



Australian Government

Future Fund

2006-07

annual report



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About the Future Fund

The Future Fund Act commenced on 3 April 2006 and established the Future Fund.

The object of the Fund is to strengthen the Australian Government's long term financial position by making provision for unfunded Commonwealth superannuation liabilities. These liabilities will become payable at a time when an ageing population is likely to place significant pressure on the Australian Government's finances.

Under the Future Fund Act, the Board of Guardians, supported by the Future Fund Management Agency, is required to seek to maximise the return earned on contributions to the Fund over the long term, consistent with international best practice for institutional investment and subject to any directions provided by the Responsible Ministers, being the Treasurer and Minister for Finance and Administration.

The Board received its first Investment Mandate on 3 May 2006 and a Ministerial Direction in relation to the escrow restrictions for its Telstra shareholding on 28 February 2007. Copies of these documents are included in the Appendices.

The Australian Government has made a number of cash contributions to the Future Fund and, in conjunction with the sale of part of its holding in Telstra, transferred its residual holding to the Fund.

Letter of Transmittal



Australian Government

Future Fund

18 September 2007

Senator the Hon. Nick Minchin
Minister for Finance and Administration
Parliament House
CANBERRA ACT 2600

Dear Minister

As the Minister with nominated responsibility for the Future Fund, I have pleasure in presenting to you the Annual Report of the Future Fund Board of Guardians and the Future Fund Management Agency for the year ending 30 June 2007 for presentation to the Parliament.

The report has been prepared in accordance with section 81 of the *Future Fund Act 2006* (the Act). Subsection 81(3) of the Act requires you to ensure a copy of the report is tabled in each House of the Parliament within 15 sitting days of that House receiving the report.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'D Murray'.

David Murray

Chair
Future Fund Board of Guardians



Report from the Board

Review by the Chair
Board of Guardians

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David Murray AO, Chair, Future Fund

Review by the Chair of the Future Fund

The 2006-07 annual report covers the Future Fund's first full year of operations, following its creation in April 2006.

This year the Fund has taken important steps in establishing its operations and beginning its investment program.

The experience of similar funds globally is that success is dependent upon having a clear purpose and mandate; effective governance by the Board and high quality management. This year we have focused on these areas.

Contributions and performance

During the financial year, the Fund's assets rose to \$52 billion. Having received \$18 billion in seed capital from Government in the previous financial year, the Fund received further contributions from the budget surplus and the proceeds of the T3 Telstra sale during 2006-2007. This included \$18.6 billion in January 2007, \$3.6 billion in February 2007 and the receipt of 2.1 billion shares in Telstra in February 2007, valued at \$8.9 billion at transfer.

The cash contributions were invested with the Reserve Bank of Australia (RBA) pending the development of the investment strategy and organisational infrastructure. We set a target of beginning the investment program by the end of June 2007 and this was met.

At 30 June 2007, the Fund had established, in addition to its holding in Telstra, an exposure to Australian equities of \$1.85 billion and to international equities of \$2 billion. The remaining assets remained invested with the RBA.

The Board believes it appropriate to view the performance of the Telstra shareholding and the broader portfolio separately. This reflects the escrow directions that apply to the Telstra holding and the reduced level of diversification that this creates. This approach will continue until a portfolio that is more consistent with the long term strategic allocation has been constructed, sometime after the conclusion of the escrow period.

The cash and equities portfolio (excluding Telstra) generated a net return of 6.24% over the year. With the inclusion of the Telstra holding, which the Fund held for four months from the end of February, the Fund generated an overall return of 7.36%.

The Board is required to focus on real rather than nominal returns, but notes that the Consumer Price Index (CPI) measure of inflation used in its Investment Mandate can be affected by temporary disturbances. In constructing the long term investment portfolio, the Board has adopted an inflation assumption of 2.5% per annum, consistent with the mid-point of the RBA's target range. Over time the Board will assess the behaviour of the CPI and the RBA's underlying measure of inflation relative to its long term assumption.

As foreshadowed in the Investment Mandate, returns are expected to be lower than the long term objective during the initial transition stage, whilst the portfolio is being built. The General Manager's report provides further information on the development of the investment portfolio.

The following table details the Fund's nominal performance and real performance using CPI at 2.1% and the Board's long term inflation assumption of 2.5%.

Portfolio performance

Operating result		Rate of return		
AUD million		Nominal %	Real %	
			CPI at 2.1%	Portfolio inflation assumption of 2.5%
Total income	2817.5	7.39	5.29	4.89
Total expenditure	(9.9)	(0.03)	n/a	n/a
Operating result	2807.6	7.36	5.26	4.86
Operating result (ex Telstra)	1715.2	6.24	4.14	3.74

Rates of return are calculated as a percentage of average assets.

Real return is the nominal return adjusted for inflation.

Governance and People

The Board of Guardians has now been in place for just over a year and brings considerable breadth and depth of experience to the Fund. Following the resignation of Robert Elstone, whose contribution was acknowledged in last year's report, I was pleased to welcome John Paterson to the Board in December 2006.

The Board's core focus is overseeing the development of the strategy for the organisation to meet its objectives and to approve the structure of the portfolio and to monitor investment returns. The critical success factor is the quality of the management team and its ability to build an investment strategy that takes full advantage of the Fund's characteristics and to ensure that strategy is implemented effectively.

Building from the clear direction of our Investment Mandate, we have developed a number of investment principles for the initial stages of the investment program. Our Statement of Investment Policies, which is available on our website, provides a framework for the governance and management of the Fund and its investment activities. We will continue to develop this framework and publish updates as required under legislation.

The Statement of Investment Policies also summarises our thinking on our business model and our approach to risk, compliance and audit functions which is overseen by the Audit Committee.

The Board was pleased to welcome Paul Costello as General Manager in November 2006. In the short time since he arrived he has made important appointments to investment, operations and finance roles as well as drawing together other supporting staff. I would like to place on record the Board's recognition of the efforts of all of our people in getting the Fund up and running during the year.

I would like to thank those departmental officials who helped the Fund to get established and have since completed their secondments.

I am fortunate to have a skilled and dedicated Board, committed to value creation through good governance. I thank them for their ongoing support and encouragement.

Future

The coming year is a particularly exciting one for the Fund. The emphasis will be on further developing our organisation and continuing to implement the investment program with a view to substantially advancing it towards our targeted portfolio structure. Returns should continue to reflect both the transition we are making and normal fluctuations in markets.

While market timing is a consideration for all investors, we are focused on building a portfolio that will perform in the long term and it would be unwise to be distracted from this horizon. The Telstra shareholding will continue to distort the expected pattern of returns as the escrow period does not expire until the 2008/09 financial year.

Since the end of the 2006/07 year the Future Fund has also received a further contribution of \$7 billion and there has been further development of the proposal to establish a Higher Education Endowment Fund (HEEF), the investment of which will be undertaken by the Future Fund.



DAVID MURRAY AO
Chair, Future Fund Board of Guardians

The Board of Guardians

The Board of Guardians comprises a Chair and six other members. Members of the Board are appointed by the Responsible Ministers for terms of up to five years. Appointees must have substantial experience or expertise and professional credibility in investing financial assets, managing financial investments or corporate governance.

As reported in the 2005-2006 Annual Report, Mr Robert Elstone resigned as a member of the Board of Guardians with effect from 6 July 2006. Mr John Paterson was appointed to the Board on 18 December 2006.



Mr David Murray AO

Mr Murray was appointed on 3 April 2006 for a period of five years.

Mr Murray spent 39 years' at the Commonwealth Bank of Australia (CBA), holding the role of Chief Executive Officer from 1992 until his retirement in 2005. Mr Murray has substantial experience in the finance and banking sector and considerable knowledge of financial markets.

Mr Murray also has strong corporate governance credentials, having guided CBA through a number of major changes, including its privatisation in 1996. In 2003, Mr Murray was awarded the Centenary Medal for his contributions in the areas of banking and corporate governance. He was appointed an Officer of the Order of Australia in 2007.



Mr Jeffrey Browne

Mr Browne was appointed on 3 April 2006 for a period of five years.

Mr Browne was a Partner (New York) and Managing Partner of Australian Offices (Melbourne and Sydney) in the legal firm Sullivan & Cromwell until recently, and has extensive experience in capital market transactions. Mr Browne has also acted for the Commonwealth and state governments, mainly in relation to international bond offerings and privatisations.



Ms Susan Doyle

Ms Doyle was appointed on 3 April 2006 for a period of three years.

Ms Doyle is Chair of the Australian Reward Investment Alliance (ARIA) and Deputy Chair and Chair of the Audit Committee of the South Australian Water Corporation. Ms Doyle had an extensive executive career in the funds management industry, particularly in the equities and fixed interest sectors, working with Commonwealth Funds Management, Suncorp Metway and Insurance Australia Group.



Dr John Mulcahy

Dr Mulcahy was appointed on 3 April 2006 for a period of five years.

Dr Mulcahy is Chief Executive Officer and Managing Director of Suncorp. Dr Mulcahy has broad corporate experience and expertise in retail financial services having held a number of senior roles in the Commonwealth Bank including Group Executive, Investment and Insurance Services and previously the positions of Chief Executive of Lend Lease Property Investment Services and Chief Executive of Civil and Civic.



Mr John Paterson

Mr Paterson was appointed on 18 December 2006 for a period of three years.

Mr Paterson spent 31 years with JBWere & Son. He has extensive experience of financial markets having held roles as Director of Research, Investment Strategist, Managing Director of Were Stockbroking and Managing Director of Corporate Finance. He is a Director of Australian Foundation Investment Company and of Djerriwarrh Investments and is on the External Advisory Board of the Salvation Army (Southern Region).



Mr Trevor C Rowe AM

Mr Rowe was appointed on 3 April 2006 for a period of five years.

Mr Rowe is Chairman, Rothschild Australia Limited. Mr Rowe has been the Chairman of the Queensland Investment Corporation (QIC) since 2001, Chairman of the United Group Limited since 2002, Chancellor of Bond University since 2003 and a Director of the Australian Securities Exchange Limited (ASX) since 2002. He was also a member of the Takeovers Panel from 2000 to 2003 and has been a member of the Foreign Affairs Council since 2000. He has substantial experience and expertise in financial management, investments and corporate governance.



Mr Brian Watson

Mr Watson was appointed on 3 April 2006 for a period of three years.

Mr Watson is Executive Chairman of Georgica Associates Pty Limited, an independent private equity investment management firm. Prior to establishing Georgica Associates in 2002, Mr Watson spent 16 years with JP Morgan & Co in a number of senior roles, including Global Head of Equity Capital Markets and Global Head of Private Equity, both based in New York, and Chairman of JP Morgan Australia. Mr Watson is also Chairman of the Australian Government's Venture Capital Registration Board and was Chairman of the Government's Venture Capital Industry Review, conducted in 2005.

Board meetings and attendance

Board member	No. of meetings attended	No. of meetings eligible to attend
David Murray AO	11	11
Jeffrey Browne	11	11
Susan Doyle	11	11
John Mulcahy	10	11
John Paterson	5	5
Trevor Rowe AM	11	11
Brian Watson	11	11

Mr Robert Elstone resigned from the Board with effect from 6 July 2006 and was therefore not eligible to attend any Board meetings in the financial year.

The Remuneration Tribunal determined an annual remuneration of \$156,630 for the Chair and \$78,320 for the members of the Board, with their official travel entitlement at tier 1.

Audit Committee

A permanent Audit Committee was established in March 2007.

Prior to this an interim committee met on three occasions during the year. The interim committee comprised two independent members and two representatives from the Future Fund's Interim Management Group. The independent members were Mr Tony Ayres AC, formerly Secretary of several Departments including the Department of Defence and Mr Mark Bateman, an experienced finance professional with specialist experience in funds management.

The Audit Committee's charter is to oversee compliance and audit functions, monitor control frameworks, review key financial statements, track legislative compliance and evaluate the adequacy and effectiveness of the risk management plan.

The Audit Committee is chaired by John Paterson and comprises all members of the Board of Guardians except for David Murray, who is excluded as is customary due to his role as Chair and statutory Chief Executive Officer of the Agency. PriceWaterhouseCoopers provides internal audit services reporting to the audit committee.

Under its charter the Committee will meet at least four times a year and report to the Board at least once a year.

