



INVESTING FOR THE BENEFIT OF FUTURE GENERATIONS OF AUSTRALIANS

ANNUAL REPORT
2017-2018

© Future Fund Board of Guardians
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The document must be attributed as the *Future Fund Annual Report 2017-18*.



Guide to reading this report

This report describes the governance, operations and performance of the Future Fund Board of Guardians and the Future Fund Management Agency over the 2017-18 financial year. Additional information, including periodic investment and operational updates, policies and plans, is available at www.futurefund.gov.au.

An electronic version of this report is available at www.futurefund.gov.au/about-us/annual-reports

Data in this report may not sum due to rounding.

Investment performance data in the main sections of this report may not correspond directly with data in the Financial Statements due to differences in classification. Investment performance data presented in the main sections of the report include the investments and notional values of derivatives held by both the Future Fund and Future Fund Investment Companies. The Statement of Financial Position in the Financial Statements presents the investments and net market value of derivatives held directly by the Future Fund and the Future Fund Investment Companies are shown as one aggregated number.

As an aid to readers, this report includes a glossary of abbreviations and an alphabetical index.

Material used 'as supplied'

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Feedback

If you have questions about any aspect of this report, please contact the Future Fund's Head of Public Affairs & Strategic Relations on (03) 8656 6400.

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Letter of transmittal



Australian Government
Future Fund

25 September 2018

Dear Minister

I am pleased to present the Annual Report of the Future Fund Board of Guardians (Board) and the Future Fund Management Agency (Agency) for the 2017-18 financial year.

The report has been prepared in accordance with section 46 of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) and section 81 of the *Future Fund Act 2006*, and includes the required disclosures in relation to the Future Fund, the Medical Research Future Fund, the DisabilityCare Australia Fund, and the Nation-building Funds.

The report includes the Board and Agency's audited financial statements as required by section 34(i) of the Public Governance, Performance and Accountability (Financial Reporting) Rule 2015.

As Accountable Authority of the Agency, I certify that:

- fraud risk assessments and fraud control plans have been prepared by the Agency
- appropriate mechanisms for preventing, detecting incidents of, investigating or otherwise dealing with, and recording or reporting fraud that meet the specific needs of the Agency are in place
- all reasonable measures have been taken to deal appropriately with fraud relating to the Agency.

Yours sincerely

A handwritten signature in blue ink, reading "P Costello".

Hon Peter Costello AC

Chairman

Future Fund Board of Guardians

2017-18 at a glance

Future Fund

balance at 30 June 2018

\$145.8 billion

Return 2017-18

9.3%

10 year return

8.7% pa

Earnings for 2017-18

\$12.4bn

Value added since inception

\$85.3bn

Other fund performance in 2017-18

Medical Research Future Fund

Return Benchmark target

4.7% **3.0%**

DisabilityCare Australia Fund

Return Benchmark target

2.1% **2.1%**

Education Investment Fund

Return Benchmark target

2.1% **2.1%**

Building Australia Fund

Return Benchmark target

2.1% **2.1%**

Cash flow history at 30 June 2018

Future Fund

Contributions (bn)		Earnings (bn)		Withdrawals (bn)		Balance (bn)
\$60.5	+	\$85.3	-	\$0	=	\$145.8

Medical Research Future Fund

Contributions (bn)		Earnings (bn)		Withdrawals (bn)		Balance (bn)
\$6.7	+	\$0.6	-	\$0.1	=	\$7.2

DisabilityCare Australia Fund

Contributions (bn)		Earnings (bn)		Withdrawals (bn)		Balance (bn)
\$14.3	+	\$0.5	-	\$0.1	=	\$14.7

Education Investment Fund

Contributions (bn)		Earnings (bn)		Withdrawals (bn)		Balance (bn)
\$6.5	+	\$1.6	-	\$4.2	=	\$3.9

Building Australia Fund

Contributions (bn)		Earnings (bn)		Withdrawals (bn)		Balance (bn)
\$10.9	+	\$2.2	-	\$9.2	=	\$3.9

All funds

Balance (bn)	\$175.5
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Report from the Chairman



Over 10 years the Fund has achieved a return of 8.7% per annum, exceeding its benchmark of 6.6% per annum.

2017-18 was a strong year for the Future Fund, delivering a return of 9.3% and adding over \$12 billion in earnings.

Over 10 years the Fund has achieved a return of 8.7% per annum, exceeding its benchmark of 6.6% per annum.

From the original seed capital of \$60.5 billion the Future Fund has earned \$85.3 billion.

The Fund now stands at \$145.8 billion.

The Medical Research Future Fund (MRFF) is performing well. Since inception the Fund has achieved a return of 4.2% per annum, ahead of its target return of 3.1% per annum. The MRFF, now valued at \$7.2 billion, is designed to provide funding grants to support medical research and medical innovation.

The DisabilityCare Australia Fund and the two Nation-building Funds also performed well, meeting their benchmark target return.

The Board of Guardians now invests over \$175 billion across the five public asset funds.

Role of the Future Fund

The Future Fund was set up to strengthen the Commonwealth's long-term financial position. It generates earnings which increase its value. As a Sovereign Wealth Fund, the capital and earnings are held for the benefit of the Australian people.

The Government's decision in 2017 to defer drawdowns from the Future Fund until at least 2026-27 will prove to be critically important.

It will allow the continued growth of the Fund which will considerably strengthen the Commonwealth's financial position. A longer timeframe will give the opportunity to further develop and take advantage of the attractive opportunities offered by private markets in particular.

Over the years the Board has also been entrusted with funds additional to the Future Fund. Prudent investment has seen these funds grow to benefit the purposes for which they are established.

As the Australian Sovereign Wealth Fund, the Future Fund represents Australia at important forums around the world and contributes to policy on international investment.

Balancing risk and return in today's environment

Since inception the Board has been successful in achieving its objective to deliver strong long-term returns while avoiding excessive risk.

Looking forward, we remain disciplined in balancing our risk and return objectives.

In recent times investors have benefited from a period of sustained synchronised growth and this appears set to continue in the near term.

But over the medium to longer term, a number of risks remain. As interest rates around the world begin rising towards more normal levels we expect to see downward pressure on asset prices.

Adding to this, international political tensions and trade restrictions continue to impact markets and the potential for further shocks remains.

In this environment, and given the Government's decision to defer drawdowns from the Future Fund until at least 2026-27, the Board continues to focus on its long-term objective. We are thinking carefully about how to position the Fund to achieve its mandated benchmark return across another decade and beyond, and the level of risk it will take to get there.

During the year, the Board moderately increased risk in the Future Fund. We are prioritising portfolio flexibility, ensuring the portfolio is as robust as possible to a range of possible scenarios.

We maintain our view that prospective long-term returns will be lower relative to history and are conscious that while pursuing returns we must avoid excessive risk.

Governance

The Future Fund's revised Investment Mandate of CPI + 4% to 5% per annum took effect from 1 July 2017 and reflects the Government's view of the lower return investment environment operating into the future.

In February 2018 the Government announced its intention that the Board of Guardians manage the new Aboriginal and Torres Strait Islander Land and Sea Future Fund. Once the necessary legislative arrangements are in place, we will be well positioned to add this fund to our existing responsibilities.

During the year, Rob Priestley resigned from the Board of Guardians. Rob made a valuable contribution to the Board and I thank him for his service.

I also thank my colleagues on the Board of Guardians who brought their experience and skill to the Board and to the operation of its Committees.

Acknowledgements

On behalf of the Board I thank the responsible Ministers for their continued support during the year.

I also acknowledge the support of the staff, led by David Neal, and thank them for their enthusiasm and commitment.



Hon Peter Costello AC

Chairman
Future Fund Board of Guardians

Report from the CEO of the Future Fund Management Agency



The number of funds we manage has grown, and given the Government's decision to defer cash flows, our assets under management will continue to grow strongly for many years to come.

2017-18 was one of the busiest and most productive years in the Future Fund Management Agency's history.

We continued to focus sharply on supporting the Board to deliver strong risk-adjusted returns. Our portfolio activity has been disciplined in markets that appear, in general, fully priced.

Whilst we have continued to position our portfolios around the middle of their typical risk appetite ranges, even moderately increasing risk over the financial year, we have at the same time sought to prioritise flexibility and liquidity. This balance sets us up well to continue to generate good long-term returns while allowing us to navigate any challenges the investment environment might lay in our path.

The scale and complexity of our task has grown over the years. The number of funds we manage has grown, and given the Government's decision to defer cash flows from the Future Fund, as well as the expected growth in the Medical Research Future Fund, our assets under management will continue to grow strongly for many years to come.

At the same time, the investment environment has become more complex and competition for attractive investment opportunities is intensifying. Meanwhile, at CPI + 4% to 5% per annum over the long term, the Future Fund benchmark return in the Investment Mandate from the Government is a demanding one.

In this context we undertook a review of the design and operation of the Agency. We have had great success over our first decade, and the review was aimed at ensuring we have an organisation that can sustain this success over the next decade and beyond, in the context of a portfolio that will continue to grow for many years to come.

We made some important changes, which will enhance our joined-up, collaborative team approach, increase the speed of our decision-making, sharpen our risk management discipline and increase our ability to embrace and exploit the ever-faster development of technology.

Speaking of technology, we have been working hard to deploy new systems and capabilities to add greater efficiency and effectiveness across our business and investment processes. We have now entered the third and final year of an important program of work to enhance our investment data and analytics capability. We have completely redesigned our operating model for the sourcing, management and delivery of investment data, in the process establishing important new external partnerships to leverage best-in-class technology, services and skills.

This provides the foundation onto which we are building a comprehensive analytics capability, which will give us more insight into our portfolio exposures, transforming data into insights and in turn helping us to generate strong returns and manage risk.

During the year we farewelled a number of staff as a result of our organisational changes. Thank you to all who made a valuable contribution to our organisation that will no doubt contribute to our future success. We were also thrilled to welcome new members to our team as we further build our capabilities.

My sincere thanks to the Chairman and the Board of Guardians for their continued guidance and leadership through the year.

Most importantly, I thank and congratulate the team of the Future Fund Management Agency for another productive and successful year. I am highly appreciative of the effort and commitment the team displays, and the passion with which it goes about the task of investing for the benefit of future generations of Australians.



David Neal

Chief Executive Officer
Future Fund Management Agency

ORGANISATION OVERVIEW

01

We are Australia's sovereign wealth fund, investing for the benefit of future generations of Australians.

Every dollar that we make is a dollar that adds to Australia's wealth and contributes to its future.

Our organisation

Established in 2006, we invest the assets of five special purpose public asset funds: the Future Fund, the Medical Research Future Fund, the DisabilityCare Australia Fund and two Nation-building Funds.

The Future Fund Board of Guardians is responsible for investing the assets of the funds, supported by the Future Fund Management Agency.

We operate independently from the Australian Government, and balance the risk and return aspects of each fund's investment mandate to maximise returns.

Australia's Sovereign Wealth Fund

The Future Fund invests historical contributions of Budget surpluses and Government Telstra shares.

It is not a superannuation fund. It does not have any superannuation liabilities to manage nor does it receive any superannuation contributions. No individual has a claim on, or is entitled to a payment out of, the Fund.

Our funds

Each fund we manage has an investment mandate that is determined by the Australian Government under legislation.

We have no role in determining the projects and initiatives that are supported by drawdowns out of the various funds. Our sole responsibility is to invest the funds.

Future Fund

The Future Fund was established in 2006 to strengthen the Australian Government's long-term financial position.

The Fund received contributions from a combination of budget surpluses, proceeds from the sale of the Government's holding of Telstra and the transfer of remaining Telstra shares.

Until 30 June 2017 the Investment Mandate for the Future Fund was to achieve an average annual return of at least the Consumer Price Index (CPI) + 4.5% to 5.5% per annum over the long term with an acceptable but not excessive level of risk.

From 1 July 2017 the long-term benchmark return target was reduced by the responsible Ministers to CPI + 4% to 5% per annum, reflecting the changed investment environment. The return objective must continue to be pursued with acceptable but not excessive levels of risk.

While legislation permits drawdowns from the Future Fund from 1 July 2020, the Government announced in the 2017-18 budget that it will refrain from making withdrawals until 2026-27.

The expected continued growth in the portfolio as a result of this decision will considerably strengthen the Commonwealth's position. A longer timeframe will give the opportunity to further develop and take advantage of the attractive opportunities offered by private markets in particular.

Withdrawals from the Future Fund, when they are made, will help the Australian Government to meet its obligations out of Consolidated Revenue (including defined benefit pensions) and thereby ease the pressure on Government finances.

Medical Research Future Fund

The Medical Research Future Fund was established in 2015 in order to improve the health and wellbeing of Australians by providing grants of financial assistance to support medical research and medical innovation.

The Fund's Investment Mandate is to achieve at least the Reserve Bank of Australia cash rate target + 1.5% to 2.0% per annum, net of investment fees, over a rolling 10-year term.

Payments from the Medical Research Future Fund for particular projects and initiatives are determined by the Australian Government in accordance with the *Medical Research Future Fund Act 2015*.

DisabilityCare Australia Fund

The DisabilityCare Australia Fund was established in 2014 to help fund the National Disability Insurance Scheme (NDIS), which will support a better life for Australians with a significant and permanent disability and their families and carers.

The Fund will reimburse States, Territories and the Commonwealth for expenditure incurred in relation to the NDIS.

The Fund's Investment Mandate sets a benchmark return of the Australian three-month bank bill swap rate + 0.3% per annum calculated on a rolling 12-month basis. Investments must minimise the probability of capital loss over a 12-month horizon.

Payments from the DisabilityCare Australia Fund are managed in accordance with the *DisabilityCare Australia Fund Act 2013*.

Nation-building Funds

The Nation-building Funds, namely the Building Australia Fund and the Education Investment Fund, were established in 2008 to provide financing resources to help meet the Australian Government's commitment to Australia's future through investment in critical areas of infrastructure.

The Funds' Investment Mandates set a benchmark return of the Australian three-month bank bill swap rate + 0.3% per annum calculated on a rolling 12-month basis.

The Mandates require that investments minimise the probability of capital loss over a 12-month horizon. The assets of the Nation-building Funds are invested in a combination of short- and medium-term debt instruments.

Payments from the Funds are determined by the Australian Government, with advice from Infrastructure Australia in accordance with the *Nation-building Funds Act 2008*.

Building Australia Fund

The purpose of the Building Australia Fund is to enhance the Australian Government's ability to make payments in relation to the creation or development of transport, communications, energy and water infrastructure and in relation to eligible national broadband matters.

Education Investment Fund

The purpose of the Education Investment Fund is to enhance the Australian Government's ability to make payments in relation to the creation or development of higher education infrastructure, research infrastructure, vocational education and training infrastructure.

Every dollar of value that we add to the **Future Fund** will be a dollar that future taxpayers won't have to contribute

“
One of the best things about working at the Future Fund is that the Fund's goals are for the public good
”

Every dollar that we add to the **Medical Research Future Fund** contributes to life-saving medical initiatives

The **Nation-building Funds** have supported investment in areas of infrastructure such as transport, communications, energy, water, education, research and health

The value we create for the **DisabilityCare Australia Fund** goes towards expenditure under the National Disability Insurance Scheme

“
People that work here are genuinely motivated to do their best to benefit future generations of Australians
”

“
The best thing for me is working at a place where you can actually make a difference to Australia's future
”

Our purpose

The Board has defined a clear purpose:
investing for the benefit of future generations of Australians.

Everything we do is aligned to achieving our purpose. It provides a focus for our people, their efforts and our priorities.

Every extra dollar of value that we add to the funds we manage will have a real impact on future generations of Australians.

Our business strategy

To execute our purpose, we developed a long-term business strategy that articulates a consistent, shared understanding of the direction and priorities of the organisation.

There are a number of factors that feed into our strategy – our purpose, our strategic imperatives and pillars, our culture and values, and the strategic activities we need to focus on.

Strategic imperatives

Our strategic imperatives highlight the essential ingredients to our success. They are:

- The best portfolios to achieve our Investment Mandates.
- A well-managed organisation with a talented, motivated and engaged team.
- Efficient, effective and fit-for-purpose processes and technology.
- The trust and respect of the Australian Government, Parliament and the investment community.

Culture and values

This is how we go about doing what we do – the character and behaviour we embed into the way we act and interact:

- We **focus on what matters**. Everything we do is focused on achieving our purpose, we don't get sidetracked by distractions.
- We always **do the right thing** by our country, our organisation and our team.
- We **work together** to achieve the best outcome every time and ultimately to achieve our purpose.

Strategic pillars

There are three key pillars of our business strategy:

- **One team, one purpose** – we work as one team, striving to find the best possible solutions. Combining a breadth of experience and skills into a collaborative whole creates a meaningful competitive advantage.
- **Nimble and flexible** – we are broad and creative in our search for opportunities to improve the portfolio, the organisation and ourselves. We believe that being flexible, nimble and opportunity-driven will add substantial value.
- **Leveraging the best in the world** – we have access to the best investment thinkers in the world through our peers and partners. We leverage the best in the world, building strong and enduring partnerships.

The number of funds we manage, and the value of these funds, has grown over the years. At the same time, the investment environment has become more complex.

Upgrading our investment data and analytics is our highest priority initiative. Darren, Gloria, Tom, Daniel, Julia, Phil and Emma are just a handful of staff working collaboratively across the organisation to develop and deploy new systems and capabilities to the investment teams that will deliver greater insights into our portfolios.

Strategic activities

To deliver our business strategy, we are currently focused on, and making good progress in, three priority areas:

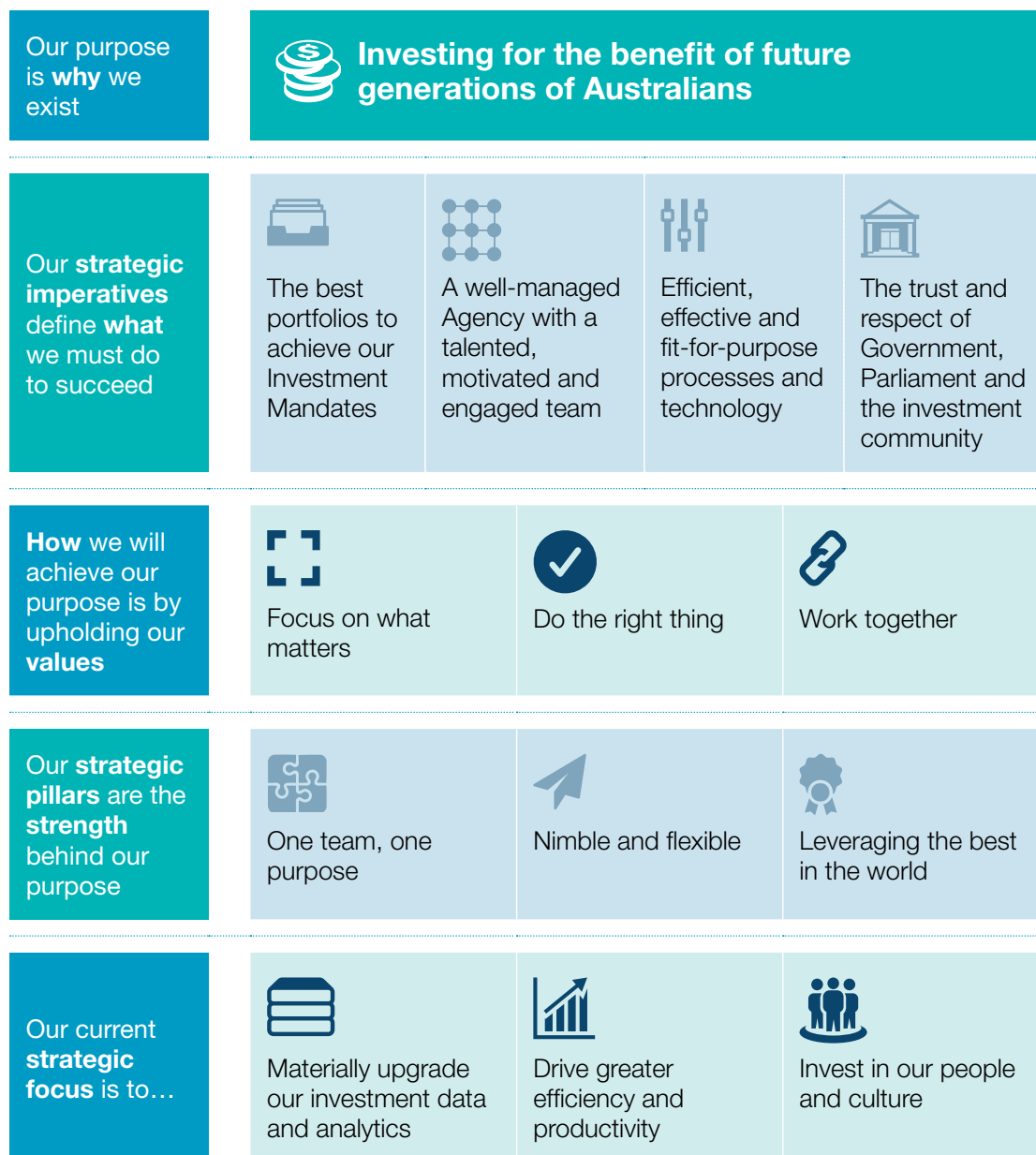
1. A multi-year program of work to materially upgrade our investment data, systems and analytics capability.
2. Driving greater efficiency and productivity improvements across the business.
3. Ongoing investment in our people and culture, through the provision of training and development and also through a well-structured employee environment that attracts and retains high performers.

The strategic activities we have chosen to focus on reflect the context we are operating in. The number of funds we manage, and the value of these funds, has grown over the years. At the same time, the investment environment has become more complex, and the increasing sophistication of institutional investors has led to a growing level of competition for attractive investment opportunities. Adding to that, significant improvements in technology are disrupting traditional investment models and creating new opportunities to generate returns and monitor and manage risk.

Upgrading our investment data, systems and analytics capability, and using technology to drive greater efficiency and effectiveness across our business and investment processes will give us more insight into our portfolio exposures in real time and in turn help us to generate strong returns and monitor risk. We are investing in our people and culture because we recognise that the capability of our staff is at the heart of our success.



Our business strategy





Designing the Future Fund of the future

In May 2017 the Australian Government announced it would delay withdrawing money from the Future Fund until at least 2026-27.

This was a significant decision for our organisation – it signalled the beginning of an exciting and demanding new phase in our work.

Over the last decade, the Future Fund has exceeded its benchmark return and generated over \$85 billion in investment returns.

Following the Government's decision to delay withdrawals, the Fund will continue to grow through accumulated earnings. This could significantly enhance its size.

This means we need to design and build an organisation that can manage a portfolio of substantial additional size and complexity while sustaining the success we have achieved to date.

During the year we reviewed our organisational structure, making changes to strengthen our investment, technology and risk functions.

The changes we have made will help the organisation to be more nimble and collaborative, recognise the importance of technology in maximising the value of data and information in the investment process and further strengthen risk management and the use of risk insights.

A snapshot of the changes:

- Creation of a Chief Technology Officer role to further strengthen the organisation's focus on maximising value through the use of technology.
- Appointment of a Chief Risk Officer to ensure the organisation remains resilient and robust in identifying risks and extracting insights from our risk monitoring and management processes.
- Consolidation of the investment team under the leadership of the Chief Investment Officer to streamline and simplify the leadership of our investment process and more easily facilitate our collaborative, joined-up investment approach.
- Appointment of two Deputy Chief Investment Officers to simplify the investment structure and reinforce our focus on the performance of the portfolio as a whole.
- Reorganisation of our investment team and appointment of a number of new Sector Heads to support collaboration and the efficient and flexible management of the investment portfolio as it continues to grow.

The new structure will help us build on our success as the Future Fund grows over the decade ahead and will ensure we stay sharply focused on our task of investing for the benefit of future generations of Australians.

Designing the Future Fund of the future isn't just about how we structure ourselves – we also made changes to the Future Fund's structural risk profile going forward. Read more on pages 34–35.

HOW WE INVEST

02

Each of the funds we manage has its own investment mandate which sets out its investment objective.

Our core investment beliefs inform our interpretation of each mandate and we apply a consistent investment process across the funds.

Our investment approach is based on one team working together for the benefit of the portfolio as a whole. We call this our 'one team, one purpose' philosophy.

Our team collectively channels its best ideas, irrespective of asset class, up to the total portfolio to achieve the investment objective of each fund.

We invest across public and private markets in the broad categories shown in the table on page 16. Across each category we develop an investment strategy for each fund that is consistent with its investment objectives and our approach to total portfolio construction, which is discussed further in the following pages.

For the Future Fund and the Medical Research Future Fund, we construct highly diversified portfolios that are as robust as possible to range of possible scenarios.

The DisabilityCare Australia Fund and the Nation-building Funds have shorter-term investment horizons. The assets of these funds are invested in a combination of short- and medium-term debt instruments.

Investment categories

Category	Sectors covered
Public Markets	
Alternative assets	Skill-based absolute return strategies and other risk premia providing diversity of return streams
Cash	Treasury bills, bank bills and deposits
Debt	Primarily through non-government fixed interest securities extending to mortgages, high yield credit and corporate loans
Portfolio overlays	Listed equities, developed market currency, emerging market currency, domestic and global interest rates and portfolio protection strategies
Listed equities	Australian equities, global developed market equities, global emerging market equities
Private Markets	
Private equity	Venture capital, growth capital, buyout, distressed debt for control
Tangible assets	Real estate, infrastructure, timber and agricultural assets gained through public or private markets

Joined-up investment approach

When constructing the portfolio we bring together the top-down and bottom-up views – we call this being joined up. It is the cornerstone of our investment philosophy, and we further consider it a key comparative advantage that significantly improves our prospects of meeting our investment objective.

Our top-down people look at the global economy, financial markets and political risk, and think about how this will impact the portfolio. Our bottom-up people look across the world for great assets and investment opportunities, thinking about whether they are being rewarded for the risk they are taking.

This whole of portfolio approach challenges our people to think broadly, to test and challenge their views and the thoughts of their managers and to compare the merits of any one investment versus another.



Dynamic investment process

We don't set a fixed strategic asset allocation from the top and then require those allocations to be filled across each of the investment sectors. Prospective returns and risks for all the different types of investment opportunities are always changing, so we manage the portfolios dynamically.

Our dynamic investment process seeks to extract the best possible return adjusted for the level of risk in markets and individual investments. We expect to increase risk levels when the expected reward for taking risk is high and to reduce risk levels when the expected reward for taking risk is low.

The key elements of our investment process are:

Foundation inputs: Our core investment beliefs inform our interpretation of each fund's investment mandate and its objectives and help us to determine our appetite for the types and levels of risk we are prepared to take in each of the funds. Our beliefs are listed on page 20.

Analysis of the investment environment: We develop a deep understanding of the investment environment we are operating in at any one time, along with regularly analysing a range of plausible future scenarios over multiple time horizons so that we can better understand how our portfolios might behave if conditions change.

Risk management and budgeting: Our investment policy framework helps us to clearly and effectively manage the risk of our funds at what we consider to be acceptable – rather than excessive – levels. Given our assessment of the environment and consistent with our investment policy framework, we then choose appropriate and mutually consistent risk settings for each of our portfolios, which are informed by their mandates. These risk budgets are dynamically managed.

Investment analysis and selection: Once we have decided on an appropriate risk budget for a given fund, we allocate and implement that budget through underlying investment activity. Our ongoing assessment of the investment environment provides us with insight into the behaviour of the investments we make and how they interact with each other in portfolio construction. We assess appropriate risk levels on a total portfolio level using a range of factor lenses.

The Future Fund's venture capital portfolio reached a significant milestone in 2017 with two of our co-investments issuing Initial Public Offerings (IPO). Mongo DB, pictured here, is a leading next generation database company. It was one of the largest enterprise technology IPOs in 2017. It IPO'd at US\$24 per share and at the time of writing this report was trading at over US\$80. At 30 June 2018 the Future Fund owned around 5% of the company.





Our Deputy CIOs on investing in private and public markets

During the year we appointed two Deputy Chief Investment Officers as part of changes to our investment team. They will play a critical role in supporting our joined-up investment approach, bringing together the collective skills of our sector teams to benefit the whole portfolio.

Wendy Norris is Deputy Chief Investment Officer, Private Markets – she oversees Private Equity, Property and Infrastructure & Timberland.

David George is Deputy Chief Investment Officer, Public Markets – he oversees Listed Equity, Debt, Overlays and Alternatives.

Read Wendy and David's perspectives on their new roles and their priorities for the year ahead.

What are your priorities in the new role?

WN: We want to create a team that makes the best investment decisions by increasing the focus on joint accountability for our investment objectives. That includes balancing the need to grow the illiquid portfolio in the long term with the desire to have a portfolio that is able to respond flexibly to market opportunities in the short term, and making sure the investments we make in private markets deliver the best outcomes for the whole portfolio. It also means developing our investment team to be total portfolio investors – in addition to being specialists in their respective sectors.

How do your roles work together?

DG: By bringing the right skills and shared experience to run the total portfolio better.

Alongside the Chief Investment Officer and Head of Portfolio Strategy it is our job to focus the overall team's priorities so that we take maximum advantage of our small and agile operating model.

How does the new structure support your investment team's joined-up investment approach?

DG: Bringing Public Markets together brings many similar and related activities under one umbrella. This makes clear where we may have differing approaches to similar problems and where our complementary capabilities, models and experience reside. This can help drive a more efficient team and better practice.

WN: Bringing Private Markets together allows for a richer conversation about the contest for capital from across the illiquid parts of the portfolio. This continuous appraisal of all the opportunities available to us against each other, irrespective of asset class label, is what allows us to contribute the best risk-adjusted return to the overall portfolio.

Has there been a shift in your investment approach since the restructure of the investment team?

DG: Our investment strategy is unchanged but our new structure will help us be flexible, nimble and more joined-up even as we grow. As with any change, it will take time to settle into our new structure and see the tangible benefits. However, it has been very encouraging to see an increase in collaboration across the teams, conversations where approaches and views are being sought and shared in a proactive way toward investment problems. Access to diverse and valuable input from across the team empowers more confident decision-making and is a key element of our 'one team' philosophy.

WN: From my perspective it's not a shift in the investment approach, it's just that with a bigger team we can't all fit around the one table to make every decision as we could in the beginning. We have to adapt our structures to make sure we are still having high quality conversations, with the right people in the right forums. The restructure is helping us drive our core values of 'one team' deeper in to the organisation to counteract the effect of the overall growth in the size of the team.

What are the big issues facing private markets in the year ahead?

WN: Like many investment markets at present, valuations are high by historical standards and we need to work hard to find the best opportunities. In this environment we are taking advantage of strong markets to sell assets where the businesses have matured, being very selective about the managers that we re-invest with and refreshing our strategies to prioritise sub-sectors and themes where the balance of risk and reward is most attractive.

What are the big issues facing public markets in the year ahead?

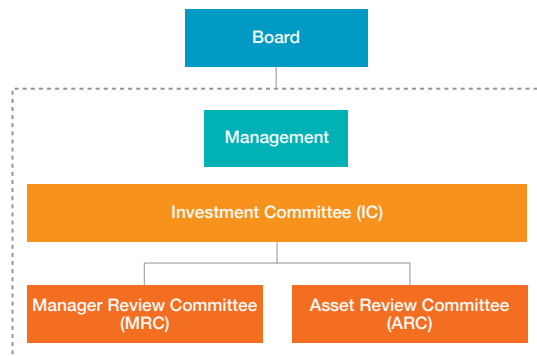
DG: The market context, which broadly offers a later-in-the-cycle set of attributes such as fair to full pricing, is a strong signal that 'planning' might be more valuable than 'doing' this year. What I mean by that is that we must prepare the ground, whether that be by investing in developing our systems and data, portfolio house-keeping work that refines toward our highest conviction strategies, or putting in place the levers of access that will enable nimble investment in opportunities when and if they appear.

Decision-making

The Agency's Investment Committee, which meets at least twice a month, provides review and decision-making in respect of the total portfolio construction and brings forward recommendations to the Board for review and approval. The Committee also oversees the management of the portfolio within the delegations agreed by the Board.

The Investment Committee is supported by the Manager Review Committee and the Asset Review Committee. Both of these Committees comprise senior representatives from across the Agency and have delegated authority from the Investment Committee to assess manager and asset due diligence. The Committees consider detailed recommendations in relation to investment manager appointments and investment in specific assets.

Investment decision-making structure



The Investment Committee



Mr David Neal
Chief Executive Officer



Mr Craig Thorburn
Director, Emerging Markets



Ms Wendy Norris
Deputy Chief Investment Officer,
Private Markets



Mr David George
Deputy Chief Investment Officer,
Public Markets

Investment beliefs

Essential to how we invest are our core investment beliefs. These beliefs shape the way we interpret each fund's investment mandate and its objectives, and how we reach investment decisions.

We believe that:

- Success for the Future Fund and the Medical Research Future Fund is achieving returns over rolling 10-year periods in accordance with the benchmark return of the respective mandates, while avoiding excessive downside risk.
- Success for the Nation-building Funds and the DisabilityCare Australia Fund is achieving returns over rolling 12-month periods in accordance with the benchmark return of the respective mandates, while minimising the probability of capital losses over a 12-month horizon.
- The Board is ultimately responsible for all investment decisions. The Board's role is to act as if it is the owner of the Funds which belong to the Government on behalf of the Australian people.
- The Board must ensure all parties involved in the management of the funds, both internal management and external service providers, are as aligned as possible to delivery of success as defined above.
- The likelihood of meeting investment goals is directly related to the time, expertise and organisational effectiveness applied to decisions. Moreover, it is critical that a high quality and clear governance framework, incorporating adequate time and diversity of view, is in place.
- Portfolios are most efficiently managed as a whole, rather than a collection of sub-portfolios.

- Risk management should emphasise qualitative considerations, including a deep understanding of the investment environment. Quantitative measurement is important in supporting and testing this process.
- Investment risk is not well captured by a single metric, and there are additional risks that must be assessed and managed, such as liquidity, operational, counterparty and reputational risk.
- Focus should be on appropriate exposure to market risk factors because these are a stronger driver of long-term total portfolio risk and return than skill-related risk.
- A higher expected return per unit risk (investment efficiency) can be obtained from a broadly diversified allocation across different return drivers.
- Prospective returns and risks vary materially over time in a way that is at least partially observable and hence exploitable. The amount of risk taken should therefore be managed dynamically as conditions change.
- Being long-term funds, the Future Fund and the Medical Research Future Fund can invest in illiquid assets where illiquidity is appropriately rewarded, providing opportunities to increase returns.
- Markets can be inefficient to an extent that skilful management can add value after fees. Such 'net alpha', being uncorrelated with other return streams, is extremely valuable to the total portfolio.
- The management of costs is very important to maximising returns. The Board will seek to lever the Fund's scale and market standing to reduce costs.

Partnering with investment managers

We partner with external investment managers who execute investment strategies on our behalf.

These managers have a detailed understanding of our investment strategy and our internal investment team works closely with them to seek out the best investment opportunities around the globe.

A list of our external managers at 30 June 2018 is available at Appendix A.

We prefer fewer, more meaningful, relationships with external managers. We select managers for their ability to generate information and insight, their willingness to genuinely collaborate and share knowledge and for the breadth of their collective coverage.

Our focus on alignment and building relationships has improved the quality of investment opportunities available to us, and also helped to make our dynamic investment process more efficient.

Using investment managers also aligns with our preference to keep our internal investment team as small and nimble as possible, while being as large as is necessary to cover our investment universe. This allows the team to focus on key investment decisions rather than being drawn into day-to-day asset management.



Mr Hugh Murray
Head of Overlays



Dr Raphael Arndt
Chief Investment Officer



Mr Björn Kvarnskog
Head of Listed Equities



Mr Steve Byrom
Head of Private Equity

Our investment manager selection process is designed to deliver a high quality initial selection decision, and to ensure that the portfolio construction does not lead to excessive concentration of manager risk in any one investment manager. We seek the best commercial terms available and favour those that are appropriately structured. We also undertake regular reviews of our managers.

Appropriately experienced investment professionals are responsible for undertaking investment manager and asset due diligence. These professionals apply a structured framework to assess the manager or asset and bring forward a recommendation to the Manager Review Committee or Asset Review Committee as appropriate.

The framework incorporates assessment against agreed evaluation criteria and includes desk research, third party research, site visits and interviews.

We undertake detailed operational due diligence through the operational business units of Operations, Finance, Public Affairs and Legal. We also use external advisers to undertake specialist due diligence or supplement the internal due diligence work as required.

Our investment monitoring practices ensure that the portfolio is managed within our predetermined limits. These limits relate to the actual and target allocations to sectors and the exposure to individual managers as well as manager and portfolio performance. A regular portfolio report is provided to the Board which tracks performance against these limits.

We undertake regular reviews of external managers with a focus on ensuring that they continue to satisfy the criteria for their appointment.

Where we invest

As a global investor, we look across the world for the best investment opportunities available to maximise returns for the benefit of future generations of Australians.

We pursue strong relationships and close collaboration with our partners around the world. We share and acquire knowledge and access the best investment ideas through working with world-leading investment organisations.

As an Australian fund we are always actively looking for domestic investment opportunities. Our base currency is the Australian dollar and the return objective for the Future Fund is tied to Australian inflation.

Managing currency

In managing currency risk for the Future Fund and the Medical Research Future Fund we conceptually consider offshore investments on a fully hedged basis and then separately evaluate to what extent we wish to hold an exposure to foreign currencies. We explicitly manage the size and nature of the foreign currency exposures rather than allowing them to be shaped by the underlying investments.

We hold foreign currency exposure for a variety of reasons. We believe it can enhance portfolio diversification, in particular through access to defensive currencies that provide returns and liquidity in times of market stress and protect purchasing power when the Australian dollar weakens.

In the case of the DisabilityCare Australia Fund and the Nation-building Funds, given their higher domestic weighting and the conservative nature of these investment programs, we require our investment managers to fully hedge all foreign currency exposures back to Australian dollars at the individual account level.

Currency exposure for the Future Fund and the Medical Research Future Fund in 2017-18 is discussed in the Investment Performance section of this report.

Managing tax arrangements

In implementing our investment strategies we invest through various jurisdictions and investment vehicles for a variety of commercial, legal and tax reasons.

In Australia the *Future Fund Act 2006* exempts the Board from paying income tax. This reflects the fact that our earnings are owned by the Australian Government. Internationally we also benefit from sovereign immunity for tax purposes on the bulk of our investments.

Nonetheless, properly structuring our investments can be essential to maintaining our rights and entitlements, including the benefit of sovereign immunity for tax purposes in certain jurisdictions. Failure to manage these matters can have a material impact on performance and would be inconsistent with our mandated objective to maximise returns while not causing any diminution of the Australian Government's reputation in financial markets.

We will only invest through arrangements and structures that are commonplace and well tested by other public investment institutions and funds in terms of compliance with applicable laws and regulations. We do not invest in schemes that contravene the OECD's key principles of transparency and information exchange for tax purposes. In making investments we assess whether the jurisdictions through which we invest are regarded by the OECD as having substantially implemented the internationally agreed tax transparency standard.

Management of environmental, social and governance issues

Our approach

We believe that effective management of material financial and reputational risks and opportunities related to environmental, social and governance (ESG) factors will support our requirement to maximise the long-term returns earned on our funds. The integration of ESG factors enables investors and companies to better understand the full spectrum of future risks and opportunities to which assets are exposed.

Beyond its impact on the specific investments of the funds, sound management of ESG factors contributes to the development of more efficient and sustainable capital markets, in turn enhancing long-term return outcomes.

We focus on those ESG factors that have the potential to materially impact the performance of the investment portfolio and/or our reputation. Relevant ESG factors vary by industry and across asset classes, but can include any of the following: environmental quality, climate change, human and labour rights, occupational health and safety, supply chain risks, corruption and corporate governance.

We incorporate ESG into our own investment decision-making approach, both at individual investment and portfolio levels. This approach includes the evaluation of ESG factors in direct investments, integration of ESG into the process for selecting the external investment managers responsible for individual investment decisions, and management of ownership rights.

Given our long-term investment approach, we steer our focus towards the impact of ESG factors on long-term investment value and quality.

In particular, we believe that there is a positive relationship between good governance and investment value and acknowledge the value of exercising our ownership rights, including voting rights where relevant, across the broad range of our investments. Ownership rights are essential to ensuring the appointment and retention of fiduciaries of the highest quality, and motivating those agents to manage value creation over the long term.

Our overall framework for managing the complex financial and reputational risks and opportunities related to ESG factors is articulated in our Statement of Investment Policies on our website.

Integrating ESG into the investment process

Partnering with our managers

Our investment model relies heavily on external investment managers to make investment decisions based on the overall investment strategy determined by the Board. As such, these investment managers play an important role in implementing our ESG management strategy.

This model requires careful coordination and alignment between our organisation and our managers. As part of our manager selection and monitoring process we consider the extent to which the manager is effectively managing financial risks and opportunities that may arise from ESG issues. This process is underpinned by dedicated and ongoing engagement and supported by detailed ESG portfolio analytics. To the extent that formal or informal ownership rights accrue in the manager's portfolio and are delegated to the manager, due consideration is given to the manager's ability to exercise those rights in the best interests of our organisation.

Transactional due diligence

We have integrated ESG into the due diligence for transactions going through our Investment Committee as well as those committees overseeing manager appointments and asset-specific investments. Moreover, the transaction tools and delegation authorities that support the investment process guide our investment teams in the treatment of relevant ESG factors.

Where we make direct investments – such as for direct infrastructure or property investments – or for any other investment decisions that fall outside the investment mandates with our external managers, an evaluation of ESG and reputational risk factors is undertaken internally. These assessments are conducted by the relevant sector team, and supported by a dedicated ESG team with line of sight over all investment activities. Moreover, to further enhance our ESG due diligence activities, we engage third party consultants where appropriate, and have recently joined the GRESB reporting initiative which assesses the sustainability performance of real estate and infrastructure portfolios worldwide.

