

CO<sub>2</sub> concentration in parts per million (data collected at Baring Head, Wellington, from 1973 to 2021)

Submission

**Financial Sector (Climate-related  
Disclosures and Other Matters)  
Amendment Bill**

28 May 2021

## **About the McGuinness Institute**

The McGuinness Institute was founded in 2004 as a non-partisan think tank working towards a sustainable future for New Zealand. Project 2058 is the Institute's flagship project focusing on New Zealand's long-term future. Because of our observation that foresight drives strategy, strategy requires reporting, and reporting shapes foresight, we developed three interlinking policy projects: *ForesightNZ*, *StrategyNZ* and *ReportingNZ*. Each of these tools must align if we want New Zealand to develop durable, robust and forward-looking public policies. The policy projects frame and feed into our research projects, which address a range of significant issues facing New Zealand. The six research projects are: *CivicsNZ*, *ClimateChangeNZ*, *OneOceanNZ*, *PublicScienceNZ*, *TacklingPovertyNZ* and *TalentNZ*.

The Institute's key interest in this submission is to contribute to a discussion of how to build an informed New Zealand, especially in light of the ongoing climate crisis and the need to transform to a low carbon economy. The Institute sees the transparent, effective communication of climate-related disclosures in the annual reports of New Zealand's most powerful entities as an essential tool in informing New Zealanders.

## **About the author**

### **Wendy McGuinness, Chief Executive**

Wendy McGuinness wrote the report *Implementation of Accrual Accounting in Government Departments* for the New Zealand Treasury in 1988. She founded McGuinness & Associates, a consultancy firm providing services to the public sector during the 1988–1990 transition from cash to accrual accounting. Between 1990 and 2003, she continued consulting part-time while raising children, largely undertaking risk management work. In 2002, she was a member of the New Zealand Institute of Chartered Accountants (NZICA) Taskforce, which published the Report of the Taskforce on Sustainable Development Reporting. From 2003 to 2004, she was Chair of the NZICA Sustainable Development Reporting Committee. In 2004, Wendy established the McGuinness Institute in order to contribute to a more integrated discussion on New Zealand's long-term future. In 2009, she became a Fellow Chartered Accountant (FCA).

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## About the cover

1. The radar diagram is the final image of a short video that illustrates the change in CO<sub>2</sub> parts per million (ppm) between the years 1973 and 2021. The centre shows the year monthly data is added. It closes with the year 2021, which reflects all the data collected to date. For example, the blue rings are added last and represent the years 2016 to 2021. The short video aims to emphasize the climate emergency we face and can be viewed on the McGuinness Institute Instagram.<sup>1</sup>
2. The data is from NIWA's clean air station at Baring Head/Ōrua-pouanui.
3. The data used in the radar diagram is the monthly average steady interval (baseline) CO<sub>2</sub> parts per million (ppm) between 1973 and 2021. Note: The 2020 and 2021 data is yet to undergo full quality control processes.
4. For comparison, the pre-industrial level of CO<sub>2</sub> in the atmosphere was 280 parts per million.
5. Baseline data are collected in southerly wind conditions so, occasionally, months have no baseline data; this is shown as gaps in lines of the radar graph.
6. NIWA's clean air station at Baring Head/Ōrua-pouanui is situated on the Wellington coast and overlooks Cook Strait. This station has been running since 1972 and provides the longest-running continuous CO<sub>2</sub> measurement in the Southern Hemisphere.
7. The oldest continuous CO<sub>2</sub> monitoring station in the world is based in the Northern Hemisphere, at Mauna Loa Laboratory in Hawai'i.

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<sup>1</sup> See McGuinness Institute Instagram: [https://www.instagram.com/p/CPZowvLMO-R/?utm\\_medium=c&utm\\_source=copy\\_link](https://www.instagram.com/p/CPZowvLMO-R/?utm_medium=c&utm_source=copy_link)

## **To whom it may concern**

The McGuinness Institute welcomes the opportunity to respond to the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill. The Institute would appreciate the opportunity to be heard by the committee.

Climate reporting is a great example of how the reporting framework needs to adjust to meet the information needs of existing and new users – both in terms of new types of information (e.g. future focused information), new data (e.g. emissions) and new users of information (e.g. citizens and policy analysts interested in learning more about environmental impacts, societal impacts and impacts on the economy). This is both urgent and important work.

## **Background**

The Institute identified the external reporting framework as an important area of study in early 2011 (see list of publications in Appendix 1). Our work programme focused on the current reporting framework to see if it is fit for purpose, and if not, to look at ways it could be improved. In particular, the goal is to ensure information is accurate, accessible and relevant so that businesspeople and policy analysts (and others) are able to make effective business and policy decisions – both now and in the long term. The Institute uses the concept of an optimal reporting framework to drive our work and thinking. To be successful a reporting framework needs to deliver relevant, timely, accurate information that is accessible and relevant to the needs of users – and most importantly is consistent and therefore durable over time.

## **Our approach**

Given the number of Acts that need to be adapted to establish climate reporting, our approach has been to highlight key concerns and then, where possible, make suggestions as to how these concerns might be addressed. We appreciate this may not appear easy to analyse, but given the number of permutations, the approach (outlined below) is designed to set out the logic and explore possible solutions. We hope that this approach proves useful.

Part 1 is in effect one large table, which sets out a review of the Bill in terms of the Institute's three major recommendations. Column 1 contains our three recommendations on how we would go about embedding climate reporting. Column 2 refers to the explanatory note to the Bill. Column 3 identifies where the Institute agrees with the content of the Bill and where it does not.

Part 2 of this submission explores the reasons why we disagree with some parts of the Bill, and puts forward some ideas on how those concerns might be addressed.

Seven key concerns were identified and grouped under why, who, where and what. For each of these concerns, we describe the problem, then discuss the issues and lastly suggest a solution.

1. Why – expand purpose of legislation
2. Who – remove exemptions
3. Who – extend type of preparer
4. Who – extend definition of large
5. Where – create a central public register of climate statements
6. What – increase size and nature of penalties for offences
7. What – add feedback loops to improve the system

### **Further research**

We note that the single broad policy objective that is intended to be achieved by the bill is ‘to broaden non-financial reporting by requiring and supporting the making of climate-related disclosures by certain FMC reporting entities and supporting related matters’. This means putting in place an effective climate reporting regime in legislation, regulations, standards and guidelines.

The submission refers to four working papers in progress. Together they aim to provide an evidence base for the important task before the committee. The Institute intends to make these papers public in the next few weeks and will ensure the committee is provided final copies.

- i. *Working Paper 2021/06 – Reviewing TCFD information in 2018–2020 annual reports of NZSX-Listed companies* collects and analyses annual reports that publish Task Force on Climate-related Financial Disclosures (TCFD) information.
- ii. *Working paper 2021/10a – Climate change analysis of Government Department Strategies in operation as at 31 December 2020* illustrates that current operational government department strategies are failing to embed climate change.
- iii. *Working Paper 2021/12 – Analysis of Climate Change Reporting in the Public and Private Sectors* explores the extent of climate-related reporting in both public- and private-sector annual reports.
- iv. *Working Paper 2021/13 – Reviewing Voluntary Reporting Frameworks Mentioned in 2018–2020 Annual Reports* first identifies which entities mention climate reporting frameworks in their annual reports and, second, explores how these entities are engaging with these frameworks.

These working papers contribute to the Institute’s Project *ReportingNZ: Building a Reporting Framework Fit for Purpose*, which is a portfolio of work that the Institute hopes provides a useful resource for ongoing dialogue.

## **Supporting information**

We have included five appendices:

Appendix 1: Timeline of McGuinness Institute *ReportingNZ* publications

Appendix 2: Registers managed by the Companies Office

Appendix 3: Major Recommendations from *Report 17 – ReportingNZ: Building a Reporting Framework Fit for Purpose*

Appendix 4: *Legal Opinion: Obligations on directors to report risk in New Zealand annual reports under the Companies Act 1993*

Appendix 5: Excerpt from *Task Force on Climate-related Financial Disclosures 2020 Status Report*

## **Contact us**

If you have any questions, please do not hesitate to contact Wendy McGuinness or Reuben Brady on 04 499 8888 or [enquiries@mcguinnessinstitute.org](mailto:enquiries@mcguinnessinstitute.org).

## Part 1: Comparing the Bill with the McGuinness Institute Recommendations

The three key documents that set out in detail the basis of our proposed way forward (in Column 1) are *Report 17 – ReportingNZ: Building a Reporting Framework Fit for Purpose* (June 2020), *Submission – Climate-related financial disclosures: Understanding your business risks and opportunities related to climate change* (December 2019) and *Discussion Paper 2019/01: The Climate Reporting Emergency: A New Zealand Case Study* (October 2019). We link to all of these in the left-hand column of the table.

### Comparison of McGuinness Institute’s climate-related recommendations with the proposals in the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill

McGuinness Institute’s recommendations <a href="#">MI Report 17</a> (June 2020) <a href="#">Discussion paper</a> (Oct 2019) <a href="#">Submission</a> (Dec 2019)	Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill proposals  <a href="#">Bill introduced</a> April 2021	McGuinness Institute response, June 2021  Agrees (1–19) Disagrees/suggests (a–l)
<p><b>Recommendation 1:</b> Use the existing legislative and financial reporting frameworks for determining who must make climate-related financial disclosures and what they must disclose (in this case, to prepare, publish and file a ‘Statement of Climate Information’). (<a href="#">Report 17</a>, p. 112)</p>	<p>[Ref: Explanatory note to Bill]</p> <p><i>Proposes amending existing legislative framework by amending the Financial Markets Conduct Act 2013, the Financial Reporting Act 2013 and the Public Audit Act 2001.</i></p> <p><i>The Bill introduces mandatory climate-related disclosure requirements for certain FMC reporting entities that, under section 461K of the Financial Markets Conduct Act 2013, are considered to have a higher level of public accountability, including listed issuers, large banks, large non-bank deposit takers, and large insurers, and large managers in respect of managed investment schemes.</i></p> <p><i>The disclosures will be aligned with the framework provided by the Task Force on Climate-related Financial Disclosures and made in accordance with standards issued by the External Reporting Board (the XRB).</i></p> <p><i>Note: The Bill also provides for the XRB to issue guidance on a wider range of environmental, social, governance (ESG), and other non-financial matters that can be applied by entities on a voluntary basis. The purposes of these provisions are—</i></p> <ul style="list-style-type: none"> <li>• <i>to provide those who prepare financial statements with guidance on best practice ESG and related disclosures;</i></li> <li>• <i>to improve the quality of disclosures on a range of issues beyond the types of information presented in financial statements.</i></li> </ul>	<p><b>Agrees</b></p> <ol style="list-style-type: none"> <li>1. We agree with a mandatory climate-related disclosure regime.</li> <li>2. We agree with using the existing legislative and financial reporting frameworks.</li> <li>3. We agree with a mandatory reporting and assurance standards to prepare and assure climate reporting.</li> <li>4. We agree that disclosures should align with the recommendations of the Task Force on Climate-related Financial Disclosures.</li> <li>5. We agree with the creation of voluntary reporting standards and guidance on a wider range of environmental, social, governance (ESG), and other non-financial matters.</li> </ol> <p><b>Disagrees/suggests</b></p> <ol style="list-style-type: none"> <li>a. The Institute appreciates that it may appear easier in the short term to leave the Companies Act untouched, but we believe that climate reporting is here to stay and that the Companies Act will require an overhaul in the short to medium term.</li> </ol>
<p><b>Recommendation 2:</b> Require for-profit and public benefit entities to report on climate change mitigation and adaptation using the same reporting framework through the application of a common set of standards and guidance. (<a href="#">Report 17</a>, p. 112)</p>	<p>[Ref: Explanatory note to Bill]</p> <p><i>The Explanatory note states that the disclosures will be aligned with the framework provided by the Task Force on Climate-related Financial Disclosures and the XRB is charged with issuing standards and guidance.</i></p>	<p><b>Agrees</b></p> <ol style="list-style-type: none"> <li>6. We agree that the External Reporting Board (XRB) should be charged with issuing reporting and assurance standards and providing guidance on those standards (where appropriate).</li> </ol>

<p>McGuinness Institute’s recommendations</p> <p><a href="#">MI Report 17 (June 2020)</a>  <a href="#">Discussion paper (Oct 2019)</a>  <a href="#">Submission (Dec 2019)</a></p>	<p><b>Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill proposals</b></p> <p><a href="#">Bill introduced April 2021</a></p>	<p><b>McGuinness Institute response, June 2021</b></p> <p>Agrees (1–19)  Disagrees/suggests (a–l)</p>
	<p><i>These will apply only to certain FMC reporting entities, which include some public entities that meet the criteria (e.g. have debt listed on the stock exchange).</i></p> <p><i>However, in addition the Climate Change Response Act 2002 requires certain public entities to provide climate-related information on request based on TCFD concepts, but this information is not publicly disclosed information – section s 5ZW of the Climate Change Response Act 2002.</i></p>	<p><b>Disagrees/suggest</b></p> <p>b. The Institute considers mandatory reporting limited to ‘certain FMC reporting entities’ is too narrow.</p> <p>c. The Institute considers that information under s 5ZW of the Climate Change Response Act 2002 should be publicly disclosed information.</p>
<p><b>Recommendation 3:</b> Implement a reporting framework as follows (<a href="#">Report 17</a>, p. 112):</p>		
<ul style="list-style-type: none"> <li><b>Who:</b> Require the following groups of entities (the ‘external climate reporting organisations’) to disclose a ‘Statement of Climate Information’ in their annual report: <ul style="list-style-type: none"> <li>— Group 1: Participants in the New Zealand Emissions Trading scheme (NZ ETS) (under s 54 of the Climate Change Response Act 2002)</li> <li>— Group 2: Reporting organisations (under s 5ZW of the Climate Change Response Act 2002)</li> <li>— Group 3: External Reporting Board (XRB) Tier 1 for-profit entities and Tier 1 public benefit entities.</li> </ul> </li> </ul>	<p>[Ref: proposed new sections 461P and 461Q of the Financial Markets Conduct Act 2013]</p> <p><i>Climate reporting entities include an FMC reporting entity that is considered to have a higher level of public accountability that is:</i></p> <ul style="list-style-type: none"> <li>• <i>a listed issuer of quoted equity securities or quoted debt securities</i></li> <li>• <i>a registered bank that is “large”</i></li> <li>• <i>a licensed insurer that is “large”</i></li> <li>• <i>a credit union that is “large”</i></li> <li>• <i>a building society that is “large”</i></li> <li>• <i>a manager of a registered scheme in respect of the scheme if the manager is a “large” manager</i></li> </ul> <p><i>“Large” generally means that, as at the balance date of each of the 2 preceding accounting periods, the combined assets of an entity and its subsidiaries were more than \$1 billion.</i></p> <p><i>In the case of a licensed insurer, if the insurer is not large on account of assets it will still be large if, in each of its 2 preceding accounting periods, the combined annual gross premium revenue of the insurer and its subsidiaries was more than \$250 million.</i></p> <p><i>“Large”, in the case of an entity that is a body corporate incorporated outside New Zealand, looks at whether its New Zealand business, or its group’s New Zealand business, is large.</i></p> <p><i>Broadly, managers of registered schemes will be climate reporting entities in respect of those schemes, and required to prepare climate statements for each separate fund of each scheme (or for the scheme itself if any liability of the manager or the scheme is not limited to a separate fund), if they are “large managers”; the size of individual schemes or funds is immaterial. The definition of large manager looks at whether the assets of schemes managed by the manager and schemes managed by authorised bodies providing that service under the manager’s licence total more than \$1 billion as at the balance date of each of the manager’s 2 preceding accounting periods. If a manager is a large manager, the authorised bodies will also be large managers.</i></p>	<p><b>Agrees</b></p> <ul style="list-style-type: none"> <li>• We agree that all listed issuers of quoted equity securities or quoted debt securities should be required to report.</li> </ul> <p>7. We agree with the concept of ‘large’ but consider it is too narrow, see below.</p> <p><b>Disagrees/suggests</b></p> <p>d. The Institute considers that the threshold of ‘large’ is set too high.</p> <ul style="list-style-type: none"> <li>- The Institute suggests that all entities (other than issuers) be determined as large if they are incorporated in New Zealand and have more than \$60 million in assets and \$30 million in revenue. This will align reporting with tier 1 as per s 45 of the Financial Reporting Act 2013.</li> <li>- Overseas companies should also follow existing s 45 requirements specified for overseas entities.</li> </ul> <p>e. The Institute considers the criteria could be broadened to include full-time staff (FTE) and should be triggered if more than 100 FTE are employed by the entity as at each of its two preceding accounting periods.</p> <p>f. The Institute considers that the following groups should be required to be part of a mandatory climate-related disclosure regime.</p> <ul style="list-style-type: none"> <li>- Group 1: Participants in the New Zealand Emissions Trading scheme (NZ ETS)</li> </ul>



