STATEMENT OF
PERFORMANCE EXPECTATIONS

FOR THE PERIOD
01 JULY 2016 TO 30 JUNE 2017
GUARDIANS OF NEW ZEALAND SUPERANNUATION

NZSUPERFUND
Te Kaitiaki Tāhua Penihana Kaumatua ō Aotearoa

Contents

1. Introduction

The New Zealand Superannuation Fund is a global investment fund designed to help pre-fund the future costs of universal superannuation. By using the Fund to save now in order to pay for future retirement benefits, the Government aims to smooth the cost of New Zealand Superannuation between today's taxpayers and future generations.

The Fund, which was established in 2001, is managed by the Guardians of New Zealand Superannuation, a Crown entity. Investing began in 2003. To date, the Government has contributed NZ$14.88 billion to the Fund.

	SINCE INCEPTION (AFTER COSTS, UNAUDITED, AS AT 31 MARCH 2016)
Government contributions	$14.88 billion
Investment returns	$19.20 billion
NZ tax paid	$(4.49) billion
Other movements	$0.01 billion
Fund size, as at 31 March 2016	$29.60 billion

2. Our Mandate

As required by the NZ Superannuation and Retirement Income Act 2001, the Guardians must invest the Fund on a prudent, commercial basis and, in doing so, must manage and administer the Fund in a manner consistent with:

- best-practice portfolio management;
- maximising return without undue risk to the Fund as a whole; and
- avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

The Guardians' mission is to maximise the Fund's return over the long-term, without undue risk, so as to reduce future New Zealanders' tax burden.

For more information about the Guardians and the Fund, see www.nzsuperfund.co.nz.

3. 2016/17 Activities

As set out in our 2016-2021 Statement of Intent (available on www.nzsuperfund.co.nz), the Guardians' output comprises five work programmes covering:

- investment;
- risk management;
- cost control;
- governance; and
- organisational capability.

The Statement of Intent outlines the medium-term strategic direction for the Guardians and Fund. In this Statement of Performance Expectations we describe key 2016/17 activities under each of the five work programmes set out in the Statement of Intent. These activities support the objectives of our 2016- 2021 Strategic Plan.

We will report on our performance in implementing these activities in our 2016/17 Annual Report.

We also provide, for 2016/17:

- a statement of estimated Fund returns (section 4);
- a statement of the key risks to the performance of the Fund over the coming year and the actions being taken by the Guardians to manage those risks (section 5);
- financial projections (section 6);
- prospective financial statements and a summary of significant accounting policies (section 7).

KEY ACTIVITIES FOR 2016/17	STRATEGIC PLAN OBJECTIVE FOR 2016 – 21	RELEVANT WORK PROGRAMME, REPORTING, PERFORMANCE MEASURES
Collateral optimization – Implement additional measures to manage collateral supply and demand in the most efficient manner possible. *(A multi-year objective for 2016-17 and 2017-18.)*	• Best Portfolio • Efficiency, scalability and innovation	**Investment** (SOI pages 8-11) • Actual Fund returns relative to Reference Portfolio **Cost control** (SOI page 11) • Cost and value-add relative to peers in CEM survey
Concentrated portfolio – Investigate the benefits of concentrating on fewer stocks at lower cost (particularly for internal passive management and responsible investment purposes).	• Efficiency, scalability and innovation	**Cost control** (SOI page 11) **Investment** (SOI pages 8-11)
Risk System – Implement the platform that best matches our requirements; in particular for liquidity and counterparty risk. *(This is a follow-on project from the 2015-16 risk system investigation and selection.)*	• Best Portfolio • Efficiency, scalability and innovation	**Investment** (SOI pages 8-11) • In a 1-in-100 year event, potential Reference Portfolio loss **Risk** (SOI pages 12) • Transparency ratings • Best practice – Response to Santiago Principles
Data Management – Implement the target architecture and governance structures recommended during 2015-16 as an evolution of the existing SuperMart data management platform.	• Best Portfolio • Efficiency, scalability and innovation	**Investment** (SOI pages 8-11) **Cost Control** (SOI page 11)
Document and Records Management – Implement a replacement solution and vendor in the event of a successful prototype being completed in 2015/16. *(Suitability of the current eDocs system for the next five years is currently being assessed).*	• Efficiency, scalability and innovation	**Investment** (SOI pages 8-11)
Cost management – Better visibility of what it costs us to invest, and identify opportunities to improve cost effectiveness	• Best Portfolio • Efficiency, scalability and innovation	**Cost Control** (SOI page 11) **Governance** (SOI page 14)
IFSWF 2016 – Contribute to the development of best practice among sovereign wealth funds globally; promote opportunities for peer collaboration; showcase New Zealand as an attractive, globally competitive and well-governed investment destination	• External Relationships	**Investment** (SOI pages 8-11)
Engagement – Continue development of a great team by implementing lessons from the staff engagement survey	• Building & maintaining a Great Team • Best Portfolio	**Organisational capability** (SOI page 14)

HIGHLIGHTED KEY ACTIVITIES

In this section we discuss in more detail three of the most significant key activities for 2016/17. We will report on our progress in implementing these activities in the Statement of Performance in our 2016/17 Annual Report.

Risk Systems

The Guardians' focus on managing risk will continue in 2016/17 with a new Risk Management System project. This project is one of the recommendations from the 2014/15 Portfolio Management System Project.

There are two main objectives for the Risk Management project:

- Identify a robust Risk Management System that best meets the Fund's requirements; and
- Implement the selected system or identify options if such a system is not available.

The new system will consolidate the wide range of systems currently used by the Guardians to automate the process of model building for areas such as liquidity and counterparty risk. The system will also have the flexibility to run multiple scenario tests, which will make our processes stronger.

Concentrated Portfolio

This project aims to investigate the benefits and costs of using an internally implemented, concentrated portfolio of stocks within our passive portfolio. Given that the Fund's passive portfolio replicates the Reference Portfolio, we expect that a concentrated portfolio would:

- approximate the risk exposures of the Reference Portfolio; and
- potentially lower operating costs from responsible investment monitoring and the use of passive managers.

The potential efficiency gains will be assessed against the potential costs of holding a less diversified portfolio, as well as any flow-on impact on operations and the flexibility to choose between physical and synthetic exposures.

Collateral Optimisation

The Guardians holds and uses a range of collateral assets (cash, marketable securities) to support the Fund's value-adding investment activities. This initiative aims to improve management of our collateral assets in order to minimise the costs of meeting collateral obligations and maximise the financial gains achieved.

The main strategies we will be exploring are:

- implementing additional measures to manage collateral supply and demand efficiently;
- implementing a securities lending programme; and
- researching IT systems to assist collateral optimisation.

4. Statement of Estimated Fund Returns

We are required to outline our expectations for the performance of the Fund over the next financial year.

Predicting short-term financial market returns with any useful accuracy over such a near-term horizon is, however, impossible. We therefore show our long-term, or equilibrium, expectations for the Reference Portfolio return (see our 2016-2021 Statement of Intent for more information about the Reference Portfolio).

To that we add our expectations of returns from added-value activities to arrive at the mid-point for the actual Fund.

Finally, we estimate a range of possible Fund returns for 2016/17, given our assumed volatility of market returns. Using this approach, we have estimated as follows:

	RISK-FREE RATE		EXCESS RETURN AFTER COSTS		REWARD FOR VALUE-ADDING ACTIVITIES		
COMPONENT OF RETURN	5.0%	+	2.7% (which is the reward for taking market risk above cash or the risk-free rate)	+	1.0%	=	8.7%
EXPLANATION	Our estimate of the equilibrium return on 90-day Treasury Bills. Note: our estimate has reduced from 6% p.a. in 2014/15 to 5% p.a.		We define the reward for market risk as the margin between the risk-free rate and the return that would be generated on the Reference Portfolio (after assumed costs of 0.25%). Although the estimates of market risk vary over time, we provide the equilibrium, or long term, expectation of the rewards for market risk on the Reference Portfolio. Our estimate of the reward for market risk has a very wide range over a one-year horizon, although this range tightens over longer horizons.		Our estimate of the return from the investment activities we undertake to add value. We summarise those activities as part of our explanation of the Reference Portfolio in our Statement of Intent.		The mid-point of our estimated range for the Fund return over 2016/17 is 8.7%.

