What difference can directors make?

September 2023

KPMG

Chapter Zero New Zealand
The Directors' Climate Forum

Hosted by

Institute of DIRECTORS
NEW ZEALAND

Contents

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> We are looking at a future of unprecedented economic transformation, as businesses look to radically evolve and adapt to the climate crisis. While this change can seem daunting, we encourage directors on all of Aotearoa New Zealand's boards to realise the significant opportunity to lead and navigate the businesses they govern through this crucial period. In your position of influence, you have the ability to lead by example, inspire your colleagues and make a significant positive impact on our future.

Dame Therese Walsh, CFInstD, Chair of Chapter Zero New Zealand

Directors interviewed

This guide has been developed to help directors in Aotearoa New Zealand implement the strategic governance their organisations require to survive and thrive in a climate-resilient world. Developed by KPMG and Chapter Zero New Zealand, this guide is supported by the Institute of Directors New Zealand and was created through interviews with 13 of our country's leading professional directors. These business and community leaders have generously shared insights and practical advice from their own climate governance journeys.

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Aotearoa New Zealand Directors' Guide to Climate Governance

As overseers of risk and stewards of long-term value, providing good climate governance is an essential function of the director's role. The impacts of climate change are increasing in scope and scale. The time to debate the science or politics has passed. Organisations need to act. Directors must guide them.

To meet the Paris Agreement's target of limiting global warming to well below 2°C by 2030, global emissions need to reduce by a further 45 percent (compared with projections based on current policies). Building a low-emissions, climate-resilient global economy at pace is a challenge that requires system-wide transformation at all levels.

New Zealand organisations will need to find strategic ways to contribute to this new environment and ensure they are ready to thrive within it.

The disruptive effects of climate change will be experienced universally. Already, the degree to which specific factors (geography, industry, core value proposition etc) influence an organisation's climate-related risk, is diminishing – along with the notion that any individual or entity can remain unaffected.

There is increasing pressure from banks, insurers, investors and a growing list of stakeholders for organisations to make climate-related disclosures and assurances. Employees, suppliers and customers are all considering sustainability credentials as a core component of an organisation's social licence to operate.

Directors understand the need to ready their organisations for a low-emissions, climate-resilient future. There is excitement and a growing realisation that, when done properly, emissions reduction and transition planning pay their own way via lower costs, increased productivity, and an improved triple bottom line.

This guide sets out two sections of a roadmap for directors who want to deliver strategic climate governance. Firstly, experts from Chapter Zero New Zealand, Institute of Directors and KPMG, alongside our contributing professional directors, outline what good climate governance should look like and include. The second section provides practical advice from professional Aotearoa New Zealand directors about the actions they believe directors can take to drive climate governance within their organisations.

To meet the Paris Agreement's target of limiting global warming to well below 2°C by 2030, global emissions need to reduce by a further

45%

(compared with projections based on current policies).

What Good Climate Governance Looks Like

Rather than being an onerous exercise, responding to the climate crisis is an opportunity for directors to strategically build their organisation's long-term resilience and enterprise value.

Organisational climate governance should have three distinct, but intertwined, strands:

1. **Decarbonisation: How can your organisation reduce its fossil fuel emissions?**
2. **Transition: What changes does your organisation have to make to survive and thrive post climate change?**
3. **Economy-wide transformation: How can your organisation contribute to building the climate-resilient future it will be operating in?**

Directors should consider these questions across three different channels: inside their organisation, across their organisation's value chain and outside their organisation's value chain.

1. Inside your organisation

Strategically guiding an organisation to thrive in a climate-resilient future starts with understanding the likely impacts of climate change. Directors need to consider how climate change will impact their organisation's business model, value proposition and operational output.

Aotearoa New Zealand's External Reporting Board (XRB), Te Kawai Arahi Pūrongo Mowaho, requires entities to use climate scenario analysis to explore the current and anticipated risks and opportunities inherent in different climate change scenarios.

Directors and boards will find parallels between climate governance and 2015's health and safety reforms. They both require a response tailored to, and integrated throughout an organisation. As with health and safety, embedding the consideration of climate-related risks and opportunities as core board business will prioritise it as an essential agenda point of every board discussion.

An organisation's specific climate strategy should focus on decarbonisation and transition.

