



Wendy McGuinness meeting with IFRS staff in London, on 15 August 2019, to discuss the urgent need for climate standards.

## Submission

**Exposure Draft: Proposed Targeted  
Amendments to the IFRS Foundation  
Constitution to Accommodate an  
International Sustainability Standards Board  
to Set IFRS Sustainability Standards**

29 July 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*.

## **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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## 1.0 Introduction

The Institute congratulates the Foundation on this initiative and wishes to thank the trustees for seeking public feedback.

The Institute agrees with many of the comments made in the Exposure Draft:

- There is an urgent need for global sustainability reporting standards.
- The Foundation should play a leading role in the development of such standards.
- The creation of an international sustainability standards board (ISSB) under the Foundation's governance structure is an effective and timely way to deliver sustainability reporting standards.
- Prioritising climate standards is essential due to the urgent need for better information about climate-related matters. We also support a move to quickly meet information needs of investors on other environmental, social and governance (ESG) matters.

## 2.0 Comments on the Exposure Draft (paragraphs in text)

**The focus will be on standards and information that is *material* to the decisions of investors and other participants in the world's capital markets.**

Our view is that this requires a broader view of materiality than currently exists in the International Accounting Standards Board (IASB) Practice Statement 2.<sup>1</sup> We are concerned that, if the IASB definition of materiality is applied to the ISSB standards, it would be problematic for both. We believe the IASB definition of materiality is too narrow. There needs to be a bridge between the two Boards and their respective standards, and it may be useful to consider whether the Practice Standards should be rewritten to, in effect, become that bridge.

**They [ISSB] will build on the well-established work of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD), as well as work by the alliance of leading standard-setters in sustainability and integrated reporting focused on enterprise value.**

New Zealand is in the process of passing the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill,<sup>2</sup> which places a requirement on our External Reporting Board (XRB) to produce standards that require certain entities to produce climate statements. The Institute has provided research and undertaken consultation to support this Bill.<sup>3</sup> Our view is that the IFRS has been slow to respond to the climate emergency and, because of this, New Zealand and a number of other countries, including the UK, have had to push forward.

Our chief executive, Wendy McGuinness, visited the offices of IFRS on 14 August 2019 to raise concerns over the growing gap between what was needed and what was being provided by IFRS in terms of climate reporting. The IFRS staff who attended the meeting made it clear

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<sup>1</sup> See <https://www.xrb.govt.nz/accounting-standards/ifrs-practice-statements-and-guides/ifrs-practice-statement-2>

<sup>2</sup> This omnibus bill will amend the Financial Markets Conduct Act 2013, the Financial Reporting Act 2013, and the Public Audit Act 2001 by implementing a single broad policy to broaden non-financial reporting, that is, requiring and supporting the making of climate-related disclosures by certain FMC reporting entities and supporting related matters. See [https://www.parliament.nz/en/pb/bills-and-laws/bills-proposed-laws/document/BILL\\_109905/financial-sector-climate-related-disclosures-and-other](https://www.parliament.nz/en/pb/bills-and-laws/bills-proposed-laws/document/BILL_109905/financial-sector-climate-related-disclosures-and-other)

<sup>3</sup> See Appendix 1 to this submission.

that IFRS was unlikely to commit to preparing climate-related standards in the short to medium term and that such standards were considered outside their remit. (This has proven to be correct, given the need to now change IFRS's constitution.) On returning to New Zealand, the Institute, with others, worked hard to ensure New Zealand's XRB were able to develop climate-related standards. This cumulated in the 2021 Bill, referred to above.

Our point is that IFRS has been late to engage and that has had a detrimental impact. The question remains whether it is going to be possible for IFRS to enter this space late and deliver the much-needed guidance and standards that are required to deliver on the Paris Agreement. This will mean working with what the Exposure Draft refers to as sustainability standard-setters, such as New Zealand's XRB. Therefore, the new ISSB will not only need to engage with and focus on TCFD, but also on new sustainability standard setters like the XRB. These relationships must be established early and will ideally help speed up the ISSB by learning the lessons of those who have traversed or are about to traverse this new terrain.

We agree with the building-blocks approach and the need for the ISSB to work with standard-setters from key jurisdictions. This way, standards issued by the ISSB will provide a globally consistent and comparable sustainability reporting baseline, while also providing flexibility for coordination on reporting requirements that capture wider sustainability impacts. This will require a need for the ISSB to seek out lessons learned and, as such, will require a significant change in approach – from teacher to student.

### **3.0 Comments on the Exposure Draft (five questions)**

**Question 1:** Do you agree that the amendments proportionately reflect the Trustees' strategic direction, considering in particular: (a) the proposed amendments to the objectives of the Foundation, outlined in the proposed new section 2b of the Constitution, as set out in Appendix A; and (b) the proposed amendments to reflect the structure and function of the new board, outlined in the proposed new sections 43–56 of the Constitution, as set out in Appendix A?

#### **Box 1: The Foundation proposal, excerpt from section 2 (p.16)**

The objectives of the IFRS Foundation are:

- (a) through the IASB, to develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles. These standards should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the world's capital markets and other users of financial information make economic decisions.
- (b) through the ISSB, to develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted sustainability standards based upon clearly articulated principles. These standards should require high quality, transparent and comparable information in corporate reports to help investors and other participants in the world's capital markets in their decision-making and connect with multi-stakeholder sustainability reporting.

The Institute believes the existing proposal is repetitive, lacks clarity and creates unnecessary rigidity. Table 1 below, illustrates key differences between s2(a) and 2(b) of the proposal.

