boardroom

FEB/MAR 2020

Magazine of the Institute of Directors in New Zealand

Plus:

Challenging audit

School board shuffle

Digital resilience

Institute of DIRECTORS NEW ZEALAND

boardroom

Boardroom is published six times a year by the Institute of Directors in New Zealand (IoD) and is free to all members. Subscription for non-members is $155 per year.

Boardroom is designed to inform and stimulate discussion in the director community, but opinions expressed do not reflect IoD policy unless explicitly stated.

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BRANCH MANAGERS
For a full list of branch managers, see *page 40*.

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FROM RESPONSIBLE SOURCES

A note from the editor

This issue, we look at climate action and moves by the government to introduce mandatory disclosure requirements.

It is a rapidly-changing area of reporting and governance and, whatever final form the regulations take, directors would be wise to keep an eye on local and international developments. The IoD has recommended to government that it consider exempting smaller organisations from any new mandatory requirements.

Continuing the climate theme, we look at how boards can begin to think about the potential long-term impact of climate change on their organisations, perhaps using a Three Horizons framework.

The challenges facing auditors, and how regulatory change or economic shifts could impact on audited accounts, are explored through the eyes of outgoing External Reporting Board (XRB) Chief Executive Warren Allen and Financial Markets Authority Chief Executive Rob Everett.

We also highlight other changes in the New Zealand governance landscape, touching on school boards, the impact of technology and the importance of digital resilience.

It reads like 2020 is well underway already, doesn't it?

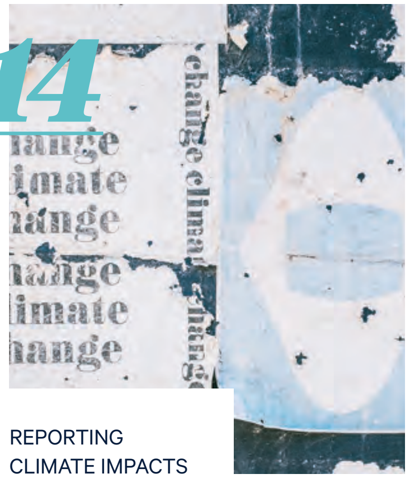
Aaron Watson
Boardroom editor

Institute of DIRECTORS NEW ZEALAND

Boardroom is the magazine of the Institute of Directors in New Zealand. **iod.org.nz**

The Agenda

FEB / MAR 2020



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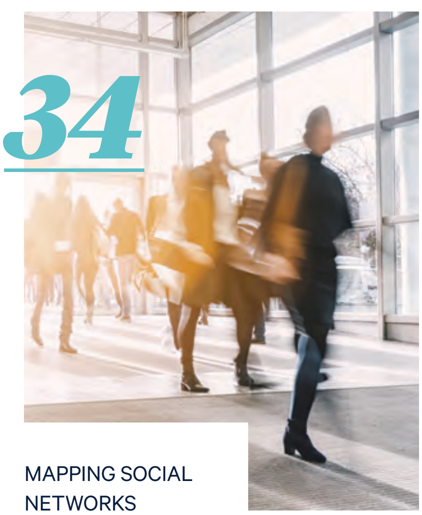
ADAPTING TO CLIMATE-RELATED FINANCIAL RISKS AND OPPORTUNITIES / KPMG



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MAPPING SOCIAL NETWORKS

INSIDE IoD

FEATURES

FROM OUR PARTNERS

Cover and feature photo by Daria Shevtsova from Pexels.

A time for action

KIRSTEN PATTERSON
CEO, INSTITUTE OF DIRECTORS

Tēnā koutou katoa

"Red sky at night, shepherd's delight. Red sky in the morning, shepherd's warning."

Anyone holidaying in New Zealand over the Christmas break would have had a hard time relying on the old weather poem as dust particles from the Aussie bush fires turned the sky red all day.

Much of our climate change discussion here in New Zealand has focused on rising sea levels – too much water – while for our colleagues across the ditch the rising temperatures mean they don't have enough.

If you have read BlackRock's recent letter to CEOs, released on 15 January, you could be forgiven for thinking the author, Larry Fink, has been reading *Boardroom* magazine and keeping up to date with the IoD's "Top 5 Issues for NZ Directors".

He writes that "climate change has become a defining factor in companies' long-term prospects" and that "climate change is almost invariably the top issue that clients around the world raise with BlackRock". He emphasises that he believes we are "on the edge of a fundamental reshaping of finance" that "climate risk is investment risk" and that "every government, company and shareholder must confront climate change".

In echoing another of the Top 5 issues we have identified for 2020 he also emphasised that: "Ultimately purpose is the engine of long-term profitability."

In one of my first *Boardroom* letters when I joined the IoD in 2017 I wrote: "Climate change is not 'fake news', and sustainability is not just about the environment. In fact, climate change is becoming main stream and is now critical to long-term business sustainability."

Since then we have had NZ legislation introduced and we have had a legal opinion from the The Aotearoa Circle's Sustainable Business Forum confirming that directors must assess and manage climate risk as they would any other financial risk as "climate change presents a foreseeable risk of financial harm to many businesses".

Our own Four Pillars of Governance Best Practice says at 1.3 Sustainability:

- Focusing on key strategic, social, governance and environmental risks, and long-term business sustainability, is fundamental to good governance.
- To create value in a sustainable manner requires organisations to shift from short-term to long-term thinking.
- Transparency of corporate activities and intentions helps build trust, and aids business resilience and long-term sustainability.
- The role of business is critical in transitioning to a sustainable world.

Climate change has been in our "Top 5 Issues for Directors" three times in the past five years. This year we deliberately and consciously changed the concept to climate action. The recent IoD/ASB 2019 *Director Sentiment Survey* shows a lift in the number of boards that said they were engaged and proactive on climate change, but it was still only 35%, up from 29% in 2018.

It seems 65% of us have more work to do this year.

Ngā mihi

Kirsten KP

UpFront

Davos 2020

Stakeholders for a Cohesive and Sustainable World was the theme of the 50th annual meeting of the World Economic Forum (WEF) held in Davos, Switzerland in January. Over 3,000 business and world leaders (including President Trump and Greta Thunberg) from more than 100 countries came together to debate global issues of a political, economic, environmental and social nature and to encourage international cooperation. Highlights from the meeting include:

- a shift in focus from technological transformation to stakeholder capitalism
- stakeholder capitalism was promoted with the launch of the new Davos Manifesto, *The Universal Purpose of a Company in the Fourth Industrial Revolution*. The first edition of the Manifesto was published in 1973 and the new 2020 edition aims to achieve "a better kind of capitalism" to strengthen the long-term prosperity of a company
- a major focus on the climate emergency with a greater understanding of the investment risk of global heating.

Climate tops global risks

The WEF's *Global Risks Report 2020* reveals the top five risks in terms of likelihood and impact. Ten years ago no environmental risks made the top five in terms of likelihood – in 2020 all five are environmental:

	Likelihood 2020	**Likelihood 2019**	**Impact 2020**	**Impact 2019**
1	Extreme weather	Extreme weather	Climate action failure	Weapons of mass destruction
2	Climate action failure	Climate action failure	Weapons of mass destruction	Climate action failure
3	Natural disasters	Natural disasters	Biodiversity loss	Extreme weather
4	Biodiversity loss	Data fraud or theft	Extreme weather	Water crises
5	Human-made environmental disasters	Cyberattacks	Water crises	Natural disasters

This 15th edition of the report warns that "The world cannot wait for the fog of geopolitical and geo-economic uncertainty to lift' and that quick action is needed "on key issues such as the economy, the environment, technology and public health."

Director Vacancies

Director Vacancies is a cost-effective way to reach our extensive pool of membership talent. We will list your vacancy until the application deadline or until you find a suitable candidate. A full list of vacancies can be viewed at **iod.org.nz**

» Contact us on 0800 846 369

Unless otherwise stated, the following positions will remain open until filled.

INSTITUTE OF DIRECTORS
Role: IoD Canterbury Branch Committee
Closes: 18 March

CARE GROUP
Role: Independent Director
Closes: 14 February

ACTION ENGINEERING LTD
Role: Board members (2)
Closes: 17 February

TE WHARE POUNAMU DUNEDIN WOMEN'S REFUGE
Role: Board member
Closes: 31 March

TRUST TAIRĀWHITI
Role: Director
Closes: 31 March

Be **prepared**

As the economic impact of COVID-19 becomes clearer, and bushfires continue to threaten Australia, businesses around the world and in New Zealand are increasingly considering potential effects on their organisations, including people, services and supply chains.

Our article "Preparing for the unexpected" provides information for directors to help prepare for challenging times. Read it at **iod.org.nz**

New Year **Honours 2020**

The Institute of Directors congratulates the following members who have received honours in recognition of the contribution made in their respective fields.

COMPANIONS OF THE NEW ZEALAND ORDER OF MERIT (CNZM)

Robert James Campbell, of Auckland.
For services to governance and business.

Anthony John Carter, of Auckland.
For services to business governance.

OFFICERS OF THE NEW ZEALAND ORDER OF MERIT (ONZM)

Susan Jane Kedgley, of Wellington.
For services to women and governance.

Annette Margaret Milligan, of Nelson.
For services to health, particularly nursing.

Suzanne Mary Sinclair, of Auckland.
For services to the community and governance.

Stephen John Tew, of Wellington.
For services to rugby and sports administration.

MEMBERS OF THE NEW ZEALAND ORDER OF MERIT (MNZM)

Donald William Scarlet, of Hamilton.
For services to conservation.

COMPANIONS OF THE QUEEN'S SERVICE ORDER (QSO)

John Morgan Williams, of Richmond.
For services to the State and the environment.

For further information visit **dpmc.govt.nz**

Consumer credit contract reform

In 2019, the Credit Contracts Legislation Amendment Bill received Royal assent making significant changes to the Credit Contracts and Consumer Finance Act 2003 (the Act). New provisions are intended to address issues in the credit market including strengthening requirements to lend responsibly and address harm to vulnerable customers. Directors of creditors (lenders) subject to the Act need to be aware of their new responsibilities and potential liability.

From 1 June 2020, there will be a duty on directors and senior managers of a creditor to exercise due diligence to ensure that the creditor complies with its duties and obligations under the Act and associated regulations. They will be required to exercise the care, diligence, and skill that a reasonable director or senior manager would exercise in the same circumstances, taking into account:

- the nature of the business (for example, its size and the nature of the credit provided)
- the position of the director or senior manager and the nature of the responsibilities undertaken by the director or senior manager.

"Due diligence" includes taking reasonable steps to ensure that the creditor:

- requires its employees and agents to follow procedures, or has implemented automated procedures, that are designed to ensure compliance with the Act and regulations
- has in place methods for systematically identifying deficiencies in the effectiveness of the procedures for compliance
- promptly remedies any deficiencies discovered.

There are new pecuniary penalties of up to $200,000 for an individual and $600,000 in any other case. There are also restrictions on indemnities and insurance in relation to pecuniary penalties including for directors and senior managers.