Investment in long-term themes

Given our status as a large, long-term asset owner with a globally diversified portfolio, top-down views on the strategic trends that will influence outcomes for investors over the medium to long term are an important component in the capital allocation process. Many of those trends have a strong ESG component, both in terms of system inputs (such as demography and resource scarcity) and regulatory and consumer responses to those inputs (such as policies that seek to internalise negative environmental or social externalities).

Climate risk

As with other ESG risks, we incorporate climate risks, where these could pose a material risk to investment performance, into our investment decision-making. This means understanding the risks that cash flows associated with our investments might be impaired due to regulatory, policy or technological initiatives, or lack of resilience to changes in the natural environment. We also engage with our investment managers, with the support of third party research, to ensure they do the same on our behalf. We view these risks from a risk-adjusted returns perspective. Consistent with this we have invested in a range of clean technologies such as wind, solar and energy efficiency technologies as part of our diversified investment portfolios, where expected returns over an appropriate time horizon are attractive on a risk-adjusted basis.

We also consider the ability of the companies we invest in to manage these and other issues through direct engagement and voting our shares at shareholder meetings.

Disruptive innovation

The world is currently experiencing a period of profound technological innovation. Through rapid adoption and convergence, these technologies are reshaping the way we live and work. They are also changing the way investors operate and disrupting the business models of the companies in which they invest.

The Future Fund benefits from disruptive innovation as active investors in companies of the future. Our multi-billion dollar venture capital program gives us access to innovative, high potential companies as well as insight into the disruption trends that are impacting the way societies and economies operate, and how those trends may play out in our portfolio.

While we aim to harness the opportunities disruptive innovation offers, we are equally cognisant of the risks it poses to our portfolio. For example, the introduction of autonomous vehicles may have implications for our infrastructure investments, just as the increasing influence of e-commerce may impact our retail property assets. Accordingly, we are integrating these thematic into our investment decision-making frameworks with the aim of more thoughtfully evaluating their impact on long-term investment performance and portfolio construction.

For more information regarding our integrated approach, refer to a speech prepared by Dr Raphael Arndt, Chief Investment Officer, titled *Investing responsibly*, available on our website at www.futurefund.gov.au

Exercising ownership rights

Exercising the voting rights attached to the securities in which we have an ownership position is a key means by which to encourage good governance in investee entities.

This reflects our view that good governance (that is, how an organisation is structured, operated and controlled and how it manages environmental, social and regulatory risks and opportunities) protects and creates investment value.

Voting our Australian equities shares

Voting rights in publicly listed Australian companies are exercised directly by our organisation.

In exercising these voting rights we apply our voting principles, as detailed on page 27, while also drawing on the insight of our investment managers and proxy research providers.

The way in which we exercise the voting rights attached to our holdings in publicly listed Australian companies is reported in detail on our website. Activity for the 2017-18 financial year is summarised below.

Where a company resolution is found in conflict with our corporate governance principles or does not align with our best interests, we will consider voting against the company board. In total in Australia in 2017-18, we voted against company boards in approximately 6.7% of all resolutions.

Exercise of voting rights in publicly listed Australian companies

Resolution type	Number of resolutions	FF with Company Board	FF Abstain	FF against Company Board
Elect director	512	95.7%	0.0%	4.3%
Approve Remuneration Report	200	88.0%	0.0%	12.0%
Approve Remuneration Grant	205	90.7%	0.0%	9.3%
Other Remuneration	50	90.0%	0.0%	10.0%
Capital Management	55	96.4%	0.0%	3.6%
Fees for Directors	23	91.3%	0.0%	8.7%
Mergers & Acquisitions	18	100.0%	0.0%	0.0%
Other	96	94.8%	1.0%	4.2%
Total Resolutions Voted	1,159	93.2%	0.1%	6.7%
Total Meetings Participated	216			
Not Voted	0/0 (Meetings/ Resolutions)			
Total Eligible (Resolutions)	1,159			
Total Eligible (Meetings)	216			

Voting our international listed equities shares

The Board exercises all eligible voting rights in publicly listed international companies. Given the scope and complexity of corporate governance and proxy voting regimes in (multiple) international markets, our external investment managers advise us in exercising these voting rights. These managers, responsible for managing investments on our behalf, are well placed to evaluate good corporate governance in investee entities. We oversee the quality of our managers' insights into corporate governance and proxy voting as part of our Manager ESG Review framework and by regularly evaluating their ownership policies and proxy voting practices. The Board retains the right in all cases to override managers' recommendations and determine voting decisions directly.

In 2017-18, the Board exercised proxy votes in respect of 34,815 resolutions at 3,052 shareholder meetings. In the cases where our votes were not exercised, generally our investment manager judged that it was not in our best interests to vote given structural impediments to shareholder voting (such as share blocking/re-registration or power-of-attorney requirements), or that we were ineligible to vote.

In aggregate, we voted against company boards' recommendations in approximately 10% of international resolutions voted.

Exercise of voting rights in publicly listed overseas companies

Resolution type	Number of resolutions	FF with Company Board	FF abstain	FF against Company Board
Capital Management	2,883	80.6%	0.4%	19.0%
Elect Director	16,631	88.9%	1.9%	9.2%
Mergers & Acquisitions	413	87.9%	0.5%	11.6%
Remuneration	3,673	87.8%	0.8%	11.3%
Other	11,215	84.8%	6.6%	8.5%
Total resolutions voted	34,815	86.8%	3.2%	10.0%
Total meetings participated	3,052			
Not Voted	30/391 (Meetings/ Resolutions)			
Total eligible (resolutions)	35,206			
Total eligible (meetings)	3,082			

We oversee the quality of our managers' insights into corporate governance and proxy voting as part of our Manager ESG Review framework

Our voting principles

- Companies should disclose accurate and material information on a timely basis to allow shareholders to make informed decisions.
- Companies should respect shareholder rights and their directors should engage shareholders, particularly on major decisions.
- All shareholders should be treated equally and have the right to vote in proportion to their economic interest in the company.
- Companies should compose high calibre, commercially experienced and diverse boards of directors to provide superior business leadership and integrity.
- Boards should appropriately balance measures to protect the capital adequacy of the company with equitable treatment of shareholders.
- Companies should establish a sound system of oversight, management and control of business risks.
- Structures that transfer power from shareholders to management or third parties to protect against takeovers are generally undesirable.
- Boards of directors should be composed to ensure the exercise of objective independent judgement on corporate affairs.
- Companies should have appropriate performance evaluation and incentive systems that align executives with long-term shareholder interests and company strategy.

Engagement with investee entities

Engagement with the boards and executive management of the entities in which we invest is a valuable tool for protecting our interests. Such contact is helpful in establishing a climate of long-term asset stewardship, with active oversight from investors and accountability of management to the provider of capital.

Engagement is also used as a complement to voting activities to improve analysis and the signalling power of the votes cast.

In addition, maintaining open, constructive relationships with investee entities improves fundamental investor understanding of the quality of management and the long-term drivers of value, including ESG risks and opportunities.

We engage directly with key investee entities to drive improvement in corporate governance practices and better understand the strategic risks and opportunities to which these organisations are exposed. This direct engagement is conducted mainly with Australian domiciled companies, given the size and influence of our investments in our local market and practical considerations.

Each engagement is tailored to the particular company and may include board and executive management quality, remuneration, strategic priorities, relevant environmental and social issues, culture, and long-term value creation. Over the last three years, we have engaged with board representatives from a broad range of Australian listed companies, including across the ASX20.

Where applicable, we partner with investment managers to coordinate engagement activities with investee entities to ensure we communicate a consistent and mutually reinforcing message. We consider this 'one-face to the investee entity' approach essential in driving positive outcomes.

In international markets, we leverage the engagement activities of our investment managers. These managers are the front line of engagement, given their in-depth company knowledge and contacts.

Ownership rights in private markets

In relation to private markets investments, ownership rights generally accrue in three forms: formal voting rights (connected to shareholdings in companies and unit holdings in pooled vehicles), rights to participate on the advisory boards of pooled investment vehicles and rights to appoint directors to the boards of companies and other entities.

Where shareholder voting rights accrue to pooled vehicles from the underlying investments, the external managers of those vehicles analyse and exercise the voting rights on behalf of our organisation. Likewise, rights arising from co-investments alongside external managers are exercised by those managers.

Shareholder votes resulting from direct holdings in assets and unitholder votes from the Board's interests in pooled vehicles are managed directly by our private markets teams.

Many of the private markets' pooled vehicles in which we invest have advisory boards that give investors a voice on certain key decisions. We have the right to appoint a representative to the advisory boards of many of the pooled vehicles in which we invest. This right was taken up wherever practical in 2017-18.

One of the most powerful expressions of ownership rights occurs where investors take up seats on the boards of unlisted entities. We have exercised the right to appoint directors to the boards of a number of the entities.

In some cases, such as APAC (Melbourne and Launceston Airports), the Port of Melbourne, Gatwick Airport and Perth Airport, our staff sit as directors. In other cases, such as Edinburgh Airport, we have appointed high-quality directors to act on our behalf. Those directors are either employees of the relevant external manager or suitably qualified third parties selected in consultation with the manager.

Collaboration and contributing to a stronger investment system

We have a direct interest in supporting financial markets that are stable, transparent and efficient.

The scale and global, interconnected nature of many of the ESG risks and opportunities faced by long-term investors makes collaboration between like-minded investors attractive.

We are an active participant in a number of investor collaborations that address some of the systemic challenges related to ESG factors, including ESG Research Australia, and the International Corporate Governance Network. These structured multi-stakeholder initiatives are complemented by ongoing informal engagement with leading domestic and international asset owners and fund managers in identifying and promoting best practice in ESG investment integration.

More broadly, we are involved in industry networks that aim to improve system integrity, build new markets and advance best practice for institutional investment. The initiatives supported include Focusing Capital on the Long Term (FCLT), the Thinking Ahead Institute, the Standards Board for Alternative Investments (SBAI), the Institutional Limited Partners Association (ILPA), the International Forum of Sovereign Wealth Funds, the Institutional Investors Roundtable (IIR), the Pacific Pension & Investment Institute (PPI), the Australian Private Equity & Venture Capital Association Limited (AVCAL), and 20-20 Investment Association.

In a number of cases our staff have taken on roles in the leadership of these initiatives. For example, staff sit on the Board of Trustees of the SBAI, the Board of the IIR, and ILPA's Membership Committee.

Portfolio exclusions

Australia has ratified a number of international conventions and treaties that limit certain activities. Where the activities of an entity or funding activity may contravene such a convention or treaty, the Board will consider the exclusion or removal of the investment from the portfolio. Where serious breaches of ESG standards have been identified, the Board prefers engagement over exclusion, working with the entity to improve ongoing performance where relevant. The Board reserves the option to exclude an investment for the most egregious sustained activities where the entity is unwilling or unable to change its practices.

Since 2009 we have restricted all managers of directly held investments from investing in securities issued by companies that may be involved in activities that are limited by the 2008 Convention on Cluster Munitions or the 1997 Anti-Personnel Mines Convention.

In February 2013 the Board made a decision to restrict managers of directly held investments from investing in securities issued by entities directly involved in the manufacture of complete tobacco products.

A list of entities excluded on the basis of Australia's international convention commitments or direct involvement in the manufacture of tobacco products is on our website.

INVESTMENT PERFORMANCE

03

Investment environment

Insights from our Chief Investment Officer, Dr Raphael Arndt

Across the financial year, economic growth was stronger than expected and global markets strengthened, however, long-term risks are building.

The investment environment was generally positive for financial markets over the last year leading to overall returns modestly above the Future Fund's benchmark, although it was a tale of two halves.

The global economy began the financial year showing strong momentum and synchronised growth across most major markets. Low inflation, accommodative monetary policies and low bond yields supported equity markets and delivered exceptionally strong returns to investors with very little volatility. On top of this, the prospect of tax reform and fiscal stimulus in the United States provided a further boost.

As 2018 unfolded conditions became somewhat less favourable leading to a marked pick-up in market volatility with significant falls in asset prices. An acceleration in wages in the US in February led to concerns of increasing inflation and tighter monetary policy that fed into higher bond yields and falling equity prices. Around the same time, global economic momentum peaked and showed more divergence with European growth moderating sharply while the US continued to show strength following its fiscal package.

This divergence also showed up in relative regional asset prices. As the year progressed trade concerns moved to centre stage, with the US imposing tariffs across a range of industries and countries and several of the impacted countries retaliating.

While economic conditions appear to have peaked for this cycle, the near-term outlook for the global economy remains relatively benign with forecasts of modestly above trend growth rates in the near term. However, central banks seem generally unable to raise policy rates meaningfully from the highly stimulative levels required to steer economies through the Global Financial Crisis, which is an indication that economic activity has not normalised yet. Monetary policy remains broadly supportive of growth in developed markets. Fiscal policy in the US is expected to support economic growth through to 2019.

There are a number of factors that could challenge this outlook. In the shorter term, rising oil prices over the last year are a headwind to growth, although less so than in the past given lower US reliance on imported oil. The US is expected to continue on its path of interest rate normalisation in the year ahead. A higher US dollar and interest rates would impact both the US and emerging market economies, particularly those with significant levels of US dollar borrowings. Despite some recent policy easing, China is likely to be a less significant source of growth given the Government's efforts to constrain debt growth and shift its economy towards consumption. Finally, trade issues could escalate to a damaging 'trade war' and risk an investment strike by corporates, as they wait to see the lay of the land.

Beyond the next year the economic outlook becomes significantly less certain and the monetary policy backdrop likely to be less favourable to financial markets. The gradual erosion of spare capacity in developed markets is expected to lead to inflationary pressures continuing to slowly build, particularly in the US. By many measures the US labour market is in its healthiest state for nearly two decades. Setting monetary policy to ensure that the expansion is maintained while capping inflationary pressures will likely prove challenging for central banks, especially if regional differences persist.

This task is heightened by the uncertain impact of monetary tightening given the extraordinary policies implemented after the Global Financial Crisis. Over a longer horizon, the rising economic and geopolitical power of China could have significant implications for investors as the global economic order is reshaped.

This economic backdrop could prove challenging for financial markets and overall portfolio returns in the year ahead. Asset prices generally remain elevated despite the volatility seen in the second half of the year, and markets do not appear to be pricing in the significant risks which lie ahead. Material risks include the uncertainty of trade relations between the two largest economies in the world and a rising interest rate environment.

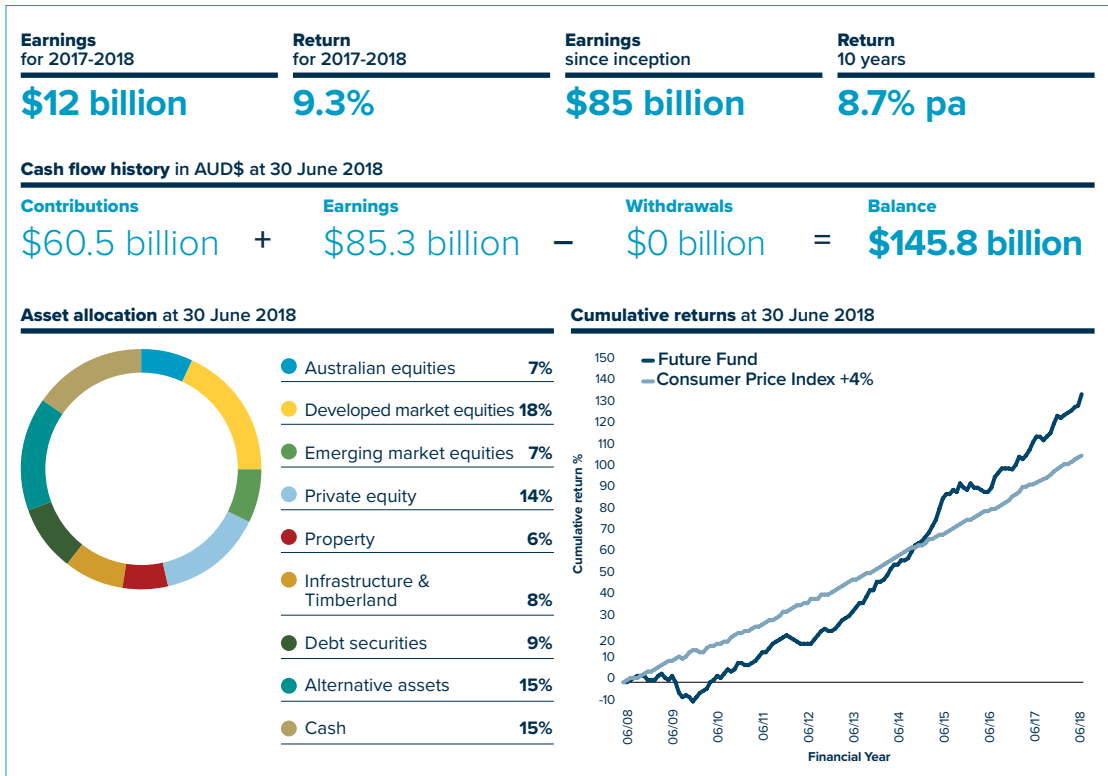
The longer the current expansion continues, the greater the risk of imbalances or inflationary pressures that central banks will look to contain, potentially leading to a classic recession.

While this risk appears far from imminent, the forward-looking nature of financial markets means that asset values are likely to turn before any downturn. Also complicating the outlook is the fact that expected long-term real returns are low relative to history and become even less attractive when adjusted for cyclical and structural economic risks.

As always, the path ahead is uncertain and it is possible that the global economic expansion and robust asset returns could continue for some time.

In summary, the near-term economic outlook remains relatively benign, however, asset valuations reflect these conditions continuing. These conditions suggest a moderate exposure to risk assets is warranted. Given the uncertain path ahead, it is important to maintain portfolio flexibility to allow the level of portfolio risk to be adjusted as needed.

Future Fund



Mandate:
Consumer price index plus 4% to 5% per annum over the long term with an acceptable but not excessive level of risk.

Interpreting the Investment Mandate

The Future Fund’s initial Investment Mandate was issued to the Board by the responsible Ministers in May 2006.

Until 30 June 2017 the Fund’s Investment Mandate was to achieve an average annual return of at least the Consumer Price Index (CPI) + 4.5% to 5.5% per annum over the long term with an acceptable but not excessive level of risk.

A new Investment Mandate came into effect from 1 July 2017, which reduced the long-term benchmark return target to CPI + 4% to 5% per annum, reflecting the changed investment environment. The return objective must continue to be pursued with acceptable but not excessive levels of risk.

The Fund's Investment Mandate is available at Appendix B.

As the Board pursues the Investment Mandate, it is also required to conduct itself in a manner that:

- is consistent with international best practice for institutional investment
- minimises the impact on the Australian financial markets, and
- is unlikely to cause a diminution of the Australian Government's reputation in financial markets.

In balancing the risk and return aspects of the Fund's Investment Mandate, our primary objectives are to:

- maximise the value of the Fund over the long term, which we define as rolling 10-year periods
- minimise the risk of significant capital losses along the way, with a particular focus on expected downside outcomes over rolling three-year periods.

There is a natural tension between these two objectives, and our investment policy framework has been designed to guide resolution of issues like this by formalising our approach to investment risk management in portfolio construction. This framework, along with the broad investment process of which it is an important part, are described in greater detail in the 'how we invest' section of this report.

While we publicly report and discuss the performance of the Future Fund at a high level each quarter, and in more detail at various points through each year, outcomes over these short periods of time are not appropriate indicators of the likelihood of achieving the outcomes set out in the Mandate over the long term.

We explicitly reject the concept of 'peer risk' (the risk of underperforming other institutional investors over the short term) as being inconsistent with the mission and Mandate of the Fund. However, we appreciate that comparisons between the Fund's return and the returns of other funds with similar objectives, both locally and globally, are valid over the longer term.

Getting the balance right – reassessing the Future Fund’s risk profile

The Future Fund has a clear Investment Mandate: to achieve CPI + 4% to 5% pa over the long term. Importantly, the Mandate requires us to achieve this rate of return while taking ‘acceptable but not excessive risk’.

In investing the assets of the Future Fund, our purpose, to invest on behalf of future generations of Australians, is front of mind in everything we do. It requires us to be prudent in investing the assets of the Future Fund and has a very real impact on how we build and manage the portfolio.

To achieve strong returns we have to take risks, but we have to be thoughtful about how we do that.

The Future Fund’s structural risk appetite is a key determinant of returns over the long term. It balances the ambition to secure high long-term returns – to get to a good destination – with the desire to manage volatility – to have a good journey.

The structural risk appetite refers to the total high-level amount of risk the Fund is expected to be exposed to on average over long periods of time. It is not a target but helps to define how we will trade off risk in striving to achieve the Investment Mandate and how we will interpret ‘acceptable but not excessive risk’.

The current investment environment is characterised by good returns and a positive near-term outlook but with lower returns expected over the longer term and a range of structural risks which are becoming increasingly elevated. This reminds us of our obligation to deliver strong returns while not exposing the assets in our care to excessive risk.

This environment, coupled with the Government’s decision to defer drawdowns from the Future Fund until at least 2026-27, means that we need to think carefully about how to position the Fund to achieve its mandated benchmark return across another decade and beyond, and the level of risk we need to take to get there.

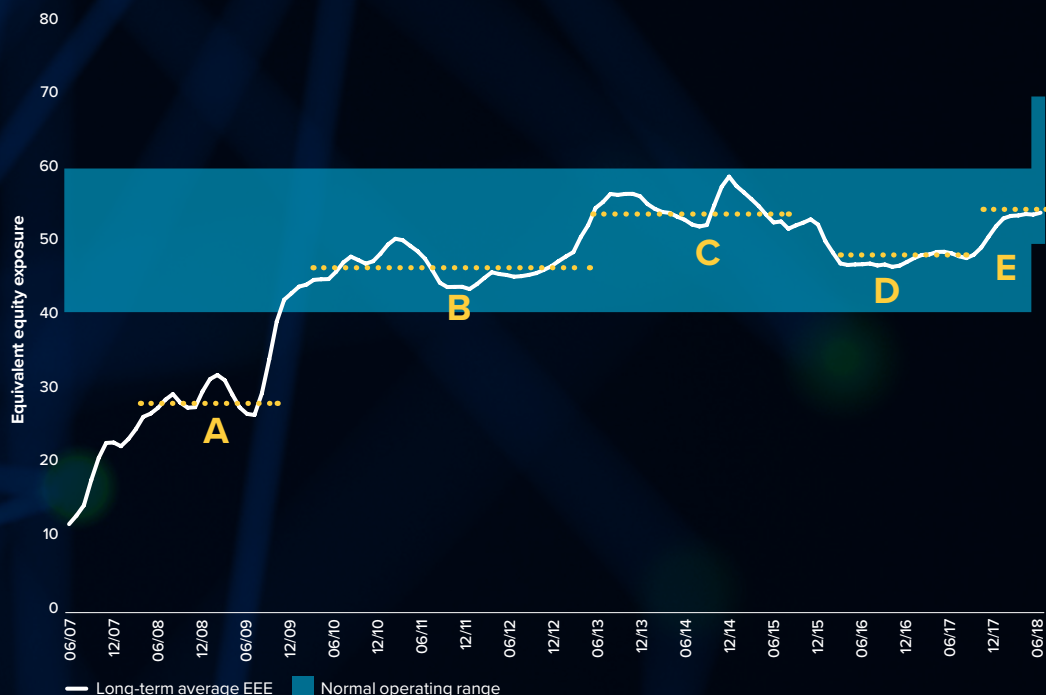
For this reason, during the year we reviewed the Fund’s structural risk appetite. We determined that given the lower expected returns from holding risk assets compared with the past, to increase the likelihood of meeting the mandated benchmark return over the long term while continuing to manage risk, a slightly higher structural risk appetite was appropriate.

One of the primary metrics we use to understand and manage the broad market risk exposure of the Future Fund is Equivalent Equity Exposure (EEE). This is the amount of market exposure we have when looking through the whole portfolio.

As a result of our decision, the expected average EEE over time has moved from 50 to 55. This implies that our normal risk range has shifted to 45–65 (from 40–60). The Fund’s EEE since inception is shown on page 35.

In practice, we expect to dynamically manage the risk level within the 45–65 range over time, but we expect an average level of 55. This aligns with our structured approach to risk management, maintaining our discipline to only take on risk where the potential rewards justify it.

The chart below demonstrates how the Future Fund's EEE has changed through time. We are now in the fifth distinct risk-taking regime for the portfolio over the last 10 years:



- A Soon after inception in 2006, the build of the Future Fund portfolio was suspended in late 2007 due to concerns over financial stability and the sustainability of high asset prices, and a very low risk profile was maintained into the global financial crisis.
- B Portfolio risk exposure was increased as extraordinary and globally coordinated economic policies were implemented to fight the crisis.
- C Risk levels were raised further as the European crisis subsided and the President of the European Central Bank, Mario Draghi, committed to “do whatever it takes” to underwrite the integrity of the Euro.
- D As expected returns declined (given strong market performance supported by low interest rates), portfolio risk was gradually reduced to moderately below normal levels.
- E Risk levels increased towards more normal levels, reflecting the emergence of strong economic growth and corporate earnings, together with the decision to increase the Fund’s structural risk appetite.

Risk positioning

Based on its interpretation of the Investment Mandate, the Board has an appetite for material levels of risk in the Future Fund. Nonetheless, in accordance with our investment process we aim to build a portfolio with some degree of resilience to the investment environment. We seek genuine diversification that achieves greater balance in portfolio construction while allocating risk in a flexible and dynamic manner.

Our view is that real discount rates for risky assets are low and cash-flow growth is expected to be positive but moderate over the long term, so expected real returns are below average relative to history. When we adjust these returns for risk, then the expected reward for taking more risk than we do at present is relatively unattractive. This trade-off is illustrated in stylised form in the chart below.

Synchronised global growth, low inflation and accommodative monetary policies supported markets and delivered good returns to investors in 2017-18. Our outlook on the global economy and markets is explored in more detail in our Chief Investment Officer's investment environment report on pages 30–31.

The broad focus of our portfolio construction activity in 2017-18 has been to:

- **Modestly increase the portfolio risk exposure**, balancing our perspective on the positive near-term outlook drive by the emergence of synchronised global growth with the longer-term risks that remain elevated.
- **Retain high levels of portfolio flexibility** to both withstand – and potentially take advantage of – any market dislocations that might arise.
- **Be opportunistic and skill-based.** Internally, and through our external investment managers, we aim to add additional return, or reduce risk, through the application of skill. Strategies that have low correlation with risk assets are particularly attractive (such as hedge funds, private equity and alternative risk premia).

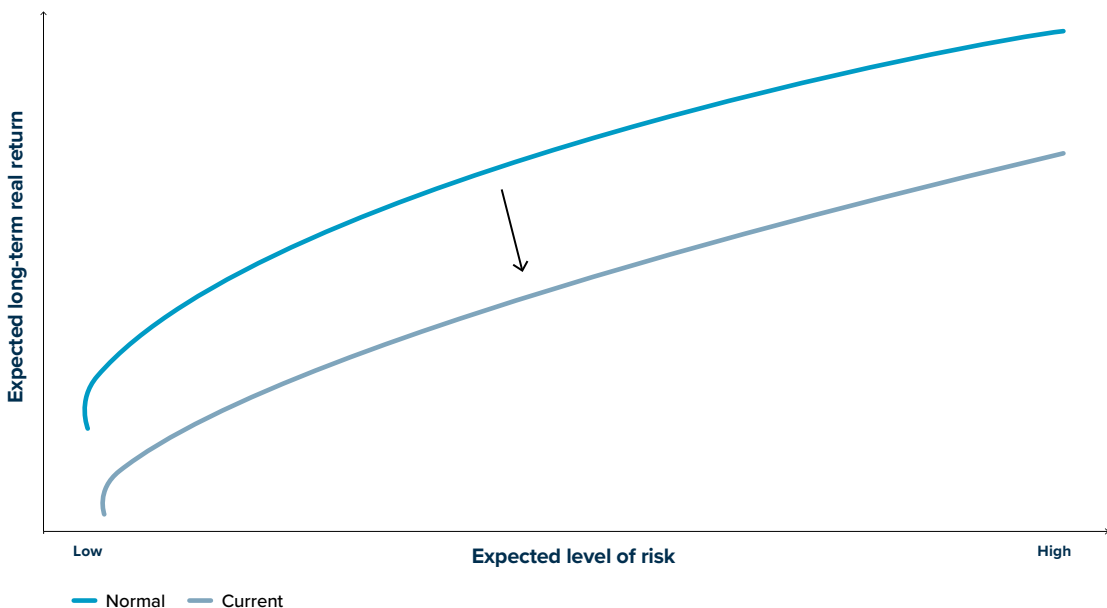
Measuring risk

One of the primary metrics we use to understand and manage the broad market risk exposure of the Future Fund is Equivalent Equity Exposure (EEE).

EEE estimates the amount of market exposure we have when looking through the whole portfolio.

As discussed in the feature article on pages 34 and 35, during the year we shifted the expected EEE range for the Future Fund from 40–60 to 45–65. The average EEE in 2017-18 was 52 and at 30 June 2018 the EEE stood at 55.

Current risk/reward trade-off versus 'normal'



Investment reviews

Listed equities

Strategy

The objective of the listed equities portfolio is to provide a flexible and liquid exposure that generates attractive risk-adjusted returns over the long term. This is achieved by systematically harvesting risk premia through exposure to factors that compensate for undiversifiable risk. We complement the risk premia exposure by investing in a skill based (stock picking) portfolio, targeting uncorrelated equity returns.

The opportunity set for the listed equities portfolio includes all listed equity-related strategies:

- Australian, developed, emerging and frontier markets
- physical and synthetic investments.

The portfolio is structured into an alternative beta and beta sleeve for harvesting risk premia, and an alpha sleeve to tap into the skill based universe.

Report

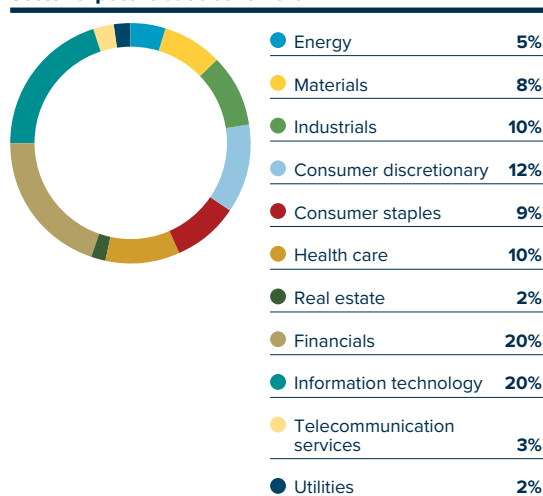
The listed equities portfolio is valued at \$46.9 billion as at 30 June 2018. The portfolio, as a percentage of the total Future Fund, has increased from 27.8% at 30 June 2017 to 32.1% at 30 June 2018. We implemented the increase across all of our major regions. Our portfolio remains concentrated in global developed markets while we continue to hold sizeable but smaller exposures to Australia and emerging markets.

Within our alpha sleeve, our long/short developed markets portfolio continues to maintain low exposure to market risk and an emphasis on stock picking skill. During the year, we targeted a number of new opportunity sets in order to deliver improved breadth and geographical exposure to the portfolio.

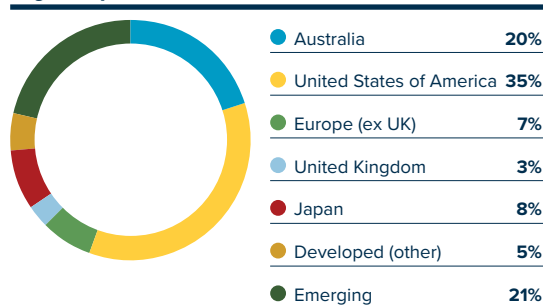
Within the alternative beta sleeve, we are making good progress in the implementation of each sub-strategy. During the year, we rebalanced our allocations to achieve a better balance of long-term equity factor premia and risk. Though we still maintain a large defensive, high quality core, we have also increased our exposure to value premia.

We believe it is important that risk premia are captured and implemented efficiently. We have invested in our technology and systems, and continue to work closely with select partners to help ensure the desired risk premia from an aggregate portfolio is achieved.

Sector exposure at 30 June 2018



Region exposure at 30 June 2018



Alternatives

Strategy

The alternatives portfolio is designed to provide a return stream to the Future Fund that comprises a combination of active management skill based strategies and exposure to other diversifying risk premia. The returns of the portfolio should have little to no relationship with those produced from the other portfolio sectors or capital markets in general.

The opportunity set includes:

- a broad variety of specialised active management strategies within traditional asset classes
- exposure to 'alternative' or non-traditional risk premia such as momentum, volatility and insurance
- other managers or mandates which do not align well with the principal sector strategies.

The mandate flexibility of such strategies increases the Fund's exposure to diversifying active management return. We address the complexity and breadth of the alternatives portfolio through a hybrid approach of direct manager relationships supplemented by activity with investment platforms operated by a handful of strategic partners. These partners act as an extension of our team and provide us with operational leverage.

We recognise that active manager skill is scarce, but also valuable as the ability to capture skill helps maximise the risk-adjusted performance of the total Fund. We take a value based approach to evaluating the costs of acquisition of such return streams – that is, management and performance fees. Our activity is centred on finding the right balance between identifying and accessing managers, strategies and organisations who can persistently add value while testing the market for more economic access points to the same or similar pattern of returns.

Further information about the alternatives portfolio is available in a speech delivered by Dr Raphael Arndt, Chief Investment Officer, titled *Hedge Funds 2.0: The evolution of the role of hedge funds in the Future Fund portfolio*. The speech is available on our website at www.futurefund.gov.au

Report

During 2017-18 the alternatives portfolio increased in size from 14.8% of Future Fund in 2016-17 to 15.3%.

This growth included two new manager appointments, although it mainly reflected additional allocations within our existing roster of strategies. Apart from the increase in capital, the strategic imperative was to maximise potential diversification at the total Fund level as efficiently as possible. The portfolio largely delivered on its objective, providing positive returns while also offering significant protection to unexpected tail events in global equity markets.

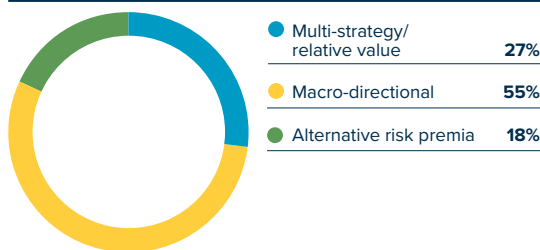
We have made considerable changes to the portfolio over the last four years in order to increase the impact of diversification and deliver the most efficient portfolio possible in terms of capital, fees and risk. As a result, we expect forward investment activity to be more muted.

We remain vigilant in seeking opportunities in alternative risk premia. Across the year, the alternative risk premia sub-sector expanded from a 15% to 18% weight within the alternatives portfolio, reflecting both capital additions to existing programs and a new manager appointment. We anticipate this to continue to grow in the forward period.

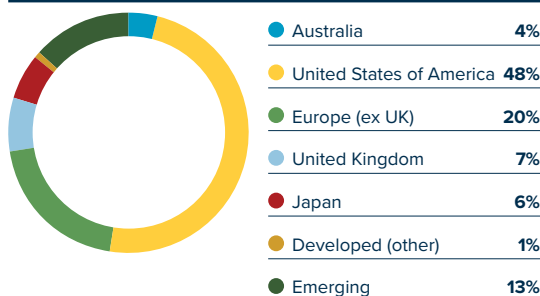
Activity within the largest sub-sector, macro-directional strategies, was lower than in previous years and focused on ensuring the portfolio is maximising the diversification potential against risk assets in multiple potential scenarios. Our belief that the forward environment for financial asset markets was potentially more volatile and the growth and monetary paths of regional economies more divergent than in the past began to play out in the second half of the year and this continues to inform our investment decisions. We continue to run an active seeding program and are positioning the portfolio in a way which helps us to identify and provide capital to mispriced assets following potential market dislocations.

The multi-strategy sub-sector was further concentrated into our highest conviction managers. This sub-sector performed very strongly with minimal exposure to risk assets. We continue to work with the managers in this sub-sector on maximising our exposure to their highest conviction ideas.

Strategy exposure at 30 June 2018



Region exposure at 30 June 2018



Debt

Strategy

The debt opportunity set is global and includes all credit-oriented investment products and strategies including:

- corporate credit
- securitised credit
- private debt, including corporate and mortgage loans
- emerging markets debt, denominated in both hard and local currencies
- distressed and special situation credit.

The breadth and complexity of credit sub-sectors calls for our strategy to be, with few exceptions, implemented through discretionary mandates. These may be broad and multi-sector in nature or with specific thematic, regional or sector specialisation. The accumulation of a range of these capabilities enables us to dynamically access the most attractive opportunities.

Interest rate positioning is managed at the total Fund level and is thus not a key component of debt portfolio construction. Instead, the debt portfolio's primary role is return generation, with a core of interest income ideally augmented by capital gains over time. The debt portfolio's aim is to deliver strong risk-adjusted returns with more downside protection than equity-orientated investments.

Report

2017-18 was a positive year for debt markets. Global economic conditions remained strong, with substantial growth in output and corporate earnings; in turn, credit market fundamentals remained generally robust, and default levels remained low. However, central bank activity, particularly in the US and Europe, gave investors ample cause to consider the paths of both interest rates and credit market supply and demand dynamics. As a result, debt markets generated moderate returns, and so did our portfolio, where strength in private debt and distressed portfolios was partially offset by disappointing returns in emerging market debt.

Consistent with a view we have held for some time, we continue to believe we are in the later stages of the credit cycle. We do not expect a plethora of defaults in the near term, but as and when conditions change, lenders may not be as well protected as in previous cycles. In addition to historically high leverage levels, nearly all new issuance in broadly syndicated US and European corporate credit is 'covenant-lite', which means that lenders have few avenues to properly monitor and arrest the decline of struggling borrowers.

At the same time, most credit sectors see pricing at or near historically tight spread levels, leaving little compensation for the added risk of such unfavourable structures. While each bond or loan is unique, we question if credit markets in general are adequately compensating investors for the risk of both elevated default levels and lower recoveries on defaulted bonds or loans.

Our strategy remains one of discipline, patience and preparation. We have continued to reduce exposure, particularly to liquid corporate credit and mortgage-backed securities, and the portfolio reduced from 10.6% of total Future Fund assets at 30 June 2017 to 8.9% at 30 June 2018.

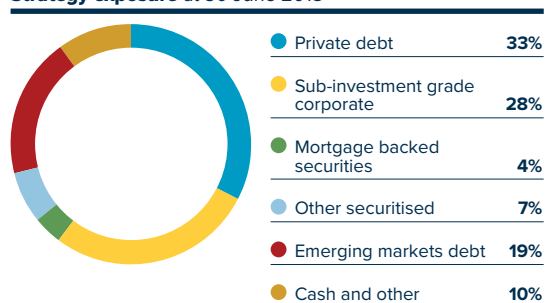
Our private debt program remains the largest debt sub-sector allocation. This program provides capital to a range of borrowers in developed markets around the world, with lending secured by collateral such as corporate assets and cash flows, property and infrastructure. We have built partnerships with several managers and plan to maintain this exposure while providing additional capital prudently as conditions warrant.

We continue to believe that emerging market sovereign and corporate bonds can provide valuable portfolio diversification benefits. However, developments in global trade and other macroeconomic conditions and the potential for volatility in capital flows have led us to approach this sub-sector more cautiously.

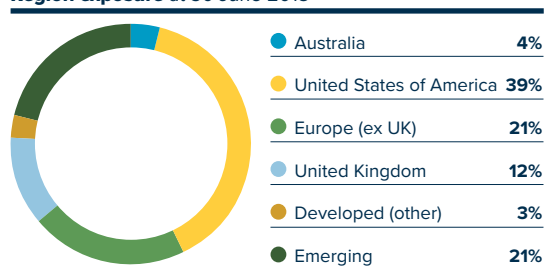
Our distressed debt, investment grade and high yield credit and mortgage-backed securities allocations are geared as much as possible toward idiosyncratic opportunities instead of general 'credit beta'. We continue to harvest gains from these sub-sectors as value is realised while our managers deploy capital prudently into a select group of opportunities, such as non-performing corporate and property-backed loans in Europe.

Most importantly, we have created a selection of levers through which we can deploy capital opportunistically as and when conditions warrant while minimising 'sunk costs' such as management fees on committed but uncalled capital.

Strategy exposure at 30 June 2018



Region exposure at 30 June 2018



Infrastructure and Timberland

Strategy

The infrastructure and timberland strategy is designed to assist the Fund in meeting its investment mandate, by providing inflation protection and diversification from the broader equities market. These characteristics are also expected to provide downside protection and lower volatility during periods of market downturn. We invest across the risk return spectrum, with our core assets considered more defensive, and our opportunistic assets expected to deliver a higher level of return. This reflects our investment belief that a return premium exists for illiquidity and complexity and active asset management is required to deliver this premium.

Our investment approach is to understand the underlying drivers of return within our existing assets and identify new opportunities to match our portfolio requirements. We have a long-term partnership approach with our managers and have the flexibility to access new opportunities across a combination of pooled funds, co-investments, direct asset mandates and listed infrastructure strategies.

Report

As at 30 June 2018 we had \$11.7 billion of capital invested in infrastructure and timberland, representing 8.1% of the Future Fund. Our United Kingdom airports (Gatwick and Edinburgh) delivered a strong performance over the past year, reflecting increasing capacity and efficiency improvements. Our Australian assets, representing 46% of the infrastructure and timberlands portfolio, also performed well, with Melbourne Airport and Port of Melbourne in particular experiencing strong growth over the prior year.

During the year we invested or committed over \$700 million in infrastructure and timberland. This included additional investments through the Powering Australian Renewables Fund (PARF), completing two new investments in our timberland portfolio, and further investments across our opportunistic infrastructure portfolio. As at 30 June 2018, we had \$1.0 billion of undrawn capital committed to infrastructure funds, with a further \$720 million of available co-investment capacity.

PARF has now made investments in two solar farms and two large-scale wind farms, bringing the platform to a capacity of over 800MW of a total objective of 1,000MW. The two new investments in the timberland portfolio were made via our shareholding in OneFortyOne Plantations and included a sawmill in Mt Gambier and Nelson Forests in New Zealand, which are both considered complementary to OneFortyOne Plantation's existing business.