Table 1: Analysis of the Proposal

	2(a): IASB	2(b): ISSB
Preparers	Public and private sector	Public and private sector
Users type	... help investors, other participants in the world's capital markets <i>and other users of financial information</i>	... help investors and other participants in the world's capital markets ... <i>and connect with multi-stakeholder sustainability reporting</i>
Benefit for User	<i>Economic decisions</i>	<i>Decision-making</i>
Report type	<i>Financial statements and other financial reporting</i>	<i>Corporate reports</i>
Reason why	In the public interest	In the public interest

The analysis, shown in Table 1, indicates there is little difference between the two boards (see italics) and we would argue there is no difference between economic decisions and decision-making. This means the only significant difference is where the information is reported – the financial statements or corporate reporting. Our view is that corporate reports may be problematic and it may be better to focus on whether it is financial information or sustainability information. Our view is that these two boards will share common concepts and practice standards and, as such, the constitution should be future proofed.

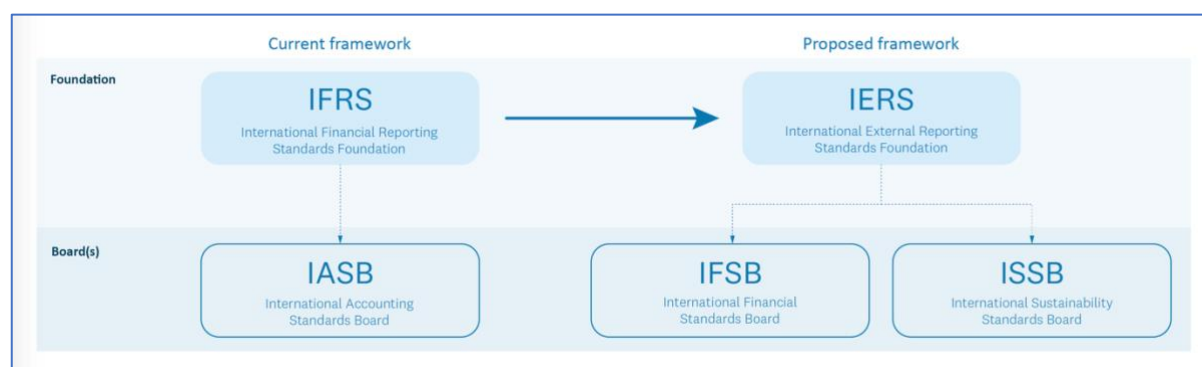
**Option 1: A long-term durable and flexible solution**

Ideally, we consider the constitution should just state it can establish boards to manage international external reporting requirements and that those boards are required to meet certain characteristics (e.g. along the lines of the proposed new sections 43–56). Not defining the boards and the boards’ roles in the constitution, in our view, would create a more durable constitution, one where the trustees can evolve the Foundation as new needs (and possibly boards) emerge. However, given this would likely require a new Exposure Draft, the Institute has outlined in Box 2 a temporary solution.

**Option 2: A short-term durable and flexible solution**

The aim is to reduce duplication and make the roles clear and the goals concise. Box 2 sets out suggested changes in name. Figure 1 illustrates the suggested solution.

Figure 1: The McGuinness Institute short-term proposal



## **Box 2: The McGuinness Institute proposal**

1. The International Financial Reporting Standards Foundation (IFRS Foundation) becomes the *International ~~Financial~~ External Reporting Standards Foundation (IERS Foundation)*.
2. The objectives of the *IERS Foundation* are to develop, in the public interest, high quality, understandable, enforceable and globally accepted standards based upon clearly articulated principles. These standards should require high quality, transparent and comparable information in the *public reports of organisations to enable users to make investment, supply, purchase, employee and/or policy decisions*.
3. To do this the IERS will establish two boards:
  - The International ~~Accounting~~ *Financial* Standards Board (*IFSB*) will be responsible for preparing financial reporting standards for the preparation of regular external financial information.
  - The International Sustainability Standards Board (ISSB) will be responsible for preparing sustainability reporting standards for the preparation of regular external sustainability information.

[Note: Italics refer to key changes in content from the proposal]

**Question 2:** On the potential naming of the new board and its associated standards, do you agree that ‘the International Sustainability Standards Board (ISSB)’ setting ‘IFRS sustainability standards’ accurately describes the function of the new board and its associated standards?

Yes.

**Question 3:** Do you agree with this proposed consequential amendment, outlined in proposed new sections 60 and 61 of the Constitution, as set out in Appendix A?

Yes. However, we do believe some consideration should be given to having key stakeholders sign off/certify the trustees of the IRS Foundation. For example, the FSB, NASD, the World Bank, G20, the United Nations, the OECD and/or the IMF could all certify support for the Foundation as the International standard setter of external information. This is to provide intentional authority to the foundation to be ‘the’ international reporting standard-setter, delivering comparable external information globally.

**Question 4:** Are there any other matters you would like to raise in relation to the proposed targeted amendments to the Constitution?

Please note the suggestion in response to Q1 for changing the name of the Foundation (by removing ‘Financial’ from the title).

Please note the suggestion in response to Q3 for providing more authority for the Foundation by having key stakeholders authenticate the Foundation as the international reporting standard-setter.

## **Other Matters**

In times of uncertainty, a key weapon is timely, accurate and meaningful information – which can be summarised in the term ‘decision-useful information’. The Institute has continuously recommended the XRB work with IFRS. For example, see our Project 2058 report, *Report 17 – ReportingNZ: Building a Reporting Framework Fit for Purpose* (2020), page 132, where we recommended ‘XRB to continue to work with all international accounting and assurance (including ethics) institutions to improve the usefulness and relevance of financial statements.’

