Officer.

9. REPORT AGAINST THE STATEMENT OF INTENT

The Guardians' governing legislation requires them to provide, in the Annual Report, an analysis and explanation of the performance of the Fund compared with their expectations as set out in the Statement of Intent issued at the beginning of the year. In addition, the Guardians are required to report progress against the key objectives they set for the 2006/07 year. This section deals with these requirements.

Fund Performance

In the Statement of Intent issued in July 2006, the Guardians estimated that the Fund's return (after costs, but before tax) would be 8.2% in the 2006/07 year. The actual return was 14.58%.

While considerably ahead of the initial estimate, the result is within the expected range of forecast accuracy. The financial modelling used in forming the Strategic Asset Allocation highlights that in any given year the Fund's return is likely to be within a range of +/-10% around the estimated average approximately two-thirds of the time. This range narrows considerably as the time horizon for the forecast lengthens due to the 'trend-reverting' time series behaviour of asset prices.

A copy of the Statement of Intent can be found on the Fund's website.

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Report Against Key Objectives

The key objectives for the 2006/07 year are outlined below together with an analysis of progress towards these objectives.

STRATEGIC OBJECTIVE	OPERATIONAL OBJECTIVE	PROGRESS
IMPROVE THE EFFICIENCY OF THE GUARDIANS' INVESTMENT PROGRAMME AND INTELLIGENTLY EXPLOIT RISK TO MAXIMISE EARNINGS WITH PARTICULAR FOCUS ON THE ADVANTAGES THAT THE GUARDIANS' LONG TIMEFRAME AND LOW NEED FOR LIQUIDITY GIVE THE GUARDIANS	Ensure the composition of market risk in the portfolio is efficient over the Fund's long-time horizon	• A review of the Strategic Asset Allocation has been undertaken. The results of this review are being considered by the Board for implementation. • An enhanced framework for forecasting expected financial returns from the portfolio has been completed and utilised for budgeting purposes. • The implication of adjusting the financial risk profile of the Fund over time based on updated earnings data and other inputs is being assessed using external experts. • Assessment of whether it is beneficial to alter the asset allocation of the Fund on a tactical basis based on market asset pricing is near completion. An international peer group review has been completed, with mixed views as to the net benefits. • A review of the fixed interest component of the Fund was completed, with a decision to lengthen the duration of the portfolio and move to corporate investment grade credit over time.
	Diligently measure the allocation of risk in the portfolio and optimise this based on the outlook over the medium-term	• A financial 'risk budget' framework has been implemented for investment assessment.
	Continue the diversification of the portfolio into private markets to reduce total risk	• Diversification has continued in the portfolio, with less exposure to publicly listed equity markets and more exposure to private assets. • A private equity strategy has been agreed to, and implementation is in progress. • An organisation structure that includes a dedicated private markets team has been implemented. The Guardians are in the process of recruitment. • Agreement has been reached as to appropriateness and use of subsidiaries for investments in private markets.
	Increase the contribution from active risk to portfolio returns	• Continued investments have been made in active manager mandates, including the appointment of new multi-strategy managers. • A risk factor analysis framework has been established to ensure active risk is diversified. The factor analysis model is integrated into manager due diligence. • A review of the Guardians' conviction ratings in the current investment managers is largely complete.
ACCESS ADVICE, EXPERIENCE AND PARTNER ORGANISATIONS FROM AROUND THE WORLD TO ENSURE THE GUARDIANS ARE OPERATING TO BEST-PRACTICE STANDARDS	Ensure competition of views from external sources in policy development	• The Board undertook a second 'reference group' meeting with leading external experts. • Relationships with relevant external advisors have been maintained, including leading advisory firms and asset class experts. • The Board and management continue to maintain and develop external relationships amongst peer group funds. • The Guardians also maintain a watching brief for emerging managers.
	Benchmark efficiency of risk-adjusted performance generation against appropriate peer groups	• The Guardians have completed the review of their 2005 calendar year against a peer group utilising a survey conducted by an independent specialist, CEM Benchmarking Inc. A 2006 review is underway.
	Expand networks with high-quality peer funds to raise insights into more effective strategy/implementation/organisational design	• The Guardians continue to deepen existing working relationships with other sovereign peer funds, as well as relevant endowment funds. Board and management also continue to participate and attend international conferences and initiatives.

Report Against Key Objectives - continued

STRATEGIC OBJECTIVE	OPERATIONAL OBJECTIVE	PROGRESS
ENSURE THAT THE GUARDIANS OPERATIONALISE THEIR INVESTMENT STRATEGY EFFICIENTLY AND THAT THERE ARE EFFECTIVE CONTROLS TO MANAGE THE ATTENDANT RISKS	Ensure custody and investment administration services can support the developing needs of the organisation, meeting international quality standards and minimising transactional leakages where appropriate	• A review of custodians was completed, with a decision taken to appoint Northern Trust as the Fund's new custodian. Northern Trust assumed custodial responsibility for the Fund's assets in July 2007. • The Guardians have completed New Zealand IFRS transitional adjustments and opening balance sheets, both for the Guardians and the Fund.
	Ensure information management systems enable the organisation to meet business requirements	• The Guardians have completed their review of requirements for the internal data warehouse. • The Guardians initiated an external review of information management and are developing an action plan to implement the findings of that review.
	Exploit opportunities to generate revenue and reduce costs within the operational environment	• The Guardians appointed eSecLending as their third-party provider to manage their securities lending programme. The securities lending programme generates additional revenue by lending the Fund's securities to approved borrowers. • Recommendations following the review of foreign exchange hedging activities will reduce foreign exchange transaction costs.
	Ensure the risk management environment is appropriate to the stage of growth of the organisation	• An accountancy firm was appointed to undertake internal audits. The inaugural internal audit plan was developed, and internal audits were completed. • The Guardians reviewed aspects of the Business Continuity Management requirements and contracted an external provider to supply core business continuity facilities including IT access. • The Guardians completed a review of investment manager compliance with their agreed reporting requirements. Changes to this process were developed and implemented. • The Guardians developed and implemented a project management framework for use on all Guardians' projects. • The Board identified the top five risks facing the Guardians, with a monitoring framework agreed to, and a link to the Statement of Intent. • A process was developed to manage internal incidents, including reporting to the Board. • The process for managing the introduction of new products and mandates was enhanced and includes an Anti Money Laundering Check.
	Ensure office operating environment is both conducive to organisational success and cost efficient	• The Guardians completed an office fit-out and relocation to their new premises, with all team members now on one floor.

Report Against Key Objectives - continued

STRATEGIC OBJECTIVE	OPERATIONAL OBJECTIVE	PROGRESS
BE OPEN IN THE GUARDIANS' DEALINGS, TRANSPARENT IN THEIR REPORTING, AND COMMUNICATE EFFECTIVELY WITH THEIR STAKEHOLDERS TO SUPPORT THE ACHIEVEMENT OF THE FUND'S AIMS	Ensure Crown retains confidence in Guardians' strategy and execution through comprehensive and timely disclosure	• All legal obligations were met with regard to publications, including the Statement of Intent and Annual Report. • The Guardians developed and implemented a process to allocate costs between the Guardians and the Fund. • A quarterly report has continued to be delivered to the Minister of Finance with Treasury comment when needed. • All Official Information Act and Parliamentary questions have been responded to.
	Increase understanding of the Guardians' purpose, strategy and expected performance in both the financial services and wider community as a way of building confidence	• The Guardians' Board and management have attended and presented at various domestic and international conferences, outlining the work of the Fund. • The Fund's website is highly developed and functional, supporting the Guardians' transparent approach. There will be ongoing developments to the website. • A communications policy has been developed, particularly around business continuity management and financial crisis.
	Ensure Fund's policies and initiatives in responsible investing meet contemporary standards and are effectively communicated	• The Guardians recruited a Head of Responsible Investment to provide leadership in this area. • A responsible investment strategy consistent with the Act has been developed. • The Guardians are signatories to the UN Principles for Responsible Investment and the Carbon Disclosure Project. • The Guardians implemented a global proxy voting platform, and appointed Institutional Shareholder Services (ISS) to assist in the management of their proxy voting. • The Guardians have developed and implemented specific voting guidelines for New Zealand equity portfolios. • Decisions have been taken to engage, exclude, and divest from various holdings based on responsible investment principles.
DEVELOP A GOVERNANCE MODEL THAT CLARIFIES RESPONSIBILITY AND PROMOTES ACCOUNTABILITY	Ensure optimal use of the Board's limited time to advance the organisation's interests	• The Guardians have reviewed and implemented delegations from the Board to management. • The Guardians established a Private Markets Board Committee, to efficiently deal with private market transactions.
	Review effectiveness of current operating structure to see if improvements in efficiency can be made	• The Board completed an externally facilitated board effectiveness survey. • The Guardians introduced four internal committees (Management, Portfolio, Investment, and Communications) to improve accountability, co-ordination, and the robustness of delegated decisions and recommendations to the Board. • The Guardians completed their review of OAG Procurement Good Practices. These principles were adhered to for the Custodian review. • A review of policies and procedures is near completion.
	Meet financial review standards required of the Guardians and the Fund	• The Guardians received unqualified audits for the Guardians and for the Fund for 2005/06. • The Guardians operating costs were maintained within the 2006/07 appropriation.

Report Against Key Objectives - continued

STRATEGIC OBJECTIVE	OPERATIONAL OBJECTIVE	PROGRESS
INVEST IN A TALENTED AND COMMITTED TEAM OF PEOPLE	Ensure the employee compensation structure is effective to meet the recruitment and retention needs of the organisation	• The Guardians completed the benchmarking of salaries to ensure remuneration was within target range, as agreed with the Employee Policy and Remuneration Committee. • The Guardians have implemented an employee long-term incentive programme based on the financial out-performance of the Fund against the medium-term benchmarks, as well as organisational performance against plan.
	Provide effective support for the professional development of employees and Board Members to promote continuous advancement of Fund's interests	• The Guardians appointed a General Manager Human Resources, who is in the process of implementing a framework that includes the development of a professional development programme, and performance management plan.
	Reduce reliance on key personnel through succession planning	• The Guardians' staff numbers grew by 15 during the year. Many of these staff appointments were at a senior level, and will assist in addressing key person risk and support succession planning. • The use of external investment managers has been continued.
AIM FOR MUTUAL RESPECT IN THE GUARDIANS' RELATIONSHIPS WITH EXTERNAL PARTNERS IN ORDER TO MAXIMISE VALUE	Ensure key advisory relationships are stable and productive	• The Guardians have maintained their relationships with key advisors. • Contracts have been reassessed and renewed with advisors in timber, property, and private equity.
	Ensure key service provision relationships for the Guardians are competitive and reliable	• The Guardians recruited in-house IT resources to improve service delivery. • A review of investment managers was commenced to ensure interests remained aligned and service level agreements were being met. • A competitive tender process resulted in the appointment of Northern Trust as custodian to the Fund.

10. OVERVIEW OF THE GUARDIANS AND THE FUND

The Fund is a 'buffer fund' created to partially provide for the future cost of funding New Zealand Superannuation payments.

New Zealand Superannuation

New Zealand currently has a taxpayer-funded 'pay-as-you-go' retirement income system, where eligible residents over the age of 65 receive a pension irrespective of their income or assets. This means that current pensions are paid by people currently in employment. The pension is known as New Zealand Superannuation.

At present, in New Zealand, there is only one person in eight over the age of 65. Longer term the picture looks very different with a sharp increase in the proportion of the population over 65 years of age. New Zealand's ageing population means that by 2030 the ratio of people over 65 will have risen to one in four. This ageing of the population, an issue which many developed countries face, is due to a combination of increased life expectancy and lower birth rates.

Meeting the Cost of an Ageing Population

The increase in the number of retired people relative to the working-age population will inevitably lead to a significant increase in the cost of providing New Zealand Superannuation. Currently, the net cost is 3.4% of GDP. Projections indicate that by 2030 that will be about 5.6%, and by 2050 about 6.9% of GDP.

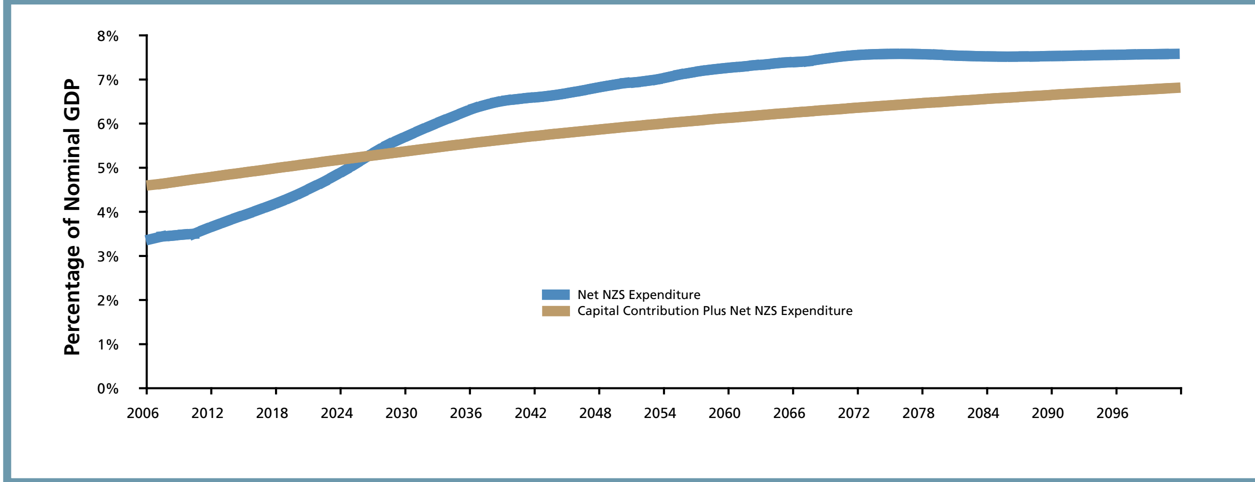
One way to alleviate this funding pressure is to move from a complete reliance on the 'pay-as-you-go' system to a partially pre-funded system, which is what New Zealand has done with the creation of the Fund.

A Smoothed 'Pay-as-You-Go' System

Established under the Act, the Fund is an investment fund that accumulates and invests Crown contributions. These contributions, which are paid out of general taxes, are expected to average approximately $2 billion a year over the next two decades (please refer to graphs Forecast Capital Contribution to Fund and Forecast Size of Fund Assets). The Fund invests this money in a way that maximises returns, without undue risk, over the long term, while avoiding prejudice to New Zealand's reputation.

