



17 December 2015

## NZX review of corporate governance reporting requirements – Z Energy’s submission

### Objectives and proposed framework

Z supports updating the Corporate Governance Best Practice Code (NZX Code). The reporting provisions within the NZX Code have not been updated since their introduction in 2003. Z agrees with NZX that, as a result, there is a lack of consistency, which needs to be addressed, between the NZX Code and more recently updated regimes such as the ASX Corporate Governance Principles and Recommendations (ASX Principles), the Financial Markets Authority’s ‘Corporate Governance in New Zealand Principles and Guidelines’ (FMA Handbook) and the NZ Corporate Governance Forum (NZCGF) guidelines.

Z agrees with the principles and proposed structure of the updated NZX Code. Specifically, Z supports using:

- the nine principles outlined in the FMA Handbook as a basis for the updated NZX Code to ensure consistency between the two regimes (noting these principles were also used as a basis for the guidelines released by the NZCGF and are broadly consistent with ASX Principles);
- a tiered approach to reporting according to principles, recommendations and commentary; and
- recommendations of a more prescriptive nature to be met on a “comply or explain” basis.

Where possible, in updating the NZX Code, NZX should make every effort to ensure consistency between the various regimes in operation in New Zealand and Australia.

### Principle 2: Board composition and performance

*Question 14: Should NZX address anything else in this area, including within best practice commentary?*

Z’s view is NZX should address diversity under Principle 2 of the NZX Code. Diversity encompasses gender, race, ethnicity, disability, age, sexual orientation, physical capability, family responsibilities, education and cultural background. At Z we believe that diversity within our workforce makes our organisation stronger and more capable. With a diverse team we are more able to understand our broad-ranging customer and stakeholder needs and to respond effectively to them.

As stated in the NZX Guidance Note on Diversity Policies and Disclosure (NZX Guidance Note), Z agrees with NZX that diversity in a variety of forms, and gender diversity in particular, contributes to improved performance at both board and senior management level, through promoting additional and broader perspectives in approach, leadership, problem-solving and thought.



As referred to on page 12 of the discussion document, NZX recently introduced new Listing Rule requirements in relation to diversity on boards and in senior executive roles<sup>1</sup>. The rules do not require an issuer to adopt a diversity policy. However, should an issuer choose to adopt one, the NZX Guidance Note includes suggestions as to the content of a diversity policy and examples of measurable objectives that issuers may wish to set for themselves.

Z considers the new Listing Rules and NZX Guidance Note will be more effective if the NZX Code contains a recommendation that issuers adopt a diversity policy, establish measurable objectives for achieving appropriate diversity within its senior management and board and report on progress made in achieving such objectives. Z notes this is consistent with ASX Principles and the NZCGF guidelines. The NZX Guidance Note could be updated and referenced under best practice commentary to provide context to issuers in applying this recommendation.

Best practice commentary should also encourage issuers to adopt numerical targets for measuring performance against diversity in the broader sense – not just gender diversity. Z agrees with the ASX Principles in that adopting a diversity policy is unlikely to be effective in itself unless backed up with appropriate numerical targets.

Z notes that on page 13 of the discussion document, in the context of gender diversity, NZX states they do not support the use of quotas. Z questions this view given the significant body of evidence to support the efficacy of quotas in achieving improved gender ratios on boards and in management. Z also thinks this statement is inconsistent with the NZX Guidance Note, which states:

*While NZX is not prescribing quotas, issuers may wish to adopt numerical targets if they consider that it is in their best interests. If an issuer does commit to a particular target, NZX would expect it to report against that target in its annual report in compliance with rule 10.4.5(k). However, NZX is not mandating the adoption of targets.*

Other suggestions within commentary are to encourage issuers to extend metrics beyond senior management and board level to all layers of the organisation, to include pay equity in diversity reporting and for issuers to consider ethnicity, in particular, as a priority in achieving diversity and in their reporting.

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<sup>1</sup> Listing Rule 10.4.5(j) requires issuers to include a quantitative breakdown of the gender composition of the issuer's directors and officers in their annual report. Listing Rule 10.4.5(k) requires issuers to contain a statement from the board providing its evaluation of the issuer's performance with respect to its diversity policy (if applicable) in their annual report.