Directors and senior managers of a creditor (or a mobile trader) offering consumer credit contracts will also have to meet a "fit and proper person" test in order for the creditor to register on the Financial Service Providers Register. There are exemptions including if creditors are already licenced (eg banks and non-bank deposit takers).

A fundamental **reshaping of finance**

In his annual letter to CEOs around the world, Larry Fink (Chair and CEO of the world's largest investment company, BlackRock) says that climate change will cause a transformational reallocation of capital towards sustainable investments and bring about a fundamental reshaping of finance – ultimately helping achieve a more sustainable and inclusive capitalism for greater longer-term prosperity. Key points in Fink's letter include:

- Equating climate risk to investment risk and announcing that BlackRock would place sustainability at the centre of its investment approach, for example exiting investments in coal production.
- Re-iterating the importance of stakeholder interests and embracing purpose as 'the engine of long-term profitability.'
- Asking that companies it invests in improve disclosures and report:
  - sustainability information in line with the Sustainability Accounting Standards Boards (SASB) guidelines; and
  - climate related risks in line with Taskforce on Climate-related Financial Disclosures (TCFD) recommendations.
- Giving notice that if companies don't effectively address material issues it will hold directors and management accountable (by voting against them).

Fink concludes that the climate crisis is fundamentally different to the various financial crises and challenges of the past 50 years and that 'companies, investors and governments must prepare for a significant reallocation of capital' including in response to the increasing demands of the next generation for more transparency and action in order to achieve a more sustainable and inclusive capitalism.

Larry Fink's letter is available at **blackrock.com**

The **trust paradox**

The Edelman Trust Barometer 2020 report, launched at Davos, shows a growing sense of inequality is undermining trust in institutions. Now in its 20th year, the survey measures trust in four institutions around the world; business, government, media and NGOs. Global highlights from the 2020 report include:

- Despite strong economic performance and near full employment no institution is trusted - a trust paradox.
- For the first time business is seen as the most trusted institution on key issues.
- 73% believe companies can both increase profits and improve conditions in communities.
- Ethics is three times more important to company trust than competence.
- 56% said capitalism as it exists today does more harm than good in the world.
- 83% of employees fear losing their jobs.
- 92% expect CEOs to speak up about issues such as future of work, income inequality, climate change and diversity.

Question: Under which duty in the Companies Act 1993 would you expect directors to have regard to climate change in making decisions?

A. *Duty to act in good faith and in the best interests of the company*

B. *Duty to act for a proper purpose*

C. *Duty to comply with the Companies Act and constitution*

D. *Duty to exercise reasonable care*

Q&A

ANSWER

D. *The Aotearoa Circle's 2019 legal opinion on directors' duties and climate change available at* ***aotearoacircle.nz*** *states that "directors of New Zealand companies are generally permitted, and will in many contexts be required, to take climate change into account when making business decisions. The requirement stems principally from the directors' duty to act with reasonable care".*

Empowering small business

The Small Business Council delivered its small business strategy to the government in 2019 with key recommendations to improve access to finance, build capability and skills, and shift from compliance to enablement. In December, the government announced its support for the recommendations and agreed to implement initiatives to support small business owners. The IoD endorsed the importance of good governance to small business and backs the move to build capability and reduce the compliance burden.

Five questions with...
Leeson Baldey, Associate

NELSON BRANCH COMMITTEE

Leeson and Julia Baldey.

1. Why did you join the IoD?

I have had an interest in governance for some time and was looking for a way to connect with like-minded people. A friend recommended I attend an IoD luncheon to see if the organisation was something for me. Five years later here we are.

2. How did you find yourself on a branch committee?

I was inspired by my early experiences with the IoD and wanted to share this with my colleagues, clients and professional network. As such, I arranged a "Meet the IoD" evening at work where we invited 30-odd guests along to learn about how the organisation can help with personal/professional development. The night was a hit. Not long after that I was co-opted onto the local committee.

3. Why do you feel it is important to give back to the IoD?

People development and governance education are important to me. My role in the IoD allows me the opportunity to promote, and inform others as to, what is available through the organisation.

4. If you had one tip for a person interested in a governance career, what would it be?

Get connected. There is a wealth of knowledge and experience in our member base which is there to be leveraged and learned from. This will give you insights that cannot be read in books.

5. What's the one gadget you find indispensable?

My Thoren's turntable. I believe it is important to be able to switch off and make time for yourself and family.

New governance resources for SMEs

The IoD, working with the business.govt.nz and the Companies Office, helped produce a new suite of online governance resources to enable and equip directors of SMEs with the tools they need to succeed. These resources include modules that look at why good governance is important and how it can help businesses to run smoothly, achieve goals and maintain a good reputation. The resources are available at **business.govt.nz**

Our policy and advocacy

2019 was another busy year for the IoD in advocating on issues relevant to directors and governance. We advocate through formal submissions on a range of policy and legislative matters and promoting our views through the media.

The first half of 2020 is set to be the same as the government priorities policy and legislative changes before the country goes to the polls. A number of bills with governance implications are still making their way through the legislative process including the Privacy Bill, the Education and Training Bill, the Financial Markets (Conduct of Institutions) Amendment Bill and the Public Service Legislation Bill.

A continuing key area of focus for the IoD in 2020 will be on laws and regulations seeking to increase director responsibilities and personal liability. For more on this see our article "Balance of responsibilities" in the Aug/Sept issue of *Boardroom* 2019.

Improving conduct of **financial institutions**

Reforms aimed at improving the conduct of financial institutions and their intermediaries in providing services and products to consumers are included in the Financial Markets (Conduct of Institutions) Amendment Bill. This introduces a licencing regime for banks, insurers and non-bank deposit takers and includes requirements for:

- financial institutions and intermediaries to comply with a 'fair conduct principle' to treat consumers fairly including by having regard to their interests
- financial institutions to establish, implement, and maintain an effective 'fair conduct programme' which operationalises the fair conduct principle through policies, processes, systems, and controls throughout the business (from the governance level to day-to-day interactions with consumers)
- financial institutions and intermediaries to comply with the fair conduct programme (and that financial institutions ensure that intermediaries comply)
- financial institutions and intermediaries to comply with regulations in relation to incentives based on volume or value sale targets.

In addition to the requirements for institutions described above, new accountability requirements for directors and senior managers of deposit takers and insurers in respect of conduct are expected to be introduced at some stage to supplement the reforms in the Bill.

Individual accountability in financial services signalled

Following a global trend, New Zealand is eyeing an "executive accountability regime" to hold individuals to account in financial institutions. The United Kingdom led the way several years ago in enacting a "senior manager regime" to improve behaviour and culture in organisations after a number of high profile scandals. Australia and Hong Kong have implemented similar regimes, and Singapore and Ireland are also exploring options to increase individual accountability.

The government announced in December that the accountability of directors and senior managers of deposit takers will be strengthened under Reserve Bank reforms, including by:

- imposing duties to ensure that a deposit taker is run in a prudent manner, acts with honesty and integrity, and deals with the Reserve Bank in an open and transparent manner and
- enforcing obligations largely under a civil liability framework rather than a criminal framework (although there will still be criminal sanctions for cases of clear intent or recklessness on the part of directors).

Consultation is expected in February 2020.

At this stage, it is not clear how the accountability regimes will work together. The IoD will continue to engage with policymakers and stakeholders on the design and scope of the accountability regimes including to ensure that any proposed responsibilities and liability of directors are proportionate and appropriate.

Accountability requirements for directors and senior managers of deposit takers and insurers in respect of conduct are expected to supplement provisions in the Financial Markets (Conduct of Institutions) Amendment Bill. These requirements will be under the remit of the Financial Markets Authority.

KEY IN-PRINCIPLE DECISIONS BY CABINET ON THE FUTURE OF THE RESERVE BANK:

- Responsibility for prudential regulation will remain with the Reserve Bank.
- The Reserve Bank will have a high level objective to protect and promote the stability of New Zealand's financial system.
- A governance board will be established for the Reserve Bank. This will have statutory responsibility for all the Reserve Bank's functions, except those reserved for the Monetary Policy Committee.
- The two separate regulatory regimes for banks and non-bank deposit takers will be united into a single "licensed deposit taker" framework.
- A deposit insurance scheme will be established (insuring deposits up to $50,000 per person, per institution).

APPOINTMENTS

Pania Gray
Chartered Member, has been appointed to the board of the New Zealand Film Commission.

Olivia Hall
Member, has been appointed to the Nelson Marlborough District Health Board.

Anita Killeen
Associate Member, has been appointed an independent director of the Domain Name Commission Ltd.

Lady Tureiti Moxon
Chartered Fellow, has been appointed to a new panel of Māori advisers to the Chief Ombudsman.

Samantha Sharif
Chartered Member, has been appointed to the Board of MOTAT, the Museum of Transport and Technology.

David Wright
Member, has been appointed to the board of the New Zealand Film Commission.

New **Chartered Fellows**

Congratulations to our members who became Chartered Fellows in 2019. This is the highest award in the IoD's Chartered pathway and is bestowed on members whose knowledge, character and experience makes them a role model for other members, their organisations and the community.


Peter Batcheler, Auckland


Jenny Black, Nelson Marlborough

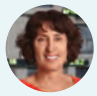

Mary-Jane Daly, Auckland


Mark Darrow, Auckland


Bev Edlin, Bay of Plenty


Abby Foote, Canterbury

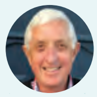

John Gallaher, Otago Southland


Alison Gerry, Otago Southland


Catherine Harland, Auckland


Douglas Hill, Otago Southland


Peter Hughes, Wellington


Don Huse, Auckland


Clare Kearney, Otago Southland


Tim Loan, Otago Southland


Bob Major, Bay of Plenty


Jonathan Mason, Auckland


Ian McInnes, Canterbury

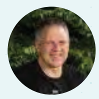

Giselle McLachlan, Otago Southland


Rosanne Meo, Auckland


James Miller, Auckland


Joe O'Connell, Otago Southland


Neil Paviour-Smith, Wellington


Deryck Shaw, Bay of Plenty


Aaron Snodgrass, Auckland


Roger Sowry, Wellington


Paul Steere Nelson, Marlborough


Craig Stobo, Auckland

Welcome

Welcome and congratulations to the newest members of the institute of Directors.