Audit Committee meetings and attendance

Board member	No. of meetings attended	No. of meetings eligible to attend
Jeffrey Browne	2	2
Susan Doyle	2	2
John Mulcahy	1	2
John Paterson	2	2
Trevor Rowe AM	1	2
Brian Watson	2	2

note: the interim audit committee also met on three occasions during the year.

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Paul Costello, General Manager, Future Fund

Review by the General Manager

Since joining the Fund in late 2006, I have worked closely with the Board in thinking about the type of organisation we wish to build, the way we will make investment decisions and the culture we wish to develop. The Board's unwavering commitment to establishing a best practice institutional investment organisation has been very important in attracting skilled people to be part of building the Future Fund.

While all businesses are defined to some extent by the calibre and commitment of the employees, this is especially important to us in our formative years.

Each of us shares the excitement of being a part of this project at such an early time in its life, the honour of being responsible for the investment of such a large pool of public savings and the determination to ensure that we create a market leading organisation.

People

Consistent with our public commitment to begin the investment program by June 2007, our early priority was putting the infrastructure in place to deliver investment readiness. This meant establishing the operations team to build our back office functionality; consolidating the finance and audit management capabilities; and introducing specialist legal, communications and human resources support as well as general administration assistance. In each of these areas, we have made significant progress under the senior appointments and are well positioned to deal with the challenges ahead.

During this period we also gave considerable thought to the structure of the investment program and the team we would need to build to deliver this. With the appointment of our Chief Investment Officer, David Neal, in June we are now concentrating on growing our internal capabilities. We are determined to harness a wide range of skills and perspectives to respond to a rapidly evolving universe of investment strategies and products. Our early thinking on this issue is outlined in our Investment Report later in this section.

Partners

The appointment of a global bank to act as custodian and investment administration back office was a major priority in the first quarter of 2007. We are delighted with the progress of our relationship with Northern Trust who are building their Australian operations on the back of this appointment.

Watson Wyatt has played an important advisory role over the last year. Given the lack of an internal investment team, we have relied heavily on their experience and resources. As the scope of our program expands over the next year or so, we will be seeking a range of other advisory and investment management relationships. In a world where specialist insights and sustainable excess returns are in short supply relative to the high demand from pension funds, our aim is to be regarded as an intelligent, informed and respectful partner to maximise our access to these firms.

There are many lessons to be learned from the experiences of other similar institutions in Australia and around the world and we have already benefited from this exposure. Over the coming year this will be a particular focus for us as we put in place structures which will shape the organisation for the medium term.

We are also grateful for the assistance of the interim management team from the Department of Finance and Administration who established our office and initial operations and for the support of the team in the Department who continue to provide input and advice.

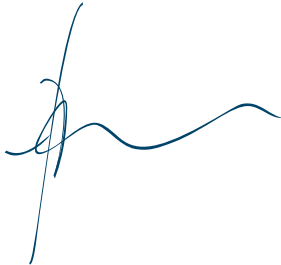
“The Board’s unwavering commitment to establishing a best practice institutional investment organisation has been very important in attracting skilled people to be part of building the Future Fund.”

Sharing our Progress

We recognise the legitimate interest of many groups in the structure and implementation of our investment program. As a manager of public assets it is appropriate for us to be as open as commercial activities prudently allow.

Recognising the considerable challenge of launching a multi billion dollar investment program, and in particular noting the requirement under our mandate to avoid impacting the normal volatility and efficiency of Australian financial markets, we have decided, over the short term, not to disclose the proposed structure of the target portfolio we are building or the rate at which investment is occurring.

We approach the coming year with confidence that we are bringing together the people and expertise to establish a globally respected investment program and look forward to providing further updates on our progress.

A handwritten signature in blue ink, consisting of a stylized 'P' followed by a series of loops and a long horizontal stroke.

PAUL COSTELLO
General Manager

Management Team

The Future Fund Management Agency assists the Board in developing and implementing its investment strategy. It also provides executive support to the Board and is responsible for the operational activities associated with the investment of the Fund assets. While the Chair of the Board of Guardians is also Chief Executive Officer of the Agency, day to day operations have been delegated to the General Manager.

During the year the Agency has transitioned from an interim structure including officers seconded from the Department of Finance and Administration, to a permanent management team which has been structured into five areas: Investment Strategy, Investment Operations, Finance, Corporate Services and Corporate Support. Details of key members of the team are provided below.



Paul Costello, General Manager

Paul took up his role as General Manager in November 2006. Previously he was the inaugural Chief Executive Officer of the New Zealand Superannuation Fund. Prior to that he was the Chief Executive Officer of the Superannuation Trust of Australia.



***David Neal, Chief Investment Officer**

David joined the Future Fund from Watson Wyatt Australia where he was Head of Investment Consulting. David started his career with Watson Wyatt in the United Kingdom and led the establishment of the firm's investment consulting business in Australia. He is a graduate of Oxford University.



Gordon McKellar, Head of Investment Operations

Gordon has over 20 years experience in asset servicing including roles in Edinburgh, New York and Sydney. Most recently he was Head of Operations at BNP Paribas Securities Services. He has also held operational and client management roles with Deutsche Bank and Bankers Trust Company.



Paul Mann, Head of Finance

Paul is a Chartered Accountant with an extensive audit background in financial services gained at PricewaterhouseCoopers in Australia and the United Kingdom. He also has five years experience in the provision of fund accounting and tax reporting services to investment clients gained at National Custodian Services in Melbourne.



Robyn Fry, General Counsel

Robyn joined the Future Fund after nine years at ASX-listed biotech company Zenyth Therapeutics Limited where she was General Counsel & Company Secretary. She has extensive experience in commercial transactional and corporate legal practice with a particular focus on corporate governance. Over the past 16 years Robyn has practised in-house, establishing and leading ASX-listed company corporate legal and company secretariat functions. She is a member of the Australian Institute of Company Directors.



Will Hetherton, Head of Communications

Prior to joining the Future Fund, Will spent five years in corporate affairs roles at the National Australia Bank, including roles in the bank's UK operations and in its institutional banking arm nabCapital. Previously he spent seven years in corporate affairs consulting in Melbourne and London. Will is a graduate of Oxford University.



***Caroline Sabolek, Human Resources Manager**

Caroline has more than 19 years experience in human resources, most recently as Head of Human Resources for the listed diversified property organisation, Becton Property Group. Caroline holds a Master of Business (HRM) degree and is a Certified Professional member of the Australia Human Resources Institute.

*Joined the organisation after 30 June 2007

Investment Report

Designing the investment strategy involves balancing a number of the Fund's positive features – its scale and the long investment horizon – against the challenge of a lack of predictable future cashflows through which market exposures can be built. Indeed, in announcing a further \$7 billion contribution in August 2007, the Responsible Ministers have indicated that once the second instalment of the proceeds of the T3 Telstra sale have been contributed in May/June 2008 (approximately \$6.6 billion) no further payments are expected to be needed in order for the Fund to reach its target of offsetting the Government's unfunded public sector superannuation liabilities in 2020.

The shares in Telstra are required to be held in escrow until November 2008 (subject to limited disposal options) so our focus during the year was largely on developing the strategy for the approximately \$40 billion of cash contributions.

Our Mandate

Under the governing legislation, the general objective is to maximise the return on assets over the long term. The Investment Mandate issued by the Responsible Ministers is more specific – it states that the Board is to adopt an average return of at least the Consumer Price Index (CPI) plus 4.5% to 5.5% per annum over the long term as the benchmark return. In targeting this benchmark return, the Board is required to determine an acceptable but not excessive level of risk for the portfolio.

Being clear on the timeframe is fundamental to all investing. We have taken the reference to the 'long term' in the Act to mean rolling 10 year periods. This was decided after taking into account the legislated requirement that money is not to be withdrawn from the Fund until at least 2020, apart from meeting operating costs or unless the Fund balance exceeds the target asset level defined by the Act. In addition, average annual earnings after 2020 are expected to exceed predicted average annual withdrawals for many years based on the liability profile.

This means that returns over a single year are not a particular focus for us, nor a useful indicator of the effectiveness of our strategy. Assessments about the probability of delivering on the long term objective are best made over at least 5 year rolling periods. The clarity of our mandate in terms of timeframes and return hurdles means that we do not have any specific focus on comparing returns over the short term with other institutions.

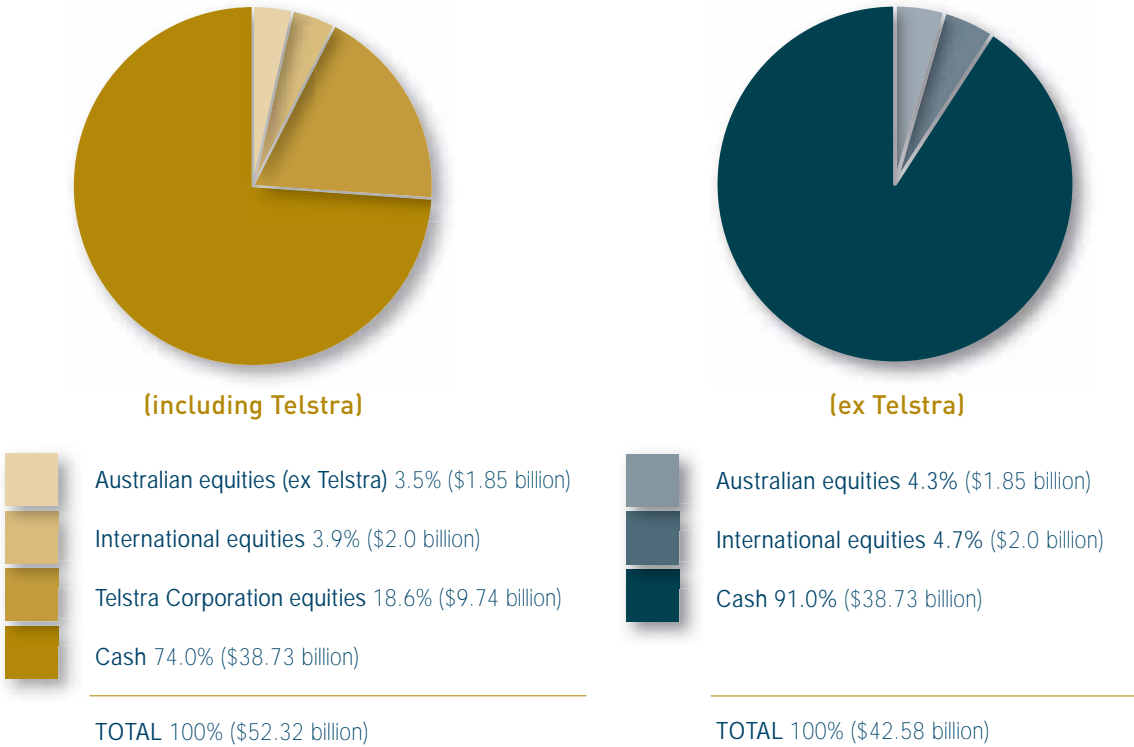
With respect to determining appropriate risk levels for the portfolio we have considered a range of criteria. In addition to assessing the probability of a negative result over varying periods, we have assessed the prospect of underperforming our real return target as well as our effective cost of capital (10 year government bonds) and the risk free rate (reflecting the focus on excess return for risk). Drawing on these considerations we have modelled the expected outcomes of various combinations of asset classes to assess the probabilities of meeting our return objectives within acceptable risk parameters.

There is a risk of getting absorbed in the challenge of trying to perfect the assumptions in a modelling exercise like this. We resisted this temptation as our priority was to agree a broad combination of risk exposures which had a high probability of meeting our return objectives and then commence the process of transitioning from our starting point of 100% cash to a more diversified holding. We know that we will have many opportunities to finesse the portfolio over the coming years as our internal capacity grows.

Our Portfolio

We publicly committed to begin the transition program before 30 June 2007 (acknowledging the need for our policy position to be settled and our operational capacity to be developed) and this target was met. The graphs below summarise the position at 30 June 2007 both inclusive and exclusive of the Telstra shareholding.

