

14 December 2011

International Integrated Reporting Committee

To whom it may concern,

Please find attached the Sustainable Future Institute's submission.

The Institute supports the integrated reporting framework initiative undertaken by the International Integrated Reporting Committee and welcomes the opportunity to comment on the *Towards Integrated Reporting: Communicating Value in the 21st Century* discussion document.

The Institute has pursued a research programme focused on integrated reporting through its *Project One Integrated Report* and believes that integrated reporting has the potential to produce significant public-good outcomes globally.

Kind regards,

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Chief Executive

Rory Sarten
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About the Sustainable Future Institute

The Sustainable Future Institute, which was founded in 2004, is a non-partisan think tank working for the public good, contributing strategic foresight through evidence-based research and policy analysis.

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Background

The Sustainable Future Institute has been actively working to build capacity for integrated reporting in New Zealand through its *Project One Integrated Report*.¹ Wendy McGuinness, was a member of the New Zealand Institute of Chartered Accountants (NZICA) Taskforce on Sustainable Development Reporting from 2002. The taskforce went on to establish the Sustainability Development Reporting Committee (SDRC), which McGuinness chaired for two years from 2003 to 2004. From 2005 to 2007 she was an NZICA Councillor, being appointed a Fellow of the College of Chartered Accountants in 2009.

Project One Integrated Report was developed after McGuinness interviewed Professor Robert G. Eccles at Harvard Business School in July 2010, which led to her return to Harvard in October 2010, to attend the *Developing an Action Plan for Integrated Reporting Conference*. The research stemming from this conference was initially published in the Harvard Business School e-book, *The Landscape of Integrated Reporting: Reflections and Next Steps*.²

In 2010 the Institute conducted a survey and in early 2011 published the results under the title *Integrated Annual Report Survey of New Zealand's Top 200 Companies: Exploring responses from Chief Financial Officers on emerging reporting issues*.³ The aim was to provide a snapshot of the current practices and views on integrated reporting of the top revenue-earning companies operating in New Zealand, as shown by responses from the Chief Financial Officers (CFOs). The survey provided insights into how accounting practitioners regard integrated reporting, explored the challenges and opportunities of integrated reports, the nature of filing programmes, the optimal length of the reports and the extent to which companies are consulting with stakeholders. The Institute intends to rerun the survey in 2012.

¹ See *Project One Integrated Report*:

http://sustainablefuture.info/Site/Project/One_Integrated_Report/Project_One.aspx

² Harvard Business School (2010). *The Landscape of Integrated Reporting: Reflections and Next Steps*, November, 2010: <http://www.hbs.edu/environment/docs/The%20Landscape%20of%20Integrated%20Reporting.pdf>

³ Sustainable Future Institute (2011). *Integrated Annual Report Survey of New Zealand's Top 200 Companies*: http://sustainablefuture.info/Site/Publications/One_Integrated_Report.aspx

Q1

(a) Do you believe that action is needed to help improve how organizations represent their value-creation process? Why/why not?

(b) Do you agree that this action should be international in scope? Why/why not?

(a) Yes. The Sustainable Future Institute strongly believes that this action is needed.

The accounting landscape has changed considerably over recent decades and today faces at least four key drivers of change: (i) the short-term future is no longer a close reflection of the past; (ii) government regulation is increasingly complex, and government itself is a key player in the economy; (iii) the world population has recently passed 7 billion, and as a result we are increasingly faced with challenges of managing resources that are often scarce and/or compromised, and (iv) climate change, which is likely to be the most significant driver of change in the 21st Century.⁴ In our increasingly complicated and fast-paced world decision-makers must look for new ways of responding to the complexity that faces them.