New Members December-January

AUCKLAND

Tim Boyle
Jon Brough
Nicole Buisson
Terence Burns
Phil Cameron
Ryan Campbell
Rhys Clark
Jan Clark
Tracey Cross
Mark Denvir
Andrew Eagles
Simon Edgar
Paul Evans
Anson Gao
Stephen Glading
Tabetha Gorrie
James Grieve
Dee Hackett
Wendie Hall
Angela Henderson
Paul Herrod
Jason Hill
Anna Howard
Andrew Hunter
John Hunter
Mark Hutchinson
Dylan Hutt
Robert Khan
Lisa Kingi-Bon
Donald Lawrie
Andrew Lazootin
Xingyao Li Li
Angela Lim
Ana-Marie Lockyer
Sarah Longbottom
Steve Main
Donald Mann
Glen McLatchie
Andrea McLeod
Bryce Moffat
Stephanie Poole
Jun Qi Qi
Jarrod Renall
Faiz Salim
Sooz Sawbridge
Andy Schmidt
Ana Sever
Greg Stone
Pam Tregonning
Alan Van der Nagel
Helen van Orton
John Wadsworth
Michelle Walsh
Gill Webb
Katrina Winn
Chloe Xue

BAY OF PLENTY

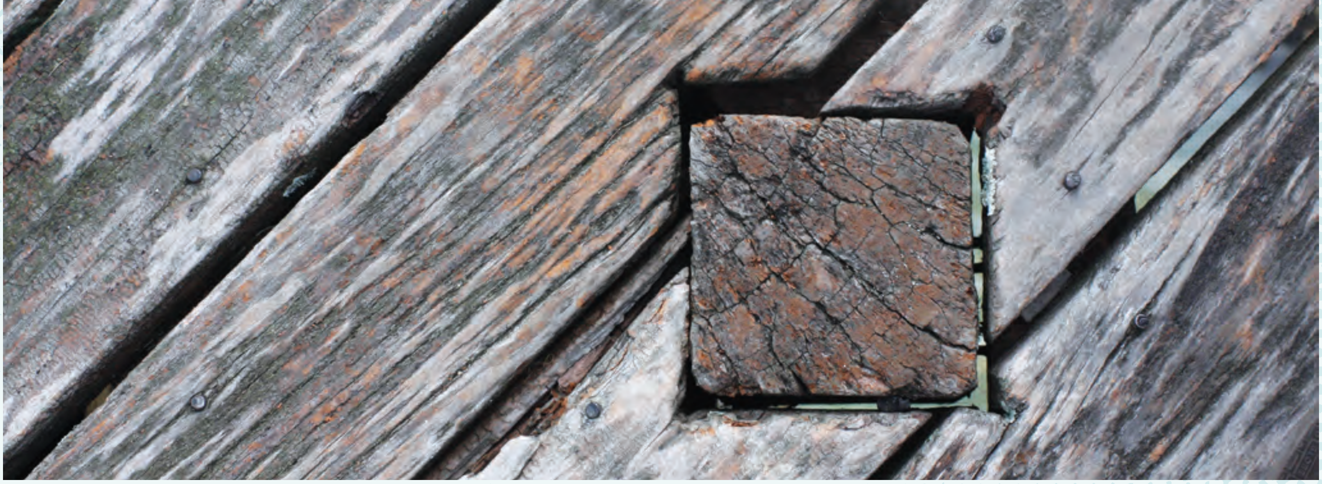
Ngarangi Bidois
Colin Boggiss
Phillip Claydon
Sally Cooke
Hinemaua Rikirangi
Stacey Rose
Jess Rule
Will Samuel
Hingatu Thompson
Geoffrey Thorpe

CANTERBURY

Stuart Anderson
Katrina Azer
Nathan Breckell
David Broderick
Jenn Chowaniec
Lesley Crichton
Kara Edwards
Cam Finlayson
Richard Fitzgerald
Mark Ginnever
Carol Glover
Anthony Honeybone
Warren Ladbrook
Keith Land
David Lindsay
Latham Martin
Craig Palmer
Rob Reid
Andy Rowden
Benita Wakefield
Tristan Williams

NELSON MARLBOROUGH

John Armstrong
Otago Southland
Catherine Bone
Keri Bryan
Fiona Clarkson
James Heath
Maria Larcombe
Julie Scott
Laura Warren



TARANAKI

Sam Bennett
Bali Haque
Liam O'Sullivan

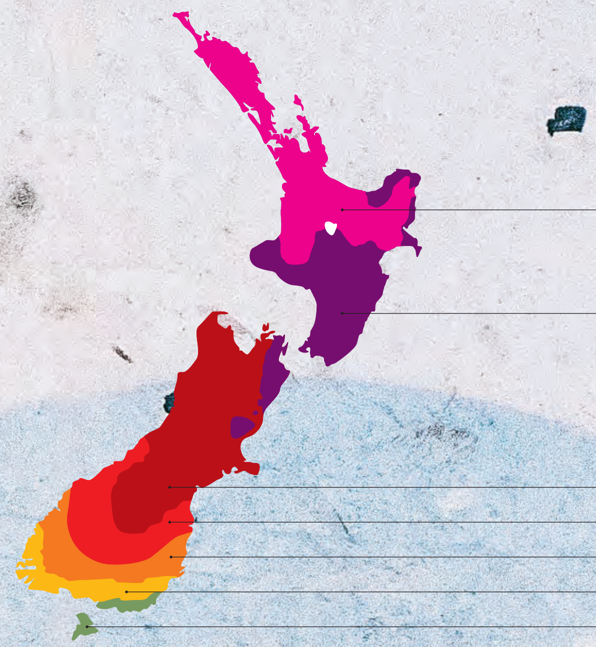
WAIKATO

Dean Gittings
Adam Lynch
Corne Mackie
Rena Schuster
Kate Taylor

WELLINGTON

Raewyn Bleakley
Mark Carver
Will Chaney
Eddie Christian
Michael Finlayson
Mark Ford
Debbie Gee
Simon George
Sumati Govind
René Hattingh
Renee Hogg
Hayley Horan
James Hudson
Candice Johanson
Matire Kupenga-Wanoa
Kaleb Leeming
Anna Moodie
Simon Norrie
Vanessa Powell
Moe Robinson
Simon Taylor
Ayesha Verrall
John Witkowski

Climate science



Human activity

GLOBAL

Climate change is a consequence of increased greenhouse gases in the atmosphere, which trap heat.

Our extraction from the ground and consumption of fossil fuels such as oil, petroleum and coal has contributed to a 52% increase in carbon dioxide levels (a key greenhouse gas) in the atmosphere between 1990 and 2016.

We need to reduce greenhouse gas emissions 7.6% per year up to 2030 to limit the global temperature rise by 2100 to 1.5%, considered a tipping point for extreme climate impacts.

More than 11,000 scientists signed a letter published in the BioScience journal in November 2019 warning that "the climate crisis has arrived".

NEW ZEALAND

New Zealand's greenhouse gas emissions have risen by 20% since 1990.

Heat

GLOBAL

The UN *Emissions Gap Report 2019* says global temperatures have risen by 1.1% (versus a baseline temperature in the 150 years before 1900).

Scientists fear that a rise of more than 1.5% could trigger severe impacts. Under the Paris Agreement of 2016, the global temperature is expected to rise 3.2% by 2100.

The average global temperature has been higher each decade since 1980 than in all records back to 1850.

Glaciers, permafrost and the continental ice in the Arctic and Antarctica is melting – which contributes to rising seas. The Arctic has seen a 13% decrease in sea ice since 1979.

NEW ZEALAND

Three of the past five years have been among the hottest on record.

November 2019 was the hottest November on record.

The ice volume of the Southern Alps has been reduced by a third over the past 40 years.

Sea level

GLOBAL

The seas are rising (on average) due to an influx of water from melting ice and volume expansion due to being warmer. In 2014, the average was 2.6cm above the 1993 average.

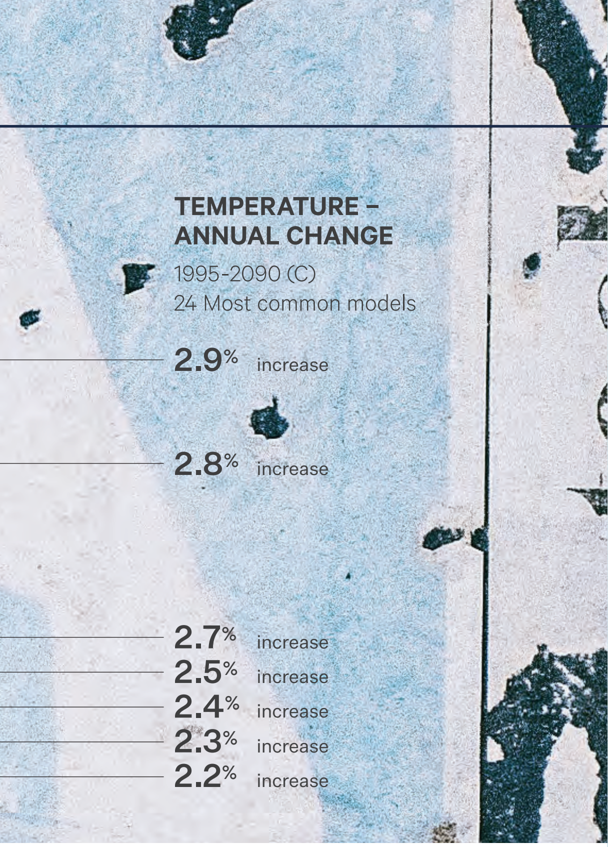
It is projected to rise one metre by 2100 if global greenhouse gas emissions are not curtailed.

Six million people live in areas vulnerable to projected sea level rises this century, even if the temperature rise is curtailed at 1.5%.

NEW ZEALAND

The sea level has been rising at around 3mm per year for the past 25 years.

The seas around New Zealand are expected to rise 5-10% more than the global average rise.



Weather

GLOBAL

Global weather patterns are becoming more extreme – extreme heat, more powerful storms than expected and a heightened risk of droughts and, concomitantly, floods.

NEW ZEALAND

Storm damage has cost $800m over the past five years. NIWA predicts extreme rainfall and intense thunderstorms will continue to become more common.

Global data is drawn from the *UN Emissions Gap Report 2019*. Data for New Zealand is drawn from the National Institute of Water and Atmospheric Research (NIWA – Taihoro Nukurangi).

What is climate action?

How four businesses around the globe are integrating "climate action" in their operations.

The number one priority in our "Top Five Issues for Directors in 2020" (Boardroom, December/January) was climate action.

But what does climate action mean? Here, we review some of the recent examples of businesses around the globe finding ways to incorporate it into their activities. Each of these initiatives was announced in January. Expect to see more as 2020 progresses.

BLACKROCK EXITS THE BLACK (OR BROWNISH) ROCK

The world's biggest fund manager has announced it will divest itself of shares in thermal coal (the kind used in electricity generation).

BlackRock got good press for the announcement, which was made as part of CEO Larry Fink's annual letter to chief executives. It shows the US$7 trillion investment manager accepts the risk that climate change poses to its business and the planet and is seeking to mitigate this.

It will continue at this point to maintain stakes in major oil companies including BP, Shell and ExxonMobil.

TIFFANY SAYS CLIMATE CHANGE IS FOREVER

As Australia swelters and fires rage, Tiffany & Co ran newspaper ads urging Prime Minister Scott Morrison to take climate action seriously.

It's another sign of climate change being seen as good marketing for global organisations, but also reflects an awareness that businesses and politicians must find ways to work together if the worst risks of climate change are to be avoided.

As Tiffany's advertisements said: "The disaster of climate change is too real, and the threat to our planet and to our children is too great."