5. Risk Statement

The Guardians has extensive risk-management policies, procedures and other internal controls for application by our staff. These policies and procedures also cover our expectations of risk management for our external investment managers and other expert service providers.

The Guardians' approach to managing investment risks is set out in our Statement of Investment Policies, Standards and Procedures including the Risk Management Policy, both of which are available on www.nzsuperfund.co.nz.

WHAT ARE OUR RISKS?

The Guardians has identified five major categories of risk:

1) Investment risk: The risks attached to investment goals and objectives, including market, credit, counterparty, manager and liquidity risk;
2) Strategic risk: The risks associated with our strategic choices and the implementation of our selected strategies;
3) Legislative and regulatory risk: The risks of financial loss or reputational damage due to non-compliance with actual or proposed laws, rules and regulations and prescribed industry practices;
4) Operational risk: The risks of financial loss from inadequate or failed internal processes, people or systems, or from external factors; and
5) Reputation risk: The risks to our reputation or credibility due to internal or external factors.

GUARDIANS' RISK MANAGEMENT PROCESS

The Board is responsible for reviewing and approving the Guardians' risk-management framework. The Audit Committee reviews the reports of management, and of the Guardians' external and internal auditors, on the effectiveness of systems for internal controls and financial reporting. The Board delegates day-to-day management of risk to the Chief Executive Officer.

Inherent in this delegation is a desire to ensure that day-to-day responsibility for risk management is at the business unit level, where risk is seen as part of the overall business process, and a robust framework of identification, evaluation, monitoring and control exists.

The Guardians' risk-management process has four stages:

1) Identifying risks: we identify events that could impact the achievement of our business objectives contained in our strategic and business plans.
2) Analysing risks: we consider how likely it is that the risks could lead to an event and the severity of the impact on business plans if that event occurred.
3) Effectiveness of controls: for each risk, we identify what controls we can use to appropriately manage them and analyse the effectiveness of our existing controls. Our controls include management actions, policies, procedures, standards, processes and codes of practice. Findings from external and internal audits, case studies of reported incidents and any other relevant and useful information are used to assist our understanding of the risks we face. We then regularly consider which risks require particular focus our attention.
4) Accountability and continuous improvement: We ensure accountability for each control and monitor these to confirm that risks continue to be actively managed. In this way, we are able to continuously improve and strengthen our risk management framework.

Each year, we report on a series of investment and business risk indicators in our Annual Report. For further detail see our 2016-21 Statement of Intent and the Risk Management section in our Annual Report.

6. Financial Projections for 2016/17

COST ALLOCATION MODEL

Our Cost Allocation Model encompasses both the Guardians and the Fund.

Fund expenses are met from the Fund and are those incurred in the establishment and implementation of investment policy and the financial and risk management of Fund assets including fees paid to external managers and the master custodian.

The Guardians' expenses – with the exception of those incurred by the Board – are met from the Fund and include remuneration, staff expenses such as office services, travel, and professional development.

The expenses of the Board are met from Parliamentary appropriation and include Board fees, the cost of travel to and from Board meetings and the cost of external audit for the Guardians.

All operating costs, irrespective of whether they are sourced from appropriations or Fund assets, are consolidated in the financial statements of the Guardians and subject to the reporting and disclosure obligations of the Crown Entities Act (2004).

We have prepared prospective financial statements for the Fund. The estimates assume that earnings will be broadly in line with the long-term estimate (i.e. 8.7% p.a. after costs but before New Zealand tax). Some costs are fixed (e.g. audit costs) and can be easily estimated, but the majority are variable (i.e. base and performance fees paid to investment managers or transaction fees paid to the custodian).

We have prepared estimates of these variable costs based on our expectations of the Fund over the year.

EXPECTED TOTAL COST OF MANAGING THE FUND IN 2016/17

The forecast cost of managing the Fund in 2016/17 – excluding performance fees, but including any direct costs that sit within net operating income – is $130.8 million or 0.44% of expected average funds under management, compared to the forecast for 2015/16 of $126.1 million or 0.42%.

Of this amount the Guardians' expenses are $49.7 million (of which $0.53 million are Board expenses met by Parliamentary Appropriation), amounting to 0.17% of expected average funds under management.

The amount to be met by Parliamentary Appropriation may increase, commensurate to an increase to Board fees announced by the Minister of Finance in December 2015.

Performance fees are only paid when investment managers outperform their benchmarks and so they are better described as an offset against returns than a cost. However, if we include forecast performance fees, the forecast cost of managing the Fund in 2016/17 is $160.2 million or 0.53%, compared to the forecast for 2015/16 of $160.6 million or 0.53%.

It is important to emphasise that these are forecast figures and that actual fees will be dependent on market conditions and the availability of suitable investment opportunities and access points.

Actual performance fees incurred each financial year are disclosed in our Annual Report.

7. Prospective Financial Statements

We have prepared prospective financial statements for the Guardians (in our role as manager and administrator of the Fund) and for the Fund consistent with this Statement of Performance Expectations. These prospective financial statements rely on assumptions with respect to unknown or uncertain future events. Assumptions represent a risk in that actual events may vary from the assumption and that all of the outcomes that may flow from actual events cannot be guaranteed.

These prospective financial statements should be read within the context of the 2016-21 Statement of Intent and this Statement of Performance Expectations. Information in these prospective financial statements may not be appropriate for purposes other than those described.

The Board authorised the issue of these prospective financial statements on 14 April 2016. The Board is responsible for the prospective financial statements presented, including the appropriateness of the assumptions underlying the prospective financial statements and all other required disclosures.

The assumptions used in preparing the prospective financial statements have been disclosed following the accounting policies of the Guardians and the Fund. Actual financial results have not been incorporated into the prospective financial statements. The Board does not intend to update these prospective financial statements subsequent to presentation.

Contents

Prospective Consolidated Statement of Comprehensive Revenue and Expense

For the year ending 30 June 2017	$000
Revenue from Parliamentary Appropriation	528
Revenue from New Zealand Superannuation Fund	48,910
Other income	130
Total revenue	**49,568**
Board-related expenses	(800)
Employee remuneration and related expenses	(39,017)
Depreciation	–
Other expenses	(9,751)
Total expenses	**(49,568)**
Surplus/(Deficit) for the year	**–**
Total comprehensive revenue and expense for the year	**–**

Prospective Consolidated Statement of Financial Position

As at 30 June 2017	$000
ASSETS	
Current assets	
Cash and cash equivalents	774
Receivables from exchange transactions	9,830
Receivables from non-exchange transactions	–
Non-current assets	–
Receivables from exchange transactions	–
Property, plant and equipment	–
Total assets	**10,604**
LIABILITIES	
Current liabilities	
Payables under exchange transactions	(601)
Employee entitlements	(8,652)
Deferred lease incentive	(75)
Non-current liabilities	
Employee entitlements	(405)
Deferred lease incentive	(371)
Total liabilities	**(10,104)**
Net assets	**500**
EQUITY	–
Accumulated comprehensive revenue and expense	–
General equity reserve	500
Total public equity	**500**

Prospective Consolidated Statement of Changes in Public Equity

For the year ending 30 June 2017	$000
Balance at 30 June 2016	**500**
Surplus/(Deficit) for the year	–
Total comprehensive revenue and expense for the year	–
Balance at 30 June 2017	**500**

Prospective Consolidated Statement of Cash Flows

For the year ending 30 June 2017	$000
CASH FLOWS FROM OPERATING ACTIVITIES	
Cash was provided from:	
Receipts from the Crown	528
Receipts from New Zealand Superannuation Fund	46,000
Interest received	34
Other receipts	92
Total cash inflow from operating activities	**46,654**
Cash was applied to:	
Payments to Board members	(417)
Payments to suppliers	(13,090)
Payments to employees	(33,197)
Goods and Services Tax	(32)
Total cash outflow from operating activities	**(46,736)**
Net cash provided by/(used in) operating activities	**(82)**
Net increase/(decrease) in cash and cash equivalents	**(82)**
Cash and cash equivalents at the beginning of the year	856
Cash and cash equivalents at the end of the year	**774**

Summary of significant accounting policies

GENERAL INFORMATION

These are the prospective financial statements of the Guardians of New Zealand Superannuation (Guardians) and its subsidiaries (Group). The Guardians is a Crown entity as defined by the Crown Entities Act 2004. The Guardians is also a public authority in terms of the Income Tax Act 2007 and therefore is exempt from income tax.