Portfolio at 30 June 2007



It is important not to draw too much from this picture. It shows the status after only a very short period of investment. The presence of listed equities to the exclusion of other asset classes reflects the fact that this was a natural sector with which to commence the investment program given the ease with which broad market exposure could be obtained. Similarly the split between the Australian and international equity markets should not be seen as indicative of our policy. Rather it reflects opportunistic buying in the short window of time between commencing investing and the end of the financial year.

While Australian equities are a very small component of the global opportunity set, they are especially attractive to us as a full credit for the company tax on dividends is receivable. This clearly encourages us to overweight our exposure to Australian equities relative to global market capitalisation but this benefit needs to be balanced against the concentration risk in a relatively small market.

Acknowledging the significant challenges around launching the program, a formal 'transition period' is envisaged in the legislation before formal assessment against the return hurdle commences. While it will take many years for the portfolio to be as diversified as we envisage, the period until 30 June 2008 has been agreed to allow us to lay the foundations of the long term program.

Our Philosophy

Given our belief that most value will come from our organisation being focused on fully understanding the risks present in a diversified portfolio, and ensuring we are being appropriately rewarded for them, this is our main priority.

Combining a wide variety of lowly correlated assets to reduce return volatility is the fundamental driver of our portfolio construction process. At the centre will be our capital markets research capacity. Developing this over 2007/8 is critical as it will drive our risk articulation and budgeting process. Once this is operational we will have a robust mechanism to anticipate material deviations from medium to long term expected outcomes for sectors and adjust our exposures accordingly.

Our long investment horizon allows us to allocate a sizeable proportion of the portfolio to private markets where liquidity is limited and investors are rewarded for being able to bear this. We are very cognisant of the implementation challenges involved and the need to have sophisticated analytical skills to fully understand the risks embedded in the structure of many opportunities in these sectors. We are committed to ensuring that we have these skills available to us through a combination of the internal team we will build and specialist, fully aligned, external partners we plan to work with. This is a priority for 2007/8.

Public markets exposures are expected to make up a very significant proportion of the Fund, especially in the early years. Like many investors who consider their trading strategies separately from the underlying market exposures, we are focusing initially on building a portfolio of market risks and adding active management later. This will come on stream during 2007/8 as we build our methodology for the active management program and recruit the team who manage it. We will use closely aligned external investment managers in these markets rather than seek to build this capacity in-house.

Operating Costs

Our total operating costs during 2006/7 totalled \$9.9 million – equivalent to 0.028% of average assets during the period. This covers all internal and external costs (Board, employees, office expenses, advisory and investment management fees). The low figure reflects the predominance of cash in the portfolio during the period. Going forward, these costs will rise as diversification increases and we introduce active management. While conscious of the leakage from returns that costs (both manager fees and transaction costs) will bring, our emphasis will be on generating after-cost returns rather than trying to simply minimise market participation expenses.

Looking Forward

As this report is being written, the shakeout from the repricing of credit risk is being felt across all markets. While, like most investors, we are uncertain what the ultimate impact will be, we believe we are well positioned to use our current defensive asset mix to take advantage of the opportunities likely to emerge.

Over the 2007/08 year we will focus on diversifying the Fund's investments. While the process will not be completed by year end, we expect to have built a portfolio which is well positioned to meet the long term return objectives of the Fund.

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Outcomes and Resourcing

The following tables summarise key aspects of the Future Fund's activity and resourcing.

Future Fund Management Agency outcomes and output groups

Outcome	Description	Output groups
Enhanced capacity for the Australian Government to offset its unfunded superannuation liabilities	<p>The capacity of the Australian Government to offset its unfunded superannuation liabilities is important for reducing pressure on the Budget in future years when other age-related expense pressures are expected to grow.</p> <p>The Future Fund will accumulate assets for the purpose of offsetting the government's unfunded superannuation liabilities. Through investment in a broad range of financial assets, the Fund will contribute to enhancing the net worth of the Australian Government. Preserving the assets for the time when increasing inter-generational expense pressures are anticipated will enhance the capacity of the government to offset these liabilities and will support inter-generational equity.</p>	To be advised

Resourcing for Outcome

Total resourcing for the outcome applied by the Future Fund in 2006-07 and budgeted for 2007-08.

	Actual 2007 \$'000	Budget 2006-07 \$'000	Budget 2007-08 \$'000
Expenses			
Depreciation and amortisation	364	374	449
Agency and Board remuneration expenses	2,868	1,976	6,468
Other expenses	6,701	5,071	35,115
Total expenses	9,933	7,421	42,032
Income			
Investment revenue	2,817,416	2,059,226	3,658,669
Other income	75	30	35
Total income	2,817,491	2,059,256	3,658,704
Net cost (contribution) of outcome	(2,807,558)	(2,051,835)	(3,616,672)
Average staffing level (number)	11	9	20

Section 81 Future Fund Act requirements

Appropriations and other funding

Table 5 reports on, or cross references, the items required to be included in the Annual Report by section 81(1) of the Future Fund Act 2006 (the Future Fund Act). Under section 81(1), the Future Fund Management Agency (the Agency) must prepare and give to the nominated minister a report covering the items listed in 81(1)(a) to (h). Further, subsection 81(2) requires that amounts referred to in paragraphs (1)(d) to (h) are benchmarked.

Compliance with Section 81 of the Future Fund Act 2006

Total amount debited from the Fund Account for the year ended 30 June 2007	Total	Benchmark
Subsection 81(1)(d) in relation to paying remuneration and allowances of Board members	\$647,464	i. The Remuneration Tribunal determines the remuneration and allowances payable to Board Members. ii. These costs, together with movements in accrued costs, are also included within the Management Costs and Indirect Cost Ratio reported below.
Subsection 81(1)(e) in relation to paying or discharging costs, expenses and other obligations incurred by the Board under a contract between the Board and an investment manager	Zero	For the year ended 30 June 2007, no actual cash payments were made. Accruals for these costs are included within the Management Costs and Indirect Cost Ratio reported below.
Subsection 81(1)(f) in relation to paying remuneration and other employment related costs and expenses, in respect of the staff of the Agency	\$1,515,207	These costs, together with movements in accrued costs, are included within the Management Costs and Indirect Cost Ratio reported below.
Subsection 81(1)(g) in relation to paying or discharging the costs, expenses or other obligations incurred by the Commonwealth under a contract entered into under section 78 (consultants and persons seconded to the Agency) or 82 (consultants and advisors to the Board)	\$3,077,283	These costs, together with movements in accrued costs, are included within the Management Costs and Indirect Cost Ratio reported below.
Subsection 81(1)(h) in relation to paying or discharging the costs, expenses or other obligations incurred by the Commonwealth in connection with the establishment or operation of the Agency	\$2,435,466	These costs, together with movements in accrued costs, are included within the Management Costs and Indirect Cost Ratio reported below.

The Future Fund Act requires certain costs of the Fund to be reported in the Annual Report and benchmarked. The Act does not require all costs to be reported and benchmarked. Therefore, the above numbers are not the total expenses of the Fund as reported within the Financial Statements of the Fund. Further, the above expenditures are also reported on a cash basis as required under the Act, whilst the Financial Statements are prepared on an accruals basis.

The Fund has deemed it appropriate to use as its benchmark measurement for costs the disclosure measures as prescribed by the Government for financial products as laid out in the Corporations Amendment Regulations 2005 (No.1) ["the Regulations"]. These prescribed disclosures have been further clarified by ASIC through their Information Releases. The Fund has not presented a relative benchmark measure but has rather reported its costs as defined below to enable readers of the Annual Report to make their own comparisons to other financial institutions as considered appropriate. The costs reported are the total costs of operating the Fund for the period, rather than only the items reported in the above table and are extracted from the Fund's Financial Statements.

Cost categories

As the Fund does not incur costs associated with, nor charge fees to "members" (the Commonwealth Government is responsible for the unfunded public sector superannuation liability and associated membership record keeping costs), there is no disclosure of fees and costs charged directly to members as required under the Regulations. The Fund has deemed it appropriate to report its costs under the following categories as defined by Schedule 10 of the Regulations.

- "Management costs" : these costs include custody fees (exclusive of settlement costs), amounts paid to external fund managers (including performance fees) and any other investment-related expenses and reimbursements, inclusive of amounts incurred in administering the Fund. This includes all internal operating costs of the fund including remuneration.

Cost Measure	
Management costs	\$9,632,445
Transactional and operational costs	\$300,722
Indirect cost ratio	0.028%

- "Transactional and operational costs" : these costs include brokerage, stamp duties and custody costs charged for transaction settlement.
- "Indirect cost ratio" : is the ratio of the Fund's total management costs to the Fund's average net assets.

Advertising and market research

During 2006-07 the Agency made no payments to advertising, market research organisations, polling organisations or direct mail organisations.

Discretionary grants

No discretionary grants are administered by the Agency.

Commonwealth Fraud Control Guidelines

The Agency has prepared fraud risk assessments and has a fraud control plan in place and approved by the Audit Committee.

Human resources

Management of Human Resources

The Agency has employed a Human Resources Manager, who commenced in July 2007, to support the provision of effective services in relation compliance and in attracting, developing and retaining talented, high performing individuals, to achieve Agency objectives.

Agency Workforce

During the year the Agency transitioned from its temporary staffing arrangements with officers seconded from the Department of Finance and Administration.

Detailed staffing arrangements as at 30 June 2007 are included in the following table.

Staffing table

FFMA Classification	Ongoing	Non-ongoing	APS temporary transfer	Full time	Part-time	Male	Female	Location
FFMA Band 1								
FFMA Band 2		1		1			1	1 x Melbourne
FFMA Band 3	1			1			1	1 x Melbourne
FFMA Band 4	2	3		5		1	4	3 x Melbourne 2 x Sydney
FFMA Band 5	2		1	3		3		3 x Melbourne
FFMA Band 6	1			1		1		1 x Melbourne
Totals	6	4	1	11	0	5	6	11

Australian Workplace Agreements

All Agency staff are engaged under Australian Workplace Agreements (AWA). Each AWA provides the terms and conditions of engagement including the requirement to adhere to the Australian Public Service Values and Code of Conduct and is consistent for all staff. It also provides staff with a flexible remuneration structure including the opportunity to earn performance bonuses, and their choice of superannuation.

Remuneration

Remuneration is market competitive. Salary ranges for each level are being established. Salaries will be reviewed annually with adjustments effective 1st July. Remuneration adjustments are to be based on a combination of market remuneration and individual staff performance.

Performance Management

A formal performance management system will be established to link the Agency's goals with individuals' roles and responsibilities.

Training and Development Strategies

A formal training and development program is being developed to enhance the Agency's ability to attract, and retain talented and high performing staff.

Performance Pay

Performance pay has been paid to eleven FFMA staff in the following classifications for the financial year ended 30 June 2007.

FFMA Classification	No. Employees
FFMA Bands 1 – 4	7
FFMA Bands 5 & 6	4
Total	11

The aggregated amount of such performance payments for the Future Fund Management Agency for FY2007 was \$317,512.00. The aggregate performance payment for FFMA classifications 1 to 4 was \$81,670.00, providing an average payment of \$11,667.00. The aggregate performance payment for FFMA classifications 5 and 6 was \$235,842.00, providing an average payment of \$58,960.50.

Occupational, Health and Safety Management

The Agency recognises that health and safety is vital to the combined well-being of its employees, contractors and visitors, and the success of its business. The Agency has therefore commenced the development of an OH&S manual and have devolved the role of Health and Safety Representative for the Agency to the Human Resources Manager.

Statutory obligations under the OH&S Act with reference to Section 74(1) of the OH&S Act

Section 68 Occurrences (Notification and reporting of accidents and dangerous occurrences)

There were no accidents or dangerous occurrences at the Agency.

Section 29 Notices (Provisional Improvement Notices)

No provisional improvement notices were issued under Section 29 of the OH&S Act.

Section 45 Directions (Power to direct that Workplace Not Be Disturbed)

No directions were given to the Agency under Section 45 of the OH&S Act.

Section 46 Notices (Power to Issue Prohibition Notices)

No notices were issued under Section 46 of the OH&S Act.

Section 47 Notices (Power to Issue Improvement Notices)

No notices were issued under Section 47 of the OH&S Act.

Commonwealth Disability Strategy

The Agency is establishing a Workplace Diversity Program and Disability Action Plan in accordance with the Commonwealth Disability Strategy and in accordance with section 18 of the Public Service Act 1999. This strategy will support our commitment to diversity in the workplace.