We note in our 2020 report:

‘International standard setters must evolve in response to emerging trends. In the for-profit sector, areas where improvement to international standards or guidance would be helpful include:

- IFRS information provided outside the financial statements. The IASB currently focuses on financial statements, leaving guidance and legislation relating to annual reports to individual nation states. This highlights the issue of how to present and assure Generally Accepted Accounting Principles (GAAP) information in parts of the annual report other than the audited financial statements.
- Non-IFRS information, such as Alternative Performance Measures (APMs), provided within financial statements. The Institute does not believe financial statements should contain non-GAAP information, as this undermines the integrity of financial statements and may lead to confusion for investors.’

We consider the pressure being placed on financial reporting will be alleviated, to some extent, by the creation of the sustainability standards. However, we consider that the growth of non-IFRS information in financial statements needs to be identified, considered, assessed and policed to ensure the financial statements contain only IFRS information. To some extent, the boundaries of financial and sustainability reporting will need to be negotiated by both boards. This will require collaboration and perhaps shared practice statements.

As we transition to ‘decision-useful’ information, we will need to learn by doing. This means we will need to continue to undertake relevant and timely research to inform standard setting. The Institute is committed to doing this work in New Zealand in the short term (see our research to date listed in Appendix 1) but we expect the XRB will go on to lead this work in the years to come. However, it is a timely reminder that the profession must continue to learn by doing, especially during times of uncertainty. For example, the IASB has a lot of work to do given the growing gap between the value of net assets on financial statements and the value in the market (e.g. intangibles), meaning both boards will need to work hard on providing ‘decision-useful’ information.

The new board will need to engage in foresight. This is going to be critically important in times of uncertainty, particularly given the triple crisis that the world currently faces: the

pandemic, climate change (as indicated by TCFD) and biodiversity loss (as indicated by the Taskforce on Nature-related Financial Disclosures [TNFD]).<sup>4</sup> Appendix 2 includes two articles; one written on a potential pandemic (2005) and the second on climate change (2006). The accounting profession has understandably been backward looking, but that is no longer appropriate. We need to consider how best to produce forward-looking information – and that will mean focusing on usefulness not accuracy. This will be a difficult transition for many in the profession.

Given all of the above, it will be very important for the Foundation to commit to, nurture and guide the new ISSB as the new board will need to navigate a diverse range of vested interests and develop working relationships with a number of new organisations. It will also need a great deal of additional resources in order to deliver on its purpose. There are challenging times ahead and the world will need a diverse group of experts, working together with a large number of stakeholders, to deliver durable and reliable guidance and standards. This will be hard work, requiring a different approach; perfection should not be allowed to get in the way of useful. Mistakes will need to be tolerated and quick changes in direction accepted, simply because it is the right thing to do. Put simply, a fast-fail standard-setting culture will need to be the norm for the ISSB, which will be in complete contrast to the existing cultural paradigm of slow and cautious standard-setting by the IASB.

Thank you for the invitation to comment. The work the Foundation does is critically important for the future of the planet; thank you for reading and considering our suggestions. If you have any questions, please do not hesitate to contact the Institute.

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<sup>4</sup> See <https://tnfd.info>



## Appendix 1: Relevant McGuinness Institute Publications

In addition to the three key reports listed below, the Institute has published a number of more specific research papers, called Working Papers. A full list can be found on the website here: <https://www.mcguinnessinstitute.org/publications/working-papers>. We are currently undertaking some research that analyses NZSX-listed annual reports for mentions of Non-IFRS information, such as Alternative Performance Measures (APMs), in the financial statements of annual reports (see upcoming *Working Paper 2021/15: Analysis of NZSX-listed companies by Non-IFRS information*).

Three key reports:

- [Discussion Paper 2019/01 – The Climate Reporting Emergency: A New Zealand case study](#) (2019)
- [Report 17 – ReportingNZ: Building a Reporting Framework Fit for Purpose](#) (2020). See a full list of supporting Working Papers in Appendix 1 (images below).
- [Working Paper 2021/06 – Reviewing TCFD information in 2017–2020 Annual Reports of NZSX-listed companies](#) (2021)