The Guardians is domiciled in New Zealand and the address of its principal place of business is 21 Queen Street, Auckland.

The prospective financial statements of the Guardians of New Zealand Superannuation and its subsidiaries for the year ended 30 June 2017 were authorised for issue in accordance with a resolution of the Board of Guardians of New Zealand Superannuation on 14 April 2016.

STATEMENT OF COMPLIANCE

The prospective financial statements have been prepared in accordance with the Crown Entities Act 2004 and the Public Finance Act 1989 and comply with Public Benefit Entity Financial Reporting Standard 42: Prospective Financial Statements.

The Guardians is a public benefit entity, as the primary purpose is to manage and administer the New Zealand Superannuation Fund (Fund). The prospective financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP) as it applies to prospective financial statements. They comply with Tier 1 Public Benefit Entity (PBE) Accounting Standards.

BASIS OF PREPARATION

The prospective financial statements have been prepared on a historical cost basis, are presented in New Zealand dollars and all values are rounded to the nearest thousand dollars (NZD’000).

Accounting policies are selected and applied in a manner which ensures that the resulting financial information satisfies the concepts of relevance and reliability, thereby ensuring that the substance of the underlying transactions or other events is reported.

The following particular accounting policies which materially affect the preparation of the prospective financial statements have been applied:

a) Basis of consolidation

Subsidiaries are those entities that are controlled by the Guardians. The Guardians controls an entity when it has the power to govern the financial and operating policies of that entity so as to obtain benefits from their activities.

The prospective financial statements of subsidiaries are prepared for the same reporting period as the parent entity, using consistent accounting policies. In preparing prospective consolidated financial statements, all inter-entity transactions, balances and unrealised gains and losses are eliminated.

b) Revenue

The Group primarily derives revenue through the provision of services to the Crown and to the Fund and from its investments. Revenue is recognised to the extent that it is probable that economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

REVENUE FROM EXCHANGE TRANSACTIONS

Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

Rendering of services

Cost reimbursement from the Fund is recognised by reference to the stage of completion of services provided at balance date when the translation involving the rendering of services can be reliably estimated. The stage of completion is measured by the proportion of costs incurred to date compared with estimated total costs of the transaction.

Interest income

Interest income is recognised as the interest accrues, using the effective interest method. The effective interest method allocates interest at a constant rate of return over the expected life of the financial instrument based on the estimated future cash flows.

REVENUE FROM NON-EXCHANGE TRANSACTIONS

Non-exchange transactions are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

Appropriations from the Crown

Revenue is recognised from the Crown when it is probable that appropriations will be received and the value of those appropriations can be reliably measured. To the extent there is a related condition attached to the appropriations that would give rise to a liability, deferred revenue is recognised instead of revenue. In such situations, revenue is then recognised as the conditions are satisfied.

c) Operating leases

The determination of whether an arrangement is (or contains) a lease is based on the substance of the arrangement at the inception of the lease. The arrangement is (or contains) a lease if fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset. Leases in which the lessor retains substantially all the risks and benefits of ownership of an asset are classified as operating leases. Operating lease expenses are recognised on a straight-line basis over the period of the lease.

d) Foreign currencies

Transactions denominated in foreign currencies are converted to New Zealand dollars using the exchange rates prevailing at the dates of the transactions. Foreign currency monetary assets and liabilities are translated at the exchange rate prevailing at balance date. Where there is a movement in the exchange rate between the date of a foreign currency transaction and balance date, resulting exchange differences are recognised in the Prospective Consolidated Statement of Comprehensive Revenue and Expense.

e) Financial instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

The Group is party to financial instruments as part of its normal operations. These financial instruments include cash and cash equivalents, receivables, payables and employee entitlements. All financial instruments are recognised in the Prospective Consolidated Statement of Financial Position and all revenues and expenses in relation to financial instruments are recognised in the Prospective Consolidated Statement of Comprehensive Revenue and Expense.

INITIAL RECOGNITION

Financial assets and financial liabilities are recognised in the Prospective Consolidated Statement of Financial Position when the Group becomes a party to the contractual provisions of the financial instrument.

SUBSEQUENT MEASUREMENT

Subsequent to initial recognition, the Group classifies its financial assets and financial liabilities into the following categories:

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. This category includes cash and cash equivalents and receivables. Subsequent to initial recognition, loans and receivables are measured at amortised cost using the effective interest method, less any allowance for impairment.

Financial liabilities at amortised cost

Financial liabilities at amortised cost are non-derivative financial liabilities. This category includes payables and certain employee entitlements. Subsequent to initial recognition, payables and employee entitlements are measured at amortised cost using the effective interest method.

DERECOGNITION

Financial assets are derecognised when the rights to receive cash flows from the investments have expired or when the Group has transferred substantially all of the risks and rewards of ownership. The Group derecognises a financial liability when the obligation under the liability is discharged, cancelled or has expired.

IMPAIRMENT

The Group assesses, at each reporting date, whether there is any objective evidence that a financial asset is impaired. A financial asset is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an 'incurred loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated. Financial difficulty of a debtor, default payments or receivables of more than 60 days overdue are considered objective evidence of impairment of receivables. The amount of the impairment loss is the difference between the carrying amount of the financial asset and the present value of the estimated cash flows, discounted at the original effective interest rate.

OFFSETTING FINANCIAL INSTRUMENTS

The Group offsets financial assets and financial liabilities when it has a current legally enforceable right to set-off the recognised amounts and there is an intention to settle on a net basis.

f) Cash and cash equivalents

Cash and cash equivalents includes cash balances on hand, cash held in bank accounts, demand deposits and other highly liquid investments with an original maturity of three months or less.

g) Goods and Services Tax (GST)

Revenues, expenses, assets and liabilities are recognised exclusive of GST, with the exception of receivables and payables which are stated inclusive of GST. Where GST is irrecoverable as an input tax, it is recognised as part of the related asset or expense.

Summary of significant accounting policies (continued)

h) Employee entitlements

Liabilities for salaries, annual leave, long service leave and incentives are recognised in the Prospective Consolidated Statement of Comprehensive Revenue and Expense during the period in which the employee rendered the related service when it is probable that settlement will be required and such employee entitlements are capable of being measured reliably.

Employee entitlements that are due to be settled within 12 months are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Employee entitlements that are not due to be settled within 12 months are measured at the present value of the estimated future cash outflows. The estimated future cash flows are based on likely future entitlements accruing to staff, based on years of service, years to entitlement, the likelihood that staff will reach the point of entitlement, and contractual entitlement information.

LONG SERVICE LEAVE

Employees become eligible for long service leave after five years of service.

