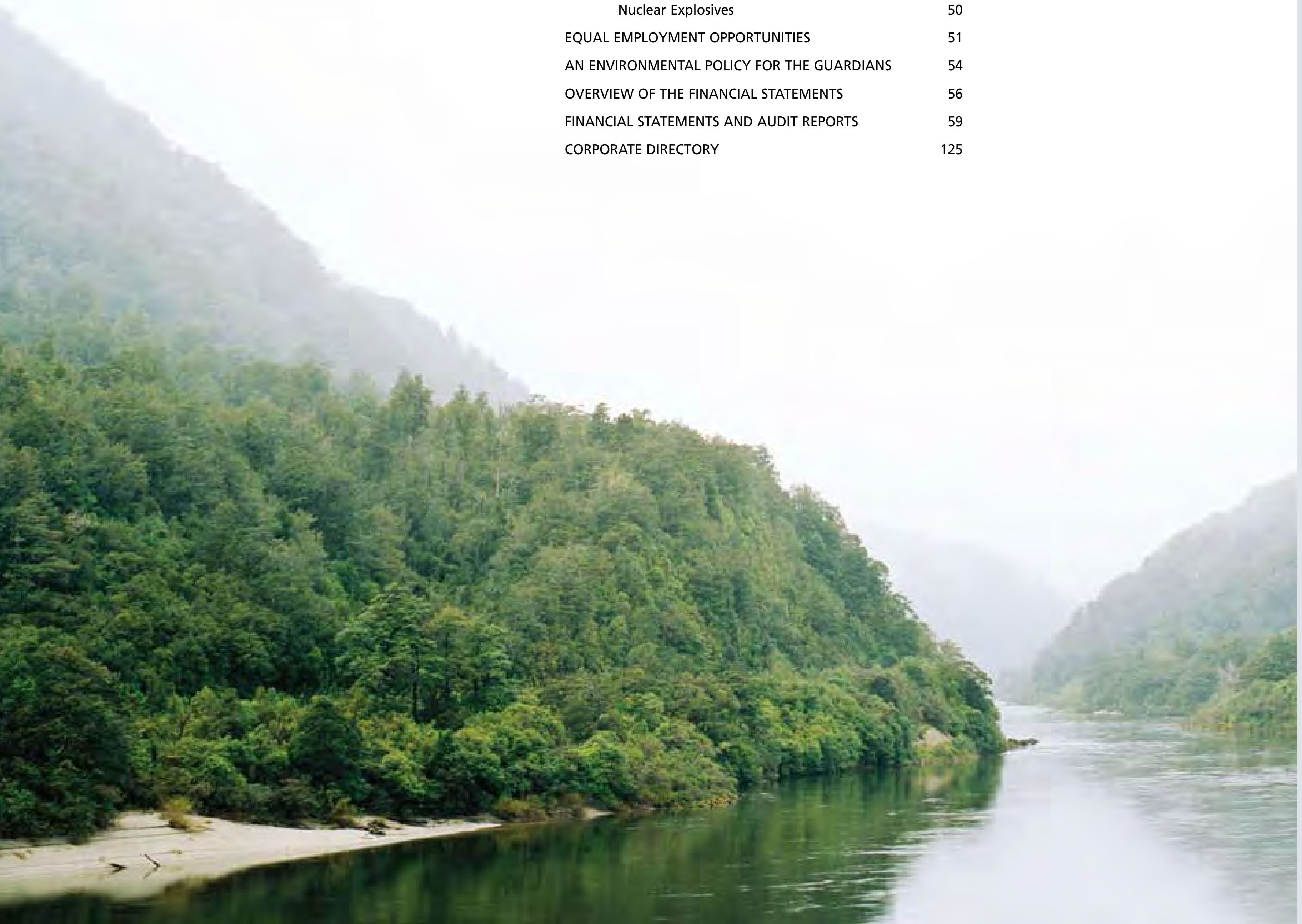
Guardians of New Zealand Superannuation

# ANNUAL REPORT 2009

NEW ZEALAND SUPERANNUATION FUND

## Contents







| FUND SIZE AT 30 JUNE 2009: | $13.3 billion (excluding provision for tax) | | |
|---|---|---|---|
| Returns | Quarter to 30 June | Year to 30 June | Since inception |
| New Zealand Superannuation Fund | 10.9% | -22.1% | 3.8%p.a. |
| Treasury Bills | 0.8% | 5.5% | 6.6% p.a. |

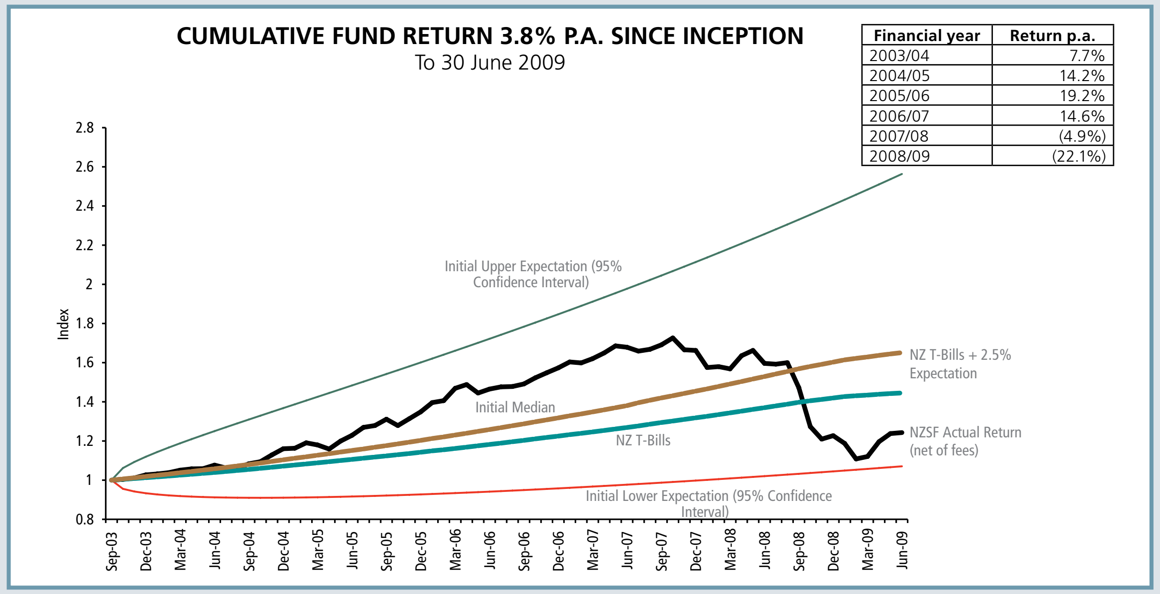
## Key Events in 2008/09


| | |
|---|---|
| Global Financial Crisis (GFC) | see page 2 and 6 |
| Reduction in Government contributions | see page 3 |
| Revision of investment beliefs | see page 24 |
| NZ investment directive | see page 36 |
| Exclusion of cluster munitions and nuclear explosives | see page 50 |


> *If you are currently aged 43, you and other eligible New Zealanders of the same age will be the first to have part of the cost of your New Zealand Superannuation met from the Fund[1].*

> *The size of the Fund is not expected to peak until today's 18-year-olds are eligible to retire in 2056.*

> *The Fund is estimated to represent more than 17% of New Zealand's GDP in 2090. That's when New Zealanders who won't be born for 16 years (in 2025) are eligible to retire.*




| Financial year | Return p.a. |
|---|---|
| 2003/04 | 7.7% |
| 2004/05 | 14.2% |
| 2005/06 | 19.2% |
| 2006/07 | 14.6% |
| 2007/08 | (4.9%) |
| 2008/09 | (22.1%) |

1. According to current Treasury forecasts and retirement policy relating to eligibility for and 'generosity' of New Zealand Superannuation

# Board Statement On Global Financial Crisis

**David May - Chairman**

In this past financial year we have experienced the most profound and globally wide-reaching economic and financial crisis in a generation.

The impact has been severe across all sectors, in all markets and in every country. It has been severe on us. As the headline figures at the front of this document make clear, this has been a tough year for the New Zealand Superannuation Fund.

For the year to 30 June 2009 the Fund's return was -22.1% which reflected the dramatic fall in the values of equities and other real assets. This year's result has erased the strong gains we made over our first five years of investing and means that our total return since inception of 3.8% p.a. is below the 6.6% p.a. return on the risk-free rate over the same period.

By comparison with most investors the Fund has an extremely long time horizon. Our role is to reduce the tax burden on future New Zealanders of the cost of New Zealand Superannuation. Under current Treasury modelling the Fund will peak when today's 18 year olds are eligible to retire. This sets a clear context for everything we do and constantly reminds us that our horizons are over decades rather than years.

As a long-term investor the Fund has an ability to hold relatively illiquid assets and a higher-than-average tolerance to volatility in investment markets. Our investment strategy with its strong emphasis on equities and other real assets has been designed with these characteristics in mind.

In common with most of our peer funds we have had a tough ride that has put that tolerance to the test. Now is the time we must retain our discipline to stay the course, retain our focus on the long term and capitalise on our ability to ride out tough patches without selling undervalued assets

At the start of the crisis we had largely avoided investing in the credit markets that precipitated it. However what we and many others failed to anticipate was the contagious impact that the crisis would have on economic growth and on real or growth assets throughout the world. Our assessment at the time was that markets were not significantly overvalued and that over the long term, investment in growth assets would continue to provide superior risk-adjusted returns.

We recognised the potential for increased volatility but believed that using our own expertise to out-guess markets and predict short-term movements in prices was difficult and unlikely to improve the Fund's long term performance. We did appoint some of the best global managers in the world to take limited tactical asset positions to take advantage of pricing anomalies. In the event, they, collectively, like most of our peer funds did not predict the crisis and performed relatively poorly throughout the period. We discuss this further on page 30.

As the crisis deepened we asked our team to concentrate not on predicting short-term price movements but on retaining their discipline. Our efforts were successfully focused on managing and diversifying our counterparty risk, managing our cash flow and liquidity and rebalancing our investment so that we did not need to realise assets at distressed prices.

Subsequently, since the worst of the crisis in March 2009, we have experienced a significant rebound in our returns. This is in large part related to our ability to hold our focus on the long-term and to retain our risk tolerance as the rewards for risk increased.

## The Budget

In the 2009 Budget, the Government announced its intention to reduce contributions to the Fund, until the Crown operating balance returns to surplus sufficient to resume contributions. The Treasury estimates this to be in 2020. In the Budget speech the Minister of Finance explained that this was done because of the scale of the impact of the crisis on the Government's finances.

New Zealand Treasury modeling shows that the reduction in contributions means that the Fund will be smaller in size when withdrawals begin in 2031 and so the 'buffer' effect of the Fund on the future cost of New Zealand Superannuation will also be less. In the sidebar for this section we have included Treasury graphs showing the impact of the Budget announcement on the rate and profile of contributions and on projected Fund size.

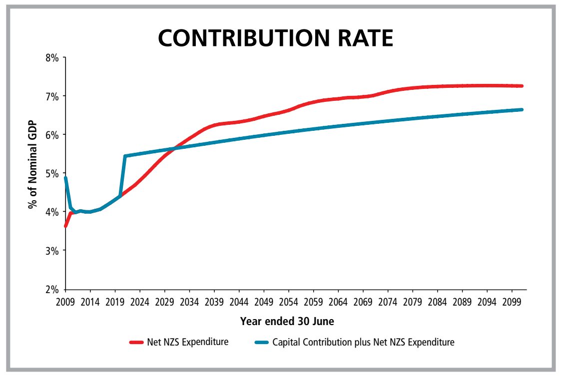
*At the start of the crisis we had largely avoided investing in the credit markets that precipitated it.*

The reduction in contributions will mean that the Fund will not, in the immediate future, grow at the rapid pace we anticipated. But our long-term investment horizon, our focus on adding economic value and on making prudent commercial investment decisions remains unchanged.

At the time of Budget we also received a direction from the Minister of Finance requiring us to actively identify and consider investments in New Zealand, subject to remaining commercially prudent in our investment activities. This is the first Ministerial Directive the Guardians have received, consistent with section 64 of our guiding Act. The Act requires the Guardians to regularly report on how we are having regard to the directive. We do so for the first time in this Annual Report on page 34.

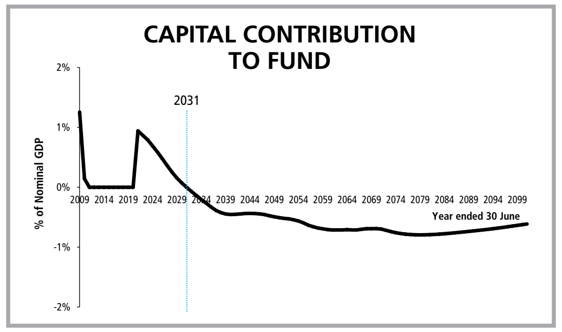
I note the retirement at the end of the year of our deputy chair Sir Douglas Graham. Sir Douglas has been with the Guardians since its inception and we would like to warmly acknowledge the strong contribution he has made across every aspect of the organisation over the ensuing seven years.

## Board Statement On Global Financial Crisis (continued)

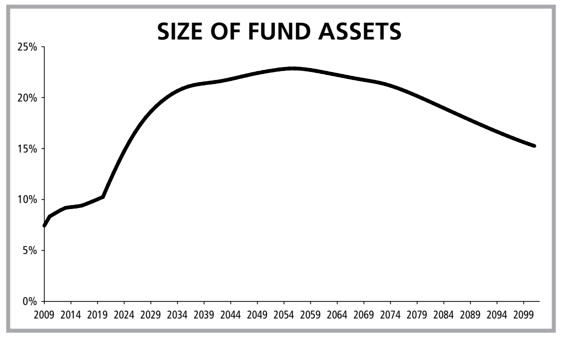



The red line shows the projected cost of New Zealand Superannuation as a percentage of nominal GDP, absent the existence of the Fund. The blue line shows the projected cost after allowing for contributions into (withdrawals from) the Fund.

The difference (the 'gap') between the two lines shows the amount of the projected contribution (withdrawal) in any one year. Source: NZ Treasury




This chart shows the profile over time of Government contributions to the Fund. Consistent with the Budget announcement, the line is flat until 2020. It then 'spikes' as contributions are resumed, with initial contributions required to 'make up' for the 11 years in which none were made. From 2031 withdrawals begin, when the line dips below zero. Source: NZ Treasury




This chart shows the projected size of the Fund over time. It peaks at 22.86% of GDP in 2056 (when today's 18-year-olds will be eligible to retire). Source: NZ Treasury

Finally I would like to thank my colleagues and the team at the Guardians for their significant efforts during a tumultuous financial year. Their cool heads, beliefs, expertise and dedication have ensured that the Guardians' capabilities have grown significantly for the future. Our organisation, and our objective, can gain from the opportunities now available to a long term investor.

**DAVID MAY**
Chairman

# CEO Statement: First Five Years of the Fund

**Adrian Orr - CEO**

In September 2008, investment at the New Zealand Superannuation Fund turned five. Investment commenced in September 2003 with $2.3 billion in cash. Five years later in September 2008, and just before the worst impacts of the global financial crisis, the Fund stood at $13.6 billion. At 30 June 2009, having gone through the crisis, it was $13.3 billion.

The small difference between those two figures disguises the severe fluctuations across global markets and in Fund returns over that period. The December 2008 quarter performance was the Fund's worst since inception (-16.7%), closely followed by the March 2009 quarter which was the second worst (-8.7%). The June 2009 quarter then produced the best return since inception (10.9%). We have set out the market turbulence in the midst of the crisis, from December 2007 to June 2009, in the chart on page 7.

Ultimately we arrived at 30 June 2009 with a return since inception of 3.8% p.a. which translates to a net investment gain of $96 million (net of fees, pre-tax). Across that period the Fund has received $14.6 billion in contributions from the Government and paid $1.2 billion in tax.

This is a modest result after nearly six years of investing. However it must be seen in the context of the global financial crisis, which was the largest since the 1930s. It wreaked havoc on returns, investment portfolios and in many cases brought down financial institutions and other businesses.

In looking at impacts on other funds we are always careful to note that comparison is difficult and has limited relevance. The performance of any fund is a function of its asset allocation which is itself a function of its purpose. Comparing performance between funds is therefore problematic. However by way of general illustration of the profound volatility in the market, surveys have found that, at an aggregate level, Sovereign Wealth Funds (SWF) across the globe suffered marked-to-market losses, on listed stocks alone, of -46.7%[2]. This is the main influence on SWF portfolios overall having contracted some 18.0% since the end of 2007[3].

*Sovereign Wealth Funds across the globe suffered marked-to-market losses, on listed stocks alone, of -46.7%*

Some have asked us why we didn't convert the Fund to cash early on in the crisis. As we have said, we don't think it is useful to focus our investment efforts on trying to predict highly volatile short-term market movements. Instead, we undertake a variety of investment activities such as diversifying across asset classes and geographies, and across investment management styles (passive to highly active).

2. Unadjusted. *From Weathering the Storm* by the Monitor Company Group and *Fondazione Eni Enrico Mattei*, 2009
3. Deutsche Bank study on contraction of SWFs, 2009

## CEO Statement On Five Years (continued)

It is only recently that we have also invested on the basis of a varying risk appetite (i.e. 'strategic tilting'). It is important to note that this is a complementary activity to those already mentioned, it is done at the margin and is assessed on a medium-term view of risk and return. Had we sought conversion to cash, in late 2008 and early 2009 when volatility was most severe, we would have been trying to do so in a market where:

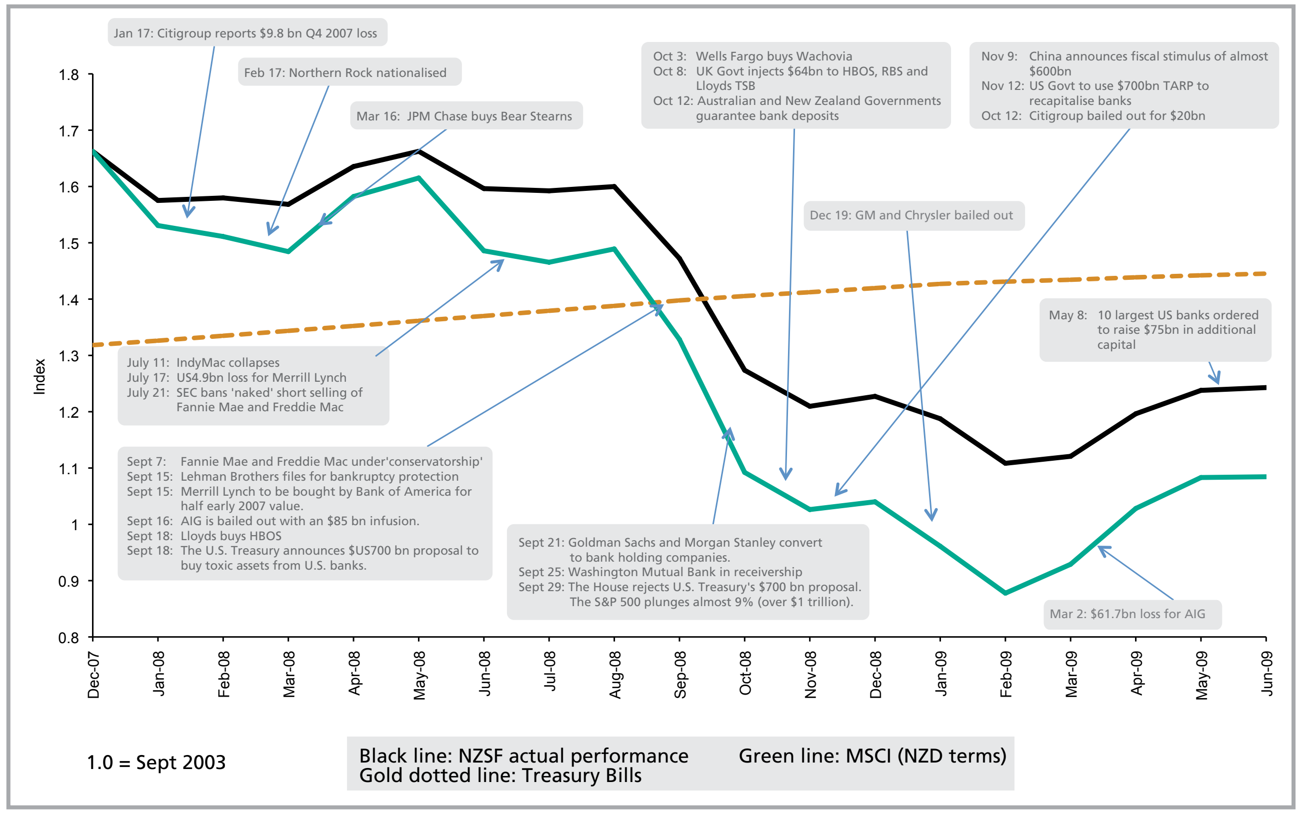
1. It was neither possible nor economically sensible to realise illiquid assets (in fact the rewards for increasing exposure to illiquid assets rose through this period); and
2. At the peak of the crisis it was risky to move assets into many forms of cash, as there was little certainty around the previously sound institutions that would hold the cash when the stability of the global banking system was in question.

Naturally, the global financial crisis caused us to carefully examine every aspect of our investment practices and consider how we might improve them. Most importantly this involved revisiting our investment beliefs in these testing times to ensure they were still well-founded. What we decided was:

1. We confirmed that diversification is absolutely necessary to mitigate risk.
2. We confirmed that a capacity, in both skills and experience, to be opportunistic is highly complementary to diversification.
3. We are more wary of investing where the crowd does. Sometimes even good ideas can turn out to be not so good if too many try to implement them at once and rewards decline.
4. We have tested our liquidity management strengths, including a range of 'stress tests' to ensure that sufficient liquidity is maintained to meet our near term obligations even under extreme market conditions.
5. We have carefully reviewed our approach to manager selection and broadened our analysis to also incorporate the characteristics of a market conducive to generating excess returns (see page 30 for more detail).
6. We enhanced our focus on operational due diligence risk, by increasing our own capabilities and requiring higher standards in these areas from our managers.
7. We added additional counterparties and enhanced the way we consider their creditworthiness, by moving beyond reliance only on credit ratings to using a suite of credit assessment measures.
8. We have ensured that we communicate clearly and often with our stakeholders – in particular the Board and the Government – but also to the public more generally.

Short-term volatility aside, what is more important is that the Fund is young. New Zealand has a considerable amount of money invested in fulfilling our important multi-generational purpose of reducing the tax burden on future New Zealanders of the cost of New Zealand Superannuation. We are confident of success.

### Anatomy of Global Financial Crisis December 2007 – June 2009




Accordingly we believe that it is vital to understand that the Fund has experienced these setbacks early in its life. While we would clearly have preferred not to have seen the worst financial crisis in 80 years play out in the Fund's performance, we came out of it having learned invaluable lessons about the Fund, our investment counterparties and ourselves. As important, we are in an opportunistic position with a stronger organisation.

This long-term perspective is a fundamental influence on how we have structured the Fund and on how we manage it. Communicating this is important for us, as it drives how we set priorities, and then act, on what matters

And what is that? At the highest level, what matters is the long-term return to the Fund net of all costs and foreign taxes. That will be the ultimate measure of the extent to which the Fund is fulfilling its purpose.

Our reference point for that is benchmarking the Fund performance against the 90-day Treasury bill rate (i.e. a proxy for the Government's 'risk-free' rate or its opportunity cost of raising debt). Based on our investment blueprint – our Strategic Asset Allocation (SAA) – our internal expectation is to deliver a rate of return averaging at least 2.5% per annum above the 90-day Treasury bill (T-Bill) rate over

## CEO Statement On Five Years (continued)

***We continue to rate as one of the most transparent SWFs in the world.***

rolling 20-year periods[4]. We have depicted this in the graph on page 1. It is important to note that this outperformance is not our target, which is to maximise return without undue risk. In fact we aspire to outperforming the +2.5% whenever we have opportunities to do so.

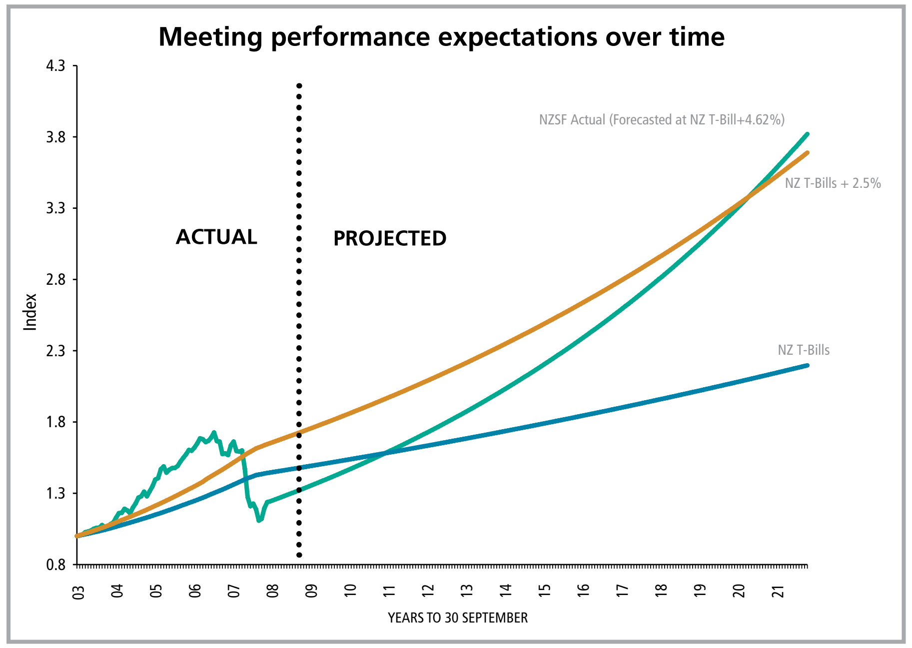
In practical terms we accept however that 20 years is beyond the patience of most observers, beyond the term of any Board member and in all likelihood beyond the length of service that we might hope to expect from most staff members.

We therefore also monitor a five-year rolling average period as an indicative intermediate target. Even then, the outcome is most unlikely to be statistically significant – in other words it will be difficult to discern with precision the relative significance of the influence of our input and that of market fluctuation. This is the nature of investing.

Nevertheless, this intermediate target is why the five-year anniversary of the Fund is a relevant time to examine our and the Fund's performance in both absolute and relative terms.

We have set out below where our current performance places us with respect to our own performance expectations. Clearly, having underperformed relative to the long-term performance target over the first years of its existence, the Fund will need to outperform that target over subsequent years for our longer-term expectations to prove accurate.

We have calculated that outperformance of T-Bills by 4.6% (the green line) over time would 'catch up' with, then surpass, our performance target (and we note that, under current Treasury projections, Government contributions to the Fund are anticipated to resume in 2020).



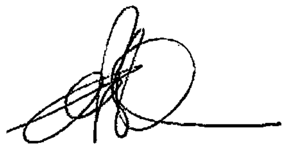

We believe such outperformance is achievable. The Fund outperformed the risk-free rate for four of its first five years. As well, outperformance of T-Bills by 4.6% is consistent with the estimated returns we set out in our Statement of Intent for 2009.

Five years is also a relevant time to examine how the Guardians have developed as an organisation. Physically, this has been rapid as the size of the funds under management has grown. We had two staff when we prepared our first Annual Report in 2003. As at 30 June 2009 we had 56.2 full-time equivalent staff. The growth to date in our staff numbers, which is focused entirely around delivering against our and the Fund's purpose, has been across the board in strategy, implementation, operations and support.

We have also grown our capabilities, both through attracting and developing passionate and talented people to our team and through building and sharing knowledge through frequent engagements with our peer organisations globally. Consistent with our stronger capabilities we have widened our investment strategies, in order to ensure we are maximising and making the most of opportunities to add value.

In terms of international reputation, the Guardians are represented on the International Working Group of Sovereign Wealth Funds, we are a founding signatory to the United Nations Principles of Responsible Investment, and our team are regularly invited to address experienced international audiences on every aspect of fund management from asset allocation to governance to the incorporation of responsible investment approaches within private equity investing. We continue to rate as one of the most transparent SWFs in the world.

Finally, I would like to thank the Board and the team at the Guardians for their efforts in an especially testing year. We have come through some extreme highs and lows and worked together professionally, respecting our organisational values. I am very confident the team remains focused on ensuring the Fund is a financial success and that the Guardians is an organisation of which New Zealand can be proud.



**ADRIAN ORR**
Chief Executive Officer

**4. This is measured on a time-weighted basis as is common for long-term investors and before tax, as tax is a return to the NZ Crown.**

# Reporting On The Statement of Intent 2008/09

In this section we compare the performance of the New Zealand Superannuation Fund with the expectations set out in the Statement of Intent for 2008/09. We also report progress against the key organisational objectives set out in the same document.

## Fund Performance

We are legally required to outline our expectations of the performance of the Fund over each financial year. As we have said repeatedly since the Fund's inception, predicting short-term financial markets returns with any useful accuracy over such a near-term horizon is impossible. At best we can use our modelling techniques to provide a range of likely outcomes and outline the mid-point of this range. It is not our prediction of what we think will happen.

This is the basis on which we estimated the Fund's return for 2008/09 in the 2008/09 Statement of Intent. In that document we estimated that the mid-point of the estimated range for the Fund return, after costs but before tax, would be 9.6% p.a. The actual return was minus 22.1%. As discussed in the CEO report, included in this were the two worst, and best, quarters in the history of the Fund.

Obviously this is disappointing. However it occurred in the worst financial conditions for decades. To provide some context, indexes for global large-capitalisation equities fell 24.0% – one of the worst performances on record – commodities fell 49.0% and property fell 44.0%.

## Report against key organisational objectives

In the following table we have set out the progress we have made against the organisational outputs identified in our Statement of Intent for 2008/09.

It is important to note that in our Statement of Intent for 2009 we have reframed our key outcome, outputs and performance measurements following feedback from Audit NZ.

Accordingly while the thrust of our organisational focus is the same across both 2008 and 2009, the 2010 annual report will reflect the changes made to our 2009 Statement of Intent with respect to reporting on progress, and will be set out differently to this table.