APPENDIX 1   TIMELINE OF REPORTINGNZ PUBLICATIONS		
Special topics	Research document	Data set
<b>Topic 3: Voluntary reporting frameworks</b>		
(3) Voluntary reporting frameworks	Working paper 2019/05 – Reviewing Voluntary Reporting Frameworks Mentioned in 2017 and 2018 annual reports (September 2019)	NZSX-listed company annual reports 2017 [126] 2018 [123] 2019 [130]* [was 120 in May 2020*]
	Working Paper 2020/05 – Reviewing Voluntary Reporting Frameworks mentioned in 2019 Annual Reports (June 2020)	Deloitte Top 200 company annual reports 2017 [158] 2018 [161] 2019 [173]* [was 101 in May 2020*]
	Updating this report in May 2021 (post-COVID-19)*	Government department annual reports 2017 [29] 2018 [30] 2019 [32]
	Crown agents and Crown entities annual reports 2017 [65] 2018 [63] 2019 [57]	District health board annual reports 2017 [20] 2018 [20] 2019 [20]
		Crown Research Institute annual reports 2017 [7] 2018 [7] 2019 [7]
		Local authorities annual reports 2017 [78] 2018 [78] 2019 [78]
		State-owned enterprises annual reports 2017 [13] 2018 [12] 2019 [9]
<b>Topic 4: Outstanding annual report disclosure issues</b>		
(1) Risks	Working Paper 2020/02 – The Role of a Directors' Report: An analysis of the legislative requirements of selected Commonwealth countries (May 2020)	
	Legal Opinion 2020/02 – Obligations on directors to report risk in New Zealand annual reports under the Companies Act 1993 (May 2020)	
(2) Climate-related information	Working Paper 2018/03 – Analysis of Climate Change Reporting in the Public and Private Sectors (July 2018)	Crown agent and Crown entity annual reports 2017 [65] 2018 [63] 2019 [57]
	Working Paper 2019/06 – Updated Analysis of Climate Change Reporting in the Public and Private Sectors (September 2019)	State-owned enterprise annual reports 2017 [13] 2018 [12] 2019 [9]
	Working Paper 2020/04 – Analysis of Climate Reporting in the Public and Private Sectors (June 2020)	Local authority annual reports 2017 [78] 2018 [78] 2019 [78]
APPENDIX 1   TIMELINE OF REPORTINGNZ PUBLICATIONS		
Special topics	Research document	Data set
(2) Climate-related information (cont.)	Legal Opinion 2020/02 – Obligations on directors to report risk in New Zealand annual reports under the Companies Act 1993 (May 2020)	District health board annual reports 2017 [20] 2018 [20] 2019 [20]
	Updating this report in May 2021 (post-COVID-19)*	Crown Research Institute annual reports 2017 [7] 2018 [7] 2019 [7]
		Deloitte Top 200 company annual reports 2017 [118] 2018 [161] 2019 [173]* [was 101 in May 2020*]
		Government department annual reports 2017 [29] 2018 [30] 2019 [32]
(3) Gender and cultural representation	Working Paper 2018/02 – NZSX-listed Company Tables (March 2018)	NZSX-listed company annual reports 2016 [126] 2019 [130]* [was 120 in May 2020*]
	Research undertaken specifically for Report 17 looking at 2019 annual reports of NZSX-listed companies.	
	Updating this report in May 2021 (post-COVID-19)*	
(4) Health and safety	Working Paper 2018/02 – NZSX-listed Company Tables (March 2018)	NZSX-listed company annual reports 2016 [126] 2019 [130]* [was 120 in May 2020*]
	Research undertaken specifically for Report 17 looking at 2019 annual reports of NZSX-listed companies.	
	Updating this report in May 2021 (post-COVID-19)*	
(5) Political donations	Working Paper 2018/02 – NZSX-listed Company Tables (March 2018)	NZSX-listed company annual reports 2016 [126] 2019 [130]* [was 120 in May 2020*]
	Research undertaken specifically for Report 17 looking at 2019 annual reports of NZSX-listed companies.	
	Updating this report in May 2021 (post-COVID-19)*	
(6) Tax paid in cash to the New Zealand government	Working Paper 2018/02 – NZSX-listed Company Tables (March 2018)	NZSX-listed company annual reports 2016 [126]
	Research undertaken specifically for Report 17 looking at 2019 annual reports of NZSX-listed companies.	N/A
(7) Penalties	Nuplex v Auckland Regional Council (2003)	N/A
(8) Intangible assets	Research undertaken specifically for Report 17 looking at 2017 annual reports of NZSX-listed companies.	Existing international research NZSX-listed company annual reports 2017 [126]
<b>Topic 5: Assurance</b>		
	Working Paper 2018/02 – NZSX-listed Company Tables (March 2018)	NZSX-listed company annual reports 2016 [126]
	Updating this report in May 2021 (post-COVID-19)*	2019 [130]* [was 120 in May 2020*]

## Appendix 2: Articles for the New Zealand Accountant's Journal (2005 and 2006)

# Managing the risk of a 'bird flu' pandemic – a Chartered Accountant's perspective

By Wendy McGuinness



Wendy McGuinness is an Institute Councillor and member of the Sustainable Development Reporting Committee. She is a risk management consultant and editor of [www.sustainablefuture.info](http://www.sustainablefuture.info).

International concern about the so-called "bird flu" continues to rise, and a growing number of companies are realising they need to launch their own "pandemic contingency plan", as reported in the *Financial Times* in October.

Myles Druckman, vice-president of medical assistance at International SOS, a US-based medical consultancy with 6,400 corporate clients, stresses that while companies may have general contingency plans in place, "you have to tailor your responses to a potential pandemic, which are a little different from, say, a bomb ... A pandemic is a phased process and you need to be able to respond differently at different stages."

In this article I review the current landscape and provide a general context for further thought and discussion. To this end, Chris Peace of Risk Management Ltd has contributed a graphical assessment of the pandemic risk compared with other, national scale risks; and Rachel Farrant, a partner at BDO Spicers, has supplied some responses to key questions about what a pandemic might mean for Chartered Accountants in public practice.

### The current landscape

A seminar held at Te Papa in Wellington on 1 November by the New Zealand Society for Risk Management Inc, entitled *Avian influenza (bird flu) – the next pandemic?* (sponsored by MARSH, Solid Energy – Coals of New Zealand, URS New Zealand, Air New Zealand and ACC), drew the big picture. Table 1 outlines seven key observations from the seminar.

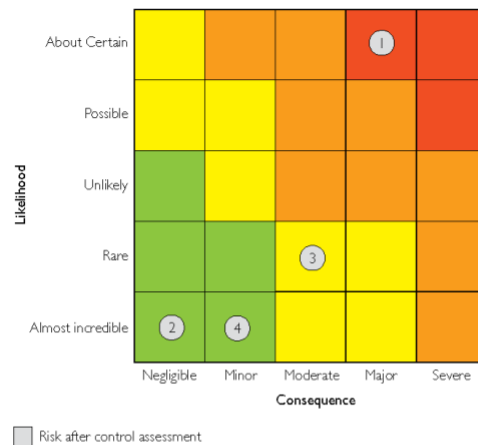
The scale of risk due to an influenza pandemic is significant as shown in Figure 1, where the risk levels (after taking into account current controls) of four events are mapped and compared: the influenza pandemic (risk 1), a nuclear-powered ship suffering a radiation leak in Wellington harbour (risk 2), a major earthquake in Wellington (risk 3) and a Boeing 737 crash (risk 4). As can be seen, the current level of control for an influenza pandemic still

leaves the country exposed to a high level of risk, whereas the other risks are at much more acceptable levels.