INCENTIVES

The Guardians has an incentive scheme in place for all employees. For some employees, a component of their incentive payment is based on the performance of the Fund that vests progressively over a rolling four-year period. During the first three years of the four-year calculation period, the value of the accrual is dependent on the outcome of future periods. The liability reflected in the Prospective Consolidated Statement of Financial Position reflects the present value of the Guardians' obligations in respect of that liability. The liability has been calculated based on a medium-term expectation of Fund performance.

i) Property, plant and equipment

RECOGNITION AND MEASUREMENT

All items of property, plant and equipment are initially recognised at cost. Cost includes the value of consideration exchanged and those expenses directly attributable to bringing the item to working condition for its intended use.

Subsequent to initial recognition, property, plant and equipment is stated at cost less accumulated depreciation and impairment losses.

DERECOGNITION

An item of property, plant and equipment is derecognised when it is sold or otherwise disposed of or when no future economic benefits are expected to arise from its continued use. Any gain or loss arising on disposal (being the difference between the net disposal proceeds and the carrying amount of the item) is included in the Prospective Consolidated Statement of Comprehensive Revenue and Expense in the year in which the item is disposed of.

IMPAIRMENT

All items of property, plant and equipment are assessed for indicators of impairment at each balance date. If any indication of impairment exists, an estimate of the asset's recoverable amount is calculated, being the greater of fair value less costs to sell and value in use. Where the carrying amount of an asset is greater than its recoverable amount, the asset is written down to its recoverable amount. The write-down is recognised in the Prospective Consolidated Statement of Comprehensive Revenue and Expense. Where an impairment loss subsequently reverses, the carrying amount of the item is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount which would have been determined had no impairment loss been recognised for the item in prior years. A reversal of an impairment loss is recognised in the Prospective Consolidated Statement of Comprehensive Revenue and Expense immediately.

DEPRECIATION

Depreciation is provided on a straight-line basis to write off the cost of property, plant and equipment to estimated residual value over their useful lives. The estimated useful lives of the major categories of property, plant and equipment are as follows:

Office equipment	3 years
Computer equipment	1-3 years

j) Statement of Cash Flows

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

Operating activities include all activities other than investing or financing activities. The cash inflows include all receipts from the sale of goods and services, interest 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, holding and disposal of current and non-current securities and any other non-current assets.

Financing activities are those activities relating to changes in public equity and debt capital structure of the Group and those activities relating to the cost of servicing the Group's equity capital.

Cash flows are included in the Prospective Consolidated Statement of Cash Flows on a gross basis. The GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority, is classified as operating cash flows.

k) Changes in accounting policies

The Guardians has early adopted Amendments to PBE IPSAS 1 Disclosure Initiative. The amendments clarify existing PBE IPSAS 1 requirements that relate to materiality, order of the notes, subtotals, accounting policies and disaggregation. Adoption of these amendments has impacted on the presentation of the Guardians prospective financial statements as certain accounting policies have been relocated and immaterial disclosures have been removed. Adoption of these amendments has had no impact on recognition or measurement within the prospective financial statements.

Aside from the above, there have been no changes in accounting policies. All accounting policies have been applied consistently throughout these prospective financial statements.

l) Significant judgements and estimates

The preparation of the Guardians prospective financial statements requires management to make judgements and use estimates that affect the reported amounts of revenue, expenditure, assets, liabilities and the accompanying disclosures. Uncertainty about these judgements and estimates could result in outcomes that require a material adjustment to the carrying amounts of assets and liabilities in future periods. The judgements and estimates used by the Guardians are continually evaluated. They are based on historical experience and other factors, including expectations of future events that may have a financial impact on the Guardians and that are believed to be reasonable under the circumstances. The judgements and estimates that management have assessed to have the most significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year are as follows:

EMPLOYEE ENTITLEMENTS – LONG SERVICE LEAVE

The key assumptions used in calculating the long service leave liability include the discount rate, the likelihood that the employee will reach the required level of service and the salary inflation factor. Any changes in these assumptions will affect the carrying amount of the liability. Expected future payments are discounted using forward rates derived from the yield curve of New Zealand government bonds. The discount rates used have maturities that match, as closely as possible, the estimated future cash outflows. The salary inflation factor has been determined after considering historical salary inflation patterns.

EMPLOYEE ENTITLEMENTS – LONG TERM PORTION OF INCENTIVES

Calculation of the long-term portion of the incentive liability utilises assumptions regarding the future performance of the Fund, the employee's average salary over the vesting period and the percentage of service rendered. The key variable is the performance of the Fund. Should the performance of the Fund differ from the assumption used in the calculation of the long-term portion of the incentive liability, this will impact the employee entitlements expense in the Prospective Consolidated Statement of Comprehensive Revenue and Expense and the carrying amount of the incentive liability in the Prospective Consolidated Statement of Financial Position. The Group manages this risk by using a medium-term expectation of Fund performance.

HEADCOUNT

The Guardians' forecast is based on the key assumption that the headcount for the Guardians will increase from the budgeted level of 131.0 as at the end of January 2016 to 138.1 full-time equivalent employees by 30 June 2017. The actual headcount as at the end of March 2016 was 115.5.

The forecast increase in headcount numbers was determined from the annual business plan compiled by the Guardians senior management team.

In the event that the Guardians are unable to recruit the additional headcount as forecast, actual results may vary materially from the forecast. Any variance in actual headcount is likely to result in a material reduction of expenses, resulting in a corresponding decrease in revenue received from the Fund.

Prospective Statement of Financial Position

As at 30 June 2017	$000
ASSETS	
Cash and cash equivalents	2,175,704
Cash pledged as collateral	1,318,473
Trade and other receivables	1,727,859
Investments	
Investments in derivative and other financial assets	26,520,993
Other financial assets pledged as collateral	60,365
Investments in unconsolidated subsidiaries	600,678
Total investments	**27,182,036**
Property, plant and equipment	1,226
Intangible assets	722
Total assets	**32,406,020**
LIABILITIES	
Cash collateral received	(390,723)
Trade and other payables	(548,414)
Income tax payable	(122,082)
Provision for performance–based fees	(21,526)
Deferred tax liability	(317,023)
Total liabilities	**(1,399,768)**
Net assets	**31,006,252**
PUBLIC EQUITY	
Retained surplus	16,054,303
Available–for–sale reserve	34,134
Asset revaluation reserve	35,736
Contributed capital	14,882,079
Total public equity	**31,006,252**

Prospective Statement of Comprehensive Income

For the year ending 30 June 2017	$000
INCOME	
Interest income	324,291
Dividend income	438,634
Fair value changes in investments held at fair value through profit or loss	1,947,739
Net foreign exchange gain / (loss)	–
Net operating income	**2,710,664**
EXPENSES	
Managers' fees – base	(30,038)
Managers' fees – performance	(29,380)
Custody fees	(5,300)
Depreciation	(268)
Amortisation	(468)
Reimbursement of Guardians' expenses	(48,910)
Other expenses	(28,734)
Profit for the year before income tax expense	**2,567,566**
Income tax expense	(620,903)
Profit for the year after income tax expense	**1,946,663**
Other comprehensive income – reclassifiable to profit or loss in subsequent period	
Net fair value gains on available-for-sale financial assets	7,369
Other comprehensive income – not reclassifiable to profit or loss in subsequent period	
Gain on revaluation of assets	9,994
Income tax on items of other comprehensive income	–
Other comprehensive income for the year, net of tax	**17,363**
Total comprehensive income for the year	**1,964,026**

Prospective Statement of Changes in Public Equity

For the year ending 30 June 2017	ASSET REVALUATION RESERVE $000	AVAILABLE-FOR-SALE RESERVE $000	CONTRIBUTED CAPITAL $000	RETAINED SURPLUS $000	TOTAL $000
Balance at 30 June 2016	**25,742**	**26,765**	**14,882,079**	**14,107,640**	**29,042,226**
Profit for the year				1,946,663	1,946,663
Other comprehensive income	9,994	7,369			17,363
Total comprehensive income for the year	**9,994**	**7,369**	**–**	**1,946,663**	**1,964,026**
Fund capital contributions from the Crown			–		–
Capital contributions from the Crown in respect of funding the net cost of New Zealand Superannuation entitlements			12,911,646		12,911,646
Capital withdrawals by the Crown in respect of funding the net cost of New Zealand Superannuation entitlements			(12,911,646)		(12,911,646)
Balance at 30 June 2017	**35,736**	**34,134**	**14,882,079**	**16,054,303**	**31,006,252**