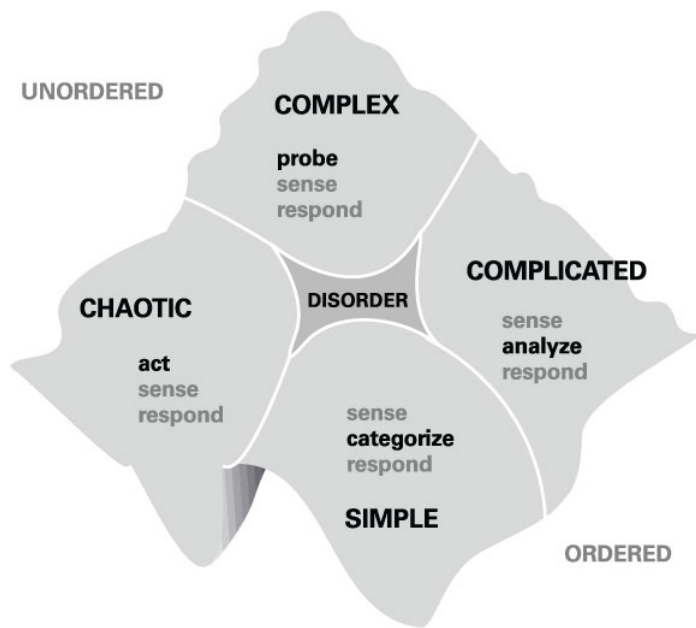
Dave Snowden and Mary Boone, who are experts in complexity theory, suggest that decision-makers and policy analysts need to take into account their unique environment when making decisions. They developed the Cynefin framework (Figure 1) to help leaders determine the prevailing operative context so that they can make appropriate choices. The framework is divided into four domains which require different actions:

Simple and *complicated* contexts assume an ordered universe, where cause-and-effect relationships are perceptible, and right answers can be determined based on the facts. *Complex* and *chaotic* contexts are unordered—there is no immediately apparent relationship between cause and effect, and the way forward is determined based on emerging patterns. The ordered world is the world of fact-based management; the unordered world represents pattern based management. The very nature of the fifth context—*disorder*—makes it particularly difficult to recognize when one is in it. Here, multiple perspectives jostle for prominence, factional leaders argue with one another, and cacophony rules. The way out of this realm is to break down the situation into constituent parts and assign each to one of the other four realms. Leaders can then make decisions and intervene in contextually appropriate ways.⁵

⁴ Sustainable Future Institute (2011). *Integrated Annual Report Survey of New Zealand's Top 200 Companies*.: http://sustainablefuture.info/Site/Publications/One_Integrated_Report.aspx Page 1.

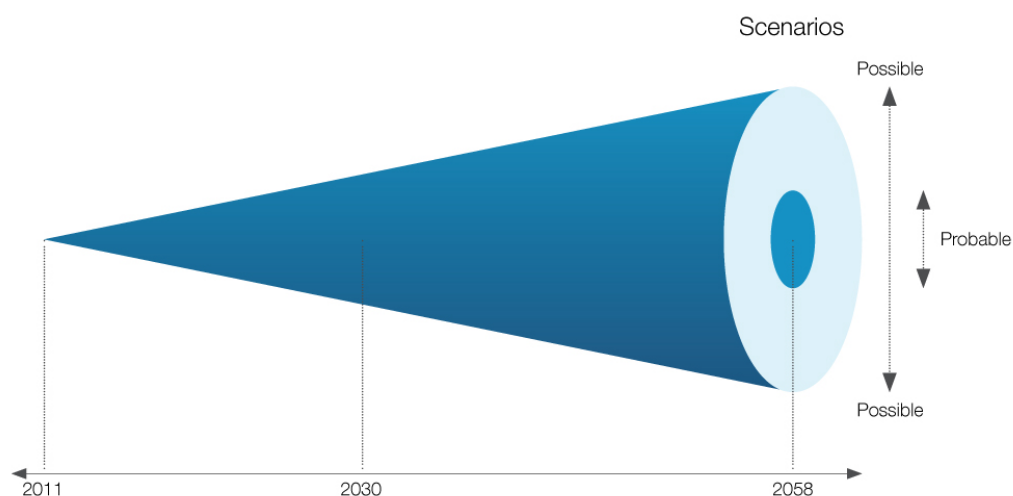
⁵ Snowden & Boone (2007) (2007). A leader's framework for decision making. *Harvard Business Review*. Retrieved November 1, 2011 from <http://hbr.org/2007/11/a-leaders-framework-for-decision-making/ar/1>: Page 4.