In addition to our ongoing investment activity, we continue to engage with our global manager relationships and are actively involved in the management of our larger Australian assets.

Infrastructure

In an environment of continuing (although moderating) global growth and rising interest rates, we continue to see global demand for infrastructure assets increase, with record capital flowing into the sector. The enhanced competition for core infrastructure assets has put downward pressure on expected returns and we remain disciplined in assessing new opportunities.

In recent years, we have committed additional capital to more complex infrastructure strategies, where our managers can deliver an attractive return through active management. We recognise this sector is not immune from increased competition as managers continue to launch new funds to target 'core-plus' opportunities, although we still believe this area of the market can offer relatively better returns on a risk-adjusted basis. Our deployment in this area has slowed this year, reflecting our preference that our managers exercise investment discipline through the investment cycle.

Australian infrastructure assets remain a good fit for our mandate due to their correlation to our inflation linked, Australian dollar denominated benchmark. Following a number of years of privatisation activity, the opportunity pipeline for Australian infrastructure assets has reduced in recent times. However, capital supply for Australian infrastructure remains strong, with expectations that assets will continue to be competitively bid. As a consequence of the market and our existing Australian exposure, we expect to be highly selective when assessing opportunities going forward.

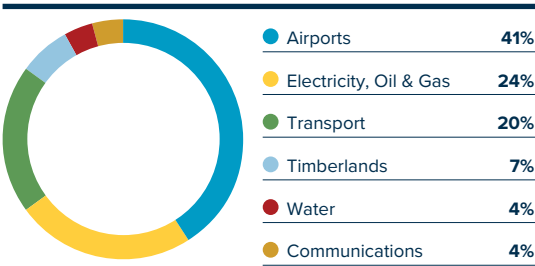
With our managers, we are monitoring a number of emerging themes within infrastructure. The risk of disruption from new technology is affecting all asset classes and its potential impact on infrastructure may provide opportunity as well as challenge. Our asset management approach is also focused on ensuring appropriate capital is invested in our existing assets in order to deliver services efficiently and support future growth.

Timberland

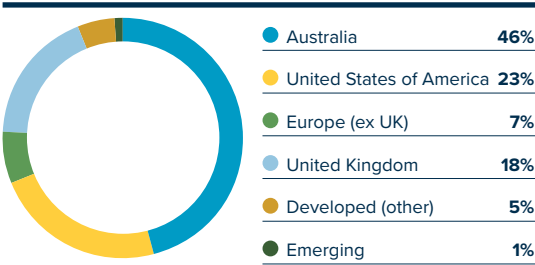
Our timberland assets performed well this year, driven by an increase in global log prices. This pricing increase reflects a number of factors, including the US housing market recovery, constrained supply from Canada and increasing demand in the Asia Pacific region, which is in wood supply deficit. The acquisition of Nelson Forests in New Zealand was consistent with our non-US timberland strategy, which targets high quality soft wood assets with demand exposure to emerging markets.

We maintain our interest in timberland markets and continue to observe the US, Australia and New Zealand markets closely. Similar to the broader infrastructure market, there is strong global competition for timberland assets, although we have observed less competition for assets of scale. This provided us with a competitive advantage in the process to acquire Nelson Forests.

Sector exposure at 30 June 2018



Region exposure at 30 June 2018



Through our infrastructure program, we are invested in some of Australia's major infrastructure assets, including Melbourne Airport. The Airport had record breaking passenger numbers in 2017-18, welcoming 36.7 million travellers, an increase of 4.4% from 2016-17.

Melbourne Airport is Australia's busiest 24/7 airport and continues to grow. Looking forward, it will service more passengers, new aircraft and more flights. During the year the Airport released its 2018 Preliminary Draft Master Plan, which outlines its vision, objectives and strategic intent for the next 20 years.

Photo credit: Melbourne Airport



Property

Strategy

We invest in direct and listed property across the globe, primarily taking equity positions. We will consider debt as a point of entry if it provides the best risk adjusted returns.

We seek partnerships with aligned, experienced, and disciplined investment managers with deep insight into and across global markets. We favour separate account mandates, joint ventures, syndicates, and funds with active co-investment structures. This provides us a deep visibility into our individual asset positions and the ability to influence strategic decisions across the portfolio.

Report

We remain cautious in an environment where the global monetary cycle continues to gradually tighten and geopolitical risks are elevated. Despite positive signals of a broader global recovery, we are cognisant of a business cycle that has been extended by a period of low interest rates, bringing with it late-cycle risks in owning illiquid assets.

This has led our focus to be on defensive characteristics including strong income returns and opportunities with downside protection. Additionally, we are seeking investments that are supported by strong secular investment themes including continued demand for global logistics facilities and an aging population. Our managers are positioned to take advantage of divergent cycles across the globe with prudent market selection.

Demand for direct real estate remains robust, with a significant weight of capital driving competition for assets. There is depth in major debt markets, with low borrowing costs and leverage availability. We have taken advantage of liquidity by selling into such markets. Conversely, this has created capital deployment challenges.

Challenges to the traditional retail format from e-commerce and the demographic shift of consumers has presented opportunities. Online shopping growth continues to outpace traditional channels, driving a rotation of new retail concepts. There are positive signs of wage inflation and increased consumer spending, though a bifurcation in the market has emerged with the best centres outperforming. The logistics sector continues to benefit from the modernisation of the supply chain and the penetration of online shopping.

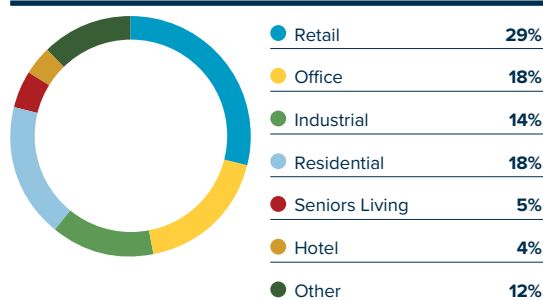
The dispersion in some major markets between listed and direct markets persists and we monitor the relative attractiveness of each entry point to the real estate market.

Our direct property portfolio has multiple levers through which our managers can generate attractive returns. Our preferred partner status with our most important managers continues to deliver us attractive deal flow.

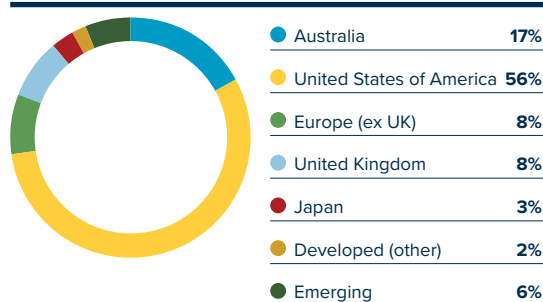
The portfolio is unconstrained by geography. Our global managers continue to search markets to take advantage of idiosyncratic opportunities as they arise. We retain a material weighting to the US that provides us with strong cash flows underpinned by relatively inexpensive debt.

We are selectively introducing new manager relationships, and expanding the mandates of our highest conviction managers. We will continue to increase our investments in secular themes such as senior housing and logistics. Conversely, we expect to reduce our exposure to late-cycle sectors over the next 12 months.

Strategy exposure at 30 June 2018



Region exposure at 30 June 2018



Private equity

Strategy

Our private equity strategy reflects our view that the asset class fulfils two functions within the Future Fund's investment portfolio.

The first is to invest in high 'alpha' opportunities, where we believe we can earn a significant premium over similar but more liquid public market equity investments. Most of these investments would fall in the buyout, co-investment or secondaries categories across developed and emerging markets.

The second function is to expose the Fund to investment themes that it cannot readily gain exposure to through other more liquid investments. In the second category we would include such themes as exposing the portfolio to innovative and disruptive companies (venture and growth), companies in financial difficulty that require capital to undertake financial restructurings and/or operational turnarounds (distressed opportunities), and funding idiosyncratic growth within small companies, particularly in sectors or geographies where alternative funding options are scarce (venture growth equity).

Report

As of 30 June 2018 the Future Fund had \$27.5 billion of capital (invested plus committed) with 31 private equity managers. During the year we allocated \$100 million to one new manager, and a further \$5.2 billion to our existing managers, including \$1.3 billion in co-investments alongside those managers. Invested capital increased from \$15.5 billion to \$20.6 billion over the course of the year, reflecting \$4.3 billion of capital calls, \$2.6 billion of distributions and \$3.4 billion of unrealised asset value appreciation. As it was a big commitment year, our unfunded commitments increased from \$7.4 billion to \$8.3 billion over the course of the year.

Of the capital called, 27% was for co-investments, 36% was for venture capital and growth equity opportunities and 37% was for buyout opportunities.

Of the distributions received, 6% were from realisations in our co-investment portfolio, 42% from the venture capital and growth equity portfolio, 37% from the buyout portfolio, 10% from the secondaries portfolio and 5% from the distressed portfolio. At 30 June 2018 private equity represented 14.1% of the Future Fund's total assets.

Private equity markets are not immune to the low return environment we are experiencing, which is being compounded by investors' capital looking for higher returning opportunities. We continue to believe that many segments of the market are not offering sufficient return for the risks we are expected to take, which is leading us to look for more idiosyncratic return opportunities.

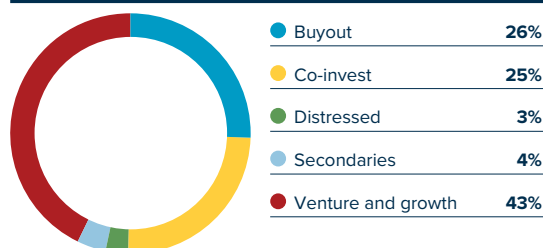
During the year Dr Raphael Arndt, Chief Investment Officer, spoke about how the Future Fund utilises private equity and venture capital globally to access the next generation of opportunities. Refer to his speech titled *Investing in disruption* available on our website at www.futurefund.gov.au.

Our core area of focus remains the funding of innovation, disruptive business models and small company growth across both developed and emerging markets.

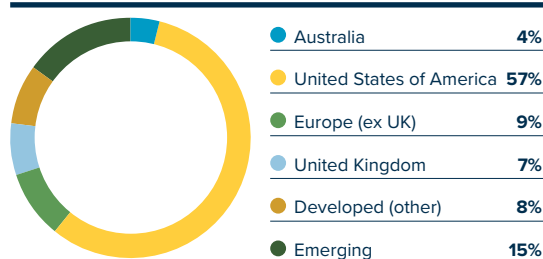
We continue to look for highly disciplined managers with (among other attributes) experience in generating strong returns in volatile economic environments and who provide good access to co-investment opportunities but in doing so are focused on alternative, more innovative and less crowded means of getting capital to work in private companies.

Consistent with our long-standing focus on venture capital, during the year we committed capital with existing manager Greenspring Associates, focused on Australian venture capital. We were pleased to make an investment in local venture firm Blackbird Ventures in the first quarter of 2018. We hope to build on this where we find suitably strong opportunities.

Strategy exposure at 30 June 2018



Region exposure at 30 June 2018



Total Investments by geography at 30 June 2018

Australia

22%

United States of America

37%

Europe (ex UK)

10%

United Kingdom

6%

Japan

8%

Developed (other)

4%

Emerging

13%

Currency

As discussed on page 22, we explicitly manage the size and composition of the foreign currency exposures in the portfolio rather than allowing them to be shaped by our underlying investments.

At 30 June 2018, we held an exposure to foreign developed market currencies equivalent to 25% of the total Future Fund. We expect our basket of developed market currencies to diversify the portfolio against broad market risk and generate liquidity in adverse conditions.

We also held an exposure of 14.4% to emerging market currencies in the Future Fund on 30 June 2018. We expect a diversified exposure to emerging market currencies to deliver a modest excess return through some combination of gradual real effective interest rate appreciation and/or positive real interest rate differentials relative to the Australian dollar. Given that we expect its performance to be uncorrelated with broad market risk over the long term, we consider our basket of emerging market currencies to be an attractive risk-adjusted exposure at portfolio level.

Performance

At 30 June 2018 the Future Fund delivered a 10-year return of 8.7% pa, beating its target of 6.6% pa.

The Fund stood at \$145.8 billion at 30 June 2018 with investment returns adding \$85 billion to the seed capital from the Australian Government.

The Fund returned 9.3% in 2017-18.

Investment returns to 30 June 2018 are shown below, together with the target benchmark return set by the Investment Mandate.

Given the Future Fund's Investment Mandate requires us to take acceptable but not excessive risk, when assessing our overall performance we look closely at the level of risk we took in the portfolio. Capturing risk in a single number is problematic, but the table shows the level of realised volatility in the portfolio. While not perfect, this measure of risk is the standard, and perhaps best understood, industry measure.

Alongside the level of realised volatility we also report the Sharpe ratio, a measure for calculating the risk-adjusted return.

All returns are reported net of costs.

Future Fund returns, benchmarks and levels of risk

Period to 30 June 2018	Return (% pa)	Target return (% pa) (CPI + target return)	Volatility (%)	Sharpe ratio
Inception (May 2006)	7.9	6.8	4.1	1.0
Ten years	8.7	6.6	4.3	1.3
Seven years	9.9	6.3	3.6	2.1
Five years	10.4	6.3	3.6	2.3
Three years	7.6	6.0	3.6	1.6
2017-18 financial year	9.3	6.1	3.1	2.5

Note: The Investment Mandate sets a benchmark target return of at least CPI + 4.5% to 5.5% pa to 30 June 2017 and CPI + 4% to 5% pa thereafter.

Costs

Cost management

Our use of external investment managers, together with our commitment to a broadly diversified portfolio and breadth of investment classes, means that over time our costs will generally be higher than those investors with less complex portfolios.

The commitment to genuine diversification is an important facet of our investment strategy and has been beneficial to the Fund's overall performance delivering strong returns net of costs while reducing volatility. We are therefore more willing to pay higher fees to our investment managers or areas where significant value is added over broad market exposure (such as private equity) or for exposures which are truly diversifying (such as hedge funds).

In asset classes where manager skill is less evident (such as listed equities), we have been transitioning the portfolio to a cheaper, more passive approach. However, we remain willing to support active management where we are confident that a manager can reliably add value net of fees.

We continue to closely monitor costs in the asset classes in which we invest, reviewing the expected returns and costs of implementing the investment strategy on an ongoing basis. In negotiating terms, we focus on securing arrangements that offer value for money for the skills and resources applied, that are competitive relative to other managers in the sector and that provide for strong alignment between managers and our organisation.

Every decision we make in relation to the portfolio is considered having regard to the returns and risks net of all costs, and all returns we report are always net of all costs.

Direct costs

Direct costs, previously reported as management costs and transaction and operational costs, reflect all directly incurred costs associated with the management of the Future Fund as reported in the audited financial statements.

The Future Fund's direct costs over the last three years are shown below. This includes the direct cost ratio (direct costs divided by the average net assets for the financial year).

Changes in costs over the years reflect changes in the size of the Future Fund, investment activity undertaken during the year, and the accrual and payment of performance fees.

Look-through costs

In addition to direct costs, investment management and performance fee costs incurred indirectly through investment vehicles or where the fund is part of a co-mingled group of funds are reported as 'look-through' costs.

The look-through costs are identified by making additional enquiries of managers of non-consolidated investment vehicles to estimate the underlying management and performance fees of these entities.

In providing this additional information, we seek to provide a full and complete indication of investment management and performance fee costs.

We note that these additional cost disclosures are based on unaudited estimates and derived using a variety of methodologies, particularly with regard to performance fees which may become payable.

We employ a range of performance fee arrangements, which incorporate the use of high-water marks and claw-back provisions, to ensure as far as possible that performance fees reflect genuine outperformance over time.

It is important to note that the majority of accrued performance fees are only paid on realisation of an investment and therefore it is possible not all accrued fees will ultimately be paid.

The additional look-through costs over the last three years are shown below.

Summary of direct costs and direct cost ratio

	2015-16	2016-17	2017-18
Direct costs	\$350.1 million	\$383.1 million	\$319.2 million
Direct cost ratio	0.295%	0.301%	0.231%

Summary of look through costs

	2015-16	2016-17	2017-18
	0.90%	1.31%	1.34%

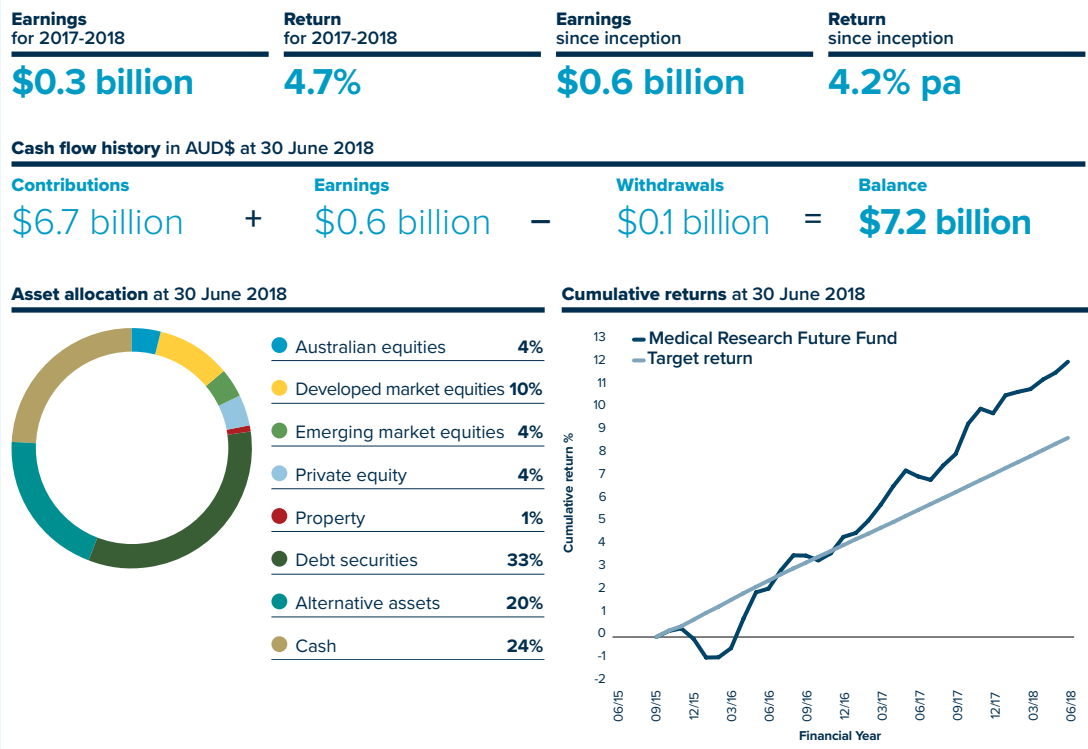
Disclosures under the *Future Fund Act 2006*

Under its statutory arrangements the Board also reports costs in accordance with section 81 of the *Future Fund Act 2006*.

Purpose	Amount debited 2015-16	Amount debited 2016-17	Amount debited 2017-18
Contracts with investment managers	\$251,506,695	\$254,382,038	\$291,006,497
Board remuneration and allowances	\$894,571	\$908,032	\$852,505
Agency remuneration and allowances	\$34,988,290	\$38,842,944	\$43,663,298
Consultants and advisers to the Board and Agency	\$24,475,120	\$16,064,403	\$14,339,000
Agency operations	\$20,126,715	\$23,646,429	\$23,564,832

Note: all costs reported under section 81 of the *Future Fund Act 2006* are reported on a cash basis, whereas the direct costs in the above table include accruals.

Medical Research Future Fund



Mandate:

Reserve Bank of Australia cash rate plus 1.5% to 2.0% per annum over rolling 10-year periods with an acceptable but not excessive level of risk.

Interpreting the Investment Mandate

The Medical Research Future Fund's Investment Mandate was issued to the Board by the responsible Ministers in November 2015 and is available at Appendix B and on our website.

The Mandate asks the Board to generate a return of 1.5% to 2.0% per annum above the Reserve Bank of Australia official cash rate over the long term while taking 'acceptable but not excessive risk'. The Board must also determine a Maximum Annual Distribution Amount taking account of:

- the principle that the nominal value of the credits to the Fund be preserved over the long term
- the principle to moderate the volatility of the maximum annual distribution.

In the same manner as the Future Fund, the Board is also required to conduct itself in a manner that:

- is consistent with international best practice for institutional investment
- minimises the impact on the Australian financial markets
- is unlikely to cause a diminution of the Australian Government's reputation in financial markets.

In managing the Fund's risk and return requirements and our role in declaring Maximum Annual Distribution Amounts, we try to:

- ensure a high probability of achieving the minimum benchmark return over rolling 10-year periods
- control the risk of losses, with a particular focus on expected downside outcomes over rolling three-year periods, so as to help preserve the nominal value of contributions over the long term
- determine a combined level of investment risk and an approach to distributions that facilitates relative predictability in distributions.

At times there may be a conflict between these competing objectives because of the so-called 'endowment trilemma', whereby:

- higher expected returns and distributions tend to increase the risk of losses
- for a given distribution policy increased investment risk increases the volatility of distributions
- adjusting the distribution policy for a given investment strategy can either decrease the volatility of distributions or the risk that capital is impaired over time, but not both at the same time.

However, our investment policy framework has been designed to guide the resolution of issues like this by formalising our approach to investment risk management in portfolio construction. This framework, along with the broad investment process of which it is an important part, are described in greater detail in the 'How We Invest' section of this report.

Risk positioning

Based on its interpretation of the Mandate, the Board has a moderate appetite for risk in the Medical Research Future Fund on average. In accordance with our investment process, we also aim to build a portfolio with a relatively high degree of resilience to the investment environment. We seek genuine diversification that achieves greater balance in portfolio construction while allocating risk in a flexible and dynamic manner.

One of the primary metrics we use to understand and manage the broad market risk exposure of the Medical Research Future Fund is Equivalent Equity Exposure (EEE).

EEE estimates the 'look-through' sensitivity of the portfolio to price movements in global equity markets.

Our expected EEE range for the Medical Research Future Fund is 20 to 35. The average EEE in 2017-18 was 26 and at 30 June 2018 the EEE stood at 27, which is the middle of the range.

Investment reviews

Listed equities

Strategy

The objective of the listed equities portfolio is to provide a flexible and liquid exposure that generates attractive risk-adjusted returns over the long term. This is achieved by systematically harvesting the equity risk premium through exposure to beta. We complement the equity risk premium exposure by investing in a skill based (idiosyncratic) portfolio, targeting uncorrelated equity returns.

The opportunity set for the listed equity portfolio includes all listed equity-related strategies:

- Australian, developed, emerging and frontier markets
- physical and synthetic investments.

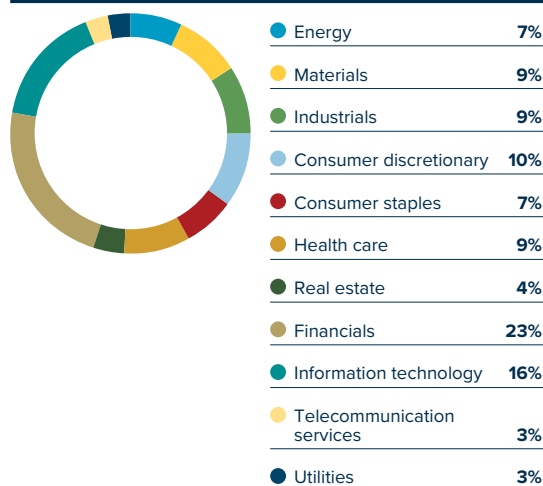
Report

The listed equities portfolio is valued at \$1.27 billion as at 30 June 2018. The portfolio, as a percentage of the total Medical Research Future Fund, has increased from 15.8% at 30 June 2017 to 17.8% at 30 June 2018. This change reflects a combination of strong equity market returns plus a cash inflow from the Australian Government in July 2017 which was partially invested in listed equities.

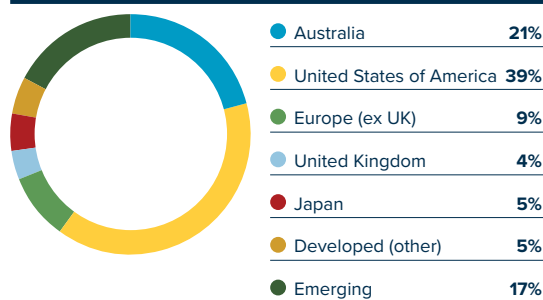
Our portfolio remains concentrated in developed markets while we continue to hold sizeable but smaller exposures to Australia and emerging markets. We believe that it is important to be cost efficient and flexible, particularly while the Fund is relatively small and the strategy is still being built. For this reason we have decided to mainly replicate the market beta and we have achieved this in domestic and offshore markets through the use of both physical assets and futures.

During the year, we commenced investment in active management via long/short strategies. As the Medical Research Future Fund size grows, we also expect to harvest equity factor premia in the portfolio.

Sector exposure at 30 June 2018



Region exposure at 30 June 2018



Alternatives

Strategy

The opportunity set includes:

- a broad variety of specialised active management strategies within traditional asset classes
- exposure to ‘alternative’ or non-traditional risk premia such as momentum, volatility and insurance
- other managers or mandates which do not align well with the principal sector strategies.

These strategies increase the Fund’s exposure to diversifying active management return. The Medical Research Future Fund’s alternatives portfolio has a similar profile to the Future Fund and is made up of a subset of the same managers. Differences in the portfolios exist due to the different establishment date of the two funds, as well as the size and specific portfolio objectives of the funds.

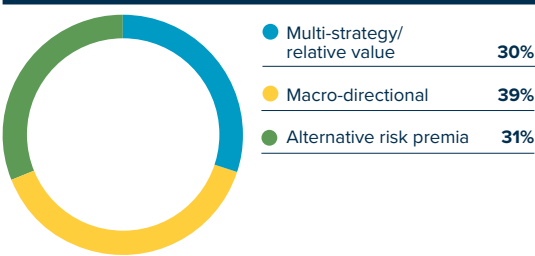
We recognise that active manager skill is scarce, but also valuable as the ability to capture skill helps maximise the risk-adjusted performance of the total Fund. We take a value based approach to evaluating the costs of acquisition of such return streams – that is, management and performance fees. Our activity is centred on finding the right balance between identifying and accessing managers, strategies and organisations who can persistently add value while testing the market for more economic access points to the same or similar pattern of returns.

Report

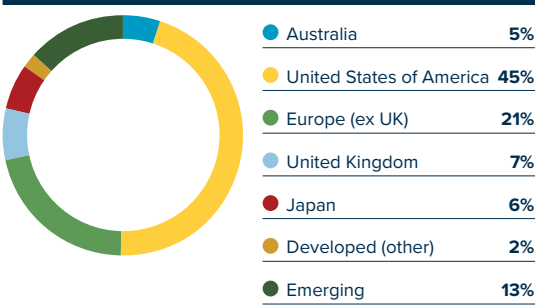
The alternatives allocation in the Medical Research Future Fund fulfils a similar role to that of the Future Fund, which is the provision of a return stream which offers a diversification benefit at the total Fund level.

2017-18 saw the alternatives allocation expanded in scale and diversified through new allocations across all sectors. Two additional macro managers were added, along with three new managers in the alternative risk premia sub-sector. The overall objective remains to provide stable, diversifying earnings which can support regular distributions.

Strategy exposure at 30 June 2018



Region exposure at 30 June 2018



Debt

Strategy

The debt opportunity set is global and includes all credit-oriented investment products and strategies including:

- corporate credit
- securitised credit
- private debt, including corporate and mortgage loans
- emerging markets debt, denominated in both hard and local currencies
- distressed and special situation credit.

The breadth and complexity of credit sub-sectors call for our strategy to be, with few exceptions, implemented through discretionary mandates. These may be broad and multi-sector in nature or with specific thematic, regional or sector specialisation. The accumulation of a range of these capabilities enables us to dynamically access the most attractive opportunities.

Interest rate positioning is managed at the total Fund level and is thus not a key component of debt portfolio construction. Instead, the debt portfolio's primary role is return generation, with a core of interest income ideally augmented by capital gains over time. The debt portfolio's aim is to deliver strong risk-adjusted returns with more downside protection than equity-orientated investments.

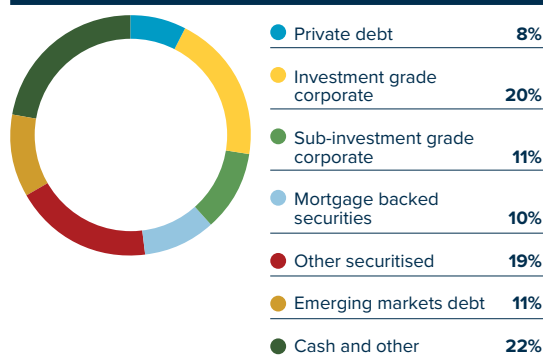
Report

The Medical Research Future Fund's mandate has a lower risk profile than the Future Fund. As a result, we have built a debt portfolio which contains many, but not all, of the same sub-sectors as the Future Fund, but with a heavier tilt toward investment grade credit.

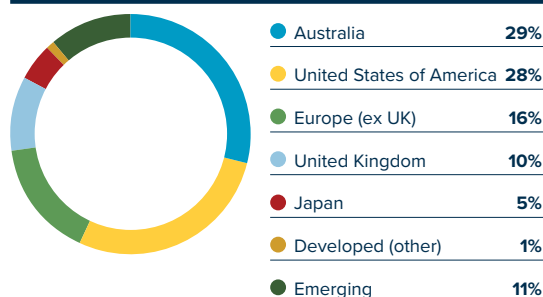
The debt portfolio generated modest returns in 2017-18, with gains from liquid corporate credit and private debt partially offset by lower returns in emerging market debt and low-beta, relative-value strategies.

In 2017-18 we focused on completing the range of manager relationships and mandates which we think will suit the portfolio through the credit cycle. We funded the portfolio's first exposure to liquid, sub-investment grade credit and intend to add another private debt mandate in the coming year.

Strategy exposure at 30 June 2018



Region exposure at 30 June 2018



Property

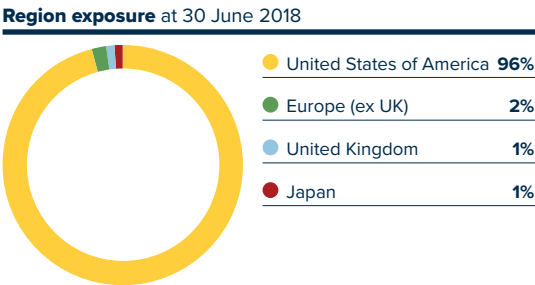
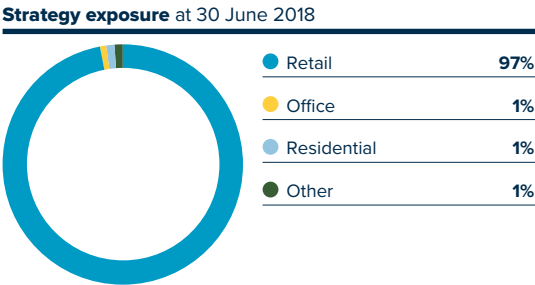
Strategy

Our strategy for the Medical Research Future Fund involves a concentrated build out of our highest conviction ideas. This focuses on income producing strategies and where our global managers can assess relative value across markets, ultimately providing superior risk-adjusted returns.

Report

During the year, we made our first property allocations within the Medical Research Future Fund. The investments comprised commitments to two of our high conviction global direct managers and an allocation in the listed sector.

The Fund's property portfolio will continue to build over time.



Through the Future Fund's property program we have invested in shopping centres and office buildings across the globe. We also have exposure to some more unique property assets such as Center Parcs, which owns and operates five family holiday villages in the United Kingdom. Each village is set within 400 acres of protected and enhanced woodland and centres around an indoor water park. The villages also offer sports and leisure activities, restaurants and spas. Woburn Forest village, pictured here, is located in Bedfordshire, England.



Private equity

Strategy

In 2015-16 the Fund purchased \$233 million of mature private equity positions (plus \$194 million of unfunded commitments) from Future Fund, as part of a broader rebalancing sale process conducted by Future Fund.

Following the acquisition in 2015-16, we are building a highly concentrated portfolio of private equity exposures, the majority of which will come from a subset of the Future Fund relationships.

Report

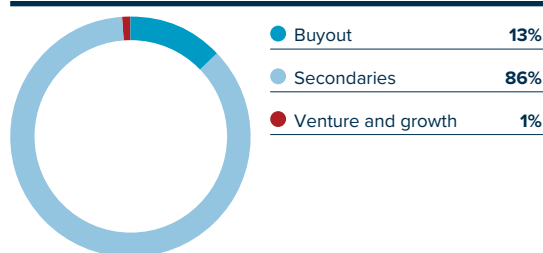
As of 30 June 2018 the Medical Research Future Fund had \$501 million of capital (invested plus committed) with 14 private equity managers. During the year we allocated \$159 million to four new managers and a further \$35 million to our existing managers. Invested capital increased from \$256 million to \$297 million over the course of the year, reflecting \$33 million of capital calls, \$52 million of distributions and \$60 million of unrealised asset value appreciation. Unfunded commitments increased from \$48 million to \$220 million over the course of the year.

Of the capital called, 69% was for buyout opportunities, 17% was for venture capital and growth equity opportunities, and 14% was for the secondary portfolio. 94% of the distributions received were from the secondary portfolio with the remainder from the venture capital and growth equity portfolio.

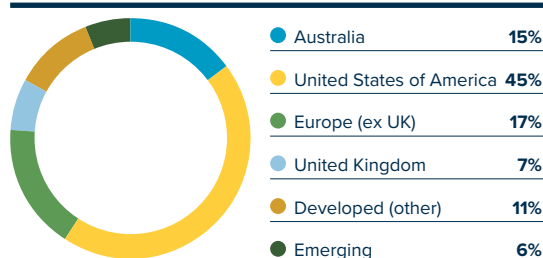
As at 30 June 2018 private equity represented 4.1% of the Medical Research Future Fund's total assets.

During the year Dr Raphael Arndt, Chief Investment Officer, spoke about how the Future Fund utilises private equity and venture capital globally to access the next generation of opportunities. Refer to his speech titled *Investing in disruption* available on our website at www.futurefund.gov.au.

Strategy exposure at 30 June 2018



Region exposure at 30 June 2018



Total Investments by geography at 30 June 2018

Australia

37%

United States of America

28%

Europe (ex UK)

12%

United Kingdom

5%

Japan

6%

Developed (other)

2%

Emerging

9%

Currency

As discussed on page 22, we explicitly manage the size and composition of the foreign currency exposures in the portfolio rather than allowing them to be shaped by our underlying investments.

At 30 June 2018, we held an exposure to foreign developed market currencies equivalent to 13.1% of the total Medical Research Future Fund. We expect our basket of developed market currencies to diversify the portfolio against broad market risk and generate liquidity in adverse conditions.

We also held an exposure of 5.1% to emerging market currencies in the Medical Research Future Fund at 30 June 2018. We expect a diversified exposure to emerging market currencies to deliver a modest excess return through some combination of gradual (but incremental) real effective exchange rate appreciation and/or positive real interest rate differentials relative to the Australian dollar. Given that we expect its performance to be uncorrelated with market risk over the long term, we therefore consider our basket of emerging market currencies to be an attractive risk-adjusted exposure at portfolio level.

Performance

In 2017-18 the Medical Research Future Fund generated an investment return of 4.7%, exceeding its target benchmark of 3.0%.

Since inception the Fund has delivered a return of 4.2% pa, exceeding its target benchmark of 3.1% pa.

The Fund received a contribution of \$2.2 billion from the Australian Government on 3 July 2017, and at 30 June 2018 was valued at \$7.2 billion.

Costs

Cost management

Our use of external investment managers, together with our commitment to a broadly diversified portfolio and breadth of investment classes, means that over time our costs will generally be higher than those investors with less complex portfolios.

The commitment to genuine diversification is an important facet of our investment strategy and has been beneficial to the Fund's overall performance delivering strong returns net of costs while reducing volatility.

We continue to closely monitor costs in the asset classes in which we invest, reviewing the expected returns and costs of implementing the investment strategy on an ongoing basis. In negotiating terms, we focus on securing arrangements that offer value for money for the skills and resources applied, that are competitive relative to other managers in the sector and that provide for strong alignment between managers and our organisation.

Every decision we make in relation to the portfolio is considered having regard to the returns and risks net of all costs, and all returns we report are always net of all costs.

Direct costs

Direct costs, previously reported as management costs and transaction and operational costs, reflect all directly incurred costs associated with the management of the Medical Research Future Fund.

The Medical Research Future Fund's direct costs over the last three years are shown on the following page. This includes the direct cost ratio (direct costs divided by the average net assets for the financial year).

Changes in costs over the years reflect changes in the size of the Medical Research Future Fund, investment activity undertaken during the year, and the accrual and payment of performance fees.

We continued to build out and diversify the Fund's portfolio during the year, including the first allocation to property.

Look-through costs

In addition to direct costs, investment management and performance fee costs incurred indirectly through investment vehicles or where the fund is part of a co-mingled group of funds are reported as 'look-through' costs.

The look-through costs are identified by making additional enquiries of managers of non-consolidated investment vehicles to estimate the underlying management and performance fees of these entities.

In providing this additional information, we seek to provide a full and complete indication of investment management and performance fee costs.

We note that these additional cost disclosures are based on unaudited estimates and derived using a variety of methodologies, particularly with regard to performance fees which may become payable.

We employ a range of performance fee arrangements, which incorporate the use of high-water marks and claw-back provisions, to ensure as far as possible that performance fees reflect genuine outperformance over time.

It is important to note that the majority of accrued performance fees are only paid on realisation of an investment and therefore it is possible not all accrued fees will ultimately be paid.

The additional look-through costs over the last three years are shown below.

Summary of direct costs and direct cost ratio

	2015-16 (22 September to 30 June 2016)	2016-17	2017-18
Direct costs	\$3.3 million	\$10.1 million	\$11.8 million
Direct cost ratio	0.160%	0.231%	0.168%

Summary of look through costs

	2015-16 (22 September to 30 June 2016)	2016-17	2017-18
	0.03%	0.56%	0.61%

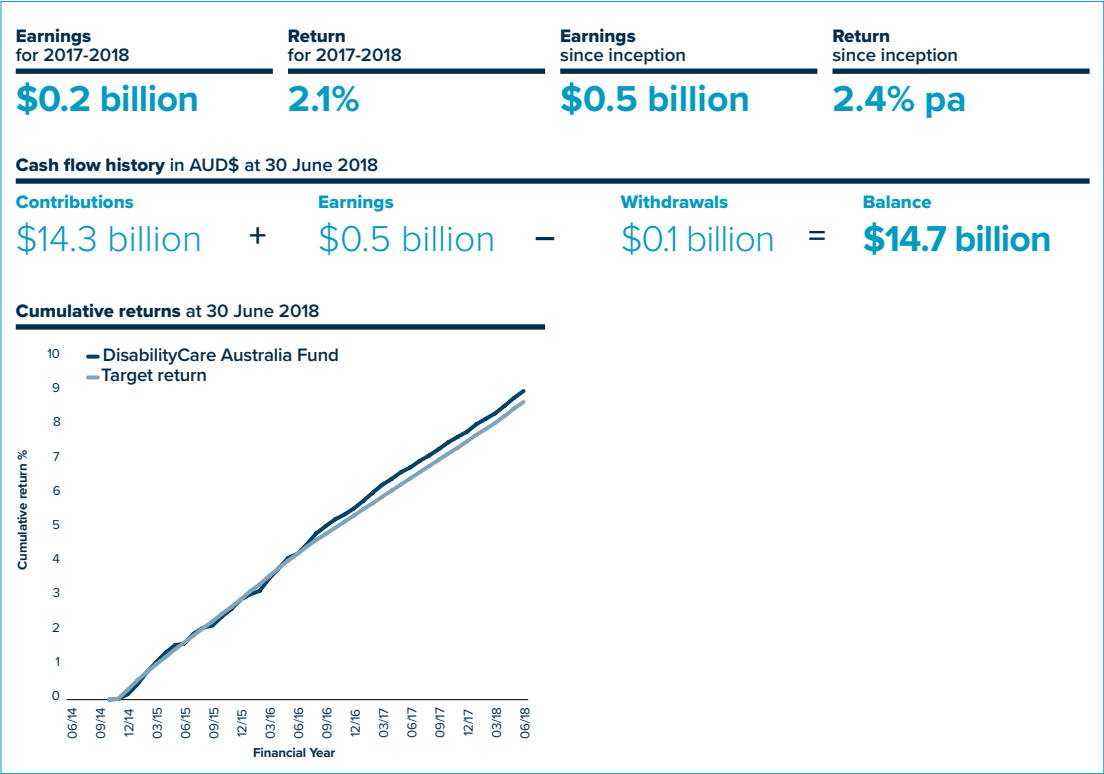
Cost disclosures under section 81 of the *Future Fund Act 2006*

Under its statutory arrangements the Board also reports costs in accordance with section 81 of the *Future Fund Act 2006*.

Purpose	Amount debited 2015-16	Amount debited 2016-17	Amount debited 2017-18
Contracts with investment managers	\$1,408,635	\$7,532,456	\$9,390,187
Board remuneration and allowances	-	-	-
Agency remuneration and allowances	-	-	-
Consultants and advisers to the Board and Agency	-	-	-
Agency operations	\$141,833	\$2,017,154	2,271,251

Note: all costs reported under section 81 of the *Future Fund Act 2006* are reported on a cash basis, whereas the direct costs in the above table include accruals.

DisabilityCare Australia Fund



Mandate:
Australian bank bill swap rate plus 0.3% per annum calculated on a rolling 12-month basis while minimising the probability of capital loss.

Interpreting the Investment Mandate

The DisabilityCare Australia Fund’s Investment Mandate was issued to the Board by the responsible Ministers in July 2014 and is available at Appendix B and on our website.