WESTPAC NZ MAKES CONTACT ENERGY A SUSTAINABILITY-LINKED LOAN

In a New Zealand first (with a small "f") Westpac NZ has extended Contact Energy a NZ$50m sustainability-linked loan facility.

Contact receives a lower interest rate if it meets targets linked to its environmental, social and governance (ESG) rating (as determined by RobecoSAM).

It's an interesting example of industries working together to find was to take action that will benefit the climate, the planet and the businesses themselves.

MICROSOFT GOES FOR NEGATIVE CARBON

Microsoft wants to remove from the environment all the carbon it has emitted since 1975. To do this, it plans to begin removing more carbon from the environment than it emits.

Chief Executive Satya Nadella says Microsoft could be carbon negative by 2030 and to have balanced its carbon ledger since founding by 2050.

"When it comes to carbon, neutrality is not enough," said Microsoft president Brad Smith.

Reporting climate impacts

Mandatory climate-related financial disclosure is coming

AUTHOR:
SELWYN EATHORNE, SENIOR GOVERNANCE ADVISOR AT THE IOD

The Productivity Commission's 2018 Low Emissions Economy report noted that climate-related financial disclosures can be a powerful mechanism to focus reporting entities on the impacts of climate change on their own activities, and that disclosure can enable investors to make decisions across investment opportunities that accurately reflect the climate risk of those choices.
Some organisations in New Zealand are already expected to disclose climate-related financial information and others are reporting voluntarily in a rapidly evolving space. Following early adopters overseas, the government has signalled that it intends to implement a mandatory disclosure regime.

The Ministry for the Environment and the Ministry of Business, Innovation and Employment consulted in December 2019 on introducing a mandatory, principles-based climate-related financial disclosure regime (on a "comply or explain" basis) for listed issuers, banks, general insurers, asset owners and asset managers.

It has been proposed that the Task Force on Climate-related Financial Disclosures (TCFD) reporting framework could be used as a default framework. Other suitable frameworks such as Integrated Reporting and the Global Reporting Initiative could also be used.

The TCFD is mainly concerned with the impacts of climate change on companies rather than impacts of the companies on the environment.

Photography - Daria Shetsova from Pexels.

What is the TCFD?

In 2015, the Financial Stability Board established the Task Force on Climate-related Financial Disclosures and asked it to develop a set of voluntary climate-related financial disclosures that companies could use when providing information to stakeholders.

The TCFD identified two types of climate-related risks:

- Transition risks (policy risk, litigation risk, technology risk, market risk and reputational risk).
- Physical risks (both event driven (eg extreme weather) and driven by long-term shifts in climate patterns).

The TCFD recommends 11 areas of disclosure within four thematic areas:

- Governance – disclosing the organisation's governance and management around climate-related risks and opportunities.
- Strategy – disclosing the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material.
- Risk management – disclosing how the organisation identifies, assesses, and manages climate-related risks.
- Metrics and targets – disclosing the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

ADAPTATION REPORTING UNDER THE ZERO CARBON ACT

The Climate Change Response (Zero Carbon) Amendment Act 2019 enables the Climate Change Minister and the new Climate Change Commission to request certain organisations (eg public service organisations, Local Authorities, SOEs, Crown Entities (excluding school boards) and Lifeline Utilities) to provide information on climate change adaptation, which is relevant to National Adaptation Plans produced by the government.

For further information on how organisations can approach climate-related disclosures see:

- TCFD Implementation Guide
- TCFD Good Practice Handbook
- UK Financial Reporting Lab's Climate-related Corporate Reporting resource
- McGuiness Institute's The Climate reporting emergency: A New Zealand Case Study

OUR VIEW

In our submission on the proposed new regime, we agreed that the TCFD framework would be appropriate for climate-related financial disclosures in New Zealand. We note that the proposed "comply or explain" approach to implementing the TCFD framework can support good governance and provides flexibility and proportionality for organisations to report in a way that is appropriate and meaningful relevant to their circumstances. We also:

- raised questions about how the proposed mandatory requirements will fit with the principles-based nature of the TCFD framework, and how it is intended to be implemented, monitored and enforced
- agreed that disclosure should apply to listed issuers, banks, general insurers, asset owners and asset managers but we consider that there should be exemptions for some smaller organisations below a certain size (eg assets/revenue) given the existing disclosure burden (particularly for listed companies) and costs associated with complying
- agreed that mandatory assurance obligations should not be imposed at this stage
- encouraged government guidance, education and support to help organisations report effectively.

Corporate reporting is continuing to change and there are many different reporting frameworks in place globally. It is important that any mandatory climate-related financial disclosure regime in New Zealand provides a foundation framework that:

- is flexible enough to allow organisations to evolve their reporting as needs and demands in this area change, including if other entities are included in the regime at a later date
- is cohesive for organisations intent on developing more holistic reporting and aligns with other common reporting frameworks (eg integrated reporting)
- aligns (and can be integrated) with any other reporting obligations that organisations may have to the government (for example under the Climate Change Response (Zero Carbon) Amendment Act 2019) and the frameworks and requirements of other agencies such as the External Reporting Board. This will also be important if mandatory assurance is introduced at a later date
- can be incorporated into companies' annual reports in a cohesive way that avoids unnecessary repetition
- ensures there is alignment with the roles and responsibilities of existing reporting and regulatory bodies (such as the Financial Markets Authority).

Thoughts from outgoing External Reporting Board Chief Executive Warren Allen

"There is a big shift from short-termism when we talk about listed companies – the profit for the next three months, six months or year. Investors are very much more interested in how they can be sure the business will still be there in ten years. That's been a real revolution in the past five or six years," Allen says.

"The big funds and investor groups want to know that, if they are investing in you, that the value will be maintained and enhanced for five to ten years. They are less interested in the outlook for six months. What are you doing to create and maintain value in the long term? Thank goodness that is the new thinking.

"Directors cannot just look at the immediate impact of climate change on this year's results. For example, future flooding of a coastal plant would be considered in the valuation of that plant. It doesn't have the same valuation of a plant up the hill that in ten years is not going to be flooded. Even if the impact is ten years out, it may well have an impact on your valuations now.

Allen notes that climate change is just one of many issues that directors today should ensure their organisations report on, citing environmental damage, modern slavery issues, gender, diversity and remuneration.

"If these issues are significant to an entity, have an impact on the sustainability of an entity, have an impact on the valuation and profitability of an entity, then directors need to make sure they are identified, managed and reported on," he says.

"The Companies Act and the responsibilities of directors require them, already, to be managing and reporting on these types of issues."

Adapting to climate-related financial risks and opportunities

Successful climate action requires businesses to focus on adaptation, not just emmissions.

AUTHOR
DR CHARLES EHRHART, DIRECTOR, CLIMATE CHANGE AND SUSTAINABILITY SERVICES, KPMG

Opening the United Nations annual climate talks (COP25) in Madrid this past December, Secretary-General António Guterres said: "The point of no return is no longer over the horizon."

During the following two weeks, representatives from almost 200 countries worked to negotiate a collective response to the climate crisis. Meanwhile, many corporate collaboratives – including New Zealand's Climate Leaders Coalition (CLC) – used the event as backdrop to announce lofty goals.

The contrast between government and corporate discourse was stark, with the latter focused almost exclusively on reducing greenhouse gas emissions.

While necessary, ambitious emissions reductions by business are no longer sufficient. Indeed, global mean temperatures have already risen more than 1 degree Celsius above pre-industrial levels, with greater than expected consequences.

In order to avoid potentially catastrophic impacts, signatories to the 2016 Paris Agreement have committed to keep total warming below 2 degrees Celsius this century. As a result of past procrastination, this will require abrupt transition to a low-emissions economy and accelerated adaptation to a range of risks.

"Adaptation" is the process of anticipating, absorbing, accommodating and building long-term resilience to climate-related risks while capturing opportunities. According to Mark Carney, outgoing governor of the Bank of England: "Companies that don't adapt will go bankrupt, without question." Nonetheless, few businesses are giving adaptation the same level of attention allocated to emissions reduction. This failure is contrary to principles of the Paris Agreement and places investors, employees, their communities and the planet in jeopardy.

IDENTIFYING YOUR COMPANY'S CLIMATE-RELATED RISKS

To enhance the robustness, consistency, comparability, and utility of climate risk analyses, KPMG has developed an analytical framework distinguishing between physical, transition, legal and capital "pathways."

Physical risks include long-term climatic changes (eg higher temperatures and shifting seasons) as well as their impacts and implications (eg sea level rise and increasing intensity and/or frequency of extreme weather events). Unless counter-measures are taken, these changes can damage assets and affect production, operation, supply chains and employee safety.

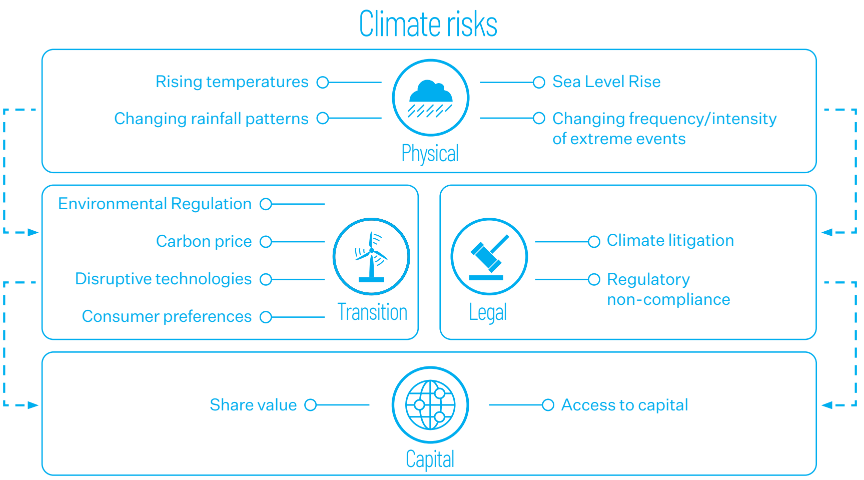
Transition risks arise from the necessary shift to a low-emissions, climate-resilient economy. Examples include new regulations that spike the cost of carbon; the development and deployment of green technologies that affect organisational competitiveness; changes in supply and demand for certain goods (eg imported foods), products (including insurance) and services (eg long-haul air travel) as well as stakeholder perceptions of a business' positive or negative contribution to climate change.

Legal risks are avoidable liabilities that stem, for example, from a company's failure to comply with rapidly evolving regulations, fulfil increasingly complex fiduciary duties (including climate risk assessment and disclosure), properly account for carbon assets/ liabilities or address impairment in annual financial reports.

Capital risks accumulate as a result of unresolved physical, transition and legal risks, crystalize around systemic changes occurring in the finance sector, and express themselves as losses in share value or diminished access to equity and capital debt markets.

KPMG's framework builds upon models developed by the Task Force on Climate-related Financial Disclosure (TCFD, 2017), the Intergovernmental Panel on Climate Change (IPCC, 2014) and International Standards Organisation (ISO, 2019). However, it differs from typical descriptions by treating avoidable liabilities and capital as distinct categories/pathways of risk.