Purchasing

The Minister for Finance and Administration has exempted the Future Fund from the Commonwealth Procurement Guidelines' mandatory provisions for the procurement of a range of investment and related services. These include investment management, investment advisory, master custody and safekeeping services for the purpose of managing and investing the assets of the Future Fund. The actual purchase of assets is an investment activity and is not covered by the guidelines.

Consultants

In line with the principles of the Commonwealth Procurement Guidelines (CPGs), the Future Fund's policy on selection and engagement of consultants is based on the principles of:

- value for money
- open and effective competition
- ethics and fair dealing
- accountability and reporting
- national competitiveness and industry development, and
- support for other Australian Government policies.

These guidelines have been included in the Future Fund's Chief Executive's Instructions. The Internal Audit Unit conducts probity reviews to help ensure compliance with the general probity principals of the CPGs and CEIs.

During 2006-07, 20 consultancy contracts were entered into by the Future Fund Management Agency, involving total actual expenditure of \$362,923.93.

In addition, 1 ongoing consultancy contract was active during the 2006-07 year, involving total actual expenditure of \$443,741.90.

Information on expenditure on contracts and consultancies is also available on the AusTender website www.tenders.gov.au. Information is also available on the Future Fund website.

Procurement practices

The Agency purchases goods and services in accordance with environmental procurement policy, as set out in the Commonwealth Procurement Guidelines. This ensures goods and services are:

- environmentally sound in manufacture
- re-usable or recyclable
- designed and made for reliability and long life, and
- in line with environmental best practice in energy efficiency and or energy consumption.

Ecologically sustainable development and environmental performance

During the year the Agency undertook an analysis of the energy efficiency initiatives suitable for its offices in Melbourne. This work has resulted in the installation of a Managed Lighting System that is expected to reduce electricity consumption over the life of the lease. The Agency also employs dry and wet waste recycling as part of its tenancy agreement and promotes the use of recycled paper in its operations wherever possible.

External scrutiny

Senate Finance and Public Administration Committee

Mr David Murray appeared before the Senate Finance and Public Administration Committee in October 2006. The General Manager, Mr Paul Costello, gave evidence at the Committee's February 2007 and May 2007 hearings.

Judicial decisions

There were no matters in 2006–07 relating to the Agency that were the subject of judicial proceedings, tribunal hearings or consideration by the Ombudsman.

Reports to Auditor General

There were no reports made to the Auditor General in 2006–07 by the Future Fund.

Freedom of Information

The Agency was established on 3 April 2006 as a 'prescribed' agency under the FMA Act.

Section 8 of the Freedom of Information Act 1982 requires the Agency to publish detailed information about:

- how it is organised and what decision making powers it has
- what arrangements it makes for public involvement in its work
- what types of documents it holds, and
- how the public can obtain access to these documents.

The following information addresses these requirements.

Organisation of the Agency

The Agency's investment operations encompass the execution of instructions received from the Board.

Agency activities also encompass risk management and compliance activities, financial reporting and portfolio administration.

Agency delegations

The Minister for Finance and Administration holds certain delegated powers under the Constitution and the FMA Act (and Regulations to the Act) in relation to Agency management. These powers have been delegated to the CEO of the Agency.

Categories of documents held by the Agency

The Agency holds the following categories of documents. The Agency intends to place an indexed list of its policy file titles on its website every six months.

Representations to portfolio ministers The Agency holds representations made to the Minister for Finance and Administration and the Treasurer on matters relating to the operation of the Agency and related investment policies.

Working files The Agency holds files dealing with policy and administration in the investment of funds in accordance with the Investment Mandate and investment policies issued by the Board. The documents on these files include internal and externally-provided investment advice, correspondence, analysis and policy advice by Agency officers and drafts of these and other documents.

Documents on internal departmental administration Agency documents relating to staff and departmental organisation and operation include personal records, organisation and staffing records, financial and expenditure records, and internal operations such as office procedures and instructions.

Documents open to public access

The Agency's primary published document is its Annual Report which is available on the Agency's website as well as in the printed version. In accordance with the Future Fund Act, the Investment Mandate and investment policies are published on the Agency's website.

Facilities for accessing documents

If a member of the public requests a document and access is approved, the Agency will provide copies of documents after the applicant pays any charges.

Freedom of Information applications and initial contact points

The Agency's Freedom of Information Coordinator coordinates requests under the FOI Act. Applicants seeking access under the FOI Act to Agency documents should apply in writing to:

FOI Coordinator

Future Fund Management Agency, Locked Bag 20010, MELBOURNE VIC 3001

An application fee of \$30 should accompany requests, or a written request pursuant to subsection 30A(1) of the FOI Act that the application fee be waived. Telephone inquiries should be directed to the Freedom of Information Coordinator, phone (03) 8656 6400, between 9am and 5pm Monday to Friday (except public holidays or public service holidays).

Nominated Agency officers can grant or refuse requests for access to documents under section 23 of the FOI Act. In accordance with section 54 of the FOI Act, an applicant may, within 30 days of receiving notification of a decision under the FOI Act, apply to the CEO of the Agency seeking an internal review of a decision to refuse a request. The prescribed fee of \$40 should accompany this application.

Freedom of Information activity

The Agency received no requests for access to documents under the FOI Act in 2006-07.

Financial Statements

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Auditor-General for Australia



INDEPENDENT AUDITOR'S REPORT

To the Minister for Finance and Administration

Scope

I have audited the accompanying financial report of Future Fund Management Agency and Board of Guardians (the "Future Fund"), which comprise:

- Statement by the Chair of the Board of Guardians and Head of Finance;
- Income Statement for the year ended 30 June 2007;
- Balance sheet as at 30 June 2007
- Statement of Cash Flows for the year ended 30 June 2007;
- Statement of Changes in Equity for the year ended 30 June 2007;
- Schedules of Commitments; and
- Notes to and forming part of the financial statements.

The Responsibility of the Chair of the Board of Guardians for the Financial Report

The Chair of the Board of Guardians of the Future Fund is responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Finance Minister's Orders made under the *Financial Management and Accountability Act 1997*. This responsibility includes establishing and maintaining internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

My responsibility is to express an opinion on the financial report based on my audit. I conducted my audit in accordance with Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing Standards. These Auditing Standards require that I comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting

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policies used and the reasonableness of accounting estimates made by the Chair of the Board of Guardians, as well as evaluating the overall presentation of the financial report.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Auditor's Independence Declaration

In conducting my audit, I have complied with the independence requirements the Australian National Audit Office, which incorporate the requirements of the Australian accounting profession.

Auditor's Opinion

In my opinion, the financial report of the Future Fund

- (a) complies with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Finance Minister's Orders made under the *Financial Management and Accountability Act 1997*; and
- (b) gives a true and fair view of the matters required by the Finance Minister's Orders, including the Future Fund's financial position as at 30 June 2007 and of its performance for the year ended on that date.



Ian McPhee

Auditor-General

Canberra

22 August 2007

FUTURE FUND MANAGEMENT AGENCY AND BOARD OF GUARDIANS

Statement by the Chair of the Board of Guardians and Head of Finance

In our opinion, the attached financial statements of the Future Fund Management Agency and the Board of Guardians (the Fund) for the year ended 30 June 2007 are based on properly maintained records and give a true and fair view of the matters required by the Finance Minister's Orders, subject to the exemption granted as noted below, made under the Financial Management and Accountability Act 1997, as amended and are in compliance with accounting standards.

In preparing the financial statements, the Fund has applied the exemption provided by the Minister for Finance and Administration allowing the Fund to present a financial report in a format consistent with that used in the funds management industry in place of the prescribed format as outlined in Annexure A to Schedule 1 of the Finance Minister's Orders. The effect of this exemption is that fund will present its financial report as a single entity.

Signed  _____
D Murray
Chair 21 August 2007

Signed  _____
P Mann
Head of Finance 21 August 2007

Income Statement for the financial year ended 30 June 2007

	Notes	Year ended 30 June 2007 \$'000	Period from 3 April 2006 to 30 June 2006 \$'000
INCOME			
Dividends & imputation credits	3	425,473	–
Distributions	3	2,267	–
Interest		1,737,773	163,667
Net realised losses on disposals of investments		(73)	–
Net unrealised changes in the fair value of investments		640,876	–
Net unrealised foreign currency gains		11,100	–
Other income	4	75	25
TOTAL INCOME		2,817,491	163,692
EXPENSES			
Investment management and consulting fees		1,759	–
Custodian's fee		332	–
Transaction costs		301	–
Agency employees' remuneration	5	2,225	115
Board of Guardians' remuneration	5	643	161
Auditor's remuneration	6	75	25
Depreciation and amortisation	5	364	1
Administrative expenses		4,234	348
TOTAL EXPENSES		9,933	650
OPERATING RESULT		2,807,558	163,042

The above Statement should be read in conjunction with the accompanying notes

Balance Sheet as at 30 June 2007

	Notes	30 June 2007 \$'000	30 June 2006 \$'000
ASSETS			
Financial assets			
Cash and cash equivalents	13(b)	4,888	4,773
Term Deposits	7	38,600,500	18,046,000
Unlisted unit trusts held at fair value	7	724,171	–
Listed equities and listed managed investment schemes held at fair value	7	13,574,361	–
Currency contracts and exchange traded futures held at fair value	7	10,290	–
Receivables	8	146,085	112,459
Other		28	42
Total financial assets		53,060,323	18,163,274
Non-financial assets			
Infrastructure, plant and equipment	9	1,768	19
Intangibles – software licenses	9	94	24
Total non-financial assets		1,862	43
TOTAL ASSETS		53,062,185	18,163,317
LIABILITIES			
Payables	10	594,458	228
Employee provisions	11	521	47
Other provisions	11	516	–
TOTAL LIABILITIES		595,495	275
NET ASSETS		52,466,690	18,163,042
EQUITY AND AMOUNT ATTRIBUTABLE TO THE GOVERNMENT			
Contributions by Government	12	49,496,090	18,000,000
Accumulated results		2,970,600	163,042
Total equity and amount attributable to the Government		52,466,690	18,163,042

The above Statement should be read in conjunction with the accompanying notes

Statement of Cash Flows for the year ended 30 June 2007

	Notes	Year ended June 30 2007 \$'000	Period from 3 April 2006 to 30 June 2006 \$'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash received			
Interest received		1,837,011	51,208
Dividends received		294,876	–
Other income received		66	–
Total cash received		2,131,953	51,208
Cash used			
Investment management and consulting fees paid		(1,584)	–
Custodian's fees paid		–	–
Other expenses		(6,269)	(391)
Total cash used		(7,853)	(391)
Net cash provided by operating activities	13(a)	2,124,100	50,817
CASH FLOWS FROM INVESTING ACTIVITIES			
Cash received			
Proceeds from sale of securities		5,138,923	–
Total cash received		5,138,923	–
Cash used			
Payment for securities		(29,688,725)	(18,046,000)
Purchase of property, plant and equipment and software		(2,183)	(44)
Total cash used		(29,690,908)	(18,046,044)
Net cash used by investing activities		(24,551,985)	(18,046,044)
CASH FLOWS FROM FINANCING ACTIVITIES			
Cash received			
Amounts contributed by Government		22,428,000	18,000,000
Total cash received		22,428,000	18,000,000
Net cash received from financing activities		22,428,000	18,000,000
Net increase in cash held		115	4,773
Cash at the beginning of the reporting period		4,773	–
Cash at the end of the reporting period	13(b)	4,888	4,773

The above Statement should be read in conjunction with the accompanying notes

Statement of changes in equity for the year ended 30 June 2007

Item	Accumulated results	Contributed equity	Total equity
	2007 \$'000	2007 \$'000	2007 \$'000
Opening balance	163,042	18,000,000	18,163,042
Net operating result	2,807,558	–	2,807,558
Income and expenses recognised directly in equity	–	–	–
Contributions made by Government	–	31,496,090	31,496,090
Closing balance	2,970,600	49,496,090	52,466,690

Item	Accumulated results	Contributed equity	Total equity
	Period from 3 April 2006 to 30 June 2006 \$'000	Period from 3 April 2006 to 30 June 2006 \$'000	Period from 3 April 2006 to 30 June 2006 \$'000
Opening balance	–	–	–
Net operating result	163,042	–	163,042
Income and expenses recognised directly in equity	–	–	–
Contributions made by Government	–	18,000,000	18,000,000
Closing balance	163,042	18,000,000	18,163,042

The above Statement should be read in conjunction with the accompanying notes.