Figure 1: The Cynefin Framework



Reporting institutions have traditionally operated in the *simple* quadrant where the information required was limited to quantitative capitals. Increasing complexity coupled with an increasing rate of change means that it is increasingly important to having information that allows people to respond quickly to emerging situations and emergencies, not just those in the financial sector, but the public as well. This situation has been particularly evident in New Zealand following the major earthquakes experienced in Christchurch early in the year. The situation highlighted how information that can help make sense of disorder is increasingly important. It also underlined the importance of timely information, information that is always as up-to-date as possible. A world experiencing exponential growth in pace and complexity necessarily needs a greater capacity for forecasting than has previously been required of reports in order to understand the landscape within which one is operating. The Future Cone (Figure 2) is a useful way of understanding the expanding boundaries of possible scenarios into the future. This is the terrain that integrated reporting should be focusing on.

Figure 2: The Future Cone⁶



Traditional methods of reporting results are proving inadequate in an increasingly complex and changing world. Improving global governance of resources, as well as human health and well-being, is vitally important. One important step towards a solution is for companies to publish integrated annual reports. Integrated reporting provides the transparency needed for stakeholders to trust the companies in which they invest and on which they rely. It is also important to develop trust, not simply in the investor market, but to foster confidence on the part of those who cannot afford to invest actively, or choose not to, but are nevertheless affected by the way these entities operate. Investing in integrated reporting would improve both public-good and private-sector outcomes.

(b) Yes. The increasing connectedness of the world over the last 25 years means that problems are also increasingly connected. The recent PricewaterhouseCoopers report, *Counting the cost of carbon: Low carbon economy index 2011*, shows that carbon intensity has increased in 2011 following a small but gradual decline in previous years.⁷ The report states that these results 'call into question the current likelihood of our global decarbonisation ever happening rapidly enough to avoid 2 degrees of global warming.' Developments such as this highlight the importance of global responses to international challenges. New Zealand has limited scope to influence social and environmental issues that transcend its territorial boundaries.

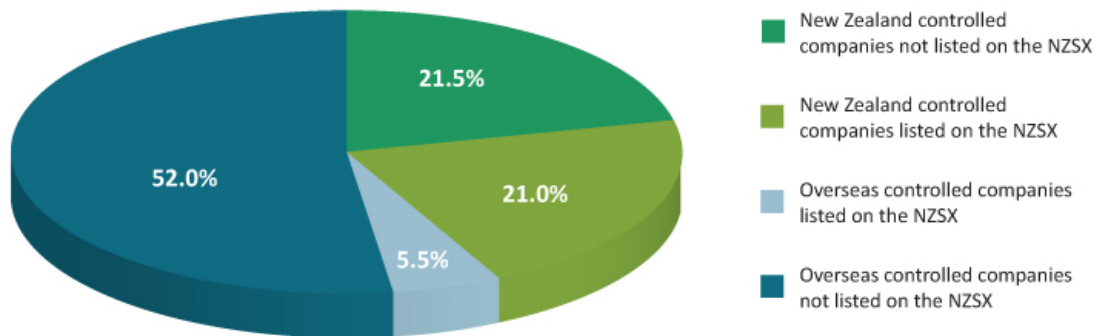
Large overseas controlled companies operating in New Zealand have a significant impact on our economy, our people and our environment. 57.5% of New Zealand's Top 200 companies (by revenue) are '50% or more controlled by overseas interests', and only 26.5% are listed on the New Zealand Stock Exchange (NZSX). In other words, almost three-quarters of our Top 200 companies are not traded publicly on the New Zealand Stock Exchange (see Figure

⁶ Sustainable Future Institute (2011). StrategyNZ: Mapping our Future Workbook: Exploring visions, foresight, strategies and their execution: http://sustainablefuture.info/Site/Publications/Project_Reports.aspx Page 25.

⁷ PricewaterhouseCoopers (2011). *Counting the cost of carbon: Low carbon economy index 2011*: <http://www.pwc.com/gr/en/surveys/low-carbon-economy-index-2011.jhtml> Page 2.

3). Therefore, it is in our interests to ensure that the overseas controlled companies treat our citizens and country well. Like other small countries, New Zealand has a significant interest in the development of international standards that improve the quality of integrated reporting.