Prospective Statement of Cash Flows

For the year ending 30 June 2017	$000
CASH FLOWS FROM OPERATING ACTIVITIES	
Cash was provided from:	
Proceeds from the sale of investments	32,500,855
Dividends received	421,782
Interest received	309,364
Cash was applied to:	
Purchase of investments	(32,999,625)
Managers' fees	(29,906)
Payments to suppliers	(129,694)
Income tax paid	(402,992)
Net cash provided by/(used in) operating activities	**(330,216)**
CASH FLOWS FROM INVESTING ACTIVITIES	
Cash was applied to:	
Purchases of property, plant and equipment	(273)
Purchases of intangible assets	(865)
Net cash provided by/(used in) investing activities	**(1,138)**
CASH FLOW FROM FINANCING ACTIVITIES	
Cash was provided from:	
Capital contributions from the Crown	-
Net cash provided by/(used in) financing activities	-
Net increase/decrease in cash and cash equivalents	**(331,354)**
Cash and cash equivalents at the beginning of the financial year	2,507,058
Effects of exchange rate changes on the balance of cash held in foreign currencies	-
Cash and cash equivalents at the end of the financial year	**2,175,704**

Summary of significant accounting policies

GENERAL INFORMATION

These are the prospective financial statements of the New Zealand Superannuation Fund (Fund), a fund established under Section 37 of the New Zealand Superannuation and Retirement Income Act 2001 (Act) on 11 October 2001.

The Fund is a long-term, growth-oriented, sovereign wealth fund that was established to help reduce the tax burden on future taxpayers of the rising cost of New Zealand superannuation. The Fund is managed and administered by the Guardians of New Zealand Superannuation (Guardians). The Guardians was established as a Crown entity by Section 48 of the Act and became operative from 30 August 2002. The Guardians is expected to invest the Fund in a commercial, prudent manner consistent with:

- best-practice portfolio management;
- maximising return without undue risk to the Fund as a whole; and
- avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

The Fund's master custodian is the Northern Trust Company.

The Fund is domiciled in New Zealand and the address of its principal place of business is 21 Queen Street, Auckland.

The prospective financial statements for the year ended 30 June 2017 were authorised for issue in accordance with a resolution of the Board of the Guardians of New Zealand Superannuation on 14 April 2016.

BASIS OF PREPARATION

The Fund is a profit-oriented entity. The prospective financial statements of the Fund have been prepared in accordance with Financial Reporting Standard No. 42: Prospective Financial Statements and Generally Accepted Accounting Practice in New Zealand (NZ GAAP) as it relates to prospective financial statements.

The prospective financial statements have been prepared on a fair value basis, except for certain items as detailed in the policies below.

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

Accounting policies are selected and applied in a manner which ensures that the resulting financial information satisfies the concepts of relevance and reliability, thereby ensuring that the substance of the underlying transactions or other events is reported.

The Fund meets the definition of an investment entity and has applied the exemption from preparing prospective consolidated financial statements available under NZ IFRS 10 Consolidated Financial Statements. As a result, its investments in subsidiaries are measured at fair value through profit and loss in the Statement of Financial Position. These separate prospective financial statements are the only prospective financial statements presented by the Fund.

The following particular accounting policies which materially affect the preparation of the prospective financial statements have been applied:

a) Investment entity

The Fund meets the definition of an investment entity as the following conditions exist:

- The Fund obtains and manages funds for the purpose of providing its investor with investment management services;
- The Fund has committed to its investor that its business purpose is to invest funds solely for returns from capital appreciation and investment income;
- The Fund measures and evaluates the performance of substantially all of its investments on a fair value basis;
- The Fund has more than one investment; and
- The Fund has documented exit strategies for its investments.

Although the Fund does not meet all of the typical characteristics of an investment entity (namely, the Fund does not have multiple investors, its investor is not an unrelated party and ownership interests in the Fund are not in the form of equity), management believe the Fund is an investment entity because it has been specifically established as an investment vehicle; it has a diversified investment portfolio with best practice investment policies and procedures in place; it invests funds for the purpose of maximising returns; and it has elected to fair value the majority of its investments where feasible for the purposes of its prospective financial statements.

b) Subsidiaries

Subsidiaries are entities (including structured entities and other holding vehicles) that are controlled by the Fund under the provisions of NZ IFRS 10 Consolidated Financial Statements. The Fund controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity. The Fund reassesses whether or not it controls an entity if facts and circumstances indicate that there are changes to one or more of the elements of control.

Under Section 59 of the Act, the Guardians must use their best endeavours to ensure the Fund does not control any other entity. However, the Guardians seeks to maximise returns for the Fund and in some cases this includes the use of 'controlled' holding vehicles that are not caught within the provisions of Section 59 but may be considered subsidiaries for accounting purposes. All investment opportunities are diligently evaluated to ensure compliance with all relevant laws.

On 23 October 2015, Section 59 of the Act was amended to specifically exclude Fund Investment Vehicles (FIV's). A FIV is defined as an entity that is formed or controlled by the Guardians for the purpose of holding, facilitating or managing the investments of the Fund. A FIV is a subsidiary for accounting purposes.

c) Associates

An associate is an entity over which the Fund has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the entity, but is not control or joint control over those policies.

The Fund is an investment entity as defined in NZ IFRS 10: Consolidated Financial Statements and accordingly its investments in associates are measured at fair value through profit and loss in accordance with NZ IAS 39 Financial Instruments: Recognition and Measurement.

d) Joint ventures

A joint venture is a type of joint arrangement whereby the parties that have joint control have rights to the net assets of the arrangement. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

The Fund's investments in joint ventures are measured at fair value through profit and loss in accordance with NZ IAS 39: Financial Instruments: Recognition and Measurement.

e) Structured entities

A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. A structured entity often has some or all of the following features or attributes:

- restricted activities;
- a narrow and well-defined objective, such as to provide investment opportunities for investors by passing on risks and rewards associated with the assets of the structured entity to investors;
- insufficient equity to permit the structured entity to finance its activities without subordinated financial support; and
- financing in the form of multiple contractually linked instruments to investors that create concentrations of credit or other risks.

The Fund is principally involved with structured entities through investments in private equity investment funds, unconsolidated subsidiaries, collective investment funds, unlisted unit trusts, insurance-linked investments, shareholder loans, agency mortgage-backed securities and asset-backed securities that are issued by structured entities. The Fund invests in structured entities to assist with the implementation of its overall investment strategy. The Fund does not sponsor any structured entities.

f) Fair value measurement

The Fund measures assets and liabilities at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The Fund uses valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure fair value, maximising the use of relevant observable inputs. All assets and liabilities for which fair value is measured or disclosed in the prospective financial statements are categorised within a fair value hierarchy as follows:

Level 1 – Quoted (unadjusted) market prices in active markets for identical assets and liabilities. An active market is one where prices are readily available and those prices represent actual and regularly occurring market transactions on an arm's length basis. The fair value of Level 1 assets and liabilities requires little or no judgement.

Level 2 – Valuation techniques that use observable market data. Such techniques include the use of market standard discounting methodologies, option pricing models and other valuation techniques widely used and accepted by market participants.

Level 3 – Valuation techniques that use inputs not based on observable market data. Unobservable inputs are those not readily available in an active market due to illiquidity or complexity of the product. These inputs are generally derived and extrapolated from other relevant market data and calibrated against current market trends and historic transactions. These valuations are calculated using a high degree of management judgement.