Schedule of commitments as at 30 June 2007

	Notes	2007 \$'000	2006 \$'000
BY TYPE			
CAPITAL COMMITMENTS			
Infrastructure, plant and equipment		29	–
Intangibles		–	–
Total capital commitments		29	–
OTHER COMMITMENTS			
Operating leases		2,808	3,466
Other commitments ^(a)		4,185	1,565
Total other commitments		6,993	5,031
BY MATURITY			
Capital commitments			
One year or less		29	–
From one to five years		–	–
Over five years		–	–
Total capital commitments by maturity		29	–
Operating lease commitments			
One year or less		706	671
From one to five years		2,102	2,795
Over five years		–	–
Total operating lease commitments by maturity		2,808	3,466
Other commitments			
One year or less		2,814	435
From one to five years		1,371	1,130
Over five years		–	–
Total other commitments by maturity		4,185	1,565

Note: Commitments are GST inclusive.

(a) Other commitments relate to contractual obligations for the provision of internal audit services, payroll services, and consultancies. The above schedule should be read in conjunction with the accompanying notes.

Notes to and forming part of the financial statements for the year ended 30 June 2007

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Note 1: Objectives of the Future Fund

The Future Fund Act 2006 (the Act) commenced on 3 April 2006 and established the Future Fund Special Account (the Fund Account), the Future Fund Board of Guardians (the Board) and the Future Fund Management Agency (the Agency), collectively referred to as the Future Fund. The object of the Act is to strengthen the Commonwealth's long-term financial position.

The Future Fund will make provision for unfunded superannuation liabilities that will become payable during a period when an ageing population is likely to place significant pressure on the Commonwealth's finances. The legislation quarantines the Fund, the balance of the Fund Account and other investments, for the ultimate purpose of paying unfunded superannuation liabilities and expenses associated with the investment and administration of both the Board of Guardians, and by direct transfer from the administered funds, the expenses of the Future Fund Management Agency.

Future Fund Management Agency (the Agency)

The Agency is a statutory agency for the purposes of the *Public Service Act 1999* (the Public Service Act) and is prescribed for the purposes of the *Financial Management and Accountability Act 1997* (the FMA Act). The Agency is responsible for implementing the investment decisions made by the Future Fund Board of Guardians (the Board).

The Agency will be responsible for the operational activities associated with the investment of funds in the Fund Account. This includes the provision of advice to the Board on the investment of the portfolio and managing the Board's contracts with investment managers, advisors and other service providers.

Future Fund Board of Guardians

The Board is a body corporate with perpetual succession and is a separate legal identity to the Commonwealth.

In line with subsection 18(1) of the enabling legislation the Government issued the Board with the first Investment Mandate for the Future Fund, effective 22 May 2006. The objective of these directions is to give guidance to the Board in relation to its investment strategy for the Future Fund. The main object of the acquisition by the Board of a financial asset, as an investment of the Fund, is to enhance the ability of the Commonwealth to discharge unfunded superannuation liabilities.

The roles and responsibilities of the Board are set out in the enabling legislation. The Board is collectively responsible for the investment decisions of the Fund and for the safekeeping and performance of the assets of the Fund. As such, the Board's primary role is to provide strategic direction to the investment activities of the Fund including the development of an investment strategy that adheres to the Investment Mandate.

Future Fund Investment Mandate Directions 2006

The objective of these directions is to give guidance to the Board in relation to its investment strategy for the Future Fund. The Future Fund Board of Guardians is required under section 18 of the Act to seek to maximise the return earned on the Fund over the long term, consistent with international best practice for institutional investment and subject to its obligations under the Act and any directions given by the responsible Ministers under subsection 18(1) or subclause 8(1) of Schedule 1 of the Act.

Investments by the Future Fund will be confined to financial assets.

Note 2 : Summary of significant accounting policies

2.1 Basis of preparation of the financial statements

These financial statements comprise the Future Fund Management Agency and the Future Fund Board of Guardians, collectively referred to as the Future Fund, in accordance with Section 80 of the *Future Fund Act 2006*.

The financial statements are required by section 49 of the *Financial Management and Accountability Act 1997*, and are a general purpose financial report prepared on a going concern basis.

The financial statements have been prepared in accordance with:

- Finance Minister's Orders (FMOs) (being the *Financial Management and Accountability Orders (Financial Statements for reporting periods ended on or after 1 July 2006)*);
- Australian Accounting Standards and Accounting Interpretations issued by the Australian Accounting Standards Board (AASB) that apply for the reporting period; and

In preparing the financial statements, the Fund has applied the exemption provided by the Minister for Finance and Administration allowing the Fund to present a financial report in a format consistent with that used in the funds management industry in place of the prescribed format as outlined in Annexure A to Schedule 1 of the Finance Minister's Orders. The effect of this exemption is that the Fund will present its financial report as a single entity.

These financial statements have been prepared on an accrual basis and are in accordance with the historic cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative instruments) at fair value through the profit or loss, certain classes of property, plant and equipment and employee entitlements. Except where stated, no allowance is made for the effect of changing prices on the results or the financial position.

Unless alternative treatment is specifically required by an accounting standard, assets and liabilities are recognised in the Balance Sheet when and only when it is probable that future economic benefits will flow and the amounts of the assets or liabilities can be reliably measured. However, assets and liabilities arising under agreements equally proportionately unperformed are not recognised unless required by an Accounting Standard.

Liabilities and assets which are unrecognised in the Balance Sheet are reported in the Schedule of Commitments or where remote or unquantifiable, as contingencies reported at Note 14.

Unless alternative treatment is specifically required by an accounting standard, revenues and expenses are recognised in the Income Statement when and only when the flow, consumption or loss of economic benefits has occurred and can be reliably measured.

Significant Accounting Judgements and Estimates

No accounting assumptions or estimates have been identified that have a significant risk of causing a material adjustment to carrying amounts of assets and liabilities within the current or future accounting periods.

2.2 Statement of Compliance

The financial report complies with Australian Accounting Standards, which include Australian Equivalents to International Financial Reporting Standards (AEIFRSs).

Australian Accounting Standards require the Future Fund to disclose Australian Accounting Standards that have not been applied, for standards that have been issued but are not yet effective.

The AASB has issued amendments to existing standards, these amendments are denoted by year and then number.

The table below illustrates standards and amendments that will become effective for, and apply to, the Future Fund. The nature of the impending change within the table, has been out of necessity abbreviated and users should consult the full version available on the AASB's website to identify the full impact of the change. The expected impact on the financial report of adoption of these standards is based on the Future Fund's initial assessment at this date, but may change. The Future Fund intends to adopt all of the standards upon their application date. No accounting standard has been adopted earlier than the effective date in the current period.

Title	Standard affected	Application date	Nature of impending change	Impact expected on financial report
2005–10	AASB 132, AASB 101, AASB 114, AASB 117, AASB 133, AASB 139, AASB 1, AASB 4, AASB 1023 and AASB 1038	1 Jan 2007*	Amended requirements subsequent to the issuing of AASB 7.	No expected impact.
2006–1	AASB 121	31 Dec 2006^	Changes in requirements for net investments in foreign subsidiaries depending on denominated currency.	No expected impact.
AASB7 Financial Instruments: Disclosures		1 Jan 2007*	Revise the disclosure requirements for financial instruments from AASB132 requirements.	Additional disclosures in respect of financial instruments
AASB 2007–04	AASB's which currently do not reflect all options available under their IFRS equivalent standard or contain extra Australian specific disclosures	1 July 2007*	Inclusion of all options currently available under IFRS in Australian equivalents to IFRS and the elimination of additional Australian specific disclosures	No expected impact
AASB 101	AASB 101	1 Jan 2007*	Inclusion of all options currently available under IFRS in Australian equivalents to IFRS and the elimination of additional Australian specific disclosures	No expected impact

* Application date is for annual reporting periods beginning on or after the date shown

^ Application date is for annual reporting periods ending on or after the date shown.

2.3 Revenue

Dividends and distribution income is recognised when the right to receive payment is established.

Interest revenue is recognised using the effective interest method as set out in *AASB 139 Financial Instruments: Recognition and Measurement*.

Receivables for goods and services, which have 30 day terms, are recognised at the nominal amounts due less any provision for bad and doubtful debts. Collectability of debts is reviewed at balance date. Provisions are made when collectability of the debt is no longer probable.

2.4 Other Income

Services and resources received free of charge

Services and resources received free of charge are recognised as revenue when, and only when, a fair value can be reliably determined and the services would have been purchased if they had not been donated. Use of those resources is recognised as an expense.

Contributions of assets at no cost of acquisition are recognised as revenue at their fair value when the asset qualifies for recognition. Contributions of assets at no cost of acquisition or for nominal consideration are recognised as gains at their fair value when the asset qualifies for recognition, unless received from another government agency as a consequence of a restructuring of administrative arrangements.

Net realised and unrealised gains

Accounting policies for recognising gains and losses on financial instruments are stated at Note 17.

Gains from disposal of non-current assets are recognised when the risks and rewards of ownership of the asset have passed to the buyer.

2.5 Transactions with the Government as owner

2.5.1 Credits to Fund Account

From time to time the responsible Ministers may determine that additional amounts are to be credited to the Fund Account. In addition, the responsible Ministers may transfer Commonwealth-owned financial assets to the Account. These amounts are shown as Contributions by Government in Note 12.

2.5.2 Debits to Fund Account

Amounts may be debited from the Fund Account in accordance with the purposes of the Fund Account. The main purpose of the Fund Account is to discharge unfunded superannuation liabilities from whichever is the earlier of (a) the time when the balance of the Fund is greater than or equal to the target asset level; or (b) 1 July 2020.

2.6 Employee entitlements

Liabilities for services rendered by employees are recognised at the end of the financial year to the extent that they have not been settled. The nominal amount is calculated with regard to the rates expected to be paid on settlement of the liability.

2.6.1 Leave

The liability for employee entitlements includes provisions for annual leave and long service leave. No provision has been made for sick leave as all sick leave is non-vesting and the average sick leave taken in future years by employees of the Future Fund is estimated to be less than the annual entitlement for sick leave.

The leave liabilities are calculated on the basis of employees' remuneration, including the Agency's employer superannuation contribution rates to the extent that the leave is likely to be taken during service rather than paid out on termination.

The leave liabilities are calculated on the basis of employees' remuneration at the end of the financial year, adjusted for expected increases in remuneration effective from 1 July 2007. Liabilities for short-term employee benefits (i.e. wages and salaries, annual leave etc, expected to be settled within 12 months from the reporting date) are measured at their nominal amounts.

All other employee benefits are measured at the present value of the estimated future cash flows to be made in respect of all employees at the end of the financial year. In determining the present value of the liability, the Future Fund has commissioned an actuarial assessment by the Australian Government Actuary of the anticipated attrition rates and pay increases through promotion and inflation. The Australian Government Actuary has recommended the application of the shorthand method, as prescribed by Section 4C of the FMOs, for determining the present value of the long serve leave liability.

2.6.2 Superannuation

Staff of the Future Fund are variously eligible to contribute to the Commonwealth Superannuation Scheme, Public Sector Superannuation Scheme (Defined Benefit) or the Public Sector Superannuation Scheme (Accumulation Plan). Staff may join any other employee nominated schemes.

For any staff who are members of CSS or PSS (Defined Benefit), the Future Fund makes employer contributions to the Australian Government at rates determined by an actuary to be sufficient to meet the cost to the government of the superannuation entitlements of its employees. The liability for superannuation benefits payable to an employee upon termination is recognised in the financial statements of the Australian Government.

As CSS and PSS are multi-employee plans within the meaning of AASB 119, all contributions are recognized as expenses on the same basis as contributions made to defined contribution plans.

A liability has been recognised at the end of the financial year for outstanding superannuation co-contributions payable in relation to the final fortnight of the financial year.

2.7 Leases

A distinction is made between finance leases and operating leases. Finance leases effectively transfer from the lessor to the lessee substantially all risks and benefits incidental to ownership of leased non-current assets. Under operating leases the lessor effectively retains substantially all such risks and benefits.