The purpose of the Fund is to build up a portfolio of Crown-owned financial assets during a period where the cost of New Zealand Superannuation remains relatively low. Those financial assets will then be progressively drawn on by the Crown to supplement the Crown's annual budget as its finances adjust to the higher level of ongoing expense for New Zealand Superannuation. In effect, the Fund provides a smoothing mechanism (or 'buffer fund') for what remains, fundamentally, a 'pay-as-you-go' pension system (please refer to graph Smoothing the Cost of New Zealand Superannuation).

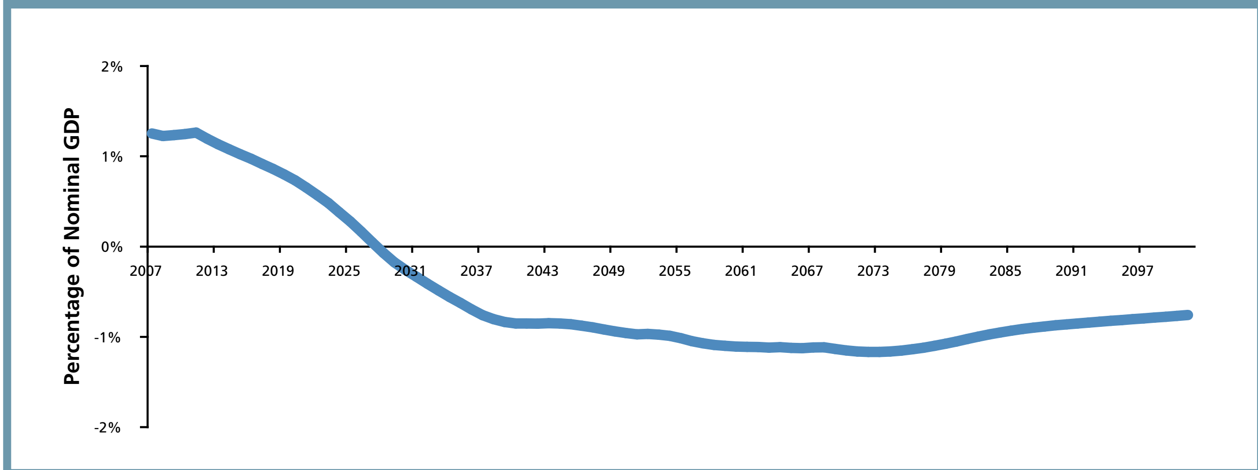
SMOOTHING THE COST OF NEW ZEALAND SUPERANNUATION *Source: The Treasury - as at 30 June 2007*



Drawing on the Fund

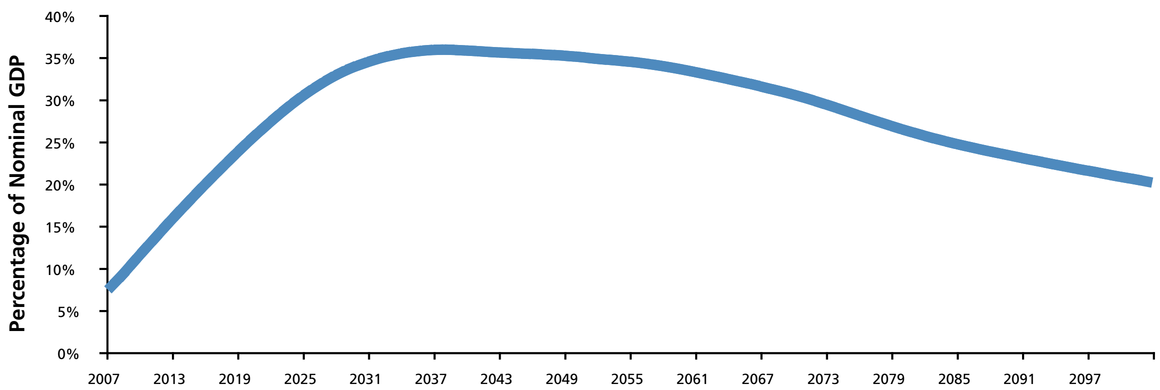
Under law, no capital withdrawal is allowed from the Fund before 1 July 2020. According to current Treasury fund modelling, capital contributions from the Crown are projected to cease by 2028, at which time the Crown will start to make capital withdrawals from the Fund. However, the Fund is projected to be a net contributor from 2022, at which point tax flowing to the Crown is projected to exceed the Crown's capital contribution to the Fund. The Fund's assets under management are projected to peak at just under 36% of GDP in 2037 and then gradually fall as a proportion of GDP over the ensuing decades. Because capital withdrawals are forecast to always be less than the Fund's income net of tax, the Fund is expected to continue to grow in nominal dollar terms.

CAPITAL CONTRIBUTION TO FUND *Source: The Treasury - as at 30 June 2007*



SIZE OF FUND ASSETS

Source: The Treasury - as at 30 June 2007



Who Oversees the Fund?

The Fund is governed by a separate Crown entity called the Guardians. This entity is overseen by a Board selected by the Minister of Finance for their skills and experience.

While accountable to the Crown, the Guardians operate at arm's length from the Crown. The Minister of Finance may give directions to the Guardians regarding the Crown's expectations as to the Fund's performance, but must not give any direction that is inconsistent with the duty to invest the Fund on a prudent and commercial basis. The Guardians must have regard to any direction from the Minister. Any direction given by the Minister must be tabled in Parliament.

Notes:

Demographic projections are sourced from Statistics New Zealand (www.stat.govt.nz). Projections of future New Zealand Superannuation costs are sourced from The Treasury's Funding Model or Contribution Rate Model (www.treasury.govt.nz).

To learn more about New Zealand Superannuation visit the websites of Work and Income (www.winz.govt.nz) and The Office for Senior Citizens (www.osc.govt.nz).

11. PORTFOLIO INFORMATION

Section 68(g) of the Act requires the Guardians to provide a schedule of their external investment managers and custodians.

External Investment Managers and Custodians

The schedule below details the Guardians' external investment managers and the number of mandates awarded, as well as their global Custodians as at 30 June 2007.

EXTERNAL INVESTMENT MANAGERS AND CUSTODIANS	CLASSES															
	New Zealand Equities	New Zealand Fixed Interest	New Zealand Property	Global Equities (Large Cap)	Global Equities (Small Cap)	Global Equities (Emerging Markets)	Global Equity Market Neutral	Multi-Strategy Alpha	Global Property	Infrastructure	Global Fixed Interest	Private Equity	Timber	Currency	Custody	Cash
Adams Street Partners												1				
Alliance Bernstein L.P.				2												
AMP Capital Investors	1		1													
AMP Pencarrow (No. 2) Limited												1				
Apax Partners												1				
AXA Rosenberg Investment Management Limited					1		1									
Barclays Global Investors Australia Limited				1												
BNP Paribas Fund Services Australasia Pty Limited																
Bridgewater Associates, Inc.								1								
Brook Asset Management Limited	1															
Capital Partners Pty Limited										1						
Coller Capital												1				
Direct Capital Management Limited												1				
Fisher Funds Management Limited	1															
GMO LLC				1	1			1								
GMO Renewable Resources													1			
Goldman Sachs Asset Management, L.P.					1			1								
Hancock Timber Resource Group, Inc.													1			
HarbourVest Partners												1				
ING NZ Limited		2														1
Legg Mason International Limited						1										
LSV Asset Management Limited				1		1										
Morrison & Co Funds Management Limited										1						
Northern Trust Company (From 1 July 2007)																
Numeric Investors LLC					1			1								
Overlay Asset Management														1		
Smartshares Limited	1															
Sterling Johnston Capital Management Limited					1											
Thompson, Siegel & Walmsley, Inc.					1											
Vanguard Investments Australia Limited									1		1					

12.INVESTMENT POLICIES

Section 61 of the Act states the Guardians' Annual Report must develop and comply with a Statement of Investment Policies, Standards and Procedures, which sets out how the Fund's assets will be invested and how performance will be measured. A summary of this Statement follows.

A full copy of the 2007 Statement is available on the Fund's website.

www.nzsuperfund.co.nz

Statement of Investment Policies, Standards and Procedures

Asset Classes and Selection Criteria

Section 61(a) – the classes of investments in which the Fund is to be invested and the selection criteria for investments within those classes

The Fund shall be invested in the following general asset classes and sub-categories:

(a) Global equities, comprising separate allocations to large/mid capitalisation; small capitalisation; and emerging markets equities;

(b) New Zealand equities, incorporating a constrained allocation to Australian equities (recognising the close economic relationship with Australia);

(c) Global fixed interest, comprising separate allocations to sovereign and non-sovereign debt;

(d) New Zealand fixed interest, comprising separate allocations to sovereign and non-sovereign debt;

(e) Property, comprising New Zealand and international unlisted assets and listed property securities;

(f) Private market assets which have less liquidity than, and/or are lowly correlated with, listed equities. These include, but are not limited to, New Zealand and international private equity, absolute return strategies, timber and infrastructure; and

(g) Commodities, comprising a broad basket of futures prices for frequently traded commodities.

The strategic asset allocation identifies the mix of asset classes determined to best meet the long-term performance target for the Fund. This is reviewed from time to time.

Statement of Investment Policies, Standards and Procedures - continued

The Investment Management Agreement with each external investment manager details the constraints on security selection. Typically those constraints include: maximum exposure to a particular company, sector, country or credit rating; maximum deviation from the manager's benchmark exposure to a particular company, sector, currency or country; minimum and maximum number of stocks that can be held; ranges for ex-ante tracking error relative to the manager's benchmark; and maximum issued capital or debt of an individual company that can be held.

Benchmarks

Section 61(b) – the determination of benchmarks or standards against which the performance of the Fund as a whole, classes of investments, and individual investments, will be assessed

Benchmarks must be consistent with the risk and return assumptions that underpin the strategic asset allocation for the Fund.

The benchmarks for individual asset classes must be broadly representative of that asset class. The performance of asset classes will be assessed by comparing the aggregate performance of investment managers within that asset class against the benchmark for that asset class.

The benchmarks for individual managers should be either the benchmark for the asset class within which that manager is selected, or broadly representative of the universe of securities from which the manager makes its selections. A manager's performance will be assessed by comparing its performance against its respective benchmark, taking into account the amount of risk the manager has adopted relative to that benchmark.

The performance of the Fund as a whole is assessed against the risk-free rate of return. Performance against this benchmark is reported monthly, and should be measured over rolling five-year periods as milestones towards achieving the stated 20-year objective of exceeding the risk-free rate of return by an average minimum of 2.5% p.a.

Investment performance for the Fund as a whole is measured after the deduction of fees, transaction costs, and foreign taxes.

Reporting Standards

Section 61(c) – standards for reporting the investment performance of the Fund

The external investment manager and custodian reports must contain sufficient detail to enable management to make an assessment of the investment manager's performance against its mandate and its progress towards achieving its investment objectives, as well as to analyse manager, asset class, and whole-of-Fund performance.

Management reporting to the Board will enable the Board to determine the effectiveness of manager selection and the Fund's strategic asset allocation decisions.

Public reporting through the website and statutory reports will be as open and transparent as commercial sensitivities allow.

Statement of Investment Policies, Standards and Procedures - continued

Responsible Investment

Section 61(d) – ethical investment, including policies, standards and procedures for avoiding prejudice to New Zealand's reputation as a responsible member of the world community

Section 61(i) – the retention, exercise or delegation of voting rights acquired through investments

The Board has adopted a Responsible Investment Policy to assist in meeting the Guardians' obligation to manage the Fund in a manner consistent with adopting best practice portfolio management, maximising returns without undue risk to the portfolio as a whole, and avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

The Guardians consider responsible investment to be part of evolving best practice investment management and believe that long-term financial performance can be affected by environmental, social, and governance issues. The Guardians are committed to the United Nations (UN) Principles for Responsible Investment and aim to encourage companies to meet internationally agreed standards for responsible corporate behaviour, in particular the principles of the UN Global Compact. The Guardians have adopted guidelines and procedures to exercise the Fund's voting rights internationally in line with good corporate governance practice.

Balance Between Risk and Return

Section 61(e) – the balance between risk and return in the overall Fund portfolio

Analysis of the risk/return trade-off, over 20 years, of various asset allocation options resulted in setting a performance expectation of exceeding, before New Zealand tax, the risk-free rate of return by an average of at least 2.5% p.a. over rolling 20-year periods.

The policy is that in order to achieve the investment objective while minimising the risk to the Fund as a whole, the mix of assets within the Fund should be as efficient as possible (that is, should offer the highest level of return for a given level of risk). Portfolio optimisation techniques are used to achieve this balance.

In addition, it is recognised that the use of active management of assets carries costs and risks, but is an appropriate policy where there is an expectation of a reward for that risk.

Fund Management Structure

Section 61(f) – the Fund management structure

The Guardians have overall responsibility for the management of the Fund. The Board has appointed an internal management team, supported by a range of external advisors and a global custodian. A custodian provides appropriate separation between the investing function and the settlement of transactions, as well as the recording and reporting of investment activities. The Guardians have also appointed external investment managers to manage portfolios within nominated asset classes.

Statement of Investment Policies, Standards and Procedures - continued

Derivatives

Section 61(g) – the use of options, futures and other derivative financial instruments

Derivatives are permitted as part of the investment strategy to manage risk, achieve or reduce exposure to asset classes, and achieve transactional efficiency. Derivatives are not to be used for investment activity where derivative exposure combined with physical exposure results in a net exposure for that asset class, or the portfolio as a whole, that is inconsistent with the investment strategy.

All derivatives must be in the form of an exposure over the same asset class as the physical instrument.

Risk Management

Section 61(h) – the management of credit, liquidity, operational, currency, market and other financial risks

The Guardians have determined that the quality of all their risk management procedures must be of best-practice standard.

Risks are managed through clearly specifying eligible assets in investment mandates, ensuring adequate diversification within and between portfolios, ensuring there are adequate procedures to manage operational risks including effective internal controls, separation of roles and codes of conduct, and implementing policies for the hedging of foreign currencies.

At 30 June 2007 the policy for managing foreign currency exposure was that 72.5% of the Fund's exposure in the global growth assets sector (equities, and property assets), and 100% of infrastructure, global fixed interest, and timber assets, would be hedged back to New Zealand dollars.

Securities Lending

Section 61(h) – the management of credit, liquidity, operational, currency, market, and other financial risks

The Board approved the creation of a third-party securities lending programme, to make use of the possibilities in the market for third-party securities lending and generate supplementary income for the Fund by lending securities to qualified borrowers. Borrowers provide collateral in exchange for the right to borrow securities.