The level within which an asset or liability is categorised in the fair value hierarchy is determined

Summary of significant accounting policies (continued)

based on the lowest level input that is significant to the fair value measurement as a whole.

The specific valuation techniques and the observability of the inputs used in valuation models for significant product categories are outlined below:

DERIVATIVE FINANCIAL INSTRUMENTS

The fair values of derivative financial instruments are principally determined using valuation techniques with market observable inputs. The most frequently applied valuation techniques include forward pricing and swap models using present value calculations. The models incorporate various inputs including foreign exchange spot and forward rates, interest rates, futures prices, default rates, credit spreads, volatility curves and discount rates.

In some instances the fair values of derivative financial instruments are determined using valuation techniques with non-market observable inputs. These instruments are classified within Level 3 of the fair value hierarchy and include longevity contingent swaps and other OTC swaps. The fair value of longevity contingent swaps is provided by the counterparty at balance date. The price is a non-binding price based on the fair value of the underlying basket of contracts. The fair value of other OTC swaps is determined using an internally-generated discounted cash flow model, with the key input being interest rates.

LISTED EQUITIES

The fair value of listed equities is determined based on the last quoted price on the relevant exchange at balance date. In some instances, where the market on which the security is traded is not highly liquid (e.g. the security may be listed on an emerging market stock exchange), the price can also be determined using non-binding broker quotes. These securities have been classified within Level 3 of the fair value hierarchy.

FIXED INCOME SECURITIES

The fair value of highly liquid fixed income securities is determined based on the last quoted price provided by a reputable pricing vendor (being a financial data provider such as Bloomberg or Thomson Reuters) or broker at balance date. Where the market for fixed income securities is illiquid, fair value is determined by a reputable pricing vendor who uses models to value the securities. The models incorporate various inputs including loan level data, prepayment and default assumptions and benchmark prices for similar securities. Because of the inherent uncertainty of valuation, it is possible that the fair values estimated for illiquid securities may differ from those that would have been determined had a ready market for those securities existed and those differences may be significant.

These securities have been classified within Level 3 of the fair value hierarchy.

The fair value of unlisted debt instruments, including fixed and floating rate instruments, that form part of an investment into a private equity investment, are valued by a suitably qualified independent valuer who ascribes an enterprise value to the entire private equity investment then apportions that value across the instruments held, including the debt instruments. These securities have been classified within Level 3 of the fair value hierarchy.

COLLECTIVE INVESTMENT FUNDS

The fair value of collective investment funds is provided by the investment managers or administrators at balance date. The price is based on the fair value of the underlying net assets or securities of the collective investment fund.

INSURANCE-LINKED INVESTMENTS

Insurance-linked investments which are catastrophe bonds are valued using prices provided by reputable pricing vendors or brokers at balance date.

PRIVATE EQUITY

The fair value of private equity investment funds is provided by the investment managers or administrators at balance date. The price is based on the fair value of the underlying net assets of the private equity investment which is determined using a variety of methods, including independent valuations, valuation models based on the price of recent transactions, earnings multiples or discounted cash flows. Private equity investments (not invested via a managed fund structure) are valued by reference to either an independent valuation or the price of recent investments.

UNLISTED UNIT TRUSTS

The fair value of unlisted unit trusts is determined based on the last price of the unit or security provided by the administrators at balance date. The price is based on the fair value of the underlying net assets or securities of the unlisted unit trust.

UNCONSOLIDATED SUBSIDIARIES

The fair value of unconsolidated subsidiaries is provided by the investment managers or administrators at balance date. The price is based on the fair value of the underlying net assets of the specific investment which is determined using a variety of methods, including independent valuations, valuation models based on the price of recent transactions, earnings multiples or discounted cash flows.

AGRICULTURAL ASSETS

The fair value of 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. Forest assets are valued separately from the underlying freehold land.

The fair value of livestock is determined by an independent valuer at balance date who uses recent observable livestock sales adjusted for the condition and location of livestock where necessary.

PROPERTY, PLANT AND EQUIPMENT

Land and land improvements and buildings are measured at fair value, as determined by Property Advisory Limited, an independent registered valuer. The valuer uses New Zealand Valuation and Property Standards as a reference, to determine the fair value of the land and land improvements and buildings. Fair value is determined by direct reference to recent transactions for land and land improvements and buildings of comparable size and location as those held by the Fund, adjusted for differences in the nature, location or condition of the specific property.

INTANGIBLE ASSETS

Allocations of New Zealand Units (NZU's) and/or other carbon credits that the Fund owns in relation to its forestry operations are recognised at net realisable value where they have been received, or where the Fund is reasonably certain they will be received, and a price can be reliably ascertained either through the existence of an observable active market or through pricing obtained from reputable brokers.

g) Financial instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

The Fund is party to financial instruments as part of its normal operations. These financial instruments include cash and cash equivalents, derivatives, investments (excluding agricultural assets), 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 Comprehensive Income.

INITIAL RECOGNITION

Financial assets and financial liabilities are recognised in the Statement of Financial Position when the Fund becomes a party to the contractual provisions of the financial instrument. They are initially recognised at fair value plus, in the case of financial assets and liabilities not recorded at fair value through profit or loss, transaction costs e.g. trading commission, that are attributable to the acquisition of the financial asset or liability.

Purchases or sales of financial instruments that require delivery within a time frame established by regulation or convention in the market place are recognised on the trade date, i.e. the date on which the Fund commits to purchase or sell the financial instrument.

SUBSEQUENT MEASUREMENT

Subsequent to initial recognition, the Fund classifies its financial assets and financial liabilities into the following categories:

Financial assets and financial liabilities at fair value through profit or loss

Financial assets and financial liabilities at fair value through profit or loss – held for trading

Financial assets and financial liabilities are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. All derivatives held by the Fund are classified as held for trading. The Fund does not designate any derivatives as hedges in a hedging relationship.

Financial assets and financial liabilities at fair value through profit or loss – designated upon initial recognition

Financial assets and financial liabilities designated at fair value through profit or loss upon initial recognition include equity and debt instruments. They are designated at fair value upon initial recognition on the basis that they are part of a group of financial instruments that are managed and have their performance evaluated on a fair value basis, in accordance with the financial risk management and investment objectives of the Fund.

Subsequent to initial recognition, financial assets and financial liabilities at fair value through profit or loss are recognised in the Statement of Financial Position at fair value with changes in fair value being recognised in the Statement of Comprehensive Income in the period in which they arise.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. This category includes cash and cash equivalents, cash pledged as collateral, trade and other receivables, reverse repurchase agreements and some unlisted debt instruments. Unlisted debt instruments that are classified as loans and receivables include fixed and floating rate notes and redeemable preference shares.

Subsequent to initial recognition, loans and receivables are measured at amortised cost using the

Summary of significant accounting policies (continued)

effective interest method, less any allowance for impairment.

Available-for-sale financial assets

Available-for-sale financial assets include private equity investments that do not have a quoted market price in an active market or whose fair value cannot be reliably measured. Management has determined that the fair value for certain private equity investments cannot be reliably measured where the entity's financial statements have not been prepared under either IFRS or a recognised and reliable accounting basis such as US GAAP.

Available-for-sale financial assets also include private equity investments in cooperative and processing companies. The Fund is required to hold these investments to facilitate farming investment operations. As such, the Fund is normally unable to sell these investments without disrupting farming investment operations.

After initial recognition, available-for-sale financial assets are subsequently measured at fair value, where fair value can be reliably measured, with unrealised gains or losses recognised in other comprehensive income and the available-for-sale reserve. Available-for-sale assets whose fair value cannot be reliably measured are measured at cost less impairment. Transaction costs are included in the cost of the investment.

Financial liabilities at amortised cost

Financial liabilities at amortised cost include all non-derivative financial liabilities. This category includes cash collateral received and trade and other payables.