> **"Taking action at a board level released a powerful energy throughout the entire organisation."**
>
> Jackie Lloyd CFInstD

Cutting carbon

The director's challenge is to develop a strategy that reduces carbon and strengthens long-term resilience. Climate risk mitigation is more than the opportunity to reduce emissions and transition to innovative energy solutions and renewable technologies. It provides directors the opportunity to review and optimise systems and processes, with a view to achieving cost savings alongside productivity gains – and emissions reductions.

Aotearoa New Zealand Climate Standards[1] have been developed and published by the XRB. While the formal reporting requirements only apply to around 200 of our most economically significant entities, the framework and principles will be useful to any organisation wanting to measure, manage and ultimately mitigate its contribution to climate change.

Transitioning to a new reality

The frequency and intensity of extreme weather-related events and their associated disruptions will continue to increase. You need to develop a strategic roadmap to help your organisation change and navigate the challenges posed by climate change, and survive and thrive despite climate disruption. This plan should be created with an opportunistic mindset, seeking to adapt but also generate long-term enterprise value for the business.

Best practice transition planning assesses the material impacts of climate change. It identifies the implications these pose to your organisational model, value proposition and strategy, and it then sets out the appropriate strategic response.

Having to adapt to a rapidly changing environment will be familiar to directors who served through the pandemic lockdowns of 2020 and 2021. However, an organisation's climate crisis transition strategy must go beyond the Horizon 1 thinking that sufficed during Covid.

Instead of only asking, "What do we need to do differently?", directors must extend their thinking to consider, "What do we need to do that's new?" (Horizon 2) and "What might we need to become?" (Horizon 3).

Applying this thinking will lead to economic transformation, not only of the businesses you represent, but a longer-term overall shift in where companies derive their economic value leading to societal economic transformation.

[1] https://www.xrb.govt.nz/standards/climate-related-disclosures/aotearoa-new-zealand-climate-standards/

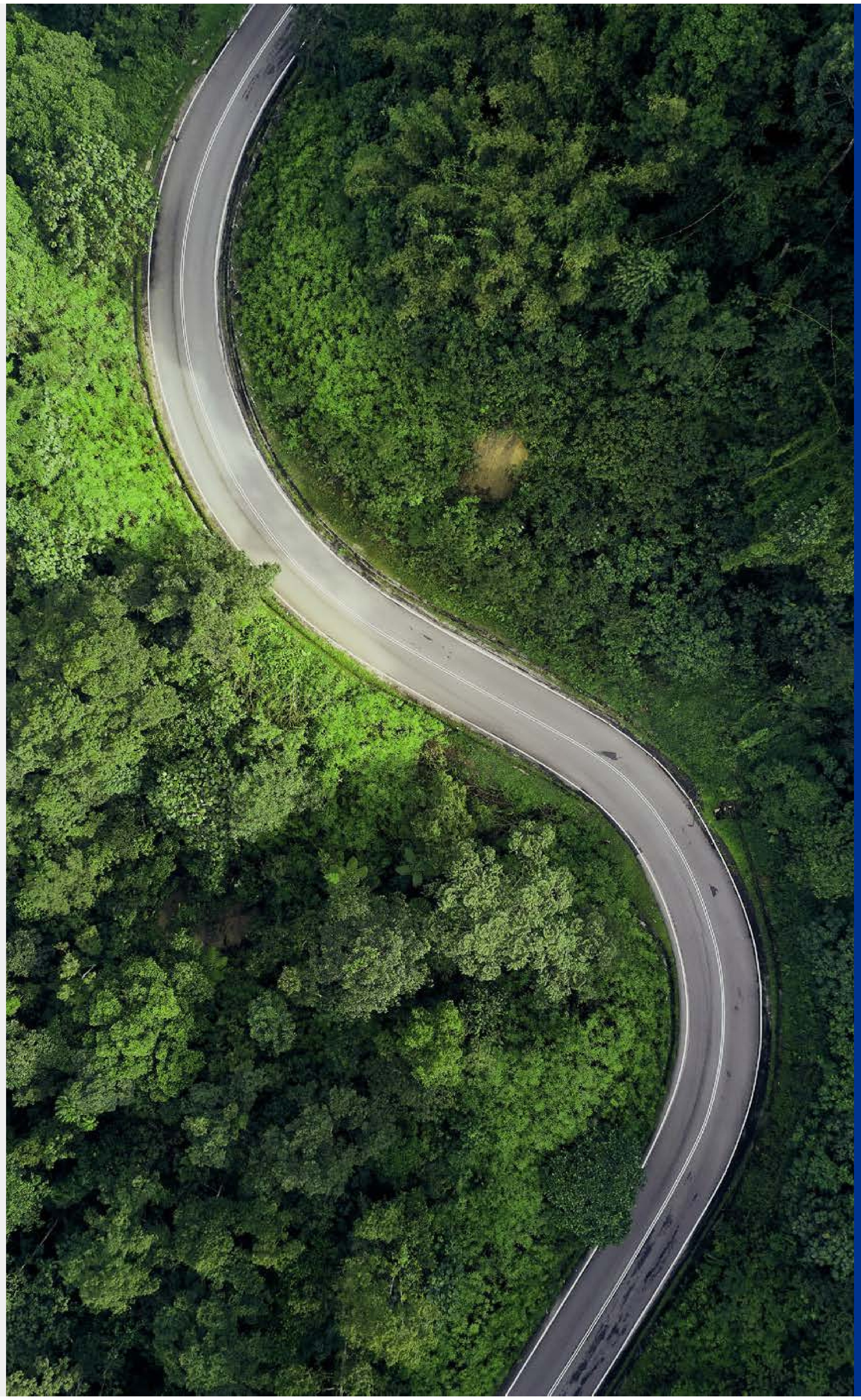
> **Align your response with the purpose of your organisation and what it stands for.**
>
> Amelia Linzey