RISK PATHWAYS



OPPORTUNITIES

Early action can mitigate many physical and legal risks. It can also transform some transition and capital risks into compelling opportunities.

The International Framework Standard on Climate Change Adaptation (ISO 14090:2019) sets out principles, requirement, and guidelines for managing climate risks. However, capturing climate-related financial opportunities requires shifting from a risk-reduction to a business-benefit' (aka. when life gives you lemons, make lemonade) mindset.

The Three Horizons (3H) framework can help. The 3H framework accepts that change is constant, competition restless and markets always evolving. Within the context of adapting to climate change, its value lies in prompting organisations to challenge current practices, identify emerging niches and question their core business model.

Horizon one asks:

"What should we do differently?"

Ideas may include reducing sensitivity to the cost of carbon by cutting energy consumption (eg through investment in LED lighting technology), adopting low-emissions energy sources/providers, or improving the efficiency of production and distribution processes.

Horizon two asks:

"What should we do that's new?"

Ideas could include developing low-emissions products or services based on current assets/areas of expertise, accessing new markets through collaboration with governments and development banks supporting the shift to a lower-carbon economy, and tapping new green financial products (eg sustainability-linked loans) or services.

Horizon three asks:

"What should we become?"

Some businesses will become marginal, or simply fail to fit, within the low-emissions economy of our future. Therefore, this is about questioning core assumptions and pivoting from a sunset to sunrise business model. It is about blending foresight and insight to avoid a Kodak-outcome.

BOTTOM LINE

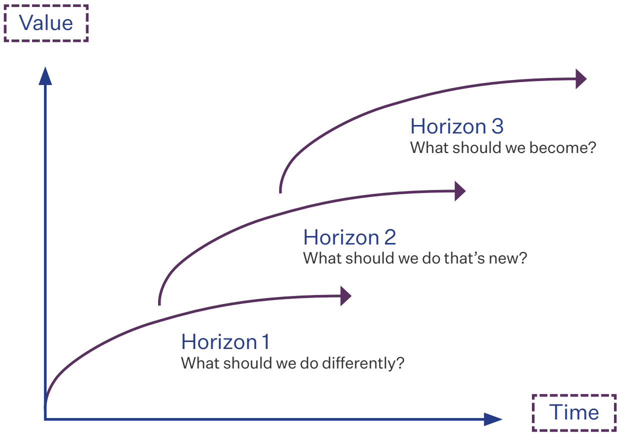
Climate-related risks are no longer over the horizon. Indeed, they pose a material, immediate and escalating threat to the short-term operations and long-term viability of many businesses.

Early action can substantially mitigate some risks while transforming others into opportunity. The scope, scale and urgency of the challenge requires board leadership.

Now is the time.

KPMG

Three Horizons framework and adaptation to climate change



Regardless of whether an organisation already has a sophisticated methodology for managing climate risks and opportunities or is just getting started, it can use the 3H framework to support improved decision making and enhance market resilience.

Steps to effective climate action

Grounding	Ensuring sound governance and climate risk management processes. Good practice includes assigning oversight to relevant board committees/sub-committees (eg audit and risk committees) and identifying which internal and external stakeholders to involve (as well as when and how).
Analysing	Conducting a first-pass materiality assessment of climate-related risks and opportunities. This assessment should consider direct and indirect (eg supply chain) risks stemming from the physical impacts of climate change, the transition to a low-emissions economy, avoidable liabilities and access to capital.
	Developing a range of plausible, distinctive, consistent and relevant scenarios. These scenarios should challenge conventional wisdom and simplistic assumptions about the future. Businesses may want to start with simple, yet robust, qualitative scenarios. As they gain experience, businesses at significant risk should consider building progressively quantitative scenarios.
	Evaluating potential effects under each scenario. The United Nations Intergovernmental Panel on Climate Change advises taking a "whole-systems approach" that considers how climate-related risks may impact key upstream and downstream stakeholders, the natural and built environment, and how climate-related risks might interact with existing and/or emerging risks.
Planning	Identifying and prioritising potential responses. The results of a robust scenario analysis should be used to identify and prioritise options for managing climate-related risks and opportunities through adjustments to strategic and financial plans.
Sharing	Documenting and disclosing. Good practice includes documenting climate risk identification and management processes, plans to address climate risks/capture opportunities and progress made against those plans.

Challenging audit

AUTHOR
AARON WATSON

The fallout from financial company collapses has yet to impact fully on the audit profession, and the directors who rely on it.

“You are fiddling with a model that is not fit for purpose, really.”

It’s a challenging comment on the audit industry, coming as it does from the outgoing External Reporting Board Chief Executive Warren Allen, a former president of the International Federation of Accountants and chartered accountant with extensive professional experience of audit.

Allen says the way financial statements are prepared and audited no longer meets the needs of major stakeholders. Accounting firms themselves are moving into more profitable – and less pressured – lines of work. And that a lack of faith in the audit model among legislators since the global financial crisis (GFC) and recent company collapses – led by the UK and Australia – has taken the initiative off audit firms and professional bodies.

“There is definitely going to be some change made. Over the next 18 months or two years, it is going to be very interesting to see what that change is,” Allen says.

“There is a lot of talk about independence, there is a lot of talk about audit-only firms, and there is a lot of talk about the process of setting audit fees. Change will come and, with audit being an international process, that will filter through to New Zealand.”

DIRECTING AUDIT

New Zealand’s largest companies (based on assets and revenue) must file audited financial reports signed off by directors. Many entities that do not have a statutory responsibility produce audited financial statements for the information of their stakeholders.

Directors’ legal duties under the Companies Act 1993 include exercising powers for a proper purpose, not to trade recklessly and a duty of care. These duties all come to the fore in audited financial statements.

“Directors have a very important role to play in ensuring audit quality,” Allen says.

“The directors have a responsibility to ensure that good work is done and they can’t just say our work has been signed off by a major accounting firm. They need to be comfortable themselves that management has done a good job. They have a responsibility in the really difficult areas, the high-judgement areas, such as the accounting estimates and the valuation of assets and liabilities, the valuation of unlisted equities...”

According to the Financial Markets Authority (FMA), this responsibility to explain the judgements behind accounting treatments is an area New Zealand directors could focus on more.

“In some financial statements, being able to see that process whereby judgments were made that are central to the financial statements, and to the health of the company, is really difficult,” says FMA CEO Rob Everett. “And that’s not the way it should be.”

The FMA releases an annual *Audit Quality Report*. In 2019, it concluded audit quality had “broadly improved” but also enjoined directors to work with management to ensure auditors receive high-quality information on key business judgements.

“The financial statements belong to the company, they belong to the board. Outsourcing the responsibility for key decisions, the key judgments, that are made is not the way it is supposed to work. We know that makes it harder for the audit firm to do a good and efficient audit – within their fee estimate – if in fact they are having to recreate, or to create for the first time, accounting records,” Everett says.

> “Change will come and, with audit being an international process, that will filter through to New Zealand.”

"We have encouraged audit firms to be blunt in their feedback to companies where the accounting records or the process whereby judgments have been made – audit and risk committee, board, potentially CFO – don't lay a clear trail to those quite often difficult judgments."

INDEPENDENCE AND FORECASTING

"The audit process was developed well over a century ago for what were called joint-stock companies. They had what we might refer to as retail – or mum and pop – investors that were distinct from management; they didn't have any collective power. They wanted assurance that the financial statements they were getting were true and fair," Allen says.

"Today, the entities that have investments are very wide ranging. In the past ten years we have seen a big shift into wholesale investors – managed funds, sovereign wealth funds – so you have big collectives of investors that wield a lot of power. They have the ability to get information."

The discussions going on at the moment may be a catalyst for us to look at who the users of audit are today and ask what they need from an audit, he adds.

Proposals coming out of the UK and Australia aim to strengthen auditor independence from company management in order to boost the forward-looking aspects of an audit – the going-concern assumption – in order to avoid a repeat of the company collapses seen globally during the GFC.

These include setting up audit-only firms, potentially splitting audit off as a profession apart from accountancy, or enabling a regulator to match up companies with auditors in order to ensure that relationship is maintained at arm's length.

Allen sees room for increased professional scepticism by both auditors and directors.

"Directors need to apply a level of scepticism to management," notes Allen. "If you take the governance lens applied by directors then the auditors come along and apply their lens, which is when you are most likely to get a positive outcome.

"Independence is also a state of mind. The auditor has to have that independent, challenging, professional sceptic state of mind and to be prepared, if they see something, to call it out and discuss it with the directors. It can be very difficult in some of these valuation exercises or around going concern discussions."

Everett notes that one of the "more extreme proposals" out of the UK is to take the selection of the audit firm out of the hands of the company and put it in the hands of a government entity.

"That is likely unworkable. However, the extreme nature of that proposal, and the fact it is being seriously considered, reflects the unease as to whether audit firms in the current set up really have the freedom to say how it is.

Everett notes that "going concern has been lightning-rod issue in the UK, "not more so than where within 12 months of the going concern statement the company ceases to be a going concern".

"To be fair to boards, it is very difficult to forecast ahead, particularly in complex businesses. It's very difficult for the audit firm to do work in that space.

"But I do worry that, even during what has been a quite benign economic period, if we get into some difficulties in financial markets and companies fall over, it has the risk of convincing a lot of investors that the audit is a bit of a rubber stamp and doesn't help you form any confident view about the immediate risks to a company's business model. Confidence in what the audit does is absolutely essential outside the building and inside the building."

DECREASING NUMBER OF FIRMS

The FMA's audit monitoring show the number of licensed auditors and registered audit firms in New Zealand has been gradually declining over recent years. This is a risk at the big end of town.

"The worry you have about the absolute dominance of the Big 4 is what happens if one of them falls over. What happens if one of them has a conflict of interest? What if one of them is too busy? All of a sudden you have one choice of auditor," says Everett. "We are concerned at the potential lack of choice for big, complex audits."

"If you look at the business model of the big accounting firms now, audit is such a small part. They are out there doing advisory and consulting work. Internationally, the financial statements audit as a percentage of revenues is down around 15%," Allen says

"Is the economic and business model sustainable? I don't think the idea of audit-only firms is sustainable. If that service line is causing you a lot of grief, a lot of reputation exposure and huge issues getting capable staff to come in, how long with audit continue as a major service line? I will be a very interested bystander."