In summary, the Mandate:

- benchmarks returns against the Australian three-month bank bill swap rate +0.3% per annum calculated on a rolling 12-month net-of-fee basis

- requires us to invest in such a way as to minimise the probability of capital losses over a 12-month horizon
- requires us to act in a way that:
 - is consistent with international best practice for institutional investment
 - minimises the impact on the Australian financial markets
 - is unlikely to cause a diminution of the Australian Government's reputation in financial markets
- allows for a review of the Mandate, including the benchmark return, by the responsible Ministers in consultation with the Board of Guardians.

Risk positioning

We are required to invest the assets of the Fund in such a way as to pursue the benchmark return while minimising the probability of capital losses over a 12-month horizon.

Our core strategy is to invest in a combination of short and medium-term domestic and global debt instruments, providing some yield above the base cash rates while maintaining a high quality, liquid and defensive profile. The Government has indicated that it expects to make additional capital contributions to the Fund as well as withdrawals to reimburse States, Territories and the Commonwealth for expenditure incurred in relation to the National Disability Insurance Scheme. We continue to focus on maintaining additional liquidity to help manage transaction costs and the timing of cash flows as they are confirmed.

Investment review

Strategy

To date the DisabilityCare Australia Fund has received contributions of \$14.3 billion from the Government. The Fund is expected to be called upon to fund cash flows related to National Disability Insurance Scheme spending. Accordingly, we invest the Fund to provide an ample liquidity buffer to support these outflows.

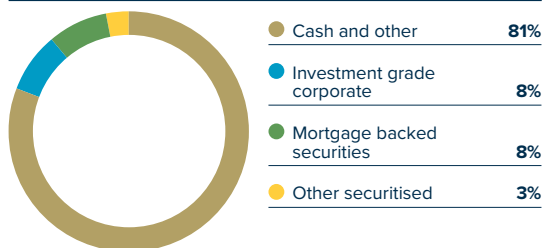
Our core strategy is to invest in a combination of short-and medium-term domestic and global debt instruments, providing some yield above base cash rates while maintaining a high quality, liquid and defensive profile.

Report

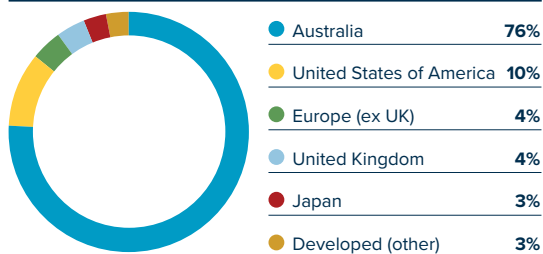
Early in the life of the Fund, before withdrawals were expected, we positioned the portfolio into somewhat longer-maturity high quality credit instruments. As the expected duration of capital has fallen, we have taken steps to increase available liquidity and reduce risk. This has included broadening the active management strategy beyond a credit spread emphasis and lowering the level of credit spread duration risk.

The Fund received a single inflow during the year, in June 2018, which was invested in accordance with our strategy.

Strategy exposure at 30 June 2018



Region exposure at 30 June 2018



Performance

In 2017-18 the DisabilityCare Australia Fund generated an investment return of 2.1%, meeting its benchmark of 2.1%.

The Fund received a capital contribution of \$4.2 billion from the Australian Government on 22 June 2018. The value of the Fund was \$14.7 billion at 30 June 2018.

Costs

Cost management

We continue to closely monitor costs in the asset classes in which we invest, reviewing the expected returns and costs of implementing the investment strategy on an ongoing basis. In negotiating fee arrangements, we focus on securing arrangements that offer value for money for skill and resources applied, that are competitive relative to other managers in the sector and that provide for strong alignment between managers and our organisation.

All returns reported are net of costs.

Direct costs

Direct costs, previously reported as management costs and transaction and operational costs, reflect all directly incurred costs associated with the management of the DisabilityCare Australia Fund.

The DisabilityCare Australia Fund's direct costs over the last three years are shown below. This includes the direct cost ratio (direct costs divided by the average net assets for the financial year).

Changes in costs over the years reflect changes in the size of the DisabilityCare Australia Fund and the investment activity undertaken during the year.

Summary of direct costs and direct cost ratio

	2015-16	2016-17	2017-18
Direct costs	\$3.9 million	\$4.7 million	\$7.0 million
Direct cost ratio	0.083%	0.072%	0.065%

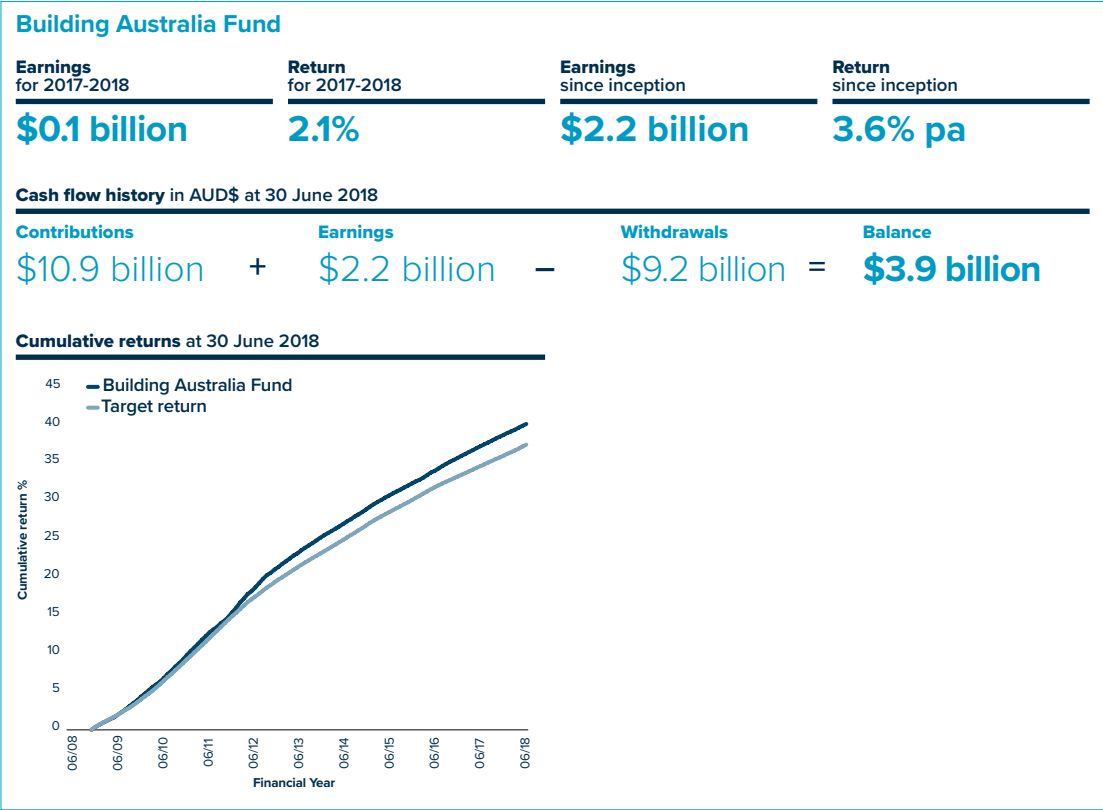
Cost disclosures under section 81 of the *Future Fund Act 2006*

Under its statutory arrangements the Board also reports costs in accordance with section 81 of the *Future Fund Act 2006*.

Purpose	Amount debited 2015-16	Amount debited 2016-17	Amount debited 2017-18
Contracts with investment managers	\$2,984,313	\$4,664,201	\$5,836,281
Board remuneration and allowances	-	-	-
Agency remuneration and allowances	-	-	-
Consultants and advisers to the Board and Agency	-	-	-
Agency operations	\$1,670	\$868,195	\$748,573

Note: all costs reported under section 81 of the *Future Fund Act 2006* are reported on a cash basis, whereas the direct costs in the above table include accruals.

Nation-building Funds



Mandate:
Australian bank bill swap rate plus 0.3% per annum over rolling 12-month periods while minimising the probability of capital loss.

Interpreting the Investment Mandate

The Investment Mandates for the Building Australia Fund and the Education Investment Fund, known collectively as the Nation-building Funds, were issued to the Board by the responsible Ministers in July 2009 and are available at Appendix B and on our website.

In summary, each Mandate:

- benchmarks returns against the Australian three-month bank bill swap rate +0.3% per annum on a rolling 12-month net-of-fee basis

Education Investment Fund

Earnings
for 2017-2018

\$0.1 billion

Return
for 2017-2018

2.1%

Earnings
since inception

\$1.6 billion

Return
since inception

3.6% pa

Cash flow history in AUD\$ at 30 June 2018

Contributions

\$6.5 billion

+

Earnings

\$1.6 billion

–

Withdrawals

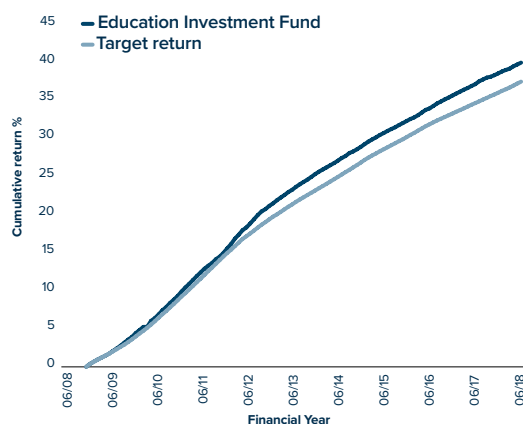
\$4.2 billion

=

Balance

\$3.9 billion

Cumulative returns at 30 June 2018



- requires the Board to invest in such a way as to minimise the probability of capital losses over a 12-month horizon
- requires the Board to act in a way that:
 - is consistent with international best practice for institutional investment
 - minimises the impact on the Australian financial markets
 - is unlikely to cause a diminution of the Australian Government's reputation in financial markets
- allows for a review of the Mandate, including the benchmark return, by the responsible Ministers in consultation with the Board of Guardians.

Risk profile

We are required to invest the assets of the Funds in such a way as to pursue the benchmark return while minimising the probability of capital losses over a 12-month horizon.

Our core strategy is to invest in a combination of short and medium-term domestic and global debt instruments, providing some yield above the base cash rates while maintaining a high quality, liquid and defensive profile. The Government has indicated that it intends to abolish the Nation-building Funds through a repeal of the *Nation-building Funds Act 2008* with the uncommitted balances transferred to the National Disability Insurance Scheme Savings Fund Special Account. The timing of this process is uncertain and accordingly we continue to maintain additional liquidity.

Investment review

Strategy

Our core strategy is to invest in a combination of short-and medium-term domestic and global debt instruments, providing some yield above the base cash rates while maintaining a high quality, liquid and defensive profile. This profile facilitates periodic withdrawals in accordance with program spending.

Report

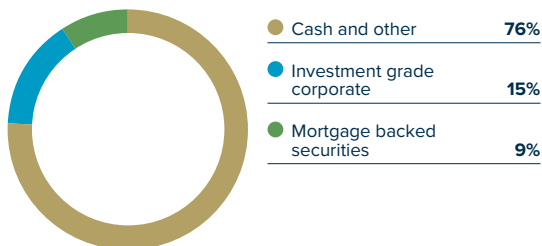
We continue to manage the Funds in accordance with their Mandates, with little activity during the period. Outflows from the Funds have slowed, although the portfolios continue to be positioned in a highly liquid manner.

Performance

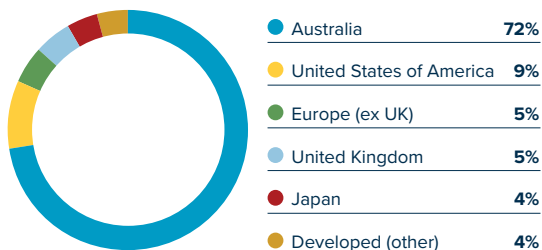
The benchmark return for each of the Nation-building Funds in 2017-18 was 2.1%. Both Funds met this benchmark, each achieving a return of 2.1%.

The value of the Building Australia Fund was \$3.9 billion at 30 June 2018. The value of the Education Investment Fund was also \$3.9 billion at 30 June 2018.

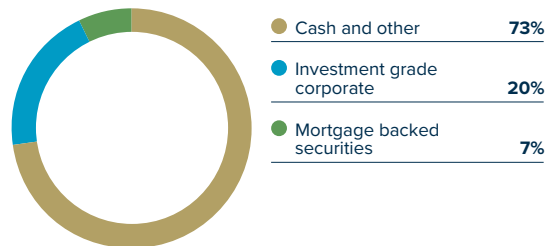
Building Australia Fund Strategy exposure at 30 June 2018



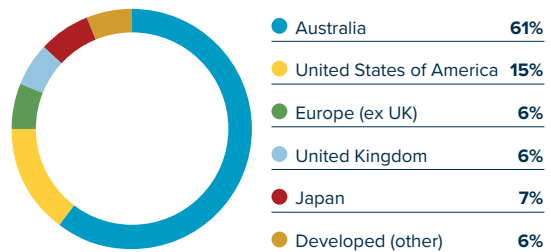
Building Australia Fund Region exposure at 30 June 2018



Education Investment Fund Strategy exposure at 30 June 2018



Education Investment Fund Region exposure at 30 June 2018



Costs

Cost management

We continue to closely monitor costs in the asset classes in which we invest, reviewing the expected returns and costs of implementing the investment strategy on an ongoing basis. In negotiating fee arrangements, we focus on securing arrangements that offer value for money for skill and resources applied, that are competitive relative to other managers in the sector and that provide for strong alignment between managers and our organisation.

All returns reported are net of costs.

Direct costs

Direct costs, previously reported as management costs and transaction and operational costs, reflect all directly incurred costs associated with the management of the Nation-building Funds.

The Nation-building Funds' direct costs over the last three years are shown below. This includes the direct cost ratio (direct costs divided by the average net assets for the financial year).

Changes in costs over the years reflect changes in the size of the Nation-building Funds and the investment activity undertaken during the year.

Summary of direct costs and direct cost ratio

Building Australia Fund

	2015-16	2016-17	2017-18
Direct costs	\$3.6 million	\$3.6 million	\$3.8 million
Direct cost ratio	0.097%	0.097%	0.098%

Education Investment Fund

	2015-16	2016-17	2017-18
Direct costs	\$3.9 million	\$3.8 million	\$4.1 million
Direct cost ratio	0.106%	0.102%	0.107%

Cost disclosures under section 81 of the *Future Fund Act 2006*

Under its statutory arrangements the Board also reports costs in accordance with section 81 of the *Future Fund Act 2006*.

Building Australia Fund

Purpose	Amount debited 2015-16	Amount debited 2016-17	Amount debited 2017-18
Contracts with investment managers	\$3,522,928	\$3,486,610	\$3,676,473
Board remuneration and allowances	-	-	-
Agency remuneration and allowances	-	-	-
Consultants and advisers to the Board and Agency	-	-	-
Agency operations	\$208,781	\$358,894	\$294,829

Education Investment Fund

Purpose	Amount debited 2015-16	Amount debited 2016-17	Amount debited 2017-18
Contracts with investment managers	\$3,923,777	\$3,693,845	\$3,993,854
Board remuneration and allowances	-	-	-
Agency remuneration and allowances	-	-	-
Consultants and advisers to the Board and Agency	-	-	-
Agency operations	\$270,836	\$361,726	\$295,548

Note: all costs reported under section 81 of the *Future Fund Act 2006* are reported on a cash basis, whereas the direct costs in the above table include accruals.

GOVERNANCE AND ACCOUNTABILITY

04

The statutory governance arrangements for the funds we manage are set out primarily in the *Future Fund Act 2006*, the *Medical Research Future Fund Act 2015*, the *DisabilityCare Australia Fund Act 2013* and the *Nation-building Funds Act 2008*.

This core legislation sets out the roles and responsibilities of the Australian Government and of the Board and the Agency. In addition, the *Public Governance, Performance and Accountability Act 2013* applies to the Agency and (to a limited extent) the Board and, together with Commonwealth regulations, guidelines, procedures and orders, establishes arrangements for delegations and authorities, spending and the accounting treatment of costs, liabilities, income and expenses.

The core legislation provides the Government, through the responsible Ministers, with oversight of the funds subject to the arrangements that establish the independence of the Board. The government's role includes the appointment of Board members and the establishment of investment mandates for each of the funds. The legal framework retains beneficial ownership of the assets of each fund in the Commonwealth. It also clearly states the purpose of each fund and sets out the arrangements for contributions to and withdrawals from the various Funds.

The Board is responsible for investing the assets of the funds in accordance with the legislation. To assist it in this role, the Board receives recommendations and advice from the Agency which is also responsible for implementing the Board's investment decisions.

The Board operates independently from Government. This independence is emphasised in a number of ways, including:

- The expenses of the funds are met from the assets of the funds themselves rather than from annual appropriations through Parliament.
- The Board must be consulted on draft Investment Mandate Directions which must be consistent with the requirements of the legislation, and any submissions the Board makes on a draft Investment Mandate must be tabled in Parliament. The investment mandates for each of the funds define the risk and return requirements and timeframe for investment activity while the legislation imposes very few limitations on asset allocation, selection of markets and portfolio design on the Board.
- Board members must be drawn from outside government and must meet the requirements of having substantial expertise and professional credibility in investing or managing financial assets or in corporate governance.

The Board is not involved in advising on macroeconomic management or policy formation and implementation and so is focused solely on the pursuit of its investment objectives in a commercial manner.

More broadly, we are a founding member of the International Forum of Sovereign Wealth Funds (IFSFW) and fully implement the Santiago Principles. The Santiago Principles provide a framework of generally accepted principles and practices for sovereign funds that reflect appropriate governance and accountability arrangements as well as the conduct of investment practices on a prudent and sound basis.

Accountability

The legislation provides accountability arrangements for the organisation, including the tabling in Parliament of an annual report and audited financial statements. We also publish quarterly portfolio updates to provide details of the investment activity and performance of our funds. Other public updates are provided in the form of published speeches and comments to the media. We are required to keep the responsible Ministers informed of the operations of the organisation. The nominated Minister may also, by written notice, require us to prepare reports or provide information on specified matters relating to the performance of our functions and have these published.

Statements of Expectations and Statements of Intent have also been exchanged between the then Minister for Finance and Deregulation and our organisation. These documents further delineate the responsibilities and communication arrangements between the parties and are available on our website.

We routinely appear before public Estimates Hearings of the Senate Committee on Finance and Public Administration to provide the Committee with updates on our operations and the performance of the funds. In 2017-18 we appeared at hearings in October 2017, February 2018 and May 2018. These public hearings are based upon the Outcome and Output structure detailed in the Portfolio Budget Statements.

Board of Guardians

As at 30 June 2018 the Board consisted of a Chair and five other members. Mr Robert Priestley served as a member of the Board during part of 2017-18 having been appointed with effect from 7 November 2017 and resigning on 19 June 2018.

Members are appointed by the Treasurer and the Minister for Finance and selected for their expertise in investing in financial assets, managing investments and corporate governance.

Board members are appointed on a part-time basis for a term of up to five years and are eligible to be reappointed.



Hon Peter Costello AC **Chairman**

Mr Costello was first appointed to the Board with effect from 18 December 2009. Mr Costello was appointed acting Chairman on 11 January 2014 and Chairman with effect from 4 February 2014 for a five-year term.

Mr Costello served as a member of the House of Representatives from 1990 to 2009 and was Treasurer of the Commonwealth of Australia from March 1996 to December 2007. He has been Chair of the G20 Central Bank Governors and Finance Ministers, the OECD Ministerial Council, the APEC Finance Ministers, and a Governor of the IMF, World Bank and Asian Development Bank.

He has served as Chairman of the Independent Advisory Board to the World Bank.

Mr Costello is the Chairman of Nine Entertainment Co. and ECG Financial Pty Ltd. Mr Costello was appointed a Companion of the Order of Australia in 2011 for eminent service to the Parliament of Australia through the development of landmark economic policy reforms.

Ms Erin Flaherty

Ms Flaherty was appointed with effect from 3 April 2016 for a five-year term.

Ms Flaherty has extensive experience in corporate governance, finance, infrastructure and law, including most recently as an Executive Director at Infrastructure NSW and Deputy Chief Executive Officer at Reliance Rail. Ms Flaherty is an inaugural member of the Sydney Metro Authority, the new independent body established to oversight the Sydney Metro rail project. Her current appointments include National Chair, Professional Scholarship Selection Committee of the Australian-American Fulbright Commission and Non-Executive Director of the Australian Youth Orchestra and PCYC NSW.





Ms Carolyn Kay

Ms Kay was appointed with effect from 14 April 2015 for a five-year term.

Ms Kay has more than 30 years' experience in the finance sector both in executive and non-executive roles. As an executive Carolyn worked as a banker and as a lawyer at Morgan Stanley, JP Morgan and Linklaters & Paines in London, New York and Australia. In addition, she has been and remains a non-executive director of enterprises across a broad range of industries. Ms Kay is currently a Director of Allens Linklaters, Brambles, Scentre Group, the Australia-China Council and in the not-for-profit sector, the General Sir John Monash Scholarship Foundation. She was awarded a Centenary Medal for services to business.



Mr John Poynton AO

Mr Poynton was appointed with effect from 4 February 2014 for a five-year term.

Mr Poynton is Chairman of Jindalee Partners, Strike Energy Limited and Sapient Cyber Ltd. He is also the Chairman of Council of Christ Church Grammar School and Giving West and has previously served as the Chairman, Deputy Chairman or Non-Executive Director of a number of ASX listed companies, Federal Government boards, education institutions and not-for-profit enterprises. Mr Poynton is an Officer in the General Division of the Order of Australia and is a past recipient of a WA Citizen of the Year award in the industry and commerce category. He holds a Bachelor of Commerce and an honorary Doctor of Commerce from the University of Western Australia.



Mr Rob Priestley

Mr Priestley was appointed with effect from 7 November 2017 for a five-year term. Mr Priestley resigned from his position with effect from 19 June 2018.

Mr Priestley has over 30 years' experience in the financial services industry. He served as the Chief Executive Officer of J.P. Morgan Australia & New Zealand, and was a member of the bank's Asia Pacific Management Committee, roles he held for 15 years. Other roles at J.P. Morgan have included CEO of the ASEAN Region, Head of Global Emerging Markets and Head of International Fixed Income for Europe, Middle East and Africa Region, and Head of International Fixed Income, Asia Pacific Region. Prior to J.P. Morgan, Mr Priestley held senior financial markets roles, including at Macquarie Bank after starting his career at Price Waterhouse. He has been a Director and Chairman of the Australian Financial Markets Association, a member of the Business Council of Australia, and a Director of ASX Limited. Mr Priestley is currently the Non-Executive Chairman of J.P. Morgan Australia & New Zealand, a Director of the Banking and Finance Oath, a Council member of the Australian Business & Community Network, and a member of the Tennis NSW Corporate Advisory Board.

**Mr Michael Wachtel**

Mr Wachtel was appointed with effect from 3 April 2016 for a five-year term.

Mr Wachtel's primary business experience is global in nature and predominantly in the area of large complex international business. Through various leadership roles in the professional services industry he has extensive experience in organisational leadership, finance, risk management and governance, including as a former Chair (Asia Pacific & Oceania) of Ernst & Young (EY) and a member of the EY Global Governance Council & Global Risk Executive Committee. He is a Non-Executive Director of SEEK, the Australian Centre for the Moving Image (ACMI) and the St Vincent's Medical Research Institute, and a past President of the International Fiscal Associations (IFA Australia).

**Dr Jane Wilson**

Dr Wilson was appointed with effect from 14 April 2015 for a five-year term.

Dr Wilson has had a distinguished career as an independent Director with a background in finance, banking and medicine. Dr Wilson is a non-executive Director of Transurban and an independent Director of Sonic Healthcare Ltd and the General Sir John Monash Foundation. She is also Co-Chair of the Australian Government Advisory Board on Technology and Healthcare Competitiveness. Dr Wilson was Deputy Chancellor of the University of Queensland and has previously served on boards of ASX-listed companies, Government-owned Corporations and non-for-profit companies. Dr Wilson was awarded the 2016 Australian Institute of Company Directors Queensland Gold Medal Award for contribution to business and the wider community.

Board and Board Committee membership 2017-18

Board/Committee	Members
Future Fund Board of Guardians Responsible for the investment of the public asset funds in accordance with the relevant legislation and Directions.	Hon Peter Costello AC (Chair) Ms Erin Flaherty Ms Carolyn Kay Mr John Poynton AO Mr Robert Priestley ¹ Mr Michael Wachtel Dr Jane Wilson
Audit & Risk Committee² Focuses on the control framework, external accountability, legislative compliance, internal and external audit and the appropriate identification and management of risks.	Mr Michael Wachtel (Chair) Ms Erin Flaherty Ms Carolyn Kay Mr John Poynton AO Mr Robert Priestley ³ Dr Jane Wilson
Remuneration & Nominations Committee Focuses on remuneration and appointment matters for staff and appointments to investment companies and advisory Boards.	Hon Peter Costello AC (Chair) Ms Carolyn Kay Mr Robert Priestley ³ Mr Michael Wachtel
Conflicts Committee Provides oversight of and advises the Board in relation to any questions of possible conflict of interest arising for Board and Board committee members.	Mr John Poynton AO (Chair) Ms Erin Flaherty Dr Jane Wilson
Transaction Committee Provides support and assistance to the Board in respect of any transaction, matter or issue as referred to the Committee by the Board from time to time.	Hon Peter Costello AC (Chair) Ms Carolyn Kay Mr Robert Priestley ³

Notes:

1. Appointed to the Board with effect from 7 November 2017. Mr Priestley resigned from his position with effect from 19 June 2018.
2. Hon Peter Costello AC attends meetings as an observer.
3. Appointed to Committees with effect from 5 February 2018. Committee memberships ceased as at 19 June 2018 due to his resignation from the Board.

Board and Board Committee attendance 2017-18

Member	Future Fund Board of Guardians		Audit & Risk Committee		Remuneration & Nominations Committee	
	Meetings held and eligible to attend as a member	Attended	Meetings held and eligible to attend as a member	Attended	Meetings held and eligible to attend as a member	Attended
Hon Peter Costello AC	9	9	0	5	3	3
Ms Erin Flaherty	9	9	5	5	0	1
Ms Carolyn Kay	9	9	5	5	3	3
Mr John Poynton AO	9	9	5	5	0	1
Mr Rob Priestley ^{1,2}	5	5	1	1	1	1
Mr Michael Wachtel	9	9	5	5	3	3
Dr Jane Wilson	9	8	5	4	0	1

Notes:

The Conflicts Committee and the Transaction Committee are ad-hoc Committees. The Committees meet on an as needs basis and did not formally convene during the year.

Board Members are able to attend meetings of Committees of which they are not a member.

1. Appointed to the Board on 7 November 2017 and Remuneration & Nominations, Audit & Risk and Transaction Committees with effect from 5 February 2018.
2. Resigned from the Board with effect from 19 June 2018 and therefore Committee membership also ceased as at that date.

Future Fund Management Agency

The Board is supported by the Future Fund Management Agency. Employed under the *Public Service Act 1999*, the Agency comprises professionals from a range of sectors including finance, investment, legal and corporate services, who are responsible for making recommendations to the Board on the most appropriate investment strategy for each fund, and for the implementation of these strategies.

The Chair of the Board is the accountable authority for the Agency, although operational management has been delegated to the Chief Executive Officer.

The Agency's Management Committee, led by the Chief Executive Officer, is accountable for the operations of the Agency. At 30 June 2018 the Management Committee comprised the Chief Executive Officer, General Counsel and Chief Risk Officer, Chief Culture Officer, Chief Operating Officer, Chief Financial Officer, and Chief Investment Officer. The Chief Investment Strategist was a member of the Management Committee until 30 April 2018 when he left following an organisational restructure. Information and context about the changes to the organisational structure is provided on page 14.

Mr David Neal *Chief Executive Officer*

Mr Neal took up his position as Chief Executive Officer on 4 August 2014 having previously served as Chief Investment Officer. Mr Neal joined the Future Fund as Chief Investment Officer in 2007 from Watson Wyatt Australia (now Willis Towers Watson) where he was Head of Investment Consulting. He started his career with Watson Wyatt in the United Kingdom and led the establishment of the firm's investment consulting business in Australia.

Mr Cameron Price *General Counsel and Chief Risk Officer*

Mr Price joined the Future Fund in March 2014 as General Counsel. He took up the additional position of Chief Risk Officer in March 2018. Previously he was a Partner and Board member at law firm Allens Linklaters, where he had 25 years of experience in corporate law, with particular expertise in mergers and acquisitions, private equity, equity capital markets and corporate governance.

Ms Elizabeth McPherson *Chief Culture Officer*

Ms McPherson joined the Future Fund in 2010 and has held the position of Chief Culture Officer since 2014. In 2016 Ms McPherson's responsibilities of people, culture and communication were expanded to include strategic project management and in March 2018 change management and planning was added to create a business unit focused on organisational development.



Mr David Neal



Mr Cameron Price



Ms Elizabeth McPherson

Ms McPherson has a Masters in Leadership, Postgraduate qualifications in Change Management and in Employee Relations as well as undergraduate qualifications in HR and Business. Ms McPherson was part of the Promina Insurance leadership team when it merged with Suncorp in 2007 and remained with Suncorp until 2010, leading organisational design and change management initiatives. Previously she worked with CSL and Wesfarmers, Mandarin Oriental Hotel Group Hong Kong and with the South African Government.

Mr Gordon McKellar
Chief Operating Officer

Mr McKellar began with the Future Fund in 2007 and has over 20 years' experience in asset servicing including roles in Edinburgh, New York and Sydney. Previously 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.

Mr Paul Mann
Chief Financial Officer

Mr Mann commenced his role as Chief Financial Officer in 2007. He served as acting Managing Director between 1 March and 4 August 2014. He is a CFA Charterholder and 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.

Dr Raphael Arndt
Chief Investment Officer

Dr Arndt has held the role of Chief Investment Officer since 1 September 2014. In March 2018 Dr Arndt took on a number of responsibilities previously held by the Chief Investment Strategist. Prior to his appointment as Chief Investment Officer, Dr Arndt had been Head of Infrastructure and Timberland since 2008.

Dr Arndt is Chair of the Investment Committee and a Board Member of the Melbourne Lord Mayor's Charitable Foundation. He has previously been an Investment Director with Hastings Funds Management and has also held infrastructure policy positions with both the private sector and the Victorian Department of Treasury and Finance. Dr Arndt started his career as an engineer working with Ove Arup & Partners.

Mr Stephen Gilmore
Chief Investment Strategist

Mr Gilmore joined the Future Fund in 2009 having previously worked in senior strategy roles in London and Hong Kong with AIG Financial Products and Morgan Stanley. Prior to that, he worked with both the International Monetary Fund and the Reserve Bank of New Zealand.

Mr Gilmore left the Future Fund Management Agency in April 2018 as part of an organisational restructure (further information is available on page 14).



Mr Gordon McKellar



Mr Paul Mann



Dr Raphael Arndt



Mr Stephen Gilmore

Risk management

We believe that effective governance of our own operations is essential to the successful pursuit of our objectives. In particular, we are focused on the prudent management of risk.

The organisation, along with many financial institutions, has adopted the 'Three Lines of Defence' model for risk governance. This model is built around three elements which we have adapted to suit our organisation:

- i) First line of defence is the business. The business 'owns' each risk and must ensure that there are controls in place to appropriately manage the risk within our risk appetite. The business is responsible for identifying, analysing, managing, monitoring and reporting risks.
- ii) Second line of defence is the independent Risk Team, led by the Chief Risk Officer. This team develops the organisation's risk management framework to promote effective and consistent risk management across the organisation, assists and supports the business in developing its risk management policies, systems and controls, and provides independent review and challenge of the first line.
- iii) Third line of defence is an independent audit function (both the internal audit function which is outsourced, and the external audit function carried out by the ANAO). The function provides independent assurance that the risk management framework is adequate and is operating effectively.

Monitoring and managing risk

In managing risk, we consider risk in three broad categories: investment risk, strategic risk and operational risk:

- i) Investment risk is the risk that the Board-approved investment strategies fail to achieve the mandated return and risk objectives for each fund. Investment risk management includes not only the development of an appropriate strategy, but also the design and execution of robust frameworks, processes, decision tools and governance arrangements to select and monitor investment managers and instruments through which to implement the strategy, and managing market, credit, liquidity, counterparty and other investment risks;

- ii) Strategic risks are those top level organisational risks which could impact the development and implementation of the strategic plan. These risks include ineffective Board/Agency operating structure, human resources risk, reputation risk, key stakeholder relationship risk and program execution risk; and
- iii) Operational risks are those which could result in the organisation not meeting its objectives through the failure of the Agency's processes, controls and systems. Examples of operational risks managed by the Agency include legal, fraud, business continuity, outsourcing, information security and compliance risks.

The Board has overall responsibility for risk management, which includes acceptance of the residual risk rating for each key risk identified in the organisation's Risk Register. The Board has specific responsibility for the oversight of investment risk. The Board's Audit & Risk Committee meets at least five times during the year. Its responsibilities include the review of the financial statements, oversight of the compliance and audit functions and evaluating the efficiency and effectiveness of the risk management framework.

The Agency has a number of committees which are involved directly in risk management, including:

- i) Management Committee – for strategic risks;
- ii) Investment Committee – for investment risks; and
- iii) Operational Risk & Compliance Committee – for operational risks.

The Agency's Risk Register documents the key risks, and key controls, in these three categories. The effectiveness of these key controls is assessed by control owners on a quarterly basis, with results reported to the Agency's Operational Risk & Compliance Committee and the Board's Audit & Risk Committee.

Risk culture

A strong culture of risk and compliance management exists within our organisation. All staff are required to adhere to the Australian Public Service Code of Conduct and comply with core operational policies which underpin the risk management framework. On an annual basis, staff certify their compliance with the Code of Conduct and these core policies.

The Agency seeks out opportunities to identify and share best practice approaches and benchmarks our approach to operational risk and compliance management through engagement with peer organisations.

Internal and external audit

Deloitte Touche Tohmatsu provides internal audit services reporting to the Audit & Risk Committee and has full access to staff and information when conducting its reviews. The Australian National Audit Office undertakes the external audit of the organisation engaging a professional accounting firm to assist in this process.

The Audit & Risk Committee receives internal and external audit reports and monitors management action in respect of these reports. During the year, the Committee has met separately with the internal and external auditors in the absence of management.

Fraud control

The Agency undertook a regular fraud and corruption risk assessment and updated its Fraud and Corruption Control Plan during the year which was reviewed and approved by the Agency's Operational Risk & Compliance Committee. There were no suspected or actual fraud incidents in 2017-18.

Fraud and corruption control initiatives are embedded into the Agency's internal control framework. Key controls such as segregation of duties, approval hierarchies, dual signatories and third party due diligence form part of the mitigation strategies. The effectiveness of these controls is assessed on a quarterly basis as part of the internal control assessment referred to above.

Crisis management and business continuity

The Agency undertook a crisis management exercise in May 2018 to test its ability to implement its Crisis Management Plan. A program of ongoing development and testing of this capability is planned.

The Agency undertook its annual disaster recovery test in June 2018. The Agency's critical processes were included in this test which was completed successfully with the results reported to both the Agency's Operational Risk & Compliance Committee and the Board's Audit & Risk Committee.

Cyber security

As part of the Agency's internal control framework, a specific IT risk management framework has been established to provide assurance that IT-related risks, including cyber risk, are identified, managed and monitored. A defence-in-depth cyber security strategy has been implemented to assist in identifying, managing, and monitoring the cybersecurity landscape, threats, technologies and controls.

OUR PEOPLE

05

We made good progress against our strategic priority of investing in our people and culture, recognising that the capability of our staff is at the heart of our success.

The funds we manage grew to \$175bn and our team grew to 161 people.

We introduced new systems and technology to support our people and our processes, launched a flexible work policy, refreshed our values and undertook activities to support diversity and inclusion in our team.

We made changes to our structure, which position us for success over the next 10 years.

Changes to our organisational structure

As our organisation grows in size, funds and assets under management, and as the investment environment around us becomes more complex, we must ensure our organisation is in the best shape possible to sustain our success into the future.

During the year we undertook a review of our structure, identifying where our processes and practices could be adjusted to support our joined-up investment approach, to make our decision-making more nimble and streamlined, and to harness the benefits of technology, data management and analytics.

We made changes in two phases. Phase one strengthened our investment, technology and risk functions, and repositioned the people, change and projects functions under Organisational Development. Phase two involved changes to our investment team, which will support the efficient and flexible management of the investment portfolio as it continues to grow over the decade ahead, and increased our tax, projects and change capability.

We were pleased to draw from our talent pool to fill a number of new positions. This highlights the strength of the organisation, the deep skills available within our team and the effectiveness of long-term succession planning.

The changes to our structure are discussed in more detail on page 14 of this report.

A refreshed set of values

Our values underpin our culture and define how we go about doing what we do.

The values we have had in place for the past 10 years have served us well. However, this year we have looked closely at our values to ensure they are fit for purpose for the organisation as it stands today and moves into the future.

We want values that resonate with staff, are robust and relevant, and set clear expectations in regard to the behaviours we want to see from our team.

Our revised values are:

- We **focus on what matters**. Everything we do is focused on achieving our purpose, we don't get sidetracked by distractions.
- We always **do the right thing** by our country, our organisation and our team.
- We **work together** to achieve the best outcome every time and ultimately to achieve our purpose.

The values were launched at our team development day in November 2017. The development day focused on planning for new ways of working as we transition from a small to a medium-sized organisation.

We launched myTime, our flexible work policy.

We are committed to creating a workplace where everyone feels that there is a healthy balance in all they do. We believe this will support a culture of inclusion, trust and respect and will encourage innovation, creativity, productivity, discretionary effort and focus.

MyTime enables staff to make choices about when, where and for how long they engage in work-related tasks, supporting staff to manage their own time to balance the multiple demands from life and work.

A number of flexibility arrangements are available, including job-sharing, telecommuting and compressed work schedules. Together, managers and employees make flexibility arrangements that work for them and our organisation.

Contributing to diversity in investment management

We continued to make good progress against our Inclusion and Diversity Plan, which provides a framework for how we will achieve an inclusive and diverse culture.

The strategies and initiatives we have put in place include:

- Actively encouraging females within our organisation to apply for senior roles.
- Actively encouraging the executive recruitment agencies we work with to provide balanced shortlists in terms of gender representation, as well as a greater mix of cultural backgrounds.
- Introducing our flexible work arrangement, myTime, which allows our people to manage their time in a way that works for them.
- Improving our technology capability to support flexible work practices.

In line with our business strategy, we are looking for ways to drive greater efficiency and productivity across the business. During the year we made good progress in improving the capabilities of our in-house human resources platform and launched an online career portal for external candidates. The hard work of our team, including Victoria and Nicole, to deliver these key system improvements has increased the efficiency and effectiveness of our recruitment processes.



We are committed to creating a workplace where everyone feels that there is a healthy balance in all they do.

We support our staff to create flexible work arrangements that balance the multiple demands of life and work. James, a Director in our Infrastructure & Timberland team, took 12 months of parental leave and is now working part-time. Sara from our Organisational Development team has recently returned to part-time work following her second parental leave break while working with us. Judi has a job-sharing arrangement in place with her fellow Office Administrator & Facilities Coordinator, which allows both staff members to work part-time and make a collective contribution to the organisation.

We were also pleased to partner in the Future IM/Pact initiative. Future IM/Pact is an industry-led initiative focused on attracting diverse talent into Australia's investment management industry. The initiative, led by Mercer in partnership with a number of Australia's leading institutional investors and fund managers, aims to help Australia's best and brightest problem solvers from diverse backgrounds consider how they can impact the world as an investor.

A diversity statement from our CIO, Dr Raphael Arndt

Our business and investment models rely on diversity of background, experience and thought. Integrating different perspectives from across the organisation into decision-making is critical to our success.

Our 'one team, one purpose' philosophy and our values set the foundation for our approach to inclusion and diversity and we drive this through our people systems, processes and policies.

We understand that inclusion is key to success: Valuing all contributions, challenging ideas respectfully and supporting one another, as needed, allows each person to contribute to their maximum potential.



We made good progress on a range of projects

Recognising the need for strong project and change management capabilities as we grow, we continued to build our project management capability. The focus was expanded to incorporate a formal change management role and oversight of internal communication.

The project management team provides direct management and support to projects and facilitates development of project and change management skills across the Agency. During 2017-18 the project management team managed 12 strategic projects and is set to support 14 in 2018-19.

Our workforce

Our workforce as at 30 June 2018 was 161 staff. There were 28 new positions created in 2017-18: 13 were replacements for existing roles, and 15 were for new roles. There were five internal promotions. In addition we recruited and managed a contingent workforce of up to 50 at any one time, most based in Information Technology.

All staff work from the Melbourne office. We have a small office in Sydney used primarily by two staff who have arrangements in place to regularly work across both locations.

A strong positive culture and high level of engagement is reflected in the three main Human Resource statistics: lost time injuries – nil; absentee rate – 1.8%; and turnover rate – 5.2%.

Formal flexible work arrangements are available to all staff. This includes personal leave arrangements for primary and secondary carers. As at 30 June 2018, 24 employees had flexible work arrangements in place. In addition to these arrangements we have a flexible working policy, myTime, that provides flexibility in how, when or where we work but does not require a formal agreement. During 2017-18, 14 employees accessed myTime arrangements.

No staff have identified as Indigenous.

Work, health and safety

Employee safety and wellbeing continues to be a focus for the organisation.

Our Work Health & Safety Committee operated throughout the year and undertook safety audit reviews of the office space.

We provided appropriate workspaces and equipment and ensured new staff were informed of our ergonomic principles of work space management. First aid and fire warden training was also provided.

A number of wellbeing initiatives including health checks and awareness programs were delivered throughout the year.

We recorded one lost-time injury for the period.