2. Inside your value chain

The Covid-19 pandemic and resulting supply chain disruptions exposed the vulnerabilities of our interconnected global economy. Good climate governance must therefore examine all the material interdependencies throughout an organisation's total value chain — identifying risk and opportunity as it relates to the natural environment, workers, suppliers, communities and consumers.

A decade ago, value chain governance was the near-exclusive domain of organisations with strong sustainability value propositions. Today an increasing number of lenders, investors, insurers and stakeholders are calling for the organisations they deal with to map and manage risk across their entire value chain.

By strategically cooperating at a governance level with suppliers and other partners, directors can cut collective and individual carbon emissions and identify opportunities for mutually beneficial transition planning.



> "We must engage with shareholders, suppliers and customers. They need to feel confident that we understand the risks and have constructive solutions."
>
> Jane Taylor CFInstD

Inside your value chain

Strengthen your value chain for a stronger organisation.

Compelling reasons exist to extend climate governance across your entire value chain.

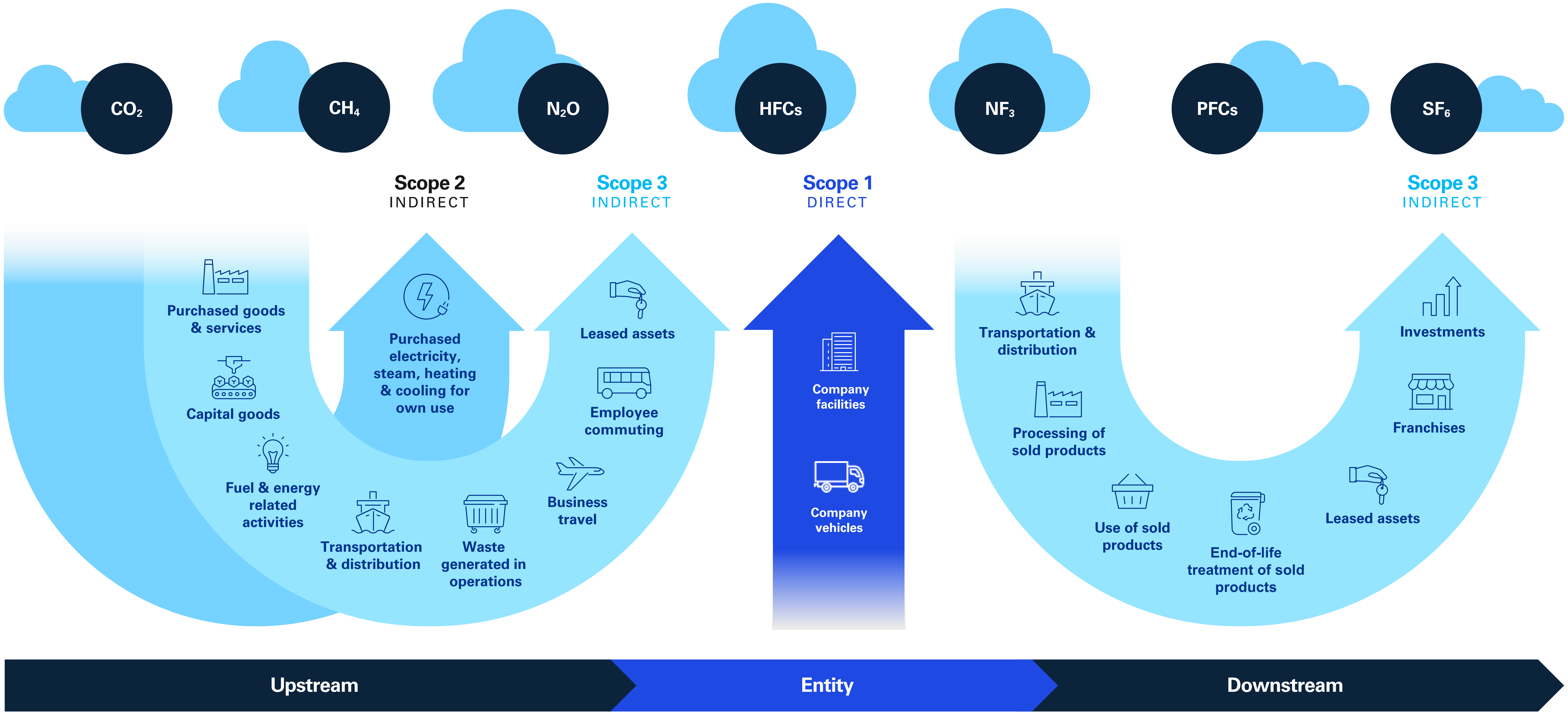
Our supply chain partners' numbers are our numbers.