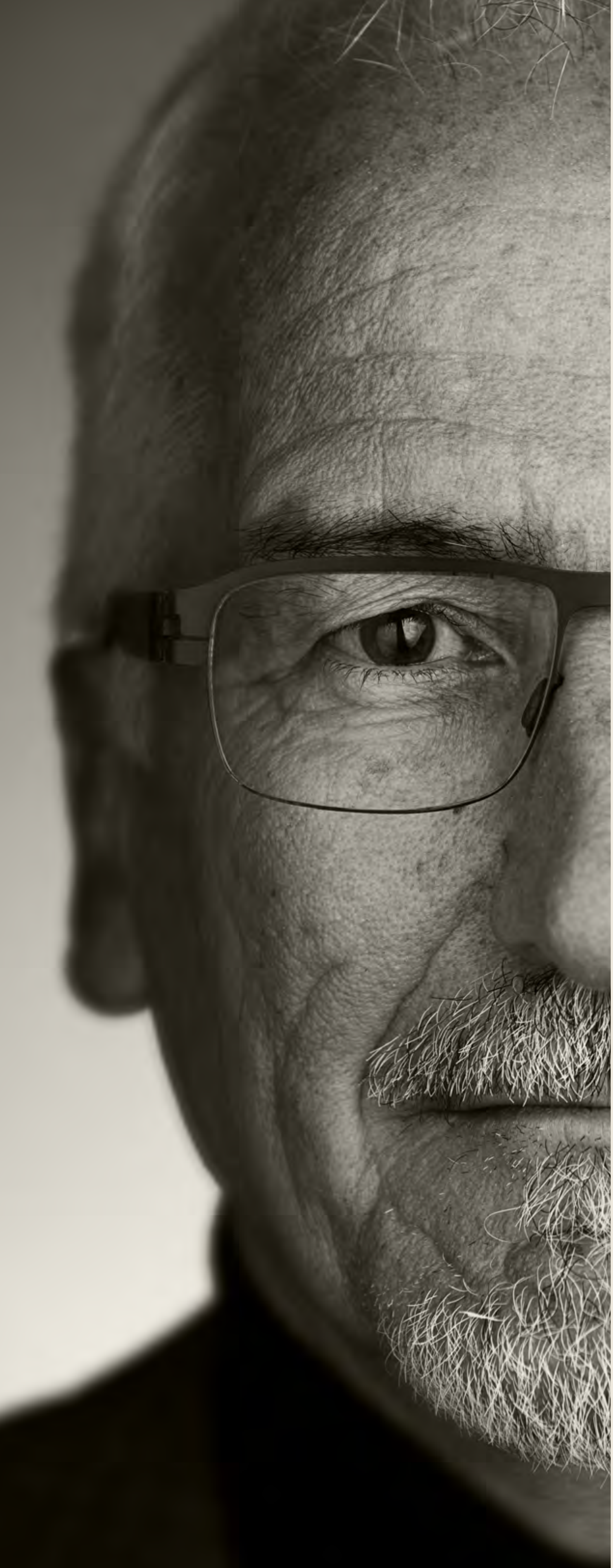
What skills does a board need?

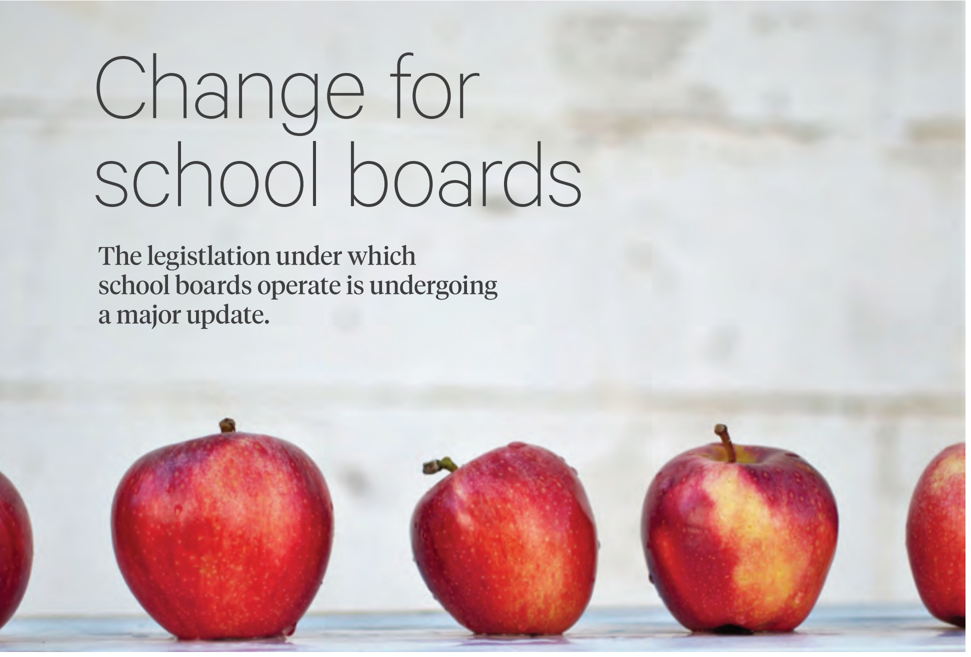
Rob Everett has a clear view on the skills mix needed for a board to oversee an audit effectively.

"You want some people with financial skillsets on your board so that you are not completely dependent on your CFO or auditor. You really do want a couple of people who are able to go toe to toe with the auditor or the CFO.

For the rest of the directors, I've done the IoD's Company Directors Course and there was a very good piece on this, you can't be completely oblivious. You can't be a good director and not be aware of the key issues that are in your audited statement, financial statements, you accounting treatments.

You don't need to be an expert, but you need to know which are the features that change it from a good year to a bad year, which are the features where management might be slightly inclined to gild the lily."





Change for school boards

The legistlation under which school boards operate is undergoing a major update.

AUTHOR
JANE PETERSON, POLICY ANALYST IN OUR GOVERNANCE LEADERSHIP CENTRE

The Education and Training Bill was introduced late last year after the completion of the government's comprehensive Education Work Programme which included the final report of the Tomorrow's Schools Independent Taskforce, and the Government's response to that report: *Supporting all Schools to Succeed: Reform of the Tomorrow's Schools System.*

The Bill replaces all major existing education and training legislation and is intended to be a simpler, more modern and less prescriptive replacement than the current framework. Currently the *Education Act 1964*, the *Education Act 1989* and the *Industry and Training Apprenticeships Act 1992* are the main Acts framing the education system works. Over the years these have been regularly amended and updated, resulting in legislation that is difficult to follow and understand. The Bill addresses this issue by consolidating the existing Acts into one piece of legislation. It also incorporates the Education (Pastoral Care) Amendment Bill and the Education (Vocational Education and Training Reform) Amendment Bill.

Boards are to ensure school governance is underpinned by Te Tiriti o Waitangi and relevant student rights, as well as refocussing boards on a wider range of objectives. Where educational achievement was once the only primary objective, there will now be four primary objectives:

- every student is able to attain their highest possible standard in educational achievement
- the school is a physically and emotionally safe place for students and staff; gives effect to relevant student rights; and takes reasonable steps to eliminate racism, stigma, bullying and discrimination
- the school is inclusive of, and caters to students with differing needs
- the school gives effect to Te Tiriti o Waitangi by:
  - working to ensure it plans, policies and local curriculum reflect local tikanga Māori, mātauranga Māori, and te ao Māori
  - taking all reasonable steps to make instruction available in tikanga Māori and te reo Māori
  - achieving equitable outcomes for Māori students.

Provision for the Minister to issue a code of conduct for members of school boards that sets out minimum standards of conduct which each member must comply with. Boards have the ability to specify additional standards of conduct as long as they are not inconsistent with the code. Sanctions for failure to comply include censuring a board member for a significant or persistent breach of the code and removal of the board member by the Minister. (The sanctions do not apply to principals.)

Boards will be required to consult students (when appropriate), staff and the school community when making bylaws.

Local complaint and dispute resolution panels will be established for when serious rights based disputes cannot be resolved within the school. This includes disputes relating to stand-downs, suspensions, expulsions, discrimination, safety issues and rights to education and enrolment, with panels made up of local members and members from a central list of experts and appointed by a Chief Referee. The panels will be able to resolve disputes by mediation and determination, can make recommendations and, with the consent of both parties, binding determinations (the latter can be enforced through the courts).

The responsibility of enrolment schemes will shift from school boards to the Ministry, although schools must still be consulted on their development.

The Minister will issue eligibility criteria that must be met by applicants for appointment to the position of school principal. Boards can develop additional criteria as long as it is not inconsistent with the criteria issued by the Ministry.

There will be various amendments to update the school board of trustees elections.

The government has also agreed to establish a new Education Service Agency as part of a redesigned Education Ministry which is intended to provide more responsive and accessible support to principals and boards.

Digital resilience for directors

Research suggests that effective leadership accounts for nearly 60% of the advantage “digitally capable” organisations have of over “digitally incapable” organisations.

AUTHOR
CHRISTOPHER VAS, RUSSELL WORDSWORTH, MICHAELA BALZAROVA AND VENKATARAMAN NILAKANT FROM THE UNIVERSITY OF CANTERBURY COLLEGE OF BUSINESS AND LAW

In recent years, a host of digital technologies ranging from traditional web and cloud-based services to more complex machine-learning, augmented reality and additive manufacturing technologies has been transforming the landscape of business.

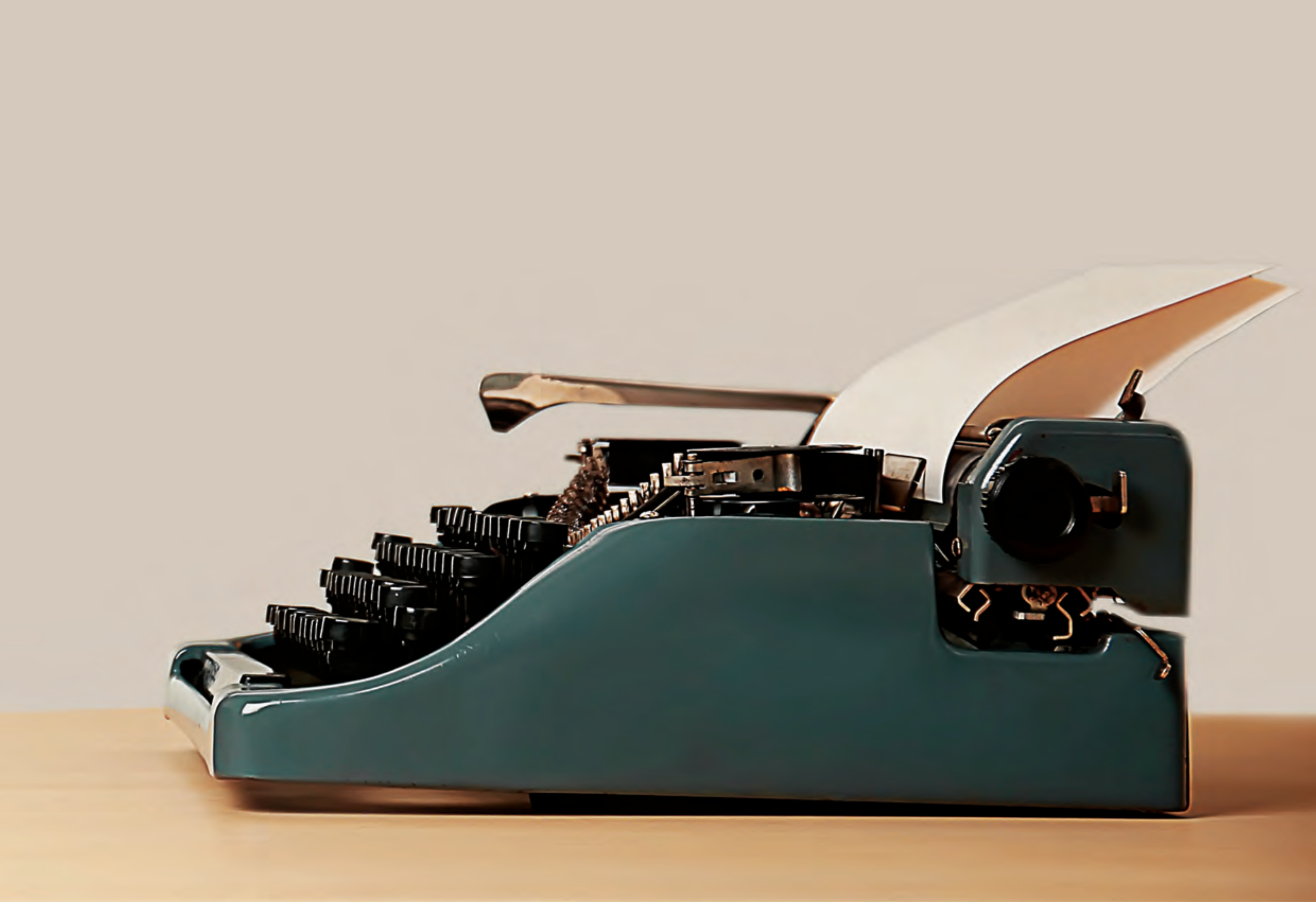
Nearly 90% of respondents to a global survey of managers and executives conducted by MIT Sloan Management Review and Deloitte predicted that their industries will be disrupted by digital technology to a moderate or great extent in the future. This same study indicated that 80% of digitally mature organisations had clear strategies in place to respond to digital disruption.