As suggested by Druckman, the seminar clearly identified that a phased process was likely, and that each phase would require a different response. Consequently, it is clear businesses, communities and families should plan for:

- (i) a potential full border closure until a vaccine is developed.
- The period of time between the first outbreak and the development of the appropriate vaccine will be a critical factor in managing the risk. This is currently expected to be in the range of six weeks to six months. Consequently, the longer New Zealand can keep the virus out (i.e. reduce the gap), or ideally, completely prevent the virus entering New Zealand (resulting in the second phase not occurring), the fewer negative effects on human health and the economy.

Figure 1. Controlled Risk Matrix: national scale risks in New Zealand



Risk	Control Consequence	Control Likelihood	Control Risk
1 Avian influenza – national impacts	Major	Almost certain	Extreme
2 Radiation from nuclear powered ship	Negligible	Almost incredible	Low
3 Earthquake on the Wellington fault	Moderate	Rare	Medium
4 B 737 crash – domestic flight	Minor	Almost incredible	Low

(Source: Risk Management Ltd, November 2005)

(ii) a potential influenza pandemic within New Zealand.

If the pandemic arrives, New Zealand should expect as many as three waves over a six-month period. Each wave of infection should be over in around eight weeks and most sickness will be concentrated in the middle of this period. Hence, in each wave, there may be a number of weeks where it would not be possible to conduct business as usual.

Directors and managers may find it useful to consider in advance how to operate their business if the border is closed, or in the second phase, how they can best maximise the health of their staff and families, maintain the value of their assets (cash, crops, animals, etc) and manage distribution systems, maintain critical infrastructure assets and services and where possible, meet the new needs of the wider community where people will be sick and/or absent.

Planning for these two contingencies will not only soften the blow if a serious influenza does develop, but as an island nation, any actions taken now must significantly improve New Zealand's recovery from a wide range of potential disasters in the future.

### A pandemic contingency plan

New Zealand business has, in the past, had to manage significant external risks, notably the 1998 power failure in Auckland. The subsequent inquiry and resulting report, "Auckland Power Supply Failure 1998: The Report of the Ministerial Inquiry into the Auckland Power Supply Failure", discussed the governance and accountability role of public companies' directors. Table Two provides an excerpt.

The power failure not only resulted in a general improvement in risk management but also is perhaps our most recent example of how firms can adapt and respond to such external risks. For example, as noted in Telecom's 1998 Annual Report (p8): "When the power failed in central Auckland, some extraordinary efforts by Telecom helped keep businesses running. Staff and their computers were able to move to premises outside the blacked-out area, often into their own homes, because Telecom provided the essential links to alternative workplaces and started a huge programme of free Call Diversions."

Preparing a pandemic contingency plan is a new concept that raises a number of questions for Chartered Accountancy firms with, as yet, very few answers.

### A Chartered Accountant's perspective

Rachel Farrant, a partner at BDO Spicers (Wellington), has some answers to key questions about the potential risks of bird flu and how the resulting impacts could be managed.

#### 1. Has BDO Spicers discussed in detail the potential risk of a pandemic and if so, to what degree is a pandemic contingency plan in place?

A bird flu pandemic has only recently appeared on our radar. We are aware of the October 2005 reports by the Ministry of Economic Development and the Ministry of Health, in particular the Business Continuity Planning Guide. The issue has been raised at a partners meeting and we have discussed the need to review our current contingency plan, but we have not yet completed the process. As we currently have a policy of providing flu vaccines

to all staff, I expect we would continue this practice by offering staff the bird flu vaccine, once it is developed.

In a general sense, a pandemic has consequences for both our firm and our clients, so issues like "key man insurance", wills, succession planning, maintaining accurate contact details, flexible working hours, maximising the health of staff and clients (for example, "if you are sick, stay home", quality hand-washing, minimising shaking hands, maximising availability of tissues), and considering issues surrounding tax deductibility of pandemic expenditure and legal liability, will have to be addressed.

#### 2. Have any issues been raised by staff or clients?

Not to date, although one IT client has discussed buying masks and also, if necessary, the new vaccine. In my view, although a small number of people are worried about the implications, most see the risk in the same context as SARS and Y2K – that is, "crying wolf".

#### 3. After reading the seven key observations in Table 1, can you provide your thoughts on the potential implications for staff, clients and the community, under both phases, that is:

##### (i) a potential full border closure until a vaccine is developed (from six weeks to possibly as long as six months)

This would impact on international business and staff travel. Obviously staff being trapped overseas is a serious concern. In regard to business services, we have international offices, so I expect we could easily outsource international commitments and offer reciprocal services.

Many of our clients would not initially be affected by closing the border; but businesses operating in the tourist industry and exporters sending goods by air would immediately feel the full effects. Relevant issues would include storage of perishable products, redundancies and subsequent cash flow problems for those with high fixed costs. It may take several weeks for the full effects to ripple through to other parts of the economy but there may be some winners. For example, New Zealand's home-grown produce, lifestyle products and services, and medical and nursing products and services may experience increased turnover. Other entities may also find a little bit of Kiwi ingenuity goes a long way – for example factories previously dependent on imports may either change methods of production or divert resources to other products.

In this phase, I imagine that BDO Spicers will put additional resource effort into preparing for the worst case – the arrival of deadly avian flu in New Zealand. Hence our focus would be two-fold - helping our clients through the initial impacts of a border closure while working to develop long-term strategies and practices to manage the effects of a potential pandemic in New Zealand.

##### (ii) a potential influenza pandemic within New Zealand

Provided the IT systems are working, I can imagine a scenario similar to the Auckland power crisis in 1998. Current policy at BDO Spicers is that only partners can take files home, but as indicated in 1998, extreme situations call for extreme solutions.