#### Principle 4: Reporting and disclosure

*Question 19: Should NZX introduce any additional recommendations or best practice commentary in relation to non-financial reporting matters, including ESG disclosures?*

Non-financial reporting is an area where Z would like to see significant change. Z has always been committed to values-based reporting as we believe this provides the context required for our stakeholders to understand the way we operate and why we do what we do. Z also believes in providing investors with insight into how we create value over the long term, which is about economic, environmental and social – as well as financial – sustainability.

As referred to on page 17 of the discussion document, there is a growing trend for exchanges to provide ESG reporting guidance and Z believes NZX is aptly placed to play a role in improving the quality of ESG/sustainability reporting in New Zealand. ESG/sustainability factors are increasingly becoming a part of the investment decision-making process and issuers will improve their access to capital by providing transparency in these areas.

Z considers the NZX Code should contain a recommendation that issuers report their performance in relation to ESG/sustainability. This will:

- give issuers' financial performance a wider social, environmental and economic context;
- provide a better picture of the total value an issuer generates for society – not just financial value;
- highlight how issuers create value over the short, medium and long term;
- facilitate the sharing of values;
- increase issuers' accountability for their non-financial impacts to enhance trust from employees, investors and stakeholders; and
- provide investors with adequate information to assess the impact and contribution of businesses to the wider economy and to understand which issuers may be a better investment in the long term.

Best practice commentary is of particular importance here to provide guidance to issuers in terms of what high quality ESG/sustainability reporting looks like. Under best practice commentary, NZX should encourage companies to use a recognised international reporting framework. At present there are two well-recognised international frameworks – the Global Reporting Initiative (GRI) and Integrated Reporting (IR). These frameworks can be used simultaneously.

GRI's aim is to assist reporting organisations and their stakeholders in articulating and understanding an organisation's contribution to sustainable development. GRI provides metrics and methods for measuring and reporting sustainability-related impacts and performance. Z uses the Global Reporting Initiative, which ensures we disclose our most critical impacts – be they positive or negative – on the environment, society and the economy.



The IR framework is aimed at the long-term investor and requires companies to identify the interdependency between all internal and external elements that materially affect their ability to create value over time. These elements include intangible assets such as intellectual capital, research and development, brand value, natural and human capital. These intangible assets are not universally assessed under current financial reporting frameworks despite their important contribution to a company's market value. The concept of IR is explained more fully in EY's report [Integrated reporting: Elevating value](#). Z is working towards integrating IR into annual reporting from FY17 (alongside GRI).

Using one of these recognised international frameworks will assist issuers to incorporate ESG/sustainability factors into their reporting effectively and enable investors and stakeholders to draw comparisons between issuers by providing an external standard against which a company's non-financial performance can be measured.

#### **Principle 5: Remuneration**

*Questions 21. Should NZX introduce recommendations as follows?*

- a. Issuers must publish a remuneration policy dealing with remuneration of directors and senior executives.*
- b. Senior executive remuneration (including CEO remuneration) should include an element that is dependent on entity and individual performance.*

Remuneration is a key issue for investors. Z believes investors should have insight into a company's remuneration framework and be able to assess whether directors and senior executives are motivated to pursue the growth and success of the company to create sustainable shareholder wealth.

Z is in favour of NZX introducing the recommendations above to provide an adequate level of transparency and to ensure the incentives of executives and shareholders are aligned. Z notes these recommendations will bring the NZX Code more closely into line with ASX Principles.

## Principle 6: Risk management

*Question 25: Should NZX introduce recommendations or best practice commentary covering the following matters?*

- *Issuers should have appropriate policies and procedures in place to identify and manage the key risks facing their businesses.*
- *Issuers should disclose details of their internal audit function, where applicable, or provide explanation of the alternative measures in place.*
- *Issuers should have a staff share dealing policy and disclose details of this.*

Z agrees with NZX that risk management is a significant gap in the current reporting regime. Z considers NZX should include the matters above as recommendations in order to address this gap.