**TABLE 1: Summary of our Activities, Outputs and Performance Assessment**

| Outcome #1: Ensure a cost-effective, fit-for-purpose portfolio | | | |
|---|---|---|---|
| **Operational output** | | **Implementation** | **Comments** |
| Implementation of a 'liabilities-driven' investment strategy. | ✓ | FY08-10 | Work on framework issues complete. The evaluation part of this initiative has been incorporated as part of the SAA review. |
| Implementation of a strategic tilting framework. | ✓ | FY08-10 | Strategic tilting has been implemented. |
| Implementation of revised investment benchmarks. | ✓ | FY08-10 | The Board considered a framework paper setting out broad purposes for alternative non-market cap indices and a decision to implement the strategy is pending. |
| Implementation of more passive investment exposure and increased use of derivatives. | ✓ | FY08-10 | We have increased passive exposure in credit, real estate, emerging market equities and small cap equities. Derivative usage has also increased, where pricing is favourable. |
| Implementation if beneficial of a revised, targeted investment strategy. | ✓ | FY08-10 | Framework papers relating to Macro Themes and Stress Testing have been considered by the Board and are to be used to inform our investments. |
| **Outcome #2: Maintain public and Government confidence in our organisation's capabilities and integrity** | | | |
| **Operational output** | | **Implementation** | **Operational output** |
| Production of a global benchmark study. | ✗ | FY08-11 | We continue to actively engage with our peers, however production of a comprehensive, holistic and "live" database of key peer information has been deferred to the 2009/10 financial year. |
| Implementation of a framework for the efficient allocation of capital across competing investments. | ✓ | FY08-11 | A framework is in place for determining expected return hurdles for private market assets based on their contribution to total portfolio risk. |
| Finalisation of global and New Zealand private equity, and property investment strategies. | ✓ | FY08-11 | Strategies are in place for private equity and for property. Global advisors have been selected – Hamilton Lane for private equity and Franklin Templeton in property – to assist in due diligence and appointment of managers and in the identification of investment opportunities. |
| Continuous monitoring of responsible investment activity through UNPRI. | ✓ | FY08-11 | UNPRI in Practice reporting. UNPRI self-evaluation = top/2nd quartile for region. |

## Reporting On The Statement Of Intent 2008 (continued)

| Operational output | | Implementation | Operational output |
|---|---|---|---|
| Implementation of our IT strategy. | ✓ | FY08-11 | The IT Strategy and related implementation roadmap was approved during the year and implementation of a robust IT infrastructure environment was completed in August 2009 with the relocation of IT assets to a Data Centre. |
| Implementation of enhanced derivatives management capabilities. | ✓ | FY08-11 | In January 2009 a Treasury Unit was created and recruitment for all roles is complete. In June 2009 the Board approved the Fund purchasing an investment management system to support the Treasury Unit. Implementation of the investment management system is scheduled for 2010. |
| Implementation of an in-house portfolio management and general ledger system | ✓ | FY08-11 | Internally managed trading of passive mandates in NZ securities, cash and credit commenced July 2009. We have decided that a general ledger system is not required at this time. |
| Extending the monitoring of responsible investment issues across all asset classes where possible. | ✓ | FY08-11 | Systematic monitoring of large cap equities and related bond issuance is ongoing. Case by case monitoring of small cap, emerging market equities and private market investments. New UNPRI guidelines for private equity developed and integrated into most recent mandates. Participating in development of industry guidelines for Private Equity and Property. PE and Property advisors remit includes working with RI team to develop Guardians' RI guidelines. RI guidelines planned for timber assets. |
| Work with other Crown Financial Institutions (CFI) on shared service provision and intellectual property. | ✓ | FY08-11 | Implementing shared CFI approach on Responsible Investment research. |
| Continue to develop an active engagement programme with other UNPRI investors. | ✓ | FY08-11 | Ongoing active engagement with other UNPRI signatories. Examples include:<br>• participation in UNPRI Steering Committee on Private Equity;<br>• participation in initiative to encourage listed companies around the world to sign the UN Global Compact and therefore adopt international standards on human rights, working conditions, the environment and anti-corruption;<br>• contributed to Climate Disclosure Project survey on business responses to climate change, by writing to each company on the NZX50 to encourage them to participate in the survey. |

| Operational output | | Implementation | Operational output |
|---|---|---|---|
| Implementation of a refined risk management framework and strategy. | ✓ | FY08-09 | We have developed risk management policies, procedures, and other internal controls for application by our staff, external investment managers, and other expert service providers. We monitor compliance with the relevant policies and procedures as well as compliance by external managers. As a consequence of the global financial crisis we have further refined our risk management framework, in particular around due diligence of counterparties. |
| Implementation of automated business and portfolio risk monitoring and reporting | ✓ | FY08-09 | Work is underway on an initiative to scope and to source further portfolio monitoring tools from external providers. |
| Publication of key documents and analysis. | ✓ | FY08 | Key decisions including legal opinions on nuclear weapons and cluster munitions have been published to our website.<br>The Ministerial Directive on investing in New Zealand and the Guardians' response to the directive have been published to our website. |
| Updates of our website. | ✓ | FY08 | Ongoing. We promptly updated our website to reflect announcements on the NZ investment directive and reduction in contributions in Budget 2009. |
| Engagement with key audiences for greater transparency and understanding of our business. | ✓ | FY08 | Regular formal and informal engagement with Treasury and Ministry of Finance<br>Engagement with public forums including International Working Group of Sovereign Wealth Funds, ASB Community Trust, NZ Dairyworkers' Union Annual Congress, Commerce Select Committee. |
| Implementation of a human resources framework. | ✓ | FY08-11 | We have consulted staff and rolled out a set of organisational vision and values. We are progressively establishing metrics to measure leadership, accountability and culture such as 360 degree reviews. |
| Development of staff specialisation. | ✓ | FY08-11 | We have in place development plans for individuals based on core competencies and capabilities and an organisation-wide development programme focused on building the capabilities necessary for the Guardians to achieve its objectives. |
| Development of a leadership model. | ✓ | FY08-11 | We have implemented a leadership development programme. |

# Governance

In this section we report on how the Guardians observed each of the Securities Commission's corporate governance principles in the year to 30 June 2009.

### PRINCIPLE 1 Directors should observe and foster high ethical standards

The Board has adopted a Board Charter incorporating Codes of Conduct for Board members. The Charter is available on our website (www.nzsuperfund.co.nz).

We also have a Code of Conduct for employees. The Codes provide Board members and employees with clear expectations of ethical standards expected at the Guardians. The Codes of Conduct address:

- professional conduct and duties of Board members and employees;
- conflicts of interests;
- confidentiality;
- securities markets;
- use of Guardians' information and assets;
- receipt of gifts and entertainment;
- political participation; and
- whistle blowing.

For Board members, actual or potential conflicts of interest are managed in accordance with the requirements of the Guardians' governing legislation.

### PRINCIPLE 2 There should be a balance of independence, skills, knowledge, experience, and perspectives among directors so that the Board works effectively

The skills and attributes required to be a Board member are set out in the Act. Board members are chosen for their experience, training, and expertise in the management of financial investments.

Board members 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 established by the Minister. On receiving those nominations, the Minister consults with representatives of other political parties in Parliament before recommending the Governor-General appoint a person to the Board.

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. The first Board members were appointed in August 2002.

The Board composition at 30 June 2009 with details of individual Board members' background is set out in the table below. We note that the Deputy Chairman, Sir Douglas Graham, retired on 30 June 2009.

| Name | DAVID MAY, Chairman |
|---|---|
| Term of office | Appointed August 2002 for five years and reappointed September 2007 for five years |
| External directorships | Deputy Chairman, Government Superannuation Fund Authority and Director of Southern Cross Medical Care Society and Annuitas Management Limited. |
| Skills, experience, and expertise | 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 Ltd (1995–2000) |
| Standing Board committee membership | Chairman of the Guardians' Employee Policy and Remuneration Committee and member of the Responsible Investment Committee. |

| Name: | SIR DOUGLAS GRAHAM, Deputy Chairman |
|---|---|
| Term of office | Appointed August 2002 for five years and reappointed September 2007 for one year. Retired 30 June 2009. |
| External directorships | Director of OTPP NZ Forest Investments Ltd and the Commonwealth Special Envoy to the Kingdom of Tonga. |
| Skills, experience, and expertise | 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. |
| Standing Board committee membership | Chairman of the Guardians' Audit and Risk Committee and member of the Guardians' Responsible Investment Committee and Employee Policy and Remuneration Committee. |

| Name | BRIDGET LIDDELL, CFA |
|---|---|
| Term of office | Appointed August 2002 for three years and reappointed June 2005 for five years. |
| External directorships | 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. |
| Skills, experience, and expertise | Before moving to the US in 2003, Bridget was Chief Executive Officer of University of Auckland Development Ltd. Bridget has been a Director of several New Zealand companies, including Sky City Entertainment Group, Fisher & Paykel Appliances Holdings Ltd, and Uniservices Ltd. Bridget has held senior executive positions at Carter Holt Harvey and was a Director of CS First Boston NZ Limited. |
| Standing Board committee membership | Member of the Guardians' Responsible Investment Committee. |

## Governance (continued)

| Name | DAVID NEWMAN |
|---|---|
| Term of office | Appointed September 2004 for five years. |
| External directorships | 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, and of the Centre for Biodiversity and Restoration Ecology at Victoria University of Wellington. |
| Skills, experience, and expertise | David 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. |
| Standing Board committee membership | Member of the Guardians' Audit and Risk Committee (became Chairman following Sir Douglas' retirement). |

| Name | GLEN SAUNDERS |
|---|---|
| Term of office | Appointed September 2004 for five years. |
| External directorships | Board member of UNPRI, a non-executive Director of Sustainable Investment Research Institute Pty Ltd, a Director of Prometheus Finance Ltd and a Director of Harbour Wind Limited. |
| Skills, experience, and expertise | A consultant, investment banker, and qualified accountant, Glen was previously UK Managing Director of Netherlands-based bank, Triodos. He 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. Glen has also served as Non-Executive Director of the Western Partnership for Sustainable Development and the Earth Centre Advisory Board. |
| Standing Board committee membership | Chairman of the Guardians' Responsible Investment Committee and a member of the Guardians' Employee Policy and Remuneration Committee. |

| Name | MARK TUME |
|---|---|
| Term of office | Appointed April 2006 for five years. |
| External directorships | Director of Infratil Limited, The New Zealand Refining Company, KiwiRail and of Ngai Tahu Holdings Corporation, Member of ACC External Maori Reference Group. |
| Skills, experience, and expertise | 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. |
| Standing Board committee membership | Member of the Guardians' Audit and Risk Committee. |

| Name | JOHN EVANS |
|---|---|
| Term of office | Appointed December 2006 for five years. |
| External directorships | Managing Director of PGE Australasia Pty, an actuarial company specialising in the application of quantitative techniques to investment business. John holds a number of other directorships, including Emerging Leaders Investment Ltd, and is actively involved with various committees at Fiducian Portfolio Services, a specialist financial services organisation. |
| Skills, experience, and expertise | John is also Associate Professor in Actuarial Studies at the University of New South Wales and Deputy Director of the Centre for Pensions and Superannuation. |
| Standing Board committee membership | Member of the Guardians' Audit and Risk Committee. |

The Guardians' governing legislation and the Board's Charter (including Code of Conduct) define Board responsibilities, responsibility of individual Board members and the Governance framework.

While the day-to-day responsibility for the operation of the business is delegated to the executive, there are a number of matters which, either because it is required by law or because the Board has decided it is in the interests of the Guardians to do so, are decided only by the Board as a whole.

Periodically the Chairman, with assistance from an advisor, formally assesses the performance of individual Board members whilst Board members also assess the collective performance of the Board and the performance of the Chairman. The last such assessment was conducted in July 2007.

### PRINCIPLE 3 The Board should use committees where this would enhance its effectiveness in key areas while retaining board responsibility

The Board has three standing Board committees:

- **Audit and Risk Committee:** Oversees financial reporting, internal and external audit, the internal risk management framework and its application, compliance (including tax compliance), accuracy of financial statements, and other governance systems.
- **Responsible Investment Committee:** Oversees the implementation of the Responsible Investment Policy.
- **Employee Policy and Remuneration Committee:** Advises on performance of the Fund and of the Guardians' service providers. The roles and responsibilities of the Board committees are set out in the respective Committee's Terms of Reference. Copies of the Terms of Reference are available on the Fund's website.

## Governance (continued)

In addition, from time to time, the Board may establish specific sub-committees to address a particular matter or for a particular purpose. This allows the Board to function effectively and to manage conflicts of interest.

The Board committees meet either quarterly or are convened as necessary. Each committee is entitled to the resources and information it requires to operate effectively. The Chief Executive Officer and senior executives are invited to attend committee meetings as necessary.

The Board met nine times during FY 2008/09, and its standing committees held 10 meetings. The table below reflects the number of meetings attended by each Board member relative to the total meetings that Board member could have attended.

| Meeting Type | Board | Audit and Risk Committee | Responsible Investment Committee | Private Markets Committee* | Employee Policy and Remuneration Committee |
|---|---|---|---|---|---|
| Number of meetings | 9 | 4 | 2 | 2 | 2 |
| David May | 9 | | 2 | | 2 |
| Sir Douglas Graham | 9 | 4 | 2 | | 2 |
| Bridget Liddell | 9 | | 2 | 1 | |
| David Newman | 9 | 3 | | 2 | |
| Mark Tume | 8 | 4 | | 2 | |
| Glen Saunders | 8 | | 2 | | 2 |
| John Evans | 8 | 4 | | 2 | |

* The Private Markets Committee was disestablished on 9 February 2009.

### PRINCIPLE 4 The Board should demand integrity both in financial reporting and in the timeliness and balance of disclosures on entity affairs

As a Crown entity the Guardians are required to meet all their obligations in respect of themselves and the Fund under the New Zealand Superannuation and Retirement Income Act 2001, Crown Entities Act 2004, and the Public Finance Act 1989, including producing this Annual Report. The Annual Report is available to the public in hard copy and on our website. The financial statements for the Guardians are signed by the Chairman of the Board, the Chairman of the Audit and Risk Committee, and the Chief Executive Officer. The financial statements of the Fund are signed by the Chairman and Chief Executive Officer.

The Guardians are required by the Crown Entities Act 2004 to prepare a Statement of Intent. Our Statement of Intent for the five years from 2009 to 2014 was tabled in the House on 29 May 2009. The Guardians also report quarterly to the Minister of Finance with a written report on progress of the Fund and the Guardians.

### PRINCIPLE 5 The remuneration of directors and executives should be transparent, fair, and reasonable

The remuneration of Board members is set by the Minister of Finance operating in accordance with the Fees Framework for Members of Statutory and Other Bodies Appointed by the Crown.

Members' remuneration is disclosed in Note 12 to the Guardians' financial statements.

The objective of the staff remuneration strategy is to provide competitive remuneration aimed at attracting and retaining competent people and aligning rewards with achievement of financial and non-financial targets. Staff remuneration comprises base or fixed remuneration and a long-term incentive scheme based on the achievement of organisation and financial performance targets.

Further details concerning staff remuneration are disclosed in Note 13 to the Guardians' financial statements.

### PRINCIPLE 6 The Board should regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks

The Board is responsible for reviewing and approving the Guardians' risk management strategy. The Board delegates day-to-day management of risk to the Chief Executive Officer and, as appropriate, other staff. Inherent in this delegation is the belief that responsibility for managing risks at the Guardians is the domain of the relevant business unit.

The Audit and Risk Committee reviews the reports of management and the external and internal auditors on the effectiveness of systems for internal control, financial reporting, and risk management. To assist in discharging this responsibility, the Board has in place a number of strategies designed to safeguard the Fund's and Guardians' assets and interests and ensure the integrity of reporting.

### PRINCIPLE 7 The Board should ensure the quality and independence of the external audit process

The Audit and Risk Committee is responsible for overseeing the external audit of the Guardians and the Fund. Accordingly, it monitors developments in the areas of audit, and threats to audit independence, to ensure its policies and practices are consistent with emerging best practice in these areas.

The external auditors are not permitted to perform non-audit work assignments.

The Guardians' external auditors, appointed by the Office of the Auditor-General to conduct the audit on its behalf, are Warren Allen of Ernst & Young (who audits the Fund) and Francis Caetano of Audit New Zealand (who audits the Guardians).

## Governance (continued)

**PRINCIPLE 8 The Board should foster constructive relationships with shareholders that encourage them to engage with the entity**

The Guardians are a Crown entity and their assets, and the assets of the Fund, form part of the Crown's assets. The Guardians are accountable to Parliament, through the Minister of Finance, for those assets. The Guardians' Statement of Intent for the five years from 2009 to 2014 is published on our website and will be reported against in the Annual Report next year. The Guardians report to the Minister on the Fund and Guardians at those intervals that the Minister may require and currently the Guardians provide a quarterly written report on the Fund's progress.

Under the governing legislation, the Minister 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 the direction in the Annual Report. Any direction given by the Minister must be tabled in Parliament. We received a direction from the Minister in May 2009. The full text of the directive and discussion of our response to it is on page 34.

The Act and the Crown Entities Act 2004 provide more information on the role and responsibility of the Minister and are available on the Fund's website.

**PRINCIPLE 9 The Board should respect the interests of stakeholders within the context of the entity's ownership type and its fundamental purpose**

The Guardians published their Statement of Intent under the Crown Entities Act 2004 in May 2009. This set out the broad parameters of work for the five years from 2009 to 2014 and a detailed plan for FY2009/10.

Objectives set out in the 2008 Statement of Intent are reported on Page 10 of this report.

## Management Team

To ensure high-quality decision-making, our management team operates through a series of internal executive committees. These committees include the:

- Leadership Team: dealing with the business operations of the Guardians;
- Investment Committee: advising on the investment decisions of the Guardians;
- Risk and Portfolio Monitoring Committee: advising on the performance of the Fund and the Guardians' service providers; and
- Communications Committee: advising on all internal and external communication issues.

In planning for growth, we have refined our organisational structure to support the overall business strategy. In particular, we have designed the structure to deliver:

- alignment to the Guardians' strategies and mandate;
- focus on driving performance and accountability;
- clarity around processes within the organisation;
- additional capability;
- support of clear governance;
- leverage of economies of scale and skill across the Guardians; and
- assurance the cost of doing business is managed appropriately.

Below are brief profiles of the Leadership Team.

**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.

**Neil Williams, General Manager Public Markets:** Responsible for investment in listed markets and for the overall Fund investment completion (i.e. the use of derivatives, cash management and rebalancing). Neil joined the Guardians in May 2008 from UBS Global Asset Management in London where he was Global Head of Asset Allocation and a Managing Director in Global Investment Solutions. Neil was previously Chief Global Strategist, Executive Director for Goldman Sachs International (London).

**Matt Whineray, General Manager Private Markets:** Responsible for investment activity, including appointment of investment managers, in alternative assets. Matt joined the Guardians in May 2008 from Credit Suisse (Hong Kong) where he was Head of Financial Sponsor Coverage for non-Japan Asia. Prior to this, Matt was a Managing Director of First NZ Capital and a Vice President at Credit Suisse First Boston (New York). Matt began his career as a Barrister and Solicitor with Russell McVeagh.

**Tore Hayward, General Manager Portfolio Research:** Responsible for overseeing the development and implementation of investment policy. Tore joined the Guardians in January 2006 from AMP Capital Investors (NZ) Ltd, where he was Chief Investment Officer. Tore previously headed the foreign reserves management team at the Reserve Bank of New Zealand. Before that, he led the wholesale investment management operations for the ANZ Bank in New Zealand.

**Adrian Orr**

**Neil Williams**

**Matt Whineray**

**Tore Hayward**

## Governance (continued)


Tim Mitchell


Mark Fennell


Stewart Brooks


Janet Gallagher

**Tim Mitchell, General Manager Corporate Strategy:** Responsible for the Guardians' overall strategy in best-practice activities, including best-practice portfolio management, responsible investment, legal, and communications. Tim joined the Guardians in April 2003. He was previously a consultant to the Board with responsibility for establishing the Fund's infrastructure and policies. 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 Managers, most recently as Chief Investment Officer.

**Mark Fennell, General Manager Operations:** Responsible for developing and overseeing investment operations and information technology. 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 for State Owned Enterprises (Forestry Corporation and NZ Railways Corporation).

**Stewart Brooks, General Manager Finance:** Responsible for financial control, tax, 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.

**Janet Gallagher, General Manager Human Resources:** Responsible for people, performance and culture. 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.

# How We Invest

As set out in previous sections the New Zealand Superannuation Fund has a simple purpose, to reduce the tax burden on future New Zealanders of the cost of New Zealand Superannuation (NZS). Deciding how we as the Guardians must fulfil that purpose, however, is complex.

In the past year the upheaval in global markets has caused us to carefully reconsider every aspect of how we invest the Fund. In parallel, and unsurprisingly, our reasons for investing the way that we do have been equally strongly tested by our many scrutineers in New Zealand and more broadly. Accordingly we thought it worthwhile to revisit in some detail how we invest, as well as reporting on major investment developments in the period.

## How we invest

The Fund's purpose makes two things obvious:

1. This clearly is a long-term objective, so the Fund must be invested so as to grow and produce suitable returns over a long period; and,
2. Many things can, and will, affect the tax burden on future New Zealand taxpayers of the cost of NZS, such as policy settings for retirement and the state of the global and New Zealand's economy. Of these, what the Guardians can influence is the return on the Fund.

A third factor shaping our investment decisions are behavioural constraints both those established in the New Zealand Superannuation and Retirement Income Act 2001 (the Act) as investment duties, and those which we have imposed on ourselves via our mission, vision, values and investment beliefs.

## Investment beliefs and duties

### BELIEFS

The Fund benefits from a number of important endowments directly relevant to our investment philosophy. Our long investment horizon and limited need for liquidity put us in an excellent position to make and benefit from investment decisions not available to many, while having an ability to deal with harsher market and economic conditions without having to revert to forced sales. Our sovereign status confers some benefits in terms of lower tax payable to foreign jurisdictions.

The combination of these factors optimises our chances of long-term investment success. Our investment beliefs which complement and underpin our endowments are set out on the following page and on page 30, where we discuss how our experiences from the past year have caused a refining of our beliefs about manager and investment selection.

## How We Invest (continued)

### Investment beliefs

| Investment Decision | Investment Beliefs | Investment Facts |
|---|---|---|
| Governance and investment objectives | Clear governance and decision-making structures that promote decisiveness, efficiency and accountability are effective and add value to the Fund. | It is important to be clear about investment objectives for the Fund, risk tolerance, and the timeframe over which results are measured. |
| Asset Allocation | Asset allocation is the key investment decision.<br>Investors with a long-term horizon can outperform more short-term focused investors over the long-run. | Risk and return are strongly related.<br>There are varied investment risks that carry premiums/compensations. Illiquidity risk is one such premium.<br>Investment diversification improves the risk to return (Sharpe) ratio of the Fund. |
| Asset class strategy and portfolio structure | Expected returns are partly predictable within asset classes and returns can revert toward a mean over time. | Investment markets are competitive and dynamic, with excess returns very difficult to find and constantly changing source.<br>Market volatility tends to cluster over short horizons but mean-reverts over longer horizons.<br>Investment risks can be unbundled to make the Fund more efficient. This includes the separation of market (beta) and investment specific investment manager skills (alpha). |
| Manager and investment selection (revised, see page 30 for discussion) | True skill in generating excess returns versus a manager's benchmark is very rare. This makes it hard to identify and capture consistently.<br>Some markets or strategies have characteristics that are conducive to a manager's ability to generate excess return.<br>These characteristics tend to evolve slowly over time, although the shorter-term opportunity set that may be available in any market/strategy can vary through the cycle.<br>We believe most excess return is driven by a combination of the research signals the manager is using, the conduciveness of their market to generating excess returns, beta factors and luck.<br>Responsible asset owners who exercise best-practice portfolio management should have concern for environmental, social, and governance (ESG) issues of companies.<br>Improving ESG factors can improve the long-term financial performance of a company. | The more efficient a market is, the more difficult it is for a manager to generate excess return.<br>Research signals and methods used by managers tend to commoditise over time through market forces.<br>In some cases synthetic exposure to a market or factor can provide a guaranteed excess return to the Fund, and this represents an additional hurdle that an active manager must surpass. |
| Execution | Managing fees and costs and ensuring efficient implementation can prevent unnecessary cost. | |

It's important to note that beliefs by themselves are not enough. An organisation must have appropriately conceived and executed strategies to deliver on those beliefs, and appropriate human and technological capabilities to deliver on the strategies.

#### STATUTORY INVESTMENT DUTIES

The Act requires the Fund to be invested on a prudent, commercial basis, 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.

As we have said, our beliefs and duties are important because they fundamentally drive the investment decisions that we make. Other investors will have different externally and internally sourced parameters and this will inform their investment choices.

However while the Act forms expectations of behaviour, none of these factors specify what the Fund must be invested in or how much weight to give to any asset or class of assets.

The Guardians use a pre-investment process to ensure we have the most fit for purpose portfolio and meet our statutory requirements. The process is as follows:

1. We determine a preferred mix of market exposures (our Strategic Asset Allocation) consistent with our investment duty to maximise returns without undue risk over the long-term;
2. We then identify a passive portfolio that includes the relevant market risks consistent with our SAA where possible, noting that not all of the desired risk exposures are available passively or consistent with our investment duty; and
3. We then identify investments and investment activities that we believe will provide superior risk-adjusted returns net of all costs over the long-term, as well as access additional risk premiums (e.g., liquidity and skill) that are not available passively.

Our Fund is thus the most cost-effective and fit-for-purpose available for our investment purposes.

## The Strategic Asset Allocation (SAA)

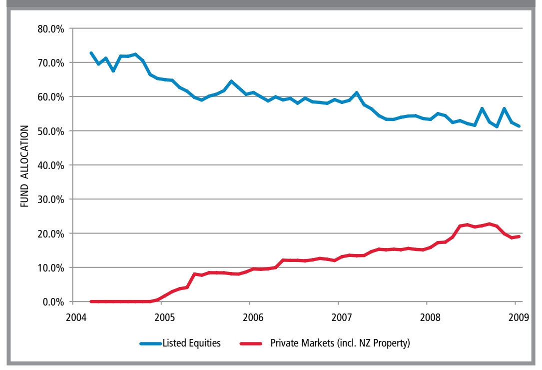
The first step before we invest is to determine a blueprint for an optimal mix of market exposures – our SAA. We design the SAA to maximise our chances of achieving our purpose. This means that the SAA is skewed toward growth assets as they produce higher expected growth returns over time.

Investments of this nature also tend to result in return volatility, particularly in the short-term, as we have indeed seen.

## How We Invest (continued)

Although we consider the balance of risk and return, our risk tolerance can be expressed in terms of expected return – outperforming NZ 90-day Treasury Bills over the long term by 2.5%.

PORTFOLIO: EXPOSURE TO EQUITIES RELATIVE TO PRIVATE MARKETS SINCE INCEPTION




Our purpose of reducing the tax burden on future taxpayers of the cost of New Zealand Superannuation (NZS) is the same as increasing the net wealth of the Crown. To do so we consider what investments we can make across a range of asset classes. We do this efficiently by ensuring our investment allocation delivers the highest expected return for any given level of risk. We then select our SAA by deciding which of these allocations has the most appropriate risk profile.

Key determinants of our SAA are the timing of future withdrawals from the Fund, our limited liquidity requirements, and the desirable risk characteristics of the asset choice. Given that the Fund is part of the core Crown balance sheet, we aim to maximise investment returns measured before New Zealand tax but after foreign tax and expenses.

Our SAA and investment approach involves exposure to market factors that contribute to expected returns in excess of NZ 90-day Treasury Bills rate on average over time. We increase the Fund's portfolio efficiency (i.e. increase the return per unit of risk) by diversifying the Fund across and within various asset classes. The Fund also has exposure to alternative growth assets such as timber and infrastructure, where we believe these can further diversify the Fund's market exposures and add to total portfolio returns

The Fund comprises a broadly diversified portfolio of financial assets. The majority of those are in publicly listed equity markets, although a growing proportion is invested in private markets. This is shown in the graph above left. The Fund has a deliberately high exposure to growth assets whose returns, while potentially volatile in the short term, provide longer-term economic reward for taking risk.

***We have a deliberately high exposure to growth assets whose returns, while potentially volatile in the short term, provide longer-term economic reward for taking risk.***

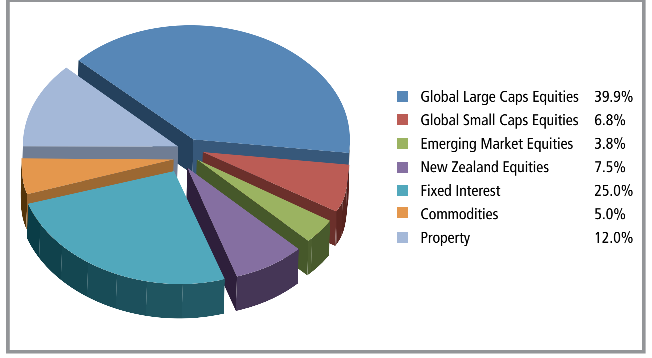
Our SAA represents the mix of investments to which the Fund aspires. However, the actual mix of investments may vary at any point in time, due to factors such as the availability of investment opportunities and pricing of the respective assets. We use public markets assets to proxy for private market exposures to keep the overall risk of the SAA consistent with our desired asset mix.

While there have been limited variations in our SAA through time there is a range of complex questions we address to further improve its efficiency. In addition the underlying assumptions behind the SAA are subject to ongoing review and the theoretical underpinnings of this work are constantly evolving. We have updated the SAA twice: most recently in December 2007. We are working on the next review, the outcome of which will be in our Annual Report for 2010.

## Passive market exposures

Having determined the blueprint for our allocation via the SAA, we also identify a hypothetical portfolio of exposures which are easily available and broadly match the SAA blueprint. We call this the "passive" portfolio because it aims only to replicate market exposures (as does, say, an index tracking fund) and we do not attempt to add value through security selection.

PASSIVE PORTFOLIO AS AT 30 JUNE 2009




Not all of the desired exposures in our SAA can be obtained that way. In particular, there is no generic exposure to replicate part or all of the Fund's desired private market exposures (e.g. in timber). Accordingly it is not possible to build and implement with 100% passive exposures what is set out in the SAA blueprint.

To overcome that limitation we 'proxy' the private market exposures with passive public market exposures. The combination means we have a hypothetical structure that both substantially matches the SAA blueprint and could be implemented at least cost.

However, as we've discussed, a passive portfolio can only go so far in matching our blueprint and, most important, serving our purpose. To meet our mandate we invest in an actual portfolio, utilising active management.

## Active management

We actively invest directly through the selection of investment managers or assets, as well as strategically tilt, and indirectly through the various processes that are required to support and monitor such activities. It is in this area that our investment beliefs come sharply into play.