<p>McGuinness Institute's recommendations</p> <p><a href="#">MI Report 17</a> (June 2020)  <a href="#">Discussion paper</a> (Oct 2019)  <a href="#">Submission</a> (Dec 2019)</p>	<p>Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill proposals</p> <p><a href="#">Bill introduced</a> April 2021</p>	<p>McGuinness Institute response, June 2021</p> <p>Agrees (1–19)  Disagrees/suggests (a–l)</p>
		<p>(under s 54 of the Climate Change Response Act 2002)</p> <ul style="list-style-type: none"> <li>- Group 2: Reporting organisations (under s 5ZW of the Climate Change Response Act 2002)</li> <li>- Group 3: External Reporting Board (XRB): Tier 1 for-profit entities and Tier 1 public benefit entities.</li> </ul>
<ul style="list-style-type: none"> <li>• <b>What:</b> Require a Statement of Climate Information to be prepared and signed by two directors (or by alternative authorities if the entity does not have directors) and be audited.</li> </ul>	<p>[Ref: proposed new section 461W of the Financial Markets Conduct Act 2013]</p> <p><i>Every climate reporting entity to ensure that, within 4 months after the balance date of the entity, climate statements that comply with applicable climate standards are—</i></p> <p><i>(a) completed in relation to the entity and that balance date; and</i></p> <p><i>(b) dated and signed on behalf of the entity by 2 directors of the entity or, if the entity has only 1 director, by that director.</i></p> <p><i>Every climate reporting entity to ensure that the climate statements or group climate statements that are required to be prepared under any of sections 461W to 461Z are, to the extent that those statements are required to disclose greenhouse gas emissions, the subject of an assurance engagement carried out by a qualified CRD assurance practitioner.</i></p>	<p><b>Agrees</b></p> <ol style="list-style-type: none"> <li>8. We agree with the concept of climate reporting entity.</li> <li>9. We agree with reporting within four months after the balance date of the entity.</li> <li>10. We agree with dating and signing on behalf of the entity by two directors of the entity or, if the entity has only one director, by that director.</li> <li>11. We agree that the Financial Markets Authority (FMA) should be responsible for the independent monitoring and enforcement of climate reporting entities' compliance with the climate standards and approval of CRD assurance bodies.</li> <li>12. We agree that greenhouse gas emissions disclosures should be subject to an assurance engagement carried out by a qualified CRD assurance practitioner.</li> <li>13. We agree with the definition of a qualified CRD assurance practitioner.</li> <li>14. We agree that the assurance practitioner should gain full access to information.</li> </ol> <p><b>Disagrees/suggests</b></p> <ol style="list-style-type: none"> <li>g. The Institute agrees that the FMA have a key role in monitoring and enforcement, but it is concerned that the penalties (set in the Bill as \$50,000) for an offence of (i) not keeping records (s 461T) or (ii) not showing records (s 461V) are set too low. Section 461ZS provides a good overview and should be retained. See link to sections in Bill <a href="#">here</a>. Suggestions include:</li> </ol>

<p>McGuinness Institute’s recommendations</p> <p><a href="#">MI Report 17</a> (June 2020)  <a href="#">Discussion paper</a> (Oct 2019)  <a href="#">Submission</a> (Dec 2019)</p>	<p>Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill proposals</p> <p><a href="#">Bill introduced</a> April 2021</p>	<p>McGuinness Institute response, June 2021</p> <p>Agrees (1–19)  Disagrees/suggests (a–l)</p>
		<ul style="list-style-type: none"> <li>- That a limit be set under legislation per individual (including a director or employee) and per entity.</li> <li>- That the FMA be given the responsibility to prepare a financial penalty schedule for all offences and contradictions under the legislation.</li> <li>- That in addition to a financial penalty, a reputational penalty be required. For example, a note be required in the climate statements and annual report of the entity for the next five consecutive years.</li> <li>- That exemptions are removed from the Bill completely.</li> <li>- That the FMA provide an annual operational report on climate statements, including who is preparing them, links to each climate statement and a list of all penalties charged and if exemptions are included in the final legislation – a list of exemptions naming each climate reporting entity.</li> </ul>
<ul style="list-style-type: none"> <li>• <b>When:</b> Require an annual Statement of Climate Information to be prepared by all external climate reporting organisations.</li> </ul>	<p>[Ref: proposed new section 461W of the Financial Markets Conduct Act 2013]</p> <p><i>Climate statements to be prepared annually in relation to the climate reporting entity [selected entities] at balance date.</i></p>	<p><b>Agrees</b></p> <p>15. We agree with the term ‘climate statement’.</p> <p>16. We agree that the timing should be annually and at the climate reporting entity’s balance date (being the date of the financial statements).</p>
<ul style="list-style-type: none"> <li>• <b>Where:</b> Require the Statement of Climate Information to be located in the annual report and require selected entities to file the annual report on the Companies Register. Where an entity is not required to prepare an annual report, the statement should then be a stand-alone document.</li> </ul>	<p>[Ref: proposed new sections 461ZN and 461ZO of the Financial Markets Conduct Act 2013]</p> <p><i>A climate reporting entity to lodge copies of climate statements and the assurance practitioner’s report on those statements with the Registrar of Financial Service Providers within 4 months of balance date.</i></p> <p><i>A climate reporting entity that is required to prepare an annual report to provide information in its annual report about where its climate statement and its assurance practitioner’s report on those statements can be accessed (ie., the address of, or a link to, the Internet site where copies of the following can be accessed).</i></p>	<p><b>Agrees</b></p> <p>17. We agree that the climate reporting entity lodge copies of climate statements and the assurance practitioner’s report within four months of balance date at the Companies Office.</p> <p><b>Disagrees/suggests</b></p> <p>h. The Institute considers that a climate reporting entity should prepare and publish an annual report.</p>

<p>McGuinness Institute’s recommendations</p> <p><a href="#">MI Report 17</a> (June 2020)</p> <p><a href="#">Discussion paper</a> (Oct 2019)</p> <p><a href="#">Submission</a> (Dec 2019)</p>	<p>Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill proposals</p> <p><a href="#">Bill introduced</a> April 2021</p>	<p>McGuinness Institute response, June 2021</p> <p>Agrees (1–19)</p> <p>Disagrees/suggests (a–l)</p>
		<p>i. The Institute considers that an annual report must provide its climate statement and its assurance practitioner’s report in the annual report (i.e. no links to a separate climate statement are allowed).</p> <p>j. The Institute considers that entities that want to voluntarily report should be able to do so on a public register provided the statement is assured (see <i>Report 17</i>, p. 89).</p>
<ul style="list-style-type: none"> <li><b>Why:</b> Require a clear purpose and an understanding that the benefits exceed the costs for primary users and other stakeholders. Primary users, wider stakeholders and government need timely, reliable, useful and comparable information about the risks and opportunities that exist now and in the future.</li> </ul>	<p>[Ref: Explanatory note to Bill]</p> <p><i>The specific purposes of the Bill are stated as:</i></p> <ul style="list-style-type: none"> <li><i>to ensure that the effects of climate change are routinely considered in business, investment, lending, and insurance underwriting decisions; and</i></li> <li><i>to help reporting entities better demonstrate responsibility and foresight in their consideration of climate issues; and</i></li> <li><i>to lead to smarter, more efficient allocation of capital, and help smooth the transition to a more sustainable, low-emissions economy.</i></li> </ul>	<p><b>Agrees</b></p> <p>18. We agree with the specific purposes listed in the Bill but considers it should be broader.</p> <p><b>Disagrees/suggests</b></p> <p>k. The Institute considers that there are other specific benefits that should be recognised:</p> <ul style="list-style-type: none"> <li>To ensure better public policy in terms of improving the quality of the emissions reduction plan, the national adaptation plan and the national climate change risk assessment (specified under the Climate Change Response (Zero Carbon) Amendment Act 2019).</li> <li>To ensure entities are more responsible employers, neighbours and citizens.</li> </ul>
<ul style="list-style-type: none"> <li><b>How:</b> Require the XRB to prepare NZ TCFD-based reporting standard(s) and an assurance standard (as well as guidance) for all external climate reporting organisations.</li> </ul>	<p>[Ref: Explanatory note to Bill and proposed amendment to section 12 of the Financial Reporting Act 2013]</p> <p><i>The XRB to issue guidance on a wider range of environmental, social, governance (ESG), and other non-financial matters that can be applied by entities on a voluntary basis. The purposes of these provisions are—</i></p> <ul style="list-style-type: none"> <li><i>to provide those who prepare financial statements with guidance on best practice ESG and related disclosures;</i></li> <li><i>to improve the quality of disclosures on a range of issues beyond the types of information presented in financial statements.</i></li> </ul>	<p><b>Agrees</b></p> <p>19. We agree that the XRB should issue voluntary guidance on a wider range of environmental, social, governance (ESG) and other non-financial matters. Over time, we expect mandatory reporting will evolve.</p> <p><b>Disagrees/suggests</b></p> <p>l. The Institute suggests that the XRB should focus primarily on climate reporting in the first instance. Getting climate reporting operating effectively will be a challenge. If New Zealand fails to do this, out-of-control climate change will have a ripple effect, negatively impacting our economy, and adversely affecting our environment and society.</p>

<p>McGuinness Institute's recommendations</p> <p><a href="#">MI Report 17</a> (June 2020)  <a href="#">Discussion paper</a> (Oct 2019)  <a href="#">Submission</a> (Dec 2019)</p>	<p>Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill proposals</p> <p><a href="#">Bill introduced</a> April 2021</p>	<p>McGuinness Institute response, June 2021</p> <p>Agrees (1–19)  Disagrees/suggests (a–l)</p>
		<p>In this way, climate reporting is the low-hanging fruit. Only by becoming effective reporters of climate risks and opportunities will we be able to get the time and skills to solve the other challenges we face.</p>

## **Part 2: Seven key concerns**

Below, each of the seven concerns are addressed in terms of the problem, followed by a discussion and lastly, a suggested solution.

1. Why – expand purpose of legislation (pp. 14–17)
2. Who – remove exemptions (pp. 18–22)
3. Who – extend type of preparer (pp. 23–27)
4. Who – extend definition of large (pp. 28–30)
5. Where – create a central public register of climate statements (pp. 31–33)
6. What – increase size and nature of penalties for offences (pp. 34–35)
7. What – add feedback loops to improve the system (pp. 36–38)

## 1. Why – expand purpose of legislation

See Part 1, Column 3 – (a), (b), (k)

### KEY PROBLEM

The primary objective of the Bill [as set out in the Cabinet Minute, para 3]<sup>2</sup> is ‘for the effects of climate change to become more routinely considered in business and investment decisions to promote and facilitate the development of fair, efficient and transparent financial markets’. The Institute believes that the resulting Bill does not enable the effects to be ‘routinely’ considered as it requires only a select few entities to consider the ‘effects of climate change’. This Bill, put simply, is not ambitious enough.

### DISCUSSION

#### The existing strategic narrative in the Bill is negative

The Bill assumes climate reporting is a risk and that the costs of climate reporting will exceed the benefits for most entities and the country in general. The Institute believes this is the wrong paradigm.

In contrast, Mark Carney in his new book *Value(s): Build a better world for all*<sup>3</sup> suggests that a market in transition to less than 2°C is dependent on the foundations of three building blocks: reporting, risk management and returns (as in providing value by delivering the type of returns society wants) and that in his view, a market in transition ‘will open up the greatest commercial opportunity of our time’ (pp. 318, 339). The Institute sees climate reporting as a key mechanism to opening up New Zealand’s economy to the ‘greatest opportunity of our time’.

Mandatory reporting of climate statements is an enormous opportunity and one that New Zealand entities can and should embrace. This is particularly the case for investors in commercial businesses as a TCFD-aligned standard will stress-test an entity’s business strategy against future challenges and opportunities.

When discussing reporting Mark Carney notes markets require information to operate effectively, which is consistent with the old adage you manage what you measure. He goes on to note that the TCFD recommendations are a solution ‘for the market by the market’ (p. 318). He also recognises the role of reporting in delivering effective public policy:

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<sup>2</sup> NZ Government. Cabinet Economic Development Committee. Minute of Decision. *Climate-Related Financial Disclosures*. [DEV-20-MIN-0151] (5 August 2020). Retrieved 21 May 2021 from <https://environment.govt.nz/assets/Publications/Cabinet-papers-briefings-and-minutes/cab-min-climate-related-financial-disclosures.pdf>

<sup>3</sup> Carney, M. (2020). *Value(s): Build a better world for all*. London, Great Britain: Harper Collins.

Public policy provides the foundation for the transition to net zero. The tragedies of the common and the horizon mean that private companies and financial institutions will not fully take into account their actions on the climate. Although leading businesses will anticipate future climate policies and adapt to them today, ultimately catalyzing a crucial mass of private sector actions requires effective, predictable and credible public policies. (Carney, 2021, p. 332)

Mandatory climate reporting is one of those effective, predictable and credible public policies. In addition to strengthening financial markets, more extensive climate reporting will deliver better public policies in terms of improving public policy instruments, such as the emissions reduction plan, the national adaptation plan and the national climate change risk assessment (specified under the Climate Change Response Act 2002).

It is important to remember that the Financial Stability Board (FSB) established the private sector industry-led taskforce as a result of a request from the G20 (while at COP21 in Paris in 2015). Members included major companies, large investors, global banks and insurers, all the major accounting firms and credit-rating agencies. The TCFD recommendations include a range of objective, subjective and forward-looking metrics. This new type of information reveals to investors, bankers and insurers and other interested parties whether the company is well-positioned (or not) to seize the opportunities and minimise the risks of the move to a low-emissions economy. Being a fast mover in this space will deliver significant benefits to the New Zealand economy, not only in terms of innovative low-emission products and services, but a more stable and durable job market.