The Future Fund holds operating leases only. Operating lease payments are charged to the Income Statement on a basis which is representative of the pattern of benefits derived from the leased assets.

2.8 Cash and investments

Cash means notes and coins held and any deposits held at call with a bank. Deposits held with a bank that are not at call are classified as investments. Cash is recognised at its nominal amount.

2.9 Financial Risk Management

The Future Fund activities expose it to normal commercial financial risk as a result of the nature of the Future Fund's business and internal and Australian Government policies, dealing with the management of financial risk. The Future Fund is exposed to market, credit, liquidity, cash flow and fair value interest rate risk. Further disclosures regarding the Future Fund's financial risks are presented in Note 17.

2.10 Financial instruments

Accounting policies for financial instruments are stated at Note 17.

2.11 Impairment of Financial Assets

Financial assets are assessed for impairment at each balance date.

2.12 Trade Creditors

Trade creditors and accruals are recognised at their nominal amounts, being the amounts at which the liabilities will be settled. Liabilities are recognised to the extent that the goods or services have been received (and irrespective of the Fund having been invoiced).

2.13 Acquisition of Non Financial Assets

Non financial assets are recorded at cost on acquisition except as stated below. The cost of acquisition includes the fair value of assets transferred in exchange and liabilities undertaken. Non financial assets are initially measured at their fair value plus transaction costs where appropriate.

Assets acquired at no cost, or for nominal consideration, are initially recognised as assets and revenues at their fair value at the date of acquisition.

2.14 Infrastructure, plant and equipment

2.14.1 Asset recognition threshold on acquisition

Purchases of infrastructure, plant and equipment are recognised initially at cost in the Balance Sheet, except for purchases costing less than \$2,000, which are expensed at the time of acquisition. The asset recognition threshold is applied to each functional asset. That is, items or components that form an integral part of an asset are grouped as a single asset.

The initial cost of an asset includes an estimate of the cost of dismantling and removing the item and restoring the site on which it is located. This is particularly relevant to ‘makegood’ provisions in property leases taken up by the Future Fund where there exists an obligation to restore the property to its original condition. These costs are included in the value of the Future Fund’s leasehold improvements with a corresponding provision for the ‘makegood’ taken up.

2.14.2 Impairment of non-current assets

All assets were assessed for impairment at 30 June 2007. Where indications of impairment exist, the asset’s recoverable amount is estimated and an impairment adjustment made if the asset’s recoverable amount is less than its carrying amount.

The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use. Value in use is the present value of the future cash flows expected to be derived from the asset. Where the future economic benefit of an asset is not primarily dependent on the asset’s ability to generate future cash flows, and the asset would be replaced if the Future Fund was deprived of the asset, its value in use is taken to be its depreciated replacement cost.

2.14.3 Depreciation and amortisation

The depreciable value of plant and equipment assets is written off over the estimated useful lives of the assets to the Future Fund using the straight line method of depreciation. Leasehold improvements are amortised on a straight line basis over the lesser of the estimated useful life of the improvements or the unexpired period of the lease.

Depreciation and amortisation rates (useful lives) and methods are reviewed at each balance date and necessary adjustments are recognised in the current, or current and future reporting periods, as appropriate. The depreciable value of infrastructure, plant and equipment assets is based on a zero residual value.

Depreciation and amortisation expenses have been determined by applying rates to new depreciable assets based on the following useful lives:

Class of depreciable asset	
Leasehold improvements	5 years
Computers, plant and equipment	3–5 years
Office equipment	5 years
Furniture	5 years

The aggregate amount of depreciation and amortisation allocated for each class of asset during the reporting period is disclosed at Note 9.

2.15 Intangibles

Purchases of computer software are recognised at cost in the Balance Sheet except for purchases costing less than \$10,000, which are expensed at the time of acquisition.

An item of software represents:

- a software licence granted for greater than 12 months; or
- a developed software application.

Developed software is recognised by capitalising all directly attributable internal and external costs that enhance the software's functionality and therefore service potential.

Software assets are amortised on a straight line basis over their anticipated useful lives, being three to five years. Software assets are not subject to revaluation and consequently are carried at cost less accumulated amortisation and any accumulated impairments in the financial statements. All software assets are assessed for indications of impairment at each reporting date.

2.16 Taxation

The Future Fund is exempt from all forms of taxation except for Fringe Benefits Tax (FBT) and the Goods and Services Tax (GST).

Revenues, expenses, assets and liabilities are recognised net of GST, except:

- where the amount of GST incurred is not recoverable from the Australian Taxation Office; and
- for receivables and payables (where GST is applicable).

Receipts and payments in the Statement of Cash Flows are recorded in gross terms (that is, at their GST inclusive amounts).

2.17 Foreign Currency

All foreign currency transactions during the period are bought to account using the exchange rate in effect at the date of the transaction. Foreign currency monetary items at reporting date are translated at the exchange rate existing at reporting date. The Fund does not hold any foreign currency non-monetary assets or liabilities as at 30 June 2007.

Exchange differences are recognised in profit and loss in the period in which they arise.

2.18 Derivative Financial Instruments

The Future Fund enters into forward foreign exchange contracts to manage its exposure to foreign exchange risk.

The Fund may also enter into exchange futures contracts to gain indirect exposure to investment markets. The use of derivative financial instruments by the Future Fund is governed by the Future Fund Act 2006.

Accounting policies for financial instruments are stated at Note 17.

2.19 Rounding of Amounts

Amounts have been rounded to the nearest \$1,000 unless stated otherwise.

Note 3: Dividends, Imputation Credits and Distribution Income

	2007	Period from 3 April 2006 to 30 June 2006
	\$'000	\$'000
Dividend income		
Dividend income – domestic equities	297,904	–
Imputation credits refundable under Section 31 of the Future Fund Act 2006	126,497	–
Dividend income – international equities	1,072	–
<i>Total dividend and imputation credit income</i>	425,473	–
Distribution income		
Distribution income – unlisted unit trusts	2,267	–
<i>Total distribution income</i>	2,267	–

Note 4: Other Income

	2007	Period from 3 April 2006 to 30 June 2006
	\$'000	\$'000
Other income		
Resources received free of charge (ANAO)	75	25
<i>Total other income</i>	75	25

Note 5: Expenses

	2007	Period from 3 April 2006 to 30 June 2006
	\$'000	\$'000
Agency employees' remuneration		
Wages and salaries	1,849	97
Superannuation	208	18
Leave and other entitlements	168	–
Total Agency employees' remuneration	2,225	115
Board of Guardians' remuneration		
Wages and salaries	590	149
Superannuation	53	12
Total Board of Guardians' remuneration	643	161
Depreciation		
Depreciation of infrastructure, plant and equipment	355	1
Total depreciation	355	1
Amortisation		
Amortisation of intangibles – computer software	10	–
Total amortisation	10	–
Total depreciation and amortisation	365	1

Note 6: Remuneration of auditors

Financial statement audit services are provided free of charge to the Future Fund. The fair value of the audit services provided by the Australian National Audit Office was:

	2007	2006
	\$	\$
	75,542	25,000

No other services were provided by the Auditor-General.

Note 7: Investments

	2007 \$'000	2006 \$'000
Term deposits		
Term deposits – at fair value	38,600,500	18,046,000
	38,600,500	18,046,000
Listed equities and listed managed investment schemes		
At fair value:		
Listed domestic equities and listed managed investment schemes (Note 7A)	11,581,391	–
Listed international equities and listed managed investment schemes	1,992,970	–
	13,574,361	–
Unlisted managed investment schemes		
At fair value:		
Unlisted managed investment schemes – cash trust	724,171	–
	724,171	–
Currency contracts and exchange traded futures contracts		
At fair value -		
Currency contracts	10,292	–
Exchange traded equity futures contracts	(2)	–
	10,290	–

Note 7A: Restrictions on Investments

Included within the listed domestic equities sub-class in Note 7 above are Telstra shares transferred to the Fund by the Commonwealth Government under Part 3 of Schedule 1 of the Future Fund Act 2006. The fair value of these shares as at 30 June 2007 is \$9,739,609,955. Under subclause 8(1) of Schedule 1 to the Future Fund Act, the Minister for Finance and Administration has directed that restrictions be placed on the disposal of the transferred shares. The restrictions remain in force until 20 November 2008. The Board of Guardians is permitted to dispose of the Telstra shareholding only in the following circumstances during the restriction period:

- If requested by Telstra and agreed by the Board, as part of any Telstra initiated dividend reinvestment plan or share top up plan;
- only if requested by Telstra and agreed by the Board, as part of any Telstra initiated capital management initiative, such as a buy-back or capital reduction (whether selective or based on equal access or of any other nature – for the avoidance of doubt, if any such initiative is based on equal access, Telstra will be taken to have requested the Board's participation); and
- to a single investor, provided that:
 - The parcel of Telstra Shares to which the Disposal relates is greater than 3% of Telstra's issued ordinary shares at the time of the Disposal; and
 - the investor provides an enforceable undertaking on terms acceptable to the Board and the Commonwealth to be bound by similar lock-up provisions to those contained in this direction for at least the balance of the Lock-up Period; and
 - Telstra is advised prior to such Disposal; and
 - the price per Telstra Share is no less than the Telstra 3 Share Offer institutional offer price; and
 - the date of the disposal is at least six months following the initial listing of Telstra 3 Instalment Receipts on the ASX.

Note 8: Receivables

	2007	2006
	\$'000	\$'000
Receivables		
Imputation credits refundable	126,497	–
Interest receivable	15,488	112,459
Dividends receivable	4,100	–
	146,085	112,459

Note 9: Non-Financial Assets

	2007	2006
	\$'000	\$'000
Infrastructure, plant and equipment		
Computers, plant and equipment – at cost	2,123	20
Accumulated depreciation	(355)	(1)
<i>Total infrastructure, plant and equipment (non-current)</i>	1,768	19
Intangibles – software licenses		
Computer software purchased – cost	104	24
Accumulated amortisation	(10)	–
<i>Total intangibles (non-current)</i>	94	24

Note 9: Non-Financial Assets (continued)

Analysis of infrastructure, plant and equipment, and Intangibles	Infrastructure plant & equipment \$'000	Computer software \$'000	Total \$'000
Opening balance as at 1 July 2006			
Gross book value	20	24	44
Accumulated depreciation/amortisation	(1)	–	(1)
Net book value as 1 July 2006	19	24	43
Additions:			
by purchase	2,103	80	2,183
Disposals:			
Gross value of disposals	–	–	–
Accumulated depreciation/amortisation	–	–	–
Depreciation/amortisation charge for the period	(354)	(10)	(364)
Net book value as of 30 June 2007	1,768	94	1,862
Represented by:			
Gross book value	2,123	104	2,227
Accumulated depreciation/amortisation	(355)	(10)	(365)
	1,768	94	1,862
Opening balance as at 3 April 2006			
Gross book value	–	–	–
Accumulated depreciation/amortisation	–	–	–
Net book value as 3 April 2006	–	–	–
Additions:			
by purchase	20	24	44
Disposals:			
Gross value of disposals	–	–	–
Accumulated depreciation/amortisation	–	–	–
Depreciation/amortisation charge for the period	(1)	–	(1)
Net book value as of 30 June 2006	19	24	43
Represented by:			
Gross book value	20	24	44
Accumulated depreciation/amortisation	(1)	–	(1)
	19	24	43

Note 10: Payables

	2007	2006
	\$'000	\$'000
Payables		
Unsettled purchases*	593,528	–
Other unsecured payables and accrued expenses	930	228
	594,458	228

* Represents amounts owing under normal market settlement terms for the purchase of investment securities

Note 11: Provisions

	2007	2006
	\$'000	\$'000
Employee provisions		
Annual leave	109	–
Long service leave	83	–
Wages and superannuation	329	47
	521	47
Other provisions		
Lease incentive	516	–
	516	–
Current	562	47
Non-current	475	–

Note 12: Contributions by Government

	2007 \$'000	2006 \$'000
Opening balance	18,000,000	–
Contribution from Government – cash	22,428,000	18,000,000
Contribution from Government – financial assets	9,068,090	–
Closing balance	49,496,090	18,000,000

Financial asset contributions represent restricted Telstra shares transferred at the closing market bid price on the respective transfer dates from other wholly owned Australian Government entities. The transfer was non-reciprocal. The conditions attached to the restricted shares are outlined in Note 7A. The Future Fund has designated the transferred shares as being prospectively accounted for at designated fair value through profit and loss.