During the power crisis many of the Auckland staff either worked from home or other locations around the city. Importantly, the focus was on urgent tasks rather than what was important in

the long term (i.e. tasks that could be left a few months). Naturally, anything to do with cash was given a high priority.

In a pandemic, government expenditure is likely to be significant while at the same time, the tax take could hit an all-time low. Consequently, reporting requirements, like those of the NZX and Inland Revenue, may need to be more flexible to meet the significant challenges of auditing and verifying information at a time of high absenteeism and travel restrictions.

In addition, creditors, banks and other financial institutions will be challenged by clients unable to pay interest or invoices, and a flexible approach will need to be developed in order for businesses to recover quickly. Some industries will be able to recover more quickly than others and the speed of recovery will depend on which groups are affected. For example, restaurants, gyms and movie theatres should recover very quickly, whereas other sectors may struggle.

For the accounting profession, the closure of PCE1 and PCE2 educational colleges may create a gap in the expertise in the accounting profession that could be felt for a number of years to come. However, this may be easily resolved by emailing assignments.

#### Further information

Information on the probability of a pandemic and the management of the possible consequences of a pandemic is constantly under review. Those interested should refer to the following websites: in New Zealand, [www.med.govt.nz/irdev/econ\\_dev/pandemic-planning/index.html](http://www.med.govt.nz/irdev/econ_dev/pandemic-planning/index.html) and [www.moh.govt.nz/pandemicinfluenza](http://www.moh.govt.nz/pandemicinfluenza), and internationally, [www.who.int/csr/disease/avian\\_influenza/en/](http://www.who.int/csr/disease/avian_influenza/en/). For those interested in understanding how New Zealand coped with the 1918 influenza pandemic, check out a book called *Black November*, by Geoffrey W Rice (revised edition 2005, Canterbury University Press), now on sale.

#### Table One: Seven key observations from the seminar on *Avian influenza (bird flu) – the next pandemic?*

1. Scientists agree there will be another influenza pandemic but it is not possible to predict when this might occur. There have been three in the last century. Influenza spreads readily from person to person via droplets and aerosols (sneezing) and hand/mouth transmission.
2. The pandemic may or may not be deadly enough to require the closure of the New Zealand border.
3. The key triggers for closure of the New Zealand border currently include:
  - (i) The World Health Organisation (WHO) confirms sustained human-to-human transmission (although WHO does not encourage countries to close their borders as a control procedure)
  - (ii) New Zealand officials strongly suspect human-to-human transmission overseas
  - (iii) Australia and/or Singapore close their borders.

#### If deadly but not in New Zealand

4. Past experience and mathematical modelling indicate that a partial border closure is unlikely to work. Consequently full border closure is the only solution and this may have to be sustained for many months, until a vaccine is available. Notably, New Zealand residents overseas may be required to stay away, overseas residents may be required to stay (NZ has approximately 200,000 international visitors a month) and will need to be accommodated, and all imports and exports stopped (with the possible exception of essential supplies) for a maximum of six months.

#### If deadly and in New Zealand

5. There will be isolation of the sick. This will mean the need for timely testing (probably by swabs) to detect the early entry of the virus to NZ, and possibly the timely creation of flu hospitals (i.e. in days/weeks). Options might include quarantine, closure of buildings/areas, a restriction on public gatherings, minimal internal travel and closures of schools and universities. These options may or may not slow the spread of illness. To be successfully implemented, such an approach will require major public support.
6. What is clear is that once bird flu is in New Zealand it will be very difficult to manage because:
  - (i) patients are likely to be contagious 24 hours before symptoms develop – children may be infectious for up to three weeks (hence the proposal to close schools)
  - (ii) some patients may be contagious but never develop symptoms
  - (iii) other individuals may have symptoms but not have the pandemic flu. (If human to human transmission does occur, bird flu symptoms are likely to initially appear similar to today's viruses.)
  - (iv) hospitals are likely to be full (they are currently approximately 90% full) and may neither have the beds nor wish to risk transmission to already unwell patients. Although a range of options are being developed for expanding acute sector capacity, the public may be asked to assist with the care of contagious patients in their own homes.
7. Past pandemics have dissipated over time and it is likely that this one would follow the same pattern. For example, past pandemics did not have Tamiflu, national health emergency plans or laboratories ready to develop, manufacture and distribute vaccines – but we do have a significant risk, which if managed well may not only save lives but also provide an effective and timely management structure to hasten our economic, social and environmental recovery.



**Table 2: Auckland power failure 1998**

In the "Auckland Power Supply Failure 1998: The Report of the Ministerial Inquiry into the Auckland Power Supply Failure", the governance and accountability role of public companies in regard to risk management was discussed and is outlined below.

"In public companies directors owe their duty to the company as a whole and not to any individual shareholders, or groups of shareholders. They must take into account the longer-term interests of the company, including the interest of future shareholders, as well as the immediate situation; this requires that directors strive to enhance shareholder wealth in perpetuity rather than maximise short-term benefits to satisfy the particular demands of individual shareholders or classes of shareholders.

"However, since the ongoing prosperity of a company depends to a large extent on its stakeholders being content with its performance and having regard to its future, directors and management must have continuing regard to the interests of stakeholders such as creditors, employees and the community in which it operates. In particular, companies depend on their customers for their revenue and it is essential that they strive to maintain and increase customer satisfaction as far as it is consistent with their other responsibilities ... Because companies vary greatly in size, complexity and ownership structure and the quality and experience of the people involved also vary it is difficult to set out a simple formula for good governance. Certain basic requirements must always be met, however, and there are principles and practices that have been found to be valuable in all or most circumstances.