The real question for New Zealand is whether we can afford to leave smaller, more nimble and arguably more vulnerable organisations out of the mandatory reporting framework. This is particularly relevant given New Zealand has so many medium-sized businesses<sup>4</sup> that have been hit hard by the pandemic and are looking at ways to pivot and/or evolve.

Mark Carney explains the important role of reporting in *Value(s): Build a better world for all*:

The more prolific the reporting, the more robust the risk assessment and the more widespread the return optimisation [of sustainable finance],<sup>5</sup> the more rapidly this transition will happen, breaking the tragedy of the horizon.... Value will be driven by identifying the leaders and laggards, as well as the most important general-purpose technologies that will overcome choke points in the transition.... the power of the market needs to be directed to achieving what society wants. (Carney, 2021, pp. 326–328)

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<sup>4</sup> MBIE notes, 'New Zealand is a nation of small and micro business – including self-employed. Defined as those with fewer than 20 employees, there are approximately 530,000 small businesses in New Zealand representing 97% of all firms. They account for 28 per cent of employment and contribute over a quarter of New Zealand's gross domestic product (GDP).' MBIE. 'Small business'. Retrieved 15 May 2021 from <https://www.mbie.govt.nz/business-and-employment/business/support-for-business/small-business>

<sup>5</sup> The Institute's understanding of the term 'the more widespread the return optimization' is that the transition to the 'green economy can be the greatest commercial opportunity of our time' and the more widespread the gains are, the more value will be provided to current and future citizens. In a December 2019 IMF article, Mark Carney stated: 'Now it's time for a giant step to bring the reporting, risk management, and return optimization of sustainable finance into everyday financial decision making. Ultimately, the speed with which the new sustainable financial system develops will be decided by the ambitions of government climate policies.' Carney, M. (2019). 'Fifty Shades of Green'. *Finance & Development*, 56(4), 12–15. Retrieved 15 May 2021 from <https://www.imf.org/external/pubs/ft/fandd/2019/12/a-new-sustainable-financial-system-to-stop-climate-change-carney.htm>

The Institute recognises that ‘prolific reporting’ on climate is a critical first step. At this stage there is very little practical information on climate risks and opportunities in the public arena, therefore the more climate statements are prepared and made public, the more information the government will have to design and support optimal public policy instruments. This information is urgently required. We believe within five years the government will need to support industries undergoing short and swift transitions, provide more R&D to encourage carbon innovation and implement a system to tax emissions. We need to ensure we minimise the pain and maximise the returns. Choosing who to support (e.g. paying farmers not to farm livestock or manage stranded assets), who to provide R&D and grants (e.g. carbon capture start-ups) and who to tax, are all decisions that rely on quality information.

### **Reporting on degrees of warming**

Mark Carney further explains the need to assess portfolios and actions to estimate the ‘degrees of warming’ those assets and strategies might deliver. This is an idea that is likely to shape climate reporting in the near future. In 2019, he described this concept in more detail:

One of the most promising options is to assess the ‘warming potential’ of investment portfolios. For example, GPIF, the world’s largest pension fund, estimates that its assets are currently consistent with a 3.7 degree path. Such a forward looking measure can help asset owners and asset managers understand the transition pathways of their investments and develop strategies to align financial flows with the necessary transition to net zero. Degree warming will reveal who is on the right and wrong side of history. It will provide a signal to governments about where the economy is on the transition path and therefore the effectiveness of their policies. It will empower consumers, giving them more choice in how to invest to support the transition. With our citizens, particularly the young, demanding climate action, it is becoming essential for asset owners to disclose the extent to which their clients’ money is being invested in line with the values of those clients. To this end, for COP26, the TCFD is establishing a subcommittee to consider how to standardise the methodology for measuring the warming potential of assets and expanding its use. (Carney, M, 2019)<sup>6</sup>

We believe that reporting on ‘degrees of warming’ of an investment portfolio (such as a superannuation fund) or even an industry or country investment portfolio, is likely in the short to medium term. This means the Bill must be designed to cater for new and emerging reporting requirements – not just TCFD.

### **The role of the stakeholder**

Neither the Companies Act 1993 nor the Financial Reporting Act 2013 define the term ‘stakeholder’. If passed, this Bill will be the first time the term stakeholder is mentioned in New Zealand law. Importantly the term stakeholder is well-recognised in terms of social responsibility and the ability of an entity to hold a social licence to operate. Of note, the FMA *Corporate Governance Handbook* states:

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<sup>6</sup> Carney, M. ‘Remarks given at a panel to launch the third annual America’s Pledge report, at the 25th Annual Conference of the Parties’. Madrid, 10 December 2019. Retrieved 15 May 2021 from <https://www.bankofengland.co.uk/-/media/boe/files/speech/2019/remarks-by-mark-carney-at-the-us-climate-action-centre-madrid.pdf>



8.5 Take account of stakeholder interests by, for example:

- having clear policies for the entity's relationships with significant stakeholders, bearing in mind distinctions between public, private and Crown ownership,
- regularly assess compliance with these policies to ensure conduct towards stakeholders complies with its code of ethics and the law, [and]
- check conduct towards stakeholders aligns with current accepted social, environmental, and ethical norms. (FMA, p. 26)<sup>7</sup>

A recent case brought by climate change activists against oil giant Royal Dutch Shell illustrate the question as to whether activists are stakeholders or citizens.<sup>8</sup> The proposed climate standards aim to protect more than the rights of investors and other stakeholders but also future citizens, and their rights and responsibilities to a better world. The purpose in the Bill is too narrow, particularly given the reason this Bill is before the committee – that we, the citizens – are facing a climate emergency. For this reason, we believe the term citizens and their wellbeing should also be included in the legislation.

## SUGGESTION

- (a) Extend the purpose of the climate-related standards and disclosures.

Change

### **Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill**

#### **Clause 19B Purpose of climate standards and climate-related disclosures**

The purpose of climate standards is to provide for, or promote, climate-related disclosures, in order to—

- (a) encourage entities to routinely consider the short-, medium-, and long-term risks and opportunities that climate change presents for the activities of the entity or the entity's group; and
- (b) enable entities to show how they are considering those risks and opportunities; and
- (c) enable investors and other stakeholders to assess the merits of how entities are considering those risks and opportunities.

to read

#### **Clause 19B Purpose of climate standards and climate-related disclosures**

The purpose of climate standards is to provide for, or promote, climate-related disclosures, in order to—

- (a) encourage ~~entities~~ boards and management to routinely consider the short-, medium-, and long-term risks and opportunities that climate change presents for the activities of the entity or the entity's group; and
- (b) enable entities to show how they are considering those risks and opportunities; ~~and~~
- (c) enable investors, lenders, insurers, suppliers, employees, and other stakeholders to assess the merits of how entities are considering those risks and opportunities,
- (d) enable government to be better informed about the risks and opportunities entities and industries face and to make better decisions considering those risks and opportunities, and
- (e) enable citizens to be better informed and therefore better able to engage with climate policy and by doing so improve their own well-being and those of future generations of New Zealanders.

<sup>7</sup> FMA. *Corporate Governance Handbook*. (2018). Retrieved 15 May 2021 from <https://www.fma.govt.nz/assets/Guidance/180228-Corporate-Governance-Handbook-2018.pdf>

<sup>8</sup> A Dutch court ruled that Royal Dutch Shell must reduce its greenhouse gas emissions 45% by 2030, based on 2019 levels. Retrieved 15 May 2021 from <https://www.npr.org/2021/05/26/1000475878/in-landmark-case-dutch-court-orders-shell-to-cut-its-carbon-emissions-faster#:~:text=Climate%20change%20activists%20have%20won,2030%2C%20based%20on%202019%20levels>

## 2. Who – remove exemptions

See Part 1, Column 3 – (g)

### KEY PROBLEM

The Bill, as it currently stands, allows for a large entity (as specified in the Bill) to be exempt from publishing climate statements. This is confusing, messy and expensive; placing an additional expense on government to develop standards for the specific purpose of managing exemptions.

### DISCUSSION

#### Exemption provisions for those ‘not materially affected by climate change’ are unnecessary

Firstly, for this exemption to exist, it is necessary to assume that there is a large entity/entities in operation in New Zealand that may not be materially affected by climate change. We do not think that is possible. Whether it is the cost of resources, the cost of rates (in order for the council to build additional infrastructure), the cost of moving to an electric car fleet, the cost of carbon credits or the cost of insurance – in 2021 we believe every large business is already materially affected by climate change.

Secondly, even if members of the committee think that a large entity may exist that is not materially impacted by climate change, the Bill does not define ‘not materially affected by climate change’ or indeed ‘materiality’. Instead it assumes that the XRB can design a climate standard that will be able to do this. The Bill states: ‘Exceptions relate to whether the entity reasonably determines, in accordance with applicable climate standards, that the relevant activities (for example, the activities of the entity or group) are not materially affected by climate change.’ The Institute does not believe a climate reporting standard can be, or should be, designed to achieve this.

Importantly, the TCFD recommendations expected governance and risk management information to be disclosed in financial filings, but only ‘material’ information on strategy, and metrics and targets should be disclosed in the annual financial filings (possibly as a note to the financial statements). It was not envisaged, based on our understanding, for the TCFD to be used as a way for information related to strategy to determine whether the entity should disclose or not.

Nor did the authors of the *Recommendations of the TCFD* ever envisage their framework to be used in this way. See for example the explanation in this excerpt from the 2017 *Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures*<sup>9</sup> (p. 11):

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<sup>9</sup> FSB. (2017). *Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures*. Retrieved 15 May 2021 from <https://assets.bbhub.io/company/sites/60/2020/10/FINAL-TCFD-Annex-Amended-121517.pdf>

The Task Force's recommendations are structured around four thematic areas that are core elements of how organizations operate—governance, strategy, risk management, and metrics and targets (Figure 6). The four overarching recommendations are supported by key climate-related financial disclosures—referred to as recommended disclosures—that build out the framework with information that will help investors and others understand how reporting organizations assess climate-related issues (Figure 7, p. 12).

Figure 6

### Core Elements of Recommended Climate-Related Financial Disclosures



#### **Governance**

The organization's governance around climate-related risks and opportunities

#### **Strategy**

The actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning

#### **Risk Management**

The processes used by the organization to identify, assess, and manage climate-related risks

#### **Metrics and Targets**

The metrics and targets used to assess and manage relevant climate-related risks and opportunities

The Task Force recommends that organizations provide climate-related financial disclosures in their mainstream (i.e., public) annual financial filings and recognizes that most information included in financial filings is subject to a materiality assessment. However, because climate-related risk is a non-diversifiable risk that affects nearly all industries, many investors believe it requires special attention. For example, in assessing organizations' financial and operating results, many investors want insight into the governance and risk management context in which such results are achieved. The Task Force believes disclosures related to its Governance and Risk Management recommendations directly address this need for context and should be included in financial filings.

For disclosures related to the Strategy and Metrics and Targets recommendations, the Task Force believes organizations should provide such information in annual financial filings when the information is deemed material. Certain organizations—those in the four non-financial groups that have more than one billion U.S. dollar equivalent (USDE) in annual revenue—should consider disclosing such information in other reports when the information is not deemed material and not included in financial filings.<sup>9</sup> Because these organizations are more likely than others to be financially impacted over time, investors are interested in monitoring how these organizations' strategies evolve.

Importantly, the TCFD recommendations expected governance and risk management information to be disclosed in financial filings, but only 'material' information on strategy, and metrics and targets should be disclosed in the annual financial filings (possibly as a note to the financial statements). It was not envisaged, based on our understanding, for the TCFD to be used as a way for information related to strategy to determine whether the entity should disclose or not.

There is circular logic in terms of the proposal set out in this Bill. Based on our understanding of the Bill, the aim is to ask a preparer to apply a TCFD-aligned standard against an entity's strategy to determine whether the entity has or is currently materially impacted by climate change (note the past tense). If it can argue that it 'has not' or 'is not' materially impacted, it may try and persuade an auditor that it does not need to prepare a climate statement. However, a TCFD-aligned standard applies a future-focus, it does not look at a past strategy, but the entities new strategy. A TCFD-aligned standard cannot deliver on what the Bill is proposing.

Thirdly, the use of the term materiality in the Bill relates to a discussion on how climate change might impact an entity – 'materially affected by climate change'. This is very different from the meaning of materiality in the existing accounting framework (see for example, *IFRS Practice Statement 2 – Making Materiality Judgements (MPS2)*).<sup>10</sup> Applying the concept of materiality differently in the legislation to the existing accounting framework will create at best unnecessary confusion, at worst misleading information for primary users of financial information. The 2017 *Recommendations of the TCFD* does discuss materiality but only in terms of the accounting definition of materiality – see for example this excerpt:

**b. Location of Disclosures and Materiality**

The Task Force recommends that organizations provide climate-related financial disclosures in their mainstream (i.e., public) annual financial filings. [FN in text: 35 – Financial filings refer to the annual reporting packages in which organizations are required to deliver their audited financial results under the corporate, compliance, or securities laws of the jurisdictions in which they operate. While reporting requirements differ internationally, financial filings generally contain financial statements and other information such as governance statements and management commentary.] **In most G20 jurisdictions, public companies have a legal obligation to disclose material information in their financial filings— including material climate-related information; and the Task Force's recommendations are intended to help organizations meet existing disclosure obligations more effectively.** [FN in text 36]. The Task Force's recommendations were developed to apply broadly across sectors and jurisdictions and should not be seen as superseding national disclosure requirements. Importantly, organizations should make financial disclosures in accordance with their national disclosure requirements. If certain elements of the recommendations are incompatible with national disclosure requirements for financial filings, the Task Force encourages organizations to disclose those elements in other official company reports that are issued at least annually, widely distributed and available to investors and others, and subject to internal governance processes that are the same or substantially similar to those used for financial reporting. [Bold added] (FSB Recommendations of the TCFD, 2017, p. 17)

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<sup>10</sup> See External Reporting Board. 'IFRS Practice Statements and Guides'. Retrieved 4 June 2021 from <https://www.xrb.govt.nz/accounting-standards/ifrs-practice-statements-and-guides/>

Next, the role of an auditor is not to make a judgement on whether an entity is materially impacted by climate change but whether the preparer has provided a set of financial statements that give a true and fair view.<sup>11</sup> In terms of climate-related standards, that is likely to be a true and fair view of climate metrics and possibly targets. The difference is very important.

The purpose of the climate statement is in our view two-fold; it should not only explain how climate change might impact an entity's proposed business proposition (e.g. strategy and risk management) but also how the entity might impact climate directly (e.g. through metrics and emission targets, and governance). Hence, allowing an exemption approach implies the user of a climate statement is solely interested in whether the entity is materially impacted by climate change (e.g. has it stranded assets or not). We consider people will read an entity's climate statement to learn whether it is operating in a socially responsible way, whether they want to invest in the entity, buy products or use services provided by the entity (or boycott them) or how they might collaborate with/learn from/support them in their strategy towards net-zero emissions. Users of climate statements want to know not just how climate change might impact an entity's strategy; they want to know how the entity is minimising its impact on the climate and whether those actions are proving successful.