Figure 3: Top 200 Companies by NZSX and by Overseas Control⁸



Q2

Do you agree with the definition of Integrated Reporting on page 6? Why/why not?

Integrated Reporting brings together the material information about an organization’s strategy, governance, performance and prospects in a way that reflects the commercial, social and environmental context within which it operates. It provides a clear and concise representation of how an organization demonstrates stewardship and how it creates value, now and in the future. Integrated Reporting combines the most material elements of information currently reported in separate reporting strands (financial, management commentary, governance and remuneration, and sustainability) in a coherent whole, and importantly:

- shows the connectivity between them; and*
- explains how they affect the ability of an organization to create and sustain value in the short, medium and long term.*

The Institute supports the current definition of integrated reporting as supplied by the IIRC as a platform for further developing this initiative. It clearly lays out the key aspects of consideration for integrated reporting. It is particularly promising to see *strategy* and a range of relevant time-frames included in the working definition. However, because of its length the current lack of a clear integrated reporting framework, the Institute expects this definition to advance as a result of consultation. Eccles and Serafeim note that ‘since no universally accepted framework for integrated reporting exists and it is still largely a voluntary practice, an ‘integrated report’ is not well defined.’⁹ This reflects the sometimes abstract nature of a definition before it is widely put into practice.

⁸ Sustainable Future Institute (2011). *Integrated Annual Report Survey of New Zealand’s Top 200 Companies.*: http://sustainablefuture.info/Site/Publications/One_Integrated_Report.aspx Page 9.

⁹ Eccles & Serafeim (2011). *The Role of the Board in Accelerating the Adoption of Integrated Reporting*: <http://www.conference-board.org/publications/publicationdetail.cfm?publicationid=2049> Page 3.

It is important to recognise that integrated reporting is a new area that is currently in the process of establishing its conceptual foundations and operational boundaries, as is clearly evidenced by the IIRC discussion paper. The development of a concise working definition will be an iterative process. The clarification of the conceptual framework through consultation and feedback from the pilot programme will support the development of its operating framework. This process will progressively highlight what should and should not be included and gradually build a robust working definition for integrated reporting.

There are three key aspects of integrated reporting that the Institute believes should be central to the definition.

1. That it provides a clear and timely picture of where an entity is at a given point in time;
2. That it clearly illustrates the future landscape and environment in which it is operating, and
3. That given the two points noted above, it provides a concise, high-level strategy of the entity going forward.

There is also considerable value to be had from a shorter, perhaps even one-line explanation centred on *strategy*. It is our hope that the feedback generated from this discussion document will assist in the clarification of this definition.

Q3

Do you support the development of an International Integrated Reporting Framework? Why/why not?

Yes. The Institute believes that decisive action is needed to help improve how organisations represent their value-creation process, as stated in response to Question 1. The Institute supports the creation of the International Integrated Reporting Committee as a positive step towards the formation of a reporting framework designed for the 21st Century. The IIRC could represent a single international authority offering a reporting framework that enables a complete assessment of organisational performance, including environmental and social factors. There are three mutually reinforcing and essential components necessary for developing a robust International Integrated Reporting Framework.

(i) Conceptual framework

It is vital that the IIRC advances a sound conceptual framework that underpins the necessity of integrated reporting. This is important because the quality of the conceptual framework will have a major influence on business and investor buy-in and thus the overall momentum of integrated reporting globally. As Brown and Fraser note, '*perspectives matter* and have profound implications for the social realities we construct, embed or seek to change'.¹⁰

¹⁰ Brown & Fraser (2006). *Approaches and Perspectives in Social and Environmental Accounting: an Overview of the Conceptual Landscape*. Business Strategy and the Environment, 15. 103-117.: <http://onlinelibrary.wiley.com/doi/10.1002/bse.452/abstract> Page 104.

A large part of the framing for integrated reporting has been a *business case*. This is the conceptual basis that has been employed by groups such as the World Business Council for Sustainable Development, Business for Social Responsibility, and Business in the Community, to spread their message internationally.¹¹ As business and investor buy-in is crucial to the success of these initiatives and the IIRC's relevance and credibility, this has understandably been a focus of their output. However, for the International Integrated Reporting Framework to be successful it needs to address a wider audience than the business community. It must communicate the value it creates globally by also appealing to other interests. Corporate Social Responsibility was largely driven by the accounting profession to communicate compliance with the spirit of the law, ethical standards and international norms. Sustainable Development Reporting has largely been driven by demand from the public and it is important integrated reporting picks up on this language and engagement to address this audience.