Contributions are made under Schedule 1 to the Future Fund Act 2006.

Note 13: Cash flow reconciliation

	2007 \$'000	2006 \$'000
(a) Reconciliation of operating result to net cash from operating activities:		
Operating result	2,807,558	163,042
Depreciation and amortisation	364	1
Net unrealised gains on revaluation of investments	(651,975)	
Net losses on disposal of investments	73	–
(Increase) / decrease in accrued income	(33,626)	(112,459)
(Increase) / decrease in other assets	14	–
Increase / (decrease) in employee provisions	474	47
Increase / (decrease) in other payables	702	186
Increase / (decrease) in other provisions	516	–
Net cash from operating activities	2,124,100	50,817

(b) Reconciliation of cash and cash equivalents

For the purposes of the cash flow statement, cash includes cash on hand and in banks net of any outstanding operating overdrafts. Cash at the end of the financial year is reconciled to the balance sheet as follows:

	2007 \$'000	2006 \$'000
Cash	4,888	4,773
Total cash and cash equivalents	4,888	4,773

Note 14: Contingent liabilities and assets

Contingencies

The Future Fund is not aware of any quantifiable or unquantifiable contingency as of the signing date that requires disclosure in the financial statements.

Remote contingencies

The Future Fund is not aware as at the signing date of any remote contingencies.

Note 15: Executive remuneration

The number of executives who received or were due to receive total remuneration of \$130,000 or more was as per the table below. Individuals who worked only part of the period were not included within the executive remuneration note if they did not reach the \$130,000 limit despite their annual remuneration being greater than this.

Remuneration means any money, consideration or benefit including wages, salaries, performance pay, accrued leave entitlements, superannuation contributions, the cost of motor vehicles, housing, commuting and allowances. Remuneration does not include reimbursement of out-of-pocket expenses incurred for work related purposes.

	2007	2006
	\$'000	\$'000
The number of senior executives who received or were due to receive total remuneration of \$130,000 or more:		
\$130,000 to \$144,999	–	–
\$145,000 to \$159,999	1	–
\$160,000 to \$174,999	1	–
\$175,000 to \$189,999	–	–
\$235,000 to \$249,999	1	–
\$460,000 to \$474,999	1	–
Total	4	–
The aggregate amount of total remuneration of executives shown above	1,031	–
The aggregate amount of separation and redundancy/ termination benefit payments during the year to executives shown above	–	–

Note 16: Average staffing level

The average staffing level for the Future Fund during the period was:

	2007	2006
	11	5

Note 17: Financial Instruments

Note 17A: Terms, conditions and accounting policies

Financial instruments	Notes	Accounting policies and methods	Nature of underlying instruments
<i>Financial Assets</i>		<i>Financial assets are recognised when control over future economic benefits is established and the amount of the benefit can be reliably measured.</i>	
Cash at bank	13(b)	Cash at bank is recognised at nominal amounts. Cash on hand and cash equivalents includes cash at hand, deposits held at call with financial institutions, other short term, highly liquid investments with original maturities of three months or less that are readily convertible to cash and which are subject to an insignificant risk of change in value and bank overdrafts which are repayable on demand.	The Future Fund maintains operational bank accounts with the Reserve Bank of Australia. Monies in the account are swept nightly to an at call investment account.
Other assets		Other assets are initially recognised at fair value and are subsequently recognised at amounts due less any accumulated impairment.	Other assets comprise of prepayments of operating expenditure items.
Investments	7	<p>Investments in term deposits are recognised at cost. Interest revenue is recognised using the effective interest method.</p> <p>Investments in listed equities and managed investment schemes are initially recognised at fair value.</p> <p>Transaction costs associated with the purchase of investments are expensed as incurred.</p> <p>All investments are designated as financial assets through profit and loss on purchase.</p> <p>Listed equities and listed managed investment schemes are re-measured each reporting date at the quoted bid price on relevant stock exchanges. Unlisted managed investment schemes are re-measured at director's valuation based on the estimated fair value of the net assets of each scheme at reporting date.</p> <p>Gains or losses from changes in the fair value of investments are included in the income statement in the period in which they arise.</p>	Investments comprise term deposits with the Reserve Bank of Australia, listed securities on Australian and overseas exchanges and units in listed and unlisted managed investment schemes.

Note 17: Financial Instruments (continued)

Note 17A: Terms, conditions and accounting policies (continued)

Financial instruments	Notes	Accounting policies and methods	Nature of underlying instruments
Financial Assets		<i>Financial assets are recognised when control over future economic benefits is established and the amount of the benefit can be reliably measured.</i>	
Derivatives	7	<p>The Future Fund enters into forward foreign currency agreements to manage its exposure to foreign exchange rate risk. Derivatives are classified as financial assets or liabilities at fair value through profit and loss. Derivatives are initially recognised at fair value on the date a derivative contract is entered into and subsequently re-measured at fair value at each reporting date. The resulting gain or loss is recognised in the income statement immediately. The Future Fund has not designated any derivatives as cash flow or fair value hedges.</p> <p>The Future Fund enters into exchange traded futures to gain indirect exposure to investment markets. Futures positions are marked to market by the relevant exchange and cash settled daily.</p> <p>The Fund's use of derivative financial instruments is governed by the Future Fund Act 2006.</p>	Derivatives comprise forward foreign exchange agreements to buy and/or sell currencies other than Australian dollars and investments in exchange traded futures contracts.

Note 17: Financial Instruments (continued)

Note 17A: Terms, conditions and accounting policies (continued)

Financial instruments	Notes	Accounting policies and methods	Nature of underlying instruments
<i>Financial Assets</i>		<i>Financial assets are recognised when control over future economic benefits is established and the amount of the benefit can be reliably measured.</i>	
Receivables	8	Interest on financial assets is credited to revenue on a time proportionate basis taking into account the effective interest method. Dividend income is recognised on a receivable basis with any corresponding withholding taxes recorded as an expense. Reclaims of withholding taxes are offset against this expense on lodgement of an entitlement to reclaim. Imputation credits received and claimable from the Australian Government are recorded as income on a receivable basis.	Receivables comprise interest receivable on term deposits and cash at bank, dividends and withholding taxes receivable, and imputation credits refundable from the Australian Government (ATO).
<i>Financial Liabilities</i>		<i>Financial liabilities are recognised when a present obligation to another party is entered into and the amount of the liability can be reliably measured.</i>	
Payables and provisions	10, 11	Creditors and accruals are recognised at the amounts at which the liabilities will be settled. Liabilities are recognised to the extent that goods or services have been received (irrespective of having being invoiced).	Trade liabilities comprise unsettled purchases settled in accordance with market conventions. Other accounts payable are normally settled on 30 day terms. Employee provisions are accrued in accordance with contractual and statutory entitlements (refer note 2.6). The lease liability is amortised on a straight line basis over the lease term.

Note 17B: Financial (investment) risk management objectives

The Future Fund's Statement of Investment Policies is available on its website. The Statement of Investment Policies provides additional detail on investment risks to which the Future Fund may be or become exposed to. These investment risks will be managed by:

- (a) Adopting an appropriate risk profile that is commensurate with the return objective and time horizon of the Fund. That risk profile is determined after careful analysis of the prospective risk and return characteristics of each asset class in which the Fund might invest;
- (b) avoiding concentration of risk by ensuring there is adequate diversification between and within asset classes;
- (c) careful selection and monitoring of managers to ensure there is sufficient confidence that each manager warrants the allocation of active risk to them;
- (d) monitoring the composition of the portfolios of active managers to ensure that there are no unintended biases away from the intended investment strategy; and
- (d) careful measurement and management of both market and active manager risk.

The use of financial derivatives is governed by the Future Fund Act 2006.

Note 17: Financial instruments (continued)

Note 17B: Financial (investment) risk management objectives (continued)

Excluding foreign exchange contracts (Note 17E), the Future Fund had open positions in exchange traded equity futures contracts as at 30 June 2007. The notional value of the open contracts and their fair value as at 30 June 2007 (2006: nil) is set out below:

	Notional Value	Fair Market Value
	\$'000	\$'000
Buy Equity Futures Contracts	4,563	(2)

Note 17C: Interest rate risk

The Future Fund's exposure to interest rate risk and corresponding weighted average effective interest rates for each class of financial asset and financial liability is set out below.

Financial instrument	Note	Floating Interest Rate	Fixed Interest Rate Maturing in			Non-Interest Bearing	Total	Weighted Average Effective Interest Rate
			1 Year or less	1 to 5 Years	> 5 Years			
		2007 \$'000	2007 \$'000	2007 \$'000	2007 \$'000	2007 \$'000	2007 \$'000	2007 %
Financial assets								
Cash and cash equivalents	13(b)	4,731	–	–	–	157	4,888	0.91
Receivables	8	–	–	–	–	146,085	146,085	–
Investments	7	(2)	38,600,500	–	–	14,308,824	52,909,322	6.25
Other financial assets		–	–	–	–	28	28	–
<i>Total assets</i>		4,729	38,600,500	–	–	14,455,094	53,060,323	
Financial liabilities								
Payables	10	–	–	–	–	594,458	594,458	–
Employee provisions	11	83	–	–	–	438	521	6.25
Other provisions	11	–	–	–	–	516	516	–
<i>Total liabilities</i>		83	–	–	–	595,412	595,495	

Note 17: Financial instruments (continued)

Note 17C: Interest rate risk (continued)

Financial instrument	Note	Floating Interest Rate	Fixed Interest Rate Maturing in			Non-Interest Bearing	Total	Weighted Average Effective Interest Rate
			1 Year or less	1 to 5 Years	> 5 Years			
		2006 \$'000	2006 \$'000	2006 \$'000	2006 \$'000	2006 \$'000	2006 \$'000	2006 %
Financial assets								
Cash and cash equivalents	13(b)	1,052	–	–	–	3,721	4,773	5.75
Receivables	8	–	–	–	–	112,459	112,459	–
Investments	7	–	18,046,000	–	–	–	18,046,000	5.84
Other financial assets		–	–	–	–	42	42	–
Total assets		1,052	18,046,000	–	–	116,222	18,163,274	
Financial liabilities								
Payables	10	–	–	–	–	228	228	–
Employee provisions	11	–	–	–	–	47	47	–
Total liabilities		–	–	–	–	275	275	

Note 17D: Credit risk exposures

The Future Fund only deals with counterparties it regards as creditworthy.

The Future Fund's maximum exposures to credit risk at reporting date in relation to each class of recognised financial assets is the carrying amount of those assets as indicated in the Balance Sheet.

Apart from the financial assets listed below, the Future Fund has no additional significant exposures to any concentrations of credit risk:

- Investment in Telstra as noted in Note 7A
- The term deposit with the Reserve Bank of Australia: 2007: \$38,600,500,000 (2006: \$18,046,000,000).

Note 17E: Foreign currency risk management

The Future Fund undertakes certain transactions denominated in foreign currencies, hence it is exposed to the effects of exchange rate fluctuations. Exchange rate exposures are managed within approved policy parameters utilising forward foreign exchange contracts.

As at 30 June 2007, the Future Fund had a direct investment in international equities with an Australian dollar fair value of \$1,992,970,000. This fair value position was 90% hedged via the use of forward foreign exchange contracts as at balance date.

Note 17F: Fair values of financial assets and liabilities

The fair value of each class of financial assets and liabilities is equal to their carrying amounts.

Note 18: Events occurring after reporting date

There have been no significant events occurring after reporting date that would materially affect these financial statements.

Note 19: Compensation and debt relief disclosures

No 'Act of Grace' payments were made during the reporting period (2006: nil).

No waivers of amounts owing to the government were made pursuant to subsection 34(1) of the Financial Management and Accountability Act 1997 during the reporting period (2006: nil).

No payments were made under the 'Defective Administration Scheme' during the reporting period (2006: nil).

No payments were made under section 73 of the Public Service Act 1999 during the reporting period (2006: nil).

No payments were made under ex-gratia programs during the reporting period (2006: nil).