Lastly, and rather alarmingly, the unintended consequence of an exemption approach is that the law will create an opportunity for some entities to argue they are not materially affected by climate change. This may create unfair advantages for those entities (in terms of marketing and branding) over those that do the right thing, acknowledge the impact and prepare a climate statement. The Institute feels strongly that the key exemption sections in the Bill [e.g. s 19 Section 561A amended (Financial reporting exemptions)] should be removed.

## SUGGESTION

- (b) Remove the exemption clauses in the Bill.

### **Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill**

#### **Exceptions**

#### **Clause 461ZA Exceptions for climate reporting entities not materially affected by climate change**

~~(1) A climate reporting entity (A) is not required to prepare climate statements or group climate statements under section 461W or 461X for an accounting period if, in accordance with applicable climate standards, A reasonably determines that the activities of A or A's group (as relevant) are not materially affected by climate change.~~

~~(2) A climate reporting entity (A) is not required to prepare climate statements or group climate statements under section 461Y for an accounting period if, in accordance with applicable climate standards, A reasonably determines that the activities of A's New Zealand business or A's group's New Zealand business (as relevant) are not materially affected by climate change.~~

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<sup>11</sup> International Standard on Auditing (New Zealand) 700: 'NZ27.1 Where the financial statements are prepared in accordance with a fair presentation framework, the explanation of the responsibility of those charged with governance for the financial statements in the auditor's report shall refer to "the preparation and fair presentation of these financial statements" or "the preparation of financial statements that give a true and fair view," as appropriate in the circumstances.' External Reporting Board. 'ISA (NZ) 700 (Revised)'. Retrieved 21 May 2021 from <https://www.xrb.govt.nz/assurance-standards/auditing-standards/isa-nz-700-revised/>

- (3) A climate reporting entity (A) is not required to prepare climate statements for a separate fund under section 461Z(2)(a) for an accounting period for the scheme if, in accordance with applicable climate standards, A reasonably determines that the activities of the fund are not materially affected by climate change.
- (4) A climate reporting entity (A) is not required to prepare climate statements for a registered scheme under section 461Z(2)(b) for an accounting period for the scheme if, in accordance with applicable climate standards, A reasonably determines that the activities of the scheme are not materially affected by climate change.
- (5) Every exception in this section is subject to the conditions in section 461ZB.

**Clause 461ZB Conditions applying to exceptions**

- (1) A climate reporting entity (A) may not rely on an exception in section 461ZA that applies to A unless —
- (a) A obtains an assurance engagement with a qualified CRD assurance practitioner in relation to A's determination under that section; and
  - (b) A prepares a document that complies with subsections (2) and (3); and
  - (c) A delivers to the Registrar for lodgement, and to the FMA, within 4 months of A's balance date, a copy of —
    - (i) the document referred to in paragraph (b); and
    - (ii) the assurance practitioner's report.
- (2) The document required by subsection (1)(b) must —
- (a) contain a statement by A to the effect that A has reasonably determined, in accordance with applicable climate standards, that the relevant activities are not materially affected by climate change; and
  - (b) contain an explanation by A as to how A has reached that determination.
- (3) The document (including A's statement and explanation contained in the document) must comply with applicable climate standards.
- (4) In subsection (2), relevant activities means, —
- (a) if A is relying on an exception in section 461ZA(1), the activities of A or A's group;
  - (b) if A is relying on an exception in section 461ZA(2), the activities of A's New Zealand business or A's group's New Zealand business;
  - (c) if A is relying on the exception in section 461ZA(3), the activities of the fund;
  - (d) if A is relying on the exception in section 461ZA(4), the activities of the scheme.

### 3. Who – extend type of preparer

See Part 1, Column 3 – (c), (e), (f), (h), (i), (j)

#### KEY PROBLEM

The Bill requires a very small number of entities to publish climate statements. The likely number of entities affected is expected to be in the vicinity of 225 entities.<sup>12</sup>

#### DISCUSSION

##### Climate statements are not expensive or long

A two-page report is arguably all that is required; see, for example, the Institute’s upcoming *Working Paper 2021/06 – Reviewing TCFD information in 2018–2020 annual reports of NZSX-Listed companies*<sup>13</sup> and the international *TCFD Good Practice Handbook*.<sup>14</sup> We must work hard to ensure greenwashing does not become the norm. If entities want to produce more information, they can do so voluntarily – but the intent of the TCFD recommendations is to keep information concise and useful – not a marketing exercise to persuade users but a reporting exercise to inform users.

##### Many large non-listed entities may like to prepare and file climate statements

The Deloitte Top 200 do not list all significant entities but the list does provide a useful insight into large for-profit entities operating in New Zealand. In regard to the 2020 Deloitte Top 200<sup>15</sup> list, 48 are NZSX-listed, which means if the Bill was passed as it is, at least 48 of the Top 200 entities would be required to publish a climate statement and 152 or less would not – which in turn means that the board and management of about 152 significant entities would not provide a climate statement to shareholders (never lone providing a climate statement on a public register for wider stakeholders). We believe that:

- many of the shareholders of the 152 entities (not caught under the Bill) would like to have access to a climate statement,
- many of the 152 entity’s boards, management (and their employees) not caught under the Bill would like to receive a climate statement, and
- many of the 152 entity’s boards may like to publish a voluntary climate statement on a public register alongside their counterparts.

The difficulty is to prove this in the timeframe that the Bill is before the committee.

##### The threshold of assets and revenue are not well aligned

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<sup>12</sup> See for example Chartered Accountants Australia and New Zealand. (2021). ‘CAs take key role in assuring climate risk reporting’. Retrieved 4 June 2021 from <https://www.charteredaccountantsanz.com/member-services/technical/audit-and-assurance/audit-and-assurance-in-focus/cas-take-key-role-in-assuring-climate-risk-reporting>

<sup>13</sup> The working paper analyses companies on the NZX Main Board (NZSX). It is the premier market for NZX’s listed equities and funds.

<sup>14</sup> See Climate Disclosure Standards Board. (2019). *TCFD Good Practice Handbook*. Retrieved 4 June 2021 from <https://www.cdsb.net/tcf-good-practice-handbook>

<sup>15</sup> The 48 NZSX-listed companies was calculated by reviewing the Deloitte Top 200 list and counting the number of companies that referred to NZX in the column – ‘name’. Note: The 2020 Deloitte Top 200 list was reviewed in terms one year (the 2020 year), whereas the Bill suggests two proceeding years. 2020 Deloitte Top 200. Retrieved 4 June 2021 from <https://www.top200.co.nz/wp-content/uploads/2020/12/2020-12-04-Dynamic-Business.pdf>

Using the Deloitte Top 200 as a petri-dish, applying the asset threshold for large entities under the Bill (i.e. exceeding \$1 billion in assets), would result in 57 entities (29%) being considered large.<sup>16</sup> In contrast, using the revenue threshold for large entities provided in the Bill (i.e. exceeding \$250 million in revenue), means 164 entities (82%) would be considered large.<sup>17</sup>

**Table A: Exploring the proposed thresholds**

	Proposed Bill (meaning of large)	Financial Reporting Act 2013 (meaning of large)	Difference between the thresholds in the proposed Bill and FR Act	Using Deloitte Top 200 as a petri-dish, the number of entities would be:
Assets	Exceed \$1000 million	Exceed \$60 million	17 times	57 entities
Revenue	Exceed \$250 million	Exceed \$30 million	8 times	164 entities

This level of disparity in Table A (between 57 and 164 entities), indicates the existing threshold in the Bill favours revenue-rich entities rather than asset-rich entities – in that it assumes revenue is a bigger determinant of climate risks and opportunities. We believe that the reverse is true – how an entity uses its assets is likely to tell us more about its ability to transition New Zealand to a low-emissions economy. Reporting on degrees of warming, discussed on page 16, further supports our view that assets are a key characteristic that should determine who prepares, provides and publishes a climate statement.

**Table B: Exploring a reduced asset threshold**

	Proposed Bill (meaning of large)	Financial Reporting Act 2013 (meaning of large)	Difference between the thresholds in the proposed Bill and FR Act	Using Deloitte Top 200 as a petri-dish, the number of entities would be:
Assets	Exceed \$250 million	Exceed \$60 million	4 times	149 entities
Revenue	Exceed \$250 million	Exceed \$30 million	8 times	164 entities

Interestingly, if you applied a lower asset threshold of say ‘exceeding \$250 million in assets’ (not the \$1 billion), to the same list of Deloitte Top 200 companies, 149 entities (75%) would be considered large.<sup>18</sup> See Table B above. Arguably, this means that it would be useful to consider a threshold of say ‘exceeding either \$250 million in assets or in revenue’ over two proceeding years.

**(i) Financial statements are the silver standard**

The obligation to prepare financial statements is specified in s 201 of the Companies Act 1993 and if the company is large (as specified in s 45 of the Financial reporting Act 2013), to give the financial statements to the Registrar to file.<sup>19</sup>

<sup>16</sup> Workings: 57 Deloitte Top 200 entities had assets exceeding \$1 billion (57/200) [29%]. See Footnote 15.

<sup>17</sup> Workings: 164 Deloitte Top 200 entities had revenue exceeding \$250 million (164/200) [82%]. See Footnote 15.

<sup>18</sup> To explore what a much lower threshold might look like, the limit was lowered to \$250 million (not \$1 billion). This resulted in the following figures. Workings: 149 Deloitte Top 200 entities had assets exceeding \$250 million (149/200) [75%]. See Footnote 15.

<sup>19</sup> See also the New Zealand Companies Register. ‘How to submit financial statements. Retrieved 21 May 2021 from <https://companies-register.companiesoffice.govt.nz/help-centre/financial-reporting/how-to-submit-financial-statements/>



### **Companies Act 1993**

#### **Section 201 Financial statements must be prepared**

Every company or overseas company to which this section applies (A) must ensure that, within 5 months after the balance date of A, financial statements that comply with generally accepted accounting practice are—

- (a) completed in relation to A and that balance date; and
- (b) dated and signed on behalf of A by 2 directors of A, or, if A has only 1 director, by that director.

### **Companies Act 1993**

#### **Section 204 Financial statements for overseas company must include financial statements for large New Zealand business**

(3) In this section, the New Zealand business or the group's New Zealand business is large in respect of an accounting period if at least 1 of the following paragraphs applies (calculated as if that business were an entity):

- (a) as at the balance date of each of the 2 preceding accounting periods, the total assets of the business exceed \$20 million;
- (b) in each of the 2 preceding accounting periods, the total revenue of the business exceeds \$10 million.

### **Financial Reporting Act 2013**

#### **Section 45 Meaning of large**

(1) For the purposes of an enactment that refers to this section, an entity (other than an overseas company or a subsidiary of an overseas company) is large in respect of an accounting period if at least 1 of the following paragraphs applies:

(a) as at the balance date of each of the 2 preceding accounting periods, the total assets of the entity and its subsidiaries (if any) exceed \$60 million:

(b) in each of the 2 preceding accounting periods, the total revenue of the entity and its subsidiaries (if any) exceeds \$30 million.

(2) For the purposes of an enactment that refers to this section, an overseas company or a subsidiary of an overseas company is large in respect of an accounting period if at least 1 of the following paragraphs applies:

(a) as at the balance date of each of the 2 preceding accounting periods, the total assets of the entity and its subsidiaries (if any) exceed \$20 million:

(b) in each of the 2 preceding accounting periods, the total revenue of the entity and its subsidiaries (if any) exceeds \$10 million.

(3) Despite subsections (1) and (2), an entity is not large in respect of an accounting period (period A) if—

(a) the entity was an inactive entity in respect of period A; and

(b) the entity, within 5 months after the end of period A, delivers to the Registrar a declaration, in the prescribed form, stating that it was an inactive entity in respect of period A.

(4) In subsection (3), an entity is an inactive entity in respect of an accounting period if,—

(a) during that period, the entity—

(i) has not derived, or been deemed to have derived, any income; and

(ii) has no expenses; and

(iii) has not disposed of, or been deemed to have disposed of, any assets; and

(b) at the end of that period, the entity has no subsidiaries or all of its subsidiaries are inactive entities in respect of that period.

(5) In determining whether an entity is an inactive entity, no account may be taken of any—

(a) statutory company filing fees or associated accounting or other costs; or

(b) bank charges or other minimal administration costs totalling not more than \$50 in the accounting period; or

(c) interest earned on any bank account during the accounting period, to the extent that the total interest does not exceed the total of any charges or costs incurred by the entity to which paragraph (b) applies.

## **(ii) Annual reports are the gold standard**

To prepare and make available to shareholders: The obligation to prepare an annual report is specified in s 208 of the Companies Act 1993 and an obligation to make that annual report available to shareholders is specified in s 209 of the Companies Act 1993. See sections 208 and 209 on page 27 below.

To make available to the public: Importantly, there is also an obligation for all FMC reporting entities to place their annual report on their website under the Financial Markets Conduct Regulations 2014, clause 61D: Annual report to be publicly available. In addition, the *NZX Listing Rules*, Para 3.6<sup>20</sup> requires the

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<sup>20</sup> NZX. (2021, 10 December). 'NZX Listing Rules'. Retrieved 21 May 2021 from <https://www.nzx.com/regulation/nzx-rules-guidance/nzx-listing-rules?>

annual report to be delivered to NZX, which is then uploaded on the NZX website, under each entity. However, there is no obligation to file an annual report with the Companies Office (MBIE) for uploading on the Companies Register.

The Institute considers it is timely for any report that is required to be made public, to also be made public on the MBIE Register (managed by the Registrar). The current system means that citizens need to have a considerable amount of knowledge to navigate the current external reporting framework – and complexity often reduces trust and confidence. We also propose a way that the Companies Act can be adapted to require climate statements to be prepared and filed in the public arena – see suggestions below.

### **Small and medium-sized entities will want to prepare and publish climate statements as well**

We note the UK is already committed to TCFD disclosure for all listed companies by the year 2025, with progressive interim targets for large companies (see Carney, p. 322).

The Institute believes climate reporting is here to stay and that a voluntary framework and mandatory framework must work together in unison. For this reason, we suggest a separate Climate Statement register be made available on the existing New Zealand Companies Office Registers website– and that the Companies Office Registers website name be changed to something like the ‘New Zealand Governance Registers’ so that non-companies can be included. This will enable legislation to evolve over time, enabling other entities to be required to mandatory file climate statements and allow for entities who wish to file voluntarily assured climate statements to do so. Many entities (even small companies) will want to position themselves as socially responsible by preparing climate statements. It is therefore important not to create inequality (and brand advantages) through legislation.

### **Information under s 5ZW of the Climate Change Response Act 2002 should be public**

It is going to be critical to learn as we go. Part of this will include having access to all key information so that we learn not only lessons and examples of good practice – but also what does not work. For this reason the Institute considers that information requested under s 5ZW of the Climate Change Response Act 2002 should be publicly disclosed and, where possible, adopt the accounting and assurance standards.

## **SUGGESTIONS**

- (c) Require every climate reporting entity (that is required to produce an annual report) to publish their climate statement in their annual report and require every climate reporting entity to upload their annual report onto the main Companies Register.
- (d) Enable a voluntary regime to work with the mandatory regime, one that enables non-climate reporting entities to upload their assured climate statement onto the main Companies Register.