Literally. Your organisation's Scope 3 emissions are your value chain partners' Scope 1 and 2 emissions. For you to reduce your Scope 3 emissions, they need to reduce their Scope 1 and 2 numbers.

Their risks are our risks.

Climate-related disruptions experienced by your value chain partners create knock-on disruptions. Conversely, improvements to their climate resilience reduce your risk and may create further opportunities.

Inside your value chain



Inside your value chain

Their reputation affects ours.

Consumers are increasingly considering the complete footprint of the brands and products they connect to. Savvy directors strengthen resilience via symbiotically beneficial long-term value chain relationships.

It makes good business sense.

When we look via a long-term governance lens and factor in the increasing importance of social and environmental performance (triple-bottom-line accounting), the cost of not doing this is prohibitively high to consider.

We don't have a choice.

Increasingly lenders, investors, insurers and stakeholders will consider our organisation within its entire operating context before working with us or for us.

> **While you can't let perfect be the enemy of action, you also can't take a scattergun approach. You can't afford to waste time and energy on things that aren't going to move the dial for your organisation.**
>
> Julia Hoare CFInstD

3. Beyond your value chain

Protecting and enhancing an organisation's long-term resilience and value requires directors to consider climate change beyond their own organisation's value chain. This isn't just a moral imperative, but a practical one – a robust climate-resilient economy and society will be required for any organisation to thrive in the future.

Directors can work collaboratively to achieve greater impacts, share costs and accelerate progress towards a more sustainable future. For example, sectoral collaboration is also being seen in the determination of underlying assumptions and the development of climate scenarios, such as the construction and property sector.

Legislative leadership and working with regulators are other ways directors can contribute to collective climate resilience. Usually competitive businesses, such as seen by the electricity supply sector, might work together to understand the risks and opportunities climate change poses, and help to develop regulatory frameworks and policy settings.

Supporting economy-wide transformation is one of the three strands (alongside mitigation and transition) the XRB recommends boards consider when undertaking climate governance. There are overlaps and interdependencies between all three, and directors should consider each as a different facet of a single cohesive approach.

For example, by reducing your organisation's carbon footprint (strand 1: mitigation) and aligning your business model to reach net-zero emissions by 2050 (strand 2: transition) you will be contributing to economy-wide transformation (strand 3). Similarly, working at an industry level may enable you to bring about legislative change (strand 3) that will drive down emissions (strand 1) and enable even more impactful industry-wide transformation (strand 2).

You should be asking:

1. How can your organisation reduce greenhouse gas emissions throughout your operations and supply chain?
2. What changes does your organisation have to make to survive and thrive in spite of climate disruption?
3. How can your organisation increase its resilience to the society and economy-wide changes resulting from our future climate response?
4. Have you mapped your value chain so that you understand your Scope 3 emissions?