Note 20: Special Accounts

Note 20A: Special Accounts: Future Fund Special Account

Future Fund Special Account

Legal Authority — Future Fund Act 2006, section 12.

Purpose — establishment and ongoing operation of the Future Fund.

Disclosures below are on a cash basis and consolidate departmental and administered items.

Future Fund Special Account	Period from 1 July 2006 to 30 June 2007 \$'000	Period from 3 April 2006 to 30 June 2006 \$'000
Balance carried from previous period	–	–
Bank interest amounts credited	–	51,041
Appropriations for reporting period	–	–
Other Receipts:		
GST credits	563	–
Amounts transferred from investment account ^(a)	9,677	167
Amounts credited to the special account	22,428,000	18,000,000
Total Credits	22,438,240	18,051,208
Available for payments	22,438,240	18,051,208
Payments made:		
Investments debited from the Special Account (FFA s17)	22,428,000	18,050,773
Payments made		
– Remuneration of Board of Guardians and Agency staff	2,339	224
– Suppliers	5,718	167
– Purchase of capital equipment and software	2,183	44
Total Debits	22,438,240	18,051,208
Balance carried forward to next year ^(b)	–	–

(a) The operations of the Future Fund are funded via the investment revenue generated.

(b) Excluding investments balances, see Note 20C

Note 20B: Special accounts: Other Trust Moneys – Future Fund Management Agency Special Account

The Other Trust Moneys – Future Fund Management Agency Special Account is a Special Public Money account established for the purpose:

- (a) disbursing amounts temporarily held on trust or otherwise for the benefit of a person other than the Commonwealth; and
- (b) to repay amounts where an Act or other law requires or permits the repayment of an amount received.

The Special Account was established under s20 of the Financial Management and Accountability Act 1997. The Special Account has not been used during the current year or the comparative reporting period and has a nil balance as at 30 June 2007.

Note 20C: Special Accounts: Investment of Public Money

Disclosures below are on a cash basis, except for the transfer of Telstra shares.

Future Fund Special Account: Investment of Public Money under section 17 of the Future Fund Act	Period from 1 July 2006 to 30 June 2007 \$'000	Period from 3 April 2006 to 30 June 2006 \$'000
<i>Opening balance</i>	18,050,773	–
Investments made on transfer of funds from the Special Account	22,428,000	18,050,773
Realised investments reinvested	5,129,245	–
Telstra shares – non reciprocal transfer	9,068,090	–
Interest earned reinvested	1,837,011	167
Dividends received reinvested	294,876	–
Amounts transferred to operations ^(a)	(9,677)	(167)
Investments realised	(5,138,923)	–
<i>Closing Balance</i>	51,659,395	18,050,773

(a) The operations of the Future Fund are funded via the investment revenue generated.

Note 21: Reporting of outcomes

Note 21: Net cost of outcome delivery

	Outcome 1 2007 \$'000	Outcome 1 2006 \$'000
<i>Expenses</i>		
Investment related expenses	2,392	–
Depreciation and amortisation	364	1
Agency and Board remuneration expenses	2,868	276
Other expenses	4,309	373
Total expenses	9,933	650
<i>Costs recovered from provision of good and services to the non-government sector</i>	–	–
<i>Income</i>		
Interest	1,737,773	163,667
Dividends, distributions and imputation credits	427,740	–
Realised and unrealised investment gains and losses	651,903	–
Other income	75	25
Total income	2,817,491	163,692
Net cost (contribution) of outcome	(2,807,558)	(163,042)

Outcome 1 is described in Note 1.

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Glossary

Audit committee

An audit committee plays a pivotal role in the governance framework of an organisation. An audit committee is fundamental in assisting the Chief Executive Officer and the Board to:

- ensure all key controls are operating effectively
- ensure all key controls are appropriate for achieving corporate goals and objectives, and
- meet their statutory and fiduciary duties

Australian Accounting Standards Board

The Australian Accounting Standards Board (AASB) is responsible for issuing the Accounting Standards throughout Australia. Accounting Standards are policies providing descriptions of acceptable methods for treating fundamentals of accounting. The AASB took over the role of the Australian Standards Review Board in 1991 and it includes the Australian Equivalents to International Financial Reporting Standards.

Australian workplace agreement

An AWA is an individual written agreement between an employer and employee about terms and conditions of employment, made under the *Workplace Relations Act 1996*.

Body corporate

A body corporate is a corporation or body of people, or even an individual with a legal existence distinct from the individual person(s) making up the corporate entity.

Commonwealth Procurement Guidelines

The Commonwealth Procurement Guidelines provide a policy framework designed to assist government agencies achieve value for money in their procurement activities. They articulate the expectations that exist for officials, or agents conducting procurement on behalf of the Australian Government, in the design, conduct and management of all aspects of government procurement. The guidelines are issued under the *Financial Management and Accountability Regulations 1997*.

Consultancy services

Consultancy services are one particular type of service delivered under a contract for services.

Consultant

A consultant is an entity (individual, partnership or corporation), engaged to provide professional, independent and expert advice or services. Consultants are not employees of the Future Fund and are not paid wages or other employee entitlements.

Corporate governance

Corporate governance is the system by which corporations are directed and controlled.

Custodian

The custodian is the organisation that has the legal responsibility for the safe keeping of assets, income collection and settlement of trades for a portfolio independent from the asset management function.

Financial Management and Accountability Act 1997

The *Financial Management and Accountability Act 1997* (FMA Act) provides a framework for the appropriate management of public money, public property and other Australian Government resources. It sets out the fundamental principles of financial control governing the financial activities of agencies subject to this Act. It applies to Australian Government agencies that do not own money or property in their own right.

Investment mandate

A series of written directions or instructions surrounding the performance of the investment function of the Future Fund Board of Guardians.

Risk management

Risk management is the systematic application of procedures and practices to clearly identify, analyse, evaluate, treat and monitor risks associated with an organisation's activities.

Secretariat

A secretariat is an administrative unit responsible for maintaining records and other secretarial duties of an organisation or board.

Abbreviations

AASB	Australian Accounting Standards Board
AC	Companion of the Order of Australia Medal
AM	Australia Medal
ANAO	Australian National Audit Office
CBA	Commonwealth Bank of Australia
CEIs	Chief Executive's Instructions
CEO	Chief Executive Officer
CPGs	Commonwealth Procurement Guidelines
FMA Act	<i>Financial Management and Accountability Act 1997</i>
FMO	Finance Minister's Orders
FOI Act	<i>Freedom of Information Act 1982</i>
FOI	Freedom Of Information
GST	Goods and Services Tax
RBA	Reserve Bank of Australia

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Contact details

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A copy of this document can be located
on the Future Fund website at

<http://www.futurefund.gov.au>

Appendix A

Future Fund Investment Mandate Directions 2006

Part 1 Preliminary

1. Name of Directions

These Directions are the Future Fund Investment Mandate Directions 2006.

2. Commencement

These Directions commence on 22 May 2006.

3. Definitions

In these Directions:

Act means the *Future Fund Act 2006*.

Fund means the Future Fund.

Board means the Future Fund Board of Guardians.

4. Objective of these Directions

The Future Fund will make provision for unfunded superannuation liabilities that will become payable during a period when an ageing population is likely to place significant pressure on the Commonwealth's finances.

The objective of these directions is to give guidance to the Board in relation to its investment strategy for the Future Fund. The Future Fund Board of Guardians is required under section 18 of the Act to seek to maximise the return earned on the Fund over the long term, consistent with international best practice for institutional investment and subject to its obligations under the Act and any directions given by the responsible Ministers under subsection 18(1) or subclause 8(1) of Schedule 1 of the Act.

These Directions are given under subsection 18(1) of the Act to articulate the Government's expectations for how the Fund will be invested and managed by the Board.

Investments by the Future Fund will be confined to financial assets.

Part 2 Directions

5. Benchmark return

The Board is to adopt an average return of at least the Consumer Price Index (CPI) + 4.5 to + 5.5 per cent per annum over the long term as the benchmark return on the Fund.

During the initial transition period, as the Board develops a long-term strategic asset allocation, a return lower than the benchmark return is expected.

In targeting the benchmark return, the Board must determine an acceptable but not excessive level of risk for the Fund measured in terms such as the probability of losses in a particular year.

6. Limits for holdings of listed companies

The Board must establish a limit for holdings on any listed company in order to prevent a breach of the statutory limits imposed by sections 21 and 22 of the Act.

7. Telstra Corporation

The Board must not acquire a direct equity holding of voting shares in Telstra Corporation Limited except as a result of a transfer of financial assets by the responsible Ministers under clause 6 of Schedule 1 of the Act or a gift of financial assets under clause 7 of Schedule 1 of the Act.

8. Board must consider impacts from its investment strategy

In undertaking its investment activities, the Board must act in a way that:

- (a) minimises the potential to effect any abnormal change in the volatility or efficient operation of Australian financial markets; and
- (b) is unlikely to cause any diminution of the Australian Government's reputation in Australian and international financial markets.

9. Corporate Governance

The Board must have regard to international best practice for institutional investment in determining its approach to corporate governance principles, including in relation to its voting policy.

Appendix B

Future Fund Ministerial Direction 2007

I, NICHOLAS HUGH MINCHIN, Minister for Finance and Administration, give the following direction under subclause 8(1) of Schedule 1 to the Future Fund Act 2006.

Dated: 28 February 2007

NICK MINCHIN
Minister for Finance and Administration

1 Definitions

For the purposes of this direction:

ASX means the Australian Stock Exchange Limited;

Board means the Future Fund Board of Guardians;

Dispose of a Telstra Share means:

- (a) sell, transfer, create a trust over or interest (including any legal, beneficial or relevant interest (as defined in the Corporations Act 2001)) in, or alienate any right or power attached to, a Telstra Share or create, issue or sell a financial product convertible into, exchangeable for or representing the right to receive a Telstra Share; or
- (b) agree or undertake to do any of the foregoing, whether conditionally or unconditionally; or
- (c) do anything having the economic effect of any of the foregoing including entering into a derivative (as defined in the Corporations Act 2001) over Telstra Shares;

Telstra means Telstra Corporation Limited;

Telstra 3 Instalment Receipts means instalment receipts that:

- a) relate to ordinary shares in Telstra; and
- b) are issued in connection with the Telstra 3 Share Offer.

Telstra 3 Share Offer means the offer by the Commonwealth of ordinary shares in Telstra to retail and institutional investors, through an offer of instalment

receipts relating to those shares (Telstra 3 Instalment Receipts) made in October and November 2006; and

Telstra Shares means ordinary shares in Telstra that are transferred to the Future Fund by the Commonwealth Government after the closure of the Telstra 3 Share Offer.

2 Ministerial direction

2. Disposal of Telstra Shares

Subject to paragraph 2.2 below, the Board must not Dispose of any Telstra Shares during the period from and including the date Telstra 3 Instalment Receipts are first listed on ASX to and including the date 2 years after that date (the "Lock-up Period").

2.2 Exceptions

At any time during the Lock-up Period, the Board may Dispose of Telstra Shares:

- (a) only if requested by Telstra and agreed by the Board, as part of any Telstra initiated dividend reinvestment plan or share top-up plan; and
- (b) only if requested by Telstra and agreed by the Board, as part of any Telstra initiated capital management initiative, such as a buy-back or capital reduction (whether selective or based on equal access or of any other nature – for the avoidance of doubt, if any such initiative is based on equal access, Telstra will be taken to have requested the Board's participation); and
- (c) to a single investor, provided that:
 - (A) the parcel of Telstra Shares to which the Disposal relates is greater than 3% of Telstra's issued ordinary shares at the time of the Disposal; and
 - (B) the investor provides an enforceable undertaking on terms acceptable to the Board and the Commonwealth to be bound by similar lock-up provisions to those contained in this direction for at least the balance of the Lock-up Period (except that the undertaking will not contain an exception equivalent to this clause 2.2(c) but may contain an exception for a Disposal as a result of a bona fide exercise of security by financiers to the investor); and
 - (C) Telstra is advised prior to such Disposal; and
 - (D) the price per Telstra Share is no less than the Telstra 3 Share Offer institutional offer price; and
 - (E) the date of the disposal is at least six months following the initial listing of Telstra 3 Instalment Receipts on the ASX.