"One of the most basic requirements is that a company manages its risks. The board is responsible for the stewardship of the company's assets, for its reputation and for arranging its affairs so that its ability to generate profits and to grow is not undermined. The board must satisfy itself that the risks facing the business have been identified and evaluated and that those that are likely to occur, and/or carry the most serious consequences if they do occur, have been adequately dealt with.

"The Australian/New Zealand Standard on Risk Management (AS/NZS 4360:1995) sets out a generic framework for risk assessment. There is no suggestion that a board needs to carry out the detailed process itself, but it has a clear responsibility to decide what process the company should adopt and to ensure that it is implemented properly." ■

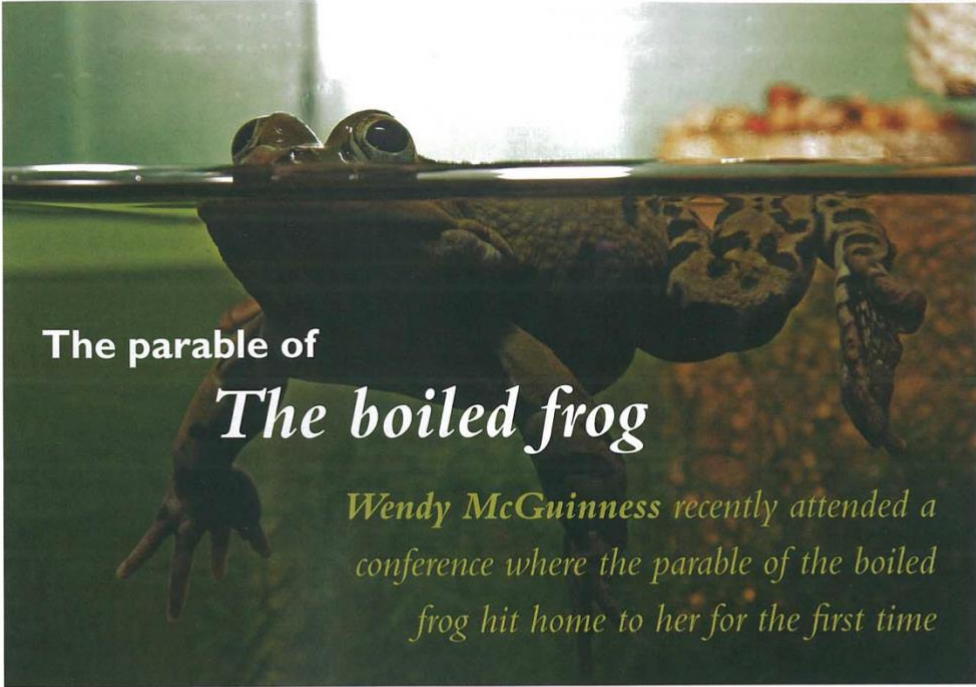


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The parable of  
*The boiled frog*

*Wendy McGuinness recently attended a conference where the parable of the boiled frog hit home to her for the first time*

Institute Councillor Wendy McGuinness is a risk management consultant and editor of [www.sustainablefuture.info](http://www.sustainablefuture.info).

The parable of the boiled frog (see box) was quoted at Victoria University of Wellington's recent Climate Change and Governance Conference in March to highlight global warming and for the first time, the parable hit home.

This article attempts to bring together what the "global warming marketplace" means for business and non-profit organisations in New Zealand. In particular, it considers the risks and opportunities that Chartered Accountants may wish to discuss with their clients. Naturally, the answers to scientific questions are still being debated; for example how much carbon is too much? Is there a tipping point? To what extent is global warming reversible? But what is clear is that very few scientists are arguing that global warming, to excuse the pun, is simply a load of hot air.

A comparison of global warming with other global risks, like the bird flu pandemic, shows that the differences are significant. A pandemic, should it arise, will be an immediate and visible crisis. Response preparation focuses both on how we should manage the risks until we have access to a vaccine and how to minimize transmission until the risk recedes. We are fortunate we can learn from past experiences and have the technology to reduce and (arguably) manage the risks.

Unfortunately, we do not have this luxury with global warming. We are largely part of an experiment and as such, the optimal solution is complex and requires an inclusive approach. The optimal approach must, by its very nature, include engagement

**The parable of the boiled frog**

"If you place a frog in a pot of boiling water, he will immediately try to scramble out. But if you place the frog in room temperature water, and don't scare him, he'll stay put. Now, if the pot sits on a heat source, and if you gradually turn up the temperature, something very interesting happens. As the temperature rises from 70 to 80 degrees F, the frog will do nothing. In fact, he will show every sign of enjoying himself. As the temperature gradually increases, the frog will become groggier and groggier, until he is unable to climb out of the pot. Though there is nothing restraining him, the frog will sit there and boil. Why? Because the frog's internal apparatus for sensing threats to survival is geared to sudden changes in his environment, not to slow, gradual changes."

– Senge, *The Fifth Discipline*, 1990, p22

by global, national, local, and organisational entities and individuals. Such a solution will not only focus on a range of solutions, but also demand the monitoring and reporting of progress and a great deal of that most critical element, leadership.

What is clear is that scientists consider that there are two types of solutions. We must turn down the thermostat, meaning we "mitigate" the risk by reducing CO<sub>2</sub> and other greenhouse



gas emissions and we must also develop and put in place tools and technologies that help us “adapt” to being in “hot water”. This means we need to find ways to live with chaotic climates, such as we are now beginning to experience.

Business will be affected by global warming in three different ways. First, organisations will continue to face the primary effects of global warming. (A list from the conference is provided in Table 1.) Second, organisations will be affected by mitigation strategies; and last by adaptation strategies. Many of the mitigation strategies outlined in Table 2 and the adaptation strategies in Table 3 provide huge opportunities for businesses. Table 4 attempts to provide insights into the characteristics of the new “global warming marketplace”. Readers interested in the underlying scientific evidence or more timely information on the effects outlined in Tables 1-4 may like to refer to the websites listed at the end of this article.