Workforce distribution across the agency at 30 June 2018

Classification Level of Work	Full time		Part time or casual		Male		Female	
	FY 17/18	FY 16/17	FY 17/18	FY 16/17	FY 17/18	FY 16/17	FY 17/18	FY 16/17
FFMA1	8	5	2	2	2	0	8	7
FFMA2	28	23	6	6	11	9	23	20
FFMA3	25	27	5	4	15	16	15	15
FFMA4	28	22	4	3	15	11	17	14
FFMA5	39	35	1	1	27	26	13	10
FFMA6	8	8	1	1	8	8	1	1
FFMA7	6	7	0	0	5	6	1	1
Total	142	127	19	17	83	76	78	68

Workforce distribution by investment/non-investment roles at 30 June 2018

Classification Level of Work	Investment		Non-investment	
	Male	Female	Male	Female
FFMA1	1	0	1	8
FFMA2	6	2	5	21
FFMA3	4	3	11	12
FFMA4	6	6	9	11
FFMA5	14	4	13	9
FFMA6	5	1	3	0
FFMA7	1	0	4	1
Total	37	16	46	62

Head count by business area at 30 June 2018

61	Investment
46	Operations & IT
22	Finance
32	Other

Note: Other includes: CEO's Office, Public Affairs & Strategic Relations, Organisational Development and Legal.

Absenteeism rate (%) in 2017-18

1.6	2015-16
1.8	2016-17
1.8	2017-18

Note: Absenteeism rate is the days lost to unscheduled absence as a percentage of work days in the period.

Turnover rate (%) in 2017-18

12.6	2015-16
6.5	2016-17
5.2	2017-18

Note: Turnover rate includes ongoing and non-ongoing employees and is calculated for average headcount for period.

Remuneration report

Remuneration strategy

Remuneration for all Agency staff, including members of the Agency Management Committee, meets the requirements outlined in the Australian Public Sector Workplace Bargaining Policy (the Bargaining Policy), which was introduced in March 2014, and later revised in October 2015 and 2018 to set the terms and conditions of employment for Australian Public Service entities.

All employees, including SES and non-SES, operate on individual employment contracts.

While Agency remuneration arrangements are determined by the Chair of the Board, as Accountable Authority for the Agency, consultation with the Board is provided through the Board's Remuneration & Nominations Committee.

Performance related pay

In addition to fixed pay, ongoing staff have the opportunity to earn a variable pay component known as Performance Related Pay (PRP), which is based on both personal performance (Individual Plan) and investment performance (Fund Plan).

The mix of variable pay based on personal performance and variable pay based on investment performance depends on the individual's role, with investment performance a higher component of variable pay for investment staff.

All staff have some exposure to investment performance in their variable pay arrangements, which serves to help focus all employees on the pursuit of the mandated investment objectives.

Performance related pay tied to personal performance

Actual variable pay based on personal performance reflects an individual's performance against key performance indicators (goals) and the organisation's values.

Each individual's goals align to the organisation's strategic imperatives, which define what the Agency must to do succeed:

- The best portfolios to achieve our Investment Mandates.
- A well-managed Agency with a talented, motivated and engaged team.
- Efficient, effective and fit-for-purpose processes and technology.
- The trust and respect of Government, Parliament and the investment community.

Performance related pay tied to investment performance

Actual variable pay based on Fund performance reflects the average performance over rolling three-year periods for the Future Fund and is determined once performance results are audited and confirmed.

Performance related pay for investment performance is assessed against the Future Fund's absolute return against its mandated target return over three years.

For the 2017-18 year investment performance was assessed against the CPI + 4% target for that year and the CPI + 4.5% target for the preceding two years.

Previously, investment performance was assessed against both the absolute return and performance relative to a policy portfolio implied by the Board's asset allocation. The Board's removal of the relative component simplifies the measure and strengthens the alignment to the pursuit of the Fund's mission of generation strong long-term real returns.

Remuneration of Key Management Personnel in 2017-18

Key management personnel (KMP) are those who have authority and responsibility for planning, directing and controlling the activities of the Board and Agency directly and indirectly throughout the year. This represents members of the Board and members of the Agency's Management Committee.

The Board of Guardians and the Agency are established by the *Future Fund Act 2006* (the Act). In accordance with the Act members of the Board are appointed by the responsible Ministers.

The Act prescribes that fees payable to Board members are determined by the Commonwealth Remuneration Tribunal (the Tribunal).

The Tribunals' Determination 2017, taking effect from 1 July 2017, set the annual fee payable to the Chair at \$206,330 and the fee for other members at \$103,170.

The official travel entitlement for Board members was set at Tier 1. Board members are not eligible for performance related payments.

During the 2017-18 year, the Guardians of the Fund were as follows:

Future Fund Board of Guardians

Name	Title	KMP status 2017-18
Hon Peter Costello AC	Chairman	Current
Ms Erin Flaherty	Board member	Current
Ms Carolyn Kay	Board member	Current
Mr John Poynton AO	Board member	Current
Mr Rob Priestley	Board member	7 November 2017 to 19 June 2018
Mr Michael Wachtel	Board member	Current
Dr Jane Wilson	Board member	Current

During the 2017-18 year, the Agency's Management Committee comprised the following:

Future Fund Management Agency

Name	Title
Mr David Neal	Chief Executive Officer
Dr Raphael Arndt	Chief Investment Officer ¹
Mr Stephen Gilmore	Chief Investment Strategist ²
Mr Paul Mann	Chief Financial Officer
Mr Gordon McKellar	Chief Operating Officer
Ms Elizabeth McPherson	Chief Culture Officer ¹
Mr Cameron Price	General Counsel and Chief Risk Officer ¹

Notes:

1. The remuneration packages of Raphael Arndt, Elizabeth McPherson and Cameron Price were adjusted in March as part of the organisational re-structure to reflect significant changes in their responsibilities. As a result, no adjustments were made to their remuneration packages as part of the end of year review.
2. Stephen Gilmore left the organisation on 30 April 2018 as a result of the organisational re-structure.

Remuneration mix for key management personnel

As is the case for all staff, remuneration for members of the Management Committee includes both fixed and at risk performance related pay. At risk performance related pay includes elements tied to investment performance (Fund Plan) and personal performance (Individual Plan).

Executives with greater influence over the investment portfolio have a larger proportion of their available at risk performance related pay linked to investment performance. Those in non-investment focused roles have at risk performance related pay more closely tied to the delivery of personal objectives that support the implementation of the business strategy.

The following table summarises the composition of at risk performance related pay for each member of the Management Committee.

At risk performance related pay for each member of the Management Committee

Name	Maximum at risk performance related pay as a % of fixed remuneration	% of at risk performance related pay tied to investment performance (Fund Plan)	% of at risk performance related pay tied to personal performance (Individual Plan)
David Neal	120%	70%	30%
Raphael Arndt	120%	70%	30%
Stephen Gilmore	120%	70%	30%
Paul Mann	55%	25%	75%
Gordon McKellar	55%	25%	75%
Elizabeth McPherson	52%	25%	75%
Cameron Price	45%	25%	75%

Remuneration outcomes for key management personnel in 2017-18

Remuneration outcomes for members of the Board are set by the Determination of the Remuneration Tribunal.

Remuneration outcomes for members of the Management Committee reflect the combination of fixed pay and performance related pay as outlined above.

The use of rolling three-year periods for the calculation of absolute investment performance aligns to the organisation's long-term investment objective.

At 30 June 2018, over three years the Future Fund earned \$28.7 billion, returning 7.6% per annum against a target benchmark return of 6.0% per annum.

Performance related pay outcomes

Name	Actual PRP/max Fund Plan (%)	Actual PRP/max Individual Plan (%)	Actual PRP/max total PRP (%)
David Neal	78	80	78
Raphael Arndt	78	80	78
Stephen Gilmore ¹	78	85	80
Paul Mann	78	75	76
Gordon McKellar	78	85	83
Elizabeth McPherson ²	78	85	83
Cameron Price	78	80	79

Notes:

1. Stephen Gilmore left the organisation on 30 April 2018 as a result of the organisational re-structure.
2. Elizabeth McPherson's maximum at risk performance related pay percentage changed on 08/03/18 from 55% to 45% as part of an overall remuneration package adjustment between fixed and variable remuneration due to increased role responsibilities.

Actual Investment Plan outcomes reflect the combination of the absolute return of the Future Fund against its policy portfolio each over three years.

Actual Individual Plan outcomes reflect the achievement of personal goals (KPIs) by each member of the Management Committee over the 2017-18 year.

Management Committee remuneration outcomes

Name	Salary	Super- annuation	PRP (Fund Plan)	PRP (Individual Plan)	Total PRP (Fund & Individual Plan)	Termi- nation benefits	Total remun- eration
David Neal	630,792	24,999	427,471	188,868	616,339		1,272,130
Raphael Arndt	599,959	20,059	404,153	178,565	582,718		1,202,736
Stephen Gilmore ¹	442,348	20,961	302,003	141,773	443,776	461,595	1,368,680
Paul Mann	498,693	32,500	56,678	164,338	221,016		752,209
Gordon McKellar	514,631	32,500	58,379	191,838	250,217		797,348
Elizabeth McPherson ²	429,743	32,500	46,236	151,935	198,171		660,414
Cameron Price	508,059	32,500	47,191	145,951	193,142		733,701
Total	3,624,225	196,019	1,342,111	1,163,268	2,505,379	461,595	6,787,218

Notes:

1. Stephen Gilmore left the organisation on 30 April 2018 as a result of the organisational re-structure.
2. Elizabeth McPherson's maximum at risk performance related pay percentage changed on 08/03/18 from 55% to 45% as part of an overall remuneration package adjustment between fixed and variable remuneration due to increased role responsibilities.

Remuneration of all staff in 2017-18

While the Agency operates on individual employment contracts rather than an enterprise agreement, the Agency adjusts its practices to meet the requirements of the Bargaining Policy and associated Directions for fixed pay (which includes superannuation). The Bargaining Policy and Directives apply for three years: 2017-18, 2018-19 and 2019-20.

In addition to fixed pay, ongoing staff have the opportunity to earn a variable pay component known as Performance Related Pay (PRP). Non-salary benefits are also available to staff, reflecting our commitment to ensuring our people have every opportunity to balance their work and life. We support and encourage flexible working arrangements to cater for family, study, community and similar commitments. Other non-salary benefits include annual flu vaccinations, skin and health checks, ergonomic assessments and furniture, contributions to relevant professional memberships and salary sacrifice arrangements.

Level of Work	From	To
FFMA 1	\$55,000	\$100,000
FFMA 2	\$80,000	\$140,000
FFMA 3	\$110,000	\$190,000
FFMA 4	\$145,000	\$255,000
FFMA 5	\$195,000	\$470,000
FFMA 6	\$315,000	\$560,000
FFMA 7	\$385,000	\$700,000

Note:

Actual salaries fall within the available ranges shown above. Salaries are inclusive of superannuation. Where a staff member sits in a range is influenced by market data. How and when a staff member moves through a range is influenced by market data, organisational and personal performance.

Performance Related Pay

As highlighted earlier, in addition to fixed pay, ongoing staff have the opportunity to earn a variable pay component known as Performance Related Pay (PRP), which is based on both individual performance and fund performance.

The mix of variable pay based on individual performance and variable pay based on fund performance depends on the individual's role, with fund performance generally a higher component of variable pay for investment staff.

At 30 June 2018, over three years the Future Fund earned \$28.7 billion, returning 7.6% per annum against a target benchmark return of 6.0% per annum.

The payments detailed in the table below include pro rata performance pay for staff who were not employed for the full 12-month cycle but were eligible for payment. Additional disclosures relating to the remuneration of senior executives are set out in the financial statements.

Performance pay summary for 2017-18

Classification Level of Work	Employees who received payments	Aggregate performance pay (\$)	Minimum performance pay (\$)	Maximum performance pay (\$)	Average payment (\$)
FFMA1	6	31,649	3,977	6,660	5,275
FFMA2	31	298,183	2,871	21,036	9,619
FFMA3	27	597,636	4,294	46,240	22,135
FFMA4	32	1,486,243	5,917	110,801	46,445
FFMA5	40	4,914,366	7,406	343,499	122,859
FFMA6	9	2,775,241	103,883	481,529	308,360
FFMA7	7	2,505,379	193,142	616,339	357,911
Total	152	12,608,697			82,952

FINANCIAL STATEMENTS

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Financial Statements for the financial year ended 30 June 2018

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These financial statements consist of the Future Fund Management Agency and the Board of Guardians.



Auditor-General for Australia

**INDEPENDENT AUDITOR'S REPORT****To the Minister for Finance and the Public Service****Opinion**

In my opinion, the financial statements of the Future Fund Management Agency and Board of Guardians for the year ended 30 June 2018:

- (a) comply with Australian Accounting Standards and the *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015*; and
- (b) present fairly the financial position of the Future Fund Management Agency and Board of Guardians as at 30 June 2018 and its financial performance and cash flows for the year then ended.

The financial statements of the Future Fund Management Agency and Board of Guardians, which I have audited, comprise the following statements as at 30 June 2018 and for the year then ended:

- Statement by the Chair of the Future Fund Board of Guardians and Chief Financial Officer of the Future Fund Management Agency;
- Statement of comprehensive income;
- Statement of financial position;
- Statement of cash flows;
- Statement of changes in equity;
- Schedule of commitments; and
- Notes to the financial statements, comprising a Summary of significant accounting policies and other explanatory information.

Basis for Opinion

I conducted my audit in accordance with the Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing Standards. My responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of my report. I am independent of the Future Fund Management Agency and Board of Guardians in accordance with the relevant ethical requirements for financial statement audits conducted by me. These include the relevant independence requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* (the Code) to the extent that they are not in conflict with the *Auditor-General Act 1997*. I have also fulfilled my other responsibilities in accordance with the Code. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Key Audit Matters

Key audit matters are those matters that, in my professional judgement, were of most significance in my audit of the financial statements of the current period. These matters were addressed in the context of my audit of the financial statements as a whole, and in forming my opinion thereon, and I do not provide a separate opinion on these matters.

Key audit matter	How the audit addressed the matter
Valuation of collective investment vehicles held at fair value through profit or loss <i>Refer to Note 17G Fair Value Hierarchy (Collective Investment Vehicles)</i> As at 30 June 2018, collective investment vehicles (as defined in note 17G) totalled	To assess the controls over the valuation of all collective investment vehicles I: • inspected the custodian's independent auditor's assurance report in respect of the relevant controls over the valuation of investments at the custodian;

\$67.9 billion.

Collective investment vehicles includes holdings of a diverse range of asset categories including debt, private equity, hedge funds, and direct property, infrastructure and timberland assets. Valuation techniques are varied depending on the particular asset category and holding.

All investments are held in custody by the Future Fund Management Agency and Board of Guardians' appointed custodian.

I consider the valuation of collective investment vehicles to be a key audit matter due to the size of the investments, and the inherent subjectivity and significant judgements and estimates required where market data is not available to determine the fair value of these investments.

In addition, the Australian Accounting Standards include detailed presentation and disclosure requirements.

- assessed the competence and experience of the custodian's independent auditor; and
- tested a sample of the controls in place at the Future Fund Management Agency and Board of Guardians to validate and challenge the valuation of collective investment vehicles.

With the assistance of a valuation specialist I assessed, on a sample basis, the valuation of indirectly held single infrastructure and timberland investments as at 30 June 2018. To do so I:

- evaluated the competence and objectivity of the valuation expert used by management;
- tested the valuation models used including the reasonableness of key assumptions regarding growth rates, discount rates and multiples applied to earnings within the models; and
- performed a cross-check between management's valuation and the valuation applied by comparable companies, including the underlying assumptions.

To assess the valuation of all other collective investment vehicles as at 30 June 2018, on a sample basis, I:

- agreed the fair value to capital account statements received from the underlying investment manager;
- obtained audited financial statements as at 30 June 2018, where available, and agreed the audited net asset value to the capital account statements;
- where 30 June 2018 audited financial statements were unavailable, performed roll forward procedures from the most recent set of audited financial statements; and
- performed an assessment of the audited financial statements of the collective investment vehicle which included considering the regulatory framework under which the financial statements were prepared, the accounting policies adopted and evaluating the competence and objectivity of the audit firm performing the audit and the opinion provided.

I assessed the appropriateness of the related disclosures in Note 17G to the financial statements.

Other Information

The Accountable Authority is responsible for the other information. The other information comprises the information included in the annual report for the year ended 30 June 2018 but does not include the financial statements and my auditor's report thereon.

My opinion on the financial statements does not cover the other information and accordingly I do not express any form of assurance conclusion thereon.

In connection with my audit of the financial statements, my responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

Accountable Authority's Responsibility for the Financial Statements

As the Accountable Authority of the Future Fund Management Agency and Board of Guardians the Chair of the Future Fund Board of Guardians is responsible under the *Public Governance, Performance and Accountability Act 2013* for the preparation and fair presentation of annual financial statements that comply with Australian Accounting Standards and the rules made under that Act. The Chair of the Future Fund Board of Guardians is also responsible for such internal control as the Chair of the Future Fund Board of Guardians determines is necessary to enable the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Chair of the Future Fund Board of Guardians is responsible for assessing the Future Fund Management Agency and Board of Guardians' ability to continue as a going concern, taking into account whether the entity's operations will cease as a result of an administrative restructure or for any other reason. The Chair of the Future Fund Board of Guardians is also responsible for disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the assessment indicates that it is not appropriate.

Auditor's Responsibilities for the Audit of the Financial Statements

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian National Audit Office Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with the Australian National Audit Office Auditing Standards, I exercise professional judgement and maintain professional scepticism throughout the audit. I also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- obtain an understanding of internal control relevant to the audit 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;
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Accountable Authority;
- conclude on the appropriateness of the Accountable Authority's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the entity to cease to continue as a going concern; and
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters, the planned scope

and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

From the matters communicated with those charged with governance, I determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. I describe these matters in my auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, I determine that a matter should not be communicated in my report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Australian National Audit Office



Grant Hehir
Auditor-General for Australia
Canberra
25 September 2018

Statement by the Chair of the Future Fund Board of Guardians and Chief Financial Officer of the Future Fund Management Agency

In our opinion, the attached financial statements of the Future Fund Management Agency and the Board of Guardians (together the 'Fund') for the year ended 30 June 2018 comply with subsection 42(2) of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act), and are based on properly maintained financial records as per subsection 41(2) of the PGPA Act.

In our opinion, at the date of this statement, there are reasonable grounds to believe that the Fund will be able to pay its debts as and when they fall due.

In preparing the financial statements, the Fund has applied an exemption from sections 6, 8 and 9 of the Financial Reporting Rules which has been provided by the Minister for Finance allowing the Fund to present a financial report in a format that complies with the 'investment entity' requirements under Australian Accounting Standards. The effect of this exemption is that the Fund will present its financial report as a single entity.



Hon P Costello AC

Chair of the Board of Guardians

25 September 2018



P Mann

Chief Financial Officer

25 September 2018

Statement of comprehensive income

for the financial year ended 30 June 2018

	Notes	Year ended 30 June 2018 \$'000	Year ended 30 June 2017 \$'000
INCOME			
Dividends and imputation credits	3	4,012,071	3,484,707
Distributions	3	683,172	404,659
Interest income from financial assets not held at fair value through profit or loss		28,740	27,080
Net gains on financial instruments held at fair value through profit or loss	3	9,137,078	5,434,614
Net foreign currency (losses)/gains	3	(1,210,415)	1,706,132
Other income		3,548	2,478
TOTAL INCOME		12,654,194	11,059,670
EXPENSES			
Investment management fees and advisory fees		106,713	133,163
Investment manager performance fees		3,229	57,634
Custody fees		15,135	13,417
Brokerage, duties and other statutory charges		31,557	35,247
Other investment portfolio expenses		5,334	4,997
Agency employees' remuneration	4	50,722	43,352
Other expenses	4,5	34,459	25,867
TOTAL EXPENSES		247,149	313,677
OPERATING RESULT FOR THE YEAR BEFORE TAX		12,407,045	10,745,993
Income tax expense	6	72,091	69,427
OPERATING RESULT FOR THE YEAR		12,334,954	10,676,566
Other comprehensive income for the year		-	-
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		12,334,954	10,676,566

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

Statement of financial position

as at 30 June 2018

	Notes	As at 30 June 2018 \$'000	As at 30 June 2017 \$'000
ASSETS			
Financial assets			
Cash and cash equivalents	14	2,418,038	1,785,174
Receivables	8	1,715,788	1,937,417
Investments	7	144,199,434	131,266,198
Other financial assets		1,811	444
Total financial assets		148,335,071	134,989,233
Non-financial assets			
Plant and equipment	9	4,774	4,032
Intangibles	9	3,474	3,820
Total non-financial assets		8,248	7,852
TOTAL ASSETS		148,343,319	134,997,085
LIABILITIES			
Financial liabilities			
Investments	7	1,560,417	753,216
Payables	10	988,072	806,765
Total financial liabilities		2,548,489	1,559,981
Non-financial liabilities			
Employee provisions	11	28,960	24,888
Total non-financial liabilities		28,960	24,888
Tax liabilities			
Deferred tax liabilities		18,700	-
Total tax liabilities		18,700	-
TOTAL LIABILITIES		2,596,149	1,584,869
NET ASSETS		145,747,170	133,412,216
EQUITY AND AMOUNT ATTRIBUTABLE TO THE GOVERNMENT			
Contributions by Government	12	60,536,831	60,536,831
Retained earnings		85,210,339	72,875,385
TOTAL EQUITY AND AMOUNT ATTRIBUTABLE TO THE GOVERNMENT		145,747,170	133,412,216

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

Statement of cash flows

for the financial year ended 30 June 2018

	Notes	Year ended 30 June 2018 \$'000	Year ended 30 June 2017 \$'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Proceeds from sale of financial instruments held at fair value through profit or loss		130,781,920	125,473,622
Purchase of financial instruments held at fair value through profit or loss		(134,172,418)	(132,395,951)
Interest received		27,839	27,091
Dividends received		3,099,768	2,711,456
Distributions received		626,425	394,722
Franking credit refunds received		835,678	628,463
Net settlement of foreign exchange contracts		(244,199)	2,450,313
GST refund received		5,052	11,093
Other income received		3,206	3,040
Investment management fees and advisory fees paid		(114,630)	(142,047)
Investment manager performance fees paid		(32,671)	(17,332)
Custody fees paid		(13,795)	(12,927)
Brokerage, duties and other statutory charges paid		(70,374)	(57,042)
Taxes paid		(53,391)	(69,427)
Other expenses paid		(88,564)	(79,461)
Net cash provided by/(used in) operating activities	14	589,846	(1,074,387)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of plant and equipment and software		(3,072)	(4,538)
Net cash used in investing activities		(3,072)	(4,538)
Net increase/(decrease) in cash held		586,774	(1,078,925)
Cash at the beginning of the reporting period		1,785,174	2,870,526
Effects of exchange rate changes on the balance of cash held in foreign currencies		46,090	(6,427)
Cash at the end of the reporting period	14	2,418,038	1,785,174

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

Statement of changes in equity

for the financial year ended 30 June 2018

	Year ended 30 June 2018		
	Contributed equity	Retained earnings	Total Equity
	\$'000	\$'000	\$'000
Opening balance	60,536,831	72,875,385	133,412,216
Net operating result	-	12,334,954	12,334,954
Other comprehensive income	-	-	-
Total comprehensive income	-	12,334,954	12,334,954
Contributions made by Government	-	-	-
Closing balance	60,536,831	85,210,339	145,747,170

	Year ended 30 June 2017		
	Contributed equity	Retained earnings	Total Equity
	\$'000	\$'000	\$'000
Opening balance	60,536,831	62,198,819	122,735,650
Net operating result	-	10,676,566	10,676,566
Other comprehensive income	-	-	-
Total comprehensive income	-	10,676,566	10,676,566
Contributions made by Government	-	-	-
Closing balance	60,536,831	72,875,385	133,412,216

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

Schedule of commitments

as at 30 June 2018

	Notes	30 June 2018 \$'000	30 June 2017 \$'000
BY TYPE			
CAPITAL COMMITMENTS			
Collective investment vehicles	7	19,418,150	16,045,761
Corporate Credit (bank loans)		52	941
Total capital commitments		19,418,202	16,046,702
OTHER COMMITMENTS			
Operating leases ^(a)		14,413	17,767
Other commitments ^(b)		11,343	8,298
Total other commitments		25,756	26,065
BY MATURITY			
CAPITAL COMMITMENTS			
One year or less		19,418,202	16,046,702
Total capital commitments by maturity		19,418,202	16,046,702
OTHER COMMITMENTS			
Operating lease commitments			
One year or less		3,527	3,388
From two to five years		10,886	14,258
Five years and above		-	121
Total operating lease commitments by maturity		14,413	17,767
Other commitments			
One year or less		9,124	7,802
From two to five years		2,219	496
Total other commitments by maturity		11,343	8,298

Note: Commitments are GST inclusive.

(a) Operating lease commitments relate to rental commitments for the lease of property. Lease terms have 4 years remaining. The Fund has no option to purchase any leased items at the conclusion of the lease term.

(b) Other commitments relate to contractual obligations for the provision of internal audit services, payroll services and Board and Agency consultancies.

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

Notes to and forming part of the financial statements

for the financial year ended 30 June 2018

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Note 1: Objectives of the Future Fund and the responsibilities of the Agency and the Board

The *Future Fund Act 2006* (as amended) (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 Fund). The objective of the Act is to strengthen the Commonwealth's long-term financial position.

The Future Fund will be available to cover costs that will be payable by the Commonwealth in relation to 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.

Future Fund Management 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 *Public Governance, Performance and Accountability Act 2013* (the PGPA Act). The Agency is responsible for implementing the investment decisions made by the Board.

The Agency is 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, advisers and other service providers.

The Agency also supports the Board in the investment of the assets of the Building Australia Fund and the Education Investment Fund (together the Nation-building Funds), the DisabilityCare Australia Fund and the Medical Research Future Fund.

Future Fund Board of Guardians

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

The roles and responsibilities of the Board are set out in the Act. 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 and implementation of an investment strategy that adheres to the Investment Mandate.

The Board is also responsible for the investment of the assets of the Nation-building Funds, DisabilityCare Australia Fund and Medical Research Future Fund as set out in the *Nation-building Funds Act 2008*, the *DisabilityCare Australia Fund Act 2013* and the *Medical Research Future Fund Act 2015*. The assets and financial results of these funds do not form part of these financial statements.

Future Fund Investment Mandate Direction 2017

In line with subsection 18(1) of the Act, the Government issued the Board with a revised Investment Mandate for the Future Fund on 15 May 2017 which came into effect on 1 July 2017.

The objective of these directions is to give guidance to the Board in relation to its investment strategy for the Fund. The Board 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 Fund will be confined to financial assets, (see also Note 2.3). 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. The target benchmark return for the 2017-18 financial year was CPI +4 to 5 per cent per annum over the long term.

Note 2:

Summary of significant accounting policies

2.1 Basis of preparation of the financial statements

These financial statements comprise the Agency and the Board, collectively referred to as the Future Fund (the Fund), prepared in accordance with Section 80 of the Act.

The financial statements are required by section 42 of the PGPA Act, and are general purpose financial statements prepared on a going concern basis.

The financial statements have been prepared in accordance with:

- Financial Reporting Rules (FRR) (being the *Public Governance, Performance and Accountability Rule 2015*) for reporting periods ending on or after 1 July 2017; and
- Australian Accounting Standards and Interpretations issued by the Australian Accounting Standards Board (AASB) that apply for the reporting period.

In preparing the financial statements, the Fund has applied an exemption from sections 6, 8 and 9 of the Financial Reporting Rules which has been provided by the Minister for Finance allowing the Fund to present a financial report in a format that complies with the investment entity requirements under Australian Accounting Standards. 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 account and the revaluation of employee entitlements. Cost is based on the fair values of the consideration given in exchange for assets or the fair value of consideration or services received in exchange for the creation of a liability.

The statement of financial position is presented on a liquidity basis as is common practice within the investment industry. Assets and liabilities are presented in decreasing order of liquidity and with no distinction between current and non-current. All balances are expected to be recovered or settled within 12 months except for:

- Investments in financial assets and liabilities. These investments are held for the longer term consistent with the Fund's investment mandate;
- plant and equipment which are depreciated over their useful lives; and
- certain employee liabilities such as leave entitlements.

Unless alternative treatment is specifically required by an accounting standard, assets and liabilities are recognised in the statement of financial position when and only when it is probable that future economic benefits or losses will flow and the amounts of the assets or liabilities can be reliably measured.

Commitments, which are not liabilities or assets under Australian Accounting Standards are not recognised in the statement of financial position. They are reported as appropriate in the schedule of commitments.

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

Significant Accounting Judgements and Estimates

In relation to collective investment vehicles, significant judgement is required in making assumptions and estimates which are inputs to the fair value of such investments. The Fund ensures that valuation principles applied are materially compliant with industry guidelines. Further details surrounding the judgements and estimates used to value these investments are disclosed in Note 17F and 17G.

Note 2: Summary of significant accounting policies *(continued)*

2.1 Basis of preparation of the financial statements *(continued)*

Consolidation exemption for investment entities

The Fund meets the definition of an “investment entity” under AASB 10 Consolidated Financial Statements and does not consolidate its subsidiaries as listed in Note 13. Instead, those subsidiaries are investments and are measured at fair value through profit or loss. The Fund’s assessment of the investment entity definition is as follows:

An investment entity is defined as an entity that:

- obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
- commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income or both; and
- measures and evaluates the performance of substantially all of its investments on a fair value basis.

Regarding the first and second requirements of the definition, the Fund is a sovereign wealth fund that invests for the benefit of future generations of Australians which is generated through both capital appreciation and investment income. Furthermore, the performance of the investments made through subsidiaries are measured and evaluated on a fair value basis.

2.2 Statement of compliance

The financial report complies with Australian Accounting Standards as applicable to the Future Fund in accordance with the Financial Reporting Rules for the year ended 30 June 2018 made under the *Public Governance, Performance and Accountability Act 2013*.

Australian Accounting Standards require the Fund to disclose Australian Accounting Standards that have not yet been applied by the Fund, for standards that have been issued by the AASB but are not yet effective at the reporting date. The Fund must also disclose new standards and interpretations affecting amounts reported in the current period and those standards adopted with no effect on the financial statements in the current period.

Adoption of new accounting standards in the current reporting period

None of the new standards and amendments to standards that are mandatory for the first time for the financial year beginning 1 July 2017 affected any of the amounts recognised in the current period or any prior period and are not likely to affect future periods.

Standards and amendments that will become effective in future reporting periods

Certain new accounting standards and interpretations have been published that are not mandatory for the 30 June 2018 reporting period and have not been early adopted by the Fund. The Fund’s assessment of the impact of these new standards and interpretations is set out below. The Fund intends to adopt all of the standards upon their application date.

(i) AASB 9 Financial Instruments, and the relevant amending standards (effective from 1 January 2018)

AASB 9 *Financial Instruments* addresses the classification, measurement and derecognition of financial assets and financial liabilities. The Fund does not expect this to have a significant impact on the recognition and measurement of the Fund’s financial instruments as they are currently carried at fair value through profit or loss.

Note 2:**Summary of significant accounting policies (*continued*)**

2.2 Statement of compliance (*continued*)*(ii) AASB 16 Leases (effective from 1 January 2019)*

The purpose of this standard is to provide a comprehensive model for the identification of lease arrangements and their treatment in the financial statements of both lessees and lessors. Lessees will be required to recognise all leases on balance sheet, except for short-term leases and leases of low value assets. The Fund does not expect this to have a material impact on the operating result of the Fund.

There are no other standards that are not yet effective and that are expected to have a material impact on the Fund in the current or future reporting periods and on foreseeable future transactions.

2.3 Financial assets and liabilities

All investments of the Fund are in financial assets or financial liabilities for the purposes of the Government Finance Statistics system in Australia as is required under section 16 of the Act. Should the Fund acquire non-financial assets, section 32 of the Act requires the Board to realise such assets as soon as practicable.

Further details on how the fair values of financial instruments are determined are disclosed in Notes 17F and 17G.

2.3.1 Cash and cash equivalents

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

Cash does not include any amounts held in escrow accounts or margin accounts where its use is restricted. These are treated as investments.

2.3.2 Receivables

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.

2.3.3 Investments

All investments are designated as financial assets held at fair value through profit and loss on acquisition. Subsequent to initial recognition, all investments held at fair value through profit and loss are measured at fair value with changes in their fair value recognised in the statement of comprehensive income each reporting date.

Investments are recognised and derecognised on trade date where purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned. Investments are initially measured at fair value, net of transaction costs that are directly attributable to acquisition or issue of the investment.

Investments in collective investment vehicles are recorded at fair value on the date which consideration is provided to the contractual counterparty under the terms of the relevant subscription agreement. Any associated due diligence costs in relation to these investments are expensed when incurred.

Note 2:

Summary of significant accounting policies (*continued*)

2.3.3 Investments (*continued*)

The following methods are adopted by the Fund in determining the fair value of investments:

- Listed securities, exchange traded futures and options, and investments in listed managed investment schemes are recorded at the quoted market prices on relevant stock exchanges.
- Unlisted managed investment schemes and collective investment vehicles are re-measured by the Fund based on the estimated fair value of the net assets of each scheme or vehicle at the reporting date. Collective investment vehicles are entities that enable investors to pool their money and invest the pooled funds, rather than buying securities directly. Collective investment vehicles are used to invest in private equity funds, hedge funds, debt funds, listed equity funds, infrastructure funds and property funds and are usually structured as interests in limited partnerships and limited liability companies. In determining the fair value of the net assets of unlisted managed investment schemes and collective investment vehicles, reference is made to the underlying unit price provided by the Manager (where available), associated Manager or independent expert valuation reports and capital account statements and the most recent audited financial statements of each scheme or vehicle. Manager valuation reports are reviewed to ensure the underlying valuation principles are materially compliant with Australian Accounting Standards and applicable industry standards including International Private Equity and Venture Capital Valuation Guidelines as endorsed by the Australian Private Equity and Venture Capital Association Limited (AVCAL).
- Derivative instruments are used by the Fund in accordance with the Act to manage its exposure to foreign exchange risk, interest rate risk, equity market risk and credit risk and to gain indirect exposure to market risks. The Fund uses forward foreign exchange contracts, swaps, swaptions, futures and over the counter options which are recorded at their fair value on the date the contract is entered into and are subsequently re-measured to their fair values at each reporting date. Further disclosure regarding the use of derivatives by the Fund is presented in Note 17.
- Asset backed securities, bank bills, negotiable certificates of deposit and corporate debt securities which are traded in active markets are valued at the quoted market prices. Securities for which no active market is observable are valued at current market rates using broker sourced market quotations and/or independent pricing services as at the reporting date.

The fair value of financial assets and financial liabilities that are not traded in an active market are determined using valuation techniques. The Fund uses a variety of methods and makes assumptions that are based on market conditions existing at each reporting date. Valuation techniques used include the use of comparable recent arm's-length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants making the maximum use of observable market inputs and relying as little as possible on entity-specific inputs. Note 17F has further information surrounding the determination of fair values for investments.

Note 2: Summary of significant accounting policies (continued)

2.3.4 Future Fund Investment Companies

Some of the investments of the Future Fund Board of Guardians are held through wholly owned investment holding companies, Future Fund Investment Companies (FFICs).

The FFICs are funded primarily via loan arrangements between the Future Fund Board of Guardians and each respective FFIC. These loans are designated as financial assets and measured at fair value with changes in their fair value recognised in the statement of comprehensive income each reporting date. Interest receivable at the reporting date is included in the fair market value of the loans.

The outstanding balance of the loan assets is unsecured and is repayable in cash on the earlier of demand or within the time period set out in the loan documents. Interest rates are set on the loans having regard to either the 5 or the 10 year government bond rate in the market in which the underlying investment is made.

As the FFICs hold a substantial portion of the investments of the Fund, disclosures in the financial instruments and financial risk management notes (Note 17) include the underlying investments of the FFICs on a look-through basis as this provides users of the financial statements with more relevant information in relation to the investment portfolio. The Note clearly states where this look-through has been applied.

Additional disclosures regarding collective investment vehicles held in the FFICs have been included in Note 7.

2.4 Revenue

Dividends, franking credits and distribution income are recognised when the right to receive payment is established. Dividend income is recognised gross of foreign withholding tax with any related foreign withholding tax recorded as income tax expense.

Imputation credits on investment in equity securities are recognised as income when the right to receive the refund of franking credits from the Australian Taxation Office (ATO) has been established.

Interest revenue is recognised in the statement of comprehensive income for all financial instruments that are not held at fair value through profit or loss using the effective interest method as set out in *AASB 139 Financial Instruments: Recognition and Measurement*. Interest income on assets held at fair value through profit or loss is included in the net gains/(losses) on financial instruments held at fair value through profit or loss in the statement of comprehensive income.

2.5 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.

Other income

Other income is measured at the fair value of consideration received or receivable.

Note 2: Summary of significant accounting policies (continued)

2.6 Transactions with the Government as owner

2.6.1 Credits to the 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 Fund Account. As shown in Note 12 there were no contributions received during the year. No contributions were received in the previous financial year.

2.6.2 Debits to the Fund Account

Amounts may be debited from the Fund Account in accordance with the purposes of the Fund Account as set out in the Act. Under the Act debits can be made to the extent of 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. In May 2017 the Government announced there would be no draw down from the Fund until at least 2026-27.

2.7 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 amount is calculated with regard to the rates expected to be paid on settlement of the liability.

2.7.1 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.

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 2018. Liabilities for short-term employee benefits (i.e. wages and salaries, annual leave, performance payments, 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. The Australian Government Actuary has recommended the application of the shorthand method, as prescribed by the FRRs, for determining the present value of the long service leave liability.

Note 2: Summary of significant accounting policies (continued)

2.7 Employee entitlements (continued)

2.7.2 Superannuation

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

For any staff who are members of CSS (Defined Benefit) or PSS (Defined Benefit), the Fund makes employer contributions to the Australian Government at rates determined by the Government actuary. 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-employer plans within the meaning of AASB 119, all contributions are recognised 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 payroll run of the financial year.

2.7.3 Performance Related Payments

All permanently employed staff at the Agency at the reporting date are eligible to receive an entitlement to a performance related payment as approved by the Board. Employees who receive an entitlement may elect to have the entitlement converted to cash and paid to them. Alternatively, they may defer part or all of the payment for an initial two year period and receive a commitment from the Agency to pay them a future amount which will be dependent on the performance of the Fund over this two year period.

A liability has been recognised at the end of the financial year for outstanding performance related payments payable in relation to previous and current financial years. For employees who have elected to receive part or all of the entitlement as cash, the cash component of the entitlement is recognised as a liability at its nominal value. For employees who have elected to defer part or all of their entitlement, the deferred portion of their entitlement is measured at the present value of the expected future entitlement at the conclusion of the initial two year deferral period. For the purpose of this calculation the Fund has assumed that the portfolio will return the minimum mandated return in making the estimate of the future value of the entitlement. This future value has then been discounted at an appropriate Australian Government bond rate to arrive at the present value of the liability. Actual returns are used to determine the present value of the entitlement for participation years where actual results are available.

2.8 Leases

The Fund enters into operating leases only. Operating lease payments are charged to the statement of comprehensive income on a basis which is representative of the pattern of benefits derived from the leased assets.

2.9 Financial Risk Management

Disclosures regarding the Fund's financial risks are presented in Note 17.

Note 2:

Summary of significant accounting policies (*continued*)

2.10 Taxation

The Fund has sovereign immunity from taxation in Australia and foreign jurisdictions. In some limited cases and in some limited countries, foreign taxes can be payable on certain classes of income and capital gains. Mostly these foreign taxes are withheld at source (income net of taxes is received by the Fund) under the withholding regimes of the relevant jurisdiction. These withholding taxes are generally a final tax and no further amounts are payable. To the extent the Fund is entitled to a lower withholding amount than that deducted at source, the Fund makes a claim to the respective foreign revenue authority for the difference and these amounts are recorded as receivables on the statement of financial position and in the statement of comprehensive income as revenue.

Current Tax

Current tax is calculated by reference to the amount of income taxes payable or recoverable in respect of the taxable profit or tax loss for the period. It is calculated using tax rates and tax laws that have been enacted or substantively enacted by reporting date. As the fund is tax exempt in Australia, there is no current Australian tax amount recognised in the financial statements.

The Fund does incur foreign withholding taxes and capital gains taxes in some jurisdictions which are recorded as current taxes.

While foreign corporate taxes are incurred on certain foreign investments of the Fund held via holding entities or within collective investment vehicles, the Fund applies the investment entity exemption and does not consolidate these investments. Those tax expenses are therefore not recorded in the financial statements. Corporate tax paid or payable on foreign investments results in a lower mark to market fair valuation of these investments and is included in the net gain or loss on financial instruments held at fair value in the statement of comprehensive income.

Deferred Tax

Deferred tax is accounted for using the balance sheet liability method. Temporary differences are differences between the tax base of an asset or liability and its carrying amount in the statement of financial position. The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.

Deferred tax liabilities are recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that sufficient taxable amounts will be available against which deductible temporary differences or unused tax losses can be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period(s) when the asset and liability giving rise to them are realised or settled. Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities, when they relate to income taxes levied by the same taxation authority and the Fund intends to settle its current tax assets and liabilities on a net basis.

While foreign deferred corporate taxes are recognised on certain foreign investments of the Fund as per above, as the Fund applies the investment entity exemption and does not consolidate these investments, those deferred tax expenses are not recorded in the financial statements. Deferred taxes on foreign investments result in an adjusted mark to market fair valuation of these investments and are included in the net gain or loss on financial instruments held at fair value in the statement of comprehensive income.

Note 2:

Summary of significant accounting policies (*continued*)

2.10 Taxation (*continued*)

Fringe Benefits Tax and Goods and Services Tax

The Fund is exempt from all forms of federal Australian taxation except for Fringe Benefits Tax (FBT) and the Goods and Services Tax (GST). The Future Fund Investment Companies (FFICs), being wholly owned Australian corporate investment holding companies are taxpaying entities. The tax paid by the FFICs is recoverable via imputation credit refunds to which the Fund is entitled under the Act.

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).

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables.

2.11 Foreign currency

(i) Functional and presentation currency

Items included in the financial statements of the Fund are measured using the currency of the primary economic environment in which the Fund operates (the functional currency). The functional currency of the Fund is Australian dollars. It is also the presentation currency.