- (e) Require participants of the New Zealand Emissions Trading scheme (NZ ETS) to prepare assured climate statements and file a climate statement on a register managed by the Companies Office.
- (f) Require reporting organisations (under s 5ZW of the Climate Change Response Act 2002) to prepare assured climate statements and file a climate statement on a register managed by the Companies Office.
- (g) Require External Reporting Board (XRB) Tier 1 for-profit entities and Tier 1 public benefit entities to prepare and make available to shareholders assured climate statements and file a climate statement on a register managed by the Companies Office.

This could be actioned by changing the Companies Act 1993, for example from:

Change

### **Companies Act 1993**

#### **Part 12 Disclosure by companies**

##### ***Disclosure to shareholders***

##### **S 208 Obligation to prepare annual report**

(1) This section applies to—

- (a) every large company (within the meaning of [section 198](#)) [[Note: which refers to ‘large’ as defined under s 45 of the Financial Reporting Act]]; and
- (b) every company that is a public entity; and
- (c) every company that is required to prepare financial statements or group financial statements under [Part 7](#) of the Financial Markets Conduct Act 2013 or [section 55](#) of the Financial Reporting Act 2013; and
- (d) every company with 10 or more shareholders unless the company has opted out of compliance with this section in accordance with [section 207I](#) (in relation to the accounting period referred to in subsection (2)); and
- (e) every company with fewer than 10 shareholders if the company has opted into compliance with this section in accordance with [section 207K](#) (in relation to the accounting period referred to in subsection (2)).

(2) The board of every company to which this section applies must, within 5 months after the balance date of the company, prepare an annual report on the affairs of the company during the accounting period ending on that date.

##### **S 209 Obligation to make annual report available to shareholders**

(1) The board of a company must send to every shareholder of the company—

- (a) a copy of the annual report; or
- (b) a notice containing the statements specified in subsection (3).

to read

##### **S 208 Obligation to prepare an annual report and a climate statement**

(2) The board of every company to which this section applies must, within 5 months after the balance date of the company, prepare an annual report on the affairs of the company during the accounting period ending on that date and a climate statement.

##### **S 209A Obligation to make an annual report and a climate statement available to shareholders**

(1) The board of a company must send to every shareholder of the company—

- (a) a copy of the annual report and climate statement; or
- (b) a notice containing the statements specified in subsection (3).

##### **S 209B Obligation to file a climate statement on a public register**

(1) The board of a ‘large’ company (outlined in s 208) must give a climate statement to the Registrar.

- (h) Require all NZX-listed companies to upload their annual report onto the main Companies Register (not just their financial statements). This would require changing the Companies Act 1993 (e.g. ‘s195 Place accounting records to be kept’).

#### 4. Who – extend definition of large

See Part 1, Column 3 – (d), (e), (f)

#### KEY PROBLEM

The proposed trigger that defines whether an entity should report is too high and should be lower so that more entities are obliged to report against TCFD-based standards.

#### DISCUSSION

##### What makes a good threshold?

The Institute discusses NZSX-listed and Deloitte Top 200 in the previous section (pp. 22-23), which raises concerns over the thresholds proposed in the Bill. We also note on page 14 the narrow and negative purpose driving the Bill. In our view, climate reporting has two major objectives:

- (i) to inform interested parties on the extent climate change will affect the business strategy and risk management of the entity, and
- (ii) to inform the extent the entity's governance, and metrics and targets, will impact directly on the climate.

The first objective implies the threshold would be best determined by the size and type of resources owned by the entity. Under these circumstances, preparers of climate statements should be determined by total assets, revenue and possibly FTE (e.g. employees and consultants, discussed below).

The second objective implies the threshold would be best determined by outputs and outcomes: carbon emissions (actual<sup>21</sup> and targets), actions to curb emissions, actions to capture emissions and what makes a good corporate citizen during a climate crisis. Under these circumstances, preparers of climate statements should in theory be those who impact negatively on the community (the polluter pays principle) and have a bigger social debt to repay (in terms of a bigger social licence) than say other types of entities.

The problem is that we do not have the information to develop thresholds for the second category (other than the EPA's heavy emitter list which we understand is not public).<sup>22</sup> Given this, the Institute believes the best approach in the short-term is to (i) maximise the number of entities (more than the 225 expected

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<sup>21</sup> MBIE. 'Emissions by sector: New Zealand's energy emissions are dominated by three main sectors — national transport, manufacturing industries, and electricity generation.' Retrieved 21 May 2021 from <https://www.mbie.govt.nz/building-and-energy/energy-and-natural-resources/energy-statistics-and-modelling/energy-statistics/new-zealand-energy-sector-greenhouse-gas-emissions/#:~:text=Emissions%20by%20sector,of%20total%20energy%20sector%20emissions>

<sup>22</sup> Stuff journalists Joel MacManus and Anuja Nadkarni identified what they believe were NZ's biggest emitters in 2019: Fonterra, Z Energy, Air New Zealand, Methanex, Refinery NZ, BP, Exxon Mobil, Genesis, Contact and Fletcher Building. These 10 companies are thought to produce 54.5 million tonnes of CO<sub>2</sub> – more than two thirds of NZ's total emissions. The article notes that 'under the Climate Change Response Act, the exact emission levels of any company which participates in the Emissions Trading Scheme are considered confidential and can't be released by the Environmental Protection Agency'. Retrieved 21 May 2021 from <https://www.stuff.co.nz/business/114431409/nzs-biggest-greenhouse-gas-emitters-and-their-struggle-to-pollute-less>

under the current Bill) and (ii) gather as much quality (and assured) information as possible, with a view to revisiting which types of entities should prepare climate statements (ideally with more precision) in the second round. We acknowledge that the current system is framed around size. While not ideal, it does provide a way to collect more reliable data so that the second objective can be addressed in the short to medium term.

For this reason the Institute believes New Zealand should fully embrace climate reporting, and that the following three groups should be required to produce assured climate statements:

- Group 1: Participants of the New Zealand Emissions Trading scheme (NZ ETS) (under s 54 of the Climate Change Response Act 2002). This should ensure all ten entities listed in the 2019 *Stuff* article publish a climate statement as we understand they all participate in the Emissions Trading Scheme.
- Group 2: Reporting organisations (under s 5ZW of the Climate Change Response Act 2002)
- Group 3: External Reporting Board (XRB) Tier 1 for-profit entities and Tier 1 public benefit entities (via s 45 of the Financial Reporting Act 2013).

### **The number of employees could be added as a further trigger**

We also consider the criteria could be broadened to include entities that employ or contract more than 100 FTEs in each of its two preceding accounting periods. This is because focusing on assets and revenue alone seems inappropriate given the number of people involved impact the climate and the values they hold impact the business model.

### **Align with s 45 and differentiate between New Zealand and overseas companies**

The Institute considers the trigger should be equivalent to that specified in s 45(1) of the Financial Reporting Act 2013 and that, the distinction between New Zealand and overseas companies should be retained. This would align with our Report 17 recommendation that all tier 1 reporting entities are required to report a climate statement.

## **SUGGESTION**

- (i) Add staff numbers as additional criteria, add participants of the ETS and align with s 45 of the Financial Reporting Act 2013. This could be actioned by changing c 461P:

Change

#### **Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill Clause 461P Meaning of Large**

(1) For the purposes of this Part, a registered bank, credit union, or building society (A) is large in respect of an accounting period if, as at the balance date of each of the 2 preceding accounting periods, the total assets of A and A's subsidiaries (if any) exceed \$1 billion.

(2) For the purposes of this Part, a licensed insurer is large in respect of an accounting period if at least 1 of the following paragraphs applies to the licensed insurer:

(a) as at the balance date of each of the 2 preceding accounting periods, the total assets of the licensed insurer and its subsidiaries (if any) exceed \$1 billion:

(b) in each of the 2 preceding accounting periods, the annual gross premium revenue of the licensed insurer and its subsidiaries (if any) exceeds \$250 million.

to read

**Clause 461P Meaning of Large**

(1) For the purposes of this Part, a registered bank, credit union, building society or insurer (A) is large in respect of an accounting period if, it meets the definition of large, as specified in s 45 of the Financial Reporting Act 2013.

or

(1) For the purposes of this Part, a registered bank, credit union, or building society (A) is large in respect of an accounting period if, as at the balance date of each of the 2 preceding accounting periods, the total assets of A and A's subsidiaries (if any) exceed ~~\$1 billion~~ **\$250 million**.

(2) For the purposes of this Part, a licensed insurer is large in respect of an accounting period if at least 1 of the following paragraphs applies to the licensed insurer:

(a) as at the balance date of each of the 2 preceding accounting periods, the total assets of the licensed insurer and its subsidiaries (if any) exceed ~~\$1 billion~~ **\$250 million**:

(b) in each of the 2 preceding accounting periods, the annual gross premium revenue of the licensed insurer and its subsidiaries (if any) exceeds \$250 million.

(c) in each of the 2 preceding accounting periods, the total number of full-time equivalents (FTEs) employees or contractors exceed 100

Note: And for overseas companies – replace \$1 billion with \$20 million and \$250 million with \$10 million respectively.

and

(3) For the purposes of this Part, participants of the New Zealand Emissions Trading scheme (NZ ETS) (under s 54 of the Climate Change Response Act 2002.

## 5. Where – create a central public register of climate statements

See Part 1, Column 3 – (a), (j)

### KEY PROBLEM

The proposed location, the Financial Service Providers Register, is not well known and is unnecessarily complex to navigate given the importance of climate reporting to the general public. The 5 August 2020 Cabinet Minute, that set out the background to the Bill, emphasised the importance of an audience-friendly location and ‘agreed that climate-related financial disclosures should appear in the main document for communicating financially material information to an entity’s relevant audience’.<sup>23</sup> We consider the audience would expect the climate report to either be in the main Companies Register or a separate register managed by the MBIE Registrar.

### DISCUSSION

#### Accessibility is key if we are to move towards a low-emissions economy

There are 21 registers managed by the Companies Office (see Appendix 2). Users of this information will expect to be able to find it on the major register, but that is not what is being proposed in the explanatory note at the front of the Bill.

## Part 1 Amendments to Financial Markets Conduct Act 2013

*Clause 3* provides that *Part 1* amends the Financial Markets Conduct Act 2013.

*Clause 4* amends the overview in section 5 and *clause 5* amends section 6, which is the main interpretation section.

*Clause 6* amends section 351 in relation to listed issuers. Existing section 351(1)(ab) allows regulations to be made that remove certain listed issuers from the list of FMC reporting entities under section 451(1)(d) and provide for replacement or modified financial reporting requirements to apply to those listed issuers. Because a person must be an FMC reporting entity to be a climate reporting entity under the new provisions that this Bill inserts into the Act, *new section 351(1)(ab)(ii)* is inserted so that the regulations may provide for replacement or modified climate-related disclosure requirements for those listed issuers.

### *New Part 7A*

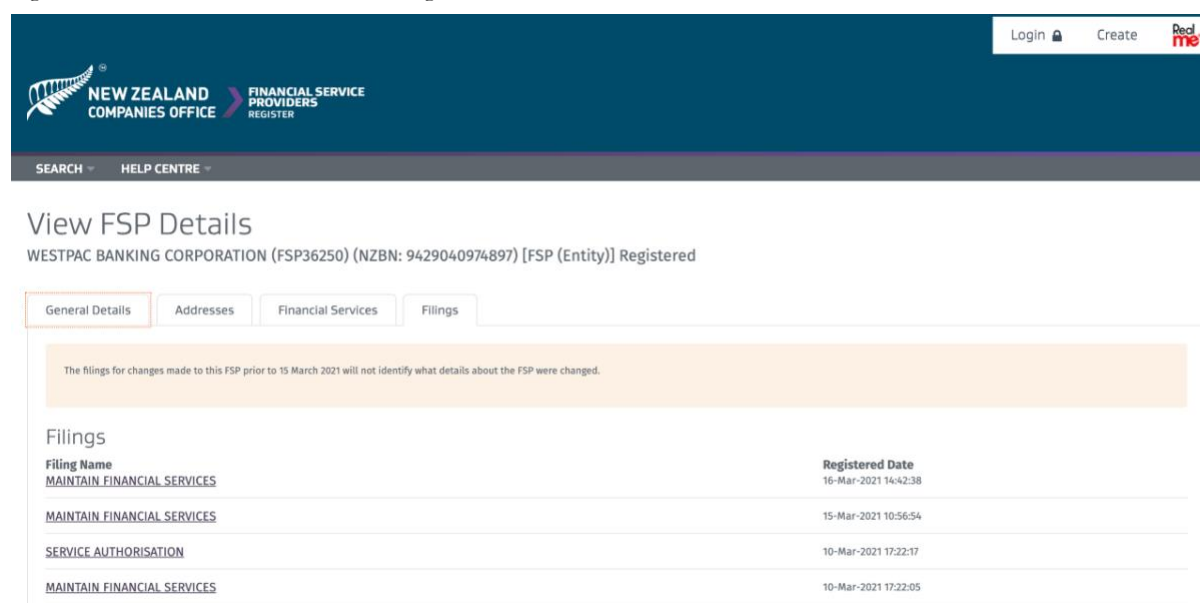
*Clause 7* is a key provision, inserting *new Part 7A* into the Act. *New Part 7A* contains climate-related disclosure requirements for certain FMC reporting entities considered to have a higher level of accountability under existing section 461K. These entities are defined in *new section 461O* as climate reporting entities. Broadly, *new Part 7A* provides for climate reporting entities to prepare climate statements in accordance with climate standards issued by the XRB, to obtain an assurance engagement in relation to those statements to the extent that those statements are required to relate to greenhouse gas emissions, to lodge those statements with the Registrar of Financial Service Providers (the Registrar), and to keep CRD records.

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<sup>23</sup> NZ Government. Cabinet Economic Development Committee. Minute of Decision. *Climate-Related Financial Disclosures*. [DEV-20-MIN-0151] (5 August 2020). Para 16. Retrieved 21 May 2021 from <https://environment.govt.nz/assets/Publications/Cabinet-papers-briefings-and-minutes/cab-min-climate-related-financial-disclosures.pdf>

A screenshot from the Companies Office website of the existing 'Financial Service Providers Register' is below (using Westpac as an example).

Figure 1: The Financial Service Providers Register



The Institute considers this is a poor cousin of the standard expected by the FSB's TCFD recommendations:

#### Disclosure in Mainstream Financial Filings

**The Task Force recommends that preparers of climate-related financial disclosures provide such disclosures in their mainstream (i.e., public) annual financial filings.** In most G20 jurisdictions, companies with public debt or equity have a legal obligation to disclose material information in their financial filings—including material climate-related information. The Task Force believes climate-related issues are or could be material for many organizations, and its recommendations should be useful to organizations in complying more effectively with existing disclosure obligations. [FN: 4 **The Task Force encourages organizations where climate-related issues could be material in the future to begin disclosing climate-related financial information outside financial filings to facilitate the incorporation of such information into financial filings once climate-related issues are determined to be material.**] In addition, disclosure in mainstream financial filings should foster shareholder engagement and broader use of climate-related financial disclosures, thus promoting a more informed understanding of climate-related risks and opportunities by investors and others. The Task Force also believes that publication of climate-related financial information in mainstream annual financial filings will help ensure that appropriate controls govern the production and disclosure of the required information. More specifically, the Task Force expects the governance processes for these disclosures would be similar to those used for existing public financial disclosures and would likely involve review by the chief financial officer and audit committee, as appropriate.' ...