Given the complexity of some issuers' internal audit functions, best practice commentary should provide guidance on the extent of information to be disclosed to ensure consistency across issuers. Disclosure should only be required for areas of material risk and issuers should have the right to refrain from disclosing details of risk management controls that may be commercially sensitive in nature.

*Question 26: Should NZX include specific recommendations or best practice commentary in relation to managing (and reporting of) health and safety risks? If so, which metrics should be reported?*

Health and safety is another area where Z would like to see significant change. New Zealand has an appalling health and safety record with New Zealand workers twice and three times more likely to die at work than their counterparts in Australia and Britain respectively.

Following the Pike River Coal Mine Tragedy (Pike River), the Government and New Zealand businesses agreed New Zealand's health and safety performance was unacceptable and ultimately unsustainable. Changes over the past five years have included new health and safety legislation, a new regulator and a new approach from business. As part of these changes, there has been a drive to increase transparency in health and safety performance. Z believes NZX has a critical role to play in supporting this change.

Both the Royal Commission into Pike River and the Independent Taskforce on Workplace Health and Safety concluded that leadership is the essential ingredient and catalyst for sustainable change in our national health and safety performance. There is an opportunity for NZX to demonstrate leadership by introducing a recommendation that issuers report on their health and safety risks, management and performance. Increasing transparency, improving reporting and sharing learnings through publicly disclosed reports will have a positive impact on our national health and safety culture and will further support the other wider systemic changes in play.



Z supports commentary to provide issuers with guidance on what constitutes best practice health and safety reporting. Z's view is that a standard set of metrics is too difficult to define to suit all issuers and could result in lagging indicators of limited value. Instead, commentary should encourage issuers to report their commitment and approach, their progress against strategy and the outcomes they have achieved including injury and illness metrics. Reporting should take into account the risk in the business as well as the wider supply chain.

Rather than prescribing specific metrics, this approach gives issuers flexibility to determine what they report depending on their risk profile and provides stakeholders with more useful insights into a company's performance. Reporting driving incidents for a business with no professional drivers is irrelevant, however this may be the most important measure for a logistics business. Reporting injury frequencies for a high hazard business provides limited insight into how they are managing the risks associated with the processes they manage. Reporting outcomes is not the most effective measure for a business that chooses to contract out risk management via their supply chain.

There is no 'one size fits all' for health and safety reporting but Z notes [Safe Work Australia's approach](#) is very good despite being ten years old. Z would welcome any further opportunity to contribute to the development of best practice commentary in this area.

*Question 27: Should NZX recommend/suggest that issuers specifically report on economic, environmental and social sustainability (or ESG) risks?*

Z's view is that investors and stakeholders should have visibility into all material risks facing a company, including non-financial risks, and issuers should also be required to disclose how they manage or intend to manage such risks.

Risk management reporting is particularly important to frame ESG under a forward-looking lens. Z supports a recommendation that issuers specifically report on material economic, environmental and social sustainability (or ESG) risks. This supports Z's view under Question 19 relating to non-financial reporting and is consistent with ASX Principles and the NZCGF guidelines.

In order to provide issuers with guidance in terms of high quality ESG risk management reporting, the suggestions made for best practice commentary under Question 19 should also apply here.



## **Principle 7: Auditors**

*Question 29: Should NZX include recommendations or best practice commentary covering the following matters?*

- a. The external auditor should attend the AGM to answer questions from shareholders in relation to the audit*
- b. Issuers should report to shareholders annually in relation to audit and non-audit fees paid to the audit firm*

Z agrees with NZX that current requirements for the appointment and role of external auditors are reasonably comprehensive. Z supports a recommendation that issuers report to shareholders annually in relation to audit and non-audit fees paid to the audit firm. Under best practice commentary, it should be recommended that the external auditor attends the AGM to answer questions from shareholders in relation to the audit.

*Question 31: Should NZX address anything else in this area, including within best practice commentary?*

Z is in favour of an additional recommendation that the CEO and CFO provide a declaration that the financial records of the entity have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the issuer. This is consistent with ASX Principles.