**Primary effects**

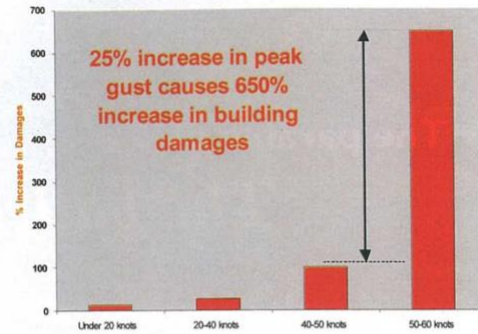
The broad pattern of change expected in New Zealand and the Pacific is outlined in Table 1. In addition, a New Zealand report, *Climate Change Effects and Impacts Assessment: A Guidance Manual for Local Government in New Zealand* (May 2004) predicts that we can expect increased temperatures (with greater increases in the winter season, and in the north of New Zealand), decreased frost risk but increased risk of very high temperatures, stronger west-east rainfall gradient (wetter in the west and drier in the east), increased frequency of extreme (heavy) daily rainfalls, increased sea level and increased westerly winds. The projected range of possible sea level changes around New Zealand by 2100, (corresponding to the full IPCC global temperature projection range), is 9-88 cm.

**Table 1: Primary effects over time may include**

- a tendency towards increased annual rainfall in the south and west of New Zealand, and decrease in the north and east
- higher annual average temperatures, fewer frosts and more hot days
- sea level rise, with resulting pressures on some low-lying island and coastal locations
- snowline rise, shortened duration of seasonal snow lying
- increased peak wind and rainfall intensity in tropical cyclones in some regions (refer Figure 1)
- heavier and/or more frequent extreme rainfalls, especially where more rain is predicted; increasing flood risk
- increasing drought risk for soils in already drought-prone eastern areas
- new health effects
- islands under stress may create increased immigration for Australia and New Zealand

- mass migration of the human and animal populations in Africa, India and Central Europe away from areas which are extremely hot, prone to flooding or stormy; some other things (such as coral) will not be able to migrate.

Figure 1: Small changes in hazard intensity can lead to multiple increases in damages (Source: IAG Insurance Australia Group)



From a Pacific perspective, Enele Sopoaga, vice-chairman of the Alliance of Small Island States (AOSIS) stated at the conference that “for someone who comes from a nation with a unique lingual, a unique cultural and a unique way of life, the thought that my nation may become uninhabitable in possibly my lifetime or in the lifetime of my children, is very distressing. Yet there continues to be denial that the climate is changing” (see picture).



**Mitigation strategies**

A range of mitigation strategies are being discussed and a number are already being implemented (Table 2).

**Table 2: Mitigation strategies**

**Global**

- Treaties to mitigate emissions and maintain energy security (the two issues have elements in common). Countries undergoing large economic growth may require more stringent efforts to lower emissions

- Emissions/carbon trading systems (cap and trade)
- Ensuring that higher prices for oil flow through to consumers (supply will not be the issue, pricing will)
- Governments using taxes to reduce demand. – e.g northern Europe
- Accelerating a transition to a hydrogen economy
- Strong emphasis on renewables (e.g biofuels, wind) development and energy security
- Research into energy storage technologies
- Carbon capture and storage technologies
- Other technologies – solar; nuclear power; biofuels derived from waste by-products like tallow/animal fat, or wood waste; interestingly there may be no need for GM technology as conventional breeding techniques may suffice

**Nationally**

- Taxes and other signals in the marketplace to reduce demand for carbon-intensive fuel (note however; that a broad-based carbon tax has recently been abandoned in New Zealand)
- Promotion of renewables, including wind, solar; biofuels
- Vehicle testing and fuel standards
- Research into carbon storage
- Emission trading systems
- Stronger regulations on private sector emissions and pollutants

**Adaptation strategies**

A range of adaptation strategies are being discussed and a number are already being implemented as outlined in Table 3.

**Table 3: Adaptation strategies**

**National and local**

- New engineering technologies to manage floods and water level rises, like dams and building techniques
- Higher building standards for energy use reduction, flooding and storms
- Transportation systems as part of the sustainable cities programme

- Managing the availability of water
- Managing the impact of extreme weather events
- Managing changes in agricultural practices

**The relationship between governance and strategies**

In practice, what Tables 2 and 3 indicate is that "global and national initiatives" will need to focus on mitigation strategies and sharing global experiences while "organisational and individual initiatives" will need to focus on adaptation strategies. Local councils will need to apply both types of strategy. However, even local actions and initiatives need guidance and support from national and regional governments. Figure 2 attempts to reflect the relationship portrayed at the conference between the types of strategy appropriate to the different governance groups.

Importantly, business must embrace a risk management approach, take a long-term view and engage with stakeholders. There may be some positive effects but as stated in the Association of British Insurers Report: Financial Risks of Climate Change (2005): "We need to understand the consequences of climate change to make informed choices about the future. Policy-makers should incorporate financial assessments of the impacts of climate change on extreme weather, as well as on average weather; in cost-benefit analyses of options."

**Table 4: Characteristics of the new "global warming marketplace"**

Note: Many provide both an opportunity and threat.

- Some form of price on carbon (e.g via a carbon tax)
- Higher insurance premiums for extreme weather as a result of increased claims
- More insurance restrictions
- Increased demand for skills in weather prediction and timely weather reporting
- Higher prices for oil and other fossil fuels
- Higher prices for water (water by bottle is already more expensive than petrol)

Figure 2: The relationship between governance and strategies. (Source: McGuinness and Associates)