Importantly, organizations should make financial disclosures in accordance with their national disclosure requirements. If certain elements of the recommendations are incompatible with national disclosure requirements for financial filings, the Task Force encourages organizations to disclose those elements in other official company reports that are issued at least annually, widely distributed and available to investors and others, and subject to internal governance processes that are the same or substantially similar to those used for financial reporting. [bold added] (FSB Recommendations of the TCFD, 2017, pp. iii–iv)<sup>24</sup>

<sup>24</sup> Task Force on Climate-related Financial Disclosures. (2017). *Recommendations of the Task Force on Climate-related Financial Disclosures*. Retrieved 15 May 2021 from <https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf>



### **Annual reports are only required to be in the public arena if the entity is an FMC reporting entity**

If the entity is a FMC reporting entity and an issuer, it is required to not only make its annual report public on its website but to also deliver its annual report to the NZX for placing on their website (see earlier discussion on pages 25 and 26). The Institute has advocated for many years for the Companies Office to integrate all its registers into one, ensuring that there is no double-up of information and that users are able to see and obtain all essential information easily. The present situation is at best messy, and adding in climate reporting on a low-level and relatively unknown little register is going to deliver all the costs and few of the benefits of this type of reporting.

Interestingly, we found that 66% of NZSX-listed companies automatically upload their 2020 annual report (rather than just their financial statements) to the Companies Register – even though they are not required to (see Table 2, *Working Paper 2021/06 – Reviewing TCFD information in 2018–2020 annual reports of NZSX-Listed companies*).

### **The climate statement and assurance practitioners report must be published together**

Although in ‘s 461ZO Information about climate statements of climate reporting entities to be made available in annual report’ it is noted that this is made up of two reports (the climate statement and the assurance practitioners report), there is a risk that these two reports could become separated in practice. Hence we suggest that this is reworded somewhere in the Bill to ensure these two reports, when in the public domain, are published together – in one pdf.

## **SUGGESTIONS**

- (j) Require the Companies Office to create a completely new register for climate statements.
- (k) Note: The Companies Office team can link the climate reporting entities on the Financial Services Provider Register to each of the entities’ climate statement on the new Climate Statements Register, so that it is streamlined for the user.
- (l) Enable preparers, who have prepared a climate statement and obtained a related assurance practitioner’s report, to upload both the statement and the report onto a new MBIE Climate Statements Register.
- (m) Require that, when publishing in the public arena, both the climate statement and the assurance practitioner’s report, are always in one pdf and treated as one document.
- (n) Create one interrelated register administered by MBIE that deals with all entities that operate across the public and private sectors.

## **6. What – increase size and nature of penalties for offences**

See Part 1, Column 3 – (g)

### **KEY PROBLEM**

The size of offences in the Bill is confusing. Further, financial penalties alone are unlikely to change the behaviour of wealthy entities or well-off directors. What is more likely to bring about change is the risk of reputational damage and/or an entity being seen to lose its social licence to operate.

### **DISCUSSION**

#### **Leverage reputational risk**

The first time in New Zealand that breaches of the law were required to be disclosed publicly in an annual report was in 2003. A dispute between Nuplex Industries and the Auckland Regional Council went to court and resulted in Nuplex paying a fine of NZ\$55,000 following a fumes leak. Following the case, Nuplex was then required to disclose the breach and the fine (the largest pollution charge at the time) in their annual report and its Board was required to put environmental issues on the agenda for 24 months.<sup>25</sup>

The Institute considers that, in addition to a penalty, an entity that is penalised under the legislation (i.e. by acting against the intent of the legislation) should be required to also come clean in the climate statement (and ideally in the annual report) for the next consecutive five years. We believe that leveraging reputational risk negatively (for those that do not follow the law) is a great way of recognising and supporting those that do follow the law. Some industries have entities that may bring the whole industry into disrepute, whereas being clear over who is not following the law is in the interests of all socially responsible entities.

#### **Set a limit under the legislation and allow the FMA to design a schedule of penalties**

Further, the actual financial penalty for an offence should be determined by the FMA and the legislation should just have a maximum fine set within law. This will allow those monitoring and regulating the system to gain a better understanding of who should pay what fine. For this reason, we suggest that a maximum per individual (employee, director or auditor) be fixed at \$500,000 or less and that a maximum per entity (the company or partnership) be fixed at \$5 million.

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<sup>25</sup> Beston, A. (2003, 20 March). 'Nuplex ordered to confess pollution'. *NZ Herald*. Retrieved 15 June 2020 from <https://www.nzherald.co.nz/nz/nuplex-ordered-to-confess-pollution/R2P5TQST5N5KUZ7FZYDKAKYAW4/> (also discussed in the Institute's *Report 17*).

The Institute feels very strongly that any offences and penalties should be published in the annual report of any company required to make their annual report public and that it should be recorded in the next five CRD assurance practitioners' reports.

## SUGGESTIONS

- (o) Add a reputation penalty. For example, this could be progressed through adding a new (3) and (4) to 'c 461ZC Offence to knowingly fail to comply with climate standards' (and also requests for information/ filing requirements):

Change

### **Clause 461ZC Offence to knowingly fail to comply with climate standards**

(3) Any 'climate reporting entity' who commits an offence under [[name each Act]] must:

(a) be reported in the next five 'annual reports' of the entity, specifying the offence, the reason and the size of the penalty.

(4) Any 'CRD assurance practitioner' who becomes aware of a possible offence under [[name each Act]] must:

(a) report it immediately to the FMA (even if they are not a client),

(b) and if found to be an offence, to be reported in the next five 'assurance practitioner reports', specifying the offence, the reason and the size of the penalty.

(5) Any 'director or any individual, including an employee or consultant' who commits an offence while operating in the interests of themselves or the interests of the entity under [[name each Act]] must:

(a) be reported in the in the next five 'annual reports' by the entity, specifying the offence, the reason and the size of the penalty, and

(b) be reported in the next five 'assurance practitioner reports', specifying the offence, the reason and the size of the penalty.

- (p) Set a significant penalty limit for individuals and for entities for offences under the Act and then delegate to the FMA the ability to prepare a penalty schedule, say every five years.

Change

### **Clause 461ZC Offence to knowingly fail to comply with climate standards**

(2) A person who commits an offence under subsection (1) is liable on conviction, —

(a) in the case of an individual, to imprisonment for a term not exceeding 5 years, a fine not exceeding \$500,000, or both; and

(b) in any other case, to a fine not exceeding \$2.5 million.

to read

### **Clause 461ZC Offence to knowingly fail to comply with climate standards**

(2) A person who commits an offence under subsection (1) is liable on conviction, —

(a) in the case of an individual, to imprisonment for a term not exceeding 5 years, a fine not exceeding \$1 million or both; and

(b) in any other case, to a fine not exceeding \$5 million.

## 7. What – add feedback loops to improve the system

See Part 1, Column 3 – (g), (l)

### KEY PROBLEM

With any system, particularly when it is new, there needs to be regular reporting and feedback by those responsible for the system to those that have invested in it.

### DISCUSSION

#### Climate reporting, in particular mandatory climate reporting, is globally novel

This means it is important to develop checks and balances within the system so that the reporting framework remains dynamic and responsive. The Bill does not appear to include any feedback loops (although they are implied by the XRB and the FMA). In addition, the NZX, another key player, is likely to adapt their rules and guidelines as a result of mandatory climate reporting.<sup>26</sup> Hence climate reporting sits in a large and dynamic ecosystem and New Zealand needs to make a major effort early in the process to ensure there is a smooth shift to a reliable and durable climate reporting framework.

The need to review the framework on a regular basis sits naturally within the role of the XRB (under the Financial Reporting Act 2013) and the FMA (under the Financial Markets Conduct Act 2013).

#### Legislation lags behind best practice

The Institute's *Report 17 – ReportingNZ: Building a Reporting Framework Fit for Purpose* proposed seven major recommendations to strengthen the existing reporting framework (see discussion on pp. 125–137). Table 17 in Appendix 3 also contains more explanation.

Major recommendation 1: Create a central register for all external filing requirements (including for Crown entities and registered charities).

Major recommendation 2: All organisations that are currently required to make their annual report publicly available should be required to file their annual report on the central register.

Major recommendation 3: Change legislation to better meet user needs and align with global best practice in relation to the reporting of information to shareholders and external users.

Major recommendation 4: Review the external financial reporting framework and accounting standards to better meet user needs.

Major recommendation 5: Require the directors' report (the annual report in New Zealand) to report on risks.

Major recommendation 6: Embed climate-related financial reporting into the New Zealand reporting framework.

Major recommendation 7: Provide clarity over the overarching principles, parameters and strategy that shape the legislative framework for external reporting.

#### Directors need to be responsible to report on risks

While undertaking research for *Report 17*, the Institute became aware of an inconsistency with UK law. Given this we sought an opinion on whether directors in New Zealand were required to report risk. The opinion is included in Appendix 4.

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<sup>26</sup> Note: The XRB has developed a number of Guidance Notes and Practice Notes to assist issuers in complying with their Listing Rule obligations, and has issued various Waivers and Rulings which clarify the application of certain Listing Rules. See NZX. 'Listing Rules Guidance'. Retrieved 4 June 2021 from <https://www.nzx.com/regulation/nzx-rules-guidance/nzx-mo-announcements>

The resulting Fitzgerald Strategic Legal opinion found that directors have no legal obligation under the Companies Act 1993 to report on risks (see p. 1 of [2020/01: Obligations on directors to report risk in New Zealand annual reports under the Companies Act 1993](#)).

### Ensuring the system is working effectively

Climate reporting is both a public and private sector investment, an investment by government in the long-term betterment of the economy (e.g. funding the XRB and the FMA) and an investment by the private sector in fine-tuning their strategy for new business opportunities. Hence the need to closely review the system is obvious (see for example the regular review and report published by the TCFD in Appendix 5). Mostly importantly, climate reporting is an investment in our future and that of our children and mokopuna; it therefore deserves our close attention.

## SUGGESTIONS

- (q) Add a review obligation in the Financial Reporting Act 2013.

Change

### Financial Reporting Act 2013

#### Section 4 Overview of financial reporting duties

(1) This Act provides for various matters relating to financial reporting duties under other enactments, including—

- (a) defining key concepts (for example, generally accepted accounting practice, financial statements, and group financial statements); and
- (b) providing for the Board to prepare and issue financial reporting standards and auditing and assurance standards; and
- (c) providing standard provisions for auditor qualifications, access to information by auditors, and balance dates.

to read

### Financial Reporting Act 2013

#### Section 23 Section 4 amended (Overview of the external reporting framework and other duties)

[[Note: do not narrow the purpose to the Financial Markets Conduct Act 2013]]

(1) This Act provides for various matters relating to ~~financial-external reporting and other~~ external reporting and other duties under other enactments, including—

- (a) defining key concepts (for example, generally accepted accounting practice, annual reports, financial statements, ~~group financial statements and stakeholders~~); and
- (b) providing for the Board to prepare and issue ~~financial~~ reporting standards and auditing and assurance standards; ~~and~~
- (c) providing a duty to undertake regular reviews of the reporting system to improve the quality and timeliness of the reporting framework, and
- (~~e~~) providing standard provisions for auditor qualifications, access to information by auditors, and balance dates.

- (r) Add a review obligation in the Financial Markets Conduct Act 2013:

Change

### Financial Markets Conduct Act 2013

#### Section 3: Main purposes

The main purposes of this Act are to—

- (a) promote the confident and informed participation of businesses, investors, and consumers in the financial markets; and
- (b) promote and facilitate the development of fair, efficient, and transparent financial markets.

### Financial Markets Conduct Act 2013

#### Section 4: Additional purposes

This Act has the following additional purposes:

- (a) to provide for timely, accurate, and understandable information to be provided to persons to assist those persons to make decisions relating to financial products or the provision of financial services:

- (b) to ensure that appropriate governance arrangements apply to financial products and certain financial services that allow for effective monitoring and reduce governance risks:
- (c) to avoid unnecessary compliance costs:
- (d) to promote innovation and flexibility in the financial markets.

#### **Financial Markets Conduct Act 2013**

##### **Section 339: FMA must make written report on market operator obligations review**

- (1) The FMA must give a written report on a review under section 338 to the Minister and the licensed market operator—
  - (a) as soon as practicable after carrying out the review; and
  - (b) in any case, within 3 months after the licensed market operator has provided its report to the FMA under section 337.
- (2) The FMA must also publish the written report on the review on an Internet site maintained by or on behalf of the FMA.
- (3) However, the FMA may, in publishing the written report of its review, omit from the published report any information for which it considers there would be a good reason for withholding under the Official Information Act 1982 if a request for that information were made under that Act.

to read

#### **Financial Markets Conduct Act 2013**

##### **Section 3: Main purposes**

The main purposes of this Act are to—

- (a) promote the confident and informed participation of businesses, investors, consumers, stakeholders and citizens in the financial markets; and
- (b) promote and facilitate the development of fair, efficient, and transparent financial markets.

#### **Financial Markets Conduct Act 2013**

##### **Section 4: Additional purposes**

This Act has the following additional purposes:

- (a) to provide for timely, accurate, and understandable information to be provided to persons to assist those persons to make decisions relating to financial products or the provision of financial services:
- (b) to ensure that appropriate governance arrangements apply to financial products and certain financial services that allow for effective monitoring and reduce governance risks:
- (c) to avoid unnecessary compliance costs:
- (d) to promote innovation and flexibility in the financial markets:
- (e) to undertake regular reviews with the aim of improving the quality and timeliness of reporting.

#### **Financial Markets Conduct Act 2013**

##### **Section 339: FMA must ~~make~~ prepare a regular written reports on market operator obligations review**

- (1) The FMA must ~~give~~ publish a written report on a market operator obligations review every year under section 338 to the Minister and the licensed market operator—
  - (a) as soon as practicable after carrying out the review; and
  - (b) in any case, within 3 months after the licensed market operator has provided its report to the FMA under section 337.
- (2) The FMA must also publish the written report on the review on an Internet site maintained by or on behalf of the FMA.
- (3) However, the FMA may, in publishing the written report of its review, omit from the published report any information for which it considers there would be a good reason for withholding under the Official Information Act 1982 if a request for that information were made under that Act.
- (4) The FMA must publish a written report to the Minister every year on the status of climate reporting. This review must include:
  - (a) List of who has prepared a mandatory climate statement: by name and type of organisation (with link to the climate statement and assurance practitioner's report);
  - (b) List of offences committed (by type of offence, name of entity and penalties collected/discharged [e.g. penalties to be reported in annual report];
  - (c) Observations on the way the process is working effectively and how it could be improved;
  - (d) Suggestions on how content and processes could be improved; and
  - (e) Any other observations on how to improve the quality and cost-effectiveness of climate statements.
- (2) The FMA must also publish the operational report on a website maintained by or on behalf of the FMA.
- (3) However, the FMA may, in publishing the written report of its review, omit from the published report any information which it considers there would be a good reason for withholding under the Official Information Act 1982 if a request for that information were made under that Act.

- (s) Undertake a complete review of external reporting and bring all the reporting together under one act – a new and improved External Reporting Act (instead of the Financial Reporting Act).
- (t) Change the Companies Act to require directors to report on risks in the annual report.

## Appendix 1: Timeline of McGuinness Institute ReportingNZ publications

The list below illustrates the research work the Institute has undertaken as part of our project *ReportingNZ*.<sup>27</sup> It also includes three new working papers and a discussion paper (in progress).