(ii) Transactions and balances

All foreign currency transactions during the period are brought to account using the exchange rate in effect at the date of the transaction. Foreign currency items at reporting date are translated at the exchange rate existing at reporting date. Exchange differences are recognised in the statement of comprehensive income in the period in which they arise. Translation differences on assets and liabilities carried at fair value are reported in the Statement of Comprehensive income on a net basis within net gains/(losses) on financial instruments held at fair value through profit and loss.

2.12 Rounding of amounts

Amounts have been rounded to the nearest thousand dollars unless stated otherwise in accordance with the Financial Reporting Rules.

Note 3:

Dividends, distributions and net gains/(losses)

	2018 \$'000	2017 \$'000
Dividend income and imputation credits		
Dividend income – domestic equities and listed managed investment scheme distributions	379,103	447,915
Imputation credits refunded or refundable under Section 30 of the <i>Future Fund Act 2006</i>	955,762	817,104
Dividend income – related entities (FFICs)*	1,859,693	1,512,626
Dividend income – international equities	817,513	707,062
Total dividend and imputation credit income	4,012,071	3,484,707
Distribution income		
Distributions – collective investment vehicles	683,172	404,659
Total distribution income	683,172	404,659

* There are no dividends receivable from FFIC related entities.

	2018 \$'000	2017 \$'000
Net gains/(losses) on financial instruments held at fair value through profit or loss		
Net gains on financial assets held at fair value through profit or loss	9,632,252	5,439,762
Net losses on financial liabilities held at fair value through profit or loss	(495,174)	(5,148)
Total net gains on financial instruments held at fair value through profit or loss*	9,137,078	5,434,614
Net (losses)/gains arising on foreign currency#	(1,210,415)	1,706,132

* This total includes the foreign currency impact from translating financial assets and liabilities from their local currency amounts into Australian dollars.

Net foreign currency losses of \$1,210,415,000 (2017: gains of \$1,706,132,000) arise mainly as a result of the implementation of the Board's foreign currency hedging policy. Offsetting gains/losses on investment values are included in the total net gain on financial instruments held at fair value through profit and loss of \$9,137,078,000 (2017: \$5,434,614,000).

Note 4: Expenses

	2018 \$'000	2017 \$'000
Agency employees' remuneration		
Wages and salaries	46,987	39,834
Superannuation	2,673	2,414
Leave and other entitlements payable	1,062	1,104
Total Agency employees' remuneration	50,722	43,352
Other expenses		
Board remuneration		
Wages and salaries	784	785
Superannuation	81	81
Total board remuneration	865	866
Depreciation & amortisation		
Depreciation of plant and equipment	1,391	1,172
Amortisation of intangibles – computer software	1,277	1,169
Total depreciation & amortisation	2,668	2,341
Other operating expenses (including audit fees)	30,926	22,660
Total other expenses	34,459	25,867

Note 5: Remuneration of Auditors⁽¹⁾

Included in other operating expenses is the financial statement audit services provided to the Fund which totaled \$145,000 (2017: \$156,000) were provided by the Australian National Audit Office (ANAO) at no cost to the Fund. The fair value of all audit services provided by the ANAO, including the services provided free of charge and for the audits of the FFICs was:

	2018	2017
	\$	\$
Auditing the financial statements – Future Fund and FFICs	205,000	216,889

No other services were provided by the ANAO.

(1) The Fund's auditor is the Australian National Audit Office who has contracted Ernst & Young (2017: Deloitte Touche Tohmatsu (Australia)) to assist with the assignment.

Note 6: Income tax expense

As per Note 2.10, the Fund is exempt from federal Australian income taxation. Tax expense reflects foreign withholding tax on income and other capital gains or corporate taxes where imposed by certain countries. Accordingly, the Australian tax rate for the Fund is 0% (2017: 0%).

	2018	2017
	\$'000	\$'000
(a) Income tax expense		
Current tax	53,391	69,427
Deferred tax	18,700	-
Adjustments for current tax of prior periods	-	-
	72,091	69,427
(b) Numerical reconciliation of income tax expense to prima facie tax payable		
Profit before income tax	12,407,045	10,745,993
Tax at the applicable Australian tax rate of 0% (2017: 0%)	-	-
Tax effect of items which are not deductible/(taxable) in calculating taxable income:		
Imputation credits earned from Australian subsidiaries	1,286,343	1,343,007
Difference in tax rates on Australian subsidiaries	(1,286,343)	(1,343,007)
Withholding tax	50,954	64,722
Other foreign corporate tax expense	21,137	4,705
Total income tax expense	72,091	69,427

Note 7: Investments

	2018 \$'000	2017 \$'000
Investment Summary		
Financial assets at fair value:		
Future Fund Investment Companies (FFICs)	55,105,566	48,984,840
Interest bearing securities	22,153,056	29,606,631
Listed equities and listed managed investment schemes	44,541,578	34,270,098
Collective investment vehicles	20,689,522	16,262,420
Derivatives	1,086,639	1,556,478
Restricted cash	623,073	585,731
Total financial asset investments	144,199,434	131,266,198
Financial liabilities at fair value:		
Derivatives	(1,560,417)	(753,216)
Total financial liability investments	(1,560,417)	(753,216)

The tables below provide more detailed information of the investments held at balance date.

	2018 \$'000	2017 \$'000
Future Fund Investment Companies (FFICs)		
At fair value:		
Loans provided to FFICs	42,954,427	39,865,117
Residual equity in FFICs	12,151,139	9,119,723
Total Future Fund Investment Companies[#]	55,105,566	48,984,840

[#] Refer to note 2.3.4 for more information regarding the FFICs and loan arrangements.

Note 7: Investments *(continued)*

The table below shows the reconciliation of loans provided to FFICs.

	2018 \$'000	2017 \$'000
Loans provided to FFICs		
Beginning of the year	39,865,117	40,465,708
Loans advanced	10,603,108	11,584,979
Loan repayments received	(7,685,305)	(9,279,912)
Interest charged*	1,000,496	900,695
Interest repayments received	(671,803)	(1,082,270)
Fair value loss	(157,186)	(2,724,083)
End of year	42,954,427	39,865,117

* Interest on the FFIC loans is included in the net gain/(loss) on financial instruments held at fair value through profit or loss – refer to note 2.4 for further details

Note 7:

Investments *(continued)*

	2018 \$'000	2017 \$'000
Interest bearing securities		
At fair value:		
Bank bills – international	19,797	-
Negotiable certificates of deposit – domestic	11,564,996	19,204,464
Corporate debt securities - international	927,652	1,326,765
Mortgage backed securities – domestic	6,216	-
Mortgage backed securities – international	461,827	900,240
Asset backed securities – international	596,314	584,131
Corporate credit (bank loans) – international	713,248	1,089,959
Government debt securities – international	7,425,579	6,049,805
Other interest bearing securities – international	437,427	451,267
Total interest bearing securities	22,153,056	29,606,631
Listed equities and listed managed investment schemes		
At fair value:		
Domestic listed equities and listed managed investment schemes	9,524,619	7,867,253
International listed equities and listed managed investment schemes	35,016,959	26,402,845
Total listed equities and listed managed investment schemes	44,541,578	34,270,098
Collective investment vehicles		
At fair value:		
Unlisted investments	18,736,786	14,343,321
Unlisted shares	1,952,736	1,919,099
Total collective investment vehicles	20,689,522	16,262,420

Note 7:

Investments *(continued)*

	2018 \$'000	2017 \$'000
Derivatives		
At fair value: - financial assets		
Currency contracts	407,631	726,922
Interest rate swap agreements	23,876	32,089
Interest rate futures	148,720	19,247
Equity options and warrants	430,998	618,575
Equity futures	13,102	279
Credit default swaps	8,624	7,825
Currency swaps	2,820	113,444
Currency options	50,868	38,097
Total derivative financial assets	1,086,639	1,556,478
	2018 \$'000	2017 \$'000
Derivatives		
At fair value: - financial liabilities		
Currency contracts	(1,329,785)	(634,449)
Interest rate swap agreements	(55,212)	(6,580)
Interest rate futures	(670)	(96,733)
Equity futures	(11,379)	(1,758)
Credit default swaps	(35,045)	(13,513)
Currency swaps	(128,316)	-
Currency options	(10)	(183)
Total derivative financial liabilities	(1,560,417)	(753,216)
Total derivatives	(473,778)	803,262

The Fund enters into certain derivative transactions under International Swaps and Derivatives Association (ISDA) agreements with various counterparties, which include provisions for netting arrangements. The derivative financial asset and financial liability balances above are stated gross of any netting arrangements.

The gross and net positions of financial assets and liabilities that have been offset in the balance sheet are disclosed in the first three columns of the following table. Under the terms of the ISDA agreements, only where certain credit events occur (such as default), the net position owing/receivable to a single counterparty in the same currency will be taken as owing and all the relevant arrangements terminated. The fourth column in the tables below show the amounts which could be offset at the counterparty level. As the Fund does not presently have a legally enforceable right of set-off, these amounts have not been offset in the balance sheet.

Note 7:

Investments *(continued)*

Financial assets	Effects of offsetting on the balance sheet			Related amounts not offset	
	Gross amounts of financial assets	Gross amounts set off in the balance sheet	Net amount of financial assets presented in the balance sheet	Amounts subject to master netting arrangements	Net amount
	\$'000	\$'000	\$'000	\$'000	\$'000

2018

Derivative financial instruments	917,311	-	917,311	(917,311)	-
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Total	917,311	-	917,311	(917,311)	-
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2017

Derivative financial instruments	1,192,914	-	1,192,914	(598,380)	594,534
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Total	1,192,914	-	1,192,914	(598,380)	594,534
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Financial liabilities	Effect of offsetting on the balance sheet			Related amounts not offset	
	Gross amounts of financial liabilities	Gross amounts set off in the balance sheet	Net amount of financial liabilities presented in the balance sheet	Amounts subject to master netting arrangements	Net amount
	\$'000	\$'000	\$'000	\$'000	\$'000

2018

Derivative financial instruments	1,509,311	-	1,509,311	(917,311)	592,000
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Total	1,509,311	-	1,509,311	(917,311)	592,000
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2017

Derivative financial instruments	598,380	-	598,380	(598,380)	-
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Total	598,380	-	598,380	(598,380)	-
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Note 7:

Investments *(continued)*

Restrictions on investments – cash

Cash provided and received as collateral

The Fund has entered into various derivative contracts which require the Fund to post or receive collateral with counterparties under certain circumstances based on minimum transfer limits. The Fund provides cash as collateral when legally required and counterparties also post collateral when legally required. Any cash provided as collateral remains a financial asset of the Fund, however, any alternate use of this cash is restricted as it is held by the counterparty. Any cash received by the Fund from counterparties is not included in the net assets of the Fund. As at 30 June 2018, the Fund has \$298,003,382 in cash which has been posted as collateral with counterparties, (2017: \$0) and has received \$215,233,235 in cash (2017: \$574,349,274) and \$0 in US Treasuries (2017: \$49,726,853).

Cash provided as margin on futures accounts

The Fund has posted cash with a futures broker to cover exchange traded futures positions as required under clearing house rules. As at 30 June 2018, the Fund had posted \$257,360,079 (2017: \$307,006,415) in futures margins to cover open positions. This cash also remains a financial asset of the Fund, however, any alternate use of this cash is also restricted.

Cash provided as margin on swap accounts

The Fund has posted cash with a central counterparty to cover exchange traded swap positions as required under clearing house rules. As at 30 June 2018, the Fund had posted \$49,440,235 (2017: \$25,807,682) in swap margins to cover open positions. This cash also remains a financial asset of the Fund, however any alternate use of this cash is also restricted.

Cash prepayments for investments

The Fund prepays cash for applications into some Alternative investments in advance of the effective date for allocation of units as set out in the legal documents. Therefore the cash remains a financial asset of the Fund, however, any alternate use of this cash is restricted. As at 30 June 2018, the Fund prepaid \$18,270,000 (2017: \$252,917,020).

Restrictions on investments – listed equities

The Fund has in place an automatic contractual lien over the Fund's listed equities with a counterparty when the Fund's exposure to that counterparty exceeds the base unsecured threshold. At 30 June 2018 no assets are subject to the lien (2017: no assets subject to the lien).

This agreement is instead of posting cash collateral, and provides the Fund with greater efficiency in managing its liquidity.

Note 7:

Investments *(continued)*

Collective investment vehicles

Commitments made to collective investment vehicles as at 30 June 2018

As disclosed in the schedule of commitments and in the following tables, the Fund, directly and via the FFICs has committed to provide capital to various collective investment vehicles. The total of these commitments at balance date is \$19,418 million (2017: \$16,046 million). The Fund's commitment obligations, being capital calls, are set out in the various underlying subscription documents. While the actual timing of the capital calls to be made by the managers of these vehicles is uncertain, as it is dependent on the managers sourcing suitable investment opportunities, the Fund has recorded the commitments as being current in accordance with the underlying legal documents (see the schedule of commitments). The Fund has appropriate liquidity planning in place to ensure a suitable allocation of resources will be available to cover these future commitments of capital.

Investment funds of the types the Fund invests in usually allow the fund's manager, general partner or other controlling entity to require repayment of distribution payments previously made to investors in order to cover certain fund liabilities (such as obligations to indemnify or to meet warranty claims on sold assets). In line with standard market practice, the Fund requires these 'giveback' obligations to be limited in both total amount (e.g. to between 10-25% of total distributions received) and liability period (e.g. for no longer than two years after the distributions are received). The Fund is not aware of any giveback obligations at 30 June 2018 (or 30 June 2017).

Note 7:

Investments *(continued)*

Collective investment vehicles *(continued)*

30 June 2018 – directly held by the Fund

As at 30 June 2018, the Fund had made commitments to a number of collective investment vehicles. Capital commitments (local currency), the net cost of the current investments net of returns of capital (Australian dollars), the outstanding commitment (Australian dollars) and the fair value (Australian dollars) of the investments as at 30 June 2018 are shown in the table below.

Description of underlying strategy	Capital called and committed as at 30 June 2018 Local Currency	Outstanding commitment as at 30 June 2018 AUD equivalent \$'000	Net capital cost as at 30 June 2018 AUD equivalent \$'000	Fair value as at 30 June 2018 AUD equivalent \$'000
Alternative strategies	AUD \$7,864,103,890	-	7,846,616	7,870,094
Debt	AUD \$1,701,713,598	342,679	1,229,699	1,172,326
Debt	EUR €967,721,129	71,900	692,122	981,173
Debt	USD \$2,317,818,216	1,219,995	1,460,095	1,645,877
Global Infrastructure	AUD \$837,917,846	-	837,918	1,854,461
Global Infrastructure	USD \$1,323,302,383	645,184	820,596	1,080,138
Listed Equities	AUD \$500,000,000	-	500,000	504,100
Listed Equities	USD \$451,270,064	-	577,735	653,995
Private Equity	EUR €169,984,161	16,424	252,447	348,933
Private Equity	USD \$350,007,136	22,718	368,847	458,425
Property	AUD \$751,934,669	200,000	94,698	151,559
Property	EUR €87,123,526	26,867	87,404	109,443
Property	GBP £362,913,861	343,521	191,102	378,524
Property	USD \$5,770,500,675	3,730,416	2,256,145	3,211,100
Timberlands	USD\$167,560,890	-	222,175	269,374
Total		6,619,704	17,437,599	20,689,522

Note 7:

Investments *(continued)*

Collective investment vehicles *(continued)*

30 June 2018 – indirectly held via the FFICs

As at 30 June 2018, the Fund had made commitments to a number of collective investment vehicles via its FFICs. Capital commitments (local currency), the net cost of the current investments net of returns of capital (Australian dollars), the outstanding commitment (Australian dollars) and the fair value (Australian dollars) of the investments as at 30 June 2018 are shown in the table below.

Description of underlying strategy	Capital called and committed as at 30 June 2018 Local Currency	Outstanding commitment as at 30 June 2018 AUD equivalent \$'000	Net capital cost as at 30 June 2018 AUD equivalent \$'000	Fair value as at 30 June 2018 AUD equivalent \$'000
Alternative Strategies	AUD \$7,395,807,355	158,544	6,796,961	7,042,008
Alternative Strategies	JPY ¥55,626,295,644	-	78,270	94,672
Alternative Strategies	USD \$9,816,648,172	536,184	5,585,376	7,391,781
Debt	AUD \$925,000,000	-	925,000	987,905
Debt	EUR €1,022,760,195	763,644	41,189	212,888
Debt	USD \$6,229,204,174	688,668	1,528,392	2,639,845
Global Infrastructure	AUD \$2,765,200,019	316,022	2,086,001	2,365,206
Global Infrastructure	GBP £262,028,692	-	252,731	1,549,763
Global Infrastructure	USD \$996,350,773	112,152	1,011,949	1,112,461
Listed Equities	USD \$2,548,370,000	-	822,042	2,174,302
Private Equity	AUD \$882,178,007	272,417	436,640	414,396
Private Equity	EUR €1,198,438,007	549,325	872,923	1,378,745
Private Equity	GBP £ 175,000,000	13,754	285,776	386,820
Private Equity	USD \$17,493,295,516	7,477,054	11,229,216	17,257,553
Property	AUD \$755,075,000	260,605	500,773	756,035
Property	EUR €1,006,391,183	676,686	728,768	747,337
Property	USD \$933,402,949	739,069	248,942	289,940
Timberlands	AUD \$557,704,311	234,322	86,068	392,463
Total		12,798,446	33,517,017	47,194,120

Note 7:

Investments *(continued)*

Collective investment vehicles *(continued)*

30 June 2017 – directly held by the Fund

As at 30 June 2017, the Fund had made commitments to a number of collective investment vehicles. Capital commitments (local currency), the net cost of the current investments net of returns of capital (Australian dollars), the outstanding commitment (Australian dollars) and the fair value (Australian dollars) of the investments as at 30 June 2017 are shown in the table below.

Description of underlying strategy	Capital called and committed as at 30 June 2017	Outstanding commitment as at 30 June 2017	Net capital cost as at 30 June 2017	Fair value as at 30 June 2017
	Local Currency	AUD equivalent \$'000	AUD equivalent \$'000	AUD equivalent \$'000
Alternative strategies	AUD \$3,139,070,000	-	3,141,076	3,203,916
Alternative strategies	USD \$2,467,576,750	-	3,087,241	3,000,413
Debt	AUD \$1,251,713,598	156,585	1,032,236	1,008,050
Debt	EUR €948,895,083	345,970	483,699	675,396
Debt	USD \$1,510,606,766	738,066	881,735	922,374
Global Infrastructure	AUD \$837,917,846	-	837,918	1,763,585
Global Infrastructure	USD \$1,491,034,277	990,338	762,941	917,889
Listed Equities	USD \$194,000,000	252,917	-	-
Private Equity	EUR €169,984,161	15,455	279,861	239,053
Private Equity	USD \$350,006,747	110,837	302,006	397,706
Property	AUD \$551,934,669	-	344,144	403,452
Property	EUR €187,324,310	43,909	233,512	268,521
Property	GBP £362,913,861	337,107	205,804	323,099
Property	USD \$3,739,708,652	1,392,571	2,082,451	2,907,618
Timberlands	USD \$167,560,890	-	222,175	231,348
Total		4,383,755	13,896,799	16,262,420

Note 7: Investments *(continued)*

Collective investment vehicles *(continued)*

30 June 2017 – indirectly held via the FFICs

As at 30 June 2017, the Fund had made commitments to a number of collective investment vehicles via its FFICs. Capital commitments (local currency), the net cost of the current investments net of returns of capital (Australian dollars), the outstanding commitment (Australian dollars) and the fair value (Australian dollars) of the investments as at 30 June 2017 are shown in the table below.

Description of underlying strategy	Capital called and committed as at 30 June 2017	Outstanding commitment as at 30 June 2017	Net capital cost as at 30 June 2017	Fair value as at 30 June 2017
	Local Currency	AUD equivalent \$'000	AUD equivalent \$'000	AUD equivalent \$'000
Alternative Strategies	AUD \$7,195,199,359	324,832	6,504,634	6,814,442
Alternative Strategies	JPY ¥55,626,295,644	-	156,484	166,612
Alternative Strategies	USD \$8,783,870,848	575,670	4,943,891	6,429,766
Debt	AUD \$875,000,000	-	875,000	1,000,086
Debt	EUR €1,014,615,675	611,946	151,387	287,762
Debt	USD \$6,364,646,235	922,330	2,272,428	3,444,753
Global Infrastructure	AUD \$2,804,202,831	371,120	2,033,579	2,296,209
Global Infrastructure	GBP £262,028,692	-	252,350	1,093,123
Global Infrastructure	USD \$1,004,065,297	124,063	1,042,676	1,188,848
Listed Equities	USD \$2,548,370,000	-	1,331,802	2,628,970
Private Equity	AUD \$597,178,007	114,345	385,387	451,357
Private Equity	EUR €1,033,438,007	338,398	754,055	1,229,416
Private Equity	GBP £100,000,000	38,070	144,676	179,463
Private Equity	USD \$14,652,316,957	6,761,789	8,660,860	12,847,452
Property	AUD \$755,075,000	287,605	473,698	662,948
Property	EUR €749,975,000	624,407	364,382	304,264
Property	USD \$737,146,593	567,431	264,998	303,349
Timberlands	AUD \$323,381,825	-	86,068	309,146
Total		11,662,006	30,698,355	41,637,966

Note 8: Receivables

	2018 \$'000	2017 \$'000
Receivables		
Imputation credits refundable	1,466,334	1,551,657
Interest receivable	2,204	1,264
Dividends & distributions receivable	166,434	161,754
Unsettled sales	80,816	222,742
Total Receivables	1,715,788	1,937,417

No amounts presented in the table above are considered to be past due or impaired.

Note 9: Non-financial assets

Analysis of plant and equipment, and intangibles	Year ended 30 June 2018		Total \$'000
	Plant & equipment \$'000	Computer software \$'000	
Opening balance as at 1 July 2017			
Gross book value	8,816	7,976	16,792
Accumulated depreciation/amortisation	(4,784)	(4,156)	(8,940)
Net book value as 1 July 2017	4,032	3,820	7,852
<i>Additions: by purchase</i>	2,143	929	3,072
<i>Disposals: gross book value</i>	(514)	(151)	(665)
<i>Disposals: depreciation/amortization adjustment</i>	504	153	657
<i>Depreciation/amortisation charge for the period</i>	(1,391)	(1,277)	(2,668)
Net book value as of 30 June 2018	4,774	3,474	8,248
Represented by:			
Gross book value	10,445	8,754	19,199
Accumulated depreciation/amortisation	(5,671)	(5,280)	(10,951)
	4,774	3,474	8,248

Note 9:

Non-financial assets *(continued)*

Analysis of plant and equipment, and intangibles	Year ended 30 June 2017		Total \$'000
	Plant & equipment	Computer software	
	\$'000	\$'000	
Opening balance as at 1 July 2016			
Gross book value	6,158	6,096	12,254
Accumulated depreciation/amortisation	(3,612)	(2,987)	(6,599)
<i>Net book value as 1 July 2016</i>	<u>2,546</u>	<u>3,109</u>	<u>5,655</u>
<i>Additions: by purchase</i>	2,658	1,880	4,538
<i>Depreciation/amortisation charge for the period</i>	<u>(1,172)</u>	<u>(1,169)</u>	<u>(2,341)</u>
Net book value as of 30 June 2017	<u>4,032</u>	<u>3,820</u>	<u>7,852</u>
<i>Represented by:</i>			
Gross book value	8,816	7,976	16,792
Accumulated depreciation/amortisation	<u>(4,784)</u>	<u>(4,156)</u>	<u>(8,940)</u>
	<u>4,032</u>	<u>3,820</u>	<u>7,852</u>

Note 10:

Payables

	2018 \$'000	2017 \$'000
Payables		
Unsettled purchases*	932,824	716,948
Other accrued expenses including management and performance fees payable	55,248	89,817
Total Payables	988,072	806,765

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

Note 11: Provisions

	2018 \$'000	2017 \$'000
Employee provisions		
Annual leave	2,174	1,984
Long service leave	5,033	4,388
Other employee liabilities	21,753	18,516
Total Employee provisions	28,960	24,888

Note 12: Contributions by Government

	2018 \$'000	2017 \$'000
Opening balance	60,536,831	60,536,831
Contribution from Government - cash	-	-
Closing balance	60,536,831	60,536,831

Contributions are made under Schedule 1 of the Act.

Note 13:**Unconsolidated subsidiaries and interests in unconsolidated structured entities**

As an investment entity, the Fund does not consolidate any of the subsidiaries listed below.

The Fund also invests via non-controlled structured entities. As these are investments of the Fund they are carried at their fair value which also equates to the Fund's maximum exposure to loss from its investment in these entities.

All entities (controlled or non-controlled) have some or all of the following characteristics:

- the requirement for the Fund (or a FFIC entity) to fund future commitments to the entity as called by the investment manager or general partner. These amounts are limited in terms of total value and callable only in accordance with the underlying legal arrangements. These amounts are disclosed in Note 7;
- the lack of control over the payment of dividends, distributions or the return of capital from the entity. These are controlled by the general partner or the investment manager in accordance with the legal arrangements entered into upon initial investment;
- limitations on transfer or redemption of the interest in the entity. The Fund ensures that these are normal commercial arrangements for investments of this type, typically existing to protect and treat all investors in an equitable manner; and
- limited recourse to the Fund (ordinarily capped at the commitment or invested capital value) for any claims or liabilities incurred by these entities.

Name of entity	Country of incorporation/ domicile	Equity holding	
		30 June 2018 %	30 June 2017 %
Future Fund Investment Company No.1 Pty Ltd^{^1}	Australia	100	100
Future Fund Investment Company No.2 Pty Ltd^{^1}	Australia	100	100
Global Hedged Strategies Fund Ltd ²	Cayman Islands	100	100
Future Fund Investment Company No.3 Pty Ltd^{^1}	Australia	100	100
GWII Unit Trust 2 ²	Australia	100	100
Co-Investment Fund (Parallel) LP ²	United States	100	100
Future Fund Investment Company No.4 Pty Ltd^{^1}	Australia	100	100
Future Fund Investment Company No.5 Pty Ltd^{^1}	Australia	100	100
Blue Jay Fund Ltd ²	Bermuda	100	100
Elementum Tranquillus Fund Ltd ²	Bermuda	100	100
Clocktower FF LP ²	Cayman Islands	100	100
QMS Diversified Global Macro Offshore Fund II Ltd ²	Cayman Islands	-	100
Future Fund Investment Company No.6 Pty Ltd (Dormant)¹	Australia	100	100
FFH No.3 Trust¹	Australia	100	100
Queenscliff Trust¹	Australia	100	100
Bain Capital Distressed and Special Situations 2016 (F) LP¹	United States	100	100
Bain Capital Distressed and Special Situations 2016 (F-EU), LP (formerly Sankaty Credit Opportunities (F) Europe LP)¹	England	100	100
Heathcote Fund Ltd¹	Cayman Islands	100	100

[^] Audited by the Australian National Audit Office.

¹ held directly by the Future Fund

² held indirectly by a Future Fund subsidiary

Note 14:

Cash flow reconciliation

	2018 \$'000	2017 \$'000
(a) Reconciliation of operating result to net cash from operating activities:		
Operating result	12,334,954	10,676,566
Depreciation and amortisation	2,668	2,341
Purchase of investments	(134,172,418)	(132,395,951)
Proceeds from sale of investments	130,781,920	126,214,251
Net gain on revaluation of investments	(9,390,033)	(3,615,739)
Unrealised loss/(gain) on foreign currency	966,216	(1,688,867)
Decrease/(increase) in accrued income	79,703	(305,905)
(Increase)/decrease in other assets	(1,367)	6,947
Increase in employee provisions	4,072	4,546
(Decrease)/increase in other payables	(34,569)	27,424
Increase in deferred tax liability	18,700	-
Net cash provided by/(used in) operating activities	589,846	(1,074,387)

(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 statement of financial position as follows:

	2018 \$'000	2017 \$'000
Cash and cash equivalents	2,418,038	1,785,174

Note 15:

Contingent liabilities and assets

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

Note 16:

Related party transactions

(i) Parent entity

The ultimate controlling entity of the Fund is the Commonwealth of Australia.

(ii) Subsidiaries

Interests in subsidiaries are set out in Note 13.

(iii) Key management personnel

Key management personnel are defined as the Board, members of the Agency's Management Committee which includes the Chief Executive Officer, Chief Investment Officer, Chief Operating Officer, Chief Financial Officer, Chief Culture Officer, General Counsel & Chief Risk Officer and Chief Investment Strategist and the Finance Minister and the Treasurer. These persons are the only persons considered to have the capacity and responsibility for decision making that can have a material impact on the strategic direction and financial performance of the Fund.

Remuneration of the Finance Minister, Treasurer and Board members is independently determined by the Australian Government Remuneration Tribunal. No member of the Board nor the statutory Accountable Authority receive any entitlement to performance related payments in undertaking their roles. The remuneration of the Finance Minister and Treasurer is not paid by the Fund and is therefore excluded from the compensation disclosed in Note 16 (iv).

Note 16:

Related party transactions *(continued)*

(iv) Key management personnel compensation

	2018	2017
	\$	\$
Short-term employee benefits	6,519,789	6,511,237
Post-employment benefits	276,513	300,281
Other long-term benefits	459,519	429,446
Termination benefits	461,595	-
Total Compensation	7,717,416	7,240,964

The total number of key management personnel that are included in the above table are 14 (2017: 14).

(v) Transactions with related parties

	2018	2017
	\$'000	\$'000
Subscriptions for capital and expenses*		
Subsidiaries	855,220	440,274
Dividend and distribution revenue*		
Subsidiaries	225,042	86,780

* FFBG subsidiaries excluding FFIC entities. FFIC transactions reflected in FFIC loans (Note 7) and FFIC dividend income (Note 3).

(vi) Terms and conditions

Transactions relating to dividends, distributions and funding of capital and expenses with related parties were made in accordance with the individual legal agreements.

(vii) Transactions with government-related entities

Transactions with other Australian government controlled entities for normal day-to-day business operations were provided under normal terms and conditions. This includes the payment of workers compensation and insurance premiums and superannuation. They are not considered significant individually to warrant separate disclosure as related party transactions. See Note 3 for details regarding the imputation credits refundable from the Australian Taxation Office.

Note 17:

Financial instruments and financial risk management

Note 17A: Risk management framework

The Board is collectively responsible for the investment decisions of the Fund and is accountable to the Government for the performance of the Fund. The Board's primary role is to set the strategic direction of the investment activities of the Fund consistent with its approved Investment Mandate. This is accomplished through setting the return targets, risk appetite and risk tolerance levels to manage investment risk. The Agency has the task and responsibility of providing considered research and accurate information and reporting to the Board to assist it in undertaking this role. The Agency monitors daily and reports to the Board, compliance with the Board approved investment guidelines and with the Board approved strategic asset allocation.

Note 17B: Financial risk management objectives

The Investment Mandate set by the Government specifies a benchmark return for the Fund and requires that it take an acceptable but not excessive level of risk. The Board sets and reviews an asset allocation designed to achieve this outcome. It encapsulates a level of risk that is expected to deliver the key return objectives while limiting the downside risk. Particular attention is paid to the worst 5% of possible outcomes under portfolio modelling over a three-year period (the 'Conditional Value at Risk' or 'CVaR' of the Fund) to ensure that medium-term risk in the portfolio is deemed acceptable while pursuing long-term returns.

The portfolio construction process involves considering a range of factors and ensuring that there is adequate diversity so that a negative outcome in any one area does not unduly impact the overall Fund return. The factors considered include the outlook for: global economic growth; inflation; global real interest rates; changes in risk premia attached to various asset classes; movements in the value of currencies held; and changes in liquidity and credit conditions.

Note 17C: Market risk

Market risk is the risk of loss arising from movements in the prices of various assets flowing from changes in interest rates, exchange rates, equity prices and other prices and derivatives contracts tied to these asset prices.

Note 17:

Financial instruments and financial risk management

(continued)

Note 17C (i): Interest rate risk

Interest rate exposure tables

The exposure to interest rates as at 30 June 2018 of the Fund and the FFICs are set out below.

Financial asset	Floating Interest Rate 2018 \$'000	Fixed Interest Rate 2018 \$'000	Non-interest Bearing 2018 \$'000	Total* 2018 \$'000
Cash and cash equivalents	3,485,427	-	-	3,485,427
Bank bills	-	19,797	-	19,797
Negotiable certificates of deposit	-	11,564,996	-	11,564,996
Corporate debt securities	92,551	1,401,096	-	1,493,647
Mortgage backed securities	447,788	20,255	-	468,043
Asset backed securities	571,517	24,797	-	596,314
Corporate credit (bank loans)	846,788	-	-	846,788
Government debt securities	38,694	8,526,333	150	8,565,177
Other interest bearing securities	400,358	590,958	1,634	992,950
Other financial assets	-	-	120,994,207	120,994,207
Total financial assets	5,883,123	22,148,232	120,995,991	149,027,346
Notional value of derivative positions				
Interest rate swaps (notional amount) – pay	(3,528,835)	(759,506)	-	
Interest rate swaps (notional amount) – receive	759,506	3,528,835	-	
Currency swaps (notional amount) – pay	(6,143,664)	-	-	
Currency swaps (notional amount) – receive	5,940,356	-	-	

As at the reporting date the Fund's debt portfolio had an effective interest rate duration of 1.16 (2017: 1.17).

* Total balances will not agree with the investment balances reported in Note 7 as this disclosure includes additional interest rate securities and cash and cash equivalents held by the FFICs.

Note 17: Financial instruments and financial risk management (continued)

Note 17C (i): Interest rate risk (continued)

The exposure to interest rates as at 30 June 2017 of the Fund and the FFICs are set out below.

Financial asset	Floating Interest Rate 2017 \$'000	Fixed Interest Rate 2017 \$'000	Non-interest Bearing 2017 \$'000	Total* 2017 \$'000
Cash and cash equivalents	3,201,014	-	-	3,201,014
Negotiable certificates of deposit	-	19,204,464	-	19,204,464
Corporate debt securities	90,394	1,785,703	-	1,876,097
Mortgage backed securities	865,037	35,203	-	900,240
Asset backed securities	508,815	75,316	-	584,131
Corporate credit (bank loans)	1,303,216	-	-	1,303,216
Government debt securities	115,955	6,685,989	203	6,802,147
Other interest bearing securities	437,179	600,727	2,350	1,040,256
Other financial assets	-	-	100,869,946	100,869,946
Total financial assets	6,521,610	28,387,402	100,872,499	135,781,511
Notional value of derivative positions				
Interest rate swaps (notional amount) – pay	(3,089,083)	(263,638)	-	
Interest rate swaps (notional amount) – receive	263,638	3,089,083	-	
Currency swaps (notional amount) – pay	(5,155,426)	-	-	
Currency swaps (notional amount) – receive	5,210,000	-	-	

* Total balances will not agree with the investment balances reported in Note 7 as this disclosure includes additional interest rate securities and cash and cash equivalents held by the FFICs.

Note 17: Financial instruments and financial risk management (continued)

Note 17C (i): Interest rate risk (continued)

Interest rate derivative contracts

The Fund had open positions in exchange traded interest rate futures contracts, interest rate swap agreements and interest rate option agreements as at 30 June 2018. The Act governs the use of financial derivatives as detailed in note 2.3.3.

Interest rate derivatives are used by the Fund's investment managers to manage the exposure to interest rates and to ensure it remains within approved limits.

The Fund transacts in interest rate derivatives in the following forms:

- bi-lateral over-the-counter contracts;
- centrally cleared over-the-counter contracts; and
- exchange traded derivatives.

The Fund's bi-lateral counterparties for interest rate swaps and options include major banking firms and their affiliates. The Fund diversifies its exposure by utilising multiple counterparties, by considering each counterparty's credit rating, and by executing such contracts pursuant to master netting agreements. All bi-lateral swap and option transactions which are not subject to mandatory central clearing are undertaken using ISDAs. Centrally cleared transactions are cash margined at least daily. The Fund's interest rate futures contracts are cash margined daily with the relevant futures clearing exchange. The notional value of the open positions, impact on fixed interest exposure and their fair value are set out below:

	Notional Value 2018 \$'000	Fair Market Value 2018 \$'000	Notional Value 2017 \$'000	Fair Market Value 2017 \$'000
Buy domestic interest rate futures contracts	8,842,183	65,473	6,915,864	(78,233)
Buy international interest rate futures contracts	13,319,327	82,693	11,824,559	(97)
Sell domestic interest rate futures contracts	(4,269,943)	546	(3,774,805)	488
Sell international interest rate futures contracts	(156,965)	(662)	(192,503)	356
Receiver (fixed) interest rate swap agreements	3,528,835	(38,319)	3,089,083	22,145
Payer (fixed) interest rate swap agreements	(759,506)	6,983	(263,638)	(1,258)
Total		116,714		(56,599)

No interest rate derivatives are held by the FFICs.

Note 17: Financial instruments and financial risk management (continued)

Note 17C (i): Interest rate risk (continued)

Interest rate sensitivity analysis

The following table demonstrates the impact on the operating result of the Fund and the FFICs for a 20 basis point (2017: 30 basis point) change in bond yields with all other variables held constant. It is assumed that the basis point change occurs as at the reporting date (30 June 2018 and 30 June 2017) and there are concurrent movements in interest rates and parallel shifts in the yield curves. A 20 basis point (2017: 30 basis point) movement would result in the following impact on the debt portfolios (including interest rate derivatives) contribution to the Fund and FFICs' operating result. The impact on the operating result includes the increase/(decrease) in interest income on floating rate securities from the basis point change.

	30 June 2018
	Impact on operating result
	\$'000
+ 20 basis points	(432,205)
- 20 basis points	398,034
	30 June 2017
	Impact on operating result
	\$'000
+ 30 basis points	(571,316)
- 30 basis points	587,113

Note 17C(ii): Foreign currency risk management

The Fund and the FFICs undertake certain transactions denominated in foreign currencies and accordingly are exposed to the effects of exchange rate fluctuations. The Board sets a target exposure to foreign currency risk and this is managed utilising forward foreign exchange contracts and other derivatives.

Foreign exchange contracts are used by the Fund's investment managers to manage the exposure to foreign exchange and to ensure it remains within Board approved limits. The Act governs the use of financial derivatives as detailed in note 2.3.3. The Fund's counterparties for foreign exchange contracts include major banking firms and their affiliates. The Fund diversifies its exposure by utilising major banking firms, by considering each counterparty's credit rating, and by executing such contracts pursuant to master netting agreements. All transactions (other than spot trades) are undertaken using ISDAs.

Note 17: Financial instruments and financial risk management (continued)

Note 17C(ii): Foreign currency risk management (continued)

The Fund and FFICs' exposure in Australian equivalents to foreign currency risk at the reporting date was as follows:

30 June 2018	USD AUD \$'000	EUR AUD \$'000	GBP AUD \$'000	JPY AUD \$'000	Other ¹ AUD \$'000	Total AUD \$'000
Cash & cash equivalents	2,442,599	161,798	86,278	101,660	246,012	3,038,347
Listed equities and listed managed investment schemes	19,034,668	3,433,753	1,888,032	3,763,998	11,193,332	39,313,783
Interest bearing securities	4,347,975	265,098	190,568	7,389,444	248,653	12,441,738
Collective investment vehicles	38,184,791	3,778,520	2,315,108	94,672	-	44,373,091
Other investments	495,800	55,381	20,834	64,495	4,920	641,430
Receivables	129,504	41,330	37,774	4,347	63,294	276,249
Payables	(247,731)	(25,965)	(16,032)	(790,350)	(9,316)	(1,089,394)
Total physical exposure	64,387,606	7,709,915	4,522,562	10,628,266	11,746,895	98,995,244
Forward exchange contracts and currency swaps						
- buy foreign currency	10,541,618	2,025,901	159,645	795,389	14,911,721	28,434,274
- sell foreign currency	(41,970,331)	(10,207,274)	(4,371,554)	(4,196,202)	(7,719,826)	(68,465,187)
Currency options	41,609	-	-	-	-	41,609
Total derivative exposure	(31,387,104)	(8,181,373)	(4,211,909)	(3,400,813)	7,191,895	(39,989,304)
Total net exposure	33,000,502	(471,458)	310,653	7,227,453	18,938,790	59,005,940

(1) Other includes AUD equivalent exposures to other currencies which, when considered individually, are immaterial.

Note 17: Financial instruments and financial risk management (continued)

Note 17C(ii): Foreign currency risk management (continued)

The Fund and FFICs' exposure in Australian equivalents to foreign currency risk at 30 June 2017 was as follows:

30 June 2017	USD AUD \$'000	EUR AUD \$'000	GBP AUD \$'000	JPY AUD \$'000	Other ¹ AUD \$'000	Total AUD \$'000
Cash & cash equivalents	2,250,592	130,959	78,984	89,042	41,678	2,591,255
Listed equities and listed managed investment schemes	14,810,320	3,226,080	1,726,484	1,352,393	8,984,220	30,099,497
Interest bearing securities	5,231,311	286,373	187,068	6,009,785	249,685	11,964,222
Collective investment vehicles	35,202,273	2,999,266	1,595,685	166,612	-	39,963,836
Other investments	867,936	44,369	8,425	62,931	17,199	1,000,860
Receivables	313,783	26,922	15,029	2,983	104,812	463,529
Payables	(238,281)	(21,530)	(18,913)	(438,025)	(17,822)	(734,571)
Total physical exposure	58,437,934	6,692,439	3,592,762	7,245,721	9,379,772	85,348,628
Forward exchange contracts and currency swaps						
- buy foreign currency	11,823,135	2,565,851	225,991	772,421	15,773,793	31,161,191
- sell foreign currency	(39,720,156)	(9,510,327)	(3,848,939)	(1,513,101)	(8,245,870)	(62,838,393)
Currency options	55,000	-	-	60,000	-	115,000
Total derivative exposure	(27,842,021)	(6,944,476)	(3,622,948)	(680,680)	7,527,923	(31,562,202)
Total net exposure	30,595,913	(252,037)	(30,186)	6,565,041	16,907,695	53,786,426

(1) Other includes AUD equivalent exposures to other currencies which, when considered individually, are immaterial.