(ii) Practical application

The discussion document notes 'interim guidance material will be made available on the IIRC website. This material will be built upon as further experience is obtained through the IIRC Pilot Programme'. As noted in the response to Question 2, defining areas to report on will be a largely iterative process and only by initiating the framework will a proper understanding of the machinery come about.

(iii) Key indicators

Relating to both the previous components is the development of high-level indicators to test the market for integrated reporting. A number of possible indicators have been put forward in the discussion document and will be addressed in later questions.

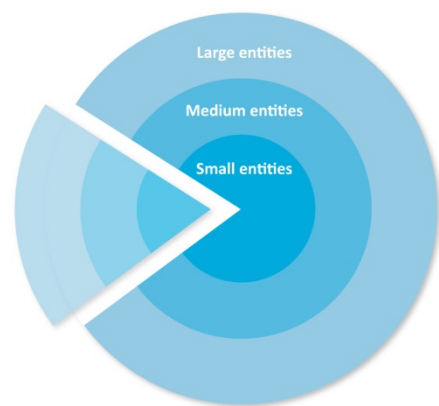
Q4

Do you agree that the initial focus of Integrated Reporting should be on reporting by larger companies and on the needs of their investors? Why/why not?

(b) *Do you agree that the concepts underlying Integrated Reporting will be equally applicable to small and medium enterprises, the public sector and not-for-profit organizations?*

(a) The Institute agrees that an initial focus on larger companies is an appropriate starting point. However, there is concern that focusing principally on large entities while developing the framework may result in an incomplete picture of the situation that does not take into account the unique needs of different entity types. We would like to see subsequent pilot programmes include a wider range of business entities. This allows the framework to be developed through the inclusion of a deeper slice of the business community, rather than segregating by entity size and only addressing the needs of large companies. We are also concerned that focusing

Figure 4: Entity Size Engagement

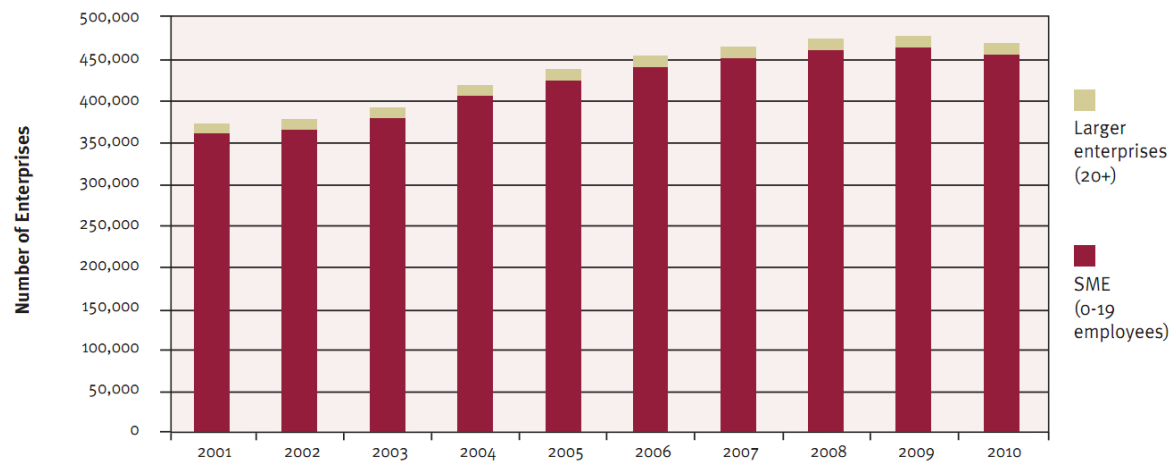


¹¹ Ibid.

on ‘the needs of their investors’ is too narrow a definition and does not go far enough to include the broader conceptual framework of corporate social responsibility. Failing to emphasise the broader social imperatives for integrating reporting from its early stages increases the risk of narrowing the interest in this initiative to the business and accounting sectors. For this reason we would advocate that integrated reporting is not just seen as being for business, but to have value for whole communities.