Year	Month	Publication
2011	Jan	<i>Integrated Annual Report Survey of New Zealand's Top 200 Companies: Exploring Responses from Chief Financial Officers on Emerging Reporting Issues</i>
	Dec	<i>Submission on the International Integrated Reporting Committee Discussion Paper</i>
2013	Feb	<i>Submission on the Public Finance (Fiscal Responsibility) Amendment Bill 2012</i>
	Jul	<i>Submission to the International Integrated Reporting Councils' (IIRC) Consultation Draft of the International Framework</i>
2014	Apr	<i>Submission on the Environmental Reporting Bill</i>
2016	Oct	<i>Submission on the NZX Corporate Governance Best Practice Code</i>
2017	Apr	<i>Submission on disclosing non-GAAP financial information</i>
	Dec	<i>Submission on NZX Listing Rule Review</i>
2018	Mar	<i>Survey Insights: An analysis of the 2017 Extended External Reporting Surveys</i>
	Mar	<i>Survey Highlights: A summary of the 2017 Extended External Reporting Surveys</i>
	Mar	<i>Preparers' Survey: Attitudes of the CFOs of significant companies towards Extended External Reporting</i> (published in collaboration with the XRB) 10 April – 3 July 2017
	Mar	<i>Users' Survey: Attitudes of interested parties towards Extended External Reporting</i> (published in collaboration with the XRB) 29 May – 21 August 2017
	Mar	<i>ReportingNZ Overview Worksheet: An analysis of the state of play of Extended External Reporting</i>
	Mar	<i>Working Paper 2018/01 – NZSX-listed Company Tables</i>
	Mar	<i>Supporting Paper 2018/01 - Methodology for Working Paper 2018/01</i>
	May	<i>Submission to the Tax Working Group on the Future of Tax</i>
	Jul	<i>Working Paper 2018/03 – Analysis of Climate Change Reporting in the Public and Private Sectors</i>
	Jul	<i>Submission to Productivity Commission on a Low-emissions Economy</i>
	Jul	<i>Submission to Ministry for the Environment on the Zero Carbon Bill</i>
	Sep	<i>Working Paper 2018/04 – Legislation Shaping the Reporting Framework: A compilation</i>
Oct	<i>Think Piece 30 – Package of Climate Change Reporting Recommendations</i>	

<sup>27</sup> McGuinness Institute. 'Timeline of *ReportingNZ* publications from 2011'. Retrieved 15 May 2021 from <https://www.mcguinnessinstitute.org/policy-projects/reporting-nz>

Year	Month	Publication
2019	Jul	<i>Submission to Ministry for the Environment on the Climate Change Response (Zero Carbon) Amendment Bill</i>
	Aug	<i>Oral Submission to Select Committee on Climate Change Response (Zero Carbon) Amendment Bill</i>
	Oct	<i>Working paper 2019/05 – Reviewing Voluntary Reporting Frameworks Mentioned in 2017 and 2018 Annual Reports</i>
	Sep	<i>Working Paper 2019/06 – Analysis of Climate Change Reporting in the Public and Private Sectors</i>
	Sep	<i>Think Piece 32 – Exploring Ways to Embed Climate Reporting in the Existing Framework</i>
	Oct	<i>TCFD Workshops: Practical steps for implementation (Auckland and Wellington)</i>
	Oct	<i>Discussion Paper 2019/01 – The Climate Reporting Emergency: A New Zealand case study</i>
	Dec	<i>Survey Insights: An analysis of the 2019 Task Force on Climate-related Financial Disclosures (TCFD) survey</i>
	Dec	<i>Submission on Climate-related financial disclosures: Understanding your business risks and opportunities related to climate change</i>
2020	May	<i>Working Paper 2020/02 – The Role of a Directors' Report: An analysis of the legislative requirements of selected Commonwealth countries</i>
	Jun	<i>Working Paper 2020/03 – Reporting Requirements of Five Types of Entities</i>
	Jun	<i>Working Paper 2020/04 – Analysis of Climate Reporting in the Public and Private Sectors</i>
	Jun	<i>Working Paper 2020/05 – Reviewing Voluntary Reporting Frameworks mentioned in 2019 Annual Reports</i>
2021	WIP	<i>Working Paper 2021/01 – Timeline of climate change institutions and instruments since 1980 (work in progress)</i>
	WIP	<i>Working Paper 2021/03 – Analysis of Independent Bodies' responses to Climate Change (work in progress)</i>
	June	<i>Working Paper 2021/06 – Reviewing TCFD information in 2017–2020 Annual Reports of NZSX-listed companies</i>
	WIP	<i>Working paper 2021/10a – Climate change analysis of Government Department Strategies in operation as at 31 December 2020 (work in progress)</i>
	WIP	<i>Working Paper 2021/12 – Analysis of Climate Reporting in the Public and Private Sectors (work in progress)</i>
	WIP	<i>Working Paper 2021/13 – Reviewing Voluntary Reporting Frameworks mentioned in 2018 – 2020 Annual Reports (work in progress)</i>
	WIP	<i>Discussion Paper 2021/02 – Reporting the off-shore mitigation costs of the Nationally Determined Contribution (work in progress)</i>
	WIP	<i>Discussion Paper 2021/03 – Accounting for Natural GHG emissions, such as wildfires and volcanic eruptions (work in progress)</i>



## Appendix 2: Registers managed by the Companies Office

The list below is from MBIE's website, specifically their Companies Register page.<sup>28</sup>

1. **Companies register** (the main register)  
Where you can search for and maintain companies incorporated or registered in New Zealand
2. **Disclose register**  
Where you can search for or register financial products and managed investment schemes offered under the Financial Markets Conduct Act 2013
3. **Financial service providers register**  
Where you can search for or register individuals, businesses and organisations that offer financial services in New Zealand
4. **Personal property securities register**  
Where you can search for and register security interests in personal property
5. **Approved overseas auditors & associations of accountants**
6. **Auditors**
7. **Building societies**
8. **Charitable trusts**
9. **Contributory mortgage brokers**
10. **Credit unions**
11. **Friendly societies**
12. **Incorporated societies**
13. **Industrial & provident societies**
14. **Insolvency practitioners**
15. **Limited partnerships (New Zealand & overseas)**
16. **Overseas issuers**
17. **Participatory securities**
18. **Registered unions**
19. **Retirement villages**
20. **Superannuation schemes**
21. **Unit trusts**

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<sup>28</sup> New Zealand Companies Office. 'All Registers'. Retrieved 15 May 2021 from <https://companies-register.companiesoffice.govt.nz/>

### Appendix 3: Major Recommendations from Report 17 – ReportingNZ: Building a Reporting Framework Fit for Purpose

The table below brings together the Institute’s major recommendations<sup>29</sup> from undertaking three years of work. The Institute reviewed the current reporting framework in order to see whether it was fit for purpose in the medium to long term. While undertaking this work, the Institute identified issues that needed urgent attention – a few of these could easily be resolved.

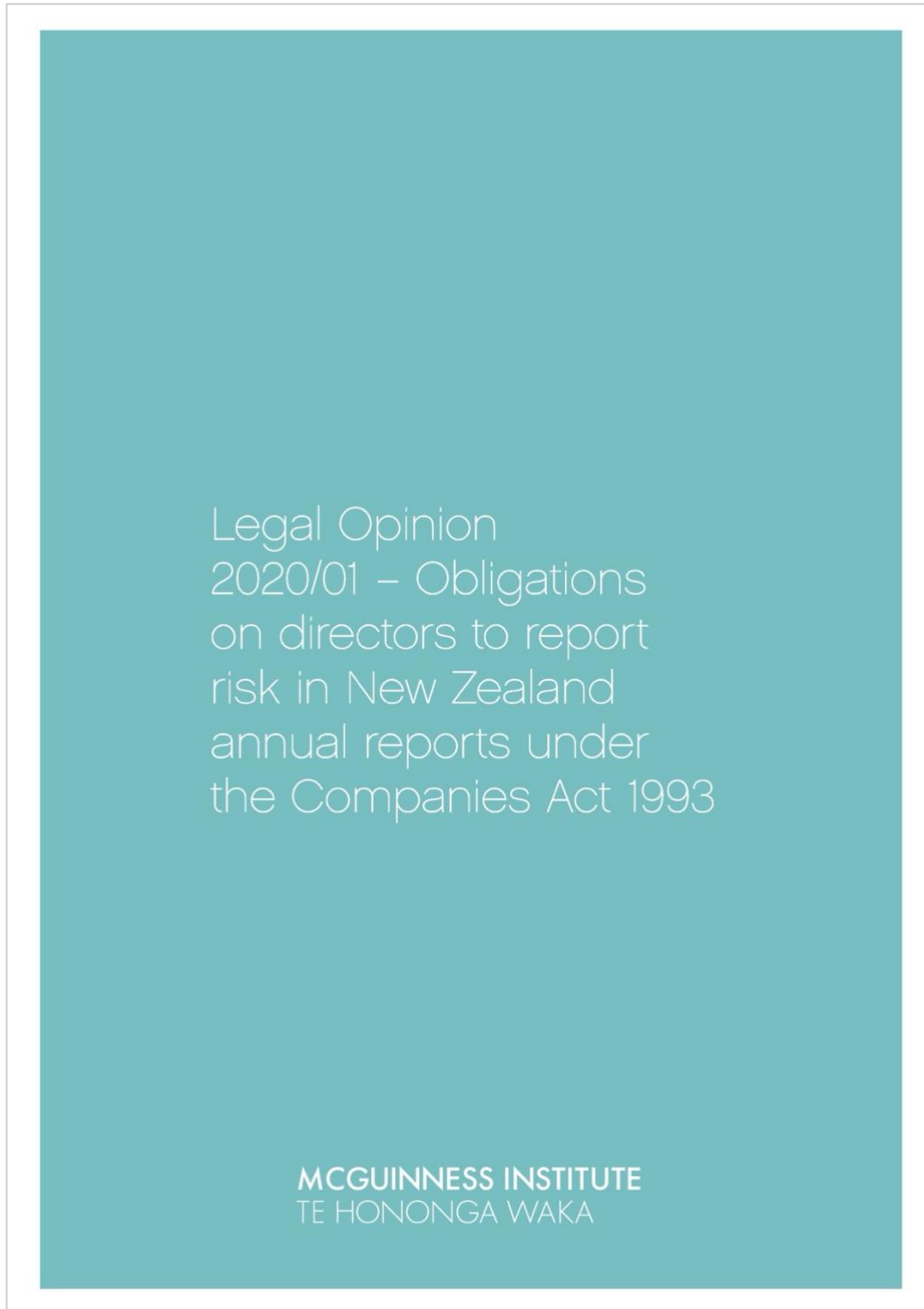
Objectives	Recommendations	Key results
<b>Objective 1: Reclaim the annual report as the key instrument for reporting to stakeholders.</b>	1. Create one central register for all external filing requirements (including for public sector entities and registered charities).	The Registrar would: <ul style="list-style-type: none"> <li>- Manage all external filing on one website (a central register).</li> <li>- Extend existing filings requirements to require annual reports (including a directors’ report and a ‘Statement of Climate Information’ for all climate reporting entities).</li> <li>- Allow voluntary filing for entities that have no mandatory filing obligations.</li> </ul>
	2. All organisations that are currently required to make their annual report publicly available, should be required to file their annual report on the central register.	<ul style="list-style-type: none"> <li>- Require local government, who are required to publish an annual report, to file the report on a central public sector register.</li> <li>- Require government departments, who are required to publish an annual report to file the report on a central public sector register.</li> <li>- Require companies that are currently required to publish their annual report publicly (NZX-listed companies), and to file it on the Companies Office.</li> </ul>
<b>Objective 2: Ensure disclosures in the annual report are useful, timely and cost-effective.</b>	3. Change legislation to better meet user needs and align with global best practice in relation to the reporting of information to shareholders and external users.	Parliament to amend legislation to: <ul style="list-style-type: none"> <li>- Expand s 211 of the Companies Act 1993 to state what is included in the annual report.</li> <li>- Require a directors’ report to be prepared by all entities that are currently required to prepare financial statements (for-profit Tier 1 and Tier 2 entities).</li> <li>- Invoke s 17(2) of the Financial Reporting Act 2013.</li> <li>- Require a ‘Statement of Climate Information’ for all climate reporting entities.</li> </ul>
	4. Review the external financial reporting framework and accounting standards to better meet user needs.	The XRB would: <ul style="list-style-type: none"> <li>- Improve the quality of disclosure requirements to meet the needs of users.</li> <li>- Align public and private sector reporting requirements.</li> <li>- Work with international standard setters.</li> <li>- Ensure annual report content is aligned to accounting and assurance standards.</li> </ul>
	5. Require the directors report (the annual report in New Zealand) to report on risks.	<ol style="list-style-type: none"> <li>1. MBIE would help facilitate changes to legislation. For example: expanding s 211 and removing the focus on shareholders.</li> <li>2. IOD would provide guidance to directors on how to prepare an annual report.</li> </ol>

<sup>29</sup> McGuinness Institute. (June 2020). *Report 17 – ReportingNZ: Building a Reporting Framework Fit for Purpose*. Retrieved 15 May 2021 from <https://www.mcguinnessinstitute.org/publications/project-2058/>

Objectives	Recommendations	Key results
<p><b>Objective 2 (cont.):</b>  <b>Ensure disclosures in the annual report are useful, timely and cost-effective.</b></p>	<p>6. Embed climate-related financial reporting into the New Zealand reporting framework.</p>	<p>From the Institute's perspective, this should be managed by the XRB as part of their normal business practice of issuing standards for selected entities to report against. The Institute envisages that this would result in a 'Statement of Climate Information' prepared and signed by two directors, audited by an external party and published in the entity's annual report.</p> <p>MBIE would help facilitate changes to legislation:</p> <ul style="list-style-type: none"> <li>- Mechanism 1 (climate reporting organisations) is through expanding the breadth of climate reporting organisations (to include for-profit entities and public benefit entities) and requiring additional information under the Climate Change Response Act 2002 (CCRA) (e.g. including a mandatory reporting regime in addition to the reporting powers already provided under ss 5ZW and 5ZX(1)(c) CCRA.</li> <li>- Mechanism 2 (financial reporting standards) is through making changes to the Financial Reporting Act 2013 (e.g. s 17).</li> <li>- Mechanism 3 (publication and location requirements) is through changes to the Companies Act 1993 (e.g. s 211).</li> </ul>
<p><b>Objective 3:</b>  <b>Maintain stewardship across the system.</b></p>	<p>7. Provide clarity over the overarching principles, parameters and strategy that shape the legislative framework for external reporting.</p>	<p>Appoint a steward to clarify the following:</p> <ul style="list-style-type: none"> <li>- Define the purpose of the annual report.</li> <li>- Ensure that the annual report is the key instrument to report to external users on the performance of an entity.</li> <li>- Ensure that disclosure requirements aim to meet user needs by ensuring information is relevant (useful) and reliable (trustworthy).</li> <li>- Clarify the role of Directors, shareholders and management.</li> <li>- Ensure that the size criteria for mandatory external reporting is appropriate. This requires a review of the size criteria in the legislative framework.</li> <li>- Clarify the parameters of the system (the system includes XRB, FMA, Charities Services, Treasury, OAG, all registrars and other entities such as NZX and IoD).</li> </ul> <p>The steward must annually review and publicly report on:</p> <ul style="list-style-type: none"> <li>- The extent compliance and penalty systems align across entities and are sufficient to change behaviour.</li> <li>- External reporting statistics across entities and any failures that exist in the system.</li> <li>- A comparison of the New Zealand system with major trading partners to ensure we are up to date with international best practice.</li> </ul>

#### Appendix 4: Legal Opinion: Obligations on directors to report risk in New Zealand annual reports under the Companies Act 1993

The legal opinion below illustrates a loophole in the current reporting framework that needs urgent attention.<sup>30</sup>



<sup>30</sup> McGuinness Institute. (2020). *Legal Opinion 2020/01 – Obligations on directors to report risk in New Zealand annual reports under the Companies Act 1993*. Retrieved 15 May 2021 from <https://www.mcguinnessinstitute.org/publications/legal-opinion/>

## About McGuinness Institute

The McGuinness Institute is a non-partisan think tank doing the research others are not. We are committed to positively influencing public policy by empowering New Zealanders to have the uncomfortable, but necessary, conversations that are required to enable New Zealand to realise its potential as a country.