The development and execution of such strategies requires effective leadership from company directors and other senior executives.

In New Zealand, a study conducted by a team of researchers at the University of Canterbury (UC) Business School appears to confirm the relationship between leadership and digital capability. The study, focussing on “digital resilience” in large organisations in Australia and New Zealand, aimed to identify factors that influence an organisation’s ability to adapt to, and thrive in, a changing digital environment and understand why some organisations are more digitally capable than others.

LEADERSHIP MATTERS

Our previous research on organisational resilience identified effective leadership as vital to responding to disruption. Based on this prior understanding we argue that an organisation’s digital capability (ie the extent to which the organisation currently makes use of digital technology) will be



enhanced through effective leadership in combination with a strategic digital orientation.

Data was gathered from a cross-section of 300 large organisations in Australia and New Zealand. Eighty-eight percent of the participants were included middle or senior level managers, with 18% being directors. Key industries that were represented in the study included information media and telecommunications (20.7%), financial and insurance services (12.4%), and manufacturing (12.1%).

> "Our research suggests that responsibility for digital transformation in New Zealand organisation lies firmly with those in leadership positions."

At the macro level, the key research findings reveal that around 60% of organisations used digital technologies to a large or very large extent:

- Only 65% use digital technologies to inform operational decisions.
- Only 62% use digital technologies to understand customers better, market products, add value to existing offerings and provide customer service.
- Much fewer than 60% use digital technologies for automation of core processes, selling products and services, and launching new business models.

For New Zealand, which aspires to become a "digital nation", more has to be done within all New Zealand organisations.

Our research suggests that responsibility for digital transformation in New Zealand organisation lies firmly with those in leadership positions. Early analysis of the data from the study indicates that effective leadership accounts for nearly 60% of the variation between digitally capable and digitally incapable organisations.

Aspects of leadership most strongly correlated with digital capability include skill building and investment in talent, fostering strategic partnerships across organisational silos (particularly with the IT function of the organisation), having clear goals and key performance indicators, and nurturing a mindset of change and inclusion in the organisation.

Given these findings, what can boards do?

DIRECTING FOR ADVANTAGE

A key pillar of governance best practice is for directors to determine purpose, goals, and strategy with a view to long-term sustainability. Given the above findings, two actions are useful for consideration.

Board chairs need to consider the diversity of "digital" skills and perspectives of the directors that come together around the board table. Just as skillsets and experiences in areas of finance, legal, commercial, marketing, international are valued, so should backgrounds and experiences that demonstrate familiarity with digital transformation. Possessing skills relating to web and mobile technologies, data and security, big data, the growing field of the internet of things (IoT) are all important but so is the need to understand how these technologies can have an impact on the company – business model, value chain, customer experiences and even employees and the associated work cultures. For instance, in NZ, MBA programmes incorporate courses relating to digital transformation, data and strategy and innovation and having Directors skill up is a first step.

Establish a digital capability committee at board level. Given where large and small organisations find themselves on the spectrum of digital capability, it is imperative that directors provide leadership and strategically consider the impacts of digital transformation on the longevity of the business. Focus must be placed on enabling aspects that relate to organisational culture, learning orientation, risk-taking, decision making and continued improvement/excellence, and not on individual technologies. The digital transformation journey for organisations is culture change and technology-enabling, not the technology itself, which also underpins the need for disciplined execution of digital strategies.

Large organisations elsewhere in the world are putting in place new executive roles such as chief digital officers increasing the pivot of the organisation to digital.

While directors implementing these actions aid the digital transformation of their relevant organisations, at the national level they will also support the government's ambition of ensuring that future generations inherit a digital nation. This aspiration comes through reviewing the Industry Transformation Plans announced by the government last year where new value-added opportunities are created, productivity is enhanced and NZ exports its solutions to the world. It is no surprise the government has made digital technologies a key priority sector as part of the ITPs. Nevertheless, as directors are well aware, no strategy can come to life without disciplined execution. Hence the need for digital resilience to become a key skill for directors.

Non-resident directors' fees

Inland Revenue has recently published a new view on the tax treatment of fees paid to non-resident directors.

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Many non-resident New Zealanders continue association with New Zealand via participation on the boards of New Zealand companies. A large number of New Zealand boards, particularly of foreign multinationals' local subsidiaries, have non-resident directors.

Inland Revenue has expressed a new view on how non-resident directors' fees should be treated for tax purposes. The key change in the Commissioner's view applies to when a non-resident director's fees are sourced in New Zealand. Or to put it another way, when that director will be expected to pay tax in New Zealand on those fees.

Inland Revenue has added its usual caveat that the answer is fact-dependent. Essentially, if the fees are paid by a New Zealand resident company to an individual the fees will be treated as New Zealand-sourced income. It doesn't matter whether director services are performed in New Zealand or elsewhere.

WHY THIS MATTERS

New Zealand companies and non-resident directors may have a New Zealand tax obligation where they may not have previously had one, due to the change in Inland Revenue's view. This new approach is generally applied for the income year beginning 1 April 2019.

DOES THIS IMPACT YOU?

Inland Revenue's previous approach was to look at where the services were actually performed (which is still the approach taken when taxing a person's employment income).

The new approach may impact you depending upon whether you perform director services directly or via a personal entity. Fees paid to a non-resident entity will be sourced in New Zealand only to the extent that they are attributable to a permanent establishment in New Zealand, or they are paid for services physically performed in New Zealand.

IR's new approach is partly a consequence of a change to New Zealand's domestic rules, introduced as part of New Zealand's response to the Organisation for Economic Co-operation and Development's Base Erosion and Profit Shifting concerns (the "Google tax" focus).

It means any income that may be taxed in New Zealand under one of New Zealand's double tax agreements (DTAs) will be New Zealand-sourced income under domestic law. As most of New Zealand's DTAs allow New Zealand to tax directors' fees paid by a New Zealand company, these fees are now taxable under New Zealand's domestic source rules.

However, even where there is no DTA in place, IR's view is that non-resident directors' fees will still be New Zealand-sourced if paid by a New Zealand resident company.

This creates an inconsistency with the taxation of employment income and director's fees paid to an entity, which is generally based on the place of physical performance of those services.

If you are a director providing services to New Zealand companies or have a New Zealand company with non-resident directors, you should seek advice to confirm your New Zealand tax obligations.

Mapping social networks

The CEO, the communications manager or the new tech in IT? Who do you trust in your organisation?

AUTHOR
AARON WATSON

BERNIE WHITE MAKES MAPS OF TRUST.

Behind organisational hierarchy, roles and responsibilities is a hidden landscape of relationships in which some individuals are trusted widely, and wield power because of it, he says,

Engaging with this group can help leaders understand risks, improve culture and deliver a strategic plan more effectively.

"We all live and work in a social system in which not everyone is equal. Some have a disproportionate influence over what everyone in the system thinks and how they behave. They are disproportionately trusted and disproportionally connected to people," says White, co-founder of Westerly.

KNOW YOUR PEOPLE

Social mapping can identify those people. It can generate a list the most trusted staff as identified by their colleagues.

The results often contain surprises.

"When I showed a sponsor of a project the list of the top 25 people he put his finger on number two and said, 'tell me that is not true'," White says.

"There was a difficult relationship with that person. But it changed the way he listens to her. Instead of being polite and then moving on, he realised she is representative of a constituency of people. If she is saying it, there could be 50 or one hundred others who think the same thing."

BOARDS AND RISK

"When you talk about risk, you are essentially talking about something that is invisible," White says. "It may only become visible after something has happened. The board wants foresight, so it can manage that. Boards want to build up a capacity to respond, or to mitigate risk in the first place."

A challenge to a board's visibility of risk is the tendency for information to become more positive as it moves up a hierarchy, he says.

"In organisations, the transfer of information upwards is subject to human nature. Something that is very alarming at the coalface can turn into something positive, or be completely invisible, to people at the top."

Identifying and tapping into a group of most-trusted staff could make visible risks that may not otherwise become visible. This group of people can also identify opportunities, or and the challenges that stand between "the beautiful articulation of strategy at the executive and board level", and the day-to-day reality of the staff, he says.

HOW BOARDS CAN TAP IN

White suggests boards "have a conversation" with this group.

"It could be possible for the group to table a report to board from 'the social system'. If that was at odds with the reporting from management, that would be interesting.

"I have seen organisations where the politics did not allow that voice to be present. People wanted the 'reality' to be a certain way. Now that's dangerous, particularly at board level, in terms of risk to the organisations and given the responsibilities of directors.

"It is no longer acceptable for directors to simply say "well. I didn't know about that'. What you should know may be unknown, until it happens. Think about that Australian banking Royal Commission - or the scandal here at Russell McVeigh. There were many people who knew what was going on.

CULTURE

"Culture is becoming a big issue for most organisations. Typically, these influential people are the holders of the culture," White says.

"If you want to make a change in culture, and that can be a big issue for the board, then the place to start would be with the people who are the holders of that culture at a social level.

"Culture is impacted by the formal structure, of course, but if you haven't got the people onside who are trusted, connected and influential then there is a risk you spend a lot of money and time on a project that doesn't go anywhere.