How To Drive Climate Governance

Determining "what" action to take is only one aspect of this challenge. Equally pivotal to success is knowing "how" to drive strong climate governance within boards and organisations. The leading professional Aotearoa New Zealand directors interviewed for this guide identified the following common principles that enabled them to implement successful climate governance across their organisations.

1. Foster the right attitude

Considered with the right mind-set, climate change is a once-in-a-generation opportunity. Directors are being called to thoroughly interrogate their value proposition and make bold, strategic decisions that may reshape fundamental aspects of what their organisations do or how they do it.

Directors who consider climate governance an exciting opportunity — rather than an onerous burden — are more likely to act and take their organisation with them.

At an individual level, we prioritise what we deem to be important, and we focus our energy on what we prioritise.

A glance into most directors' diaries reveals the same story – they have limited time available and multiple priorities to balance. Scheduling ongoing time to devote to climate governance — physically booking time in your calendar or diary — is an essential first step.

Organisational change is challenging – but attitude is contagious. Directors who can articulate the value of their climate strategy can generate buy-in and enthusiasm throughout the organisation. Galvanising support throughout on organisation allows everyone to pull together in the right direction when it comes time to turn strategy into action.

> "Just start. Climate governance isn't set and forget — it's about trying things, learning and adapting. Capital commitments will be required to deal with climate change. The cost difference between good and average decisions will run into very large numbers."
>
> Scott St John CFInstD

> I don't think of this as something we have to do, but something that we get to do. It's an opportunity to radically reframe our approach to achieve better outcomes on all levels!

Laurissa Cooney CMInstD

> One of the great privileges of being on a board is being able to be curious, to explore things and give yourself license to think about how far you or your business might be able to push change. Management will prioritise the short-term and that's good pragmatism. Board members get the opportunity to excite people to look to the horizon.

Amelia Linzey

2. Build board capability

Creating a climate strategy requires boards to bring together the right expertise within the most appropriate forum.

Undertaking an inventory of existing board member's capability, capacity and expertise allows climate-governance roles and responsibilities to be allocated optimally. Boards can use the insight generated to identify professional development opportunities to enhance climate literacy and consider skills needed when it's time to recruit new directors. Boards might also seek to supplement their knowledge with the appointment of advisory board members.

Where gaps exist, a board can partner with functions and committees within an organisation, for example a specific ESG or sustainability team, or bring in external resources, skills and experience as required. Specific or board-wide training and development will also ensure boards have the required capabilities.

> "Hire experienced consultants or use external advice from experts in the field and be prepared to take that advice. They can help you navigate reducing your carbon footprint affordably."
>
> George Adams CFInstD

3. Select the right structure

Oversight for climate governance can reside with the full board, an existing board committee, or a newly formed, dedicated committee. Organisations have found success using the different approaches individually and in combination.

Smaller organisations or those with a limited number of independent directors may be better suited to a "full board" approach. This raises the visibility of climate governance within an organisation and sends a clear message about its importance. However, smaller boards may need to devote more board time or external resources to the challenge.

Larger organisations are finding success with a full board plus subcommittee approach. Existing standing committees, such as Audit and Risk, retain continued responsibility for things within their remit, leaving the full board free to focus on the most material and complex climate-related issues. There is no one "optimal way", and directors should select the approach best suited to their particular board and organisation.

> **Boards should in my view be creating a specific "forum" for Directors and key relevant Executives in order to ensure appropriate commitment to ESG issues to ensure they receive the focus they deserve, rather than being a subset of an existing Board committee.**
>
> Dame Rosanne Meo CFInstD

Roles

Overseeing

Ensuring that management does what's expected

Guiding

Telling management what's expected

Enabling

Supporting management to do what's expected

Collaborating

Working with management to envision and help execute what's needed – contributing special knowledge, skills, and/or experience at crucial junctures

Climate Leadership Roles and Responsibilities

Governance versus Management

Board

Setting budgeting and ensuring sufficient resources, climate leadership and oversight, reporting / accountability

Responsible for:

Setting climate change as a strategic priority

Setting targets that matter

Holding management to account (early and decisively)

Enabling management

Ensuring compliance

Shared responsibility for:

Horizon scanning

Prioritisation

Demonstrating bold leadership

Engaging with key stakeholders

Responsible for:

Embedding climate change in core structures, systems, and settings

Coordinating, measuring, monitoring and constantly improving climate-related performance

Management

Climate leadership and coordination, reporting / accountability

4. Increase your climate literacy

Creating a learning culture within boards ultimately results in more robust governance. By increasing collective climate literacy, boards strengthen their understanding which in turn leads to better decision-making.