Note 17:

Financial instruments and financial risk management

(continued)

Note 17C(ii): Foreign currency risk management (continued)

Foreign currency sensitivity analysis

The following table demonstrates the impact on the Fund and the FFICs' operating result of a 9.2% (2017: 10.2%) movement in exchange rates relative to the Australian dollar at 30 June 2018, with all other variables held constant. It is assumed that the relevant change occurs as at the reporting date and the results presented are shown after taking into account the implementation of the Board's foreign currency exposure policy (that is, the sensitivity is calculated on the net exposure presented on the two previous tables).

	30 June 2018 Impact on operating result \$'000
+ 9.2% movement	7,134,323
- 9.2% movement	(6,975,279)

	30 June 2017 Impact on operating result \$'000
+ 10.2% movement	6,763,477
- 10.2% movement	(6,625,837)

Note 17C(iii): Equity price risk

Public markets equity price risk

The Fund and the FFICs are exposed to equity price risks arising from public market equity investments. The equity price risk is the risk that the value of our equity portfolio will decrease as a result of changes in the levels of equity indices and the price of individual stocks. The Fund and FFICs hold all of its equities at fair value through profit or loss.

The Fund and FFICs' exposure to public market equity price risk at the reporting date was as follows:

	2018* \$'000	2017* \$'000
Domestic listed equities and listed managed investment schemes	10,210,608	8,526,639
International listed equities and listed managed investment schemes	39,313,782	30,075,876
Total equity price risk exposure	49,524,390	38,602,515

* Total balances will not agree with the investment balances reported in Note 7 as this disclosure includes additional public market equities held by the FFICs.

Note 17: Financial instruments and financial risk management (continued)

Note 17C(iii): Equity price risk (continued)

Equity derivative contracts

The Fund had open positions in exchange traded equity futures contracts and exchange traded and over the counter equity option contracts as at 30 June 2018. The Act governs the use of financial derivatives as detailed in note 2.3.3. Equity futures, options and warrants are used to manage market exposures to equity price risk and to ensure that asset allocations remain within approved limits. The Fund's counterparties for over the counter equity options include major banking firms and their affiliates. The Fund diversifies its exposure by utilising multiple counterparties, by considering each counterparty's credit rating, and by executing such contracts pursuant to master netting agreements. All over the counter transactions are undertaken using ISDAs. The Fund's equity futures contracts are cash margined daily with the relevant futures clearing exchange. The notional value of the open contracts and their fair value are set out below:

	Notional Value 2018 \$'000	Fair Market Value 2018 \$'000	Notional Value 2017 \$'000	Fair Market Value 2017 \$'000
Buy domestic equity futures contracts	80,693	1,608	50,841	(468)
Buy international equity futures contracts	412,951	(11,219)	155,790	(1,172)
Sell international equity futures contracts	(597,396)	11,334	(24,204)	161
Exchange traded international volatility index put options	-	-	(645)	247
Over the counter domestic equity index call options	-	-	167,852	2,810
Over the counter international equity index put options	(947,596)	5,520	(725,208)	19,307
Over the counter international equity index call options	11,584,104	421,984	5,664,895	387,186
Exchange traded warrants domestic	-	130	6,894	725
Exchange traded warrants international	7,910	3,439	10,408	755
Over the counter warrants international	-	-	247,855	207,545
Total		432,796*		617,096

* Total balances will not agree with the investment balances reported in Note 7 as this disclosure includes additional equity derivatives held by the FFICs.

Note 17: Financial instruments and financial risk management (continued)

Note 17C(iii): Equity price risk (continued)

Equity price sensitivity analysis

The analysis below demonstrates the impact on the Fund and FFICs' operating result of the following movements:

- +/- 20% on Australian equities
- +/- 15% on International equities

The sensitivity analysis has been performed to assess the direct risk of holding equity instruments and associated derivatives. The analysis is undertaken on the base currency values of the underlying exposures. Currency risk sensitivity is considered separately in the currency sensitivity table presented in Note 17C(ii). The percentage change for each sub-class noted in the table below is measured with reference to each underlying security's forward looking beta, which is a measure of how the underlying security price would change relative to an absolute increase or decrease in the market portfolio which has a beta of 1.

	2018 Impact on operating result \$'000	2017 Impact on operating result \$'000
20% increase in Australian equities	3,572,582	2,942,834
15% increase in International equities	12,624,074	10,628,414
Total	16,196,656	13,571,248
20% decrease in Australian equities	(3,572,582)	(2,919,223)
15% decrease in International equities	(11,708,559)	(10,127,127)
Total	(15,281,141)	(13,046,350)

Note 17:

Financial instruments and financial risk management

(continued)

Note 17C(iv): Other price risk (collective investment vehicles)

The Fund and FFICs are exposed to other price risks arising from its investments in collective investment vehicles. The Fund and FFICs mitigate this risk through diversification of its investments.

As noted in Note 17F, in the absence of active markets for a particular investment, judgement is required in determining fair value which introduces an increased element of uncertainty in the determination of that fair value. Collective investment vehicle pricing requires this judgement to be exercised in determining appropriate market reference transactions, pricing or earnings multiples, cash flow estimates and market discount rates.

Similarly, when estimating the potential sensitivity of the inputs into the fair values, there is judgement required as to how to determine what a reasonable change in underlying inputs might be in the next financial period. The use of proxy information to assist in determining these sensitivities is detailed below.

Private real estate proxy

A proxy index of publicly traded real estate investment trusts (REITs) has been created that is appropriate for the geographical exposure of the portfolio.

Private equity proxy

A proxy after consideration of the investment strategy and geographical exposure of each private equity investment has been created. For example, a venture capital strategy is proxied using micro cap equities in the appropriate geography.

Infrastructure proxy

Utilisation of an appropriate index of publicly traded infrastructure companies in the appropriate geography and sector is used as a proxy.

Alternative strategy funds

An appropriate market index of public traded assets or similar alternative strategy funds is used as a proxy.

Other price risk sensitivity analysis

The sensitivity analysis for other price risk using the proxies noted above is incorporated within the equity risk sensitivity analysis and interest rate sensitivity analysis presented earlier in Notes 17C(i) and 17C(iii).

Note 17: Financial instruments and financial risk management (continued)

Note 17D: Liquidity risk management

Liquidity risk is the vulnerability of portfolio cash-flow management to compromise or failure. In particular, it is the risk that insufficient at-call liquidity is available to meet the Fund's liabilities and obligations as they fall due.

The Fund devotes considerable resources to liquidity risk management and the Liquidity Risk Management Policy is one of four main investment policies that support the investment process and help to ensure that the Fund and the FFICs takes 'acceptable but not excessive' risk.

The implementation of the Liquidity Risk Management Policy relies upon the following primary inputs:

- A daily stress test that is designed to ensure that the Fund and the FFICs hold enough at-call liquidity to meet our short-term obligations at all times. If the level of at-call liquidity in the Fund and the FFICs is insufficient to pass this test, it must be replenished;
- A portfolio projection model that forecasts the prospective build of the Fund and the FFICs, based on cash flow projections in a range of different market conditions;
- A commitment register of all contractual and discretionary capital commitments that may need to be funded with at-call liquidity in the future;
- A contingency plan that is designed to expedite access to alternative forms of at-call liquidity should access to traditional sources be constrained.

The following tables summarise the maturity profile of the Fund and FFICs' financial liabilities, net and gross settled derivative financial liability instruments into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. The tables have been drawn up based on the contractual discounted cash flows. As the majority of payments occur within one year, the difference between discounted and undiscounted cashflows is immaterial.

Note 17: Financial instruments and financial risk management (continued)

Note 17D: Liquidity risk management (continued)

As at 30 June 2018:

	Less than 3 months	3 months to 1 year	1 to 5 Years	> 5 Years	Total contractual cashflows	Carrying amount (assets)/ liabilities
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
2018						
Non-derivatives						
Unsettled purchases	1,096,558	-	-	-	1,096,558	1,096,558
Other payables	94,452	-	-	-	94,452	94,452
Total non-derivatives	1,191,010	-	-	-	1,191,010	1,191,010*
Derivatives						
Net settled (interest rate swaps, credit default swaps, interest rate options)	229,380	1,252	-	-	230,632	230,632
Gross settled (forward foreign exchange contracts, cross currency swaps)						
- (inflow)	(32,698,538)	(9,690,967)	-	-	(42,389,505)	(42,389,505)
- outflow	33,786,968	9,932,327	-	-	43,719,295	43,719,295
Total derivatives	1,317,810	242,612	-	-	1,560,422	1,560,422*

The Fund may be required to provide cash as collateral to counterparties under legal agreements when derivatives are in a net liability position. Refer to Note 7 for details on cash provided as collateral.

* Total balances do not agree with the investment balance reported in Note 7 and the payables balances reported in Note 10 as the FFICs are included in this disclosure.

Note 17: Financial instruments and financial risk management (continued)

Note 17D: Liquidity risk management (continued)

As at 30 June 2017:

	Less than 3 months	3 months to 1 year	1 to 5 Years	> 5 Years	Total contractual cashflows	Carrying amount (assets)/ liabilities
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
2017						
Non-derivatives						
Unsettled purchases	770,905	-	-	-	770,905	770,905
Other payables	126,814	-	-	-	126,814	126,814
Total non-derivatives	897,719	-	-	-	897,719	897,719*
Derivatives						
Net settled (interest rate swaps, credit default swaps, interest rate options)	118,767	-	-	-	118,767	118,767
Gross settled (forward foreign exchange contracts, cross currency swaps)						
- (inflow)	(22,488,551)	(4,523,076)	-	-	(27,011,627)	(27,011,627)
- outflow	23,025,526	4,620,552	-	-	27,646,078	27,646,078
Total derivatives	655,742	97,476	-	-	753,218	753,218*

* Total balances do not agree with the investment balance reported in Note 7 and the payables balances reported in Note 10 as the FFICs are included in this disclosure.

Note 17: Financial instruments and financial risk management (continued)

Note 17E: Credit risk

Credit risk is the risk of loss that arises from a counterparty failing to meet their contractual commitments in full and on time, or from losses arising from the change in value of a traded financial instrument as a result of changes in credit risk on that instrument.

The Board sets limits on the credit ratings of debt investments. These limits are reflected in the underlying investment mandates and are monitored by the Agency with compliance reported to the Board.

The 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 statement of financial position.

The Fund had, at 30 June 2018, an exposure of 7.94% (2017: 14.39%) of its net assets to interest bearing securities issued by domestic banks. Exposures to individual counterparties are separately identified in the table below.

	2018	2017
Domestic interest bearing securities issued by:	\$'000	\$'000
Westpac Banking Corporation	2,745,737	5,099,087
Australia and New Zealand Banking Group Limited	3,009,182	4,931,827
National Australia Bank Limited	2,941,786	4,325,589
Commonwealth Bank of Australia	2,669,127	4,738,210
Other domestic banks	199,164	109,751
Non-bank issued	6,216	-
Total	11,571,212	19,204,464

The exposures presented above reconcile to Note 7 of the financial statements as follows:

	2018	2017
Domestic interest bearing securities issued by:	\$'000	\$'000
Negotiable certificates of deposit - domestic	11,564,996	19,204,464
Mortgage backed securities - domestic	6,216	-
Total	11,571,212	19,204,464

Exposures are measured at the fair value of the underlying securities which is equivalent to their carrying value in the statement of financial position. Any associated income which is outstanding has been included within the numbers presented. None of these accrued income amounts are past due.

Note 17: Financial instruments and financial risk management (continued)

Note 17E: Credit risk (continued)

Credit risk derivatives

The Funds' managers utilise credit default swaps to gain exposure to credit risk. The Act governs the use of financial derivatives as detailed in note 2.3.3.

The Fund transacts in credit default swaps in the following forms:

- bi-lateral over-the-counter contracts; and
- centrally cleared over-the-counter contracts.

The Fund's bi-lateral counterparties for credit default swaps include major banking firms and their affiliates. The Fund diversifies its exposure by utilising multiple counterparties, by considering each counterparty's credit rating, and, where contracts are not subject to mandatory clearing arrangements, by executing such contracts pursuant to master netting agreements. All transactions which are not centrally cleared are undertaken using ISDAs approved by the Fund. Centrally cleared transactions are cash margined at least daily. Managers are required to fully cash back all sold credit protection positions. Outstanding positions are marked to market and collateralisation of out of the money positions is required by each counterparty or the central clearing exchange.

The notional value of the open credit default swap positions, the impact on increasing or reducing credit exposures and their fair value are set out below:

	Notional Value	Fair Market Value	Notional Value	Fair Market Value
	2018	2018	2017	2017
	\$'000	\$'000	\$'000	\$'000
Buy Credit Protection	793,950	(26,597)	441,962	(10,162)
Sell Credit Protection	212,017	176	(138,519)	4,474
Total		(26,421)		(5,688)

No credit risk derivative contracts are held by the FFICs.

Note 17: Financial instruments and financial risk management (continued)

Note 17E: Credit risk (continued)

Credit exposure by credit rating

The following table provides information regarding the credit risk exposures of the debt instruments held by the Fund and the FFICs according to the credit ratings of the underlying debt instruments.

	2018 \$'000	2017 \$'000
<i>Long term rated securities</i>		
AAA	143,687	159,035
AA	60,192	3,297,795
A	3,615,398	714,684
BBB	62,602	69,547
Below Investment grade / not rated#	5,191,312	6,100,314
<i>Short term rated securities</i>		
A-1+/A-1/A-2	18,929,500	24,510,602
Other		
US Government Guaranteed	30,448	59,588
Total debt securities and cash held	28,033,139	34,911,565
Other non-debt financial assets	120,994,207	100,869,946
Total financial assets	149,027,346*	135,781,511*

The Fund and FFICs have a number of mandates with managers specialising in managing distressed debt and corporate loans portfolios.

* Total balances will not agree with the investment balances reported in Note 7 as this disclosure includes cash and financial assets held by the FFICs.

Credit risk associated with receivables is considered minimal. The main receivables balance is in relation to franking credits which are claimable from the Australian Taxation Office annually in July each year.

There are no overdue contractual receipts due from counterparties as at 30 June 2018 (2017: nil).

Note 17: Financial instruments and financial risk management (continued)

Note 17F: Fair values of financial assets and liabilities

The carrying amounts of the Fund's assets and liabilities at the end of each reporting period approximate their fair values.

Financial assets and liabilities held at fair value through profit or loss are measured initially at fair value excluding any transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs on financial assets and financial liabilities at fair value through profit or loss are expensed immediately. Subsequent to initial recognition, all instruments held at fair value through profit or loss are measured at fair value with changes in their fair value recognised in the statement of comprehensive income.

(i) Fair value in an active market

The fair value of financial assets and liabilities traded in active markets is based on their quoted market prices at the end of the reporting period without any deduction for estimated future selling costs.

The Fund values its investments in accordance with the accounting policies set out in Note 2. For the majority of its public market investments, the Fund relies on information provided by independent pricing services for the valuation of its investments.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's-length basis.

(ii) Fair value in an inactive or unquoted market

The fair value of financial assets and liabilities that are not traded in an active market is determined using valuation techniques employed by the managers the Board has engaged or by the Fund directly. These include the use of recent transactions to the extent these are available and are not distressed transactions, reference to the current fair value of a substantially similar other instrument, discounted cash flow techniques, option pricing models, the use of independent valuation experts or any other valuation technique that provides an estimate of prices that could be obtained in actual market transactions.

Where discounted cash flow techniques are used, estimated future cash flows are based on best estimates and the discount rate used is a market rate at the balance date applicable for an instrument with similar terms and conditions.

For other pricing models, inputs are based on market data at balance date. Fair values for unquoted equity investments are estimated, if possible, using applicable price/earnings ratios for similar listed companies adjusted to reflect the specific circumstances of the issuer.

The fair value of derivatives that are not exchange traded is estimated at the amount that the Fund would receive or pay to terminate the contract at the balance date taking into account current market conditions (for example, volatility and appropriate yield curves). The fair value of a forward contract is determined as a net present value of estimated future cash flows, discounted at appropriate market rates as at the valuation date. The fair value of an option contract is determined by applying industry standard option pricing models.

Note 17:

Financial instruments and financial risk management

(continued)

Note 17G: Fair value hierarchy

The Fund classifies fair value measurements using a fair value hierarchy that reflects the subjectivity of the inputs used in making the measurements. The following tables provide an analysis of financial instruments held at year end that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable.

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Investments whose values are based on quoted market prices in active markets, and therefore classified within Level 1, include active listed equities and exchange traded derivatives.

Financial instruments that trade in markets that are not considered to be active but are valued based on quoted market prices, dealer quotations or alternative pricing sources supported by observable market data are classified within Level 2. These include both investment grade and non-investment grade interest bearing securities and over the counter derivatives.

The Fund must appoint investment managers to invest the assets of the Fund under the Act. A significant proportion of these investments are made via pooled investment vehicles which in turn invest in a variety of underlying investments. Such pooled investments are classified as Level 3 investments in these financial statements. The diverse nature of the investments they make on the Fund's behalf means it is not possible to provide additional information in these financial statements regarding how inputs into the valuation of Level 3 investments might change nor the resultant impact on the statement of comprehensive income that such changes to valuation inputs might trigger.

The Fund ensures that valuation techniques used by managers are consistent with the Fund's accounting policy.

As noted in Note 17C (iv) for collective investments, the Fund has used proxy investment exposures to provide sensitivity information surrounding the possible impact on the income of the Fund should equity or interest rate markets move up or down by a specified amount.

The Fund's policy is to recognise transfers into and transfers out of fair value hierarchy levels as at the beginning of the reporting period. The Fund determines whether transfers have occurred between levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole).

Note 17: Financial instruments and financial risk management (continued)

Note 17G: Fair value hierarchy (continued)

The tables below provide information on the fair value hierarchy for the Fund and FFICs as at 30 June 2018.

	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total* \$'000
Recurring fair value measurements				
Financial assets at fair value through profit or loss:				
Interest bearing securities	11,042	23,135,295	1,401,375	24,547,712
Listed equities and listed managed investment schemes	49,382,612	49,003	92,775	49,524,390
Collective investment vehicles	-	439	67,883,206	67,883,645
Derivatives	153,193	932,321	1,202	1,086,716
Restricted Cash	623,073	-	-	623,073
Total	50,169,920	24,117,058	69,378,558	143,665,536
Financial liabilities at fair value through profit or loss:				
Derivatives	12,049	1,548,373	-	1,560,422
Total	12,049	1,548,373	-	1,560,422

* Total balances will not agree with the investment balances reported in Note 7 as this disclosure includes cash and financial assets and liabilities held by the FFICs.

Note 17: Financial instruments and financial risk management (continued)

Note 17G: Fair value hierarchy (continued)

The following table presents the transfers between levels for the year ended 30 June 2018:

	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000
Transfers between Levels 1 and 2	(768)	768	-
Transfers between Levels 1 and 3	10,437	-	(10,437)
Transfers between Levels 2 and 3	-	4,442	(4,442)

The following table presents the movement in Level 3 instruments for the year ended 30 June 2018 by class of financial instrument.

	Interest bearing securities \$'000	Equities and listed managed investment schemes \$'000	Collective investment vehicles \$'000	Derivatives \$'000	Total \$'000
Financial assets at fair value through profit or loss:					
Opening balance	1,563,335	77,082	57,876,767	208,136	59,725,320
Purchases	219,647	21,476	20,452,802	-	20,693,925
Sales	(358,533)	(1,384)	(15,340,754)	(282,297)	(15,982,968)
Transfers into Level 3	418	17,048	-	-	17,466
Gains and losses recognised in the statement of comprehensive income	(18,039)	5,444	4,894,391	75,363	4,957,159
Transfers out of Level 3	(5,453)	(26,891)	-	-	(32,344)
Closing balance	1,401,375	92,775	67,883,206	1,202	69,378,558

There were no Level 3 financial liabilities.

Note 17: Financial instruments and financial risk management (continued)

Note 17G: Fair value hierarchy (continued)

The Fund must invest all the assets of the Fund via investment managers. Listed below are the valuation techniques and significant unobservable inputs for the investments classified in Level 2 and Level 3. Due to the diverse nature of the Fund's investments it is not possible to list the ranges of the inputs.

As at 30 June 2018:

	Fair Value	Valuation Technique	Unobservable Inputs
	\$'000		
Recurring fair value measurements			
Financial assets at fair value through profit or loss:			
Interest bearing securities	24,536,670	Discounted cash flow	Discount Rate
		Market Approach	Earnings Multiple
		Broker Quotations	N/A
		Independent Pricing Services	N/A
		Recovery Rate	Illiquidity Discount
Equities and listed managed investment schemes	141,778	Discounted cash flow	Discount Rate
		Independent Pricing Services	N/A
		Recent Transaction	N/A
		Recovery Value	Recovery Rate
Collective investment vehicles	67,883,645	Market Approach	Earnings Multiple
			Net Asset Value
		Discounted cash flow	Discount Rate
Derivatives	933,523	Independent Pricing Services	N/A
		Broker Quotations	N/A
Total	93,495,616		
Financial liabilities at fair value through profit or loss:			
Derivatives	1,548,373	Independent Pricing Services	N/A
		Broker Quotations	N/A
Total	1,548,373		

Note 17: Financial instruments and financial risk management (continued)

Note 17G: Fair value hierarchy (continued)

The tables below provide information on the fair value hierarchy for the Fund and FFICs as at 30 June 2017:

	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total* \$'000
Recurring fair value measurements				
Financial assets at fair value through profit or loss:				
Interest bearing securities	14,728	30,132,488	1,563,335	31,710,551
Listed equities and listed managed investment schemes	38,521,880	27,174	77,082	38,626,136
Collective investment vehicles	-	-	57,876,767	57,876,767
Derivatives	20,188	1,328,168	208,136	1,556,492
Restricted Cash	585,731	-	-	585,731
Total	39,142,527	31,487,830	59,725,320	130,355,677
Financial liabilities at fair value through profit or loss:				
Derivatives	20,259	732,959	-	753,218
Total	20,259	732,959	-	753,218

* Total balances will not agree with the investment balances reported in Note 7 as this disclosure includes cash and financial assets and liabilities held by the FFICs.

The following table presents the transfers between levels for the year ended 30 June 2017:

	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000
Transfers between Levels 1 and 2	(22)	22	-
Transfers between Levels 1 and 3	57,436	-	(57,436)
Transfers between Levels 2 and 3	-	(1,788)	1,788

Note 17: Financial instruments and financial risk management (continued)

Note 17G: Fair value hierarchy (continued)

The following table presents the movement in Level 3 instruments for the year ended 30 June 2017 by class of financial instrument.

	Interest bearing securities	Equities and listed managed investment schemes	Collective investment vehicles	Derivatives	Total
	\$'000	\$'000	\$'000	\$'000	\$'000
Financial assets at fair value through profit or loss:					
Opening balance	1,088,213	116,671	51,296,067	613	52,501,564
Purchases	767,679	85,651	18,245,923	281,953	19,381,206
Sales	(304,713)	(75,985)	(13,520,846)	(497)	(13,902,041)
Transfers into Level 3	4,296	2,334	-	-	6,630
Gains and losses recognised in the statement of comprehensive income	7,860	10,689	1,855,623	(73,933)	1,800,239
Transfers out of Level 3	-	(62,278)	-	-	(62,278)
Closing balance	1,563,335	77,082	57,876,767	208,136	59,725,320

There were no Level 3 financial liabilities.

Note 17: Financial instruments and financial risk management (continued)

Note 17G: Fair value hierarchy (continued)

The Fund must invest all the assets of the Fund via investment managers. Listed below are the valuation techniques and significant unobservable inputs for the investments classified in Level 2 and Level 3. Due to the diverse nature of the Fund's investments it is not possible to list the ranges of the inputs.

As at 30 June 2017:

	Fair Value	Valuation Technique	Unobservable Inputs
	\$'000		
Recurring fair value measurements			
Financial assets at fair value through profit or loss:			
Interest bearing securities	31,695,823	Discounted cash flow	Discount Rate
		Market Approach	Earnings Multiple
		Broker Quotations	N/A
		Independent Pricing Services	N/A
		Recovery Rate	Illiquidity Discount
Equities and listed managed investment schemes	104,256	Discounted cash flow	Discount Rate
		Independent Pricing Services	N/A
		Recent Transaction	N/A
		Recovery Value	Recovery Rate
Collective investment vehicles	57,876,767	Market Approach	Earnings Multiple
			Net Asset Value
		Discounted cash flow	Discount Rate
Derivatives	1,536,304	Independent Pricing Services	N/A
		Broker Quotations	N/A
Total	91,213,150		
Financial liabilities at fair value through profit or loss:			
Derivatives	732,959	Independent Pricing Services	N/A
		Broker Quotations	N/A
Total	732,959		

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: Special Accounts

Note 19A: Special Accounts: Future Fund Special Account

Legal Authority – *Future Fund Act 2006*, section 12.

Appropriation authority – section 80 of the PGPA Act.

Purpose – establishment and ongoing operation of the Fund.

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

Future Fund Special Account	Period from 1 July 2017 to 30 June 2018 \$'000	Period from 1 July 2016 to 30 June 2017 \$'000
Balance carried from previous period	-	-
Bank interest amounts credited	-	-
Appropriations for reporting period	-	-
Other Receipts:		
GST credits	5,052	11,093
Amounts transferred from investment account (a)	371,446	327,288
Amounts credited to the special account	-	-
Total Credits	376,498	338,381
Available for payments	376,498	338,381
Payments made:		
Investments debited from the Special Account (FFA s17)		
Payments made		
– Remuneration of Agency staff	43,663	38,843
– Remuneration of Board members	853	908
– Suppliers	44,049	39,710
– Investment expenses	284,861	254,382
– Purchase of capital equipment and software	3,072	4,538
Total Debits	376,498	338,381
Balance carried forward to next year^(b)	-	-

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

(b) Excluding investments balances, see Note 19B.

Note 19: Special Accounts *(continued)*

Note 19B: Special Accounts: Investment of Public Money

Disclosures below are on a cash basis.

Future Fund Special Account: Investment of Public Money under section 17 of the Future Fund Act 2006 (as amended)	Period from 1 July 2017 to 30 June 2018 \$'000	Period from 1 July 2016 to 30 June 2017 \$'000
Opening balance	116,165,293	103,077,040
Investments made on transfer of funds from the Special Account		-
Realised investments reinvested	130,723,804	130,386,653
Interest earned reinvested	1,502,829	1,840,366
Dividends received reinvested	3,726,193	3,061,785
Franking credits received reinvested	835,678	628,463
Foreign currency realised reinvested	(244,199)	2,450,313
Amounts transferred to operations ^(a)	(371,446)	(327,288)
Investments realised	(130,546,029)	(124,952,039)
Closing Balance	121,792,123	116,165,293

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

Note 20: Reporting of outcomes

Note 20A: Net cost of outcome delivery

Outcome 1: Make provision for the Commonwealth's unfunded superannuation liabilities and payments for the creation and development of infrastructure, by managing the operational activities of the Future Fund, Nation Building Funds, DisabilityCare Australia Fund and Medical Research Future Fund, in line with the Government's investment mandates.

The net contribution of outcome 1 is disclosed in the Statement of comprehensive income.

Note 20B: Net cost of outcome delivery – Programs

The Agency has two programs: the management of the investment of the Future Fund and the management of the investment of the Building Australia Fund, Education Investment Fund, DisabilityCare Australia Fund and Medical Research Future Fund. These investments are held for and on behalf of the Commonwealth of Australia.

Program 1.1 Management of the investment of the Future Fund.

The Agency supports the Board in investing to accumulate assets for the purpose of offsetting the unfunded superannuation liabilities of the Commonwealth which will fall due on future generations. The net cost of this output delivery is presented in the Statement of comprehensive income.

Program 1.2 Management of the investment of the Building Australia Fund, Education Investment Fund, DisabilityCare Australia Fund and the Medical Research Future Fund (the BAF, EIF, DCAF and MRFF).

Under the *Nation-building Funds Act 2008*, the role of the Agency was extended to include supporting the Board in the investment of the assets of the BAF and EIF (each a 'fund') and subsequently by the *DisabilityCare Australia Fund Act 2013* and the *Medical Research Future Fund Act 2015* to support the Board in the investment of the assets of the DCAF and MRFF. The Agency charges a monthly fee to each fund to reimburse the Agency for shared costs paid by the Agency, as agreed with the Department of Finance. During year the Agency charged the funds a combined amount of \$3,403,000 (2017:\$2,322,000) which is included in other income in the statement of comprehensive income and the amount owing to the Agency at 30 June 2018 was \$879,000 (2017: \$613,000). Direct costs to the BAF, EIF, DCAF and MRFF, such as investment management and custody fees, were charged directly to each fund's Special Account and are not reported as part of these financial statements.

Note 21: Budgetary reports

The following tables provide a comparison of the original budget as presented in the 2017-18 Portfolio Budget Statements (PBS) to the 2017-18 final outcome as presented in accordance with Australian Accounting Standards for the entity. The budget is not audited.

The 2017-18 budget was based on the assumption that the mandated return is achieved for each forward estimates year. CPI is estimated in these budget numbers. In that context, the budget construct, including related investment costs, was based on the estimated mandated return. Actual results will always deviate from these assumed returns. For 2017-18, the Fund generated a net of costs return of \$12.33bn (9.3%), a 51% increase from the budgeted amount. For comparative purposes, the mandated return used for budget purposes for the equivalent period was 6.3%.

There are therefore significant variances between budgeted and actual outcomes. Due to the volatile nature of investment markets, it is difficult to accurately predict the financial outcomes of the Fund. Further, as PBS financial information is presented in a concise format which differs to the level of information presented in this financial report, the tables below compare actual and budgeted information for the statement of comprehensive income and statement of financial position.

STATEMENT OF COMPREHENSIVE INCOME	Year ended	PBS - Administered	PBS - Departmental	Variance
	30 June 18	30 June 18	30 June 18	30 June 18
	\$'000	\$'000	\$'000	\$'000
Total income	12,654,194	8,604,338	72,593	3,977,263
Total expenses including income tax	319,240	422,153	72,593	(175,506) [#]
OPERATING RESULT FOR THE YEAR	12,334,954	8,182,185	-	4,152,769

STATEMENT OF FINANCIAL POSITION	As at	PBS - Administered	PBS - Departmental	Variance
	30 June 18	30 June 18	30 June 18	30 June 18
	\$'000	\$'000	\$'000	\$'000
Total assets	148,343,319	140,032,075	27,042	8,284,202
Total liabilities	2,596,149	1,678,360	27,042	890,747
TOTAL EQUITY AND AMOUNT ATTRIBUTABLE TO THE GOVERNMENT	145,747,170	138,353,715	-	7,393,455

[#] Total expenses were lower than budgeted mainly due to the total budgeted expense estimate based on the consolidation of subsidiaries under accounting standards which is required for budget preparation. As the Fund applies the investment entity standard, expenses incurred in subsidiaries are not included in the financial statements as separate expenses but are included in the change in fair value of the investment entities in which the expenses are incurred.

OTHER MANDATORY REPORTING

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Resource statement

All costs for investment activity and the operations of the Board and Agency are met from the assets of the Funds rather than from annual appropriations through Parliament. The Board monitors the annual operating budget of the Agency to ensure the appropriate use of resources is consistent with the organisation's objectives.

Nonetheless, the Agency is required to publish information in line with the outcome and output statement used by government departments and Agencies.

The Future Fund was established in 2006 to strengthen the Australian Government's long-term financial position. The outcome for the Agency is: make provision for the Commonwealth's unfunded superannuation liabilities and development of infrastructure by managing the operational activities of the Future Fund, the Medical Research Future Fund, the DisabilityCare Australia Fund and the Nation-building Funds in line with the Government's Investment Mandates.

Agency resource statement

	Actual Available Appropriations for 2017-18 \$'000	Payments made 2017-18 \$'000	Balance remaining
Special Accounts			
Opening balance	-	-	-
Non-appropriation receipts to Special Accounts	376,498	376,498	-
Total Resourcing and Payments	376,498	376,498	-

The Future Fund does not receive any annual appropriations. Its outputs are funded, through the *Future Fund Act 2006*, as payments from the Future Fund Special Account. The Board invests amounts standing to the credit of the Future Fund Special Account, and the outputs are funded from the redemption of investments.

The receipts identified in the above table are sourced from the Future Fund Special Account: Investment of Public Money.

Resources for outcome

	Budget 2017-18 \$'000	Actual Expenses 2017-18 \$'000	Variation \$'000
Program 1.1 Management of the investment of the Future Fund			
Advances from the Special Account	69,720	67,418	2,302
Total for Program 1.1	69,720	67,418	2,302
Program 1.2 Management of the investment of BAF, EIF, DCAF, MRFF			
Advances from the Special Account	2,717	3,403	(686)
Total for Program 1.2	2,717	3,403	(686)
Total for Outcome 1	72,437	70,821	1,616

Procurement

The procurement of goods and services by the Agency is consistent with the Commonwealth Procurement Rules and 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 principles have been incorporated into the appropriate internal policies and internal audit conducts probity reviews to help ensure compliance.

The purchase of investment management, investment advisory, master custody and safekeeping services for the purpose of managing and investing the assets of public asset funds are excluded from the mandatory provisions of the Commonwealth Procurement Rules.

Annual reports contain information about actual expenditure on contracts for consultancies. Information on the value of contracts and consultancies is available on the AusTender website. Given the Agency's purpose, no campaign advertising was undertaken during the year and no reportable recruitment costs were incurred.

The Agency engages consultancy services in a variety of areas where specialist expertise is not available within the Agency or where an independent assessment is desirable. This is consistent with the Agency's outsourced business model. Selection processes may include open tender, selective tender, direct sourcing or the use of a panel.

During 2017-18 ten new consultancy contracts were entered into involving total actual expenditure of \$300,812. In addition three ongoing consultancy contracts were active during the 2017-18 year, involving total actual expenditure of \$802,795.

The Agency supports small business participation in the Commonwealth Government procurement market. Small and Medium Enterprises (SMEs) and Small Enterprise participation statistics are available on the Department of Finance's website.

The Agency recognises the importance of ensuring that small businesses are paid on time. The results of the survey of Australian Government Payments to Small Business are available on the Treasury's website.

The Agency's support for small business includes using the Commonwealth Contracting Suite for procurements under \$200,000 in accordance with applicable Department of Finance resource management guidance.

Freedom of Information

Agencies subject to the *Freedom of Information Act 1982* (FOI Act) are required to publish information to the public as part of the Information Publication Scheme (IPS). This requirement is in Part II of the FOI Act and has replaced the former requirement to publish a section 8 statement in an annual report. Each agency must display on its website a plan showing what information it publishes in accordance with the IPS requirements. Information regarding the Agency's Information Publication Scheme Plan is available at www.futurefund.gov.au/About-us/access-to-information/information-publication-scheme.

Advertising and market research

During the 2017-18 year the Agency undertook recruitment advertising. The total cost of this was \$3,130.

No campaign advertising was undertaken.

Grant programs

The organisation does not administer any grant programs.

Ecologically sustainable development and environmental Performance

The *Environment Protection and Biodiversity Conservation Act 1999* requires the Agency to report on how its activities accord with ecologically sustainable development and on its environmental performance.

The 'how we invest' section of this report refers to how environmental, social and governance matters are incorporated into the investment decision-making which is the central purpose of the organisation.

As a small tenant in a large multi-tenancy office building it is difficult to establish meaningful metrics for energy and water use or to establish appropriate benchmarking and monitoring arrangements. The building from which the Agency operates has a NABERS 3 star rating. Building management continues to implement a range of energy, waste recycling and water initiatives throughout the building including the Agency's tenancy.

A NABERS self-assessment of the Agency's tenancy during the year resulted in a rating of 5 stars. This is due to a number of energy saving initiatives, including recycling office consumables, and using energy saving features on office equipment and lighting.

Disability reporting mechanisms

Since 1994 Commonwealth departments and agencies have reported on their performance as policy adviser, purchaser, employer, regulator and provider under the Commonwealth Disability Strategy.

In 2007-08 reporting on the employer role was transferred to the Australian Public Service Commission's State of the Service Report and the APS Statistical Bulletin. These reports are available at www.apsc.gov.au. From 2010-11 departments and agencies have no longer been required to report on these functions.

The Commonwealth Disability Strategy has been overtaken by a new National Disability Strategy 2010–2020, which sets out a 10-year national policy framework to improve the lives of people with disability, promote participation and create a more inclusive society. A high level two-yearly report will track progress against each of the six outcome areas of the Strategy and present a picture of how people with disability are faring. The first of these reports can be found at www.dss.gov.au.

2017-18 annual performance statement

Introductory statement

As required by the *Future Fund Act 2006* and the *Public Governance, Performance and Accountability Act 2013* (PGPA Act), this annual performance statement relates to the Future Fund Management Agency (Agency) and the Future Fund Board of Guardians (Board) as if they were a single Commonwealth entity (collectively referred to as the 'organisation').

As the accountable authority of the organisation for this purpose, I present the annual performance statement of the organisation, as required under paragraph 39(1)(a) of the PGPA Act. In my opinion, this annual performance statement is based on properly maintained records, accurately reflects the performance of the organisation, and complies with subsection 39(2) of the PGPA Act.

Hon Peter Costello AC
Accountable Authority, Future Fund Management Agency
Chair, Future Fund Board of Guardians
25 September 2018

Purpose

The organisation is responsible for investing for the benefit of future generations of Australians. Established in 2006 as Australia's sovereign wealth fund, its main objective is to strengthen the Commonwealth's long-term financial position.

The Board has responsibility for investing the assets of special purpose public asset funds including the Future Fund, the Medical Research Future Fund, the DisabilityCare Australia Fund and two Nation-building Funds (the Building Australia Fund and the Education Investment Fund).

Each fund is established by legislation and the risk and return objectives for each of the funds are set by Investment Mandate Directions issued by the Treasurer and Minister for Finance to the Board.

The Agency supports the Board with investing funds for which the Board is responsible in line with the Investment Mandate Directions for each fund.

The Portfolio Budget Statements identify the Outcome as: Make provision for the Commonwealth's unfunded superannuation liabilities, payments for the creation and development of infrastructure and payments from the DisabilityCare Australia Fund and Medical Research Future Fund by managing the investment activities of the Future Fund, Nation-building Funds, DisabilityCare Australia Fund and Medical Research Future Fund, in line with the Government's investment mandates (Outcome 1).

Results

As an investment institution, the achievement of the return and risk objectives set by the Government for each special purpose public fund is the key measure of performance. These expectations are set out in the Investment Mandate Directions issued by the responsible Ministers.

Performance criterion one – management of the investment of the Future Fund

Provide assistance and advice to the Board in pursuit of achieving the Investment Mandate target return over the long term (interpreted as rolling 10-year periods) with acceptable but not excessive risk.

The target return set out in the Investment Mandate is an average of at least 4% to 5% above the Consumer Price Index (CPI) over the long term.

Criterion source

2017-18 performance criteria outlined the 2017-18 Portfolio Budget Statements (Outcome 1, Program 1.1) and the 2017-18 Corporate Plan (Section 3, Performance).

Result against performance criterion

Performance against the Future Fund Investment Mandate Direction is set out in the table below.

Returns: Future Fund

Period to 30 June 2018	Return pa (%)	Target return ¹ pa (%) (CPI + target return)
From May 2006	7.9	6.8
10 years	8.7	6.6
Seven years	9.9	6.3
Five years	10.4	6.3
Three years	7.6	6.0
One year	9.3	6.1

¹ The Investment Mandate sets a benchmark target return of at least CPI + 4.5% to 5.5% pa to 30 June 2017 and CPI + 4% to 5% pa thereafter.

Performance criterion two – management of the investment of the Australian Government investment funds

Provide assistance and advice to the Board in pursuit of achieving the Investment Mandate Direction target returns as follows:

- For each of the Nation-building Funds and the DisabilityCare Australia Fund, the Australian three-month bank bill swap rate + 0.3% per annum, calculated on a rolling 12-month basis while minimising the probability of capital loss over a 12-month horizon.
- For the Medical Research Future Fund, an average return of at least the Reserve Bank of Australia Cash Rate target +1.5% to 2.0% per annum, net of investment fees, over a rolling 10-year term with acceptable but not excessive risk.

Criterion source

2017-18 performance criteria outlined the 2017-18 Portfolio Budget Statements (Outcome 1, Program 1.2) and the 2017-18 Corporate Plan (Section 3, Performance).

Result against performance criterion

In 2017-18, the Nation-building Funds (the Building Australia Fund and Education Investment Fund) each achieved a return of 2.1%. The target benchmark return for the Nation-building Funds during the period was 2.1%.

In 2017-18 the DisabilityCare Australia Fund generated a return of 2.1%. The target benchmark return for the period was 2.1%.

From inception in September 2015 to 30 June 2018, the Medical Research Future Fund has generated a return of 4.2% pa against a target benchmark return of 3.1% pa. In 2017-18 the Fund achieved a return of 4.7%, exceeding its target benchmark of 3.0%.

Analysis of performance against purpose

The organisation is performing well against its stated purpose.

The Future Fund's revised Investment Mandate of CPI + 4% to 5% per annum took effect from 1 July 2017 and reflects the Government's view of the lower forward looking return investment environment we are operating in.

The Fund has exceeded the target benchmark return over each time period since inception adding over \$85.3 billion to the value of the Future Fund. These returns have been delivered while avoiding excessive risk.

The Medical Research Future Fund has exceeded its target benchmark return since inception. We have continued to diversify the Fund in line with our investment strategy, including allocations to property in 2017-18. The Fund also exceeded its target benchmark over a one-year period, noting that returns are to be assessed over rolling 10-year periods.

The DisabilityCare Australia Fund and Nation-building Funds also performed well, meeting their target benchmark in 2017-18.

Across the financial year, economic growth was stronger than expected and global markets strengthened, however long-term risks are building.

As interest rates around the world begin rising towards more normal levels we expect to see downward pressure on asset prices. Adding to this, international political tensions continue to impact markets and the potential for further shocks remains.