DERECOGNITION

Financial assets are derecognised when the rights to receive cash flows from the investments have expired or when the Fund has transferred substantially all of the risks and rewards of ownership. The Fund derecognises a financial liability when the obligation under the liability is discharged, cancelled or has expired.

IMPAIRMENT

The Fund assesses, at each reporting date, whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an 'incurred loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

h) Cash and cash equivalents

Cash and cash equivalents includes cash balances on hand, cash held in bank accounts, demand deposits and other highly liquid investments with an original maturity of three months or less, which have an insignificant risk of change in fair value.

i) Goods and Services Tax (GST)

Income, expenditure, assets and liabilities are recognised exclusive of GST, with the exception of receivables and payables which are stated inclusive of GST. Where GST is irrecoverable as an input tax, it is recognised as part of the related asset or expense.

j) Property, plant and equipment

RECOGNITION AND MEASUREMENT

All items of property, plant and equipment are initially recognised at cost. Cost includes the value of consideration exchanged and those expenses directly attributable to bringing the item to working condition for its intended use.

Subsequent to initial recognition, plant and machinery, computer and office equipment, motor vehicles and office fit-outs are stated at cost less accumulated depreciation and impairment losses. Land and land improvements and buildings, which comprise farm properties in New Zealand, are measured at fair value less accumulated depreciation on land improvements and buildings and any impairment losses recognised after the date of revaluation. Independent valuations of land and land improvements and buildings are performed with sufficient regularity (at least every three years) to ensure that the carrying amount does not differ materially from the asset's fair value at balance date. The effective date for the latest independent valuation was 30 June 2015.

Any revaluation increase arising on the revaluation of land, land improvements and buildings is credited to the asset revaluation reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognised as an expense in the Statement of Comprehensive Income, in which case the increase is credited to the Statement of Comprehensive Income to the extent of the decrease previously charged. A decrease in carrying amount arising on the revaluation of land, land improvements and buildings is charged as an expense in the Statement of Comprehensive Income to the extent that it exceeds the balance, if any, held in the asset revaluation reserve relating to a previous revaluation of that asset.

DERECOGNITION

An item of property, plant and equipment is derecognised when it is sold or otherwise disposed of or when no future economic benefits are expected to arise from its continued use. Upon disposal, any revaluation reserve relating to the particular asset being disposed of, is transferred to retained surplus. Any gain or loss arising on disposal (being the difference between the net disposal proceeds and the carrying amount of the item) is included in the Statement of Comprehensive Income in the year in which the item is disposed of.

IMPAIRMENT

All items of property, plant and equipment are assessed for indicators of impairment at each balance date. If any indication of impairment exists, an estimate of the asset's recoverable amount is calculated, being the greater of fair value less costs to sell and value in use. Where the carrying amount of an asset is greater than its recoverable amount, the asset is written down to its recoverable amount. The write-down is recognised in profit or loss in the Statement of Comprehensive Income unless it relates to land and buildings, in which case it is treated as a revaluation decrease. Where an impairment loss subsequently reverses, the carrying amount of the item is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount which would have been determined had no impairment loss been recognised for the item in prior years. A reversal of an impairment loss is recognised in the Statement of Comprehensive Income immediately unless it relates to land and buildings, in which case it is treated as a revaluation increase.

DEPRECIATION

Depreciation is provided on a straight-line basis to write off the cost of property, plant and equipment to estimated residual value over their estimated useful lives. The estimated useful lives of the major categories of property, plant and equipment are as follows:

Land improvements	15 – 50 years
Buildings	25 – 50 years
Plant and machinery	3 – 17 years
Computer and office equipment	3 years
Motor vehicles	5 – 12 years
Office fit-out	12 years

The cost of office fit-out is capitalised and depreciated over the unexpired period of the lease (held by the Guardians) or the estimated remaining useful lives of the improvements, whichever is shorter.

k) Provisions

A provision is recognised in the Statement of Financial Position when the Fund has a present obligation arising as a result of a past event, it is probable that cash will be paid to settle the obligation and the amount can be estimated 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 consideration 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.

Where some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a 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.

l) Fund capital

PURPOSE

Fund capital, which comprises investments and all other assets of the Fund less any liabilities, is the property of the Crown. Its purpose is to build a portfolio of financial assets to help reduce the impact of providing retirement income, in the form of New Zealand superannuation, to an ageing population.

CAPITAL CONTRIBUTIONS

The Crown is required to make capital contributions to the Fund in accordance with Sections 42 to 44 of the New Zealand Superannuation and Retirement Income Act 2001 (Act). These capital contributions are made by the Crown for investment purposes based on a percentage of Gross Domestic Product (GDP). Under Section 44 of the Act, the Crown is entitled to contribute lesser amounts than calculated using the formula under Section 43 of the Act. The Government announced in the 2009 Budget a reduction in capital contributions to the Fund. As a consequence, no capital contributions have been received during the current year. Full capital contributions are projected to resume from 2020/21 under current Treasury modelling, however this may change based on future Fiscal and Economic Updates. Fund capital contributions are recorded in the Statement of Changes in Public Equity.

CAPITAL WITHDRAWALS

Under Section 47 of the Act, no withdrawal of capital is permitted from the Fund prior to 1 July 2020.

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 during that year. This requirement is additional to and separate from the obligation to

Summary of significant accounting policies (continued)

make annual capital contributions. As no capital withdrawals are permitted from the Fund prior to 1 July 2020, the Minister of Finance is obliged to provide funding to meet superannuation entitlements in the interim. The Treasury, through the New Zealand Debt Management Office, has facilitated funding for these superannuation entitlements from the Minister of Finance to the Ministry of Social Development on behalf of the Fund. The Guardians has no control over these transfers, with The Treasury acting as agent for the Fund. Transfers for superannuation entitlements are recorded in the Statement of Changes in Public Equity.

MANAGEMENT OF FUND CAPITAL

The Fund is a profit-oriented entity, managed by the Guardians. The Guardians' mandate is to invest the Fund on a prudent, commercial basis and, in doing so, ensure that the Fund is managed and administered in a manner consistent with best-practice portfolio management, maximising return without undue risk to the Fund as a whole, and avoiding prejudice to New Zealand's reputation as a responsible member of the world community. The Fund invests the contributions from the Crown, in accordance with its Statement of Investment Policies, Standards and Procedures, which is available at www.nzsuperfund.co.nz.

m) Income

Income is recognised when it is probable that economic benefits will flow to the Fund and the income can be reliably measured, regardless of when payment is being made. The following specific recognition criteria must also be met before income is recognised:

INTEREST INCOME

For financial instruments measured at fair value, interest income is recognised on an accruals basis, either daily or on a yield-to-maturity basis. For financial instruments not at fair value through profit or loss, interest income is recognised as it is earned using the effective interest method, which allocates interest at a constant rate of return over the expected life of the financial instrument based on the estimated future cash flows.

DIVIDEND INCOME

Dividend income is recognised when the shareholder's rights to receive payment has been established, normally the ex-dividend date. Where the Fund 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 profit or loss in the Statement of Comprehensive Income.

n) Operating leases

The determination of whether an arrangement is (or contains) a lease is based on the substance of the arrangement at the inception of the lease. The arrangement is (or contains) a lease if fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset. Leases in which the lessor retains substantially all the risks and benefits of ownership of an asset are classified as operating leases. Operating lease expenses are recognised on a straight-line basis over the period of the lease.

o) Foreign currencies

Transactions denominated in foreign currencies are converted to New Zealand dollars using the exchange rates prevailing at the dates of the transactions. Foreign currency monetary assets and liabilities are translated at the exchange rate prevailing at balance date. Where there is a movement in the exchange rate between the date of a foreign currency transaction and balance date, resulting exchange differences are recognised in the Statement of Comprehensive Income.

p) Income tax

In accordance with Section HR 4B of the Income Tax Act 2007, income derived by the Fund is subject to New Zealand tax determined using the rules applying to companies. The income tax expense recognised in profit or loss in the Statement of Comprehensive Income comprises current and deferred tax and is based on accounting profit, adjusted for permanent differences between accounting and tax rules. Income tax relating to items of other comprehensive income is recognised in other comprehensive income.