**Investing in private markets.** The SAA targets 20% in private markets which include a diverse set of assets ranging from timber to private equity to infrastructure. Our use of public market 'proxies' allows us the flexibility to vary the actual private market exposure over time, depending on opportunities, while keeping the risk profile of the Fund broadly unchanged. Most of our investing in private markets is undertaken by external managers on our behalf. Private markets investing is complex and the barriers to entry to the best assets and best managers are relatively high. Individual transactions must be assessed on their merit and often involve complex legal arrangements and have particular tax structures. Investing in private markets exploits our long time horizon and low need for liquidity.

**Active manager selection.** In public markets we identify managers who we believe can add value, over and above a passive benchmark, through active security selection. In some cases these managers will be constrained to select securities from a narrowly defined universe (New Zealand listed equities managers are a case in point) and may hold more or less of a particular security than that in a passive market portfolio. In other cases the managers are less constrained and may select from a broader universe. Some managers are "market-neutral" so called because they hold both positive and negative exposures to securities and markets with the

## How We Invest (continued)

intention of removing the market exposure from their portfolio while benefitting from market anomalies and inefficiencies. The events of the past financial year have caused us to carefully review this aspect of adding value – see page 30.

**Strategic tilting.** Strategic tilting exploits our belief that returns from asset classes are partially predictable over the long term. Strategic tilting involves developing a robust integrated framework for projecting the expected long-term returns from certain asset classes and tilting to, or away from, our SAA target weights when those expected returns are unusually high or low. Because we are looking for unusual price signals, strategic tilts will be implemented relatively infrequently. All decisions relating to strategic tilting are made in-house. Tilting was first implemented in the final quarter of 2009.

**Implementation efficiency.** There are a number of unavoidable costs when investing and these must be taken into account in any decision. These include the impact on securities prices when we invest or divest – this is particularly relevant in relatively small markets like New Zealand – as well as changing prices for cash management and derivatives management (including foreign exchange, equities, fixed interest and commodities). We have developed a Treasury unit to manage a number of our in-house investment activities and that unit is also responsible for identifying implementation gains that can be secured. An ongoing focus is to maximise the efficiency of implementation and portfolio completion.

**Responsible Investment.** In addition to specifically value adding work we also actively deviate from the passive portfolio by making decisions in line with our Responsible Investment Policy a copy of which can be found on our website. To date the most visible face of this policy has been the various securities we have excluded from the Fund's allowable universe. Those securities cover such activities as tobacco, whaling, cluster munitions and nuclear explosives manufacture and nuclear testing. We deal in more detail with Responsible Investment on pages 45-50.

Finally, our Act requires that we establish, and adhere to, a Statement of Investment Policies, Standards and Procedures (SIPSP) for the Fund that is consistent with our mandate. The SIPSP must cover issues ranging from classes of investment, benchmarks, reporting standards, operational and accounting issues, ethical investment and proxy voting. We publish our SIPSP on the Fund's website.

## The composition of our passive portfolio

In the below chart we set out how the passive portfolio is structured. We have made a distinction between how the various asset classes are weighted in our reference portfolio and the Fund's actual economic exposure to those asset classes. The reasons why they differ include:

- changes in valuations
- that we have strategically tilted the Fund toward or away from a particular asset class
- that as explained more fully above, some passive exposures are achieved through index funds, futures contracts and over-the-counter derivative contracts which do not involve actual exposure.

| PASSIVE ASSET CLASS | PASSIVE PORTFOLIO AT 30 JUNE 2009 | BENCHMARK RETURN YTD | BENCHMARK RETURN SINCE INCEPTION | ACTUAL WEIGHTING AS AT 30 JUNE 2009 |
|---|---|---|---|---|
| Global large cap equities | 39.9% | (24.5%) | 4.3% | 35.2% |
| Global small cap equities | 6.8% | (23.2%) | 3.4% | 6.3% |
| Emerging markets equities | 3.8% | (15.5%) | 12.0% | 3.6% |
| New Zealand equities | 7.5% | (10.6%) | 5.7% | 6.3% |
| Fixed interest | 25.0% | 11.2% | 8.3% | 16.2% |
| Commodities | 5.0% | (49.3%) | (3.9%) | 4.7% |
| Property | 12.0% | (32.4%) | (1.5%) | 10.9% |
| PASSIVE PORTFOLIO | 100.0% | (18.2%) | 4.3% | 83.2% |
| Private markets weightings | | | | |
| Private markets | NA | NA | NA | 16.8% |
| TOTAL PORTFOLIO ACTUAL RETURN | NA | (22.1%) | 3.8% | 100% |

How We Invest
(continued)

## What happened in the portfolio in 2008/09?

### EXTERNAL MANAGER SELECTION

It was not a good year for active management. Disappointing returns from active management, in both benchmarked and market-neutral strategies, were a common experience for investors. Of course, managers were operating in the worst market for decades. We saw the following forces at work:

First, all markets were performing poorly. This impacted our active managers by injecting considerable 'noise' into valuation signals across asset classes, making strategy assessments of value very difficult and sometimes impossible.

Second, there was general market dysfunction. The deep and broad reach of the crisis meant that access to liquidity was difficult and expensive. Assessing creditworthiness was also a significant challenge. Both of these things are crucial for markets and investment strategies to function well. The dysfunction also meant that our investment managers were facing liquidity demands from their other, less-liquid, investors putting further strain on their business viability.

Third, regulatory responses to the crisis, such as the ban on short selling, meant that managers saw some investment opportunities reduced, or the cost of the opportunities increased, removing the business rationale. It also meant that some standard arbitrage strategies came to a halt.

Finally, because of the magnitude and breadth of the crisis market correlations that should not usually occur, did. Correlations increased between the returns of the Fund as a whole, and the returns of our multi-strategy managers. These correlations appear to have been driven by the across-the-board poor market performance, regulatory responses and general credit market dysfunction discussed. No doubt there were other common factors driving disappointing returns, but they were largely indistinguishable given the sheer scale of disruption.

### WHERE WE ARE NOW

At the end of the financial year, we look back from a position where:

- 'normality' is returning to markets whereby liquidity is more readily available and credit markets have settled; and
- we remain objective in evaluating likely future returns from our managers, who continue to have a wide opportunity set i.e., we have kept our long-term focus.

For the Guardians the decision to use an active manager is a carefully considered commercial judgement. The process for deciding who will manage the Fund's capital is publicly disclosed on our website.

We have reviewed our existing managers, our appointment process and our own assumptions about whether managers add value and how they do that. The main outcome of this is a refining and deepening of our investment beliefs as they apply to manager selection. We have identified the revised beliefs on page 24.

In essence we have concluded that choosing a good manager remains necessary for investment success but it is only one ingredient. The market being invested in, and the investment strategy being used, are also important. We will now focus our judgement more on what makes a good active management environment. This involves assessing the characteristics of a market or strategy that is conducive to generating excess returns; what constitutes a good investment strategy; and what the best ways are to enter and to exit particular investments and markets.

*For the Guardians the decisions to use an active manager is a carefully considered commercial judgement.*

Placing more structured emphasis on these factors means that we complement manager selection. Ultimately we retain the belief that active management can produce positive returns over time. Time is the crucial element. As we have often said, the Fund is a long-term value proposition. In relation to managers, this means that we must have a high conviction that each manager we appoint will both exceed the testing hurdles we set for them and generate a return which, over time, is in excess of the fees that we pay them.

Along with that conviction goes our ability to terminate relationships with investment managers when our expectations are not met.

### PRIVATE MARKETS

We say 'private markets' when we mean 'alternative' investments, where we access a liquidity premium by transacting outside of listed markets in larger volume than some benchmarks dictate. Included in this category, therefore, are a range of publicly listed and private unlisted assets, across various asset classes.

We also invest in private markets to diversify from public markets. Over the long term we expect the benefits of this to be clear. In the short term, especially in times of stress, this benefit is less obvious. In such times, public markets influence private markets, often because they are the best or only regular frame of reference for an appropriate valuation for private market assets (i.e. 'marked-to-market' valuations).

With reference to the Fund's holdings in private markets, most infrastructure investments are in listed equities, such as Auckland International Airport Limited and Transurban Group Limited. Similarly, many property investments are in listed Real Estate Investment Trusts. As well, and as we've discussed, because comparable listed entities in public markets represent the best available frame of reference for valuation, the upheaval in public markets has also had an impact on valuations in the private equity portfolio.

The corollary of this is also demonstrated within the Fund's timber holdings. Of all the asset classes represented in the Fund they have produced the best returns to 30 June 2009. Timber also has the lowest correlation to the returns of the public markets (and therefore to the returns of the rest of the Fund's portfolio).

However, while we acknowledge the linkages to public markets performance, the extent of their relevance is limited. This is because private markets holdings are long-term and what really matters is that we continue to have high conviction that our managers buy well, add value and exit skillfully, over that investment horizon.

Consequently the real relevance to private markets of the influence on public markets upheaval is in the opportunities it presents to buy well. Quality assets are more

## How We Invest (continued)

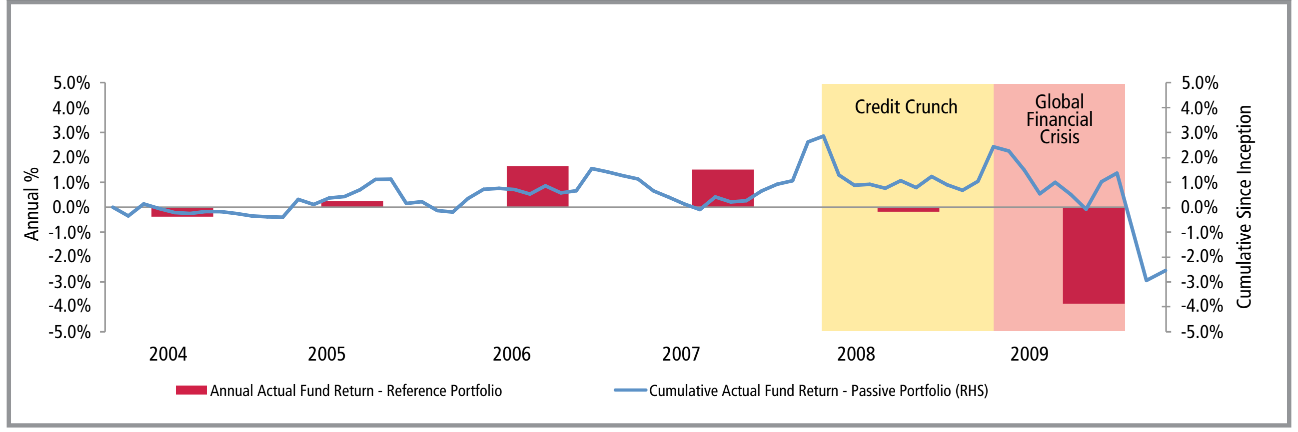
attractively priced and we believe will become still more so. The current environment is a particularly good time to begin private markets investment programmes. Fortunately, the Guardians have been able to launch two such programmes, in real estate and private equity, at a time when we can commit the Fund's capital to an environment not subject to such severe volatility. This is very positive for a long-term investor such as the Guardians.

Drivers were increases in valuations for our timber holdings, offset by marked-to-market write-downs in the valuations of our infrastructure and private equity holdings. As discussed above, marked-to-market valuations are not realised losses. The value of a private market asset is realised at the time it is bought and sold.

### COLLECTIVE INVESTMENT FUND

In October 2008, in the midst of the global financial crisis, Moody's altered their rating methodology in that any collective investment fund (CIF) that held a security below 'investment grade' required full credit support. Moody's action resulted in the immediate suspension of an 'AAA' rated CIF used by our securities lending agent. In response, and with the advantage of our in-house expertise and long investment horizon, we transferred the securities from this CIF into the Fund, where we now manage them as a small part of our wider credit portfolio. Upon transfer we wrote them down by $187m on a marked-to-market basis.  Subsequently the market value of these securities has improved. We made a deliberate decision to not have direct exposure to sub-prime assets. The presence of such assets within the CIF – which is a pool of collateral received as the proceeds of lending securities – was an indirect exposure that we will now manage as part of our normal business.

**ACTUAL vs PASSIVE PORTFOLIO SINCE INCEPTION**




**Note: We instituted the Passive Portfolio measure in 2006/07. It has been estimated for prior years.**

## Actual and Passive Portfolio Returns

The above chart sets out the difference between the Fund's Actual return and our Passive portfolio since inception – both on an annual and cumulative basis. The scale of the turbulence caused by the global financial crisis is clear.

The difference between the Actual return and the Passive portfolio is a combination of: the unavoidable costs of completing a portfolio compared to a simplistic (and under-cooked in times of severe financial turbulence) 30 basis point estimate for the cost of managing and administering the Passive portfolio; and the returns generated by our investment managers and by asset selection, including strategic tilting (i.e., our active investment decisions).

Since inception the Actual Fund return was 3.8% per annum, compared to 4.3% for our estimated Passive portfolio. This negative difference is entirely the result of performance in the FY08/09 year.

Focusing further on 2009: of the difference between the Actual and Passive portfolios, roughly three-quarters is due to unavoidable costs related to completing the portfolio in times of severe financial turbulence i.e., portfolio 'drift' in the asset class weights, as the Actual Fund was buffeted by dramatic equity price and currency changes on a daily basis; benchmark mismatches where investment indices that were previously good component indices of larger aggregates deviated widely; the marked-to-market write down of the Collective Investment Fund discussed above; and the inclusion of unallocated costs related to passive management of equities in transition, as we wound down managers into passive portfolios.

Such costs are, in more normal times, significantly smaller and would usually be offsetting over time. Compounding these costs was also the strong positive correlation that developed between the NZ dollar and global equity market returns during the crisis. The positive correlation in times of rapid market price adjustments further increased asset class 'drift'.

This interaction would have imposed the same significant costs on the Passive portfolio, however these have not been captured in the comparator.

## How We Invest (continued)

The other one-quarter of the difference between the Actual and Passive portfolio return in 2009 relates to the combination of excess returns generated by our investment managers and by our own investment activities. This is discussed above and can be summarised as a tough year for those operating investment strategies in listed markets, a reasonable year for some of our private markets activities, and a good performance by us in terms of strategic tilting – which commenced in February 2009. We also maintained sound liquidity throughout this period, thus avoiding the largest costs of realising under-valued assets. We also remained disciplined with regard to assessing our managers and the opportunity set that has opened up for them. More recently these managers have performed strongly.

### We think in terms of decades

| Horizon period | Why is it important to the Guardians? |
|---|---|
| 3 months | Appropriate milestones for monitoring of investment manager performance |
| 1 year | Meet statutory duty to provide financial reports to the Crown |
| Minimum 5-10 years | Core period for review of Strategic Asset Allocation and to assess value-add and excess return |
| 10-20 years | Key period for judging the impact of Fund returns on the Fund's objective and of our long-term value-add strategies |
| >20 years | Withdrawals begin. Consistent with our longer-term mandate |

### Managers and Custodian as at 30 June 2009

| EXTERNAL INVESTMENT MANAGERS AND CUSTODIAN | 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 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Adams Street Partners | | | | | | | | | | | | ✓ | | | |
| AMP Capital Investors | ✓ | | ✓ | | | | | | | | | | | | |
| AMP Pencarrow (No. 2) Limited | | | | | | | | | | | | ✓ | | | |
| Apax Partners | | | | | | | | | | | | ✓ | | | |
| AQR Capital Management | | | | | | | | ✓ | | | | | | | |
| AXA Rosenberg Investment Management Limited | | | | | ✓ | | ✓ | | | | | | | | |
| Barclays Global Investors Australia Limited | | | | ✓ | | | | ✓ | | | | | | | |
| Bridgewater Associates, Inc. | | | | | | | | ✓ | | | | | | | |
| CP2 | | | | | | | | | | ✓ | | | | | |
| Coller Capital | | | | | | | | | | | | ✓ | | | |
| Direct Capital Management Limited | | | | | | | | | | | | ✓ | | | |
| GMO LLC | | | | ✓ | ✓ | | | ✓ | | | | | | | |
| GMO Renewable Resources | | | | | | | | | | | | | ✓ | | |
| Goldman Sachs Asset Management, L.P. | | | | | | | | ✓ | | | | | | | |
| Hancock Timber Resource Group, Inc. | | | | | | | | | | | | | ✓ | | |
| HarbourVest Partners | | | | | | | | | | | | ✓ | | | |
| Kohlberg Kravis Roberts & Co | | | | | | | | | | | | ✓ | | | |
| ING NZ Limited | | ✓ | | | | | | | | | | | | ✓ | |
| LSV Asset Management Limited | | | | ✓ | | ✓ | | | | | | | | | |
| Morrison & Co. Funds Management Limited | | | | | | | | | | ✓ | | | | | |
| Northern Trust Company | | | | | | | | | | | | | | | ✓ |
| Numeric Investors LLC | | | | | ✓ | | | ✓ | | | | | | | |
| Overlay Asset Management | | | | | | | | | | | | | | ✓ | |
| Sterling Johnston Capital Management Limited | | | | | ✓ | | | | | | | | | | |
| Thompson, Siegel & Walmsley, Inc. | | | | | ✓ | | | | | | | | | | |
| Vanguard Investments Australia Limited | | | | | | | | | ✓ | | ✓ | | | | |

How We Invest (continued)

## Investing in New Zealand

In May 2009 we received a direction from the Minister of Finance which stated:

*It is the Government's expectation, in relation to the Fund's performance, that opportunities that would enable the Guardians to increase the allocation of New Zealand assets in the Fund should be appropriately identified and considered by the Guardians.*

Early in June 2009 we responded and indicated we would:

*"..investigate whether we can establish new management arrangements in selected areas, including small-to-medium sized infrastructure opportunities and the provision of recapitalisation and expansion capital facilities for NZ companies.*

*We may, subject to suitable opportunities arising, explore rural and land-based investment, investments within State Owned Enterprises, and larger infrastructure opportunities."*

We also said that we would report on our progress against the directive, in our Annual Reports. This is the first such report.

As we said in our response to the directive, the challenge will be around giving careful consideration to opportunities for investing in New Zealand – particularly on how they can be accessed.

Given the unpredictable nature of future commercial, prudent, investment opportunities, we are unable to offer an assurance as to how much, if at all, the Fund's New Zealand assets will increase.

As at 30 June 2009 we have the following New Zealand Investments:

| Asset | NZD Value (millions) | % of Fund |
|---|---|---|
| Cash | 692.8 | 5.4% |
| Auckland International Airport Limited | 191.2 | 1.5% |
| Equities | 690.4 | 5.4% |
| Fixed Income | 145.6 | 1.1% |
| Private Equity | 47.8 | 0.4% |
| Property | 292.2 | 2.3% |
| Timber | 991.1 | 7.8% |
| Swaps/Other | 12.2 | 0.1% |
| TOTAL | $3,071.4[5] | 23.8% |

5. Total balance differs to note 20 (E) of the Fund financial statements as this balance includes cash but excludes forward foreign exchange contracts.

The following table summarises activity from the previous quarter to 30 June 2009, during which the Minister issued the directive. We note that much of the activity was underway before the directive.

However we believe that the table is a useful indication of the potential size of the opportunity for the Fund with respect to a particular focus on direct investment in New Zealand.

| New Commitments/ Investments Made | Outstanding Commitments | Commitments Under Consideration | Opportunities Reviewed |
|---|---|---|---|
| $150 million | $273 million | c. 3% of the Fund | 23 |

We note the following about the preceding table:

1. New Commitments/Investments Made includes all investments made in New Zealand assets in the previous quarter, including amounts drawn under existing fund commitments and direct investments made by the fund
2. Outstanding commitments includes all undrawn commitments under New Zealand private markets investments, including Direct Capital III and IV, AMP Pencarrow, the Morrison & Co mandate, the Morrison & Co PIP fund (in principle commitment) and the GMO timber mandate
3. Commitments under consideration includes the aggregate estimated investment under the strategies currently being developed/reviewed
4. Opportunities reviewed is the number of new deal/fund opportunities reviewed in relation to NZ investments in the previous quarter definition to be refined.

### *Work on investment mandates*

We are completing research on the potential benefits to the Fund of some asset classes which may fulfil the requirements of the directive and our statutory duty to invest on a prudent, commercial basis. In particular, expansion capital and rural exposures. We are also looking into how to effectively access other potential asset bases.

### EXPANSION CAPITAL

We believe that there is an opportunity to provide expansion capital to small and medium sized growing businesses in New Zealand, and believe that this market is currently underserved. We are currently reviewing the size of the market opportunity and the best method to access it.

We believe that this is likely to be by way of selecting new external managers to be focused on this opportunity, which is not currently addressed by our existing New Zealand investments in Direct Capital Fund IV (our investments in Direct Capital Fund III and the AMP Pencarrow fund being largely invested at this stage).

The expected size of the opportunity is in the region of 1% of the Fund over the medium term.

### RURAL LAND

We are currently developing a rural land strategy, reviewing the scope and relative merit of investment in rural land, both domestically and internationally. We have met with numerous prospective New Zealand fund managers looking to raise capital to invest in this area. We expect to complete our review of the rural land opportunity in the next few months.

If we decide that the asset class has merit and, further, decide to concentrate our investment in New Zealand, we believe that the size of the opportunity will be at least 1.0% - 2.0% of the Fund to achieve the desired diversification.

### NEW ZEALAND DIRECT INVESTMENT

Our investment activity to date has been undertaken by external managers. However, when it comes to larger New Zealand transactions (which will change the NZ concentration to a greater extent than the strategies described above), we believe that these investments will usually be more effectively managed with in-house resource.

We are therefore in the process of recruiting additional private markets team members to run the New Zealand direct investment strategy, which will be focused on those investments which clearly match the Fund's particular characteristics as an investor, i.e. our New Zealand domicile, its size, our government connection and long investment horizon. This focus will ensure that we are properly compensated for the concentration of the Fund in New Zealand and for the inevitable illiquidity that this type of strategy will entail.

These new personnel will be responsible for coordinating the search for, and analysis of, New Zealand investment opportunities and, in conjunction with external advisors, the execution of those transactions (outside those which will be addressed by our existing managers) and the ongoing management of those positions.

Given the inevitable 'lumpiness' of transactions of the type we contemplate under this strategy, the impact on NZ concentration of the Fund is hard to forecast.

# What You Own

Each year we provide a detailed breakdown on our website of the companies and businesses in which we have invested as at 30 June. On this page you can see some of the New Zealand and global investments present in the Fund, returns from which are contributing to our objective of reducing the tax burden on future New Zealand taxpayers of the cost of New Zealand Superannuation.

**King Salmon**
**New Zealand**
**Global aquaculture**
**Held via: Direct Capital III**

**Samsung**
**Korea**
**Consumer electronics**
**Held via: equities mandates**

**Laureate Education Inc.**
**United States of America**
**Global online and university education provider**
**Held via: KKR 2006 Fund**

**BHP Billiton**
**United Kingdom**
**Steel**
**Held via: equities mandates**

**Marks & Spencer**
**United Kingdom**
**Retailer**
**Held via: equities mandates**

**Botany Town Centre**
**New Zealand**
**Shopping Centre**
**Held via: investment in AMP Capital Property Portfolio**

**Phil & Teds**
**New Zealand**
**Baby strollers and buggies**
**Held via: investment in AMP Pencarrow Fund**

**Amazon.com Inc**
**United States**
**Online retailer**
**Held via: equities mandates**

**Bharti Infratel Limited**
**India**
**Telecommunications infrastructure provider**
**Held via: KKR Asia Fund**

## What You Own (continued)

# CASE STUDIES:

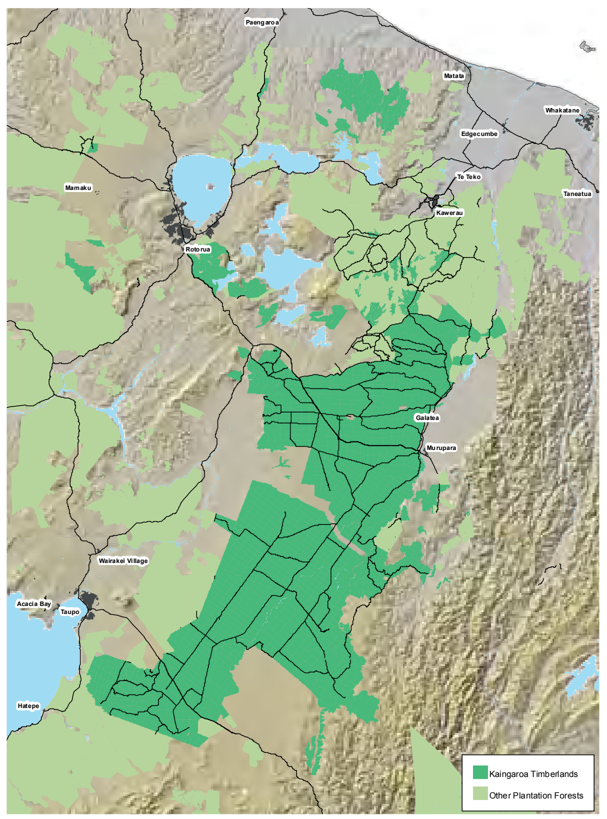
## Kaingaroa Timberlands Forestry Estate

In October 2006 the Guardians announced an agreement with the Harvard Management Company to acquire a minority interest in the Kaingaroa forest (Kaingaroa). Since then the Guardians have acquired additional shares with the result that as at 30 June 2009 our interest in Kaingaroa is 40%.

The Guardians' interest is in the tree crop rather than the underlying land, which is owned by local iwi. United States-based GMO Renewable Resources is the investment advisor for both Harvard and the Guardians, and Rotorua-based Timberlands Ltd manages the forest.

Kaingaroa is the Guardians' largest single investment. Timber as an asset class is attractive to the Guardians due to its long-term nature and relatively low levels of volatility compared with some other asset classes. Kaingaroa is widely recognised as one of the premier softwood plantations in the world given its attractive growth rates, location to markets and port, extensive infrastructure and low cost structure.

Kaingaroa is located in the Central North Island of New Zealand between Taupo and Rotorua. A map of the estate is below. It covers around 178,000 hectares of planted forest, the bulk of which is Radiata Pine, with a small quantity of Douglas Fir. The estate is managed in an environmentally sustainable manner and is registered under the strict international Forest Stewardship Council (FSC) certification standard. Kaingaroa provides direct employment for several hundred people from local communities, and this will increase in the medium term as harvest levels increase from the current 1.6 million $m^3$/year to a sustainable level of around 4 million $m^3$/year.




In June this year the New Zealand Government announced the 'Treelords' settlement, which transfers ownership of a quantity of land including the majority of the land underlying the Kaingaroa forest, from the Crown to a collective representing 100,000 Maori from eight iwi. Previous settlements have occurred on the remainder of the land. To the Guardians this simply means a change of landlord for Kaingaroa from the Crown to local iwi.

We have established a positive and useful dialogue with iwi representatives and are discussing with them options for replanting the land once the forest is harvested.

## Transurban Group Ltd


The Guardians' 3.2% interest in Transurban Group Ltd is valued at $216.4 million at 30 June 2009 and is consequently our largest single offshore equities holding.

Transurban Group is an investor, financier and manager of global toll roads. It is the largest toll road business in Australia with a portfolio of seven roads, six in Australia (including a significant interest in all of the toll routes ringing the Sydney metropolitan area as is shown in the map below) and one in the southeast of Richmond, Virginia in the United States. Transurban also has two projects under construction – a lane widening of its existing CityLink toll road in Melbourne and the installation of HOT (High Occupancy Tolled) lanes to a road in northern Virginia. HOT lanes are a congestion management tool that allows the toll rate to vary through the day depending on congestion, and drivers can choose whether to use those lanes or not. Buses, motorcycles, emergency vehicles and vehicles with more than three occupants can use the lanes for free.

The attraction of toll roads as an investment is that they are long-term, they produce stable and predictable cash flows over those periods and they can provide excellent protection against inflation.

## Life settlements

This year the Guardians invested some $80 million in life settlements. Life settlements are where an insured person transfers the payout benefit of their life insurance policy to a third party, in order to realise a significantly greater than usual surrender value for the policy than from the original insurer. The third party maintains the premiums and receives the payout when the insured person dies. The investment improves the diversification of the Fund as the returns from life settlements are uncorrelated with returns from financial markets.

The Guardians do not own individual policies. Rather, the Fund's exposure is a contract underpinned by a pool of policies. It remains the case that the returns from the portfolio are directly linked to deaths.

The portfolio consists entirely of policies belonging to insured people in the United States where life settlements regulation has been tightened due to ethical concerns relating to privacy, transparency of documentation and manipulation of the insured people.

The Guardians are very conscious of these concerns and the investment sourcing process has a number of safeguards accordingly. These include ensuring that each insured person has their own advisor; that the insured's spouse and all beneficiaries named in the policy sign the transfer document and that the investment manager has a 'closing call' with the insured to ensure they have understood the transaction before it is finalised.

# Value For Money

Another important financial measure for the Guardians is our total cost structure, expressed as a ratio of total costs to the value of the Fund.

As we have said, the ultimate measure of the extent to which we are fulfilling our purpose is the long-term return to the Fund, net of all costs and foreign taxes. Clearly, managing costs is an important element of that. This is because we believe that we can enhance the Fund's returns through active management. To support that belief, we must outperform an entirely passive, low-cost portfolio, which is simpler to implement.

## Benchmarking

We believe it is worthwhile to benchmark our cost structure against like funds with similar risk profiles who also actively manage. We subscribe to a global benchmarking service that does this – CEM Benchmarking Inc. (CEM).

The most recent CEM survey assesses cost effectiveness for the four years ended 31 December 2008. A total of 290 funds participated and 20 funds from Australia, Canada, Europe and the United States were in our peer group.

The survey concludes that the New Zealand Superannuation Fund is low-cost relative to our peer funds and to all other surveyed funds.

We note that CEM uses a different definition of added value than do we. CEM's definition is the difference between gross (i.e. pre-fees and tax) Fund return and gross policy return ('policy return' is the equivalent of our low-cost, passive portfolio return). Our definition is the difference between our net (i.e. net of fees, pre-tax) Fund return and our net passive portfolio – or 'reference portfolio' return.

Regardless of the different definitions, CEM measured every fund on the same basis so the survey remains a useful basis for comparison.

The survey found:

**Value added +0.2%**

This is positive, as it is above the global median and at our peer median.

**Excess cost an average of -2.8bps per year**

Again positive as it is significantly below our peer costs. CEM attributed this to having a lower-cost implementation style of investment than our peers and to having paid less for similar mandates than our peers.

**Net value added (value added less average costs over the four years) -0.3%**

Consistent with our peers.