Anecdotal evidence suggests robust, consensus decision-making is improved when directors have similar levels of understanding about both the climate crisis and its likely impacts on their organisation.

Directors can raise their climate literacy by reading and engaging broadly with the goal of understanding the nuanced debate (and avoiding perpetuating comfortable narratives) and joining Chapter Zero NZ to keep up-to-date with international and national insights, training opportunities, and connect and share with other directors. Experts already employed within organisations are a valuable resource directors can turn to, to increase their climate literacy, but it is equally appropriate to look externally.

Other directors, particularly those in the same sector or environment, governance experts like IoD NZ and other specific subject specialists can all help directors and boards to increase their climate literacy.

In return, directors should be prepared to share their stories and learnings to help increase others' climate literacy, which will enable more organisations to contribute to the transition.

> **The best directors remain curious and open to new ideas. Board appointments are an opportunity to bring in fresh thinking and boost your board-wide capabilities. Learning together as a board leads to stronger, more consensus-driven decision-making and better policy.**
>
> David Kirk MBE

Board Discussions Mature In Step
with Climate Maturity

STEP 3 Discussion centres around alignment to core value proposition

STEP 2 Discussion centres around risk and opportunity identification

STEP 1 Discussion centres around "need for action"

> At Fisher & Paykel Healthcare we have driven long-term thinking, which has to include climate change considerations and action. We are looking at 10-year time horizons, which allows us to model and plan for 10 years plus various scenarios.

Scott St John CFInstD

5. Adopt a strategic timeframe

Climate governance is about increasing the long-term resilience and value of an organisation. It is unrealistic to think this can be achieved within a traditional three to five-year business planning cycle. Instead, directors should approach climate governance with a strategic, long-term view — looking ahead at least 10 years.

By pushing the timeframe out past 10 years, directors will begin to see the long-term payoffs. Lower overheads (emissions reduction is essentially energy reduction), increased productivity, an enhanced value proposition and more.

Directors should also flip the scenario and ask themselves, "What is the long-term cost of not taking action?". When an organisation's long-term enterprise value – and even survivability – is on the line, it becomes easy to establish a profitable business case for investments that pay dividends over a longer period.

> If you can't make your climate change response pay, you aren't looking in the right places. Think long-term. Invest in developing a strategic response that increases productivity, strengthens your employment brand and drives staff retention and develops more meaningful relationships with your customers.

George Adams CFInstD

6. Know your numbers – then reflect and report

The more baseline information directors understand about their organisation's quantum of climate-related risk and opportunity, the better decisions they can make as a board.

Identifying your organisation's climate-related risks and opportunities, then completing a materiality assessment enables directors to understand the likely disruptive effects their organisation will face – and the likely costs of status quo policies, processes or partners. Using a scenario-based approach will help ensure this assessment addresses a wide range of uncertainties rather than being limited to your organisation's current scope of risk.

A full greenhouse gas emissions inventory identifies Scope 1, 2 and 3 numbers and is a vital first step to understanding your organisation's full value chain emissions. The next is to set quantifiable goals, monitor progress and, most importantly, report back. Measure the change you're making relative to your organisation's climate goals – not how they compare to anybody else.

"What gets measured gets managed."

Julia Hoare CFInstD

Directors should have more conversations about the numbers and what they are telling them. Talking numbers with peers can be impactful and rewarding. Measuring and reporting are crucial components to keeping your board, management, stakeholders and entire value chain focused and motivated.

> "With Precinct Properties we used specific metrics to align the strategic focus of the business within our operating environment. Our customers want to know the environmental performance of our new builds, including embedded emissions and energy efficiency. It makes good business sense, our customers want it and there's a good outcome for our net zero measures."
>
> Mark Tume CFInstD

7. Coach your team

The director's role is oversight and organisation-wide governance. In metaphoric terms, a director's position in the grandstand gives them a view of the entire field of play and lets them better direct the players for the entire team's advantage. The scale of the challenge climate change poses to organisations and operating environments justifies directors coming down to coach from the sidelines.