It is intended that the Securities Lending Portfolio generate income primarily from fees from loans and secondarily through a moderate risk collateral reinvestment strategy.

Statement of Investment Policies, Standards and Procedures - continued

Valuation of Private Market Assets

Section 61(j) – the method of, and basis for, valuation of investments that are not regularly traded at a public exchange

Investments not regularly traded on public exchanges will generally be held in pooled vehicles, where they will be valued by managers on behalf of all investors based on external valuation methodologies.

Where investments are neither held via public exchanges nor in pooled vehicles, fair value will be determined on the basis of independent valuations based on accepted market practice. These valuations will be conducted at least annually by recognised professional advisors who are suitably qualified and possess appropriate experience and expertise relevant to the nature of each specific underlying asset.

Investment Constraints

Section 61(k) – prohibited or restricted investments or any investment constraints or limits

The Guardians will not invest in any asset that does not fall into one of the asset classes described in the strategic asset allocation.

In addition, the Guardians will not invest directly in any security that is prohibited by the Responsible Investment Policy, nor will they own any business outright.

Contractual arrangements with each external investment manager will prescribe constraints on that manager's security selection discretion that are consistent with the risk budget for that manager and the risk budget for the Fund as a whole.

In seeking to achieve the performance objective for the Fund, the Guardians will not enter into arrangements with other parties that have an intended result that diminishes the New Zealand tax base.

On behalf of the Board and Management of the Guardians of New Zealand Superannuation we hereby certify that to the best of our knowledge the investment policies, standards and procedures for the Fund have been complied with throughout the 2006/07 financial year.

David May

DAVID MAY
Chairman

ADRIAN ORR
Chief Executive Officer

2007

CONTENTS

Financial Statements

Statement of Responsibility

The Board and management of the Guardians of New Zealand Superannuation accept responsibility for the preparation of the annual Financial Statements of the New Zealand Superannuation Fund and Group and the judgements used in them.

The Board and management of the Guardians of New Zealand Superannuation accept responsibility for establishing and maintaining a system of internal control designed to provide reasonable assurance as to the integrity and reliability of financial and non financial reporting of the New Zealand Superannuation Fund and Group.

In the opinion of the Board and management of the Guardians of New Zealand Superannuation the annual Financial Statements for the year ended 30 June 2007, fairly reflect the financial position, cash flows, and operations of the New Zealand Superannuation Fund and Group.

SIR DOUGLAS GRAHAM
Acting Chairman
10 September 2007

ADRIAN ORR
Chief Executive Officer
10 September 2007

Statement of Financial Performance

FOR THE YEAR ENDED 30 JUNE 2007

		GROUP ACTUAL		BUDGET
		2007	2006	2007
	Notes	$000	$000	$000
Revenue				
Investment income	2	463,359	350,212	408,437
Unrealised gains and (losses) on investments and foreign currencies	3	(444,667)	1,020,893	365,339
Realised gains and (losses) on investments and foreign currencies	3	1,672,388	138,768	243,559
Miscellaneous income		6,698	1,005	-
TOTAL OPERATING REVENUE		**1,697,778**	**1,510,878**	**1,017,335**
Expenses				
Operating expenses	4	152,384	80,915	85,335
TOTAL EXPENSES		**152,384**	**80,915**	**85,335**
Share of net surplus of associates	9(b)	45,314	-	-
Surplus before income tax expense		**1,590,708**	**1,429,963**	**932,000**
Income tax expense	14	511,339	468,776	280,110
NET SURPLUS		**1,079,369**	**961,187**	**651,890**

The attached notes form part of and should be read in conjunction with these financial statements.

Statement of Movements in Public Equity

FOR THE YEAR ENDED 30 JUNE 2007

		GROUP ACTUAL		BUDGET
		2007	2006	2007
	Notes	$000	$000	$000
Net surplus		**1,079,369**	**961,187**	**651,890**
Foreign currency translation reserve movement	6	(4,727)	4,109	-
Land revaluation reserve movement	6	3,445	7,289	-
TOTAL RECOGNISED REVENUES AND EXPENSES		**1,078,087**	**972,585**	**651,890**
Fund capital contributions from the Crown		2,049,000	2,337,000	2,049,000
Capital contributions from the Crown in respect of funding the net cost of New Zealand superannuation entitlements	19	6,809,938	6,413,619	-
Capital withdrawals by the Crown in respect of funding the net cost of New Zealand superannuation entitlements	19	(6,809,938)	(6,413,619)	-
Movements in public equity for the year		**3,127,087**	**3,309,585**	**2,700,890**
Public equity at beginning of year		**9,864,415**	**6,554,830**	**10,014,698**
PUBLIC EQUITY AT END OF YEAR		**12,991,502**	**9,864,415**	**12,715,588**

The attached notes form part of and should be read in conjunction with these financial statements.

Statement of Financial Position

AS AT 30 JUNE 2007

	Notes	GROUP ACTUAL 2007 $000	GROUP ACTUAL 2006 $000	BUDGET 2007 $000
ASSETS				
Investments				
Cash and cash equivalents	7	363,030	357,317	20,000
Investments	7	12,462,927	9,714,025	13,145,948
Investment in associates	9	331,219	18,466	-
Total investments		**13,157,176**	**10,089,808**	**13,165,948**
Property, plant, and equipment	10	1,674	-	1,000
Receivables	11	82,690	105,491	90,197
Other assets		940	40	-
Taxation receivable		-	84,580	-
TOTAL ASSETS		**13,242,480**	**10,279,919**	**13,257,145**
LIABILITIES				
Payables	12	52,276	73,828	77,958
Taxation payable		41,740	-	-
Provisions	13	40,685	12,801	-
Deferred tax liability	15	116,277	328,875	462,599
TOTAL LIABILITIES		**250,978**	**415,504**	**540,557**
NET ASSETS		**12,991,502**	**9,864,415**	**12,716,588**
Retained surplus		2,694,307	1,614,938	2,429,509
Foreign currency translation reserve	6	(618)	4,109	-
Land revaluation reserve	6	10,734	7,289	-
Contributed capital		10,287,079	8,238,079	10,287,079
TOTAL PUBLIC EQUITY		**12,991,502**	**9,864,415**	**12,716,588**

The attached notes form part of and should be read in conjunction with these financial statements.

Statement of Cash Flows

FOR THE YEAR ENDED 30 JUNE 2007

	Notes	GROUP ACTUAL 2007 $000	GROUP ACTUAL 2006 $000	BUDGET 2007 $000
CASH FLOWS FROM OPERATING ACTIVITIES				
Cash was provided from:				
Dividends		275,853	219,474	39,468
Interest		139,168	119,667	89,102
Receipts from customers		37,731	15,713	-
Miscellaneous income		6,430	-	-
Tax refund		3	24	-
TOTAL CASH INFLOW FROM OPERATING ACTIVITIES		**459,185**	**354,878**	**128,570**
Cash was applied to:				
Managers' fees		(43,586)	(25,980)	(85,768)
Tax paid		(596,175)	(294,712)	(165,059)
Payments to suppliers		(50,491)	(15,242)	-
Net Goods and Services Tax paid		(1,281)	(354)	-
TOTAL CASH OUTFLOW FROM OPERATING ACTIVITIES		**(691,533)**	**(336,288)**	**(250,827)**
NET CASH INFLOW/(OUTFLOW) FROM OPERATING ACTIVITIES	17	**(232,348)**	**18,590**	**(122,257)**
CASH FLOWS FROM INVESTING ACTIVITIES				
Cash was provided from:				
Sale of investments		8,868,142	7,774,530	390,000
TOTAL CASH INFLOW FROM INVESTING ACTIVITIES		**8,868,142**	**7,774,530**	**390,000**
Cash was applied to:				
Purchase of investments		(10,385,993)	(9,837,482)	(2,315,743)
Purchase of subsidiaries, net of cash acquired		-	(103,201)	-
Purchase of property, plant, and equipment		(1,750)	-	(1,000)
Purchase of associates	9(b)	(265,740)	(18,466)	-
TOTAL CASH OUTFLOW FROM INVESTING ACTIVITIES		**(10,653,483)**	**(9,959,149)**	**(2,316,743)**
NET CASH INFLOW/(OUTFLOW) FROM INVESTING ACTIVITIES		**(1,785,341)**	**(2,184,619)**	**(1,926,743)**
CASH FLOWS FROM FINANCING ACTIVITIES				
Cash was provided from:				
Capital contributions from the Crown		2,049,000	2,337,000	2,049,000
NET CASH INFLOW FROM FINANCING ACTIVITIES		**2,049,000**	**2,337,000**	**2,049,000**
Net increase/(decrease) in cash		**31,311**	**170,971**	**-**
Cash at beginning of the year		357,317	177,347	20,000
Effect of exchange rate changes on cash		(25,598)	8,999	-
CASH AT END OF THE YEAR		**363,030**	**357,317**	**20,000**

The attached notes form part of and should be read in conjunction with these financial statements.

Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2007

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

REPORTING ENTITY

These are the consolidated financial statements of the New Zealand Superannuation Fund (Fund) and its subsidiaries, a fund created under Section 37 of the New Zealand Superannuation and Retirement Income Act 2001 (Act). This Act commenced on 11 October 2001.

The consolidated financial statements comprise the Fund and its subsidiaries (Group).

The Fund is managed and administered by the Guardians of New Zealand Superannuation (Guardians). The Guardians were established as a Crown entity by Section 48 of the Act and became operative from 30 August 2002.

The Crown is required to make capital contributions to the Fund for investment based on a percentage of GDP as set out in the Act. Capital contributions are made by the Crown into the Fund for the purpose of investment, and funding the net cost of New Zealand superannuation entitlements (superannuation entitlements).

STATUTORY BASE

The financial statements have been prepared in accordance with the Act.

MEASUREMENT BASE

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

SPECIFIC ACCOUNTING POLICIES

The financial statements are prepared in accordance with New Zealand generally accepted accounting practice. The accounting policies that materially affect the measurement of financial performance and financial position are set out below.

(a) Budget figures

The budget was included in the Statement of Intent of the Guardians and was approved by the Guardians on behalf of the Fund for the year.

(b) Capital contributions

(i) Fund capital contributions

The Crown is required to make capital contributions to the Fund in accordance with Sections 42 to 44 inclusive of the Act. Capital contributions are made by the Crown to the Fund on a fortnightly basis for investment and for the purpose of contribution to the net cost of paying superannuation entitlements after 2020. These capital contributions are recorded in the Statement of Movements in Public Equity.

(ii) Superannuation entitlement payments

The Minister of Finance, under Section 45 of the Act, must ensure that sufficient money is transferred to the Fund in each year to meet the net cost of superannuation entitlements. These transfers are treated as capital contributions from the Crown in respect of funding the net cost of superannuation entitlements and are offset by capital withdrawals and recorded in the Statement of Movements in Public Equity.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c) Capital withdrawals

(i) Fund capital withdrawals

In terms of Section 47 of the Act no withdrawals of Fund capital contributions are permitted in any financial year before 1 July 2020.

(ii) Superannuation entitlement payments

The net cost of superannuation entitlements is treated as a capital withdrawal by the Crown in respect of funding the net cost of superannuation entitlements and is recorded in the Statement of Movements in Public Equity. These amounts equate to the associated capital contributions.

The payment of superannuation entitlements is an expense of the Crown and is recorded separately in the Crown financial statements.

(d) Consolidation of subsidiaries

Subsidiaries are those entities that are controlled by the Fund.

The Group's financial statements incorporate the financial statements of the Fund and its subsidiaries, which have been consolidated using the purchase method. The results of any subsidiaries that become or cease to be part of the Group during the year are consolidated from the date that control commenced or until the date that control ceased.

All inter-entity transactions, balances, and unrealised profits are eliminated on consolidation.

(e) Associates

An associate is an entity over which the Fund is in a position to exercise significant influence, but not control or joint control, through participation in determining the financial and operating policies of the entity.

The results, assets, and liabilities of associates are incorporated in the Group financial statements using the equity method of accounting.

(f) Property, plant, and equipment

All items of property, plant, and equipment are initially recorded at cost, including costs directly attributable to bringing the asset to its working condition.

Depreciation for property, plant, and equipment is provided for on a straight line basis at depreciation rates calculated to allocate the asset cost or valuation less residual value, over their useful lives.

Major depreciation periods are:

- Computer equipment	2–3 years
- Office furniture and equipment	4 years
- Leasehold improvements	Life of the lease

(g) Goodwill

Goodwill arising on the acquisition of subsidiaries is recognised as an asset and separately disclosed. Goodwill is amortised in the Statement of Financial Performance on a straight line basis over the period of expected benefits.

To the extent that the unamortised balance of goodwill is no longer probable of being recovered from the expected future economic benefits, it is recognised immediately as an expense.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

(h) Income tax

In accordance with Section 76 of the Act, the Fund is treated as if it is a body corporate for tax purposes and is therefore subject to income tax on any income derived from investments, and that income is treated as gross income of the Fund under the Income Tax Act 2004.

The income tax expense recognised for the year is based on the operating surplus before taxation adjusted for permanent differences between accounting and taxable income.

The impact of all timing differences between accounting and taxable income is recognised as a deferred tax liability or asset. This is the comprehensive basis for the calculation of deferred tax under the liability method.

Deferred tax is provided for on unrealised gains and losses on investments.

A deferred tax asset, or the effect of losses carried forward that exceed the deferred tax liability, is recognised in the financial statements only where there is virtual certainty that the benefit of the timing differences, or losses, will be utilised.

(i) Financial instruments

The Group is party to financial instruments as part of its normal operations. These financial instruments include cash and cash equivalents, investments, receivables and payables. All financial instruments are recognised in the Statement of Financial Position and all revenues and expenses in relation to financial instruments are recognised in the Statement of Financial Performance.

Financial assets and financial liabilities are recognised in the Statement of Financial Position when the Group becomes a party to the contractual provisions of the instrument. The Group offsets financial assets and financial liabilities when the Group has a legally enforceable right to set off and intends to settle on a net basis.

(i) Investments

Investments are initially recognised at cost on a trade date basis. Subsequent to initial recognition investments are recorded at fair value. Changes in fair value are recognised in the Statement of Financial Performance.

Transaction costs are expensed immediately.