# Risk Management

A key discipline is risk management. Our approach to this involves the Board, our staff and our external partners. We view a risk as any factor that may inhibit or prevent the Guardians achieving the outputs and outcomes we are striving for. As such, good management of such risks comprises mitigation where it is both possible and makes business sense, or being rewarded for bearing these risks when mitigation is not possible or practical.

We have developed risk management policies, procedures, and other internal controls for application by our staff, external investment managers, and other expert service providers. We monitor compliance with the relevant policies and procedures as well as compliance by external managers. Risk management is further supported by our Code of Conduct including conflict of interest procedures, defined roles and responsibilities and individual and collective accountability processes. Our five major risk categories are:

**Investment risk:** The risk inherent in achieving investment goals and objectives, including market, credit, and liquidity risk.

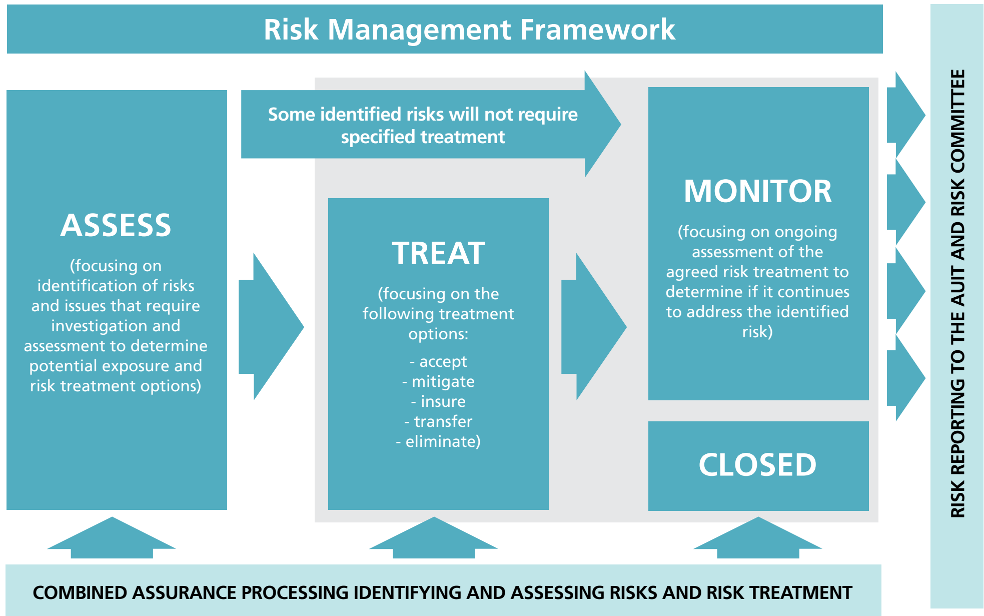
**Strategic risk:** The risk that we make inappropriate strategic choices or are unable to successfully implement selected strategies.

**Legislative and regulatory risk:** The risk of loss due to non-compliance with actual or proposed laws, rules and regulations and prescribed industry practices.

**Operational risk:** The risk of loss from inadequate or failed internal processes, people or systems, or from external factors.

**Reputation risk:** Risk of loss of reputation or credibility due to internal or external factors.

The diagram on the following page sets out our risk-management framework.




## Our Growth Exposure

The Fund is a very large pool of assets – larger than any single Kiwisaver fund. Our long-term investment horizon and our purpose means it is far better to have our money at work.

There are significant differences between the Fund and a balanced fund (and in fact the vast majority of other funds of any sort). Most important, the Fund has a long-term purpose and is not anticipating any withdrawals until at least 2031. It does not have to 'pay out' before that time. This means that the Fund's portfolio is weighted towards growth assets and requires far less liquidity than a balanced fund, which may have to pay out at any time to its investors.

Also important is that because the Fund's money comes only from Government contributions and the returns it generates on those contributions, it does not have to 'market' itself to attract capital. For other funds, most 'marketing' is done by promoting their short-term returns relative to their competitors. This need to focus on relative short-term performance has a significant impact on the composition of a portfolio and on how often that composition is changed to produce that performance. We should have no such pressure and hence design our investment activity to maximise our returns, without undue risk, over the long horizon.

# Responsible Investment

## What is Responsible Investment?

Like many institutional investors, the Guardians invest with a long-term focus. We recognise that environmental, social, and governance (ESG) issues are long-term factors that can be highly relevant to investment performance.  ESG issues present regulatory, market, reputational, and operational risks and opportunities shareholders need to consider to fully understand the companies in which they invest.

Responsible investment (RI) is the integration of ESG considerations into investment management practices in the belief that these factors can have an impact on financial performance.

***We recognise that environmental, social, and governance (ESG) issues are long-term factors that can be highly relevant to investment performance.***

The Guardians believe ESG analysis should be integrated into traditional investment analysis across asset classes, and mainstreamed into the investment process.

We see an opportunity in developing the investment strategy for the Fund to systematically consider ESG issues, with the objective to better manage long-term risks and maximise investment opportunities. This aligns with our two core RI beliefs:

1. Responsible asset owners who exercise best-practice portfolio management should have concern for environmental, social, and governance (ESG) issues of companies; and
2. Improving ESG factors can improve the long-term financial performance of a company.

## Responsible Investment (continued)

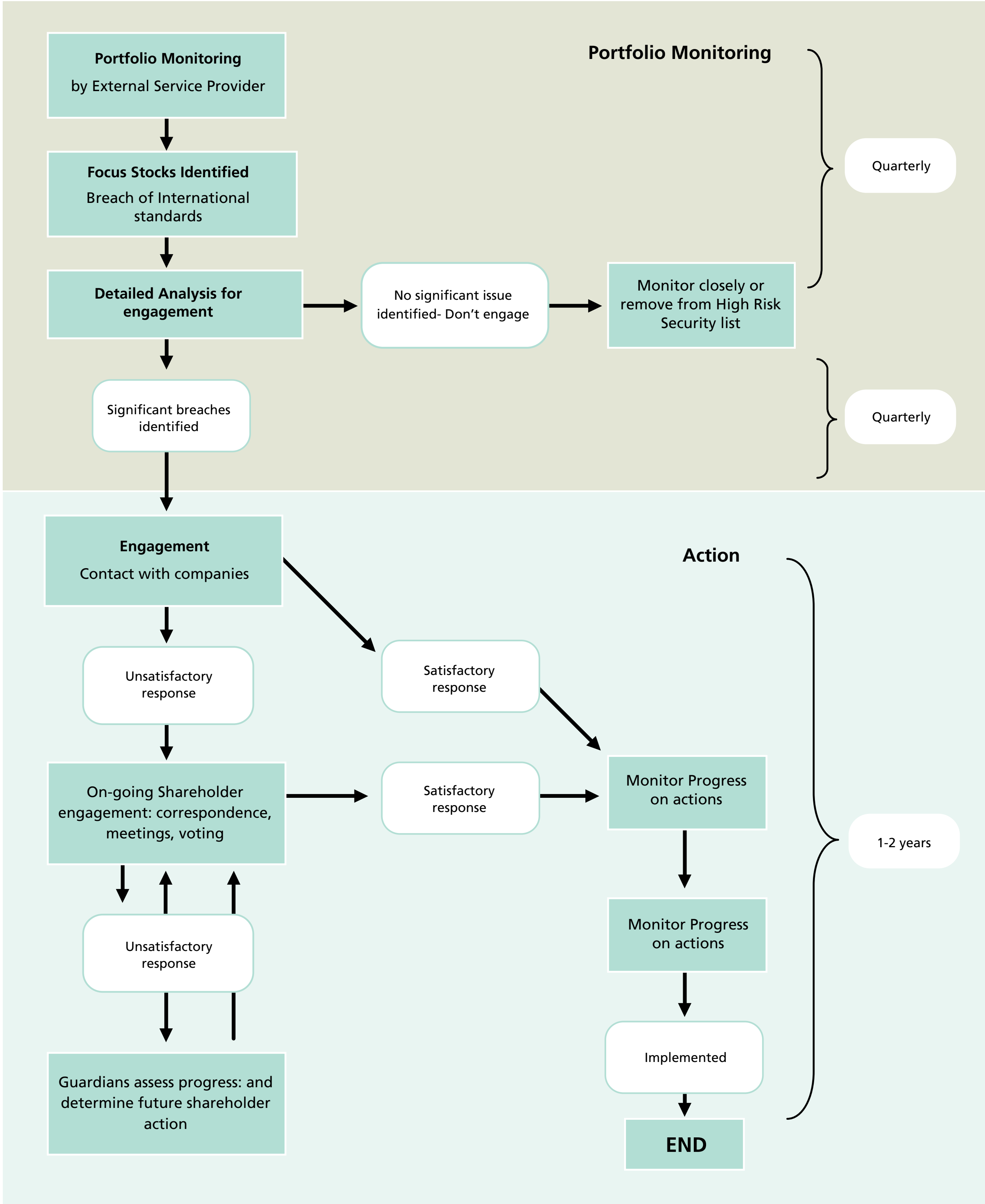
## Engagement

Our portfolio monitoring currently identifies companies that might breach internationally recognised ESG standards. We assess the information provided by our screening agency or from other sources to determine whether we should include the company in our engagement programme. The key factors we consider when prioritising engagement include:

- Whether the breach is of international standards or represents a high ESG risk and the significance of the breach:
  - Long-term or short-term
  - Historic or ongoing
  - Isolated or endemic
  - Degree of public interest and potential reputation risk internationally or nationally
- Our ability to participate in collaboration through the UNPRI clearinghouse led by others or as a co-lead;
- Our ability to engage directly with the company;
- Potential effectiveness of engagement; and
- Resources required.

The table on the following page outlines a process and timeframe for managing our engagement programme. This highlights how we need to plan and allocate resources when conducting engagement.

**Fig 1: Guardians' ESG Engagement Process**



## Responsible Investment (continued)

### Integration – Private Equity example

"Private equity" (PE) is a broad term encompassing a range of strategies for investing in companies not traded on public stock exchanges. Investors typically pursue private equity investments by pooling their capital, with other investors, in a fund under the management of a private equity firm with a defined strategy. The fund typically requires the investors to commit their capital for a long period. In this partnership structure the manager of the fund is called the General Partner (GP) and the investors who have pooled their capital are called Limited Partners (LP).

***Over the past year we have focused considerable effort on influencing the private equity industry as a whole.***

In respect of all investments, private equity or otherwise, the Guardians believe that the boards and management of investee companies are best aligned with the interests of long-term investors, when they do a good job of managing risks, including ESG risks. Examples of ESG risks may include a poor health and safety record or a sector with high exposure to bribery and corruption.

Historically, there has been little transparency or reporting on these issues to LPs. As an LP we have rarely had the right of veto over individual investments in pooled funds when ESG concerns arise. Nor have we had the ability to set specific ESG standards. Over the past year, we have therefore, along with other investors, focused considerable effort on influencing the private equity industry as a whole. If GPs integrate ESG considerations into their normal investment process, this will have a far broader impact across all private equity funds, than can be achieved by negotiating individual conditions.

The case study below highlights our private equity collaboration.

## CASE STUDIES:

### Working with a Private Equity investment partner

Direct Capital is one of our New Zealand investment managers with whom we have an investment through the Direct Capital III Fund. Direct Capital III's investments are typically in mid-sized companies requiring capital to expand. This year, prior to investing in Direct Capital's next fund, Direct Capital IV, we widened the scope of our internal due diligence to include RI criteria. We focused on three key areas:

1. Did Direct Capital include ESG risks and opportunities in their due diligence process?
2. What ongoing attention was given to these issues post-investment?
3. What was their communication and involvement with LPs on these issues?

We reviewed two major investments in depth: a fish-farming company and a transport investment, to assess how ESG factors were addressed. Direct Capital appeared to have the environmental

## CASE STUDIES:

**Working with a Private Equity investment partner** (continued)

and health and safety aspects in hand, hiring external consultants to conduct assessments, assess actions and calculate costs. Our due diligence established that it would not be difficult for Direct Capital to enhance their investment and reporting process to incorporate ESG considerations more fully.

We discussed with Direct Capital including ESG conditions in the terms of the Direct Capital IV Fund. They saw this as an opportunity, not only to improve investment management, but also to meet the evolving expectations of their broader local market.

*"It is a natural step for Direct Capital to fully integrate environmental, social and governance factors into our investment management and to report on these to our Limited Partners. We only see this as positive for investors and companies alike"* said Mark Hutton, Director, Direct Capital.

The Fund's investment with Direct Capital has now integrated RI standards into due diligence, monitoring and reporting requirements as follows:

Direct Capital IV will ensure that the due diligence in respect of each investment includes consideration of environmental, social (including health and safety, employees, human rights, consumer and community issues) and governance risks.

Direct Capital IV has included a commitment, in respect of each Portfolio Company, to monitor and report to LPs on:

(i) any plans of that Portfolio Company to address, manage or minimise any environmental or social (including health & safety, employee, human rights, consumer and community issues) issues arising from their operations which were identified by the GPs during due diligence of the Portfolio Company or which otherwise come to the attention of the General Partner;

(ii) that Portfolio Company's compliance with the principles of the UN Global Compact; and

(iii) the governance of that Portfolio Company.

As the Guardians are a significant investor in Direct Capital IV our influence is stronger than it might be with international PE Funds. While it is still rare to see integration of ESG factors included explicitly in private equity funds, we see our collaboration with Direct Capital as evidence that the industry is changing.

## Responsible Investment (continued)

### Guardians helps drive new world-wide initiative on corporate behaviour

We played a key role in an initiative to encourage listed companies around the world to adopt international standards on human rights, working conditions, the environment and anti-corruption.

This global shareholder initiative was organised by a group of 52 investors who manage around US$4 trillion in assets. The group wrote to nearly 9000 listed companies asking them to sign the United Nations Global Compact. We are part of the steering group responsible for the campaign.

Our RI Policy adopts the United Nations Global Compact as a key standard against which to monitor corporate practice. It underlines our commitment as shareholders to encourage better corporate practices across global markets.

The Global Compact enshrines universally accepted standards such as the United Nations Declaration of Human Rights. Those standards provide a framework to help companies manage environmental risks, employee conditions, societal concerns and the risk of corruption, and incorporate these into their business strategies and risk management.

We believe that businesses that embrace such standards perform best over the long term.

The initiative was launched in London in October 2008 by the UNPRI and the Global Compact.

### Decision to exclude cluster munitions and nuclear explosive devices

In December 2008 the Guardians decided to exclude from the Fund companies associated with the manufacture of cluster munitions and the manufacture or testing of nuclear explosive devices.

The Fund divested from stocks in six companies involved in the manufacture of cluster munitions, one of which is also involved in the simulated testing of nuclear explosive devices. The Fund has divested from another company involved in simulated testing. The Fund does not, and has never, held shares in any company that manufactures nuclear explosive devices.

The announcement of the decision followed the New Zealand Government joining with 93 other nations in signing an international treaty banning the production or use of cluster munitions, and a comprehensive review of the nuclear weapons issue.

As part of the same decision we decided not to exclude those companies involved in other aspects of nuclear weaponry. To assist those interested in the issue to further understand how we came to our conclusions we published to our website the policy analysis, including legal opinions we received as part of our policy decision.

We will continue to review the Fund's portfolio through specialist screening agencies to ensure our list of excluded companies remains up-to-date.



# Equal Employment Opportunities

We recognise the benefits to our organisation of having a breadth of skills and experience among our employees. We also recognise the benefits of being able to recruit, retain and develop high-quality people. To us this means our people must enjoy and feel safe in their workplace; trust the processes and procedures around their development, recognition, promotion and exit; and be enthused about and professionally satisfied by their roles.

The Guardians have put particular emphasis this year on developing our company vision of "a great team building the best portfolio" and on our shared values of integrity, innovation and inclusiveness. We strongly believe that by focusing our team in these areas we will succeed in both achieving our long term business goals, and continuing to improve our Good Employer and Equal Employment Opportunity (EEO) practices.

*The Guardians have put particular emphasis this year on developing our company vision of "a great team building the best portfolio" and on our shared values of integrity, innovation and inclusiveness.*

To ensure all employees and prospective employees are treated with integrity, fairness and respect, we have best practice policies and programmes in place to ensure equal employment opportunities are available to all. Employee participation has been promoted in the development of these policies, with particular emphasis on Good Employer initiatives to ensure the Guardians meets our objective of being an employer of choice. The Guardians review all people policies on an annual basis.

## 1. Leadership, Accountability and Culture

Throughout the year we have consulted and engaged with focus groups of our team, on our company culture. We have greatly benefited from a "whole of business" approach to building and maintaining a culture of excellence. This initiative, along with the roll-out of our leadership development programme, has laid a solid platform for growth. Throughout the coming year we will apply base metrics to each of these activities, such as individual and organisational 360° reviews, and regularly monitor our performance against those metrics. This will make any areas for improvement more obvious and will allow us to tackle those areas in a targeted way.

Our performance management system, which includes quarterly one-on-one discussions, accountabilities, competencies, key performance indicators, annual performance reviews and calibration processes, has been established to ensure our diversified workforce is treated fairly and equitably, at every stage of the performance review process.

## EEO (continued)

## 2. Recruitment, Selection and Induction

During the past year the Guardians team has experienced significant growth with key talent joining us from both within New Zealand and globally. Our policies and practices have been developed and implemented to ensure the selection process removes all barriers that may preclude minority groups. We advertise all vacancies internally and our three-month induction and follow-up induction programme for new employees is well established.

Our staff turnover and absenteeism figures remain low, which is positive. An area for our ongoing attention on is the split between male and female employees. We have found recruiting women in the traditionally male-dominated area of financial markets a challenging exercise. We will continue to monitor our progress and ensure that we are giving potential female employees an open and honest chance of working for the Guardians, in part by continuing to receive internal staff feedback.

**Employee Development, Promotion and Exit**

We have a number of activities in place for employee development, promotion and exit. They are as follows:

- an individual development plan programme based on core competencies and capabilities;
- a company-wide training plan developed to ensure that as an organisation we have the capacities to deliver against the Guardians' key priority of maximising our ability to attract, retain, motivate and manage our people;
- internal promotions based on merit; and
- exit interviews in place for all departing employees.

## 3. Flexibility and Work Design

The Guardians encourage family-friendly work practices and supports good work-life balance by way of flexible working arrangements for one third of staff, increased flexibility for expectant mothers, technology in place to support those working from home, along with processes for time off in lieu.

## 4. Remuneration, Recognition and Conditions

The Guardians' remuneration policies have been developed to ensure that the remuneration system is transparent, gender neutral, fair and equitable for all employees. This is achieved in practice, through participation in biennial market remuneration surveys and annual calibration exercises.

## 5. Harassment and Bullying Prevention

The Guardians are committed to preventing harassment and bullying in the workplace. Zero tolerance policies have been developed in conjunction with clear guidelines for the management of harassment complaints. Other activities include quarterly feedback sessions reviewed by Human Resources and the availability of relevant policies and the Employee Code of Conduct to all employees.

## 6. Safe and Healthy Environment

The development of sound occupational health and safety policies and procedures is an integral part of our ongoing commitment to the health and well-being of our employees. Key activities in place include:

- Staff participation on the Health and Safety Committee;
- First aid, civil defence and building warden training;
- Fire evacuation training;
- The annual review of health and safety practices as per our independent health and safety audit;
- Ergonomic assessments for all employees; and
- Fresh fruit made available to all employees as a healthy snack alternative.

As part of regular reporting requirements, we monitor and report on the profile of our workforce. As at 30 June 2009, the workplace profile for the Guardians is detailed as follows:

| **Headcount (FTE)** | **56.2** | |
|---|---|---|
| Full-time (FTE) | 54 | |
| Part-time (FTE) | 2.2 | |
| **Gender** | | |
| Women | 15.2 | 27% |
| Men | 41 | 73% |
| **Senior Management** | | |
| Women | 4.8 | 29% |
| Men | 12 | 72% |
| **Age** | | |
| Under 20 | 0 | 0% |
| 20 – 29 | 8 | 14% |
| 30 - 39 | 27 | 47% |
| 40 – 49 | 20 | 35% |
| 50 – 59 | 2 | 4% |
| Over 60 | 0 | 0% |
| Undeclared | 0 | 0% |

# An Environmental Policy for the Guardians

Although we have integrated environmental considerations into our Responsible Investment Policy, until recently we had no environmental policy for our own organisation. In April 2009 we prepared an environmental policy statement and developed an environmental action plan.

The environmental policy sets out high-level commitments to manage and improve the Guardians' environmental performance. An internal environment team has been set up to implement the policy. The policy states:

*The Guardians are committed to understanding and managing the environmental impact of our activities. Through our individual and collective actions, we will continuously strive to safeguard our natural environment for future generations. As part of this commitment, we aim to measure and reduce;*

- *our consumption of energy and resources;*
- *our greenhouse gas emissions; and*
- *the amount of waste we produce.*

*We will implement this environmental policy through an environmental action plan which outlines a structured approach to assessing how our operations impact on the environment and identifies clear actions for improving our performance.*

*Our core business is investment management and one of our core beliefs is that responsible asset owners should have concern for environmental, social and governance issues of companies. Our Responsible Investment Policy integrates environmental considerations into our investment processes.*

An environmental action plan is under development which will set out the specific detail and processes to manage and improve our environmental performance. We will report on its progress and implementation in future Annual Reports.

## Footprint calculation

The Guardians' main direct consumption of energy and resources arise from our office and our travel. We used power bills, taxi receipts and travel data to produce our base line Guardians' greenhouse gas 'footprint' as below. We will be working to reduce our annual emissions per person and will provide updates on our progress in ensuing Annual Reports.

| GREENHOUSE GAS EMISSIONS TO 30 JUNE 2009 | | |
|---|---|---|
| ACTIVITY | GREENHOUSE EMISSIONS (tonnes) | EMISSIONS PER PERSON (tonnes) |
| Power usage | 20.2 | 0.36 |
| Taxi usage | 7.3 | 0.13 |
| Flights | 569.4 | 10.13 |
| TOTALS | 596.9 | 10.62 |

**NOTES**

1. As at 30 June 2009 the Guardians had 56.2 staff (54 full-time and 2.2 part-time)
2. Taxi data represents 4.4 tonnes for a 5.0-litre taxi and 2.9 tonnes for a 4.0-litre taxi
3. Travel represents all domestic and international air travel
4. All emissions calculations were done via the Climate Friendly greenhouse gas emissions calculators available at www.climatefriendly.com

## Waste audit

We conducted a waste audit of one week's worth of refuse from our main Auckland office which produced a total of $1.2m^3$ of waste. We express waste in this way because cubic metres represent the amount of space occupied in a landfill – the weight of the waste is not relevant to this. Of this 95% was recyclable – the majority of it (90%) being paper. We are focusing our efforts on ensuring all of this paper is recyclable.

# Overview of the Financial Statements

## Fund Revenue

Dividend income, interest income, and timber sales remained relatively static compared with the prior year. Fair value changes in investments were a marked-to-market loss of $4.3 billion as a result of the worldwide financial market downturn. This paper loss was partially offset by foreign exchange gains of $669 million and income from the Fund's associate, Kaingaroa Timberlands Partnership, of $144 million.

*Tax*

The Fund has recognised a tax credit for the year of $408 million, largely due to tax losses on derivatives. The use of these tax losses is dependent on the Fund making future taxable profits, as well as the Fund retaining its taxable status in New Zealand. The Fair Dividend Regime sees the Fund pay tax on average assets held rather than the return on those assets. This is discussed in more depth in the notes to the Fund financial statements.

## Fund Expenses[6]

Total expenses in the graph below include governance and other costs which are funded by appropriations from the Crown. These have declined over the year as a proportion of funds under management and in total.

Base manager fees have increased largely due to movements in exchange rates during the year. Manager fees are paid quarterly and a substantial portion of fees are paid in US Dollars.

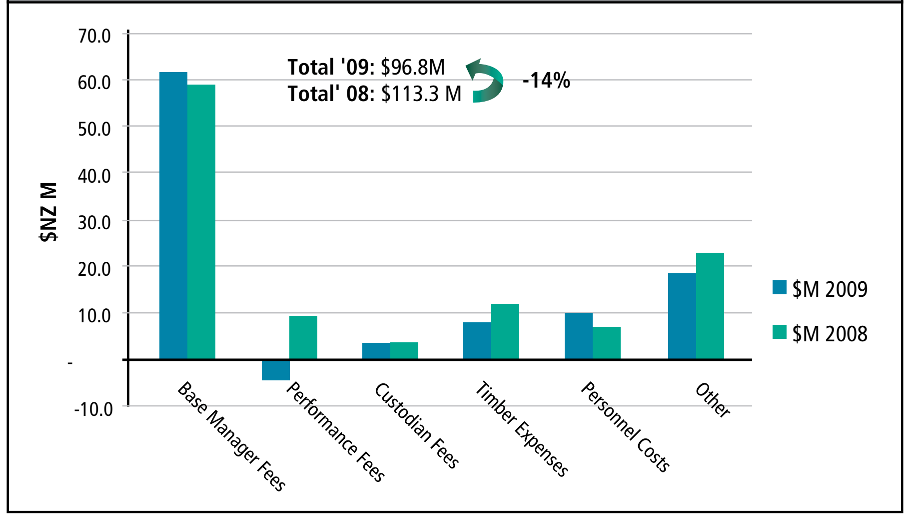
Performance fees which were accrued in the prior year have reversed due to lower-than-expected results, leading to a credit in our statement of financial performance.

Personnel costs have increased due to the increase in headcount.

Other operating expenses contain trading and brokerage expenses, loss on the sale of land and advisor costs. Advisor costs have decreased in the current year as more internal capability has been built and investment management has consequently been brought in-house.

6. Please note that this graph does not reconcile with expenses disclosed in the accounts (at note 2). The accounts also include a loss on the sale of land related to forestry holdings. The graph does not include this loss as, while for accounting purposes the loss must be treated as an expense, economically it is equivalent to a loss on financial assets. The specific, one-off loss is $7.5 million. We note that the loss is relative to the marked-to-market value of the land at the time of the sale rather than to the purchase price of the land. In fact the sale price exceeded the purchase price by in excess of $27 million.

FUND EXPENSES BY TYPE




## Change in Net Assets under Management

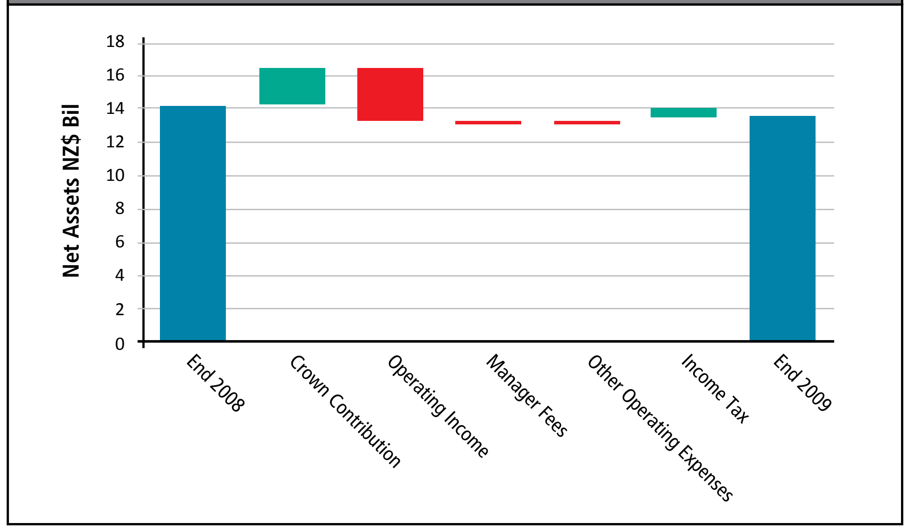
Total net assets declined during the year by $0.5 billion. This comprised Crown contributions, market-to-market losses on investments, operating expenses and income tax accruals. From an opening position of $14.2 billion (post-tax) the Fund's net assets declined to $13.7 billion (post-tax) at market value.

The total capital contribution from the Crown during the current year was $2.2 billion. Pursuant to the announcement in the 2009 Budget, we are assuming that other than the one-off $250 million contribution received on 1 July 2009, there will be no further contributions until 2020.

Investment income and operating expenses had a net negative impact of $3.2 billion. We also recognised a credit for New Zealand tax of $408 million.

Since inception, the Crown has contributed $14.6 billion. This has translated, since inception and including investment returns, to $13.4 billion of net assets under management and $1.2 billion tax paid to the Crown.

MOVEMENT IN NET ASSETS FY2008/09



# Financial Statements

## Contents

# 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 2009 fairly reflect the financial position, operations, and cash flows of the New Zealand Superannuation Fund and Group.