*Legal opinion: Obligations on directors to report risk in New Zealand annual reports under the Companies Act 1993* was commissioned to describe in general terms the framework for annual reporting by companies and directors under the New Zealand Companies Act 1993, and in particular the extent to which the Companies Act 1993 requires disclosure of risks (such as climate or pandemic).

It is intended to be read alongside the McGuinness Institute's *Working Paper 2020/02 – The Role of a Directors' Report: An analysis of the legislative requirements of selected Commonwealth countries* and Project 2058 Report 17: *Building a reporting framework fit for purpose*.

## About Gerald Fitzgerald

Gerald is the Founder of Fitzgerald Strategic Legal. He has more than 35 years legal experience primarily in financial services, corporate law and governance. Formerly with one of New Zealand's large law firms (the last six as Chair) he established his present firm in 2018 to allow him to focus particularly on strategic issues of governance, corporate and family succession, and environment.

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**Published** Copyright © McGuinness Institute Limited May 2020  
ISBN – 978-1-990013-07-2 (paperback)  
ISBN – 978-1-990013-08-9 (PDF)

## FITZGERALD STRATEGIC LEGAL

Level 6, 82 Willis Street, Wellington

27 May 2020

McGuinness Institute  
Wellington  
Cable Street

**Attention:** Wendy McGuinness

By email

### **Companies Act 1993 – Annual Reporting Requirements**

#### **1 Introduction and summary**

- 1.1 You have asked me to describe in general terms the framework for annual reporting by companies and directors under the New Zealand Companies Act 1993, and in particular the extent to which the Companies Act 1993 requires disclosure of risks (including, but not limited to, risks such as climate or pandemic).
- 1.2 You will see that whilst there is no specific requirement in the Companies Act for directors to report on risks (let alone specifically climate or pandemic-related risks), I can see arguments that a failure to include in annual reports disclosure concerning imminent and proximate risks could in some circumstances give rise to directors' liability to shareholders.
- 1.3 Your question has highlighted an uncertainty in our Companies Act that is probably best addressed by way of a legislative change to require the inclusion of key material risks within the mandated annual reporting framework for companies provided for by sections 208 and 211 (subject to the present 'opt in/opt out' regime).

#### **2 Preliminary observations as to governance**

- 2.1 In considering the reporting framework, it is helpful to bear in mind the fundamental principles of management and governance of companies in New Zealand.
- 2.2 Our Companies Act recognises that the business and affairs of a company are (and must be) managed by or under the direction of the company's board (section 128) – not shareholders.
- 2.3 The Act specifically requires directors (amongst other specific duties) to:
  - a act in the best interests of the company;
  - b act in a manner which is not likely to create a substantial risk of serious loss to the company's creditors (section 135); and

- c exercise the care, diligence, and skill that a reasonable director would exercise in the circumstances of the particular company and the relevant issue (section 137).
- 2.4 These duties overlay the specific reporting and other duties the Act requires of directors. Some duties set out in the Act are specifically expressed to be duties owed to the Company, and others to shareholders. In my view it follows logically from the vesting of governance responsibility in directors that the Act's reporting obligations are duties owed by directors to shareholders. This has implications for liability as I discuss below.
- 2.5 These reporting obligations (both financial and general) have been tailored to allow shareholders to 'opt in' or 'opt out' of many reporting requirements to suit the size and nature of the entity. This letter does not consider the permutations which arise from such choices and only addresses the default position. Nevertheless, the 'opt in/opt out' provisions provide an appropriate mechanism to balance the cost/benefit analysis from any legislative change.

### **3 Financial Reporting – sections 196 - 207ZB**

- 3.1 The extent and manner of financial reporting is set out in sections 196 – 207ZB of the Act.
- 3.2 Broadly these provisions require preparation of financial statements by companies in accordance with applicable financial reporting standards appropriate to the size and nature of the company and the wishes of its shareholders.
- 3.3 These financial statements must be:
  - a Signed on behalf of the company by its directors (section 201); and
  - b Included in the annual report sent to shareholders (section 211(1)(b)).
- 3.4 None of these financial reporting sections in the Act specifically address a requirement to report on risks generally or financial risks arising from events such as pandemics or climate change. That is left to the standards.
- 3.5 I note there is the general reporting requirement in paragraph 125 of NZIAS1:

*An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.*
- 3.6 But it is interesting to observe the relatively narrow scope of this standard – '*carrying values of assets and liabilities*' and '*the next financial year*'.
- 3.7 Likewise, I am aware of specific requirements in respect of the risk of certain financial instruments.
- 3.8 It is not clear to me that any of these standards requires a more general disclosure of the risks with which you are concerned.
- 3.9 It would, of course, be open for financial reporting standards to require such reporting, and thereby become an obligation under the Financial Reporting Act, and

consequently, the Companies Act in respect of those companies to which the standards applied.

#### **4 Section 208 – general reporting obligation**

- 4.1 Section 208 is the starting point for a consideration of the extent of the board's more general reporting obligations. It forms part of the Act (Part 12) which is entitled '*Disclosure by Companies*' and appears immediately below a heading '*Disclosure to Shareholders*'.
- 4.2 Section 208 is titled '*Obligation to prepare annual report*'. It applies to all companies subject to the 'opt in/opt' out provisions in 208(1)(d) & (e) (which I have previously noted I do not address).
- 4.3 Section 208(2) requires the board of every company to which the section applies to prepare an annual report:

*'on the affairs of the company during the reporting period.'*

Note: this obligation requires directors to report on the '*affairs*' of the company. It is separate from the financial reporting obligations which are set out in the immediately preceding part of the Companies Act. I think it is therefore reasonable to infer that this section contemplates a narrative from the board which provides insight into the company's activities over the past reporting period separate from the financial data required by the financial reporting provisions.

- 4.4 The section is, however, very general in scope and, whilst subject to the requirements of section 211, it leaves it to the board to determine the extent to which the '*affairs*' of the Company are explained. In particular '*affairs*' seems capable of a broader meaning than a mere listing of the day to day '*activities*' of a company.
- 4.5 By way of example, it would seem odd if a company operating a tourism business, in preparing its annual report in today's environment, would not include commentary on the historical and forward impact of the closure of businesses and borders as a consequence of the pandemic and declaration of a national state of emergency.
- 4.6 In contrast to the general requirement of section 208 to report on the '*affairs of the company*', Section 211(1) is specific and prescriptive. It prescribes the particular content and requirements of the annual report (again subject to the opt out provisions of 211(3)). In my view, however, section 211 is to be read alongside 208 and does not read down the general obligation to report '*on the affairs of the Company*'. Section 211 is simply prescriptive of certain minimum disclosures and does not displace the more general obligation in section 208, particularly if the minimum were to leave a shareholder with a misleading understanding of the affairs of the company.
- 4.7 Section 211(1)(a) requires the annual report to describe changes in:
- a '*the nature of the business of the company*'; or
  - b '*the classes of business in which the company has an interest.*'

but leaves to the discretion of the directors the ability to determine what changes are material, and what disclosure might be harmful to the business. The Act recognises



the desirability of a balance between informing shareholders and keeping commercially sensitive information confidential.

- 4.8 Importantly Section 211(1)(a) does not require disclosure or discussion of the business itself and its affairs. It certainly does not require the annual report to disclose perceived risks (present or imminent). Instead, section 211(1)(a) only requires disclosure of changes in the *'nature'* of the company's business, and I do not think that a risk readily falls within the concept of the *'nature of business'*.
- 4.9 While section 211(1) may not require the annual report to disclose risks, it may nevertheless be arguable that such disclosure is required by the more general obligation in section 208(2) to report on the *'affairs of the company'*.
- 4.10 I have read the opinion prepared by Chapman Tripp in October 2019. I note their opinion at paragraphs 93 - 94 that in certain circumstances disclosure of climate related risks may be required of entities to meet their financial reporting obligations.
- 4.11 I agree with that view. I think, however, that in some circumstances the disclosure of climate related risks (or indeed any risk which is sufficiently material, proximate and imminent so as to warrant active management by the board) could also be a matter which a Court might decide falls within the general obligation of section 208 to report on the *'affairs of the company in the preceding period.'*
- 4.12 While in the time available I have not had the opportunity to research whether the point has yet been tested, it is conceivable that liability might attach where a board fails to disclose a serious proximate and imminent risk in its annual report which is not apparent from other publicly available information and which subsequently eventuates and causes loss to shareholders.
- 4.13 This is because the very purpose of imposing a general reporting obligation on boards is to enable shareholders to understand businesses in which they have invested and to make informed decisions based on that disclosure (whether that be a voting decision, or a decision whether to sell, retain or increase an investment).
- 4.14 A specific requirement of section 211(k) is that the annual report be signed *'on behalf of the board'* by directors.<sup>1</sup> From this obligation; the overall framework of governance provided for by the Act, and the provisions of Part 12, I have little doubt that the obligation in section 208(2) to prepare an annual report is a duty owed by directors to shareholders, with the consequence that a breach of that duty renders directors vulnerable to actions by shareholders for a breach of that duty.
- 4.15 Is it too far a stretch to conclude that the scope of the directors' duty to shareholders under section 208(2) extends to ensure that annual reports fairly and adequately address any proximate and imminent risk which could have a material impact on the financial performance of the business?

---

<sup>1</sup> It is convenient to note at this point that I believe the annual report required by our Companies Act is effectively what some other jurisdictions may call a 'directors' report'. Likewise, while some documents published in New Zealand may contain a section titled 'Directors' Report' and other sections titled 'Chief Executive's' or 'Management Report', in my view, when published as a single document, the whole document is the annual report and that directors accordingly have responsibility for its content.

- 4.16 While this may not have been contemplated at the time the Act was drafted (30 years ago), it is clear that expectations of the business community for effective corporate governance and reporting have increased. The Act provides the scope for Court's to follow that change in sentiment.
- 4.17 Such a duty would fit comfortably with the obligation not to engage in misleading or deceptive conduct in relation to any dealing in financial products imposed by section 19 of the Financial Markets Conduct Act.
- 4.18 Likewise, it would fit comfortably with the obligation under the Financial Markets Conduct Regulations to disclose key risks when an entity raises money from the public. Afterall, it would be a slightly strange result if the obligation to disclose risks ended with the capital raising, when investor reliance on disclosure continues for ongoing decisions concerning the investment.
- 4.19 However, the present position is that neither sections 208 nor 211 specifically require such disclosure of risks. Absent a specific statutory requirement (or other obligation arising under (say) Listing Rules), and absent a court decision confirming the obligation exists in any event, it is unlikely that companies will voluntarily move to greater risk disclosure in their annual reports.
- 4.20 It would be better that legislation address the point, and my preference would be that section 211 be varied to include a more explicit requirement for annual reports to address proximate and imminent risks which would be reasonably likely to have a material adverse effect on the company's financial position or financial performance if they were to materialise.
- 4.21 The 'opt in/opt out' provisions of the Act provide an appropriate mechanism to balance the cost/benefit analysis from any legislative change and allow companies to choose their preferred approach.
- 4.22 Such legislative change might be best aligned with appropriate changes in financial reporting standards.

Yours faithfully



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**Note:** In preparing this opinion, the author asked Dentons Kensington Swan (Hayden Wilson assisted by Amelia Retter) to undertake a case review. They confirmed that based on their research as at 27 May 2020 to the best of their knowledge there was no reported New Zealand judicial authority which has considered the disclosure requirements addressed in this opinion (i.e. to disclose risk in annual reports by New Zealand companies under the Companies Act 1993). The author gratefully acknowledges the work of Dentons Kensington Swan.

## Appendix 5: Excerpt from Task Force on Climate-related Financial Disclosures 2020 Status Report

The TCFD undertake a regular review of TCFD reporting. The following table represents their latest findings.<sup>31</sup>

Table ES1

### Key Takeaways and Findings



**Nearly 60% of the world's 100 largest public companies support the TCFD, report in line with the TCFD recommendations, or both.**<sup>14</sup> In addition, nearly 700 organizations have become TCFD supporters since the Task Force issued its 2019 status report, an increase of over 85%.<sup>15</sup> The Task Force is encouraged by the growing support for its recommendations and hopes to see similar growth in the percentage of companies disclosing TCFD-aligned information going forward.



**Disclosure of climate-related financial information has increased since 2017, but continuing progress is needed.** Disclosure of TCFD-aligned information increased by six percentage points, on average, between 2017 and 2019; and the Task Force applauds the improvements made — both in terms of the number of companies reporting and the quality of such reporting. However, companies' disclosure of the potential *financial* impact of climate change on their businesses and strategies remains low. The Task Force recognizes the challenges associated with making such disclosures but encourages continued efforts and faster progress.



**Energy companies and materials and buildings companies lead on disclosure.**

For fiscal year 2019 reporting, the average level of disclosure across the Task Force's 11 recommended disclosures was 40% for energy companies and 30% for materials and buildings companies.



**One in 15 companies reviewed disclosed information on the resilience of its strategy.** The AI review found that the percentage of companies disclosing the resilience of their strategies, taking into consideration different climate-related scenarios, was significantly lower than that of any other recommended disclosure.



**Asset manager and asset owner reporting to their clients and beneficiaries, respectively, is likely insufficient.** While TCFD-aligned reporting by a sample of asset managers and asset owners increased over the past three years, the Task Force believes reporting by these organizations to their clients and beneficiaries may not be sufficient and that more progress may be needed to ensure clients and beneficiaries have the right information to make financial decisions.<sup>16</sup>



**Expert users find the impact of climate change on a company's business and strategy as the "most useful" for decision-making.** Expert users also identified information about a company's material climate-related issues for each *sector* and *geography* and its key metrics as extremely useful for financial decision-making.



**Expert users' insights on the most useful information for decision-making may provide a road map for preparers.** Companies already disclosing their governance and risk management processes for climate-related issues and working toward full TCFD implementation might consider expert users' relative ranking of specific types of climate-related information — from most useful to least useful — as one factor to consider in prioritizing their efforts.

<sup>31</sup> Financial Stability Board. (2020). *Task Force on Climate-related Financial Disclosures 2020 Status Report*. Retrieved 15 May 2021 from <https://www.fsb.org/wp-content/uploads/P291020-1.pdf>