Fair value is an estimate of the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Fair value is determined as follows:

- Fixed interest securities are valued at the last quoted sales price on the relevant exchange as of the close of business at balance date.
- Listed securities are stated at the last sales price as quoted on the relevant exchange as of the close of business at balance date.
- Investments in listed unit trusts are stated at the last quoted sales price as quoted on the relevant exchange as of the close of business at balance date.
- Investments in unlisted unit trusts are stated at the net asset value per unit as provided by the investment managers or administrators at balance date.
- Private equity investments are valued based on independent assessments utilising valuation models based on the price of recent investments, earnings multiples, or net assets. Where no reliable fair value can be estimated using such techniques, private equity investments are carried at cost less any provision for impairment.
- Investments in multi-strategy funds (unlisted open-ended investment funds) are stated at the net asset value per share as provided by the investment managers or administrators of the underlying investment funds at balance date.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(i) Financial instruments (continued)

(ii) Derivatives

The Group enters into a variety of derivative financial instruments to manage its exposure to foreign currency risk, including forward foreign exchange contracts, and achieve exposure to assets and asset classes, including futures contracts, over-the-counter equity swaps and commodity swaps. The use of derivatives is governed by the Group's Statement of Investment Policies, Standards and Procedures approved by the Guardians, which provides written principles on the use of derivatives by the Group.

Derivatives are recorded at fair value. Fair value is determined using either quoted sales prices or appropriate valuation techniques.

The fair value of derivatives that are not exchange-traded is estimated at the amount that the Group would receive or pay to terminate the contract at the balance sheet date taking into account current market conditions and the current creditworthiness of the counterparties.

The fair value of all forward foreign exchange contracts is determined as a net present value of estimated future cash flows, discounted at appropriate market rates as at balance date. The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles.

The fair value of futures contracts and equity swaps is calculated as being the difference between the contract price and the closing price reported on the primary exchange of the futures contract.

The fair value of commodity swaps is determined using broker quotations.

(iii) Receivables

Receivables are stated at their estimated realisable value.

(j) Forest assets

Forest assets are predominantly standing trees. These are shown in the Statement of Financial Position at fair value less estimated point of sale costs at harvest. The costs to establish and maintain the forest assets are included in the Statement of Financial Performance together with the change in fair value for each accounting period.

The valuation of the Fund's forest assets is based on discounted cash flow models. The yearly harvest from forecast tree growth is multiplied by expected wood prices and the costs associated with forest management, harvesting, and distribution are then deducted to derive annual cash flows.

The fair value of the forest assets is measured as the present value of cash flows from one growth cycle based on productive forest land, taking into consideration environmental, operational and market restrictions. Forests are valued separately from the underlying freehold land.

Land and land improvements are stated at fair value, as determined by an independent valuer. Revaluations are transferred to the land revaluation reserve. If the revaluation reserve has a deficit, that deficit is recognised in the Statement of Financial Performance in the period it arises. In subsequent periods any revaluation surplus that reverses previous revaluation deficits is recognised as revenue in the Statement of Financial Performance.

Major depreciation periods for land improvements are:

- Roading	15–20 years
- Fencing	10–15 years

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

(k) Income recognition

Interest income is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Dividend income is recognised when the shareholders rights to receive payment has been established, normally the ex-dividend date.

Where the Group has elected to receive dividends in the form of additional shares rather than cash, the amount of the cash dividend foregone is recognised as income. Any excess in the value of shares received over the amount of cash dividend foregone is recognised as a gain in the Statement of Financial Performance.

Any unrealised gains and losses arising from the revaluation of investments or conversion to New Zealand dollars at balance date, and realised gains and losses on the sale of investments during the year, are included in the Statement of Financial Performance. Realised gains and losses are calculated with reference to the weighted average cost of investments.

(l) Foreign currency transactions

Transactions denominated in a foreign currency are converted to New Zealand dollars at the exchange rate in effect at the date of the transaction.

Monetary assets and liabilities denominated in foreign currency at balance date are translated at the rate of exchange ruling as at that date. The resulting exchange differences are recognised in the Statement of Financial Performance. Realised foreign currency gains and losses represent gains and losses upon sale of investments that relate to foreign exchange movements in assets, and gains and losses upon settlement of forward foreign exchange contracts. Unrealised foreign exchange gains and losses represent the translation of foreign denominated assets and liabilities.

(m) Translation of the financial statements of independent foreign operations

Assets and liabilities of independent foreign operations are translated at the closing rate of exchange. Revenue and expense items are translated at a weighted average of exchange rates over the period, as a surrogate for the spot rates at transaction dates. Exchange differences arising from the foregoing are taken to the foreign currency translation reserve and recognised in the Statement of Movements in Public Equity.

Exchange differences on monetary liabilities designated as a hedge against investments in independent foreign operations are taken to the foreign currency translation reserve and recognised in the Statement of Movements in Public Equity to the extent that they are offset by the exchange differences on the net investments.

On disposal of an independent foreign operation, the accumulated amount of the exchange differences taken to the foreign currency translation reserve that relate to the foreign operation and to any monetary liability designated as a hedge of that operation are transferred out of the foreign currency translation reserve direct to retained surplus.

(n) Statement of Cash Flows

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

- **Operating activities** include all transactions and other events that are not investing or financing activities.
- **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.
- **Financing activities** are those activities relating to capital contributions and to payments of superannuation entitlements (from 2020). As the current funding by the Crown of New Zealand superannuation entitlements flows directly from the Treasury to the Ministry of Social Development it is not considered cash flow of the Fund and is accordingly not recorded in the Statement of Cash Flows.
- **Cash** and 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.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(o) Goods and Services Tax

The financial statements are prepared exclusive of Goods and Services Tax (GST), except for those expenses where GST is non-recoverable as an input tax (as the Fund does not make taxable supplies) or where GST is included in receivables and payables balances.

(p) Prior year comparatives

Certain prior year comparatives have been reclassified to conform to current year presentation.

CHANGES IN ACCOUNTING POLICIES

There have been no changes in accounting policies during the year and the accounting policies are consistent with those used in the previous period.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

		GROUP ACTUAL		BUDGET
		2007	2006	2007
	Notes	$000	$000	$000
NOTE 2: INVESTMENT INCOME				
New Zealand fixed interest – Crown		47,983	50,099	
New Zealand fixed interest – State Owned Entities		556	106	
New Zealand fixed interest – Local Bodies		4,214	3,704	
New Zealand fixed interest – Other		50,854	31,957	
Total New Zealand fixed interest		**103,607**	**85,866**	
Global fixed interest		25,434	27,258	
Other interest		17,029	3,326	
Timber sales	5	36,464	15,420	
Dividend income		280,825	218,342	
Total other income		**359,752**	**264,346**	
Total investment income		**463,359**	**350,212**	**408,437**
NOTE 3: REALISED AND UNREALISED GAINS AND (LOSSES) ON INVESTMENTS AND FOREIGN CURRENCIES				
Unrealised gains and (losses) on investments and foreign currencies:				
Unrealised gains on investments		611,990	343,779	
Unrealised appreciation in forest value	5	31,822	29,205	
Unrealised foreign currency gains/(losses) on investments		(1,564,088)	763,461	
Unrealised foreign currency hedging gains/(losses)		475,609	(115,552)	
Total unrealised gains and (losses) on investments and foreign currencies		**(444,667)**	**1,020,893**	**365,339**
Realised gains and (losses) on investments and foreign currencies:				
Realised foreign currency gains/(losses) on investments		(109,028)	98,980	
Realised foreign currency hedging gains/(losses)		1,180,061	(471,225)	
Realised gains on investments		601,355	511,013	
Total realised gains and (losses) on investments		**1,672,388**	**138,768**	**243,559**

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

	Notes	GROUP ACTUAL 2007 $000	GROUP ACTUAL 2006 $000	BUDGET 2007 $000
NOTE 4: OPERATING EXPENSES				
Timber harvesting and operating expenses	5	17,494	7,186	-
Write off of goodwill	5	-	9,945	-
Depletion of timber assets	5	17,484	8,800	-
Managers' fees – base		48,591	32,411	49,583
Managers' fees – performance	13	38,309	12,801	10,642
Depreciation – property, plant, and equipment	10	81	-	-
Depreciation – land improvements	5	316	71	-
Custody fees		10,084	7,096	10,642
Auditor's remuneration		305	228	442
Other expenses		19,720	2,377	14,026
Total operating expenses		**152,384**	**80,915**	**85,335**
NOTE 5: SURPLUS FROM TIMBER INVESTMENTS (EXCLUDING MANAGER FEES)				
Timber sales	2	36,464	15,420	
Less: Harvesting and operating expenses	4	(17,494)	(7,186)	
Depletion of timber assets	4	(17,484)	(8,800)	
Depreciation – land improvements	4	(316)	(71)	
Write off of goodwill	4	-	(9,945)	
Unrealised appreciation in forest value	3	31,822	29,205	
Surplus from timber investments (excluding manager fees)		**32,992**	**18,623**	**-**
NOTE 6: RESERVES				
Foreign currency translation reserve				
Balance at the beginning of the year		4,109	-	
Foreign exchange difference arising on translation of foreign operation		(40,857)	23,789	
Effect of hedging of net investment in foreign operation		35,826	(19,680)	
Taxation effect of movements in the translation reserve		304	-	
Balance at the end of the year		**(618)**	**4,109**	**-**
Land revaluation reserve				
Balance at the beginning of the year		7,289	-	
Revaluation of land		8,477	7,289	
Taxation effect of movements in the revaluation reserve		(5,032)	-	
Balance at the end of the year		**10,734**	**7,289**	**-**

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

	GROUP ACTUAL		BUDGET
	2007	2006	2007
	$000	$000	$000
NOTE 7: INVESTMENTS			
Cash balances in New Zealand Dollars	93,085	102,056	
Cash balances in foreign currencies	269,945	255,261	
Total cash	**363,030**	**357,317**	**20,000**
New Zealand equities – State Owned Entities	15,460	2,203	
New Zealand equities – Other	885,459	831,392	
Global equities	6,333,646	5,306,061	
Total equities	**7,234,565**	**6,139,656**	
New Zealand fixed interest – Crown	605,582	813,181	
New Zealand fixed interest – State Owned Entities	6,405	1,504	
New Zealand fixed interest – Local Bodies	70,295	47,116	
New Zealand fixed interest – Other	732,002	577,959	
Global fixed interest	895,572	572,175	
Total fixed interest	**2,309,856**	**2,011,935**	
New Zealand timber investments – land	39,760	38,880	
New Zealand timber investments – forests	153,423	147,400	
Global timber investments – land	35,718	35,965	
Global timber investments – forests	119,094	141,661	
Total timber investments	**347,995**	**363,906**	
Forward foreign exchange contracts	329,232	(149,111)	
Futures contracts	(2,485)	(3,008)	
Equity swaps	(2,967)	(2,670)	
Commodity swaps	12,256	18,960	
Other derivatives	28,088	-	
Multi-strategy funds	1,623,253	1,081,618	
Private equity	28,049	-	
Global unit trusts	555,085	252,739	
Total other investments	**2,570,511**	**1,198,528**	
Total investments	**12,462,927**	**9,714,025**	**13,145,948**
Total cash and investments	**12,825,957**	**10,071,342**	**13,165,948**

The Group participates in a securities lending programme to enhance portfolio returns. Credit risk associated with the securities lending programme is mitigated by requiring the borrower to provide daily collateral in the form of readily marketable investments of greater market value than the securities loaned. As at 30 June 2007, the Group's global equities investments include loaned securities with a fair value of $850,205,283 (2006: nil). The fair value of collateral received in respect of these loans is $888,065,640 (2006: nil).

As at balance date the Group had cash balances totaling $363,030,000 (2006: $357,317,000) of which $297,269,000 (2006: $277,711,000) had been allocated and is held by investment managers awaiting investment.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

NOTE 7: INVESTMENTS (CONTINUED)

Land as part of the New Zealand timber investments was valued by Telfer Young (Northland) Ltd, an independent registered valuer. Land as part of the global timber investments was valued by Sizemore & Sizemore, Inc. and Resource Programming, Inc.

The valuations were obtained as at 30 June 2007. The revaluation surplus has been taken to the land revaluation reserve.

The Group invests either directly or indirectly in a number of countries, and derives income from these sources. This exposes the Group to the risks associated with investing in these countries. The investment holdings of the Group are represented by geographical segments as follows:

	GROUP ACTUAL		BUDGET
	2007	2006	2007
	$000	$000	$000
Regional concentration			
New Zealand	3,173,709	2,324,731	
Australia	490,193	350,237	
Japan	749,247	681,067	
United States	5,002,817	4,320,135	
Canada	181,836	139,258	
Europe	2,704,262	1,901,784	
Other Asia	363,336	248,771	
Central & South America	107,293	64,921	
Africa	38,000	30,484	
Middle East	15,264	9,954	
Total investments and cash	**12,825,957**	**10,071,342**	**13,165,948**

NOTE 8: INVESTMENT IN SUBSIDIARIES

	PERCENTAGE HELD		BALANCE DATE
	2007	2006	
CNI Timber Holdco	100%	100%	30 June
CNI Timber Operating Company Limited	100%	100%	30 June

CNI Timber Holdco is a holding company for 100% of the shares in CNI Timber Operating Company Limited. Until 31 May 2006, CNI Timber Operating Company Limited owned a forest estate, and undertook forestry activities. On this date the forest was sold to a nominee company which holds assets and liabilities on behalf of the Fund.

Section 59 of the Act restricts the Fund from taking an enduring controlling interest in any other entity. From time to time, opportunities to purchase privately traded assets carry associated obligations to take over operating entities specific to that asset. There is a need to balance the benefit to the Fund of progressing with the transaction against the restriction on taking control of the operating entity. The acquisition of CNI Timber Holdco and CNI Timber Operating Company Limited arose during the purchase of a timberland estate. The Guardians are currently working to restructure the Group so that the entities are no longer controlled by the Fund. The restructure of these entities is substantially completed including distribution of equity to NZSF Timber Investments (No 2) Limited, a subsidiary of the Guardians. Based on legal advice, CNI Timber Operating Company Limited will be retained and shares transferred to the Guardians. CNI Timber Holdco will be struck off in the near future.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

NOTE 8: INVESTMENT IN SUBSIDIARIES (CONTINUED)

The Fund also owns 100% of the USD shares in the AXA Rosenberg Global Market Neutral Fund. This feeds into three sub-funds where the ownership is diluted. The highest percentage ownership that the Fund has in any sub-fund is 82.23%. These sub-funds were not set up for the Fund's exclusive use but were set up with the intention that the Fund would not hold a majority stake. The Fund does not have the unilateral ability to determine the financing and operating policies of the sub-funds, change the manager, extract dividends, or wind up the sub-funds (although it may redeem the majority of its units). In particular, it cannot block the manager from admitting other investors to the sub-funds. Accordingly, this investment has not been treated as a subsidiary but has been classified as an investment.