David May

**DAVID MAY**
Chairman
14 September 2009

**ADRIAN ORR**
Chief Executive Officer
14 September 2009





# Statement of Financial Performance

For the year ended 30 June 2009

| | | GROUP ACTUAL | | BUDGET |
|---|---|---|---|---|
| | | 2009 | 2008 | 2009 |
| | Note | NZ$000 | NZ$000 | NZ$000 |
| Interest income | 2(a) | 114,356 | 124,574 | 118,807 |
| Dividend income | | 232,890 | 233,240 | 267,861 |
| Timber sales | 4 | 18,767 | 19,994 | 32,713 |
| Fair value changes in investments at fair value through profit or loss | 3 | (4,261,761) | (1,340,659) | 1,013,931 |
| Net foreign exchange gain/(loss) | | 669,107 | 289,645 | - |
| Fair value changes in timber investments - forests | 4 | (33,204) | (18,876) | 7,845 |
| Share of profit of investments accounted for using the equity method | 7(f) | 144,200 | 80,408 | 38,376 |
| Other income | | 18,365 | 6,884 | 4,624 |
| **NET OPERATING INCOME/(LOSS)** | | **(3,097,280)** | **(604,790)** | **1,484,157** |
| Operating expenses | 2(b) | 103,946 | 111,670 | 157,813 |
| **PROFIT/(LOSS) FOR THE YEAR BEFORE INCOME TAX EXPENSE** | | **(3,201,226)** | **(716,460)** | **1,326,344** |
| Income tax expense/(credit) | 6 | (408,140) | 164,287 | 319,594 |
| **PROFIT/(LOSS) FOR THE YEAR AFTER INCOME TAX EXPENSE** | | **(2,793,086)** | **(880,747)** | **1,006,750** |

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

# Statement of Financial Position

As at 30 June 2009

| | Note | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and cash equivalents | 19 | 1,060,920 | 324,103 | 1,651,947 |
| Trade and other receivables | 8 | 536,580 | 215,855 | 95,757 |
| Other assets | 9 | 59 | 61 | - |
| **Investments** | | | | |
| Investments - derivative financial instrument assets | 7 | 1,073,820 | 84,435 | 6,691 |
| Investments - other financial assets | 7 | 10,213,968 | 13,167,046 | 15,067,294 |
| Investments accounted for using the equity method | 7 | 837,648 | 510,228 | 634,819 |
| Timber investments - forests | 7 | 138,988 | 259,630 | 386,846 |
| Total investments | | 12,264,424 | 14,021,339 | 16,095,650 |
| Taxation receivable | | - | 125,307 | - |
| Deferred tax asset | 6 | 371,490 | - | - |
| Property, plant, and equipment | 10 | 50,517 | 101,386 | 83,385 |
| Intangible assets | 11 | 255 | 187 | - |
| **TOTAL ASSETS** | | **14,284,245** | **14,788,238** | **17,926,739** |
| **LIABILITIES** | | | | |
| Trade and other payables | 12 | 411,036 | 227,291 | 112,210 |
| Derivative financial instrument liabilities | 7 | 149,923 | 267,011 | - |
| Taxation payable | | 33,434 | - | - |
| Provisions | 13 | 1,943 | 40,185 | 66,991 |
| Deferred tax liability | 6 | - | 41,828 | 39,769 |
| **TOTAL LIABILITIES** | | **596,336** | **576,315** | **218,970** |
| **NET ASSETS** | | **13,687,909** | **14,211,923** | **17,707,769** |
| **PUBLIC EQUITY** | | | | |
| Retained surplus/(deficit) | | (945,884) | 1,818,870 | 3,091,115 |
| Foreign currency translation reserve | | (6,435) | (21,097) | (24,133) |
| Land revaluation reserve | | 8,149 | 24,071 | 10,734 |
| Contributed capital | 15 | 14,632,079 | 12,390,079 | 14,630,053 |
| **TOTAL PUBLIC EQUITY** | | **13,687,909** | **14,211,923** | **17,707,769** |

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

# Statement of Changes in Public Equity

For the year ended 30 June 2009

| | Note | FOREIGN CURRENCY TRANSLATION RESERVE NZ$000 | LAND REVALUATION RESERVE NZ$000 | CONTRIBUTED CAPITAL NZ$000 | RETAINED SURPLUS/(DEFICIT) NZ$000 | TOTAL NZ$000 |
|---|---|---|---|---|---|---|
| **Balance at 1 July 2007** | | **(24,620)** | **10,734** | **10,287,079** | **2,699,617** | **12,972,810** |
| Gain on revaluation of property, plant, and equipment | | | 19,835 | | | 19,835 |
| Deferred tax on revaluation | | | (6,498) | | | (6,498) |
| Translation of foreign operations | | 5,259 | | | | 5,259 |
| Deferred tax on translation | | (1,736) | | | | (1,736) |
| Net income recognised directly in equity | | 3,523 | 13,337 | - | - | 16,860 |
| Loss for the year | | | | | (880,747) | (880,747) |
| Total recognised income and expense for the year | | 3,523 | 13,337 | - | (880,747) | (863,887) |
| Fund capital contributions from the Crown | | | | 2,103,000 | | 2,103,000 |
| Capital contributions from the Crown in respect of funding the net cost of New Zealand superannuation entitlements | 15 | | | 7,348,172 | | 7,348,172 |
| Capital withdrawals by the Crown in respect of funding the net cost of New Zealand superannuation entitlements | 15 | | | (7,348,172) | | (7,348,172) |
| **Balance at 30 June 2008** | | **(21,097)** | **24,071** | **12,390,079** | **1,818,870** | **14,211,923** |
| Gain on revaluation of property, plant, and equipment | | | 3,194 | | | 3,194 |
| Deferred tax on revaluation | | | 9,216 | | | 9,216 |
| Transfer to retained surplus/(deficit) on disposal of property, plant, and equipment | | | (28,332) | | 28,332 | - |
| Translation of foreign operations | | 22,294 | | | | 22,294 |
| Deferred tax on translation | | (7,632) | | | | (7,632) |
| Net income/(loss) recognised directly in equity | | 14,662 | (15,922) | - | 28,332 | 27,072 |
| Loss for the year | | | | | (2,793,086) | (2,793,086) |
| Total recognised income and expense for the year | | 14,662 | (15,922) | - | (2,764,754) | (2,766,014) |
| Fund capital contributions from the Crown | | | | 2,242,000 | | 2,242,000 |
| Capital contributions from the Crown in respect of funding the net cost of New Zealand superannuation entitlements | 15 | | | 7,744,149 | | 7,744,149 |
| Capital withdrawals by the Crown in respect of funding the net cost of New Zealand superannuation entitlements | 15 | | | (7,744,149) | | (7,744,149) |
| **Balance at 30 June 2009** | | **(6,435)** | **8,149** | **14,632,079** | **(945,884)** | **13,687,909** |

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 2009

| | Note | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | | |
| **Cash was provided from:** | | | | |
| Dividends received | | 229,301 | 221,591 | 267,861 |
| Interest received | | 138,743 | 118,141 | 118,807 |
| Receipts from customers | | 21,124 | 22,632 | 37,337 |
| Miscellaneous income | | 5,138 | 5,142 | - |
| Income taxation received | | 162,494 | - | - |
| **Total cash inflow from operating activities** | | **556,800** | **367,506** | **424,005** |
| **Cash was applied to:** | | | | |
| Managers' fees | | (61,770) | (56,678) | (73,621) |
| Payments to suppliers | | (66,859) | (50,267) | (62,665) |
| Income taxation paid | | - | (407,273) | (319,594) |
| Goods and Services Tax | | (65) | (1,107) | - |
| **Total cash outflow from operating activities** | | **(128,694)** | **(515,325)** | **(455,880)** |
| **NET CASH PROVIDED BY/(USED IN) OPERATING ACTIVITIES** | 19(c) | **428,106** | **(147,819)** | **(31,875)** |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | | |
| **Cash was provided from:** | | | | |
| Proceeds from sale of investments | | 15,388,512 | 11,270,947 | 15,112,545 |
| Proceeds from sale of property, plant, and equipment | | 58,165 | - | - |
| Proceeds from sale of timber investments - forest | | 120,955 | - | - |
| **Total cash inflow from investing activities** | | **15,567,632** | **11,270,947** | **15,112,545** |
| **Cash was applied to:** | | | | |
| Purchases of investments | | (17,290,235) | (13,130,704) | (16,059,497) |
| Purchases of property, plant, and equipment | | (1,308) | (5,032) | (3,923) |
| Purchases of intangible asset | | (224) | (199) | - |
| Purchases of associates | | (182,503) | (125,412) | (125,109) |
| **Total cash outflow from investing activities** | | **(17,474,270)** | **(13,261,347)** | **(16,188,529)** |
| **NET CASH PROVIDED BY/(USED IN) INVESTING ACTIVITIES** | | **(1,906,638)** | **(1,990,400)** | **(1,075,984)** |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | | |
| **Cash was provided from:** | | | | |
| Capital contributions from the Crown | | 2,242,000 | 2,103,000 | 2,240,000 |
| **NET CASH PROVIDED BY/(USED IN) FINANCING ACTIVITIES** | | **2,242,000** | **2,103,000** | **2,240,000** |
| **Net increase/(decrease) in cash and cash equivalents** | | **763,468** | **(35,219)** | **1,132,141** |
| Cash and cash equivalents at the beginning of the financial year | | 324,103 | 363,030 | 519,806 |
| Effects of exchange rate changes on the balance of cash held in foreign currencies | | (26,651) | (3,708) | - |
| **CASH AND CASH EQUIVALENTS AT THE END OF THE FINANCIAL YEAR** | 19(a) | **1,060,920** | **324,103** | **1,651,947** |

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 2009

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### GENERAL INFORMATION

These are the 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.

Under section 43 of the Act, 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 on a fortnightly basis for the purpose of investment, and funding the net cost of New Zealand superannuation entitlements. 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 Fund is domiciled in New Zealand and the address of its principal place of business is set out in the Corporate Directory on page 125.

### STATEMENT OF COMPLIANCE

The Fund is a profit-oriented entity. The financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP). They comply with the New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS), as appropriate for profit-oriented entities. The financial statements also comply with International Financial Reporting Standards (IFRS).

The financial statements for the year ended 30 June 2009 were authorised for issue in accordance with a resolution of the Board of Guardians of New Zealand Superannuation on 14 September 2009.

### BASIS OF PREPARATION

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

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

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

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Standards and interpretations that have recently been issued or amended but are not yet effective have not been adopted for the annual reporting period ended 30 June 2009. The standards and interpretations applicable to the Fund are outlined in the table below.

| REFERENCE | TITLE | SUMMARY | APPLICATION DATE OF STANDARD* | IMPACT ON FINANCIAL STATEMENTS | APPLICATION DATE FOR GROUP* |
|---|---|---|---|---|---|
| NZ IFRS 8 | Operating Segments | New standard replacing NZ IAS 14 Segment Reporting, which adopts a management approach to segment reporting. | 1 January 2009 | NZ IFRS 8 is a disclosure standard so will have no direct impact on the amounts included in the Group's financial statements. However, the amendments may have an impact on the Group's segment disclosures as segment information included in internal management reports is more detailed than is currently reported under NZ IAS 14 Segment Reporting. | 1 July 2009 |
| NZ IAS 1 (revised) | Presentation of Financial Statements | Introduces a statement of comprehensive income. Other revisions include impacts on the presentation of items in the statement of changes in public equity, new presentation requirements for restatements or reclassifications of items in the financial statements, changes in the presentation requirements for dividends and changes to the titles of the financial statements. | 1 January 2009 | The amendments are expected to only affect the presentation of the Group's financial statements and will not have a direct impact on the measurement and recognition of amounts under the current NZ IAS 1. The Group has not determined at this stage whether to present the new statement of comprehensive income as a single or two statements. | 1 July 2009 |
| NZ IFRS 3 (revised) and NZ IAS 27 (amended) | NZ IFRS 3 Business Combinations (revised) and NZ IAS 27 Consolidated and Separate Financial Statements (amended) | NZ IFRS 3 (revised) introduces a number of changes in the accounting for business combinations that will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs, and future reported results. NZ IAS 27 (amended) requires that a change in the ownership interest of a subsidiary is accounted for as an equity transaction. Therefore, such a change will have no impact on goodwill, nor will it give rise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by a subsidiary as well as the loss of control of a subsidiary. | 1 July 2009 | The changes introduced by NZ IFRS 3 (revised) and NZ IAS 27 (amended) must be applied prospectively and will affect future acquisitions and transactions with a minority interest. | 1 July 2009 |





# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

| REFERENCE | TITLE | SUMMARY | APPLICATION DATE OF STANDARD* | IMPACT ON FINANCIAL STATEMENTS | APPLICATION DATE FOR GROUP* |
|---|---|---|---|---|---|
| Amendments to International Financial Reporting Standards** | Amendments to IFRS 7 | The amended IFRS 7 requires fair value measurements to be disclosed by the source of inputs, using the following three-level hierarchy:<br>- Quoted prices in active markets for identical assets or liabilities (Level 1)<br>- Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices) (Level 2)<br>- Inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3) | 1 January 2009 | The amendments are expected to only affect the presentation of the Group's financial statements and will not have a direct impact on the measurement and recognition of amounts under the current NZ IFRS 7. | 1 July 2009 |

* Designates the beginning of the applicable annual reporting period.

** Pronouncements that have been issued by the IASB and IFRIC but have not yet been issued by the FRSB.

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

**(a) 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 changes 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 changes in public equity.

**(b) 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 capital withdrawals by the Crown in respect of funding the net cost of superannuation entitlements and is recorded in the statement of changes 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's financial statements.

## Notes to the Financial Statements (continued)

For the year ended 30 June 2009

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

**(c) Income tax**

In accordance with Section 76 of the Act the Group 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 Group under the Income Tax Act 2007.

The income tax expense recognised for the year is based on the accounting surplus, adjusted for permanent differences between accounting and tax rules together with the movement in deferred tax for the year.

Current tax is calculated by reference to the amount of taxes payable or recoverable in respect of the taxable profit or tax loss for the year. It is calculated using tax rates and tax laws that have been enacted or substantively enacted at balance date. Current tax for current and prior periods is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

Deferred income tax is provided on all temporary differences at balance date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences:

(i) except for a deferred income tax liability arising from the initial recognition of goodwill;

(ii) except where the deferred income tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

(iii) in respect of taxable temporary differences associated with investments in subsidiaries, associates, and interests in joint ventures, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets, and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax assets, and unused tax losses can be utilised:

(i) except where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

(ii) in respect of deductible temporary differences associated with investments in subsidiaries, associates, and interests in joint ventures, except that deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred income 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 income tax asset to be utilised.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to 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. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Income tax relating to items recognised directly in equity is recognised in equity and not in the statement of financial performance.

**(d) Financial instruments**

The Group is party to financial instruments as part of its normal operations. These financial instruments include cash and cash equivalents, derivatives, 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. Purchases or sales of financial instruments that require delivery within the time frame generally established by regulation or convention in the marketplace are recognised on the trade date, i.e., the date that the Group commits to purchase or sell the instrument. Derivatives are recognised on a trade date basis. 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.







## Notes to the Financial Statements (continued)

For the year ended 30 June 2009

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)



**(e) Investments**

| Investments are represented by the following: | **KEY** |
|---|---|
| - Financial assets at fair value through profit or loss (either designated at fair value through profit or loss or held for trading): | |
| - Equities | i) |
| - Fixed interest securities | ii) |
| - Derivatives | iii) |
| - Collective investment funds | iv) |
| - Certain private equity investments | v) |
| - Unlisted unit trusts | vi) |
| - Available for sale financial assets at cost: certain private equity investments | vii) |
| - Investments accounted for using the equity method (refer accounting policy (h)) | |
| - Timber investments - forests (refer accounting policy (i)) | |

**Initial recording**

Financial instrument investments (other than investments accounted for using the equity method and available for sale financial assets) are initially recognised at fair value on a trade date basis. Transaction costs, for example trading commission, are expensed immediately in the statement of financial performance.

**Subsequent measurement**

Subsequent to initial recognition, these investments are recorded at fair value and are classified into the category "at fair value through profit or loss". The Guardians manage and evaluate the performance of these investments on a fair value basis in accordance with the Fund's investment strategy and information about the investments is provided internally on this basis to the Guardians' key management personnel. Changes in fair value are recognised in the statement of financial performance.

Interest earned is accrued in income according to the terms of the contract, while dividend income is recorded when the right to payment has been established.

**Determination of fair value**

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:

i) Listed equities are valued at the last quoted bid price on the relevant exchange as of the close of business at balance date. The fair value of unlisted equities is determined using a variety of methods, including independent valuations, valuation models based on the price of recent investments, earnings multiples, or discounted cash flows.

ii) Highly liquid fixed interest securities are valued at the last quoted bid price by a reputable pricing vendor or broker as of the close of business at balance date. Where the market for fixed interest securities is illiquid, prices are determined by a reputable pricing vendor who uses models to value these securities. The models can utilise a variety of 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 those values estimated for the illiquid securities may differ from those values that would have been used had a ready market for those securities existed and those differences may be significant.

iii) Fair value for derivatives is outlined under "Derivatives" below.

iv) Investments in collective investment funds (unlisted investment funds) are valued at the last price of the unit or security as provided by the administrators at balance date. The price is based on the fair value of the underlying net assets or securities of the relevant collective investment fund.

v) Investments in certain private equity funds (unlisted investment funds), which are designated at fair value through profit or loss, are valued at the last price of the unit or security as provided by the investment managers or administrators at balance date. The price is based on the fair value of underlying net assets of the private equity fund. Fair value is determined using a variety of methods, including independent valuations, valuation models based on the price of recent investments, earnings multiples, or discounted cash flows. Certain private equity funds are classified as available for sale. The accounting policy for these investments is outlined under vii).

vi) Investments in unlisted unit trusts are valued at the last bid price of the unit or security as provided by the administrators at balance date. The price is based on the fair value of the underlying net assets or securities of the relevant unlisted unit trust.

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

**(e) Investments (continued)**

vii) Certain private equity funds that do not have a quoted market price in an active market and whose fair value cannot be reliably measured using the valuation methods outlined in v) above are classified as available for sale and are measured at cost less impairment. Transaction costs are included in the cost of the investment. Management has determined that fair value for these funds cannot be reliably measured where the fund's financial statements have not been prepared under either IFRS or a recognised and reliable accounting basis such as US GAAP.

**Derivatives**

The Group enters into a variety of derivative financial instruments to manage its exposure to foreign currency risk, and achieve exposure to assets and asset classes. The use of derivatives is governed by the Fund's Statement of Investment Policies, Standards and Procedures as approved by the Guardians, which provides written principles on the use of derivatives by the Group.

The fair value of forward foreign exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles.

The fair value of cross currency swaps is determined using a discounted cash flow model.

The fair value of asset swaps is determined using a model, with the key inputs being interest rates and the pricing of inflation futures.

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

The fair value of index swaps (commodity, equity, real estate and longevity contingent swaps) is provided by the counterparty and is calculated by reference to the movement in the underlying index or basket of securities or other contracts. Index swaps are settled net in cash.

The fair value of options is calculated using a Black-Scholes option valuation model.

**(f) Securities lending**

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

**(g) 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. 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.

**(h) Investments in 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 the financial and operating policy decisions of the entity.

At inception, certain of the Fund's associates are designated at fair value through profit or loss under NZ IAS-39 Financial Instruments: Recognition and Measurement (in accordance with paragraph 1 of NZ IAS-28 Investments in Associates). All other associates are equity accounted in accordance with NZ IAS-28 Investments in Associates. The designation is made with reference to how the Guardians intend to manage the investment and the extent to which the Guardians will be involved in the management of the investment.

The results and assets and liabilities of associates which are accounted for under NZ IAS-28 Investments in Associates are incorporated in the financial statements using the equity method of accounting, except where the investment is classified as held for sale, in which case it is accounted for in accordance with NZ IFRS 5 Non-current Assets Held for Sale and Discontinued Operations. Under the equity method, investments in associates are carried at cost as adjusted for post-acquisition changes in the Fund's share of the net assets of the associate, less any impairment in the value of individual investments. Losses of an associate in excess of the Fund's interest in that associate are not recognised, unless the Fund has incurred legal or constructive obligations or made payments on behalf of the associate.





Notes to the Financial Statements (continued)

For the year ended 30 June 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

**(i) Timber investments – forests**

Forest assets are predominantly standing trees. These are recognised in the statement of financial position at fair value less estimated point of sale costs. 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 forest assets is based on discounted cash-flow models. The annual 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 are 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. Further details on the valuation basis is set out in note 7(g).

**(j) Receivables**

Short-term receivables are initially recorded at fair value, then at amortised cost using the effective interest rate less any impairment.

**(k) 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 measurement**

Subsequent to initial recognition, leasehold improvements, plant, and equipment are stated at cost less accumulated depreciation and any impairment in value.

Land is measured at fair value. Fair value is determined on the basis of an independent valuation prepared by external valuation experts, based on discounted cash flows or capitalisation of net income (as appropriate).

Any revaluation increase arising on the revaluation of land 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 profit or loss, in which case the increase is credited to the statement of financial performance to the extent of the decrease previously charged.

A decrease in carrying amount arising on the revaluation of land is charged as an expense in profit or loss to the extent that it exceeds the balance, if any, held in the asset revaluation reserve relating to a previous revaluation of that asset.

Independent valuations of land are performed with sufficient regularity to ensure that the carrying amount does not differ materially from the asset's fair value at balance date.

**Disposal**

An item of property, plant, and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset.

Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of an item) is included in the statement of financial performance in the year the item is derecognised.

**Impairment**

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

Where the carrying amount is assessed to be greater than its recoverable amount, the item is written down to its recoverable amount. The write down is recognised in the statement of financial performance unless it relates to land 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 that 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 financial performance immediately unless it relates to land, in which case it is treated as a revaluation increase.

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

**(k) Property, plant, and equipment (continued)**

**Impairment (continued)**

Recoverable amount is the greater of fair value less costs to sell and value in use. It is determined for an individual asset, unless the asset's value in use cannot be estimated to be close to its fair value less costs to sell and it does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash generating unit to which the asset belongs.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

**(l) Depreciation**

Depreciation is provided on a straight line basis 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:

| | |
|---|---|
| Land improvements | 15-50 years |
| Office equipment | 3 years |
| Computer equipment | 3 years |
| Office fitout | 2-6 years |

The cost of office fitout 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.

**(m) Intangible assets**

Software and licences are finite life intangibles and are recorded at cost less accumulated amortisation and impairment. Amortisation is charged on a straight line basis over their estimated useful lives of 3 years. The estimated useful life and amortisation method is reviewed at the end of each annual reporting period.

**(n) Payables**

Short-term payables are not interest bearing and are stated at their nominal value.

**(o) Provisions**

Provisions are recognised when the Group has a present obligation as a result of a past event, 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.

**(p) Income recognition**

Revenue is recognised to the extent that it is probable that the 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:

For financial instruments measured at fair value, interest income is recognised on an accruals basis, either daily or on a yield to maturity basis. Interest earned on cash balances is accrued at the effective interest rate.

Dividend income is recognised when the shareholder's 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.

Revenue from the sale of goods is recognised when the Group has transferred to the buyer the significant risks and rewards of ownership of the goods.

Securities lending fees are recognised as earned.



# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

**(q) 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 separately in the statement of financial performance.

**(r) Translation of the financial statements of independent foreign operations**

Assets and liabilities of foreign operations with functional currencies other than New Zealand dollars are translated at the closing rate. Revenue and expense items are translated at a weighted average of exchange rates over the year, 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 changes in public equity.

Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at exchange rates prevailing at the reporting date.

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 is transferred out of the foreign currency translation reserve and recognised in the statement of financial performance when the gain or loss on disposal of the foreign operation is recognised.

**(s) 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 superannuation entitlements flows directly from the Treasury to the Ministry of Social Development it is not considered cash flow of the Group and is accordingly not recorded in the statement of cash flows.

**Cash and cash equivalents**

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

**(t) 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 with GST included. Where GST is irrecoverable as an input tax, then it is recognised as part of the related asset or expense.

Cash flows are included in the cash flow statement 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.

**(u) Changes in accounting policies**

There have been no changes in accounting policies. The accounting policies have been applied consistently throughout these financial statements.

**(v) Significant estimates and judgements**

In preparing these financial statements, estimates and judgements have been made concerning the future. These estimates and judgements may differ from the subsequent actual results. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The estimates and judgements that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities are detailed within each accounting policy above.

## Notes to the Financial Statements (continued)

For the year ended 30 June 2009

| | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **2. PROFIT/(LOSS) FROM OPERATIONS** | | | |
| **(A) INTEREST INCOME** | | | |
| New Zealand fixed interest - Crown | 6,000 | 36,922 | 39,149 |
| New Zealand fixed interest - State-Owned Entities | 242 | 408 | 349 |
| New Zealand fixed interest - Local Bodies | 1,507 | 2,342 | 4,301 |
| New Zealand fixed interest - Other | 9,382 | 13,491 | 14,659 |
| New Zealand fixed interest - Total | 17,131 | 53,163 | 58,458 |
| Global fixed interest | 61,472 | 50,504 | 56,124 |
| Other interest | 35,753 | 20,907 | 4,225 |
| **Total interest income** | **114,356** | **124,574** | **118,807** |
| **(B) OPERATING EXPENSE** | | | |
| Profit/(loss) before income tax has been arrived at after charging the following expenses and losses: | | | |
| Timber harvesting and operating expenses (note 4) | 7,649 | 12,149 | 14,631 |
| Depreciation of non-current assets (note 10) | 676 | 497 | 567 |
| Loss on disposal of property, plant, and equipment (note 4) | 7,546 | - | - |
| Amortisation of intangible assets (note 11) | 156 | 52 | - |
| Managers' fees - base | 61,015 | 57,825 | 60,295 |
| Managers' fees - performance (note 13) | (4,446) | 9,858 | 31,234 |
| Custody fees | 3,721 | 3,580 | 6,000 |
| Auditors' remuneration (note 5) | 265 | 315 | 272 |
| Reimbursement of Guardians' expenses | 11,635 | 9,410 | 17,650 |
| Other expenses | 15,729 | 17,984 | 27,164 |
| | **103,946** | **111,670** | **157,813** |
| **3. FAIR VALUE CHANGES IN INVESTMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS** | | | |
| Financial assets or liabilities designated at fair value through profit or loss | (3,191,361) | (1,466,876) | 960,006 |
| Financial assets or liabilities held for trading recognised at fair value through profit or loss | (1,070,400) | 126,217 | 53,925 |
| | **(4,261,761)** | **(1,340,659)** | **1,013,931** |
| **4. TIMBER OPERATIONS** | | | |
| Timber sales | 18,767 | 19,994 | 32,713 |
| Harvesting and operating expenses | (7,649) | (12,149) | (14,631) |
| Depreciation - land improvements (note 10) | (380) | (298) | - |
| **Net trading result** | **10,738** | **7,547** | **18,082** |
| Fair value changes in timber investments - forests | (33,204) | (18,876) | 7,845 |
| Loss on disposal of property, plant, and equipment | (7,546) | - | - |
| **Timber net surplus/(loss) (excluding managers' fees)** | **(30,012)** | **(11,329)** | **25,927** |



## Notes to the Financial Statements (continued)

For the year ended 30 June 2009

| | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **5. REMUNERATION OF AUDITORS** | | | |
| **Auditor of the parent entity** | | | |
| Audit of the financial statements - Attest | 265 | 285 | 272 |
| Audit of the financial statements - IFRS transition | - | 30 | - |
| | **265** | **315** | **272** |

The auditor of the New Zealand Superannuation Fund is Warren Allen of Ernst & Young, on behalf of the Auditor-General.

| | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **6. INCOME TAXES** | | | |
| **Income tax expense** | | | |
| Current tax - current year | 6,133 | 242,962 | |
| Current tax - prior year | (2,569) | (6,078) | |
| Deferred tax - current year | (413,476) | (79,076) | |
| Deferred tax - prior year | 1,772 | 6,479 | |
| **Income tax expense/(credit)** | **(408,140)** | **164,287** | **319,594** |
| Profit/(loss) for the year before income tax | (3,201,226) | (716,460) | 1,326,344 |
| Income tax calculated at 30%/33% | (960,367) | (236,433) | |
| Fair Dividend Regime | 467,848 | 344,307 | |
| PIE Regime | 81,045 | 77,073 | |
| Imputation credits | (9,926) | (12,306) | |
| Foreign tax credits unable to be claimed | 6,360 | - | |
| Other items | 6,900 | (8,354) | |
| **Income tax expense/(credit)** | **(408,140)** | **164,287** | **319,594** |
| **Deferred tax assets are attributed to the following** | | | |
| Staff benefits | 236 | 420 | |
| New Zealand income tax losses | 459,777 | - | |
| Amounts recognised directly in equity | - | - | |
| Decrease in tax rate to 30% | - | 132 | |
| Set off against deferred tax liability | (88,523) | (552) | |
| **Balance at the end of the year** | **371,490** | **-** | **-** |
| **Movements** | | | |
| Balance at the beginning of the year | - | - | |
| Prior year adjustments | - | 238 | |
| Set off of deferred tax liabilities | - | 3,290 | |
| Withholding tax set off | - | (10) | |
| Decrease in tax rate to 30% | - | 132 | |
| (Credited)/charged to the statement of financial performance | 371,490 | (3,650) | |
| **Balance at the end of the year** | **371,490** | **-** | **-** |

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

| | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **6. INCOME TAXES (continued)** | | | |
| **Deferred tax liabilities are attributed to the following** | | | |
| Timber investments - forest revaluation | (84,960) | (37,926) | |
| Other temporary differences | (940) | (2,014) | |
| Accrued Foreign Dividend Payments | (310) | (259) | |
| Amounts recognised directly in equity | (2,313) | (2,181) | |
| Set off against deferred tax asset | 88,523 | 552 | |
| **Balance at the end of the year** | **-** | **(41,828)** | **(39,769)** |
| **Movements** | | | |
| Balance at the beginning of the year | (41,828) | (113,575) | |
| Prior year adjustments | (1,772) | (6,718) | |
| Other | 30 | (496) | |
| Set off against deferred tax asset | - | (3,290) | |
| Amounts recognised directly in equity | 1,584 | (475) | |
| (Credited)/charged to the statement of financial performance | 41,986 | 82,726 | |
| **Balance at the end of the year** | **-** | **(41,828)** | **(39,769)** |

With effect from 1 July 2008, the applicable statutory tax rate for the Group changed from 33% to 30%. Deferred tax has been provided at 30% in accordance with NZ-IAS 12 Income Taxes.

A deferred tax asset of $459,777,000 has been recognised in relation to New Zealand income tax losses based on a history of making taxable profits and forecasted future taxable profits which will be able to be offset using these tax losses.

Use of the tax losses is dependent on the future status of the Fund as a taxable entity in New Zealand. Should this not be the case, the deferred tax asset will be reversed.



# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

| | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **7. INVESTMENTS** | | | |
| (A) INVESTMENTS BY ASSET TYPE | | | |
| **Financial assets** | | | |
| Derivative financial instrument assets: | | | |
| Forward foreign exchange contracts | 905,839 | 27,129 | |
| Cross currency swaps | 12,223 | - | |
| Asset swaps | 3,904 | - | |
| Real estate swaps | 40,937 | - | |
| Longevity contingent swaps | 85,366 | - | |
| Futures contracts | - | - | |
| Equity swaps | 25,551 | 10,633 | |
| Commodity swaps | - | 20,581 | 6,691 |
| Options | - | 26,092 | |
| **Total derivative financial instrument assets** | **1,073,820** | **84,435** | **6,691** |
| Other financial assets: | | | |
| New Zealand equities - State-Owned Entities | 3,463 | 7,821 | 11,860 |
| New Zealand equities - Other | 878,725 | 973,809 | 1,385,894 |
| Global equities | 4,394,326 | 6,094,436 | 6,065,924 |
| **Total equities** | **5,276,514** | **7,076,066** | **7,463,678** |
| New Zealand fixed interest - Crown | - | 532,843 | 744,632 |
| New Zealand fixed interest - State-Owned Entities | 2,837 | 4,307 | 6,168 |
| New Zealand fixed interest - Local Bodies | 16,854 | 15,945 | - |
| New Zealand fixed interest - Other | 134,548 | 808,234 | 182,580 |
| Global fixed interest | 2,087,773 | 1,564,402 | 1,949,497 |
| **Total fixed interest** | **2,242,012** | **2,925,731** | **2,882,877** |
| Collective investment funds | 1,961,459 | 2,350,742 | 3,728,704 |
| Private equity | 226,416 | 186,162 | 166,019 |
| Unlisted unit trusts | 507,567 | 628,345 | 826,016 |
| **Total other financial assets** | **10,213,968** | **13,167,046** | **15,067,294** |
| **Total financial assets** | **11,287,788** | **13,251,481** | **15,073,985** |
| **Investments accounted for using the equity method (refer note 7(f))** | **837,648** | **510,228** | **634,819** |
| **Non-financial assets - timber investments - forests (refer note 7(g))** | | | |
| New Zealand timber investments - forests | 138,988 | 140,573 | |
| Global timber investments - forests | - | 119,057 | |
| **Total timber investments- forests** | **138,988** | **259,630** | **386,846** |
| **Total investments** | **12,264,424** | **14,021,339** | **16,095,650** |
| **Derivative financial instrument liabilities** | | | |
| Forward foreign exchange contracts | 95,994 | 184,493 | |
| Asset swaps | 169 | - | |
| Equity swaps | 37,114 | 69,832 | |
| Commodity swaps | 16,646 | 12,686 | |
| **Total derivative financial instrument liabilities** | **149,923** | **267,011** | **-** |
| **Net investments** | **12,114,501** | **13,754,328** | **16,095,650** |

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 7. INVESTMENTS (continued)

### (B) RESTRICTIONS

The Group participates in a securities lending program. Credit risk associated with the securities lending program is mitigated by requiring the borrower to provide daily collateral in the form of cash or readily marketable securities (non-cash) of greater market value than the securities loaned. As at 30 June 2009, the Group's global equities investments include loaned securities with a fair value of $278,283,000 (2008: $999,519,000). The fair value of non-cash collateral held (by a third-party agent) in respect of these loans is $556,000 (2008: $644,171,000). This is not recognised in the Group's financial statements as the non-cash collateral is not able to be sold or repledged. Cash collateral received in respect of securities lent was invested in the collective investment fund referred to in note 7(d). The obligation to repay collateral to borrowers of $293,379,000 disclosed in note 12 will be funded out of cash, in the normal course of business.

### (C) FAIR VALUES

The basis of the fair value determination is set out in the statement of accounting policies.

### (D) ILLIQUID SECURITIES

During the year the Group redeemed its interests in a collective investment fund which was principally used to generate returns from cash collateral provided by borrowers in the Group's securities lending program. The Group received a transfer of a pro rata share of the assets of the collective investment fund. In addition to cash, the assets received were asset-backed securities, medium-term notes, and corporate bonds. The fair value of these securities is $164,686,000, which is included in the global fixed interest asset category. Securities with a fair value of $9,120,000 are currently past due. Securities with a fair value of $6,450,000 have had their terms renegotiated and are no longer past due. In addition to the securities received, the Group received a pro-rata share of a capital support agreement as disclosed in note 8.

### (E) INVESTMENTS IN SUBSIDIARIES

| NAME OF ENTITY | BALANCE DATE | COUNTRY OF INCORPORATION | OWNERSHIP INTEREST 2009 % | OWNERSHIP INTEREST 2008 % |
|---|---|---|---|---|
| CNI Timber Operating Company Limited | 30 June | New Zealand | 0%* | 0%* |

* All of the shares in CNI Timber Operating Company Limited are legally owned by the Guardians. However, beneficial ownership of the shares remains with the Fund, and as such this company has been consolidated into these financial statements. 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 Operating Company Limited arose during the purchase of timberland estate. The Group has been restructured so that legal ownership of this entity sits with the Guardians. However, due to certain performance guarantee contracts that exist within the company which have not been transferred, the beneficial ownership of the shares has been retained by the Fund.

### (F) INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD

| | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| Investments in associates | 837,648 | 510,228 | 634,819 |

| NAME OF ENTITY | BALANCE DATE | COUNTRY OF INCORPORATION | OWNERSHIP INTEREST 2009 % | OWNERSHIP INTEREST 2008 % |
|---|---|---|---|---|
| Kaingaroa Timberlands Partnership | 30 June | New Zealand | 40% | 30% |





# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 7. INVESTMENTS (continued)

### (F) INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD (continued)

| | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **Associate** | | | |
| Carrying amount at start of year | 510,228 | 290,294 | 471,334 |
| Acquisition of associate | 195,714 | 147,094 | 125,109 |
| Share of recognised revenues and expenses | 144,200 | 80,408 | 38,376 |
| Return of capital | (12,494) | (7,568) | - |
| **Carrying amount at end of year** | **837,648** | **510,228** | **634,819** |
| Goodwill at the start of the year | - | - | - |
| Goodwill at the end of the year | - | - | - |
| **Summarised financial information of associate company:** | | | |
| Current assets | 50,546 | 48,223 | |
| Non-current assets | 2,046,732 | 1,947,940 | |
| | 2,097,278 | 1,996,163 | |
| Current liabilities | 13,495 | 13,578 | |
| Non-current liabilities | - | - | |
| | 13,495 | 13,578 | |
| Net assets | 2,083,783 | 1,982,585 | |
| Revenue | 266,810 | 457,603 | |
| Net profit | 137,634 | 347,744 | |
| Share of associate's profit/(loss) | 144,200 | 80,408 | 38,376 |

### (G) NON-FINANCIAL ASSETS - TIMBER INVESTMENTS

Timber investments - forests are accounted for under NZ IAS 41 Agriculture, and carried at fair value less estimated point of sale costs. Timber investments - land is accounted for under NZ IAS 16 Property, Plant and Equipment, and is carried at fair value with revaluations reflected in reserves.

| | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **Gross carrying amount - forests** | | | |
| Carrying amount at start of year | 259,630 | 272,517 | 281,468 |
| Additions | 731 | 4,224 | 97,533 |
| Disposals | (88,169) | - | - |
| Fair value changes in timber investments - forests | (33,204) | (18,876) | 7,845 |
| Foreign exchange gain/(loss) on translation | - | 1,765 | - |
| **Carrying amount at end of year** | **138,988** | **259,630** | **386,846** |

At 30 June 2009, the Group's forests measured approximately 4.83 million $m^3$ (2008: 6.92 million $m^3$). During the year ended 30 June 2009, the Group harvested 0.3 million $m^3$ (year ended 30 June 2008: 0.4 million $m^3$), which had a fair value less estimated point-of-sale costs of NZ$15.7 million (year ended 30 June 2008: NZ$15.4 million).

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 7. INVESTMENTS (continued)

### (G) NON-FINANCIAL ASSETS - TIMBER INVESTMENTS (continued)

The forests have been measured at fair value based on a net present value or discounted cash flow approach. The following methodology and assumptions were applied:

An estate-based approach was employed whereby the net cash flows for each geographically distinct area was forecast and discounted to provide a forest value. These cash flows reflect management's future harvesting and silvicultural intentions for the forest.

(a) The forests have been valued on the basis of a going concern and captures the value of the existing crop on a single rotation basis.

(b) Notional land rental costs have been included for freehold land based on current government valuations.

(c) The net present value is calculated using a pre-tax discount rate of 8.55 - 9.5% (2008: 5.5 - 9.0%).

(d) The cash flows do not take into account income tax.

(e) No allowance for inflation has been provided.

(f) The impact of movement in prices is estimated by adjusting the starting prices for price forecasting by the quarter-on-quarter movement in market prices and maintaining a consistent price path to the long-run averages by grade category.

(g) Costs are current average costs. No allowance has been made for cost improvements in future operations.

(h) The net change in value arising from harvest, growth, and change in prices by log grade category is taken as the change in fair market value of the crop and is included in the statement of financial performance.

(i) Estimated point of sale costs of 1% have been deducted from the fair valuation.

**Forest financial risk management strategy**

The Group has procedures in place to minimise damage to forest assets from climatic risks, pests and diseases, nutrient deficiencies and imbalances, fire, and flood risk. As a member of the New Zealand Forest Owners Association the Group subscribes to the annual national forest health surveillance programme. This programme helps early detection of any exotic disease or pest incursion, data to meet New Zealand's international forest reporting requirements and forest health management information.

In addition, pest and disease populations are constantly monitored through annual region-specific surveys, site or species specific pest surveys and visual assessment by contractors. This information is then used to determine where to carry out control operations.

New Zealand forests have historically experienced low forest loss due to fire as a result of both climatic conditions and management regimes directed toward active fire risk reduction. The Group owns a number of fire fighting resources and these are located around the districts as defined by risk factors at any given point in time.

| | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **8. TRADE AND OTHER RECEIVABLES** | | | |
| Trade receivables | 2,889 | 2,986 | |
| Allowance for doubtful debts | - | - | |
| | 2,889 | 2,986 | - |
| Accrued interest | 28,657 | 36,948 | 23,503 |
| Dividends receivable | 18,254 | 23,805 | 11,365 |
| Unsettled sales | 447,614 | 152,116 | 60,889 |
| GST receivable | 183 | - | - |
| Capital support agreements receivable | 38,983 | - | - |
| | **536,580** | **215,855** | **95,757** |

Trade receivables have standard 30 day terms.

The timing and amount of expected cashflows for accrued interest, dividends receivable, and unsettled sales are certain as they are based on contractual terms and corporate actions. All receivables are expected to be settled within one year.



# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 8. TRADE AND OTHER RECEIVABLES (continued)

The capital support agreements receivable relates to the Group's investment of securities lending cash collateral in a collective investment fund. A number of letters of credit were issued by Bank of America N.A. for the benefit of the collective investment fund. Prior to year end, the Group redeemed its interests in the collective investment fund. As part of the redemption arrangements any non-transferrable assets, including a proportionate share of the benefits of the capital support agreements are held on trust by the collective investment fund for the Group. The Group's proportionate share of the proceeds of the letters of credit will be received when the capital support is drawn upon by the collective investment fund which is expected to be in the year ending 30 June 2011. The fair value of the Group's proportionate share of the capital support agreements receivable is $38,983,000.

No allowance has been made for irrecoverable amounts as the Group has assessed that there is no objective evidence of impairment.

| | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **9. OTHER ASSETS** | | | |
| Prepayments | 59 | 61 | - |
| | **59** | **61** | **-** |

| GROUP ACTUAL | LAND AND LAND IMPROVEMENTS NZ$000 | OFFICE EQUIPMENT NZ$000 | COMPUTER EQUIPMENT NZ$000 | OFFICE FITOUT NZ$000 | TOTAL NZ$000 |
|---|---|---|---|---|---|
| **10. PROPERTY, PLANT, AND EQUIPMENT** | | | | | |
| **Gross carrying amount** | | | | | |
| **Balance at 1 July 2007** | 75,794 | 318 | 123 | 1,260 | 77,495 |
| Additions | 4,319 | 5 | 75 | - | 4,399 |
| Disposals | - | - | 37 | (37) | - |
| Net revaluation increments/(decrements) | 19,835 | - | - | - | 19,835 |
| Foreign exchange gain/(loss) on translation | 537 | - | - | - | 537 |
| **Balance at 30 June 2008** | **100,485** | **323** | **235** | **1,223** | **102,266** |
| Additions | 587 | - | 231 | 302 | 1,120 |
| Disposals | (65,934) | - | - | - | (65,934) |
| Net revaluation increments/(decrements) | 3,188 | - | - | 6 | 3,194 |
| Foreign exchange gain/(loss) on translation | 11,427 | - | - | - | 11,427 |
| **Balance at 30 June 2009** | **49,753** | **323** | **466** | **1,531** | **52,073** |
| **Accumulated depreciation** | | | | | |
| **Balance at 1 July 2007** | 316 | 14 | 29 | 24 | 383 |
| Depreciation expense | 298 | 46 | 67 | 86 | 497 |
| **Balance at 30 June 2008** | **614** | **60** | **96** | **110** | **880** |
| Depreciation expense | 380 | 46 | 113 | 137 | 676 |
| **Balance at 30 June 2009** | **994** | **106** | **209** | **247** | **1,556** |
| **Net book value** | | | | | |
| As at 30 June 2008 | **99,871** | **263** | **139** | **1,113** | **101,386** |
| **As at 30 June 2009** | **48,759** | **217** | **257** | **1,284** | **50,517** |

Land as part of the New Zealand timber investments was valued by Telfer Young (Northland) Ltd, an independent registered valuer.

The valuations were obtained as at 30 June 2009. The revaluation surplus has been taken to the land revaluation reserve.

Carrying amount that would have been recognised under the cost model $40,610,000 (2008: $75,848,000).

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

| | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **11. INTANGIBLE ASSETS** | | | |
| **Gross carrying amount** | | | |
| **Opening balance** | 253 | 54 | |
| Additions - Computer software | 224 | 199 | |
| **Closing balance** | **477** | **253** | |
| **Accumulated amortisation** | | | |
| **Opening balance** | 66 | 14 | |
| Amortisation expense | 156 | 52 | |
| **Closing balance** | **222** | **66** | |
| **Net book value** | **255** | **187** | **-** |
| **12. TRADE AND OTHER PAYABLES** | | | |
| Trade payables | 2,566 | 3,083 | |
| Accrued expenses | 23,071 | 16,108 | |
| Unsettled purchases | 90,983 | 206,301 | |
| GST payable | - | 5 | |
| Related party payable to Guardians | 1,037 | 1,794 | |
| Collateral repayable to borrowers in the securities lending program | 293,379 | - | |
| | **411,036** | **227,291** | **112,210** |

The average credit period on purchases is 30 days. No interest is charged on overdue balances. The Group has financial risk management policies in place to ensure that all payables are paid within the credit time frame.

The timing and amount of expected cash flows for unsettled purchases are certain as they are based on contractual terms and corporate actions. All payables are expected to be settled within one year.

Collateral is recognised as a payable when borrowers have provided cash collateral which can be sold or repledged by the Group. The collateral is repayable to borrowers on the return of loaned securities. The loan terms are generally no longer than one year.

| | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **13. PROVISION FOR PERFORMANCE-BASED FEES** | | | |
| Balance brought forward | 40,185 | 40,685 | 48,853 |
| New provision during the year | 1,943 | 9,858 | 31,234 |
| Unused provision released during the year | (6,389) | - | - |
| Paid out during the year | (33,796) | (10,358) | (13,096) |
| **Closing provision** | **1,943** | **40,185** | **66,991** |
| Represented by: | | | |
| Current | - | 31,482 | 14,794 |
| Non-current | 1,943 | 8,703 | 52,197 |
| | **1,943** | **40,185** | **66,991** |

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.



# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 14. AMOUNTS EXPECTED TO BE RECOVERED OR SETTLED AFTER MORE THAN TWELVE MONTHS

The Group's statement of financial position is presented on a liquidity basis. Accordingly, certain line items combine amounts expected to be recovered or settled no more than twelve months after balance date and amounts expected to be recovered or settled more than twelve months after balance date. The following table sets out the amounts expected to be recovered or settled after more than twelve months:

| | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 |
|---|---|---|
| **ASSETS** | | |
| Trade and other receivables | 38,983 | - |
| **Investments** | | |
| Investments - derivative financial instrument assets | 101,493 | - |
| Investments - other financial assets | 733,983 | 814,507 |
| Investments accounted for using the equity method | 837,648 | 510,228 |
| Timber investments - forest | 138,988 | 259,630 |
| Total investments | 1,812,112 | 1,584,365 |
| Deferred tax asset | 371,490 | - |
| Property, plant, and equipment | 50,517 | 101,386 |
| Intangible assets | 255 | 187 |
| **Total assets** | **2,273,357** | **1,685,938** |
| **LIABILITIES** | | |
| Derivative financial instrument liabilities | 4,766 | - |
| Provisions | 1,943 | 8,703 |
| Deferred tax liability | - | 41,828 |
| **Total liabilities** | **6,709** | **50,531** |
| **Net assets** | **2,266,648** | **1,635,407** |

## 15. MANAGEMENT OF FUND CAPITAL

### OBJECTIVES, POLICIES, AND PROCESSES FOR MANAGING THE FUND'S CAPITAL

The Fund's "capital" comprises the investments and all other assets of the Fund less any liabilities.

### FUNDING – INVESTMENT CAPITAL

The Fund 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. 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. Contributions to the Fund are based on a percentage of GDP as set out in the Act. The Government has announced in the Budget for 2009 a reduction in contributions to the Fund. Full capital contributions are projected to resume from 2020 under current Treasury modelling, however this may change based on future Fiscal and Economic Updates.

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 15. MANAGEMENT OF FUND CAPITAL (continued)

### FUNDING – NET COST OF 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. The 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 The Treasury acting as agent for the Fund.

### MANAGEMENT OF THE FUND'S 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 the Statement of Investments Policies, Standards and Procedures, which is available at www.nzsuperfund.co.nz

The Guardians review the Fund's investment policies and strategic asset allocation on a regular basis to ensure it is efficient over the longer term.

The Guardians have determined investment policies and a strategic asset allocation (SAA) that, in their view and on the basis of professional advice received, best meets their statutory obligation to maximise the return to the Fund without undue risk and best meets the Guardians' investment objective for the Fund. This is reviewed from time-to-time.

The SAA highlights target levels for asset classes. It does not reflect the Fund's current holdings. The difference between the Fund's current and target holdings is made up through the use of proxies, whereby any differences for the private market holdings are made up of offsetting holdings of other, more readily accessible assets such as listed equities and fixed interest. The table below shows the target weights and ranges (before proxies) as at 30 June 2009.

| | 30 JUNE 2009 % | RANGES % |
|---|---|---|
| **Sector** | | |
| Global large cap equities | 32.0 | |
| Global small cap equities | 5.5 | |
| New Zealand equities | 7.5 | |
| Emerging market equities | 3.0 | |
| Property | 10.0 | |
| Private markets: | | |
| Private equity | 5.0 | 0-10 |
| Infrastructure | 5.0 | 0-15 |
| Other private markets | 5.0 | 0-10 |
| Timber | 5.0 | 0-10 |
| Total private markets | 20.0 | |
| Commodities | 5.0 | |
| Fixed interest | 17.0 | |
| **Total portfolio** | **100.0** | |
| Net unhedged foreign currency exposure | 10.0 | |



# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 16. COMMITMENTS AND CONTINGENT LIABILITIES

At year end, the Group had commitments to private equity funds totalling $430,560,000 (2008: $346,328,000), of which $172,099,000 has been called and paid (2008: $111,143,000). Capital called as at balance date but not yet paid amounted to $5,638,000 (2008: $15,924,000). The Group also had other commitments of $663,826,000 (2008: $650,758,000), of which $173,118,000 has been called upon (2008: $308,015,000).

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

There were no contingent liabilities at 30 June 2009 (2008: $nil).

## 17. RELATED PARTY DISCLOSURES

### (A) PARENT ENTITIES

The Fund is managed and administered by the Guardians which in turn are a wholly owned entity of the Crown. Both the Guardians and the Crown produce financial statements which are available to the public.

### (B) EQUITY INTERESTS IN RELATED PARTIES

Details of the interests held in subsidiaries and associates are disclosed in notes 7(e) and 7(f) (respectively) to the financial statements.

### (C) TRANSACTIONS WITH RELATED PARTIES

The Guardians have paid expenses relating to the Group, as it is required to do under the Act. A portion of these expenses is reimbursed by the Fund as is entitled under the Act. These expenses are included in the financial statements of the Guardians. The amount of the reimbursement to the Guardians for the financial year was $11,635,000 (2008: $9,410,000).

The Group and the New Zealand Debt Management Office (NZDMO) are consolidated into the Crown financial statements. The Group transacts with the NZDMO for a portion of its foreign exchange contracts and cross currency swaps. The fair value of outstanding contracts at year end was an asset of $767.32m (2008: liability $115.98m). Losses on contracts with the NZDMO recognised in the statement of financial performance for the year were $812.67m (2008: losses $251.56m). All other transactions with government entities are on an arm's length basis.

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

## 18. SUBSEQUENT EVENTS

There were no reportable events subsequent to year end.

## 19. NOTES TO THE STATEMENT OF CASH FLOWS

### (A) RECONCILIATION OF CASH AND CASH EQUIVALENTS

For the purposes of 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. Cash and cash equivalents at the end of the financial year as shown in the statement of cash flows is reconciled to the related items in the statement of financial position as follows:

| | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| Cash and cash equivalents | 1,060,920 | 324,103 | 1,651,947 |

At balance date, cash of $809,439,000 (2008: $292,767,000) had been allocated and was held by Investment Managers awaiting investment.

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 19. NOTES TO THE STATEMENT OF CASH FLOWS (continued)

### (B) COLLATERAL

$43,407,000 of cash balances (2008: $24,906,000) are held in separate bank accounts lodged with the relevant futures exchange. These funds have been pledged as collateral for potential margin calls on futures of $nil (2008: $nil) held by the Group. The counterparties are not permitted to sell or re-pledge the collateral cash balances. The pledged assets will be returned to the Group when the underlying transaction is terminated, but in the event of default the counterparty is entitled to apply the collateral in order to settle the liability.

| | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **(C) RECONCILIATION OF LOSS FOR THE YEAR TO NET CASH FLOWS FROM OPERATING ACTIVITIES** | | | |
| Loss for the year after income tax expense | (2,793,086) | (880,747) | 1,006,750 |
| Add/(deduct) non-cash items: | | | |
| Share of profit of investments accounted for using the equity method | (144,200) | (80,408) | |
| Depreciation and amortisation of non-current assets | 832 | 549 | |
| Fair value changes in timber investments - forests | 33,204 | 18,876 | |
| Fair value changes in investments | 4,261,761 | 1,340,659 | |
| Net foreign exchange gain | (669,107) | (289,645) | |
| Other non-cash items | 4,533 | 3,616 | |
| Add items classified as investing activities: | | | |
| Loss on disposal of property, plant, and equipment | 7,546 | - | |
| Changes in net assets and liabilities: | | | |
| (Increase)/decrease in assets: | | | |
| Trade and other receivables | (320,725) | (133,165) | |
| Other assets | 2 | 879 | |
| Increase/(decrease) in liabilities: | | | |
| Trade and other payables | 183,745 | 175,015 | |
| Provisions | (38,242) | 500 | |
| Increase/(decrease) in current tax balances | 158,741 | (167,047) | |
| Increase/(decrease) in deferred tax balances | (413,318) | (71,747) | |
| Deduct items classified as investing activities: | | | |
| Unsettled sales | 295,498 | 117,270 | |
| Capital support agreements receivable | 38,983 | - | |
| Unsettled purchases | 115,318 | (182,424) | |
| Collateral repayable to borrowers in the securities lending program | (293,379) | - | |
| **Net cash provided by/(used in) operating activities** | **428,106** | **(147,819)** | **(31,875)** |





# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 20. FINANCIAL INSTRUMENTS

### (A) FINANCIAL ASSETS AND FINANCIAL LIABILITIES BY MEASUREMENT BASIS

**Key:** H4T: Held for trading
Designated at FVTPL: Designated at fair value through profit and loss
L&R: Loans and receivables
A4S: Available for sale
AC: Amortised cost/cost/or equity accounted

| | H4T NZ$000 | DESIGNATED AT FVTPL NZ$000 | L&R NZ$000 | A4S NZ$000 | AC NZ$000 | TOTAL NZ$000 |
|---|---|---|---|---|---|---|
| **2009** | | | | | | |
| **Financial assets** | | | | | | |
| Cash and cash equivalents | | | 1,060,920 | | | 1,060,920 |
| Trade and other receivables | | | 536,580 | | | 536,580 |
| Investments | | | | | | |
| Investments - derivative financial instrument assets | | | | | | |
| Forward foreign exchange contracts | 905,839 | | | | | 905,839 |
| Cross currency swaps | 12,223 | | | | | 12,223 |
| Asset swaps | 3,904 | | | | | 3,904 |
| Real estate swaps | 40,937 | | | | | 40,937 |
| Longevity contingent swaps | 85,366 | | | | | 85,366 |
| Equity swaps | 25,551 | | | | | 25,551 |
| | 1,073,820 | - | - | - | - | 1,073,820 |
| Investments - other financial assets: | | | | | | |
| Equities | | | | | | |
| New Zealand equities - State-Owned Entities | | 3,463 | | | | 3,463 |
| New Zealand equities - Other | | 878,725 | | | | 878,725 |
| Global equities | | 4,394,326 | | | | 4,394,326 |
| Total equities | - | 5,276,514 | - | - | - | 5,276,514 |
| Fixed interest | | | | | | |
| New Zealand fixed interest - State-Owned Entities | | 2,837 | | | | 2,837 |
| New Zealand fixed interest - Local Bodies | | 16,854 | | | | 16,854 |
| New Zealand fixed interest - Other | | 134,548 | | | | 134,548 |
| Global fixed interest | | 2,087,773 | | | | 2,087,773 |
| Total fixed interest | - | 2,242,012 | - | - | - | 2,242,012 |
| Collective investment funds | | 1,961,459 | | | | 1,961,459 |
| Private equity | | 188,116 | | 38,300 | | 226,416 |
| Global unit trusts | | 507,567 | | | | 507,567 |
| | - | 2,657,142 | - | 38,300 | - | 2,695,442 |
| Investments accounted for using the equity method | | | | | 837,648 | 837,648 |
| Total investments | 1,073,820 | 10,175,668 | - | 38,300 | 837,648 | 12,125,436 |
| **Total financial assets** | **1,073,820** | **10,175,668** | **1,597,500** | **38,300** | **837,648** | **13,722,936** |
| **Financial liabilities** | | | | | | |
| Trade and other payables | | | | | 411,036 | 411,036 |
| Derivative financial instrument liabilities: | | | | | | |
| Forward foreign exchange contracts | 95,994 | | | | | 95,994 |
| Asset swaps | 169 | | | | | 169 |
| Equity swaps | 37,114 | | | | | 37,114 |
| Commodity swaps | 16,646 | | | | | 16,646 |
| Total derivative financial instrument liabilities | 149,923 | - | - | - | - | 149,923 |
| Provisions | | | | | 1,943 | 1,943 |
| **Total financial liabilities** | **149,923** | **-** | **-** | **-** | **412,979** | **562,902** |

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 20. FINANCIAL INSTRUMENTS (continued)

### (A) FINANCIAL ASSETS AND FINANCIAL LIABILITIES BY MEASUREMENT BASIS (continued)

| | H4T NZ$000 | DESIGNATED AT FVTPL NZ$000 | L&R NZ$000 | A4S NZ$000 | AC NZ$000 | TOTAL NZ$000 |
|---|---|---|---|---|---|---|
| **2008** | | | | | | |
| **Financial assets** | | | | | | |
| Cash and cash equivalents | | | 324,103 | | | 324,103 |
| Trade and other receivables | | | 215,855 | | | 215,855 |
| Investments | | | | | | |
| Investments - derivative financial instrument assets | | | | | | |
| Forward foreign exchange contracts | 27,129 | | | | | 27,129 |
| Equity swaps | 10,633 | | | | | 10,633 |
| Commodity swaps | 20,581 | | | | | 20,581 |
| Options | 26,092 | | | | | 26,092 |
| | 84,435 | - | - | - | - | 84,435 |
| Investments - other financial assets: | | | | | | |
| Equities | | | | | | |
| New Zealand equities - State-Owned Entities | | 7,821 | | | | 7,821 |
| New Zealand equities - Other | | 973,809 | | | | 973,809 |
| Global equities | | 6,094,436 | | | | 6,094,436 |
| Total equities | - | 7,076,066 | - | - | - | 7,076,066 |
| Fixed interest | | | | | | |
| New Zealand fixed interest - Crown | | 532,843 | | | | 532,843 |
| New Zealand fixed interest - State-Owned Entities | | 4,307 | | | | 4,307 |
| New Zealand fixed interest - Local Bodies | | 15,945 | | | | 15,945 |
| New Zealand fixed interest - Other | | 808,234 | | | | 808,234 |
| Global fixed interest | | 1,564,402 | | | | 1,564,402 |
| Total fixed interest | - | 2,925,731 | - | - | - | 2,925,731 |
| Collective investment funds | | 2,350,742 | | | | 2,350,742 |
| Private equity | | 162,091 | | 24,071 | | 186,162 |
| Unlisted unit trusts | | 628,345 | | | | 628,345 |
| | - | 3,141,178 | - | 24,071 | - | 3,165,249 |
| Investments accounted for using the equity method | | | | | 510,228 | 510,228 |
| Total investments | 84,435 | 13,142,975 | - | 24,071 | 510,228 | 13,761,709 |
| **Total financial assets** | **84,435** | **13,142,975** | **539,958** | **24,071** | **510,228** | **14,301,667** |
| **Financial liabilities** | | | | | | |
| Trade and other payables | | | | | 227,291 | 227,291 |
| Derivative financial instrument liabilities | | | | | | |
| Forward foreign exchange contracts | 184,493 | | | | | 184,493 |
| Equity swaps | 69,832 | | | | | 69,832 |
| Commodity swaps | 12,686 | | | | | 12,686 |
| Total derivative financial instrument liabilities | 267,011 | - | - | - | - | 267,011 |
| Provisions | | | | | 40,185 | 40,185 |
| **Total financial liabilities** | **267,011** | **-** | **-** | **-** | **267,476** | **534,487** |



# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 20. FINANCIAL INSTRUMENTS (continued)

### (B) FINANCIAL RISK MANAGEMENT OBJECTIVES

Through its activities the Group is exposed to the financial risks of market risk, credit risk, and liquidity risk.

The Guardians have established investment policies, standards, and procedures to manage the Group's exposure to financial risks. The Guardians manage the risks by adopting an appropriate risk profile that is commensurate with the return objective and time horizon of the Fund, avoiding concentration of risk by ensuring there is adequate diversification between and within asset classes and geographically; careful selection and monitoring of managers to ensure the Guardians have sufficient conviction that each manager will maximise the probability that return expectations for each asset class will be met and to ensure that there are no unintended biases away from the intended investment strategy; and rigorous measurement and management of market and manager risk.

Management monitors and manages the financial risks relating to the Group's operations through internal risk reports which analyse exposures by degree and magnitude of risks. These risks include market risk (which includes currency risk, interest rate risk, commodity risk, and equity price risk), credit risk, and liquidity risk. Management report regularly to the Board of the Guardians, and the Audit and Risk Committee.