Current tax is the expected tax payable to or receivable from the taxation authorities based on the taxable income or loss for the year and any adjustment in respect of prior years. It is calculated using tax rates and tax laws that have been enacted or substantively enacted at balance date.

Deferred tax is recognised in respect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the tax bases of assets and liabilities at balance date. Deferred tax liabilities are recognised for all taxable temporary differences, except:

- the initial recognition of goodwill;
- the initial recognition of assets or liabilities that affects neither accounting nor taxable profit or loss other than in a business combination; and

– temporary differences relating to investments in subsidiaries, associates and interests in joint ventures where it is probable that they will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, the carry forward of unused tax credits and unused tax losses only to the extent that it is probable that sufficient taxable profit will be available to utilise the deductible temporary differences, the carry forward of unused tax credits and unused tax losses. The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at balance date.

Deferred tax assets and liabilities are offset when a legally enforceable right to set off exists, the deferred tax balances relate to income taxes levied by the same taxation authority and the Fund intends to settle on a net basis.

q) Statement of Cash Flows

The following are the definitions of the terms used in the Prospective 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 property, plant and equipment and intangible assets.

Financing activities are those activities relating to capital contributions and to payments of superannuation entitlements. As the current funding by the Crown of superannuation entitlements flows directly from the Treasury to the Ministry of Social Development it is not considered cash flow of the Fund and accordingly, is not recorded in the Statement of Cash Flows.

Cash flows are included in the Statement of Cash Flows on a gross basis. The GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority, is classified as operating cash flows.

r) Changes in accounting policies

The Fund has adopted the following new and amended NZ IFRS and interpretations as of 1 July 2015:

– Amendments to IFRS's arising from the Annual Improvements Project (2010-2012).

The adoption of these amendments has not had any impact on recognition or measurement in the prospective financial statements.

Aside from the above new and amended standards and interpretations, there have been no changes in accounting policies. All accounting policies have been applied consistently throughout these prospective financial statements.

s) Significant estimates and judgements

The preparation of the Fund's prospective financial statements requires management to make judgements and use estimates that affect the reported amounts of income, expenditure, assets, liabilities and the accompany disclosures. Uncertainty about these judgements and estimates could result in outcomes that require a material adjustment to the carrying amounts of assets and liabilities in future periods. The judgements and estimates used by the Fund are continually evaluated. They are based on historical experience and other factors, including expectations of future events that may have a financial impact on the Fund and that are believed to be reasonable under the circumstances. The judgements and estimates that management have assessed to have the most significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are as follows:

ASSESSMENT AS AN INVESTMENT ENTITY

Management reassesses the Fund's investment entity status on an annual basis, if any of the criteria or characteristics change.

ASSESSMENT OF CONTROL, JOINT CONTROL OR SIGNIFICANT INFLUENCE

The Fund has assessed its investments in subsidiaries in light of the control model included in NZ IFRS 10 Consolidated Financial Statements to ensure the correct classification and disclosure of investments in subsidiaries. The Fund holds investments in a number of entities that are not considered subsidiaries even though its ownership interest exceeds 50%. Management has concluded that the Fund has no power to direct the relevant activities of these entities and therefore it does not have control of these entities.

The Fund has assessed its investments in associates in light of the definition of significant influence included in NZ IAS 28 Investments in Associates and Joint Venture. The Fund hold investments in a number of entities that are not considered associates even though its ownership interest exceeds 20%. Management has concluded that the Fund has no power to participate in the financial and operating

Summary of significant accounting policies (continued)

policy decisions of these entities and therefore it does not have significant influence over these entities.

The considerations made in determining joint control are similar to those necessary to determine control over subsidiaries. The Fund classifies its joint arrangements as joint ventures because the contractual arrangements provide the parties with rights to the net assets of the joint arrangements.

Datacom Group Limited - under a Shareholder's Agreement, there are a number of key operating and financial activities that require approval in writing by the Fund, as well as the majority shareholder. As a consequence, it is management's view that the Fund and the major shareholder have collective or joint control of Datacom Group Limited and therefore the investment in Datacom Group Limited is treated by the Fund as a joint venture.

RA (Holdings) 2014 Pty Limited - under a Shareholder's Agreement, there are a number of key operating and financial activities that require approval in writing by the Fund, as well as the other major shareholder. As a consequence, it is management's view that the Fund and the other major shareholder have collective or joint control of RA (Holdings) 2014 Pty Limited and therefore the investment in RA (Holdings) 2014 Pty Limited is treated by the Fund as a joint venture.

ASSESSMENT OF INVESTMENTS IN STRUCTURED ENTITIES

The Fund has assessed which of its investments are investments in structured entities. In doing so, the Fund has considered voting rights and other similar rights afforded to investors as well as any contractual arrangements in place with these investments.

Management have concluded that certain of the Fund's investments meet the definition of a structured entity because:

- the voting rights in the investments are not the dominant factor in deciding who controls the investment; and
- the investments have narrow and well-defined objectives to provide investment opportunities to investors.

DETERMINATION OF FAIR VALUE

Where the fair value of assets and liabilities cannot be measured based on quoted prices in active markets, fair value is determined using valuation techniques with market observable inputs from third parties such as brokers or pricing vendors. For assets that have no quoted price (which principally consist of investments in private equity investment funds, collective investment funds, unlisted unit trusts, fixed income securities and derivatives) the determination of fair value requires significant judgement. Fair value for these assets is determined as follows:

Private equity investment funds, collective investment funds and unlisted unit trusts where fair value is provided by investment managers or administrators

The fair value of private equity investment funds, collective investment funds and unlisted unit trusts is provided by the investment managers or administrators at balance date. Investment managers and administrators may either use their own models or they may engage independent valuers who use models to obtain the fair value of investments. Management may also directly appoint independent valuers to obtain the fair value of certain investments where this information is unable to be provided by an investment manager or administrator or where an investment is directly managed by the Fund.

Fixed income securities where fair value is determined by a pricing vendor

Where the market for fixed income securities is illiquid, fair value is determined by a pricing vendor who uses models to value the securities. Management mitigates the risk of pricing errors by only selecting reputable pricing vendors and by periodically calibrating prices against observed market data.

Derivative financial instruments where fair value is determined by a pricing vendor, broker or counterparty

Pricing vendors, brokers or counterparties may use valuation models to price certain derivatives for which the inputs may include current and forward exchange rates, estimates of cash flows, interest rates, futures prices, default rates, credit spreads, volatility curves, indicative prices for similar assets and discount rates. Management mitigates the risk of pricing errors by only selecting reputable pricing vendors, brokers or counterparties and by periodically calibrating prices against observed market data.

OTHER SIGNIFICANT ESTIMATES AND JUDGEMENTS

No capital contributions from the Government have been included in the forecast period, based on announcements made by the Government in the Budget 2009.

Investment returns for the forecast period are based on internal modelling of 20-year returns.

Management fees included in the forecast are based on investment management agreements that were in place on the date the forecast was approved by the Board. The Guardians' expenses are allocated according to the current allocation model.

The forecast has largely been based on actual experience to date with exception of the impact of foreign currency. No foreign currency impact has been forecast.

Material differences between the forecast and actual returns may also occur due to three other major factors:

(i) investment markets generate returns at a level that is greater or lesser than the rate assumed in this forecast;

(ii) the asset mix of the Fund changes in response to opportunities not anticipated in this forecast; and

(iii) foreign currency movements.

SIGNED ON BEHALF OF THE BOARD:

CATHERINE SAVAGE, CHAIR

PIP DUNPHY, CHAIR AUDIT COMMITTEE

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