NOTE 9: INVESTMENT IN ASSOCIATES

	Percentage Held	Balance Date	GROUP ACTUAL 2007 $000	GROUP ACTUAL 2006 $000	BUDGET 2007 $000
(a) Investment details					
AMP Pencarrow Private Capital Joint Venture Fund	31.67%	31 March	33,818	14,765	
Direct Capital Partners III	30.53%	31 December	7,569	3,701	
Kaingaroa Timberlands Partnership	20.00%	30 June	289,832	-	
Investment in associates			**331,219**	**18,466**	**-**

On 31 October 2006, the Group acquired 20% of Kaingaroa Timberlands Partnership, a forestry entity based in New Zealand with a 30 June reporting date. The fair value of the net assets acquired at that date was $265.7 million.

(b) Movements in carrying value of the Group's investment in associates	2007 $000	2006 $000	Budget 2007 $000
Balance at the beginning of the year	18,466	-	
Acquisition of associate	265,740	18,466	
Share of total recognised revenues and expenses	45,314	-	
Additional investment	1,699	-	
Balance at the end of the year	**331,219**	**18,466**	**-**

(c) Summarised financial information

The following table illustrates summarised financial information relating to the Group's associates:

	2007 $000	2006 $000
Extract from the associates' balance sheets:		
Assets	1,856,362	57,269
Liabilities	10,256	535
Net assets	1,846,106	56,734
Extract from the associates' income statements:		
Revenue	520,645	17,956
Net profit	469,503	1,186

There is no goodwill, contingent assets, contingent liabilities, or future capital expenditure commitments for any associates (2006: nil).

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

NOTE 10: PROPERTY, PLANT, AND EQUIPMENT

	COMPUTER EQUIPMENT $000	OFFICE FURNITURE AND EQUIPMENT $000	BUILDINGS & LEASEHOLD IMPROVEMENTS $000	TOTAL $000
Opening cost	-	-	-	-
Additions	177	318	1,255	1,750
Revaluations	-	-	5	5
Closing cost	**177**	**318**	**1,260**	**1,755**
Opening accumulated depreciation	-	-	-	-
Depreciation expense	43	14	24	81
Closing accumulated depreciation	**43**	**14**	**24**	**81**
Net book value	**134**	**304**	**1,236**	**1,674**

	GROUP ACTUAL 2007 $000	GROUP ACTUAL 2006 $000	BUDGET 2007 $000
NOTE 11: RECEIVABLES			
Accrued interest	30,875	23,974	
Other receivables	1,780	1,018	
Dividends receivable	15,189	10,217	
Unsettled sales	34,846	70,282	
Total receivables	**82,690**	**105,491**	**90,197**
NOTE 12: PAYABLES			
Accrued expenses	27,420	15,127	
Unsettled purchases	23,877	58,701	
Intercompany payable to Guardians	979	-	
Total payables	**52,276**	**73,828**	**77,958**

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

	GROUP ACTUAL 2007 $000	GROUP ACTUAL 2006 $000	BUDGET 2007 $000
NOTE 13: PROVISION FOR INVESTMENT MANAGER PERFORMANCE FEES			
Balance brought forward	12,801	-	-
Provision during the year	38,309	12,801	-
Paid out during the year	(10,425)	-	-
Closing provision	**40,685**	**12,801**	**-**
Represented by:			
Current	10,280	10,425	-
Non-current	30,405	2,376	-
Total	**40,685**	**12,801**	**-**

Investment managers earn performance-based fees once agreed hurdles are reached. The payout of the current year fee is capped, with the remainder of the fee being held by the Group for possible payout in future periods. Poor performance in the following years may lead to a reduction in the entitlement that is being held. Thus, the amount and timing of the eventual payout is uncertain.

NOTE 14: INCOME TAX EXPENSE

	GROUP ACTUAL 2007 $000	GROUP ACTUAL 2006 $000	BUDGET 2007 $000
Surplus before income tax	1,590,708	1,429,963	932,000
Plus/(less) permanent differences	(1,941)	53,417	
Imputation credits on taxable dividends	12,680	9,651	
Surplus subject to income tax	**1,601,447**	**1,493,031**	**932,000**
Tax at 33% of net income	528,478	492,700	307,560
Imputation credits on dividends	(12,680)	(9,651)	
Tax losses	-	(2,627)	
Prior year adjustment	(4,459)	(11,646)	
Tax expense	**511,339**	**468,776**	**280,110**
Represented by:			
Current tax – current year	696,156	228,955	
Current tax – prior year	25,324	(11,444)	
Deferred tax – current year	(180,358)	251,467	
Deferred tax – prior year	(29,783)	(202)	
Tax expense	**511,339**	**468,776**	**280,110**

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

	GROUP ACTUAL 2007 $000	GROUP ACTUAL 2006 $000	BUDGET 2007 $000
NOTE 15: DEFERRED TAX LIABILITY			
Balance brought forward	328,875	78,010	
Current year deferred tax liability	(146,998)	251,467	
Transition to Fair Dividend Rate (FDR)	(33,360)	-	
Withholding tax offset against deferred tax	(2,457)	(400)	
Prior period adjustment	(29,783)	(202)	
Closing deferred tax liability	**116,277**	**328,875**	**462,599**

With effect from 1 July 2008, the tax rate for the Group will reduce from 33% to 30%. Deferred tax has been provided on short-term assets at 33% with unrealised gains on long-term assets at 30% in accordance with NZ IAS 12 Income Taxes.

On 1 July 2007, the Fair Dividend Rate will apply to all equity investments excluding New Zealand equities and Australian equities listed on the Australian Stock Exchange (ASX) with franking credits. These assets will be taxed on 5% of their daily value. Gains, losses and dividends will no longer be subject to tax.

All equities that were previously classified as Grey List, were deemed to have been disposed at market value on 30 June 2007. The unrealised gain arising on these shares results in a current tax liability of $33,360,512 which will be payable in three equal instalments on 30 June 2008, 2009 and 2010.

With effect from 1 October 2007 the Group will be treated as a Portfolio Investment Entity with regard to New Zealand equities and Australian equities quoted on the ASX maintaining franking credits. The dividends on these equities will be taxable, with capital gains and losses no longer subject to tax. In accordance with the legislation, the Group will deem to dispose of these stocks on 30 September 2007 at market value and the tax liability arising on the unrealised gains at that time will be payable in three instalments on 31 March 2008, 2009 and 2010. As at 30 June 2007, the tax liability on these equities is estimated at $98 million.

NOTE 16: FINANCIAL INSTRUMENTS

Financial instruments carried on the Statement of Financial Position include cash and bank balances, investments, receivables, and payables. Investments are stated at fair value and any resultant gains or losses are recognised in the Statement of Financial Performance.

(a) Fair value

The Group's financial assets and liabilities are stated at fair value in the Statement of Financial Position.

(b) Credit risk

Credit risk is the risk that a counterparty will default on its obligation to the Group, causing the Group to incur a loss. Financial instruments which potentially subject the Group to risk include cash and cash equivalents, securities on loan, investments and receivables. Collateral in the form of cash is held in respect of the Commodity Swap instruments. Collateral for securities on loan is held by a third-party lending agent. This collateral is adjusted on a daily basis and at year end collateral held was 104.45% of the value of securities on loan.

The Group invests in a wide range of assets in New Zealand and overseas in accordance with its Statement of Investment Policies, Standards and Procedures (SIPSP). The SIPSP contains credit and exposure policies to limit credit risk from the Group's investments.

Concentration of credit risk exists if a single counterparty, or group of counterparties are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

	GROUP ACTUAL 2007 $000	GROUP ACTUAL 2006 $000	BUDGET 2007 $000
NOTE 16: FINANCIAL INSTRUMENTS (CONTINUED)			
By industry:			
Basic materials	752,966	655,596	
Communications	603,099	497,724	
Consumer – Cyclical	707,810	597,857	
Consumer – Non-cyclical	1,212,739	1,004,772	
Diversified	74,517	72,476	
Energy	525,432	503,761	
Financial	4,633,274	3,496,862	
Funds	244,132	266,793	
Government	1,482,997	1,366,757	
Industrial	1,162,395	785,194	
Mortgage securities	47,215	38,389	
Technology	335,480	303,544	
Utilities	311,825	226,634	
Other	732,076	254,983	
Total cash and investments	**12,825,957**	**10,071,342**	**13,165,948**

(c) Interest rate risk

The Group is exposed to interest rate risk in that future interest rate movements will affect market value of fixed interest assets. Interest rate risk management activities are undertaken by investment managers in accordance with their investment mandates. The intention of the Group is not necessarily to hold these assets to maturity, but to realise and purchase similar assets as part of the ongoing management of the investments of the Group.

Weighted average effective interest rates and maturity periods in the following table are based on the earlier of contractual repricing or maturity period:

	EFFECTIVE INTEREST RATE %	LESS THAN ONE YEAR $000	1–2 YEARS $000	2–5 YEARS $000	5–10 YEARS $000	OVER 10 YEARS $000	TOTAL $000
New Zealand Government stock	6.00%	-	94,513	227,323	196,951	86,795	605,582
New Zealand Stated Owned Enterprises and Crown Entities	6.59%	-	-	-	-	6,405	6,405
Other fixed bonds and securities	2.56%	603,635	209,477	350,385	274,217	260,155	1,697,869
Total fixed income		**603,635**	**303,990**	**577,708**	**471,168**	**353,355**	**2,309,856**

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

NOTE 16: FINANCIAL INSTRUMENTS (CONTINUED)

d) Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group is exposed to currency risk through its investment in offshore assets and currency risk is actively managed by following a foreign currency hedging policy of using forward foreign exchange contracts to hedge its offshore assets. In the year ended 30 June 2007 the Group's policy required hedging of 100% of global fixed interest securities and 72.5% of global equities.

The unhedged foreign currency monetary assets and liabilities are listed below:

	GROUP 2007	GROUP 2006
	NZ CURRENCY $000	NZ CURRENCY $000
Australian Dollars	87,850	72,565
Brazilian Real	45,608	37,644
Canadian Dollars	95,922	20,780
Swiss Francs	67,983	30,746
Chilean Pesos	3,298	3,900
Chinese Yuan	1,355	-
Czech Republic Koruny	2,986	3,120
Danish Kroner	26,488	6,548
Egyptian Pounds	1,154	1,096
European Union Euros	339,509	150,388
United Kingdom Pounds	198,863	101,520
Hong Kong Dollars	114,540	66,354
Hungarian Forints	2,948	3,467
Indonesian Rupiahs	9,260	6,004
Israeli New Shekels	10,763	9,952
Indian Rupees	20,172	5,709
Japanese Yen	179,424	83,205
South Korean Won	97,288	76,547
Mexican Pesos	24,525	23,446
Malaysian Ringgits	8,618	8,601
Norwegian Krone	41,281	16,822
Philippines Pesos	2,002	1,320
Polish Zlotych	4,044	3,376
Russian Rubles	713	-
Swedish Kronor	109,288	51,155
Singaporean Dollars	57,196	16,402
Thai Baht	14,938	12,866
Turkish New Lira	9,715	6,547
Taiwanese New Dollars	70,847	54,108
United States of America Dollars	534,222	913,909
South African Rand	37,074	29,388

(e) Liquidity risk

Liquidity management is designed to ensure that the Group has the ability to generate sufficient cash in a timely manner to meet its financial commitments. Because of the long-term nature of the Fund (no capital withdrawals are permitted prior to 30 June 2020 and, on current assumptions, none are expected before 30 June 2025), no specific liquidity standards have been developed.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

(f) Forward foreign exchange contracts

The Group invests either directly or indirectly in a number of countries to derive income. This exposes the Group to the risks associated with investing in these countries.

At balance date, the Group held forward foreign exchange contracts with a notional value of $13,048,466,000 (2006: $6,160,682,000) and positive fair value of $329,232,000 (2006: negative $149,111,000).

(g) Individual counterparties

At balance date the Group has counterparty exposure in respect of its forward foreign exchange contracts, commodity swaps, and equity swaps. The table below sets out the exposures by individual counterparty where an individual instrument has a positive fair value.

	GROUP NOTIONAL VALUE 2007 $000	GROUP FAIR VALUE 2007 $000	GROUP NOTIONAL VALUE 2006 $000	GROUP FAIR VALUE 2006 $000
ABN Amro	-	-	225	5
AIG Financial International	207,106	3,444	210,304	5,011
Barclays Capital London	60,388	811	-	-
BNP Paribas	193,232	2,129	315	-
Brown Brothers Harriman	66	-	-	-
Chase Manhattan Bank	19,513	537	-	-
Citibank	1,467	25	12,967	273
Commonwealth Bank Of Australia	6,269	92	199,672	2,875
Crédit Suisse First Boston	3,834	152	2,068	49
Deutsche Bank	109,403	1,449	105,938	2,180
Goldman Sachs International	577,278	3,680	37,496	893
HSBC Bank	61,150	4,865	1,197	38
JP Morgan	-	-	306	4
Lehman Brothers	13,033	492	-	-
Morgan Stanley	1,005,351	25,716	76,529	963
Morgan Stanley Capital Group	-	-	241,279	13,055
NAB FFX Broker	729,659	3,444	-	-
New Zealand Debt Management Office	8,267,650	314,721	1,568,145	30,387
Northern Trust Company London	63,827	903	-	-
Royal Bank Of Canada	88,229	1,491	-	-
Royal Bank Of Scotland	19,697	1,104	9,820	78
Société Générale	211,200	6,237	-	-
State Street	3,917	17	168,830	2,539
UBS	65,735	1,050	7,872	303
Westpac	5,626	34	259,951	2,552
	11,713,630	372,393	2,902,914	61,205

There are no other significant concentrations of credit risk.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

	GROUP ACTUAL 2007 $000	GROUP ACTUAL 2006 $000	BUDGET 2007 $000
NOTE 17: RECONCILIATION OF NET OPERATING INCOME TO NET CASH INFLOW/(OUTFLOW) FROM OPERATING ACTIVITIES			
Net surplus	**1,079,369**	**961,187**	**651,890**
Add/(less) non-cash items:			
Unrealised changes in net fair value of investments	444,667	(1,020,893)	
Depletion of timber assets	17,484	8,800	
Share of net surplus of associates	(45,314)	-	
Write off of goodwill	-	9,945	
Other non-cash items	691	18	
Total non-cash items	**417,528**	**(1,002,130)**	
Changes in assets and liabilities during the financial year:			
(Increase)/decrease in receivables	22,801	(34,281)	
Increase/(decrease) in current tax liability	126,320	(65,243)	
Increase/(decrease) in deferred tax liability	(212,598)	250,865	
Increase/(decrease) in accounts payable	(21,552)	30,983	
Increase in provisions	27,884	12,801	
Increase in other assets	900	-	
Effect of acquisition of subsidiary opening balances	-	(11,354)	
Total changes in assets and liabilities	**(56,245)**	**183,771**	**–**
Items classified as investing activities:			
Realised (gains)/losses on sale of investments	(1,672,388)	(138,768)	
Unsettled sales	(35,436)	38,202	
Unsettled purchases	34,824	(23,672)	
Net cash provided by operating activities	**(232,348)**	**18,590**	**(122,257)**

NOTE 18: RELATED PARTIES

The Group is managed and administered by the Guardians which are a wholly owned entity of the Crown.