**Strategic Asset Allocation**

| Sector | TARGET 2009 % | ACTUAL 2009 % | TARGET 2008 % | ACTUAL 2008 % |
|---|---|---|---|---|
| Global large cap equities | 32.0 | 35.2 | 32.0 | 36.8 |
| Global small cap equities | 5.5 | 6.3 | 5.5 | 6.0 |
| New Zealand equities | 7.5 | 6.3 | 7.5 | 6.8 |
| Emerging market equities | 3.0 | 3.6 | 3.0 | 3.3 |
| Private markets | 20.0 | 16.8 | 20.0 | 13.2 |
| Property | 10.0 | 10.9 | 10.0 | 9.2 |
| Fixed interest | 17.0 | 16.2 | 17.0 | 19.4 |
| Commodities | 5.0 | 4.7 | 5.0 | 5.3 |
| **Total** | **100.0** | **100.0** | **100.0** | **100.0** |

**Derivatives**

The use of derivatives is governed by the Group's investment policies which provide written principles on the use of financial derivatives. Compliance with policies and exposure limits is reviewed by the Guardians on a continuous basis.

Derivatives may be used to manage risk or hedge against movements in interest rates, values, or prices in relation to permitted investments and movements in foreign currency exposures held within the Group; to achieve or reduce exposure to assets, all or part of any asset class and foreign currency; and to achieve transactional efficiency or reduce the transactional cost of achieving required exposures.

### (C) SIGNIFICANT ACCOUNTING POLICIES

Details of the significant accounting policies and methods adopted, including the criteria for recognition, and the basis of measurement applied in respect of each class of financial asset, financial liability, and equity instrument are disclosed in note 1 to the financial statements.

### (D) MARKET RISK

The market risks that the Group is primarily exposed to are: equity price risk, both globally and in New Zealand; interest rate risk (primarily to changes in New Zealand and United States interest rates); currency risk (primarily to changes in the New Zealand dollar versus the US dollar); and commodity price risk (primarily to changes in commodity price indices).

Market risk is managed for the Group as a whole as noted above under financial risk management objectives, policies, and processes. Market risk is further managed by requiring investment managers to manage their portfolios within defined market exposure limits. Those limits include limits on percentage weight of any particular company in the portfolio relative to its benchmark weight; limits on aggregate investment in companies not represented in the benchmark; limits on investment in any individual company not represented in the benchmark; limits on the maximum investment in any individual company; duration limits relative to the duration of the benchmark; and maximum limits on exposure to single entities.

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 20. FINANCIAL INSTRUMENTS (continued)

### (D) MARKET RISK (continued)

**(i) Equity price risk**

The Group is exposed to changes in the price of equities listed on both New Zealand and international stock exchanges, as well as derivatives where value is determined with reference to an equity market index. The following table details the Group's sensitivity to a change of price with all other variables held constant. The analysis is performed on the same basis as 2008. The percentages used represent management's assessment of a reasonably possible change in equity prices.

| | % | PROFIT AFTER TAX ($000) | | TOTAL EQUITY ($000) | |
|---|---|---|---|---|---|
| | | Increase | Decrease | Increase | Decrease |
| **30 June 2009** | | | | | |
| New Zealand equities | 19% | 167,551 | (167,551) | 167,551 | (167,551) |
| Global large cap equities | 15% | 662,262 | (662,262) | 662,262 | (662,262) |
| Global small cap equities | 18% | 80,675 | (80,675) | 80,675 | (80,675) |
| Emerging markets equities | 27% | 101,771 | (101,771) | 101,771 | (101,771) |
| **30 June 2008** | | | | | |
| New Zealand equities | 19% | 210,115 | (210,115) | 210,115 | (210,115) |
| Global large cap equities | 15% | 955,190 | (955,190) | 955,190 | (955,190) |
| Global small cap equities | 18% | 144,213 | (144,213) | 144,213 | (144,213) |
| Emerging markets equities | 27% | 111,044 | (111,044) | 111,044 | (111,044) |

| | 2009 NOTIONAL VALUE NZ$000 | 2009 FAIR VALUE NZ$000 | 2008 NOTIONAL VALUE NZ$000 | 2008 FAIR VALUE NZ$000 |
|---|---|---|---|---|
| **Equity swaps at fair value at balance date:** | | | | |
| **Equity swaps** | | | | |
| Assets | 390,886 | 25,551 | (437,830) | 10,633 |
| Liabilities | 1,963,102 | (37,114) | 1,116,610 | (69,832) |

Contractual maturity of all swaps is within 90 days.

**(ii) Foreign currency exchange rate 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 investments in offshore assets and actively manages its risk by taking out forward foreign exchange contracts.

Currency risk is managed by:

(a) establishing a foreign currency hedging policy for each foreign asset class;

(b) specifying the bounds within which each manager may take on currency exposures relative to their benchmark; and

(c) engaging one or more currency execution agents to transact the Group's foreign exchange transactions, including both spot and forward transactions, at the most favourable rate.

The instruments managers may use, and the credit worthiness of the counterparties, are detailed in the investment management agreements with respective managers. Any forward contracts entered into must be with entities that have an appropriate minimum credit rating as determined by an international credit rating agency for counterparty risk and appropriate contractual arrangements must be in place between the currency manager and the counterparty.

Exposures are mainly hedged with derivative financial instruments such as forward foreign exchange contracts.



# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 20. FINANCIAL INSTRUMENTS (continued)

### (D) MARKET RISK (continued)

**(ii) Foreign currency exchange rate risk (continued)**

**Foreign currency exposure**

| | 2009 ASSETS NZ$000 | 2008 ASSETS NZ$000 |
|---|---|---|
| **Foreign currency denominated items:** | | |
| Australian Dollars | 62,792 | 115,271 |
| Brazilian Real | 52,364 | 52,469 |
| Canadian Dollars | 41,433 | 92,693 |
| Swiss Francs | 28,126 | 59,776 |
| Chilean Pesos | 5,235 | 1,912 |
| Chinese Yuan | 351 | - |
| Colombian Peso | 1,586 | - |
| Czech Republic Koruny | 2,405 | 2,461 |
| Danish Kroner | 17,580 | 41,945 |
| Egyptian Pounds | 1,703 | 1,225 |
| European Union Euros | 216,369 | 343,755 |
| United Kingdom Pounds | 91,728 | 211,052 |
| Hong Kong Dollars | 158,592 | 150,845 |
| Hungarian Forints | 4,445 | 3,580 |
| Indonesian Rupiahs | 8,943 | 12,241 |
| Israeli New Shekels | 11,285 | 8,893 |
| Indian Rupees | 36,101 | 22,299 |
| Japanese Yen | 112,339 | 205,563 |
| South Korean Won | 58,285 | 56,767 |
| Moroccan Dirhams | 1,011 | - |
| Mexican Pesos | 18,693 | 21,157 |
| Malaysian Ringgits | 11,108 | 7,010 |
| Norwegian Krone | 15,658 | 45,560 |
| Philippines Pesos | 1,938 | 955 |
| Pakistani Rupees | 992 | 1,626 |
| Polish Zlotych | 5,875 | 5,727 |
| Russian Rubles | 94 | 74 |
| Swedish Kronor | 71,530 | 86,849 |
| Singaporean Dollars | 52,895 | 72,844 |
| Thai Baht | 5,850 | 12,110 |
| Turkish New Lira | 7,849 | 7,292 |
| Taiwanese New Dollars | 54,268 | 51,500 |
| United States of America Dollars | 355,366 | 675,209 |
| South African Rand | 35,207 | 27,674 |

This table shows effective foreign currency exposure after forward foreign exchange contracts have been taken into account.

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 20. FINANCIAL INSTRUMENTS (continued)

### (D) MARKET RISK (continued)

**(ii) Foreign currency exchange rate risk (continued)**

| 2009 | CONTRACT VALUE NZ$000 | FAIR VALUE NZ$000 |
|---|---|---|
| **Forward foreign exchange contracts (buy/(sell)):** | | |
| Less than 3 months | (3,155,879) | 233,814 |
| 3 to 12 months | (5,036,608) | 576,031 |
| | **(8,192,487)** | **809,845** |
| **2008** | | |
| Less than 3 months | (8,327,856) | (159,873) |
| 3 to 12 months | 144,807 | 2,509 |
| | **(8,183,049)** | **(157,364)** |

All forward foreign exchange contracts mature within 12 months.

The target currency exposure of the Group is determined independently of the target asset exposures. The Strategic Asset Allocation target level for the net foreign exchange exposure by the Group, after currency hedging is 10% (2008: 17.5%). The higher 17.5% net unhedged currency target for the prior year reflected the unusually high level of the New Zealand dollar, which made foreign currency more attractive than usual. The Group had put in place a mechanism to progressively lower the net unhedged currency exposure target towards the long term target of 10% which was achieved in the year ended 30 June 2009.

**Foreign currency sensitivity**

The following table details the Group's sensitivity to a change in the New Zealand dollar against the major foreign currencies, with all other variables remaining constant. The analysis has been performed only on the effective foreign currency exposure after allowing for the impact of forward foreign exchange contracts. The analysis has been performed on the same basis as 2008. The percentages used represent management's assessment of a reasonably possible change in foreign currency rates.

| | % | PROFIT AFTER TAX ($000) | | TOTAL EQUITY ($000) | |
|---|---|---|---|---|---|
| | | Increase | Decrease | Increase | Decrease |
| **30 June 2009** | | | | | |
| NZD:USD | 10% | (24,876) | 24,876 | (24,876) | 24,876 |
| NZD:EUR | 10% | (15,146) | 15,146 | (15,146) | 15,146 |
| NZD:GBP | 10% | (6,421) | 6,421 | (6,421) | 6,421 |
| NZD:JPY | 10% | (7,864) | 7,864 | (7,864) | 7,864 |
| NZD:Others | 10% | (54,194) | 54,194 | (54,194) | 54,194 |
| **30 June 2008** | | | | | |
| NZD:USD | 10% | (47,265) | 47,265 | (47,265) | 47,265 |
| NZD:EUR | 10% | (24,063) | 24,063 | (24,063) | 24,063 |
| NZD:GBP | 10% | (14,774) | 14,774 | (14,774) | 14,774 |
| NZD:JPY | 10% | (14,389) | 14,389 | (14,389) | 14,389 |
| NZD:Others | 10% | (67,393) | 67,393 | (67,393) | 67,393 |

**(iii) Interest rate risk**

Interest rate risk is the risk that the value of the Group's investments in fixed interest securities and cash and cash equivalents will fluctuate due to changes in market interest rates. Interest rate risk management activities are undertaken by investment managers in accordance with their 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.

The Group is primarily exposed to changes in the New Zealand dollar BKBM interest rate and the US LIBOR/prime rate.



# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 20. FINANCIAL INSTRUMENTS (continued)

### (D) MARKET RISK (continued)

**(iii) Interest rate risk (continued)**

**Interest rate exposure - maturity profile of financial instruments**

The following tables are based on the earlier of contractual repricing or maturity period, and exclude accrued interest.

**Group**

| | WEIGHTED AVERAGE EFFECTIVE INTEREST RATE % | VARIABLE INTEREST RATE NZ$000 | FIXED MATURITY DATES: LESS THAN 1 YEAR NZ$000 | 1 - 2 YEARS NZ$000 | 2 - 5 YEARS NZ$000 | 5 - 10 YEARS NZ$000 | 10+ YEARS NZ$000 |
|---|---|---|---|---|---|---|---|
| **2009** | | | | | | | |
| **Financial assets** | | | | | | | |
| Cash and cash equivalents | 1.68% | 1,060,920 | | | | | |
| New Zealand State-Owned Entities | 5.18% | | | | | | 2,837 |
| Other investments | 3.01% | 360,907 | 18,361 | 143,167 | 736,024 | 788,848 | 191,868 |
| | | **1,421,827** | **18,361** | **143,167** | **736,024** | **788,848** | **194,705** |
| **2008** | | | | | | | |
| **Financial assets** | | | | | | | |
| Cash and cash equivalents | 3.07% | 324,103 | | | | | |
| New Zealand Government Stock | 6.59% | | 76,735 | 108,310 | 188,813 | 158,985 | |
| New Zealand State-Owned Entities | 8.53% | | | | | | 4,307 |
| Other investments | 5.94% | 92,967 | 691,161 | 179,228 | 562,752 | 523,847 | 338,626 |
| | | **417,070** | **767,896** | **287,538** | **751,565** | **682,832** | **342,933** |

**Asset swaps**

At 30 June 2009 the notional principal amounts, fair values and period of expiry of the asset swap contracts are as follows:

| | NOTIONAL VALUE NZ$000 | FAIR VALUE NZ$000 |
|---|---|---|
| **2009** | | |
| 2 to 5 years | 91,755 | (169) |
| 5 to 10 years | 266,135 | 3,904 |
| | **357,890** | **3,735** |

**Interest rate sensitivity**

The sensitivity analysis in the table below of the effect on profit after tax and total equity has been determined based on the exposure to interest rates at the reporting date and the stipulated change taking place at the beginning of the financial year and held constant throughout the reporting period, with all other variables remaining constant. The analysis has been performed on the same basis as 2008. The percentages used represent management's assessment of a reasonably possible change in interest rates.

| | BASIS POINT | PROFIT AFTER TAX ($000) INCREASE | PROFIT AFTER TAX ($000) DECREASE | TOTAL EQUITY ($000) INCREASE | TOTAL EQUITY ($000) DECREASE |
|---|---|---|---|---|---|
| **30 June 2009** | | | | | |
| Cash and cash equivalents | 50 | 3,713 | (3,713) | 3,713 | (3,713) |
| New Zealand fixed interest | 50 | (147) | 147 | (147) | 147 |
| Global fixed interest | 50 | (25,041) | 26,227 | (25,041) | 26,227 |
| **30 June 2008** | | | | | |
| Cash and cash equivalents | 50 | 1,282 | (1,282) | 1,282 | (1,282) |
| New Zealand fixed interest | 50 | (7,583) | 7,783 | (7,583) | 7,783 |
| Global fixed interest | 50 | (38,683) | 40,393 | (38,683) | 40,393 |

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 20. FINANCIAL INSTRUMENTS (continued)

### (D) MARKET RISK (continued)

**(iv) Commodity price risk**

The Group is exposed to commodity price risk through its investments in commodity swaps. These investments are classified as held for trading. The commodity portfolios are designed to closely track the Dow Jones UBS Commodities Index (2008: Goldman Sachs Commodity Excess Return Index).

**Commodity price risk exposure**

| | 2009 NOTIONAL VALUE NZ$000 | 2009 FAIR VALUE NZ$000 | 2008 NOTIONAL VALUE NZ$000 | 2008 FAIR VALUE NZ$000 |
|---|---|---|---|---|
| **Commodity swaps** | | | | |
| Assets | - | - | 725,424 | 20,581 |
| Liabilities | 644,462 | (16,646) | 958,216 | (12,686) |
| **Futures** | | | | |
| Assets | 751,737 | - | 745,133 | - |
| Liabilities | (416,749) | - | (155,900) | - |

The margin on futures contracts is settled daily. Contractual maturity of all swaps is within 90 days.

**Commodity price sensitivity**

The following details the Fund's sensitivity to a change in the commodity price index, with all other variables remaining constant. The analysis has been performed on the same basis as 2008. The percentages used represent management's assessment of a reasonably possible change in commodity prices.

| | % | PROFIT AFTER TAX ($000) | | TOTAL EQUITY ($000) | |
|---|---|---|---|---|---|
| | | Increase | Decrease | Increase | Decrease |
| **30 June 2009** | | | | | |
| Dow Jones UBS Commodities Index | 22% | 96,683 | (96,683) | 96,683 | (96,683) |
| **30 June 2008** | | | | | |
| Goldman Sachs Commodity Excess Return Index | 22% | 115,628 | (115,628) | 115,628 | (115,628) |

### (E) CREDIT RISK MANAGEMENT

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 Group to risk consist principally of cash, investments, and receivables.

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. This contains credit and exposure policies to limit credit risk from the Group's investments.

**Significant concentrations of credit risk**

Concentration of credit risk exists if a single counterparty, or group of counterparties, are engaged in similar activities, operate within similar industries, geographies, or have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions. The maximum amount of credit risk for each class is the carrying amount in the statement of financial position.



# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 20. FINANCIAL INSTRUMENTS (continued)

### (E) CREDIT RISK MANAGEMENT (continued)

At balance date, the Group has industry concentration risk in respect of its investments. The table below sets out the exposures by industry for all of the Group's investments.

| | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **By industry** | | | |
| Basic materials | 1,367,924 | 1,215,074 | |
| Communications | 48,914 | 407,125 | |
| Consumer - Cyclical | 17,591 | 502,076 | |
| Consumer - Non-cyclical | 800,410 | 1,083,283 | |
| Diversified | 4,558 | 69,729 | |
| Energy | 352,038 | 647,916 | |
| Financial | 2,373,964 | 2,496,747 | |
| Funds | 2,695,442 | 3,260,480 | |
| Government | 806,722 | 1,333,900 | |
| Industrial | 1,513,044 | 1,403,784 | |
| Mortgage securities | 101,018 | 9,293 | |
| Technology | 395,297 | 351,630 | |
| Utilities | 669,945 | 625,728 | |
| Other | 967,634 | 347,563 | |
| **Net investments** | **12,114,501** | **13,754,328** | **16,095,650** |

At balance date, the Group has geographic concentration risk in respect of its investments. The table below sets out the exposures by geography for all of the Group's investments.

| | GROUP ACTUAL 2009 NZ$000 | GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| New Zealand | 3,567,313 | 3,227,390 | |
| Australia | 562,012 | 519,966 | |
| Japan | 488,497 | 787,904 | |
| United States | 4,922,593 | 5,781,880 | |
| Canada | 191,349 | 280,499 | |
| Europe | 1,833,190 | 2,630,824 | |
| Other Asia | 358,165 | 354,359 | |
| Central & South America | 140,552 | 128,704 | |
| Africa | 37,740 | 32,867 | |
| Middle East | 13,090 | 9,935 | |
| **Net investments** | **12,114,501** | **13,754,328** | **16,095,650** |

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 20. FINANCIAL INSTRUMENTS (continued)

### (E) CREDIT RISK MANAGEMENT (continued)

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

| | GROUP ACTUAL | |
|---|---|---|
| | NOTIONAL VALUE NZ$000 | FAIR VALUE NZ$000 |
| 2009 | | |
| ANZ Banking Corp | 173,732 | 1,625 |
| Barclays Bank PLC | 180,131 | 3,077 |
| Barclays Wholesale GTS | 17,223 | 540 |
| BNP Paribas | 1,137 | 20 |
| Chase Manhattan Bank | 995 | 28 |
| Citibank NA | 4,554 | 51 |
| Citigroup Global Markets Australia | 86,004 | 828 |
| Commonwealth Bank of Australia | 618,496 | 13,978 |
| CSFB Global Foreign Exchange | 69,586 | 478 |
| Credit Suisse First Boston | 463,106 | 85,366 |
| Deutsche Bank | 670,460 | 20,360 |
| Goldman Sachs & Co | 169,419 | 6,166 |
| HSBC Bank USA | 260 | 4 |
| JP Morgan Securities Australia | 171,348 | 38,031 |
| Morgan Stanley Capital Services | (41,820) | 12,091 |
| National Australia Bank | 820,931 | 13,207 |
| New Zealand Debt Management Office | 8,022,532 | 824,287 |
| Northern Trust Singapore | 14,623 | 856 |
| RBS Financial Markets Treasury | 151,427 | 2,928 |
| Royal Bank of Canada | 351,146 | 3,483 |
| Société Générale | 268,500 | 401 |
| State Street Bank & Trust Co | 896,812 | 14,783 |
| State Street Boston DTC | 316,480 | 2,204 |
| UBS New York | 145,057 | 4,327 |
| UBS Singapore | 85,029 | 665 |
| Westpac Banking Corp | 1,118,709 | 24,036 |
| | **14,775,877** | **1,073,820** |



# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 20. FINANCIAL INSTRUMENTS (continued)

### (E) CREDIT RISK MANAGEMENT (continued)

| | GROUP ACTUAL | |
|---|---|---|
| | NOTIONAL VALUE NZ$000 | FAIR VALUE NZ$000 |
| 2008 | | |
| AIG Financial International | 237,012 | 4,146 |
| Barclays Wholesale GTS | 1,160 | 6 |
| Chase Manhattan Bank | 7,991 | 116 |
| Citibank | 73,647 | 2,048 |
| Commonwealth Bank of Australia | 3,616 | 79 |
| CSFB Global Foreign Exchange | 8,158 | 130 |
| Deutsche Bank | 322,516 | 567 |
| Goldman Sachs & Co | 234,875 | 5,492 |
| Merrill Lynch International | 5,226 | 3 |
| Morgan Stanley | (178,858) | 21,629 |
| National Australia Bank | 912,418 | 1,200 |
| Northern Trust | 12,007 | 58 |
| New Zealand Debt Management Office | 1,230,078 | 9,952 |
| Royal Bank of Scotland | 5,102 | 87 |
| Royal Bank of Canada | 409,187 | 132 |
| Société Générale | 200,400 | 2,868 |
| State Street Bank & Trust Co | 374,839 | 5,181 |
| UBS | 11,230 | 218 |
| Westpac | 807,703 | 4,431 |
| | **4,678,307** | **58,343** |

The Group has assessed that there is no objective evidence of impairment.

### (F) LIQUIDITY RISK MANAGEMENT

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.

The Fund is long-term by nature (no capital withdrawals are permitted prior to 30 June 2020 and, on current assumptions, none are expected before 30 June 2031), and has had strong positive cashflow into the Fund to date.

Liquidity risk is managed by:

(a) requiring managers to invest primarily in securities traded on recognised exchanges with specified maximums for unlisted securities;

(b) requiring managers, within the terms of their individual contracts, to hold diversified portfolios;

(c) limiting the credit rating of all fixed interest investments to minimum levels; and

(d) maintaining a cash buffer to meet short term liquidity requirements.

Information about the contractual maturity periods of financial assets and liabilities is included at 20(d) (i), (ii), (iii), and (iv) above.

### (G) FAIR VALUES

The majority of the Group's assets and liabilities are carried at fair value. For all financial assets and liabilities, carrying value is not materially different from fair value.

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 21. COMPARISON TO BUDGET

During the year ended 30 June 2009, market returns have generated a negative variance over the assumptions utilised in the budget.

The Group produces its budget based on long-term return expectations which is for a profit. The Group cannot forecast short-term returns, whether they be gains or losses.

Overall, investments in listed equities, commodities, private equity and property were negative but broadly in line with returns in world market, while in contrast, fixed interest and timber contributed positively to Group performance.



ERNST & YOUNG Chartered Accountants

## AUDIT REPORT

TO THE READERS OF
THE NEW ZEALAND SUPERANNUATION FUND AND GROUP'S
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2009

The Auditor-General is the auditor of the New Zealand Superannuation Fund (the Fund) and group (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, for the year ended 30 June 2009.

**Unqualified Opinion**

In our opinion the financial statements of the Group on pages 61 to 98:

- comply with generally accepted accounting practice in New Zealand; and
- fairly reflect:
  - the Group's financial position as at 30 June 2009; and
  - the results of operations and cash flows for the year ended on that date.

The audit was completed on 14 September 2009, 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 Guardians of New Zealand Superannuation (the Guardians) 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.

ERNST & YOUNG Chartered Accountants

**AUDIT REPORT (Continued)**

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 Guardians;
- 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 Guardians and the Auditor**

The Guardians are responsible for preparing the financial statements in accordance with generally accepted accounting practice in New Zealand. The financial statements must fairly reflect the financial position of the Group as at 30 June 2009 and the operations and cash flows for the year ended on that date. The Guardians' 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 Institute of Chartered Accountants of New Zealand.

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

Warren Allen.

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



# Statement of Responsibility

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 the statement of service performance for the year ended 30 June 2009, fairly reflect the financial position, operations, and cash flows of the Guardians of New Zealand Superannuation and Group.

David May

**DAVID MAY**
Chairman
14 September 2009

**DAVID NEWMAN**
Board Member
14 September 2009

# Statement of Financial Performance

For the year ended 30 June 2009

| | | PARENT AND GROUP ACTUAL | | BUDGET |
|---|---|---|---|---|
| | | 2009 | 2008 | 2009 |
| | Note | NZ$000 | NZ$000 | NZ$000 |
| Revenue | 2(a) | 12,148 | 11,203 | 18,224 |
| Expenses | 2(b) | 12,148 | 11,203 | 18,224 |
| **NET SURPLUS FOR THE YEAR** | | **-** | **-** | **-** |

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

# Statement of Financial Position

As at 30 June 2009

| | | PARENT AND GROUP ACTUAL | | BUDGET |
|---|---|---|---|---|
| | | 2009 | 2008 | 2009 |
| | Note | NZ$000 | NZ$000 | NZ$000 |
| **Current assets** | | | | |
| Cash and cash equivalents | 16 | 853 | 1,309 | 1,430 |
| Trade and other receivables | 4 | 211 | 31 | 80 |
| Inter-entity receivables | 4, 12 | 1,067 | 713 | 496 |
| **Total current assets** | | **2,131** | **2,053** | **2,006** |
| **Non-current assets** | | | | |
| Inter-entity receivables | 4, 12 | - | 1,355 | 1,488 |
| Investments in subsidiaries | 11 | - | - | - |
| Intangible assets | 5 | - | 11 | - |
| Property, plant, and equipment | 6 | 2 | 50 | 2 |
| **Total non-current assets** | | **2** | **1,416** | **1,490** |
| **TOTAL ASSETS** | | **2,133** | **3,469** | **3,496** |
| **Current liabilities** | | | | |
| Trade and other payables | 7 | 1,248 | 1,453 | 1,058 |
| Inter-entity payables | 7, 12 | - | 25 | - |
| **Total current liabilities** | | **1,248** | **1,478** | **1,058** |
| **Non-current liabilities** | | | | |
| Trade and other payables | 7 | - | 1,395 | 1,784 |
| Provisions | 8 | 385 | 96 | 154 |
| **Total non-current liabilities** | | **385** | **1,491** | **1,938** |
| **TOTAL LIABILITIES** | | **1,633** | **2,969** | **2,996** |
| **NET ASSETS** | | **500** | **500** | **500** |
| **Public equity** | | | | |
| Accumulated surplus | | - | - | - |
| General equity reserve | 9 | 500 | 500 | 500 |
| **TOTAL PUBLIC EQUITY** | | **500** | **500** | **500** |

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

# Statement of Changes in Public Equity

For the year ended 30 June 2009

| | PARENT AND GROUP ACTUAL GENERAL EQUITY RESERVE NZ$000 | PARENT AND GROUP ACTUAL ACCUMULATED SURPLUS NZ$000 | TOTAL NZ$000 |
|---|---|---|---|
| **BALANCE AT 1 JULY 2007** | 500 | 25 | 525 |
| Net surplus for the year | - | - | - |
| Total recognised income and expense for the year | - | - | - |
| Repayment of accumulated surplus to the Crown | - | (25) | (25) |
| **BALANCE AT 30 JUNE 2008** | **500** | **-** | **500** |
| Net surplus for the year | - | - | - |
| Total recognised income and expense for the year | - | - | - |
| **BALANCE AT 30 JUNE 2009** | **500** | **-** | **500** |

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 2009

| | Note | PARENT AND GROUP ACTUAL 2009 NZ$000 | PARENT AND GROUP ACTUAL 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | | |
| **Cash was provided from:** | | | | |
| Receipts from the Crown | | 637 | 1,527 | 647 |
| Receipts from New Zealand Superannuation Fund | | 12,433 | 7,761 | 16,354 |
| Interest received | | 89 | 182 | 87 |
| Other receipts | | 10 | - | - |
| Goods and Services Tax | | (67) | (211) | 380 |
| **Total cash inflow from operating activities** | | **13,102** | **9,259** | **17,468** |
| **Cash was applied to:** | | | | |
| Payments to suppliers | | (4,687) | (3,271) | (5,500) |
| Payments to employees | | (8,871) | (6,562) | (11,508) |
| **Total cash outflow from operating activities** | | **(13,558)** | **(9,833)** | **(17,008)** |
| **NET CASH PROVIDED BY/(USED IN) OPERATING ACTIVITIES** | 16 | **(456)** | **(574)** | **460** |
| **NET CASH PROVIDED BY INVESTING ACTIVITIES** | | **-** | **-** | **-** |
| **NET CASH PROVIDED BY FINANCING ACTIVITIES** | | **-** | **-** | **-** |
| **NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS** | | **(456)** | **(574)** | **460** |
| Cash and cash equivalents at the beginning of the financial year | | 1,309 | 1,883 | 970 |
| **CASH AND CASH EQUIVALENTS AT THE END OF THE FINANCIAL YEAR** | 16 | **853** | **1,309** | **1,430** |

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

# Statement of Commitments

As at 30 June 2009

| | PARENT AND GROUP ACTUAL | |
|---|---|---|
| | 2009 NZ$000 | 2008 NZ$000 |
| **NON-CANCELLABLE OPERATING LEASE COMMITMENTS PAYABLE** | | |
| Payable no later than 1 year | 380 | 370 |
| 1-2 years | 357 | 357 |
| 2-5 years | 624 | 981 |
| | **1,361** | **1,708** |

# Statement of Contingent Liabilities

As at 30 June 2009

There were no contingent liabilities as at 30 June 2009 (2008:nil).

# Notes to the Financial Statements

For the year ended 30 June 2009

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### GENERAL INFORMATION

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

The Guardians are domiciled in New Zealand and the address of their principal place of business is set out in the Corporate Directory on page 125.

### STATEMENT OF COMPLIANCE

The Guardians are a public benefit entity, as the primary purpose is to manage and administer the New Zealand Superannuation Fund (Fund). The financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP). They comply with the New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable financial reporting standards as appropriate for public benefit entities.

The financial statements of the Guardians of New Zealand Superannuation and Subsidiaries for the year ended 30 June 2009 were authorised for issue in accordance with a resolution of the Board of Guardians of New Zealand Superannuation on 14 September 2009.

### BASIS OF PREPARATION

The financial statements have been prepared in accordance with the Crown Entities Act 2004 and the Public Finance Act 1989.

The financial statements have been prepared on a historical cost basis and are presented in New Zealand dollars and all values are rounded to the nearest thousand dollars (NZ$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.