Some directors believe there is an argument to go further. They say directors with specific sustainability expertise can benefit their organisations best by coming on to the field and picking up the ball themselves (provided there is both the commitment and a clear plan for getting back to the grandstand). Some directors swear by actively engaging with critical functions within the organisation – literally making time on a regular basis to sit with teams, ask questions and understand what's happening.

Regardless of whether you stay in the grandstand, on the sideline or temporarily jump onto the field of play, the role of the director-coach remains constant: supporting management and C-suite with the direction, understanding and resources they need to implement the board's strategy.

> "The most valuable thing directors bring is good judgement. You need people around your board table who can understand the information, balance the trade-offs and exercise good judgement."
>
> David Kirk MBE

8. Apply IoD's Four Pillars Of Governance

1. Determine your purpose

The direct and indirect impacts of climate change ultimately threaten the long-term viability of every organisation. It is the director's job to understand, address and communicate how climate change will impact their organisation's ability to deliver on its existing value proposition. **Ask:**

- **Will our current proposition work in a low-emissions economy?**
- **How would different strategic responses drive productivity, increase resiliency and create long-term value?**

2. Develop an effective governance culture

The same principles that underpin all good governance apply to climate governance. Directors must commit to navigating the challenges and opportunities posed by climate change as a high-performing team. Learning together as a board drives open discussion and creative solutions. Directors should welcome debate, thoughtful challenges and constructive dissent. Identify what you bring to this opportunity. Involve management, shareholders and stakeholders as appropriate and bring them with you. **Ask:**

- **What skill sets, experience, and perspectives do we need around the board table?**
- **What structure will best support robust discovery, debate and informed decision-making?**

3. Hold your management to account

While directors provide strategic leadership, management ultimately oversees its implementation. Make sure management understands why your organisation needs to evolve and adapt, then support them to make the organisational changes required. Hold your management to account through regular reporting and by continuing to demonstrate that climate-governance is a consistent priority. **Ask:**

- **How can I help management understand why we need to act and why this is the plan that will ensure our long-term success?**
- **What structures are required for effective internal and external reporting?**

4. Ensure effective compliance

Good climate governance builds long-term resilience and value. It is more than a regulatory responsibility. Lenders, investors, insurers, stakeholders and more are increasingly demanding to understand our quantum of climate risk and what mitigation and transition strategies are in place to respond to it. **Ask:**

- **What will this organisation need to look like in a net zero-emissions, climate-resilient future?**
- **What do we need to change about who we are or how we do things?**
- **What climate-related information do our suppliers, stakeholders, shareholders and consumers need to know to keep working with us and for us?**

The Four Pillars of Governance Best Practice

In the IoD's cornerstone publication, The Four Pillars of Governance Best Practice, the focus is on driving excellence in governance through determining purpose, an effective governance culture, holding to account and effective compliance. The Pillars serve to emphasise the main responsibilities of the board and the value of governance.

The first pillar: Determining purpose

The board adds value by leading the development of the entity's purpose, goals and strategy. The board must take ownership of the entity's strategic direction.

Long-term business sustainability is a critical focus for the board.

The second pillar: An effective governance culture

The board adds value by acting as a team with a high-performance culture committed to engaged, quality governance of the entity. It supports open debate, diversity, thoughtful challenge and constructive dissent. Directors lead through high standards of ethical behaviour, commitment, candour and integrity. This culture is characterised by effective relationships between directors and with management, shareholders and stakeholders.

The third pillar: Holding to account

A value-adding board holds management to account through informed, astute effective and independent oversight of performance and conformance matters. It does not do the job of management but ensures purpose and strategy are understood by management and implemented. The board sets the risk appetite of the entity and oversees and monitors risk management.

The forth pillar: Effective compliance

The board adds value by ensuring the entity is, and remains, solvent. It ensures the probity of financial reports and processes, and a high standard of compliance with regulatory environments. Directors must comply with their duties and responsibilities in relation to the entity, its shareholders and other stakeholders. Excellence in governance is enhanced through complying with the spirit as well as the letter of the law.

References section

Further references and background reading

- Board structure and capability for climate
- Guide to board oversight of climate change
- How to set up effective climate governance on corporate boards
- Chapter Zero New Zealand board toolkit
- Getting started on climate risk reporting
- The board's oversight of climate change

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