The Guardians have paid expenses relating to the Group, as they are required to do under the Act. From 1 July 2006 the Guardians are entitled to receive reimbursement for these expenses, which are included in the financial statements of the Guardians.

The Group, through the Guardians, has entered into a number of transactions with the Crown, Government Departments, Crown Entities and State Owned Enterprises together with a number of other public sector entities on an arm's length basis. These transactions are not considered related party transactions.

The Group has invested a proportion of its assets in fixed income securities issued by the Government, State Owned Enterprises and Crown Entities. These are detailed in Note 7. The income earned from these investments is detailed in Note 2.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

NOTE 19: NEW ZEALAND SUPERANNUATION ENTITLEMENTS

Under Section 45 of the Act the Minister of Finance must ensure that sufficient money is transferred into the Fund in each financial year to meet the net cost of the superannuation entitlements that are payable out of the Fund. As no capital withdrawals are permitted from the Fund in any financial year commencing before 1 July 2020, the Minister of Finance is obliged to provide funding to meet ongoing superannuation entitlements in addition to the capital contributions paid under Section 42 of the Act.

Funding of superannuation entitlements under Section 45 of the Act amounted to $6,809,938,000 during the year (2006: $6,413,619,000) as set out in the Crown financial statements. These capital contributions from the Crown are to meet the expected net cost of superannuation entitlements as determined by the Ministry of Social Development. Against these capital inflow transfers, capital outflow transfers were made to the Ministry of Social Development which is responsible for the administration of superannuation entitlements.

Treasury, through the New Zealand Debt Management Office, has facilitated the flow of funding for superannuation entitlements from the Minister of Finance to the Ministry of Social Development on behalf of the Fund. The Guardians have had no control over these transfers, with Treasury acting as agent for the Fund.

NOTE 20: CONTINGENT LIABILITIES

There were no contingent liabilities as at 30 June 2007 (2006: nil).

NOTE 21: SEGMENTAL INFORMATION

The Group operates in New Zealand in one industry, investment management. As a consequence the Fund invests in a number of countries directly and indirectly in the form of direct investments, fixed interest investments, unit trusts, shares and financial derivatives.

NOTE 22: ACTUAL VERSUS FORECAST

During the year ended 30 June 2007 market returns have generated a positive variance over the assumptions utilised in the budget.

NOTE 23: IMPACT OF ADOPTING NEW ZEALAND EQUIVALENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

The New Zealand Accounting Standards Review Board announced in December 2002 that New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) will apply to New Zealand reporting entities for periods commencing from 1 January 2007. The Group will prepare its first set of NZ IFRS compliant financial statements for the year ending 30 June 2008, in line with the Crown.

The Group has set up a project team to evaluate the impact of adopting NZ IFRS and prepare the Group for transition. The project is being overseen by the Audit and Risk Committee on behalf of the Board.

The preliminary assessment of the impact of adopting NZ IFRS is detailed below.

Portfolio Pricing

Presently the Group records all assets at fair value. For listed securities the price is the last quoted sales price as of the close of business on the day the securities are being valued. Upon adoption of NZ IFRS, the Group intends to designate all financial assets and liabilities as at Fair Value Through Profit or Loss. NZ IAS 39 Financial Instruments: Recognition and Measurement, requires that all listed assets are valued at the end of day bid price as quoted on the relevant exchange. At 30 June 2007, if the Group had valued its portfolio at the bid price, the total value of the portfolio would have been reduced by $22.5 million.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

NOTE 23: IMPACT OF ADOPTING NEW ZEALAND EQUIVALENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (CONTINUED)

Taxation

The tax impact to the Group had NZ IFRS been adopted for the current financial year is as follows: tax expense would have increased by $13 million, tax payable increased by $400,000, deferred tax liability reduced by $2.7 million and the foreign currency translation reserve increased to $24 million.

Disclosure Requirements

NZ IFRS requires a large number of additional disclosures and will result in a number of changes to the way the financial information is presented. Pro-forma NZ IFRS financial statements have been developed. Systems have been put in place to ensure that all necessary data is captured.

The information disclosed in this note represents the best estimate of the impact of conversion to NZ IFRS at the date of preparing the financial statements. The information disclosed could change due to:

- Further work being undertaken by the NZ IFRS project team; and
- Potential amendment to NZ IFRS and / or interpretations thereof being issued by the standard-setters and the International Financial Reporting Interpretation Committee ("IFRIC") which are effective prior to the date of the first full set of NZ IFRS compliant financial statements.

NOTE 24: COMMITMENTS

At year end, the Fund had commitments to private equity funds of $256,731,000 (2006: $43,750,000), of which $48,711,000 has been called upon (2006: $18,431,000). The Fund also had other commitments of $440,101,000 (2006: $231,577,000), of which $129,927,000 has been called upon (2006: $166,033,000).

These commitments are denominated in the foreign currency of the respective fund, and have been translated at the year end rate.

NOTE 25: EVENTS AFTER BALANCE DATE

On 30 July 2007, the Board decided to exercise an option to acquire a further 10% stake in an associate, Kaingaroa Timberlands Partnership. The approximate value of the purchase is USD $100,000,000.

Audit Report

ERNST & YOUNG ■ Chartered Accountants

TO THE READERS OF THE NEW ZEALAND SUPERANNUATION FUND's FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2007

The Auditor-General is the auditor of the New Zealand Superannuation Fund and its subsidiaries (the "Group"). The Auditor-General has appointed me, Warren Allen, using the staff and resources of Ernst & Young, to carry out the audit of the financial statements of the Group, on his behalf, for the year ended 30 June 2007.

Unqualified Opinion

In our opinion:

The financial statements of the Group on pages 55 to 78:

- comply with generally accepted accounting practice in New Zealand; and
- fairly reflect:
  - the Group's financial position as at 30 June 2007; and
  - the results of operations and cash flows for the year ended on that date.

The audit was completed on 10 September 2007, and is the date at which our opinion is expressed.

The basis of our opinion is explained below. In addition, we outline the responsibilities of the Board of the Guardians of New Zealand Superannuation and the Auditor, and explain our independence.

Basis of Opinion

We carried out the audit in accordance with the Auditor-General's Auditing Standards, which incorporate the New Zealand Auditing Standards.

We planned and performed the audit to obtain all the information and explanations we considered necessary in order to obtain reasonable assurance that the financial statements did not have material misstatements, whether caused by fraud or error.

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

The audit involved performing procedures to test the information presented in the financial statements. We assessed the results of those procedures in forming our opinion.

Audit Report (continued)

ERNST & YOUNG ■ Chartered Accountants

Audit procedures generally include:

- determining whether significant financial and management controls are working and can be relied on to produce complete and accurate data;
- verifying samples of transactions and account balances;
- performing analyses to identify anomalies in the reported data;
- reviewing significant estimates and judgements made by the Board of the Guardians of New Zealand Superannuation;
- confirming year-end balances;
- determining whether accounting policies are appropriate and consistently applied; and
- determining whether all financial statement disclosures are adequate.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements.

We evaluated the overall adequacy of the presentation of information in the financial statements. We obtained all the information and explanations we required to support our opinion above.

Responsibilities of the Board of the Guardians of New Zealand Superannuation and the Auditor

The Board of the Guardians of New Zealand Superannuation is responsible for preparing financial statements in accordance with generally accepted accounting practice in New Zealand. Those financial statements must fairly reflect the financial position of the Group as at 30 June 2007. They must also fairly reflect the results of operations and cash flows for the year ended on that date. The Board of the Guardians of New Zealand Superannuation's responsibilities arise from the New Zealand Superannuation and Retirement Income Act 2001.

We are responsible for expressing an independent opinion on the financial statements and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001 and the New Zealand Superannuation and Retirement Income Act 2001.

Independence

When carrying out the audit we followed the independence requirements of the Auditor-General, which incorporate the independence requirements of the New Zealand Institute of Chartered Accountants.

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

Warren Allen.

WARREN ALLEN
Ernst & Young
On behalf of the Auditor-General
Auckland, New Zealand

Statement of Responsibility

FOR THE YEAR ENDED 30 JUNE 2007

The Board and management of the Guardians of New Zealand Superannuation accept responsibility for the preparation of the annual financial statements and the Statement of Service Performance of the Guardians of New Zealand Superannuation and Group and the judgements used in them.

The Board and management of the Guardians of New Zealand Superannuation accept responsibility for establishing and maintaining a system of internal control designed to provide reasonable assurance as to the integrity and reliability of financial and non-financial reporting of the Guardians of New Zealand Superannuation and Group.

In the opinion of the Board and management of the Guardians of New Zealand Superannuation the annual financial statements and Statement of Service Performance for the year ended 30 June 2007 fairly reflect the financial position, operations, and cash flows of the Guardians of New Zealand Superannuation and Group.

SIR DOUGLAS GRAHAM
Acting Chairman
10 September 2007

DAVID NEWMAN
Board Member
10 September 2007

Statement of Financial Performance

FOR THE YEAR ENDED 30 JUNE 2007

	NOTE	PARENT AND GROUP ACTUAL 2007 $000	PARENT AND GROUP ACTUAL 2006 $000	PARENT AND GROUP BUDGET 2007 $000
Crown revenue		1,537	4,318	1,536
Revenue from New Zealand Superannuation Fund		6,622	-	6,243
Interest income		100	85	66
TOTAL OPERATING REVENUE		**8,259**	**4,403**	**7,845**
Expenditure		8,234	4,417	7,779
NET SURPLUS/(DEFICIT)	**2**	**25**	**(14)**	**66**

The attached notes form part of and should be read in conjunction with these financial statements.

Statement of Movements in Public Equity

FOR THE YEAR ENDED 30 JUNE 2007

	NOTE	PARENT AND GROUP ACTUAL 2007 $000	PARENT AND GROUP ACTUAL 2006 $000	PARENT AND GROUP BUDGET 2007 $000
PUBLIC EQUITY AS AT 1 JULY		500	904	1,541
Net surplus/(deficit)		25	(14)	66
TOTAL RECOGNISED REVENUES AND EXPENSES FOR THE PERIOD		**25**	**(14)**	**66**
Equity received from the Crown		-	200	-
Provision for repayment of accumulated surpluses		-	(590)	-
TOTAL EQUITY RECEIVED/(REPAID) FOR THE PERIOD		**-**	**(390)**	**-**
PUBLIC EQUITY AS AT 30 JUNE	**3**	**525**	**500**	**1,607**

The attached notes form part of and should be read in conjunction with these financial statements.

Statement of Financial Position

AS AT 30 JUNE 2007

	NOTE	PARENT AND GROUP ACTUAL 2007 $000	PARENT AND GROUP ACTUAL 2006 $000	PARENT AND GROUP BUDGET 2007 $000
PUBLIC EQUITY				
General funds	3	525	500	1,607
TOTAL PUBLIC EQUITY		**525**	**500**	**1,607**
ASSETS				
Current assets				
Cash and bank	7	1,883	1,181	1,716
Receivables and prepayments	6	2	56	729
Inter-entity receivables	13	535	-	-
Total current assets		**2,420**	**1,237**	**2,445**
Non-current assets				
Investments in subsidiaries	4	-	-	-
Property, plant, and equipment	8	163	454	222
Inter-entity receivables	13	588	-	-
Total non-current assets		**751**	**454**	**222**
TOTAL ASSETS		**3,171**	**1,691**	**2,667**
LIABILITIES				
Current liabilities				
Payables and accruals	9	1,363	423	1,010
Employee entitlements	10	211	157	50
Provisions	11	417	590	-
Total current liabilities		**1,991**	**1,170**	**1,060**
Non-current liabilities				
Provisions	11	655	21	-
Total non-current liabilities		**655**	**21**	**-**
TOTAL LIABILITIES		**2,646**	**1,191**	**1,060**
NET ASSETS		**525**	**500**	**1,607**

The attached notes form part of and should be read in conjunction with these financial statements.

Statement of Cash Flows

FOR THE YEAR ENDED 30 JUNE 2007

	NOTE	PARENT AND GROUP ACTUAL 2007 $000	PARENT AND GROUP ACTUAL 2006 $000	PARENT AND GROUP BUDGET 2007 $000
CASH FLOWS FROM OPERATING ACTIVITIES				
Cash was provided from:				
Receipts from the Crown		1,393	4,760	1,850
Receipts from New Zealand Superannuation Fund		6,437	-	6,622
Interest received		100	84	66
Net Goods and Services Tax		200	-	-
TOTAL CASH INFLOW FROM OPERATING ACTIVITIES		**8,130**	**4,844**	**8,538**
Cash was applied to:				
Payments to employees		(3,865)	(2,014)	(4,661)
Payments to suppliers		(3,038)	(2,172)	(2,969)
Net Goods and Services Tax		-	(66)	(676)
TOTAL CASH OUTFLOW FROM OPERATING ACTIVITIES		**(6,903)**	**(4,252)**	**(8,306)**
NET CASH INFLOW FROM OPERATING ACTIVITIES	**12**	**1,227**	**592**	**232**
CASH FLOWS FROM INVESTING ACTIVITIES				
Cash was provided from:				
Sale of property, plant, and equipment		65	-	-
TOTAL CASH INFLOW FROM INVESTING ACTIVITIES		**65**	**-**	**-**
Cash was applied to:				
Purchase of property, plant, and equipment		-	(383)	-
TOTAL CASH OUTFLOW FROM INVESTING ACTIVITIES		**-**	**(383)**	**-**
NET CASH INFLOW/(OUTFLOW) FROM INVESTING ACTIVITIES		**65**	**(383)**	**-**
CASH FLOWS FROM FINANCING ACTIVITIES				
Cash was provided from:				
Capital appropriation from Crown		-	200	-
TOTAL CASH INFLOW FROM FINANCING ACTIVITIES		**-**	**200**	**-**
Cash was applied to:				
Repayment of accumulated surpluses		(590)	-	-
TOTAL CASH OUTFLOW FROM FINANCING ACTIVITIES		**(590)**	**-**	**-**
NET CASH INFLOW/(OUTFLOW) FROM FINANCING ACTIVITIES		**(590)**	**200**	**-**
Net increase/(decrease) in cash held		**702**	**409**	**232**
Plus opening cash		1,181	772	1,484
CLOSING CASH BALANCE		**1,883**	**1,181**	**1,716**

The attached notes form part of and should be read in conjunction with these financial statements.