Standards and interpretations that have recently been issued or amended but are not yet effective have not been adopted for the annual reporting period ending 30 June 2009. These are outlined in the table below:

| REFERENCE | TITLE | SUMMARY | APPLICATION DATE OF STANDARD* | IMPACT ON FINANCIAL STATEMENTS | APPLICATION DATE FOR GROUP* |
|---|---|---|---|---|---|
| NZ IAS 1 (revised) | Presentation of Financial Statements | Introduces a statement of comprehensive income. Other revisions include impacts on the presentation of items in the statement of changes in public equity, new presentation requirements for restatements or reclassifications of items in the financial statements, changes in the presentation requirements for dividends and changes to the titles of the financial statements. | 1 January 2009 | The amendments are expected to only affect the presentation of the Group's financial statements and will not have a direct impact on the measurement and recognition of amounts under the current NZ IAS 1. The Group has not determined at this stage whether to present the new statement of comprehensive income as a single or two statements. | 1 July 2009 |
| NZ IFRS 3 (revised) and NZ IAS 27 (amended) | NZ IFRS 3 Business Combinations (revised) and NZ IAS 27 Consolidated and Separate Financial Statements (amended) | NZ IFRS 3 (revised) introduces a number of changes in the accounting for business combinations that will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs, and future reported results. NZ IAS 27 (amended) requires that a change in the ownership interest of a subsidiary is accounted for as an equity transaction. Therefore, such a change will have no impact on goodwill, nor will it give rise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by a subsidiary as well as the loss of control of a subsidiary. | 1 July 2009 | The changes introduced by NZ IFRS 3 (revised) and NZ IAS 27 (amended) must be applied prospectively and will affect future acquisitions and transactions with a minority interest. | 1 July 2009 |

* Designates the beginning of the applicable annual reporting period.

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 of Guardians of New Zealand Superannuation for the year.

**(b) Consolidation of subsidiaries**

The Group financial statements comprise the Guardians of New Zealand Superannuation and their subsidiaries (Group).

Subsidiaries are those entities that are controlled by the Guardians. The financial statements of subsidiaries are prepared for the same reporting period as the parent entity, using consistent accounting policies.

Adjustments are made to bring into line any dissimilar accounting policies that may exist.

The Group financial statements incorporate the financial statements of the Guardians and their 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.

**(c) Revenue and income**

The Group primarily derives revenue through the provision of outputs to the Crown and to the Fund, and also derives income from its investments. Revenue and income is recognised to the extent that it is probable that the 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:

**Rendering of services**

Revenue from the rendering of services is recognised by reference to the stage of completion.

*New Zealand Superannuation Fund reimbursement of costs:*
Stage of completion is measured by the proportion of costs incurred to date, compared to the total costs of the outputs.

*Crown appropriations:*
Revenue is recognised on a straight line basis over the period the appropriations relate to, because the services are performed by an indeterminate number of acts over a specified period of time.

*Other service revenue:*
Where outputs cannot be measured reliably, revenue is recognised only to the extent that the expenses recognised are recoverable.

**Interest**

Interest revenue is recognised as the interest accrues (using the effective interest method which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset).

**(d) 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 with GST included. Where GST is irrecoverable as an input tax, then it is recognised as part of the related asset or expense.

Cash flows are included in the cash flow statement 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.

**(e) Taxation**

The Guardians are a public authority in terms of the Income Tax Act 2007 and consequently are exempt from income tax.

**(f) Receivables**

Short-term receivables are stated at their estimated realisable value after providing for doubtful and uncollectible debts.

**(g) Subsidiaries**

Subsequent to initial recognition, investments in subsidiaries are measured at cost.



# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 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.

**Subsequent measurement**

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

**Disposal**

An item of property, plant, and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset.

Any gain or loss arising on disposal of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of an item) is included in the statement of financial performance in the year the item is disposed of.

**Impairment**

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

Where the carrying amount is assessed to be greater than its recoverable amount, the item is written down to its recoverable amount. The write down is recognised in the statement of financial performance.

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 that 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 financial performance immediately.

Recoverable amount is the greater of fair value less costs to sell and value in use. The recoverable amount is determined for an individual asset, unless the asset's value in use cannot be estimated to be close to its fair value less costs to sell and it does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash generating unit to which the asset belongs.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

**Held for sale**

Items of property, plant, and equipment classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

Items of property, plant, and equipment are classified as 'held for sale' if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition. The sale of the asset is expected to be completed within one year from the date of classification.

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

**(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 |

**(j) Intangible assets**

Software and licences are finite life intangibles and are recorded at cost less accumulated amortisation and impairment. Amortisation is charged on a straight line basis over their estimated useful lives of 3 years. The estimated useful life and amortisation method is reviewed at the end of each annual reporting period.

**(k) Employee benefits**

Provision is made for benefits accruing to employees in respect of wages and salaries, annual leave, long service leave, long-term incentives, and sick leave when it is probable that settlement will be required and they are capable of being measured reliably.

Provisions made in respect of employee benefits expected to be settled within 12 months, are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Provisions made in respect of employee benefits which are not expected to be settled within 12 months are measured as the present value of the estimated future cash outflows to be made by the Group in respect of services provided by employees up to reporting date.

**(l) 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 straight-line basis over the period of the lease.

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as deferred income in the statement of financial position. The aggregate benefits of incentives are recognised as a reduction of rental expense on a straight-line basis over the period of the lease.

**(m) 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. Foreign exchange gains and losses for fair value through profit or loss investments are included within the change in their fair value.

**(n) Financial instruments**

The Group is party to financial instruments as part of its normal operations. These financial instruments include cash and cash equivalents, 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 a separate accounting policy, all financial instruments are shown at their amortised cost.



# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

**(o) Provisions**

Provisions are recognised when the Group has a present obligation as a result of a past event, 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 the 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.

**(p) Payables**

Short-term payables are not interest bearing and are stated at their nominal value.

**(q) Equity**

Equity is the Crown's interest in the Guardians and is measured as the difference between total assets and total liabilities.

**(r) Statement of cash flows**

The following are the definitions of the terms used in the statement of cash flows:

Operating activities include all activities other than investing and 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 equity and debt capital structure of the Group and those activities relating to the cost of servicing the Group's equity capital.

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

**(s) Changes in accounting policies**

There have been no changes in accounting policies. All policies are consistent with prior year.

**(t) Critical accounting estimates and assumptions**

In preparing these financial statements the Group has made estimates and assumptions concerning the future. These estimates and assumptions may differ from the subsequent actual results. Estimates and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year are discussed below:

*Employee entitlements - long-term incentive*

A component of the long-term incentive scheme is a measure of the performance of the Fund, calculated based on a rolling four-year performance average. The calculation of this liability utilises assumptions regarding the future performance of the Fund, the employee's average salary over the vesting period, the percentage of service rendered and the likelihood of the employee leaving before the long-term incentive is fully vested (no attrition has been factored into the current year calculation). The key variable is the performance of the Fund. Should the performance of the Fund differ from the assumption utilised in the calculation of the long-term incentive liability, this will impact the employee benefits expense in the statement of financial performance, and the carrying amount of the liability in the statement of financial position. There is no long-term incentive accrual in respect of Fund performance in the current year, as no targets were met. The Group minimises the risk of this estimation uncertainty by using a model based on historical evidence to forecast future returns of the Fund.

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

| | PARENT AND GROUP ACTUAL 2009 NZ$000 | 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **2. NET SURPLUS FROM OPERATIONS** | | | |
| **(A) REVENUE** | | | |
| Revenue from operations consisted of the following items: | | | |
| Revenue from the Crown | 384 | 1,611 | 487 |
| Cost reimbursement from New Zealand Superannuation Fund | 11,635 | 9,410 | 17,650 |
| Other revenue | 40 | - | - |
| Interest revenue | 89 | 182 | 87 |
| | **12,148** | **11,203** | **18,224** |
| **(B) NET SURPLUS** | | | |
| Net surplus has been arrived at after charging for/(crediting): | | | |
| Depreciation and amortisation of non-current assets (note 5 and note 6) | 59 | 102 | 59 |
| Auditors' remuneration (note 3) | 39 | 35 | 37 |
| Finance charge - provision discount adjustment | 18 | - | - |
| Board members' fees | 216 | 183 | 223 |
| Employee benefit expense*: | | | |
| Long-term incentive expense | (1,188) | 1,396 | 1,797 |
| Other employee remuneration and related expenses | 9,976 | 7,137 | 11,612 |
| Operating lease rental expenses: | | | |
| Minimum lease payments | 402 | 391 | 402 |
| Professional fees | 222 | 293 | 205 |
| Other expenses | 2,404 | 1,666 | 3,889 |
| | **12,148** | **11,203** | **18,224** |

* Compensation of key management personnel of the entity is specifically disclosed in the related party note 12.

| | PARENT AND GROUP ACTUAL 2009 NZ$000 | 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **3. REMUNERATION OF AUDITORS** | | | |
| **Auditor of the parent entity** | | | |
| Audit of the financial statements - Attest current year | 37 | 28 | 37 |
| Audit of the financial statements - Attest prior year | 2 | - | - |
| Audit of the financial statements - IFRS transition | - | 2 | - |
| | **39** | **30** | **37** |
| **Auditor of entities in the Group (not including the parent entity)** | | | |
| Audit of the financial statements | - | - | - |
| Review of long-term incentive scheme | - | 5 | - |
| | **-** | **5** | **-** |

The audit fees of other entities in the Group are paid by the Fund.

The auditor of the parent entity is Francis Caetano of Audit New Zealand, on behalf of the Auditor-General.

The auditor of other entities in the Group is Warren Allen of Ernst & Young, on behalf of the Auditor-General.



# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

| | PARENT AND GROUP ACTUAL 2009 NZ$000 | 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **4. TRADE AND OTHER RECEIVABLES** | | | |
| **Current receivables** | | | |
| Trade receivables | 2 | 3 | 80 |
| Goods & services tax (GST) receivable | 78 | 12 | - |
| Prepayments | 131 | 16 | - |
| Allowance for doubtful debts | - | - | - |
| Inter-entity receivables: | | | |
| State Services Commission | - | 6 | - |
| Accident Compensation Corporation | 15 | - | - |
| Government Superannuation Fund | 15 | - | - |
| The Treasury | - | 268 | - |
| New Zealand Superannuation Fund | 1,037 | 439 | 496 |
| | **1,278** | **744** | **576** |
| **Non-current receivables** | | | |
| Inter-entity receivables: | | | |
| New Zealand Superannuation Fund | - | 1,355 | 1,488 |
| | **-** | **1,355** | **1,488** |

Trade receivables have standard 30-day credit terms.

Inter-entity receivables classified as current consist of amounts payable by the Fund or other Crown Entities to the Guardians on standard 30-day credit terms.

The Group does not have a history of default on receivables. Accordingly, no allowance has been made for doubtful debts.

| | PARENT AND GROUP ACTUAL 2009 NZ$000 | 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **5. INTANGIBLE ASSETS** | | | |
| **Gross carrying amount** | | | |
| **Opening balance** | 63 | 63 | 63 |
| Additions | - | - | - |
| Disposals | - | - | - |
| **Closing balance** | **63** | **63** | **63** |
| **Accumulated amortisation** | | | |
| **Opening balance** | 52 | 35 | 53 |
| Amortisation expense | 11 | 17 | 10 |
| **Closing balance** | **63** | **52** | **63** |
| **Net book value** | **-** | **11** | **-** |

Intangible assets are software licences and applications used by the Group in day-to-day operations.

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

| | PARENT AND GROUP ACTUAL OFFICE EQUIPMENT NZ$000 | COMPUTER EQUIPMENT NZ$000 | TOTAL NZ$000 |
|---|---|---|---|
| **6. PROPERTY, PLANT, AND EQUIPMENT** | | | |
| **Gross carrying amount** | | | |
| **Balance at 1 July 2007** | 247 | 244 | 491 |
| Additions | - | - | - |
| Disposals | - | - | - |
| **Balance at 30 June 2008** | **247** | **244** | **491** |
| Additions | - | - | - |
| Disposals | - | - | - |
| **Balance at 30 June 2009** | **247** | **244** | **491** |
| **Accumulated depreciation** | | | |
| **Balance at 1 July 2007** | 197 | 159 | 356 |
| Depreciation expense | 29 | 56 | 85 |
| **Balance at 30 June 2008** | **226** | **215** | **441** |
| Depreciation expense | 19 | 29 | 48 |
| **Balance at 30 June 2009** | **245** | **244** | **489** |
| **Net book value** | | | |
| As at 30 June 2008 | 21 | 29 | 50 |
| **As at 30 June 2009** | **2** | **-** | **2** |



# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

| | PARENT AND GROUP ACTUAL 2009 NZ$000 | 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **7. TRADE AND OTHER PAYABLES** | | | |
| **Current payables and accruals** | | | |
| Trade payables [i] | 295 | 267 | 353 |
| Employee entitlements - annual leave (key management personnel) | 108 | 60 | 95 |
| Employee entitlements - annual leave (other) | 279 | 172 | 284 |
| Employee entitlements - accrued salary (key management personnel) | 20 | 28 | - |
| Employee entitlements - accrued salary (other) | 55 | 47 | - |
| Employee entitlements - long-term incentives (key management personnel) [ii] | - | 135 | 61 |
| Employee entitlements - long-term incentives (other) [ii] | 383 | 510 | 243 |
| Accrued expenses | 108 | 234 | 22 |
| Inter-entity payables: | | | |
| The Treasury | - | 25 | - |
| | **1,248** | **1,478** | **1,058** |
| **Non-current payables and accruals** | | | |
| Employee entitlements - long-term incentives (key management personnel) | - | 434 | 357 |
| Employee entitlements - long-term incentives (other) | - | 961 | 1,427 |
| | **-** | **1,395** | **1,784** |

[i] The average credit period on purchases is 30 days. No interest is charged on overdue balances. The Group has financial risk management policies in place to ensure that all payables are paid within the credit time frame.

[ii] The Guardians have a long-term incentive scheme for all employees. A component of the scheme is a measure of the performance of the Fund, calculated based on a rolling four-year performance average. The incentive vests progressively over the four-year performance period. Since payments in relation to the Fund performance component of the scheme are based on four-year averages, any negative returns generated during the four year period are offset against positive returns. As such, during the first three years of the four-year calculation period, the value of the final payment is dependent on the outcome of future periods. The liability reflected in the statement of financial position reflects the present value of the Guardians obligations in respect of that liability. The liability has been calculated based on management's best estimate of the returns that will be achieved by the Fund in future years.

| | 2009 NZ$000 | 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| **8. PROVISIONS** | | | |
| **Non-current provisions** | | | |
| Provision for refurbishment | 385 | 96 | 154 |
| | **385** | **96** | **154** |

| | PARENT AND GROUP Refurbishment [i] |
|---|---|
| **Balance at 1 July 2008** | 96 |
| Additional provisions recognised | 271 |
| Unwinding and discount rate adjustment | 18 |
| **Balance at 30 June 2009** | **385** |

[i] The provision for refurbishment represents the present value of management's best estimate of the future sacrifice of economic benefits that will be required under the Group's programme for restoring premises to the condition required under the lease agreement. The estimate has been made on the basis of advice received from a Quantity Surveyor and may vary as a result of changes in the price of building materials.

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 9. MANAGEMENT OF CAPITAL

As a public benefit entity which is fully funded by Crown appropriations (for budgeted Board and audit costs) and by Fund reimbursements (for all other operating costs), the Group has no specific liquidity policies, procedures, or targets. Operating budgets are set on an annual basis, with an emphasis upon cost control. The Group is not permitted to borrow, and ensures a positive cash position at all times through collection of appropriations and reimbursements.

## 10. LEASES

**Operating leases**

Non-cancellable operating lease commitments payable have been disclosed under the statement of commitments.

Operating leases relate to office premises in two locations. The lease terms are 4 years and 6 months, with options to extend for 6 years and 1 year respectively. All operating lease contracts contain market review clauses in the event that the Group exercises its option to renew. The Group does not have an option to purchase the leased assets at the expiry of the lease period.

## 11. SUBSIDIARIES

| NAME OF ENTITY | COUNTRY OF INCORPORATION | OWNERSHIP INTEREST AND VOTING RIGHTS 2009 % | 2008 % |
|---|---|---|---|
| **Subsidiaries** | | | |
| New Zealand Superannuation Fund Nominees Limited | New Zealand | 100 | 100 |
| NZSF Timber Investments (No 1) Limited | New Zealand | 100 | 100 |
| NZSF Timber Investments (No 2) Limited | New Zealand | 100 | 100 |
| NZSF Timber Investments (No 3) Limited | New Zealand | 100 | 100 |
| NZSF Timber Investments (No 4) Limited | New Zealand | 100 | 100 |
| NZSF Private Equity Investments (No 1) Limited | New Zealand | 100 | 100 |
| CNI Timber Operating Company Limited | New Zealand | 100 | 100 |

The principal activity of each subsidiary (with the exception of CNI Timber Operating Company Limited) 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.

The share in CNI Timber Operating Company Limited, together with the rights and benefits arising from that share, is held for and on behalf of the New Zealand Superannuation Fund. As such, this company is consolidated into the financial statements of the Fund rather than these financial statements.

## 12. RELATED PARTY DISCLOSURES

### (A) PARENT ENTITIES

The parent entity in the Group is the Guardians, which is 100% owned by the ultimate parent entity, the Crown.

### (B) EQUITY INTERESTS IN RELATED PARTIES

**Equity interests in subsidiaries**

Details of the percentage of ordinary shares held in subsidiaries are disclosed in note 11 to the financial statements.





# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 12. RELATED PARTY DISCLOSURES (continued)

### (C) TRANSACTIONS WITH RELATED PARTIES

**Revenue**

The Guardians are a wholly owned entity of the Crown, and have paid expenses relating to the Fund during the year, as they are required to do under the Act. Crown appropriations (for budgeted Board and audit costs) and reimbursement of costs from the Fund are the main sources of revenue. Other revenue is gained from sharing outputs with other Crown Entities.

| | PARENT AND GROUP ACTUAL 2009 NZ$000 | 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| Appropriations from the Crown | 384 | 1,611 | 487 |
| Cost reimbursement from New Zealand Superannuation Fund | 11,635 | 9,410 | 17,650 |
| Other income from Crown Entities: | | | |
| Accident Compensation Corporation | 14 | - | |
| Government Superannuation Fund | 13 | - | |
| Earthquake Commission | 13 | - | |
| | **12,059** | **11,021** | **18,137** |

Amounts receivable from or payable to related parties at balance date are disclosed in notes 4 and 7 of these financial statements.

The Group has entered into a number of transactions with other government entities 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.

**Employee benefits**

| The compensation of the Board, executives, and other key management personnel, is set out below: | | | |
|---|---|---|---|
| Short-term employee benefits (including board member fees) | 2,889 | 2,107 | |
| Termination benefits | - | 130 | |
| Long-term employee benefits | - | 569 | |
| | **2,889** | **2,806** | **-** |

**Board members' fees**

| Board members earned the following fees during the year: | | | |
|---|---|---|---|
| D May (Chairperson) | 54 | 46 | |
| Sir D Graham (Deputy Chairperson)* | 30 | 25 | |
| B Liddell | 27 | 23 | |
| D Newman | 27 | 23 | |
| G Saunders | 24 | 20 | |
| M Tume | 27 | 23 | |
| J Evans | 27 | 23 | |
| | **216** | **183** | **223** |

* Sir Douglas Graham resigned from the Board in June 2009.

Board fees are paid inclusive of GST. 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.

**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.

The Guardians have effected Directors and Officers Liability insurance cover in respect of the liability or costs of Board members and employees.

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 12. RELATED PARTY DISCLOSURES (continued)

**Terms/price under which related party transactions were entered into**

All balances advanced to and payable to related parties are unsecured and subordinate to other liabilities. Interest is not charged on outstanding balances.

There have been no write-downs of receivables in respect of transactions with related parties. No amounts were provided for doubtful debts relating to debts due from related parties at reporting date (2008: $nil).

The terms and conditions around settlement of related party balances are set out in note 4 and note 7.

## 13. EMPLOYEES' REMUNERATION OVER $100,000 PER ANNUM

| NZ$000 | | | | PARENT AND GROUP ACTUAL 2009 | 2008 |
|---|---|---|---|---|---|
| Total remuneration and benefits | | | | | |
| | 100 | - | 110 | 2 | 3 |
| | 110 | - | 120 | 4 | 1 |
| | 120 | - | 130 | 2 | 3* |
| | 130 | - | 140 | 2 | - |
| | 140 | - | 150 | 3 | 3 |
| | 150 | - | 160 | 2 | - |
| | 160 | - | 170 | 1 | 2 |
| | 170 | - | 180 | 2 | 1 |
| | 180 | - | 190 | 1 | - |
| | 190 | - | 200 | 2 | 3 |
| | 200 | - | 210 | 3 | 4* |
| | 210 | - | 220 | 1 | 1 |
| | 220 | - | 230 | 3 | - |
| | 230 | - | 240 | 3 | 3 |
| | 240 | - | 250 | - | 1 |
| | 250 | - | 260 | 3 | - |
| | 260 | - | 270 | 2 | 1 |
| | 280 | - | 290 | 1 | - |
| | 290 | - | 300 | 1 | 1* |
| | 300 | - | 310 | - | 1 |
| | 320 | - | 330 | 1 | - |
| | 330 | - | 340 | - | 1 |
| | 350 | - | 360 | 1 | 1 |
| | 370 | - | 380 | - | 1 |
| | 380 | - | 390 | 2 | - |
| | 390 | - | 400 | - | 1 |
| | 410 | - | 420 | - | 1 |
| | 430 | - | 440 | 1 | - |
| | 440 | - | 450 | - | 1 |
| | 520 | - | 530 | - | 1* |

* Includes payments made to terminated employees. Refer to note 14.

The total remuneration figures in this table consist of both an employee's gross base salary and the proportion of the long-term incentive entitlement that 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.

The bonus entitlement is a long-term incentive scheme that has both organisation and financial performance targets of the Fund. The financial performance component is based on rolling four-year periods 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.

For the current financial year no bonus accrual has been made in respect of key management personnel.





# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 14. TERMINATION PAYMENTS

There were no payments made in respect of terminated employees during the year. In 2008 there were five payments made in respect of terminated employees whose positions were made redundant totalling $254,000.

## 15. SUBSEQUENT EVENTS

There were no reportable events subsequent to year end (2008:nil).

## 16. NOTES TO THE STATEMENT OF CASH FLOWS

### (A) RECONCILIATION OF CASH AND CASH EQUIVALENTS

For the purposes of the statement of cash flows, cash and cash equivalents includes cash on hand and in banks and investments in money market instruments. Cash and cash equivalents at the end of the financial year as shown in the statement of cash flows is reconciled to the related items in the statement of financial position as follows:

| | PARENT AND GROUP ACTUAL 2009 NZ$000 | 2008 NZ$000 | BUDGET 2009 NZ$000 |
|---|---|---|---|
| Cash and bank | 853 | 608 | |
| Short-term deposits | - | 701 | |
| | **853** | **1,309** | **1,430** |
| **(B) RECONCILIATION OF NET SURPLUS FOR THE YEAR TO NET CASH FLOWS FROM OPERATING ACTIVITIES** | | | |
| Net surplus for the year | - | - | - |
| Add/(deduct) non-cash items: | | | |
| Depreciation and amortisation of non-current assets | 59 | 102 | |
| Changes in working capital: | | | |
| (Increase)/decrease in assets: | | | |
| Receivables | 821 | (962) | |
| Increase/(decrease) in liabilities: | | | |
| Payables and accruals | (1,625) | 209 | |
| Provisions | 289 | 77 | |
| **Net cash provided by/(used in) operating activities** | **(456)** | **(574)** | **460** |

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 17. FINANCIAL INSTRUMENTS

### (A) FINANCIAL ASSETS AND FINANCIAL LIABILITIES BY MEASUREMENT BASIS

**Key:**
L&R: Loans and receivables
AC: Amortised cost or cost

| | L&R NZ$000 | AC NZ$000 | TOTAL NZ$000 |
|---|---|---|---|
| 2009 | | | |
| **Financial assets** | | | |
| Cash and cash equivalents | | | |
| Cash and bank | - | 853 | 853 |
| Total cash | - | 853 | 853 |
| Receivables | 2 | - | 2 |
| Inter-entity receivables | 1,067 | - | 1,067 |
| **Total financial assets** | **1,069** | **853** | **1,922** |
| **Financial liabilities** | | | |
| Payables and accruals | - | 1,248 | 1,248 |
| **Total financial liabilities** | **-** | **1,248** | **1,248** |
| 2008 | | | |
| **Financial assets** | | | |
| Cash and cash equivalents | | | |
| Cash and bank | - | 608 | 608 |
| Short-term deposits | - | 701 | 701 |
| Total cash | - | 1,309 | 1,309 |
| Receivables | 3 | - | 3 |
| Inter-entity receivables | 2,068 | - | 2,068 |
| **Total financial assets** | **2,071** | **1,309** | **3,380** |
| **Financial liabilities** | | | |
| Payables and accruals | - | 2,873 | 2,873 |
| **Total financial liabilities** | **-** | **2,873** | **2,873** |

### (B) FINANCIAL RISK MANAGEMENT OBJECTIVES

Through their activities, the Guardians are exposed to the financial risks of market risk, credit risk, and liquidity risk.

The Guardians are risk averse. They do not hold significant financial assets or liabilities. Cash and cash equivalents are held with creditworthy institutions. Market risk, credit risk and liquidity risk are not considered significant for these reasons. Policies do not allow any transactions which are speculative in nature to be entered into.

### (C) SIGNIFICANT ACCOUNTING POLICIES

Details of the significant accounting policies and methods adopted, including the criteria for recognition, and the basis of measurement applied in respect of each class of financial asset, financial liability, and equity instrument are disclosed in note 1 to the financial statements.





# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 17. FINANCIAL INSTRUMENTS (continued)

### (D) MARKET RISK

The market risk that the Guardians are primarily exposed to is interest rate risk (primarily to changes in New Zealand interest rates).

The Guardians do not hold significant interest-bearing assets, and have no interest-bearing liabilities. The Guardians invest cash and cash equivalents with the The National Bank of New Zealand, ensuring a fair market return on any cash position, but do not seek to speculate on interest returns, and do not specifically monitor exposure to interest rates or interest rate returns.

**Interest rate risk**

Interest rate risk is the risk that the value of the Guardians' investments in cash and cash equivalents 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 2009 (30 June 2008: $nil). The Board does not consider that there is any significant interest exposure on the Group's investments.

The Guardians are primarily exposed to changes in the New Zealand dollar Official Cash Rate.

**Interest rate exposure - maturity profile of financial instruments**

The following tables are based on the earlier of contractual repricing or maturity period.

| | PARENT AND GROUP ACTUAL | | |
|---|---|---|---|
| | WEIGHTED AVERAGE EFFECTIVE INTEREST RATE % | VARIABLE INTEREST RATE NZ$000 | FIXED MATURITY DATES - LESS THAN 1 YEAR NZ$000 |
| 2009 | | | |
| **Financial assets** | | | |
| Cash and cash equivalents | 5.88 | 853 | - |
| | **5.88** | **853** | **-** |
| 2008 | | | |
| **Financial assets** | | | |
| Cash and cash equivalents | 8.27 | 608 | 701 |
| | **8.27** | **608** | **701** |

**Interest rate sensitivity**

The sensitivity analysis in the table below of the effect on net surplus has been determined based on the exposure to interest rates at the reporting date and the stipulated change taking place at the beginning of the financial year and held constant throughout the reporting period. A 100 basis point change is used when reporting interest rate risk internally to key management personnel and represents the Guardians' assessment of a reasonably possible change in interest rates.

| | | NET SURPLUS 2009 NZ$000 | NET SURPLUS 2008 NZ$000 |
|---|---|---|---|
| Cash and cash equivalents | + 100 bps | 9 | 10 |
| Cash and cash equivalents | - 100 bps | (9) | (10) |

The Guardians' sensitivity to interest rate changes has not changed significantly from the prior year.

# Notes to the Financial Statements (continued)

For the year ended 30 June 2009

## 17. FINANCIAL INSTRUMENTS (continued)

### (E) CREDIT RISK MANAGEMENT

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 Group to risk consist principally of cash and cash equivalents.

The Group places its investments with institutions that have a high credit rating. The Group believes 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.

**Significant concentrations of credit risk**

The Group primarily invests cash balances with The National Bank of New Zealand, which is considered to be a low credit risk institution. The maximum amount of credit risk for each class is the carrying amount in the statement of financial position.

### (F) LIQUIDITY RISK MANAGEMENT

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 the Guardians recover all expenditure from the Crown or the New Zealand Superannuation Fund, and as the Guardians have a positive cash position, no specific liquidity policies have been developed.

Information about the contractual maturity periods of financial assets and financial liabilities is included above.

### (G) FAIR VALUES

The fair value of financial instruments is equivalent to the carrying amount disclosed in the statement of financial position.

## 18. COMPARISON TO BUDGET

| | ACTUAL 2009 NZ$000 | BUDGET 2009 NZ$000 | VARIANCE 2009 NZ$000 |
|---|---|---|---|
| Statement of financial performance | - | - | - |
| Statement of changes in public equity | 500 | 500 | - |
| Statement of financial position | 500 | 500 | - |
| Statement of cash flows [i] | 853 | 1,430 | (577) |

[i] Lower cash on hand at year end is due to stricter cash management employed during the year.

## 19. REVISION OF CALCULATION METHODOLOGY OF LONG-TERM INCENTIVE ACCRUAL

During the year, an amendment was made to the calculation methodology for the long-term incentive accrual. In order to estimate the accrual, the percentage of service rendered is now taken into account, assuming vesting over a four year period. The net effect of the changes in the current financial year was a decrease in the long-term incentive accrual of $1,462,000.



# Audit Report

AUDIT NEW ZEALAND
Mana Arotake Aotearoa

TO THE READERS OF
THE GUARDIANS OF NEW ZEALAND SUPERANNUATION AND GROUP'S
FINANCIAL STATEMENTS AND STATEMENT OF SERVICE PERFORMANCE
FOR THE YEAR ENDED 30 JUNE 2009

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. 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 2009.

### UNQUALIFIED OPINION

In our opinion:

The financial statements of the Guardians and group on pages 102 to 122:

– comply with generally accepted accounting practice in New Zealand; and
– fairly reflect:
  - the Guardians and group's financial position as at 30 June 2009; 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 10 to 13:

– 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 14 September 2009, 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 2009 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 New Zealand Institute of Chartered Accountants.

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

# Corporate Directory

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### AUDITORS

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On behalf of the Auditor-General
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Private Bag 3928
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**NEW ZEALAND SUPERANNUATION FUND**

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On behalf of the Auditor-General
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48 Mulgrave Street
Private Bag 3928
Wellington

### BANKERS

**GUARDIANS OF NEW ZEALAND SUPERANNUATION**

The National Bank of New Zealand

**NEW ZEALAND SUPERANNUATION FUND**

Westpac Banking Corporation

### GLOBAL CUSTODIAN

Northern Trust Company
50 Bank Street
Canary Wharf
London E14 5NT

- Cover photo of Buller Gorge by John Savage

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