We maintain our view that prospective long-term returns are lower relative to history. We will continue to exercise patience and diligence in investing the assets of the funds in line with their relevant Investment Mandate Directions, only taking on risk where it is adequately rewarded.

REFERENCES AND INDEX

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Appendix A: Investment managers engaged by the Future Fund Board of Guardians as at 30 June 2018

Table: Investment managers as at 30 June 2018

Asset Class	Manager
Equities	
Australian Equities	• Macquarie Investment Management
Developed market equities	• Blackstone Alternative Asset Management • BlackRock Alternative Advisors • Man GLG • MFS Investment Management • State Street Global Advisors
Emerging market equities	• Mondrian Investment Partners • State Street Global Advisors • Trilogy Global Advisors
Private equity	
Buy out	• Advent International Corporation • American Industrial Partners • Apax Partners • Archer Capital • Bain Capital • Berkshire Partners • Charterhouse Capital Partners • GI Partners • Hellman & Friedman • Quadrant Private Equity • RCP Advisors • Seidler Equity Partners • Southern Cross Management • The Growth Fund • Vitruvian Investment Partners

Asset Class	Manager
Venture and growth	• Adams Street Partners • Bessemer Venture Partners • CDH Investments • Columbia Capital • FountainVest Partners • Greenspring Associates • Hillhouse Capital • Horsley Bridge Partners • Insight Venture Partners • Lightspeed Venture Partners • New Enterprise Associates • Playground Global • Quilvest • Xiang He Capital
Special opportunities	• Adams Street Partners • HarbourVest Partners • Oaktree Capital Management • TowerBrook Capital Partners
Property	
Unlisted	• Altarea Cogedim • Berkshire Property Advisors • BlackRock • Brookfield Asset Management • Columbia Pacific Advisors • CorVal Partners • DEXUS Funds Management • Garrison Investment Group LP • Harbert Management Corporation • Hillwood Investment Properties • ICAMAP Advisory • Lend Lease Investment Management • Morgan Stanley Real Estate Investing • PEET Limited • The Townsend Group • TIAA-CREF/TIAA Henderson Real Estate • Vicinity Centres
Listed	• CBRE Clarion Real Estate Securities

Asset Class	Manager
Infrastructure & Timberland	
Unlisted	• AMP Capital Investors • Campbell Global • Corsair Infrastructure Management • Global Infrastructure Partners • HRL Morrison & Co • Morgan Stanley Infrastructure • Oaktree Capital Management • Starwood Energy • QIC Global Infrastructure
Listed	• DWS
Debt	
High grade debt	• Colonial First State Global Asset Management • Goldman Sachs Asset Management • M&G Investment Management Limited • Macquarie Investment Management • PIMCO Australia
High yield debt	• Ares Management • Bain Capital Credit • BlackRock Investment Management • Glen Point Capital • Haymarket Financial • Lazard Asset Management • Oak Hill Advisors • Oaktree Capital Management • PAG Holdings Limited • Quadrant Real Estate Advisors • Westbourne Credit Management Limited
Distressed and event driven	• Bain Capital Credit • Centerbridge Partners L.P. • Oak Hill Advisors • Oaktree Capital Management

Asset Class	Manager
Alternatives	
Multi-strategy/relative value	• Arrowgrass Capital Partners • BlackRock Alternative Advisors • Citadel Advisors • PAG Holdings Limited • Wellington Management
Macro-directional	• AHL Partners • BlackRock Alternative Advisors • Brevan Howard Asset Management • Bridgewater Associates • Citadel Advisors • Clocktower Group L.P. • Glen Point Capital • GMO Australia • Ionic Capital Management • Key Square Capital Management • Pental Group • QMS Capital Management
Alternative Risk Premia	• Atom Investors L.P. • Elementum Advisors • Hiscox Re Insurance Linked Strategies Ltd. • Man FRM Investment Management • SouthPeak Investment Management
Overlay strategies	• Ashmore Investment Management Limited • Insight Investment Management (Global) • Legal & General Investment Management Limited • Macquarie Investment Management • PIMCO Australia • State Street Global Advisors Limited • UBS Securities Australia Limited
Cash	• Colonial First State Global Asset Management • Macquarie Investment Management • PIMCO Australia

Appendix B: Investment Mandate Directions

Future Fund Investment Mandate Direction 2014 – superseded

Part 1 – Preliminary

1. Name of Direction

This Direction is the *Future Fund Investment Mandate Direction 2014*.

2. Commencement

This Direction commences on the 15th day after it is given.

Note: Section 42 of the *Legislative Instruments Act 2003* (which deals with the disallowance of legislative instruments) does not apply to this instrument: see section 44 of that Act. Part 6 of that Act (which deals with the sunset of legislative instruments) does not apply to this instrument: see section 54 of that Act.

3. Revocation of Previous Direction

The *Future Fund Investment Mandate Directions 2006* are revoked in full.

4. Definitions

In this Direction:

Act means the *Future Fund Act 2006*.

Fund means the Future Fund.

Board means the Future Fund Board of Guardians.
responsible Ministers has the same meaning as in the Act.

5. Object of this Direction

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 object of this Direction 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.

This Direction is 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 – Direction

6. 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.

7. 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 84C 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.

Future Fund Investment Mandate Direction 2017

Part 1 – Preliminary

1. Name of Direction

This Direction is the *Future Fund Investment Mandate Direction 2017*.

2. Commencement

This Direction commences on 1 July 2017, or on the 15th day after it is given to the Board, whichever occurs later.

Note: Section 42 of the *Legislative Instruments Act 2003* (which deals with the disallowance of legislative instruments) does not apply to this instrument: see section 44 of that Act. Part 6 of that Act (which deals with the sunset of legislative instruments) does not apply to this instrument: see section 54 of that Act.

3. Revocation of Previous Direction

The *Future Fund Investment Mandate Direction 2014* is revoked in full.

4. Definitions

In this Direction:

Act means the *Future Fund Act 2006*.

Fund means the Future Fund.

Board means the Future Fund Board of Guardians.
responsible Ministers has the same meaning as in the Act.

5. Object of this Direction

The object of this Direction 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.

This Direction is 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 – Direction

6. Benchmark return

The Board is to adopt an average return of at least the Consumer Price Index (CPI) + 4 to + 5 per cent per annum over the long term as the benchmark return on the Fund.

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.

7. 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 84C 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.

Medical Research Future Fund Investment Mandate Direction 2015

Part 1 – Preliminary

1. Name of Direction

This Direction is the *Medical Research Future Fund Investment Mandate Direction 2015*.

2. Commencement

This Direction commences on the 15th day after it is given.

Note: Section 42 of the *Legislative Instruments Act 2003* (which deals with the disallowance of legislative instruments) does not apply to this instrument: see section 44 of that Act. Part 6 of that Act (which deals with the sunset of legislative instruments) does not apply to this instrument: see section 54 of that Act.

3. Definitions

In this Direction:

Act means the *Medical Research Future Fund Act 2015*.

Board means the Future Fund Board of Guardians.

Fund means the Medical Research Future Fund.

responsible Ministers has the same meaning as in the Act.

4. Object of this Direction

The Fund has been established to provide grants of financial assistance to support medical research and medical innovation over the long term.

The object of this Direction is to give guidance to the Board in relation to its investment strategy for the Fund. The Board is required under section 40 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
- to enhance the commonwealth's ability to provide grants of financial assistance to support medical research and innovation,

subject to its obligations under the Act and any directions given by the responsible Ministers under the Act.

This Direction is given under subsection 39(1) of the Act to articulate the Government's expectations for how the Fund will be invested and managed by the Board.

Part 2 – Direction

5. Benchmark return

The Board is to adopt an average return of at least the Reserve Bank of Australia Cash Rate target + 1.5 to 2.0 per cent per annum, net of investment fees, over a rolling 10 year term as the benchmark return on the Fund.

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. In determining the level of risk, the Board must take into account:

- the principle that the nominal value of the credits to the Fund be preserved over the long term; and
- the principle to moderate the volatility of the maximum annual distribution.

6. 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.

7. 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.

DisabilityCare Australia Fund Investment Mandate Directions 2014¹

Part 1 – Preliminary

1. Name of Directions

These Directions are the *DisabilityCare Australia Fund Investment Mandate Directions 2014*.

2. Commencement

These Directions commence on the 15th day after they are given.

Note: Section 42 of the *Legislative Instruments Act 2003* (which deals with the disallowance of legislative instruments) does not apply to this instrument: see section 44 of that Act. Part 6 of that Act (which deals with the sunset of legislative instruments) does not apply to this instrument: see section 54 of that Act.

3. Definitions

In these Directions:

Act means the *DisabilityCare Australia Fund Act 2013*.

Board means the Future Fund Board of Guardians.

Fund means the DisabilityCare Australia Fund.

responsible Ministers has the same meaning as in the Act.

4. Object of these Directions

- (1) The DisabilityCare Australia Fund is a financing source to enhance the Commonwealth's ability to reimburse the States and Territories and the Commonwealth for the expenditure incurred in relation to the *National Disability Insurance Scheme Act 2013*.
- (2) The object of these Directions is to give guidance to the Board in relation to its investment strategy for the Fund. The Board is required by the Act to seek to maximise the return earned on the Fund, consistent with international best practice for institutional investment, subject to its obligations under the Act and any directions given by the responsible Ministers under the Act.
- (3) These Directions are given under subsection 29(1) of the Act to articulate the Government's expectations for how the Fund will be invested and managed by the Board.
- (4) The responsible Ministers may review these Directions, in consultation with the Board, including after any request by the Board in the context of any material changes to either the prevailing investment conditions or the cashflow position of the Fund.

Part 2 – Directions

5. Investment Objectives

- (1) The Board should invest in such a way as to minimise the probability of capital losses over a 12 month horizon.
- (2) Subject to the Board's obligations under section 23 of the Act and to (1) above, the Board is to adopt a benchmark return on the Fund of the Australian three month bank bill swap rate + 0.3 per cent per annum, calculated on a rolling 12-month basis (net of fees).

6. The Board must consider impacts from its investment strategy

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

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

1. All legislative instruments and compilations are registered on the Federal Register of Legislative Instruments kept under the *Legislative Instruments Act 2003*. See <http://www.frli.gov.au>.

Building Australia Fund Investment Mandate Directions 2009¹

Part 1 – Preliminary

1. Name of Directions

These Directions are the *Building Australia Fund Investment Mandate Directions 2009*.

2. Commencement

These Directions commence on the 15th day after they are given.

Note: Section 42 of the *Legislative Instruments Act 2003* (which deals with the disallowance of legislative instruments) does not apply to this instrument: see section 44 of that Act. Part 6 of that Act (which deals with the sunset of legislative instruments) does not apply to this instrument: see section 54 of that Act.

3. Definitions

In these Directions:

Act means the *Nation-building Funds Act 2008*.

Board means the Future Fund Board of Guardians.

Fund means the Building Australia Fund.

responsible Ministers has the same meaning as in the Act.

4. Object of these Directions

- (1) The Building Australia Fund is a financing source to enhance the Commonwealth's ability to make payments in relation to the creation or development of transport, communications, energy and water infrastructure, and eligible national broadband network matters.
- (2) The object of these Directions is to give guidance to the Board in relation to its investment strategy for the Fund. The Board is required by the Act to seek to maximise the return earned on the Fund, 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 the Act.
- (3) These Directions are given under subsection 35 (1) of the Act to articulate the Australian Government's expectations of how the Fund will be invested and managed by the Board.
- (4) The responsible Ministers may review these Directions, including the benchmark return, in consultation with the Board. The first review is expected to occur before 1 July 2010.

Part 2 – Directions

5. Benchmark return

- (1) The Board is to adopt a benchmark return on the Fund of the Australian three month bank bill swap rate + 0.3 per cent per annum, calculated on a rolling 12 month basis (net of fees).
- (2) In targeting this benchmark return, the Board should invest in such a way as to minimise the probability of capital losses over a 12 month horizon.

6. 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.

1. All legislative instruments and compilations are registered on the Federal Register of Legislative Instruments kept under the *Legislative Instruments Act 2003*. See <http://www.frli.gov.au>.

Education Investment Fund Investment Mandate Directions 2009¹

Part 1 – Preliminary

1. Name of Directions

These Directions are the *Education Investment Fund Investment Mandate Directions 2009*.

2. Commencement

These Directions commence on the 15th day after they are given.

Note: Section 42 of the *Legislative Instruments Act 2003* (which deals with the disallowance of legislative instruments) does not apply to this instrument: see section 44 of that Act. Part 6 of that Act (which deals with the sunset of legislative instruments) does not apply to this instrument: see section 54 of that Act.

3. Definitions

In these Directions:

Act means the *Nation-building Funds Act 2008*.

Board means the Future Fund Board of Guardians.

Fund means the Education Investment Fund.

responsible Ministers has the same meaning as in the Act.

4. Object of these Directions

- (1) The Education Investment Fund is a financing source to enhance the Commonwealth's ability to make payments in relation to the creation or development of higher education, research, vocational education and training and eligible education infrastructure, and to make transitional Higher Education Endowment Fund payments.
- (2) The object of these Directions is to give guidance to the Board in relation to its investment strategy for the Fund. The Board is required by the Act to seek to maximise the return earned on the Fund, 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 the Act.
- (3) These Directions are given under subsection 154 (1) of the Act to articulate the Australian Government's expectations of how the Fund will be invested and managed by the Board.
- (4) The responsible Ministers may review these Directions, including the benchmark return, in consultation with the Board. The first review is expected to occur before 1 July 2010.

Part 2 – Directions

5. Benchmark return

- (1) The Board is to adopt a benchmark return on the Fund of the Australian three month bank bill swap rate + 0.3 per cent per annum, calculated on a rolling 12 month basis (net of fees).
- (2) In targeting this benchmark return, the Board should invest in such a way as to minimise the probability of capital losses over a 12 month horizon.

6. 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.

1. All legislative instruments and compilations are registered on the Federal Register of Legislative Instruments kept under the *Legislative Instruments Act 2003*. See <http://www.frli.gov.au>.

Appendix C: Implementation of the Santiago Principles

The Santiago Principles are a voluntary set of principles and practices which are voluntarily endorsed by members of the International Forum of Sovereign Wealth Funds (IFSFW).

The Santiago Principles identify a framework of generally accepted principles and practices that properly reflect appropriate governance and accountability arrangements as well as the conduct of investment practices by Sovereign Wealth Funds (SWFs) on a prudent and sound basis.

The IFSWF was established in 2009 to meet, exchange views on issues of common interest, and facilitate an understanding of the Santiago Principles and SWF activities. The Future Fund Board of Guardians (the Board of Guardians) is a founding member of the IFSWF with David Murray (Chairman of the Board of Guardians, 2006–2012) serving as the IFSWF's inaugural Chairman.

This document describes how the Board of Guardians implements the Santiago Principles.

Principle	Implementation and reference material
1 The legal framework should be sound and support the SWF's effective operation and the achievement of its stated objectives. 1.1 The legal framework should ensure the legal soundness of the SWF and its transactions. 1.2 The key features of the SWF's legal basis and structure, as well as the legal relationship between the SWF and other state bodies, should be publicly disclosed.	The legal framework for the Board of Guardians and its supporting management team in the Future Fund Management Agency (Agency), together with arrangements for the governance and operation of the public asset funds for which the Board of Guardians is responsible, are detailed in the <i>Future Fund Act 2006</i>, the <i>Nation- building Funds Act 2008</i>, the <i>DisabilityCare Australia Fund Act 2013</i> and the <i>Medical Research Future Fund Act 2015</i>. The framework is designed specifically to establish the sound and effective operation of the organisation and achievement of its objectives. The legal basis and structure and the legal relationships between the Board of Guardians, Agency and the Australian Government is detailed in the legislation which is publicly available. Additional detail and discussion of the basis and operation of the Board, Agency and the various public asset funds themselves are available from the Board's annual report and website. www.futurefund.gov.au/About-us/Legislation-and-governance www.futurefund.gov.au/investment/how-we-invest/investment-mandates

Principle	Implementation and reference material
2 The SWF's policy purpose should be clearly defined and publicly disclosed.	The Future Fund was established to strengthen the Australian Government's long-term financial position. The Nation-building Funds were established to provide financing resources to meet the Australian Government's commitment to Australia's future through investment in critical areas of infrastructure such as transport, communications, energy, water, education, research and health. The DisabilityCare Australia Fund was established by legislation with the object of reimbursing States, Territories and the Commonwealth for expenditure incurred in relation to the <i>National Disability Insurance Scheme Act 2013</i> and to fund implementation of the <i>National Disability Insurance Scheme Act 2013</i> in its initial period of operation. The Medical Research Future Fund was established to improve the health and wellbeing of Australians by providing grants of financial assistance to support medical research and medical innovation. The Board of Guardians is responsible for the investment of the assets in each of these Funds, not for disbursements or other policy issues. Detail on the policy purpose for each of the Funds is provided in the relevant legislation, annual reports and the organisation's website. www.futurefund.gov.au/About-us/Legislation-and-governance www.futurefund.gov.au/investment/how-we-invest/investment-mandates www.futurefund.gov.au/About-us/annual-reports

Principle	Implementation and reference material
3 Where the SWF has significant direct domestic macroeconomic implications, those activities should be closely coordinated with domestic fiscal and monetary authorities so as to ensure consistency with the overall macroeconomic policies.	The Australian Government is responsible for determining the timing and extent of withdrawals from the Future Fund, the Nation-building Funds, the DisabilityCare Australia Fund and the Medical Research Future Fund subject to legislative constraints. The Commonwealth's financial position, including the assets of the Future Fund, the Commonwealth's unfunded superannuation liabilities and the assets held in other Funds invested by the Board of Guardians, is a matter for Government. Full details are published annually in the Australian Government Budget Papers and other related documents. The Board of Guardians does not have control or influence over management of the liabilities and frames its investment strategy around the Investment Mandate Directions issued by the responsible Ministers under the legislation. The Investment Mandate Directions do not direct the Board of Guardians to invest in particular sectors or asset classes domestically or internationally. Based on its mandate the Board of Guardians develops and implements appropriate investment portfolios in line with the Investment Mandate Directions. In establishing the Nation-building Funds the Australian Government made a commitment that spending proposals would be delivered in line with prevailing macroeconomic conditions. Spending from the Nation-building Funds is undertaken consistent with the legislated process and as part of the usual Budget process within the limits of the legislated General Drawing Rights Limit. Withdrawals from the DisabilityCare Australia Fund and Medical Research Future Fund are made in accordance with the governing legislation. Coordination by Government with all relevant fiscal and monetary authorities, and relevant departments, is undertaken as part of the legislated processes for withdrawals. www.futurefund.gov.au/About-us/Legislation-and-governance www.budget.gov.au
4 There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF's approach to funding, withdrawal and spending operations. 4.1 The source of SWF funding should be publicly disclosed. 4.2 The general approach to withdrawals from the SWF and spending on behalf of the government should be disclosed.	Legislation publicly sets out the funding, withdrawal and spending arrangements and procedures for the funds, including arrangements for Parliamentary oversight and public disclosure of funding, withdrawals and spending. The source of funding is publicly disclosed together with the approach to withdrawals and spending of monies. Details on planned contributions to and withdrawals from the funds are included in the Australian Government's annual Budget. www.futurefund.gov.au/About-us/Legislation-and-governance www.finance.gov.au/investment-funds/ www.budget.gov.au

Principle	Implementation and reference material
5 The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or otherwise as required, for inclusion where appropriate in macroeconomic data sets.	Statistical data is consolidated in national financial accounts, government financial statistics, the balance of payments and international investment position by the Australian Bureau of Statistics in accordance with its regular data collection and reporting arrangements. Data is also incorporated into the Government's budget statements. Audited annual financial statements are tabled in Parliament and quarterly updates on the portfolio are released publicly. www.abs.gov.au www.futurefund.gov.au/investment/investment-performance/portfolio-updates www.futurefund.gov.au/about-us/annual-reports
6 The governance framework for the SWF should be sound and establish clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.	The roles and responsibilities of the Government, as asset owner, and the Board of Guardians and Agency, as asset manager are detailed in the legislation. Further detail is provided by the Investment Mandate Directions for each Fund and the Statement of Expectations and Statement of Intent exchanged between the Government and the Board of Guardians and the Agency. Internal policies, procedures and protocols have been established to further delineate roles and responsibilities at the operational level. www.futurefund.gov.au/About-us/Legislation-and-governance
7 The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF's operations.	The objective for each Fund, the procedures for the appointment of the Board of Guardians by Government and arrangements for the exercise of oversight, while maintaining the investment independence of the Board of Guardians, are detailed in the legislation. www.futurefund.gov.au/About-us/Legislation-and-governance
8 The governing body(ies) should act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions.	The Board of Guardians is bound by the legislation and Investment Mandate Directions set by Government to pursue the investment objectives detailed in the legislation and to act in good faith. The legislation also provides the Board of Guardians with the necessary powers to undertake its mandated activities and sets out the experience, expertise and credibility required of appointees to the Board of Guardians. www.futurefund.gov.au/About-us/Legislation-and-governance www.futurefund.gov.au/investment/how-we-invest/investment-mandates

Principle	Implementation and reference material
9 The operational management of the SWF should implement the SWF's strategies in an independent manner and in accordance with clearly defined responsibilities.	The Board of Guardians is responsible for investing the assets of the funds in accordance with the legislation and makes decisions independently of Government. The legislation establishes the Agency to provide support and advice to the Board of Guardians and to assist in giving effect to its decisions. Clear internal policies, procedures and protocols have been established to further delineate roles and responsibilities at the operational level. www.futurefund.gov.au/About-us/Legislation-and-governance
10 The accountability framework for the SWF's operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.	Accountability arrangements, including the requirement for publication of an annual report and arrangements for the provision of reports and information to the responsible Ministers, are detailed in the legislation. Members of the Board of Guardians are held accountable through the requirements imposed on them through the legislation, with civil and criminal penalties applying for breach of specific duties and obligations. Further accountability is also provided through the operation of the <i>Public Governance, Performance and Accountability Act 2013</i> governing the establishment and operation of Special Accounts for each Fund. www.futurefund.gov.au/About-us/Legislation-and-governance
11 An annual report and accompanying financial statements on the SWF's operations and performance should be prepared in a timely fashion and in accordance with recognised internal or national accounting standards in a consistent manner.	An annual report (prepared in accordance with the requirements of the <i>Future Fund Act 2006</i> and the <i>Public Governance Reporting and Accountability Act 2014</i>) and audited financial statements are prepared in accordance with the Public Governance, Performance and Accountability (Financial Reporting) Rule. The legislation requires that the annual report and audited financial statements are presented to the responsible Minister as soon as practicable after the end of each financial year and tabled in Parliament within 15 sitting days of each House of Parliament. www.futurefund.gov.au/About-us/Legislation-and-governance www.futurefund.gov.au/annual-reports
12 The SWF's operations and financial statements should be audited annually in accordance with recognised international or national auditing standards in a consistent manner.	Internal audit services are provided by an external firm reporting to the Audit Committee of the Board of Guardians. The Australian National Audit Office is responsible for an annual independent external audit conducted in accordance with the Australian National Audit Office Auditing Standards, which incorporate Australian Auditing Standards. www.futurefund.gov.au/About-us/annual-reports www.anao.gov.au

Principle	Implementation and reference material
13 Professional and ethical standards should be clearly defined and made known to the members of the SWF's governing body(ies), management and staff.	The duties and obligations of members of the Board of Guardians are detailed in the legislation together with arrangements for the management of conflicts of interest. The legislation also includes details of the civil and criminal penalties applying for breach of specific duties and obligations. Persons are eligible for appointment to the Board only if the responsible Ministers are satisfied the person has substantial experience or expertise and professional credibility and significant standing in investing in financial assets, managing investments in financial assets or corporate governance. Staff of the Agency are employed under the <i>Public Service Act 1999</i> and are bound by the Australian Public Service Values and Code of Conduct. Details of these obligations are included in internal policies and training activities. www.futurefund.gov.au/About-us/Legislation-and-governance www.apsc.gov.au/values/conductguidelines.htm
14 Dealing with third parties for the purpose of the SWF's operational management should be based on economic and financial grounds, and follow clear rules and procedures.	The approach to engaging third parties, including advisors and investment managers, by the Board of Guardians and the Agency is outlined in a Statement of Investment Policies available on the internet. Engagement of third parties is based on economic and financial grounds. The purchase of goods and services by the Agency is consistent with the Commonwealth Procurement Rules and governed by clear internal policies and procedures to encourage value for money, open and effective competition and fair dealing and ethics. www.futurefund.gov.au/investment/how-we-invest/investment-policy-and-position-papers
15 SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.	The Board of Guardians requires that all investment activities are undertaken in accordance with applicable regulatory and disclosure requirements. Detailed due diligence and reporting is in place to monitor compliance. The legislation requires the Board of Guardians to act in a way that is unlikely to cause any diminution of the Australian Government's reputation in international financial markets. www.futurefund.gov.au/About-us/Legislation-and-governance
16 The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.	The governance framework and objectives of the Board of Guardians and the Agency are set out in the legislation and in public annual reports. The framework clearly establishes the independence and accountability arrangements for each Fund, the Board of Guardians and the Agency. www.futurefund.gov.au/About-us/Legislation-and-governance www.futurefund.gov.au/annual-reports

Principle	Implementation and reference material
17 Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in internal financial markets and enhance trust in recipient countries.	An annual report and audited annual financial statements are tabled in Parliament and published via the website. The Board also issues public quarterly updates on performance and asset allocation and routinely provides updates on the operations and performance of the various Funds during formal public hearings before a Committee of the Senate. www.futurefund.gov.au/annual-reports www.futurefund.gov.au/investment/investment-performance/portfolio-updates
18 The SWF's investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the owner of the governing body(ies), and be based on sound portfolio management principles. 18.1 The investment policy should guide the SWF's financial risk exposures and possible use of leverage. 18.2 The investment policy should address the extent to which internal and/or external investment managers are used, the range of their activities and authority, and the process by which they are selected and their performance monitored. 18.3 A description of the investment policy of the SWF should be publicly disclosed.	A Statement of Investment Policies, published on the internet as required by legislation, details the investment strategy and risk tolerance of the Board of Guardians and its application of portfolio investment principles. Annual reports, as well as regular public speeches and briefings, provide additional insight and discussion of the investment strategy. The Board is prohibited from borrowing under Section 23 of the Future Fund Act. These documents and communication activities address matters relating to financial risk, leverage, the use of and extent of the activities and authority of internal/external managers as well as the process for their appointment and monitoring of their performance. The policies and practices detailed by these documents and communications are consistent with the obligations contained in the legislation. www.futurefund.gov.au/About-us/Legislation-and-governance www.futurefund.gov.au/investment/how-we-invest/investment-policy-and-position-papers www.futurefund.gov.au/annual-reports

Principle	Implementation and reference material
19 The SWF's investment decisions should aim to maximise risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds. 19.1 If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed. 19.2 The management of the SWF's assets should be consistent with what is generally accepted as sound asset management principles.	The Board of Guardians is obliged by legislation to seek to maximise risk-adjusted financial returns. Return and risk parameters for each Fund are detailed through Investment Mandate Directions created under relevant legislation. The Board of Guardians is required to operate in a manner consistent with international best practice for institutional investment. The limited set of restrictions on the Board's investment activities, such as limits on the size of stakes in Australian and foreign listed companies, are clearly expressed in the legislation. The approach to consideration of environmental, social and governance matters, and to the universe of investments the Board of Guardians considers, is detailed in the Statement of Investment policies and reflects the organisation's focus on acting as a prudent investor seeking to maximise risk-adjusted returns. www.futurefund.gov.au/About-us/Legislation-and-governance www.futurefund.gov.au/investment/how-we-invest/investment-policy-and-position-papers
20 The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.	The Board of Guardians does not seek or have a right of access to privileged information from, or inappropriate influence by, the Government in competing with private entities. Under the statutory governance framework the Board of Guardians operates and makes decisions independently of Government. Policies and processes are in place to restrict and coordinate engagement with the Government in relation to matters concerning the Board of Guardians and Agency. Board members are not permitted to be employees of the Commonwealth or to be holders of a full-time office under a law of the Commonwealth. Agency staff are bound by the Australian Public Service Code of Conduct. The Investment Mandate Directions also requires the Board of Guardians, when undertaking its investment activities, to act in a way that is unlikely to cause any diminution of the Government's reputation in Australian and international financial markets. www.futurefund.gov.au/About-us/Legislation-and-governance www.futurefund.gov.au/investment/how-we-invest/investment-mandates
21 SWFs view shareholder ownership rights as a fundamental element of their equity investments' value. If a SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.	The Board of Guardians is required to have regard to international best practice for institutional investment in determining its approach to corporate governance principles, including in relation to its voting policy. Its approach to the exercise of ownership and voting rights is detailed in the Statement of Investment Policies. The annual report discusses the application of this policy including reporting in aggregate of how voting rights have been exercised. www.futurefund.gov.au/investment/how-we-invest/investment-policy-and-position-papers www.futurefund.gov.au/investment/how-we-invest/investment-mandates

Principle	Implementation and reference material
22 The SWF should have a framework that identifies, assesses and manages the risks of its operations. 22.1 The risk management framework should include reliable information and timely reporting systems, which should enable the adequate monitoring and management of relevant risks within acceptable parameters and levels, control and incentive mechanisms, codes of conduct, business continuity planning and an independent audit function. 22.2 The general approach to the SWF's risk management framework should be publicly disclosed.	Consistent with the legislation, Investment Mandate Directions and obligation to have regard to international best practice for institutional investment, the Board of Guardians and Agency have established a framework for the identification, assessment and management of the risks of its operations, including appropriate reporting and monitoring arrangements. Policies and procedures are in place to support the risk management framework. The approach to risk management is detailed in the Statement of Investment Policies and the annual report. www.futurefund.gov.au/investment/how-we-invest/investment-policy-and-position-papers www.futurefund.gov.au/About-us/annual-reports
23 The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.	The assets and investment performance of the Funds, including performance against the benchmarks established in the Investment Mandate Directions, are reported to the responsible Ministers and publicly through quarterly portfolio updates and an annual report (including audited financial statements) which is tabled in Parliament. www.futurefund.gov.au/About-us/annual-reports
24 A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.	The Board of Guardians undertakes an annual review of its implementation of the Santiago Principles. The Board of Guardians has contributed to the IFSWF's reports on the application of the Santiago Principles. The organisation also regularly participates in workshops and discussions with other members of the IFSWF on best practice approaches to the investment and governance of SWFs. www.futurefund.gov.au/About-us/Legislation-and-governance www.ifswf.org

Appendix D: List of requirements

This list of requirements is provided as a checklist against the requirements detailed in Resource Management Guide No. 135, 'Annual reports for non-corporate Commonwealth entities', in line with reporting requirements under 17AJ(d) of the PGPA rule.

PGPA Rule Reference	Part of Report	Description	Requirement	Location in Annual Report
17AD(g)	Letter of transmittal			
17AI		A copy of the letter of transmittal signed and dated by accountable authority on date final text approved, with statement that the report has been prepared in accordance with section 46 of the Act and any enabling legislation that specifies additional requirements in relation to the annual report.	Mandatory	p2
17AD(h)	Aids to access			
17AJ(a)		Table of contents.	Mandatory	p1
17AJ(b)		Alphabetical index.	Mandatory	p195–199
17AJ(c)		Glossary of abbreviations and acronyms.	Mandatory	p194
17AJ(d)		List of requirements.	Mandatory	p188–193
17AJ(e)		Details of contact officer.	Mandatory	Inside front cover
17AJ(f)		Entity's website address.	Mandatory	Inside front cover
17AJ(g)		Electronic address of report.	Mandatory	Inside front cover
17AD(a)	Review by accountable authority			
17AD(a)		A review by the accountable authority of the entity.	Mandatory	p4–5
17AD(b)	Overview of the entity			
17AE(1)(a)(i)		A description of the role and functions of the entity.	Mandatory	p8–13
17AE(1)(a)(ii)		A description of the organisational structure of the entity.	Mandatory	p66–74
17AE(1)(a)(iii)		A description of the outcomes and programmes administered by the entity.	Mandatory	p8–12, p30–65
17AE(1)(a)(iv)		A description of the purposes of the entity as included in corporate plan.	Mandatory	p8–12, p165–167
17AE(1)(b)		An outline of the structure of the portfolio of the entity.	Portfolio departments – mandatory	Not applicable

PGPA Rule Reference	Part of Report	Description	Requirement	Location in Annual Report
17AE(2)		Where the outcomes and programs administered by the entity differ from any Portfolio Budget Statement, Portfolio Additional Estimates Statement or other portfolio estimates statement that was prepared for the entity for the period, include details of variation and reasons for change.	If applicable, mandatory	Not applicable
17AD(c)	Report on the Performance of the entity			
	<i>Annual performance Statements</i>			
17AD(c)(i); 16F		Annual performance statement in accordance with paragraph 39(1)(b) of the Act and section 16F of the Rule.	Mandatory	p165–167
17AD(c)(ii)	Report on Financial Performance			
17AF(1)(a)		A discussion and analysis of the entity's financial performance.	Mandatory	p30–65
17AF(1)(b)		A table summarising the total resources and total payments of the entity.	Mandatory	p161–162
17AF(2)		If there may be significant changes in the financial results during or after the previous or current reporting period, information on those changes, including: the cause of any operating loss of the entity; how the entity has responded to the loss and the actions that have been taken in relation to the loss; and any matter or circumstances that it can reasonably be anticipated will have a significant impact on the entity's future operation or financial results.	If applicable, mandatory	Not applicable
17AD(d)	Management and Accountability			
	<i>Corporate Governance</i>			
17AG(2)(a)		Information on compliance with section 10 (fraud systems).	Mandatory	p76
17AG(2)(b)(i)		A certification by accountable authority that fraud risk assessments and fraud control plans have been prepared.	Mandatory	p2
17AG(2)(b)(ii)		A certification by accountable authority that appropriate mechanisms for preventing, detecting incidents of, investigating or otherwise dealing with, and recording or reporting fraud that meet the specific needs of the entity are in place.	Mandatory	p2
17AG(2)(b)(iii)		A certification by accountable authority that all reasonable measures have been taken to deal appropriately with fraud relating to the entity.	Mandatory	p2

PGPA Rule Reference	Part of Report	Description	Requirement	Location in Annual Report
17AG(2)(c)		An outline of structures and processes in place for the entity to implement principles and objectives of corporate governance.	Mandatory	p66–76
17AG(2)(d) – (e)		A statement of significant issues reported to Minister under paragraph 19(1)(e) of the Act that relates to non-compliance with Finance law and action taken to remedy non-compliance.	If applicable, mandatory	Not applicable
<i>External Scrutiny</i>				
17AG(3)		Information on the most significant developments in external scrutiny and the entity's response to the scrutiny.	Mandatory	p66–67
17AG(3)(a)		Information on judicial decisions and decisions of administrative tribunals and by the Australian Information Commissioner that may have a significant effect on the operations of the entity.	If applicable, mandatory	Not applicable
17AG(3)(b)		Information on any reports on operations of the entity by the Auditor-General (other than report under section 43 of the Act), a Parliamentary Committee, or the Commonwealth Ombudsman.	If applicable, mandatory	Not applicable
17AG(3)(c)		Information on any capability reviews on the entity that were released during the period.	If applicable, mandatory	Not applicable
<i>Management of Human Resources</i>				
17AG(4)(a)		An assessment of the entity's effectiveness in managing and developing employees to achieve entity objectives.	Mandatory	p77–81
17AG(4)(b)		Statistics on the entity's APS employees on an ongoing and non-ongoing basis; including the following: • Statistics on staffing classification level; • Statistics on full-time employees; • Statistics on part-time employees; • Statistics on gender; • Statistics on staff location; • Statistics on employees who identify as Indigenous.	Mandatory	p81–82
17AG(4)(c)		Information on any enterprise agreements, individual flexibility arrangements, Australian workplace agreements, common law contracts and determinations under subsection 24(1) of the <i>Public Service Act 1999</i> .	Mandatory	p83
17AG(4)(c)(i)		Information on the number of SES and non-SES employees covered by agreements etc identified in paragraph 17AG(4)(c).	Mandatory	p83

PGPA Rule Reference	Part of Report	Description	Requirement	Location in Annual Report
17AG(4)(c)(ii)		The salary ranges available for APS employees by classification level.	Mandatory	p87
17AG(4)(c)(iii)		A description of non-salary benefits provided to employees.	Mandatory	p87
17AG(4)(d)(i)		Information on the number of employees at each classification level who received performance pay.	If applicable, mandatory	p88
17AG(4)(d)(ii)		Information on aggregate amounts of performance pay at each classification level.	If applicable, mandatory	p88
17AG(4)(d)(iii)		Information on the average amount of performance payment, and range of such payments, at each classification level.	If applicable, mandatory	p88
17AG(4)(d)(iv)		Information on aggregate amount of performance payments.	If applicable, mandatory	p88
Assets Management				
17AG(5)		An assessment of effectiveness of assets management where asset management is a significant part of the entity's activities.	If applicable, mandatory	Not applicable
Purchasing				
17AG(6)		An assessment of entity performance against the Commonwealth Procurement Rules.	Mandatory	p163
Consultants				
17AG(7)(a)		A summary statement detailing the number of new contracts engaging consultants entered into during the period; the total actual expenditure on all new consultancy contracts entered into during the period (inclusive of GST); the number of ongoing consultancy contracts that were entered into during a previous reporting period; and the total actual expenditure in the reporting year on the ongoing consultancy contracts (inclusive of GST).	Mandatory	p163
17AG(7)(b)		A statement that " <i>During [reporting period], [specified number] new consultancy contracts were entered into involving total actual expenditure of \$[specified million]. In addition, [specified number] ongoing consultancy contracts were active during the period, involving total actual expenditure of \$[specified million].</i> "	Mandatory	p163
17AG(7)(c)		A summary of the policies and procedures for selecting and engaging consultants and the main categories of purposes for which consultants were selected and engaged.	Mandatory	p163

PGPA Rule Reference	Part of Report	Description	Requirement	Location in Annual Report
17AG(7)(d)		A statement that “ <i>Annual reports contain information about actual expenditure on contracts for consultancies. Information on the value of contracts and consultancies is available on the AusTender website.</i> ”	Mandatory	p163
Australian National Audit Office Access Clauses				
17AG(8)		If an entity entered into a contract with a value of more than \$100 000 (inclusive of GST) and the contract did not provide the Auditor-General with access to the contractor’s premises, the report must include the name of the contractor, purpose and value of the contract, and the reason why a clause allowing access was not included in the contract.	If applicable, mandatory	Not applicable
Exempt contracts				
17AG(9)		If an entity entered into a contract or there is a standing offer with a value greater than \$10 000 (inclusive of GST) which has been exempted from being published in AusTender because it would disclose exempt matters under the FOI Act, the annual report must include a statement that the contract or standing offer has been exempted, and the value of the contract or standing offer, to the extent that doing so does not disclose the exempt matters.	If applicable, mandatory	Not applicable
Small business				
17AG(10)(a)		A statement that “[<i>Name of entity</i>] supports small business participation in the Commonwealth Government procurement market. Small and Medium Enterprises (SME) and Small Enterprise participation statistics are available on the Department of Finance’s website.”	Mandatory	p163
17AG(10)(b)		An outline of the ways in which the procurement practices of the entity support small and medium enterprises.	Mandatory	p163
17AG(10)(c)		If the entity is considered by the Department administered by the Finance Minister as material in nature – a statement that “[<i>Name of entity</i>] recognises the importance of ensuring that small businesses are paid on time. The results of the Survey of Australian Government Payments to Small Business are available on the Treasury’s website.”	If applicable, mandatory	Not applicable

PGPA Rule Reference	Part of Report	Description	Requirement	Location in Annual Report
	Financial Statements			
17AD(e)		Inclusion of the annual financial statements in accordance with subsection 43(4) of the Act.	Mandatory	p89–160
17AD(f)	Other Mandatory Information			
17AH(1)(a)(i)		If the entity conducted advertising campaigns, a statement that “ <i>During [reporting period], the [name of entity] conducted the following advertising campaigns: [name of advertising campaigns undertaken]. Further information on those advertising campaigns is available at [address of entity’s website] and in the reports on Australian Government advertising prepared by the Department of Finance. Those reports are available on the Department of Finance’s website.</i> ”	If applicable, mandatory	Not applicable
17AH(1)(a)(ii)		If the entity did not conduct advertising campaigns, a statement to that effect.	If applicable, mandatory	p164
17AH(1)(b)		A statement that “ <i>Information on grants awarded by [name of entity] during [reporting period] is available at [address of entity’s website].</i> ”	If applicable, mandatory	p164
17AH(1)(c)		Outline of mechanisms of disability reporting, including reference to website for further information.	Mandatory	p164
17AH(1)(d)		Website reference to where the entity’s Information Publication Scheme statement pursuant to Part II of FOI Act can be found.	Mandatory	p163
17AH(1)(e)		Correction of material errors in previous annual report.	If applicable, mandatory	Not applicable
17AH(2)		Information required by other legislation.	Mandatory	p30–65

Appendix E: Glossary of abbreviations and acronyms

AASB	Australian Accounting Standards Board
AC	Companion of the Order of Australia
ANAO	Australian National Audit Office
AO	Officer of the Order of Australia
APS	Australian Public Service
ATO	Australian Taxation Office
CPI	Consumer Price Index
EEE	Equivalent Equity Exposure
ESG	Environmental, social and governance (risk management)
FFIC	Future Fund Investment Company
FFMA	Future Fund Management Agency
Fol Act	<i>Freedom of Information Act 1982</i>
GST	Goods and Services Tax
IFSWF	International Forum of Sovereign Wealth Funds
KMP	Key management personnel
MRFFIC	Medical Research Future Fund Investment Company
OECD	Organisation for Economic Co-operation and Development
PGPA Act	<i>Public Governance, Performance and Accountability Act 2013</i>
SWF	Sovereign wealth fund

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An aerial photograph of a beach with waves crashing onto the shore. The water is a vibrant green, and the sand is a light beige. The waves are white and frothy as they break. The text 'FUTUREFUND.GOV.AU' is overlaid in white, bold, sans-serif font in the center of the image.

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