Statement of Commitments

AS AT 30 JUNE 2007

	PARENT AND GROUP 2007 $000	PARENT AND GROUP 2006 $000
NON-CANCELLABLE OPERATING LEASE COMMITMENTS PAYABLE		
Payable no later than 1 year	370	127
1–2 years	357	169
2–5 years	1,070	9
Beyond 5 years	268	-
	2,065	305

Statement of Contingent Liabilities

AS AT 30 JUNE 2007

There are no contingent liabilities as at 30 June 2007 (30 June 2006: nil).

The attached notes form part of and should be read in conjunction with these financial statements.

Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2007

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

REPORTING ENTITY

These are the financial statements of Guardians of New Zealand Superannuation (Guardians), a Crown entity in terms of the Crown Entities Act 2004.

These financial statements have been prepared in accordance with the Crown Entities Act 2004.

The consolidated financial statements comprise the Guardians and its subsidiaries (Group).

MEASUREMENT BASE

The financial statements have been prepared on an historical cost basis.

ACCOUNTING POLICIES

The following particular accounting policies which materially affect the measurement of financial performance and financial position have been applied:

a) Budget figures

The budget was approved by the Board for the year.

b) Consolidation of subsidiaries

Subsidiaries are those entities that are controlled by the Guardians.

The Group's financial statements incorporate the financial statements of the Guardians and its subsidiaries, which have been consolidated using the purchase method. The results of any subsidiaries that become or cease to be part of the Group during the year are consolidated from the date that control commenced or until the date that control ceased.

All inter-company transactions, balances and unrealised profits are eliminated on consolidation.

c) Revenue

The Guardians derive revenue through the provision of outputs to the Crown and the New Zealand Superannuation Fund (Fund) and income from its investments. Such revenue is recognised when earned and is reported in the financial period to which it relates.

Interest income is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable.

d) Goods and Services Tax (GST)

All items in the financial statements are exclusive of GST, with the exception of accounts receivable and trade creditors which are stated with GST included. Where GST is irrecoverable as an input tax, then it is recognised as part of the related asset or expense.

e) Taxation

The Guardians are a public authority in terms of the Income Tax Act 2004 and consequently are exempt from income tax.

f) Accounts receivable

Accounts receivable are stated at their expected realisable value after providing for doubtful and uncollectible debts.

g) Investments

Investments are stated at the lower of cost and net realisable value. Any write-downs are recognised in the Statement of Financial Performance.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

h) Property, plant, and equipment

Initial recording

All items of property, plant, and equipment are initially recognised at cost. Cost includes the value of consideration exchanged, or fair value in the case of donated or subsidised assets, and those costs directly attributable to bringing the item to working condition for its intended use.

Subsequent expenditure

Subsequent expenditure relating to an item of property, plant, and equipment is capitalised to the initial cost of the item when the expenditure increases the economic benefits over the life of the item or where that expenditure was necessarily incurred to enable the future economic benefits to be obtained and the expenditure would have been included in the initial cost of the item had the expenditure been incurred at the time of acquisition.

All other subsequent expenditure is expensed in the period in which it is incurred.

Impairment

All items of property, plant, and equipment are assessed for impairment at each reporting date.

Where the carrying amount is assessed to be greater than its recoverable amount, the item is written down. The write down is recognised in the Statement of Financial Performance.

Intended for sale

Items of property, plant, and equipment withdrawn from use and intended for sale are recorded at the lower of carrying amount and net market value.

Disposal

On disposal or permanent withdrawal of an item of property, plant, and equipment the difference between the disposal proceeds (if any) and the carrying amount is recognised in the Statement of Financial Performance.

i) Depreciation

Depreciation is provided on a straight line basis on all property, plant, and equipment at a rate which will write off the cost of the assets to their estimated residual value over their useful lives.

The useful lives and associated depreciation rates of major classes of assets have been estimated as follows:

Office equipment	3 years
Computer equipment	1–3 years
Leasehold improvements	life of lease

The cost of leasehold improvements is capitalised and depreciated over the unexpired period of the lease or the estimated remaining useful lives of the improvements, whichever is shorter.

j) Employee entitlements

Provision is made in respect of the Group’s liability for annual leave. Annual leave is expected to be settled within 12 months of reporting date, and is measured at nominal values on an actual entitlement basis at current rates of pay.

k) Operating leases

Leases where the lessor effectively retains substantially all the risks and benefits of ownership of the leased items are classified as operating leases. Operating lease expenses are recognised on a systematic basis over the period of the lease.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

l) Foreign currency transactions

Transactions denominated in foreign currencies are translated into the reporting currency using the exchange rate in effect at the transaction date.

Monetary items receivable or payable in a foreign currency are translated at balance date at the closing rate.

Exchange differences on foreign exchange balances are recognised in the Statement of Financial Performance.

m) Financial instruments

The Group is party to financial instruments as part of its normal operations. These financial instruments include bank accounts, short-term deposits, receivables and payables. All financial instruments are recognised in the Statement of Financial Position and all revenues and expenses in relation to financial instruments are recognised in the Statement of Financial Performance.

Financial assets and financial liabilities are recognised in the Statement of Financial Position when the Group becomes a party to the contractual provisions of the instrument. The Group offsets financial assets and financial liabilities when the Group has a legally enforceable right to set off the recognised amounts and interests and intends to settle on a net basis.

Except for items covered by separate accounting policy, all financial instruments are shown at their estimated fair value.

n) Provisions

Provisions are recognised when the consolidated entity has a present obligation, the future sacrifice of economic benefits is probable, and the amount of the provision can be measured reliably.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at reporting date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is virtually certain that recovery will be received and the amount of the receivable can be measured reliably.

o) Statement of Cash Flows

Cash means cash balances on hand, held in bank accounts, demand deposits and other highly liquid investments in which the Group invests as part of its day-to-day cash management.

- **Operating activities** include all activities other than investing and financing activities. The cash inflows include all receipts from the sale of goods and services and other sources of revenue that support the Group's operating activities. Cash outflows include payments made to employees, suppliers and for taxes.
- **Investing activities** are those activities relating to the acquisition and disposal of current and non-current securities and any other non-current assets.
- **Financing activities** are those activities relating to changes in equity and debt capital structure of the Guardians and those activities relating to the cost of servicing the Group's equity capital.

p) Prior year comparatives

Certain prior year comparatives have been reclassified to conform with current year presentation.

CHANGES IN ACCOUNTING POLICIES

There have been no changes in accounting policies since the date of the last audited financial statements.
All policies have been applied on a basis consistent with previous years.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

	PARENT AND GROUP 2007 $000	PARENT AND GROUP 2006 $000
NOTE 2: OPERATING SURPLUS/(DEFICIT)		
The net surplus is after charging for:		
• Fees paid to principal auditors		
External audit	29	25
Other services	-	-
• Board Members' fees	144	136
• Employment remuneration and related expenses	5,932	2,599
• Professional fees	277	773
• Rental expense in operating leases	226	115
• Loss on disposal of assets	58	1
• Depreciation:		
Office equipment	49	64
Computer equipment	97	60
Leasehold improvements	22	30
Total depreciation for the year	**168**	**154**

NOTE 3: PUBLIC EQUITY

	PARENT AND GROUP 2007 $000	PARENT AND GROUP 2006 $000
General funds		
Opening balance	500	904
Net surplus/(deficit)	25	(14)
Net equity received from/(repaid to) the Crown	-	(390)
Closing balance	**525**	**500**

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

	BALANCE DATE	% HELD 2007	% HELD 2006
NOTE 4: INVESTMENTS IN SUBSIDIARIES			
Subsidiaries			
New Zealand Superannuation Fund Nominees Limited	30 June	100	100
NZSF Timber Investments (No 1) Limited	30 June	100	100
NZSF Timber Investments (No 2) Limited	30 June	100	100
NZSF Timber Investments (No 3) Limited	30 June	100	100
NZSF Timber Investments (No 4) Limited	30 June	100	-
NZSF Private Equity Investments (No 1) Limited	30 June	100	-

The principal activity of each subsidiary is to act as a nominee company holding assets and liabilities on behalf of the New Zealand Superannuation Fund. These assets and liabilities are recognised in the financial statements of the New Zealand Superannuation Fund, and accordingly are not presented in these financial statements.

NOTE 5: ESTABLISHMENT OF SUBSIDIARIES

On 17 July 2006, the Guardians established a subsidiary company, being NZSF Timber Investments (No 4) Limited. The Guardians own 100% of the equity in this company.

On 26 September 2006, the Guardians established a subsidiary company, being NZSF Private Equity Investments (No 1) Limited. The Guardians own 100% of the equity in this company.

The assets and liabilities of the consolidated entity did not change as a result of the establishment of these subsidiaries.

	PARENT AND GROUP 2007 $000	PARENT AND GROUP 2006 $000
NOTE 6: RECEIVABLES AND PREPAYMENTS		
Prepayments	-	55
Other amounts receivable	2	1
Total receivables and prepayments	**2**	**56**
NOTE 7: CASH AND BANK		
Bank and short-term deposits	1,883	1,181
Weighted average effective interest rates		
Bank and short-term deposits	7.20%	7.03%

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

NOTE 8: PROPERTY, PLANT, AND EQUIPMENT (PARENT AND GROUP)

	COST $000	ACCUMULATED DEPRECIATION $000	NET BOOK VALUE $000
2007			
Office equipment	248	198	50
Computer equipment	305	192	113
Leasehold improvements	-	-	-
Total property, plant, and equipment	**553**	**390**	**163**
2006			
Office equipment	246	149	97
Computer equipment	307	96	211
Leasehold improvements	189	43	146
Total property, plant, and equipment	**742**	**288**	**454**

	PARENT AND GROUP 2007 $000	PARENT AND GROUP 2006 $000
NOTE 9: PAYABLES AND ACCRUALS		
Trade creditors	158	106
Accrued expenses	212	318
GST payable/(refundable)	199	(1)
Income received in advance (related party)	794	-
Total payables and accruals	**1,363**	**423**
NOTE 10: EMPLOYEE ENTITLEMENTS		
Annual leave	194	104
Accrued salary	17	53
Total employee entitlements	**211**	**157**
Represented by:		
Current	211	157
Non-current	-	-
Total employee entitlements	**211**	**157**

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

	PARENT AND GROUP 2007 $000	PARENT AND GROUP 2006 $000
NOTE 11: PROVISIONS		
Provision for refurbishment:		
Opening balance	21	14
Additional provisions made during the year	19	7
Charged against provision for the year	-	-
Unused amounts reversed during the year	(21)	-
Closing balance	**19**	**21**
Provision for repayment of accumulated surplus:		
Opening balance	590	-
Additional provisions made during the year	-	590
Charged against provision for the year	(590)	-
Unused amounts reversed during the year	-	-
Closing balance	**-**	**590**
Provision for employee incentive programme:		
Opening balance	-	-
Additional provisions made during the year	1,053	-
Charged against provision for the year	-	-
Unused amounts reversed during the year	-	-
Closing balance	**1,053**	**-**
Total provisions	**1,072**	**611**
Represented by:		
Current	417	590
Non-current	655	21
Total provisions	**1,072**	**611**

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

	PARENT AND GROUP 2007 $000	PARENT AND GROUP 2006 $000
NOTE 12: RECONCILIATION OF THE NET SURPLUS FROM OPERATIONS WITH THE NET CASHFLOWS FROM OPERATING ACTIVITIES		
Net surplus/(deficit)	**25**	**(14)**
Add/(less) non-cash items:		
Depreciation	168	154
Loss on disposal	58	-
Increase/(decrease) in other provisions	1,051	7
Total non-cash items	**1,277**	**161**
Add/(less) movements in working capital items:		
(Increase)/decrease in receivables	(1,069)	386
Increase/(decrease) in payables	940	(23)
Increase/(decrease) in employee entitlements	54	82
Working capital movements – net	**(75)**	**445**
Net cash flow from operating activities	**1,227**	**592**

NOTE 13: RELATED PARTY INFORMATION

The Guardians are a wholly owned entity of the Crown. The Guardians receive revenue from the Fund to cover the operating expenses of managing the Fund. Government appropriations are received to cover the expenses of the Board and the office of the Chief Executive Officer.

The Guardians received the following from the Government and the Fund for the year to 30 June 2007.

	$000
Appropriations from the Crown	1,537
Revenue from New Zealand Superannuation Fund	6,622

At year end the following inter-entity balances were receivable:

Receivable from the Crown	144
Receivable from New Zealand Superannuation Fund	979
Total inter-entity receivables	**1,123**
Represented by:	
Current	535
Non-current	588
Total inter-entity receivables	**1,123**

Funds were also received in advance from the Fund. This amount ($793,637) is included in the payables and accruals line in the Statement of Financial Position.

The Board has entered into a number of transactions between government departments on an arms length basis. Where those parties are acting in the course of their normal dealings with the Guardians, related party disclosures have not been made for transactions of this nature.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

NOTE 14: FINANCIAL INSTRUMENTS

The Group is risk averse and seeks to minimise its exposure from its treasury activities. Its policies do not allow any transactions which are speculative in nature to be entered into.

Credit risk

Credit risk is the risk that a third party will default on its obligation to the Group, causing the Group to incur a loss. Financial instruments which potentially subject the Board to risk consist principally of cash and short-term deposits.

The Group has minimal credit risk in their holdings of various financial instruments. These instruments include cash and bank, interest receivable, short-term deposits, trade creditors, and other payables.

The Group places its deposits with institutions that have a high credit rating. The Guardians believe that this policy reduces the risk of any loss which could arise from its investment activities. The Group does not require any collateral or security to support financial instruments.

There is no significant concentration of credit risk.