"Many organisations would like this group to be champions for change and I have to remind management that they are not necessarily on your side. If you approach this group with a particular agenda that you are convinced of, but they think this is just another in a long line of crazy ideas, you could make it worse. You have got to respect the power of this collective."

As in many things, the communication must go two ways.

White has sat in meetings where that

"When I showed a sponsor of a project the list of the top 25 people he put his finger on number two and said, 'tell me that is not true'"

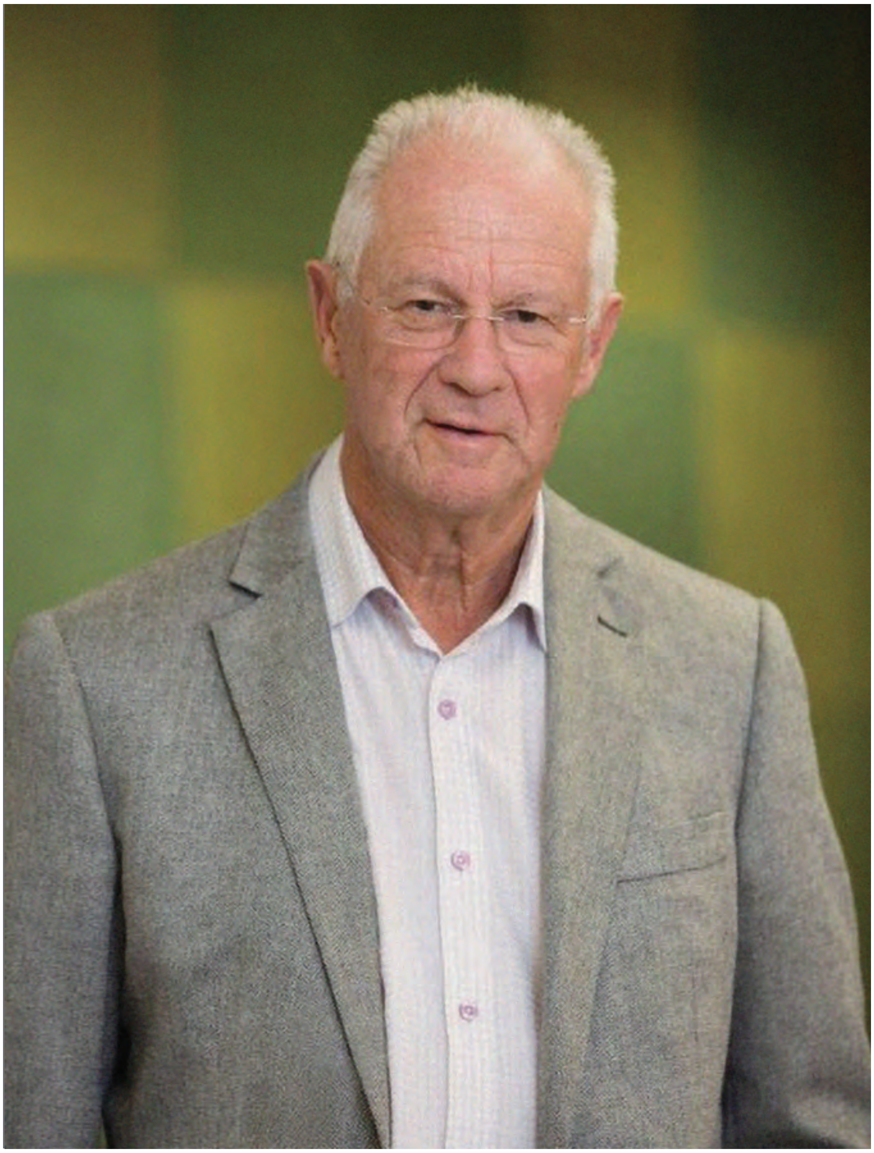
group has asked the boss, "surely you know about this?".

"He has said, 'no, how do you expect me to know about that?' That has been quite transformative for the people in the group because they thought the boss was making decisions with full knowledge, and they have been thinking that's a very poor decision."

Bernie White can be contacted at **bernie@westerlywild.com**

Mentor notes

Rick Christie CFInstD reflects on his experiences with the IoD's Mentoring for Diversity programme.



My mentoring journey commenced in 2011, which was shortly after the inception of the programme itself. I am now with my sixth mentee and still enjoying it, so I have been encouraged to record some of my thoughts about the experiences with the various mentees I have worked with – all women but each very different.

First, although the criteria in terms of experience for mentoring are demanding, my mentees came from a variety of backgrounds ranging from relatively experienced directors and managers, to relative "newbies" and each one requiring a different approach.

Second, as expected, all had a strong desire to progress their Governance careers. However their expectations varied with regard to how having a mentor might assist with this. These ranged from single-mindedly wishing to secure more directorships to a need to improve their own director or chair skillsets and/or seek advice on how to deal with specific situations they were encountering within their existing board positions.

An important first question is always, why? Mentors need to understand what has motivated the mentee and the answer is not always clear cut. It follows that the first meeting is about getting to know and trust each other, at a personal level, to enable "a free and frank" exchange of views as a precursor to a productive mentoring experience. I believe it is up to the mentor to create the right atmosphere for this to occur. The confidentiality and trust, between mentor and mentee needs to prevail, both through the mentoring, and beyond.

While mentees have varying needs, there are some common themes. Advice on developing a suitable CV, helping with letters of application for specific positions (or unsolicited approaches to prospective chairs), and advice on individual profile building are often seen as helpful by mentees.

Hand in hand with this is a process for being more selective about particular industries and companies or preferred sectors. In my view it is important for mentees to have preferences for certain sectors where they feel they have relevant knowledge and experience to offer, rather than just shoot for whatever comes along. I will ask the mentee to research and work through NZX-listed companies, identifying chairs and board members who may be approachable (through IoD or other networking opportunities) and, in the case of female mentees, where there is a lack of diversity on a board or where there may be vacancies coming up.

In some cases I have used my own contacts to arrange introductions to chairs or directors but, obviously, only where I think the mentee had relevant qualifications and could be a good appointment.

Government appointments and NFP roles can be useful additions to a mentee's portfolio of boards, but some mentees have consciously sought to build their private-sector roles to achieve more balance, and better remuneration.

Modelling suitable behaviours and language can also be helpful, especially when planning for specific interviews. There are differences between how to manage interviews for management positions, (which most mentees are familiar with), and interviewing for board roles, eg how to be quietly confident and not over enthusiastic, and to be genuinely interested in the company itself, and not just the board role.

The red line between governance and management can also arise, often where the mentee has been invited to join a board only to find that they are quickly drawn into becoming an executive director, or even being the CEO. This can be uncomfortable, and even risky, for the mentee so my advice is to be on guard against this arising, and avoid it, if a governance career is the real objective.

The mentor can be a very valuable source of advice for the mentee in dealing with difficult situations which can arise with existing, or imminent appointments. With the latter, thorough due diligence is essential and mentors can offer valuable advice on this. With the former, I think mentees appreciate the opportunity to share their concerns with an experienced director and get advice on what to do. This has been the case with nearly all of my mentees.

In some cases I still get phone calls, even after the formal mentoring is over. It is probably for others, especially the mentees, to decide on the value of the programme, and the latest survey of mentees for the 2018-2019 period seems pretty positive on most aspects.

Although most of the mentees to date have been females, there is a new emphasis on diversity per se, to embrace ethnicity, and wider skillsets such as science and engineering, which are not widely represented on NZ boards. I have personally enjoyed the experience and would urge other senior directors to consider becoming a mentor.

Looking for an opportunity to learn from one of New Zealand's top directors?

Applications for Mentoring for Diversity open 9 March 2020. Go to **iod.org.nz/mfd** to apply.

Events**diary**

For more information visit **iod.org.nz**, contact the director development team or contact your local branch manager.

February

25 Whangarei
Make your board and CEO relationship work

Join our After 5 with Patrick Strange, chair of Auckland Airport and Chorus on making board/ CEO relationships work.

25 Palmerston North
Sunshine or rain? What dealing with climate change may mean for your organisation

Join the Hon. James Shaw and other expert panellists as they discuss ESG – Governance and the environment in the Manawatu.

25 Hamilton
What does the Reserve Bank's Monetary Policy Statement mean for you?

The Waikato Branch in partnership with the Waikato Chamber of Commerce are hosting the Governor of the Reserve Bank, Adrian Orr, as the first briefing of 2020.

27 Rotorua
Cultural diversity in governance

New Zealand is a great big melting-pot of cultures and ethnicities, so how do we govern our organisations to ensure the many benefits of diversity are reflected in our board decisions?

March

2 Wellington
Highlights from the World Economic Forum's Global Risks Report

Richard Smith-Bingham from Marsh & McLennan UK joins us to provide an overview of the global risks featured in the annual World Economic Forum Global Risks Report.

3 Christchurch
Global risks facing NZ directors in 2020

Highlights from the World Economic Forum's Global Risks Report: an overview of the top global risks and their impact on NZ business.

3 Auckland
Climate change and directors' duties: From understanding to acting

Director Deep Dive session with Charles Ehrhart. This interactive discussion-style event will be capped at 30 attendees.

10 Auckland
Make your Governance CV really work for you

Aimed primarily at emerging directors, this event will offer guidance on structuring your governance CV and how to get your value proposition across from Kelly McGregor.

11 Dunedin
Director Dialogue with Michelle Read: Setting CEO remuneration

How directors can ensure robust and defensible executive pay practices within their organisations.

13 Nelson
The 4 Day Week: A simple idea on a global stage

Can less really mean more? Hear Andrew Barnes, founder of Perpetual Guardian explain what really goes on in a four day week.

17 Queenstown
Governing through the rise and fall of journalism

In the wake of significant events in 2019, the media industry has come under increasing scrutiny by the NZ Government and public.

26 Auckland
Future focus for litigation

Join us for an informative discussion with the Dispute Resolution experts from MinterEllisonRuddWatts.

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BRANCH EVENTS

For information on member events in your area, see **iod.org.nz**

Online Learning

Any time, anywhere. Offering convenience and flexibility, our self-paced courses provide focused online learning. Progress through the course slides, interactive diagrams, videos and reflective exercises at your own pace.

Health and safety governance
3 CPD points

Ethics – how directors do business
3 CPD points

Directors' and Officers' insurance
2 CPD points

Not-for-profit fundamentals
3 CPD points

Cybersecurity
3 CPD points

Out & **about**

Otago Southland
Controller and Auditor-General John Ryan offered insights to members ahead of the Dunedin Fellows' Dinner.


01


02

01 Tony Allison, John Ryan, Jemma Adams.
02 Theresa Chan, Errol Millar.
03 Robbie Burnside, Alan McKenzie, Tim Mepham.
04 Louise Brown, Karen Billinghurst, Lisa Brown.
05 Geoff Thomas, John Gallaher, Murray Donald.
06 Kathy Grant, Chris Hopkins.


03


04


06


05


Lease.
Own.