The maximum amount of credit risk for each class is the carrying amount in the Statement of Financial Position.

Fair value

The fair value of financial instruments is equivalent to the carrying amount disclosed in the Statement of Financial Position.

	PARENT AND GROUP 2007 $000	PARENT AND GROUP 2006 $000
Cash and bank	1,883	1,181
Accounts receivable	2	56
Other receivables	1,123	-
Trade creditors	(158)	(106)
Other payables	(2,488)	(960)
Total	**362**	**171**

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.
The Group had no trade creditors denominated in a foreign currency at 30 June 2007 (30 June 2006: nil).

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. There are no interest rate options or interest rate swap options in place as at 30 June 2007. The interest rates on the Group's investments are shown in Note 7.

The Board does not consider that there is any significant interest exposure on the Group's investments.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

NOTE 15: EMPLOYEES' REMUNERATION OVER $100,000 PER ANNUM

Total Remuneration and benefits	Number of Employees	
$000s	2007	2006
100 – 110	1	1
120 – 130	1	1
130 – 140	1	-
140 – 150	2	1
150 – 160	1	1
160 – 170	1	1
170 – 180	3	-
180 – 190	2	-
190 – 200	1	-
200 – 210	2	1
210 – 220	-	2
220 – 230	1	-
230 – 240	2	-
250 – 260	1	1
270 – 280	-	1
300 – 310	1	-
320 – 330	-	1
330 – 340	1	-
380 – 390	1	-
390 – 400	-	1
440 – 450	1	-
470 – 480	1	-

The total remuneration figures in this table consist of both an employee's gross salary and their bonus entitlement.

The bonus entitlement is the first year of a long-term incentive scheme that has both organisation and financial performance targets.

The financial performance component is paid out on a rolling four-year period of returns against thresholds and benchmarks. If both the organisation and financial performance targets are achieved over a rolling four-year period, a maximum of 30% of an employee's salary can be paid in bonus.

The remuneration table includes the full long-term incentive entitlement earned during the financial year. However, due to the rolling four-year average calculation, only part of this entitlement is paid this year. Payment of the remaining entitlement may be paid out over the following three years dependent on the continued financial performance of the Fund against the agreed hurdles, and at the discretion of the Board.

The total value of the long-term incentive earned in the current year is $1,053,011 of which $416,507 will be paid out after this financial year end.

The total remuneration bands and benefits listed above are annual amounts. As some employees commenced part-way through the year, the actual remuneration they received during the year is less than the amount shown. For employees who left during the year, the actual remuneration paid has been reported, rather than annual remuneration.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

NOTE 16: BOARD FEES

Board Members earned the following fees during the year:

	PARENT AND GROUP 2007 $000	PARENT AND GROUP 2006 $000
MEMBER		
DJ May (Chairman)	37	37
Sir D Graham (Deputy Chairman)	21	21
M Anderson*	2	19
B M Liddell	19	19
D Newman	19	19
G Saunders	17	17
M Tume	19	4
J Evans**	10	-
Total Board fees	**144**	**136**

* Dr Anderson left the Guardians in August 2006.

** Mr Evans was appointed to the Board in December 2006.

Board fees are paid on an inclusive of GST basis. Where a Board member is registered for GST their fees detailed above are recorded exclusive of GST.

Board Members travel expenses to attend meetings are also paid by the Guardians.

NOTE 17: TERMINATION PAYMENTS

There were no payments made in respect of terminated employees during the year. In 2006, $5,885 was paid to a former employee whose position was made redundant.

NOTE 18: BOARD MEMBERS' INDEMNITY AND INSURANCE

The Guardians have indemnified Board Members in respect of a liability incurred where that Board Member has breached one of the individual duties set out in sections 53 to 57 of the Crown Entities Act 2004 (subject to certain limitations). Liability in respect of a breach of these duties is excluded from the scope of the statutory immunity provided in section 121 of the Crown Entities Act 2004. Each Board Member is also indemnified in respect of costs incurred by that Board Member in defending or settling any claim or proceeding.

NOTE 19: BUDGET VARIATIONS

The Guardians' actual expenditure for the year exceeded budgeted primarily due to the long-term employee incentive. The Fund's performance against agreed thresholds and benchmarks was higher than forecast, thus increasing the value of the long-term employee incentive.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

NOTE 20: CONVERSION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

The New Zealand Accounting Standards Review Board announced in December 2002 that New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) will apply to New Zealand reporting entities for periods commencing from 1 January 2007. The Guardians will prepare their first set of financial statements under NZ IFRS for the year ending 30 June 2008, in line with the Crown.

The Guardians have set up a project team to evaluate the impact of adopting NZ IFRS and prepare the Guardians for transition. The project is being overseen by the Audit and Risk Committee on behalf of the Board.

There have been no major impacts identified other than a reclassification of certain items of computer software that will be reclassified to intangible assets under NZ IFRS.

NZ IFRS requires a large number of additional disclosures and will result in a number of changes to the way the financial information is presented. Pro-forma NZ IFRS financial statements have been developed. Systems have been put in place to ensure that all necessary data is captured.

The information disclosed is the best estimate of the impact of the adoption of NZ IFRS as at the date of preparing the financial statements. This could change due to:

- further work being undertaken by the NZ IFRS project team; and
- potential amendment to NZ IFRS and /or interpretations thereof being issued by standard-setters and/or IFRIC prior to the date of the first full set of NZ IFRS financial statements.

Audit Report

AUDIT NEW ZEALAND

Mana Arotake Aotearoa

TO THE READERS OF THE GUARDIANS OF NEW ZEALAND SUPERANNUATION AND GROUP'S FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION FOR THE YEAR ENDED 30 JUNE 2007

The Auditor General is the auditor of the Guardians of New Zealand Superannuation (the "Guardians") and group. The Auditor General has appointed me, F Caetano, using the staff and resources of Audit New Zealand, to carry out the audit on his behalf. The audit covers the financial statements and statement of service performance included in the annual report of the Guardians and group for the year ended 30 June 2007.

UNQUALIFIED OPINION

In our opinion:

The financial statements of the Guardians and group on pages 82 to 98:

- comply with generally accepted accounting practice in New Zealand; and fairly reflect:
  - the Guardians and group's financial position as at 30 June 2007; and
  - the results of operations and cash flows for the year ended on that date.

The statement of service performance of the Guardians and group on pages 38 to 42:

- complies with generally accepted accounting practice in New Zealand; and
- fairly reflects for each class of outputs:
  - standards of delivery performance achieved, as compared with the forecast standards outlined in the statement of forecast service performance adopted at the start of the financial year; and
  - actual revenue earned and output expenses incurred, as compared with the forecast revenues and output expenses outlined in the statement of forecast service performance adopted at the start of the financial year.

The audit was completed on 10 September 2007, and is the date at which our opinion is expressed.

The basis of our opinion is explained below. In addition, we outline the responsibilities of the Board and the Auditor, and explain our independence.

BASIS OF OPINION

We carried out the audit in accordance with the Auditor General's Auditing Standards, which incorporate the New Zealand Auditing Standards.

We planned and performed the audit to obtain all the information and explanations we considered necessary in order to obtain reasonable assurance that the financial statements and statement of service performance did not have material misstatements, whether caused by fraud or error.

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

The audit involved performing procedures to test the information presented in the financial statements and statement of service performance. We assessed the results of those procedures in forming our opinion.

Audit Report (continued)

Audit New Zealand
Mana Arotake Aotearoa

Audit procedures generally include:

- determining whether significant financial and management controls are working and can be relied on to produce complete and accurate data;
- verifying samples of transactions and account balances;
- performing analyses to identify anomalies in the reported data;
- reviewing significant estimates and judgements made by the Board;
- confirming year-end balances;
- determining whether accounting policies are appropriate and consistently applied; and
- determining whether all financial statement and statement of service performance disclosures are adequate.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements or statement of service performance.

We evaluated the overall adequacy of the presentation of information in the financial statements and statement of service performance. We obtained all the information and explanations we required to support our opinion above.

RESPONSIBILITIES OF THE BOARD AND THE AUDITOR

The Board is responsible for preparing financial statements and a statement of service performance in accordance with generally accepted accounting practice in New Zealand. The financial statements must fairly reflect the financial position of the Guardians and group as at 30 June 2007 and the results of operations and cash flows for the year ended on that date. The statement of service performance must fairly reflect, for each class of outputs, the Guardians and group's standards of delivery performance achieved and revenue earned and expenses incurred, as compared with the forecast standards, revenue and expenses adopted at the start of the financial year. The Board's responsibilities arise from the Crown Entities Act 2004 and the New Zealand Superannuation and Retirement Income Act 2001.

We are responsible for expressing an independent opinion on the financial statements and statement of service performance and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001 and the Crown Entities Act 2004.

INDEPENDENCE

When carrying out the audit we followed the independence requirements of the Auditor General, which incorporate the independence requirements of the Institute of Chartered Accountants of New Zealand.

Other than the audit, we have no relationship with or interests in the Guardians or any of its subsidiaries.

F CAETANO
Audit New Zealand
On behalf of the Auditor General
Auckland, New Zealand

14. Glossary

Absolute Return
The actual return, in dollar or percentage terms, generated by a portfolio during a specific period.

Active Management
An investing strategy that seeks returns in excess of a specified benchmark.

Active Return
Return relative to a benchmark. If a portfolio's return is 5%, and the benchmark's return is 3%, then the portfolio's active return is 2%.

Active Risk
The risk (annualised standard deviation) of the active return. Also called the tracking error.

Alpha
That part of a portfolio's return not explained by market factors. Alpha is the result of manager skill applied through active management.

Annualised Rate of Return
A rate of return expressed over one year, although the actual rates of return being annualised are for periods longer or shorter than one year.

Assets
Anything owned that has value and is measurable in terms of money.

Asset Classes
Categories of assets, such as shares, bonds, real estate.

Asset Mix
The proportion of assets held in the portfolio in percentage terms.

Basic Risk
Risk caused by a deviation in the price spread between two related instruments or markets.

Basis Point
One-hundredth of 1%. The difference between 5.25% and 5.50% is 25 basis points.

Benchmark
A standard against which the performance of a security, index, or investor can be measured.

Beta
A measure of a security or portfolio's volatility, or systematic risk, in comparison to the market as a whole.

Bond
A debt investment with which the investor loans money to an entity (company or Crown) that borrows the funds for a defined period of time at a specified interest rate.

Commodities
Tangible products, such as metals, crude oil, or grain.

Custodian
An independent organisation entrusted with holding investments and settling transactions on behalf of the owner. The custodian maintains the financial records for the investments and may perform other services (such as performance measurement, mandate compliance etc) for the owner as well.

Derivatives
Financial contracts that derive their value from an underlying asset or index, such as an interest rate or foreign currency exchange rate. They can be used to manage risk, reduce cost and enhance returns. Some common derivatives are forwards, futures, swaps and options.

Diversification
Investing in a variety of assets or through a number of managers in order to spread risk

Glossary (continued)

Equities
Securities that signify ownership in a corporation and represent a claim on part of the corporation's assets and earnings.

Fixed Interest Securities
Fixed interest securities generate a predictable stream of interest, and include bonds, bank bills, floating rate notes and negotiable certificates of deposit.

Fund Manager (aka Asset Manager)
Invests and manages the assets of others.

Hedge or Hedging
A strategy designed to reduce the risk of loss caused by fluctuations in, for example, security prices, interest rates, and foreign currency exchange rates.

Hedge Fund
An investment fund that attempts to generate active returns by employing long-short strategies and/or leverage.

Hurdle Rate
A rate of return above which an investment makes sense and below which it does not. Also called required rate of return.

Index
A measure of performance of a collection of assets typically across a sector, country, region, or style (e.g. Dow Jones, MSCI)

Index Fund
A portfolio of investments that are weighted the same as a stock-exchange index in order to mirror its performance. This process is also referred to as indexing.

Investment
An asset or item that is purchased with the hope it will generate income or appreciate in the future.

Investment Horizon
The period of time over which money is to be invested (e.g. 1 year, 20 years)

Long (or Long Position)
The buying of a security such as a stock, commodity or currency, with the expectation that the asset will rise in value.

Long Short
A portfolio construction model that can hold a negative (short) position in a stock as well as a long position.

Management Fee
A fee that the manager of a fund charges for managing the portfolio and operating the fund.

Market Neutral
An investing strategy relying purely on alpha and that is not influenced by the direction of the market as a whole.

Out-performance
Excess performance above the benchmark or above the targeted return.

Passive Management
An investing strategy that mirrors a market index and does not attempt to beat the market. Also known as ‘passive strategy’ or ‘passive investing’.

Portfolio
A group of investments, such as shares and bonds held by an investor.

Proxy
A formal document signed by a shareholder to authorise another shareholder, or commonly the company's management, to vote the holder's shares at the annual meeting.

Glossary (continued)

Private Equity
When equity capital is made available to companies or investors, but not quoted on a stock market. The funds raised through private equity can be used to develop new products and technologies, to expand working capital, to make acquisitions, or to strengthen a company's balance sheet.

Responsible Investment
The integration of social, environmental, and corporate governance considerations into investment management and ownership practices - in the belief that these factors can have an impact on financial performance.

Return
The gain or loss on an investment in a particular period, consisting of income (such as interest, dividends, or rent), plus capital gains or capital losses. The return is usually expressed as a percentage.

Risk
The chance of something happening that will have an impact upon objectives. Risk can have both positive (upside risk) and negative (downside risk) consequences. For investments, it is the chance that an investment's actual return will be different than expected – both higher or lower than expected.

Risk Adjusted Return
A measure of investment return adjusted to reflect the risk that was assumed.

Risk Management
The culture, processes, and structures that are directed towards realising potential opportunities, whilst managing adverse effects.

Risk Tolerance
The amount of loss an organisation is willing or able to tolerate should a downside risk materialise.

Shareholder
Any person, company, or other institution that owns at least one share in a company. A shareholder may also be referred to as a stockholder.

Short (or Short Position)
The selling of a borrowed security, commodity, or currency, with the expectation that the asset will fall in value.

Strategic Asset Allocation (SAA)
The division of assets within an investment portfolio with regards to the long-term view of the risk and return profile of those asset classes, and how to best achieve the portfolio's long-term objectives.

Stocks
A type of security that signifies ownership in a corporation and represents a claim on part of the corporation's assets and earnings. Also known as shares, or equity.

Voting Right
The right of a stockholder to vote on matters of corporate policy as well as on who is to compose the board of directors.

Yield
The annual rate of return on an investment expressed as a percentage.

15. Corporate Directory

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