(b) We agree that the concepts underlying integrated reporting should be applicable to small and medium enterprises (SME), not-for-profits and public sector, and we look forward to seeing these businesses included in future pilot programmes. New Zealand will have a particular interest in this area of the framework development as this will impact the majority of businesses in New Zealand. 97.2% of businesses in New Zealand are SMEs, they account for 30.7% of all employees and 39.8% of the economy’s total output.¹²

Figure 5: Total Number of SMEs and Larger Enterprises in New Zealand (February 2001-2010)¹³



The impact of required integrated reporting will likely be different across different sized enterprises and compliance costs may well be higher for SMEs. There is considerable interest therefore in developing a framework that does not unfairly burden SMEs and ensures that the strategic benefits it offers to larger companies are able to be transferred through to a smaller scale.

The Institute also takes great interest in how integrated reporting can be applied to public sector organisations, particularly to central and local government entities. The New Zealand government plays a significant role in the economy, government expenditure accounting for 40% of New Zealand’s total GDP.¹⁴ While gathering data for *Integrated Annual Report Survey of New Zealand’s Top 200 Companies* we discovered that a significant portion of State Owned Enterprises (government-owned commercial enterprises), large entities that play a significant infrastructure role in New Zealand, had already worked toward, or successfully published, integrated reports. This suggests that there is an appetite within government for

¹² Ministry of Economic Development. *SMEs in New Zealand: Structure and Dynamics 2011*.

http://www.med.govt.nz/templates/ContentTopicSummary_39289.aspx

¹³ Ibid

¹⁴ Treasury (2011). *Government and economic growth: Does size matter?*

<http://www.treasury.govt.nz/publications/research-policy/tp/govtsize/13.htm> Page 22.

integrated reporting in key areas and the establishment of a robust integrated reporting framework would further reinforce efforts in this area.

Integrated reporting is also becoming a pressing consideration for local government in New Zealand. Following recent local government reforms in Auckland, approximately a third of New Zealand's population is represented by one regional authority, while the rest of the country is represented by 77 different authorities. The new Auckland Council has gained a large measure of strategic traction because of its size as well as its ability to synthesise disparate goals for achieving unified outcomes. Following this transformation there has been consideration of making similar changes to the Wellington region. A paper put forward by a group of interested councillors argues that such a setup delivers 'real benefits of a local government with the capacity to engage in high-level, strategic planning and decisions, and regional delivery.'¹⁵ A key stated benefit of this approach is 'a single, integrated regional/district plan with consistent policies and approaches.' Furthermore, proposed legislation requiring local authorities to collect and report on environmental data further shows the changing landscape of local reporting in New Zealand.¹⁶ The Institute believes that the changing landscape of regional authorities in New Zealand is an opportunity to introduce integrated reporting at a local government level to deliver the strategic, long-term thinking, and governance benefits it offers.

Q5.

Are:

(a) *the organization's business model; and*

(b) *its ability to create and sustain value in the short, medium and long term, appropriate as central themes for the future direction of reporting? Why/why not?*

(a) The Institute does not agree the central theme should focus on 'business' models. Other organisational models may more adequately communicate the broader conceptual themes. Adopting terminology such as 'entity' or 'model' does not preclude other organisational structures from the framework.

(b) Notwithstanding the sometimes ambiguous nature of value, the Institute supports this aspect of the classification, particularly the focus on extended timeframes.

Q6.

Do you find the concept of multiple capitals helpful in explaining how an organization creates and sustains value? Why/why not?

We support the use of multiple capitals as a means of explaining different organisational values. We expect the categorisations and descriptions to develop further as a result of the pilot programme and further consultation. This approach is a useful way of addressing the broad level of metrics, qualitative and quantitative, required for integrated reporting.

¹⁵ *Some ideas on local government reform in Wellington – neighbourhood decisions with pan-regional strategy* (2011) Version 9. Page 2.

¹⁶ Ministry for the Environment (2011). *Measuring Up: Environmental Reporting – A discussion document*: <http://www.mfe.govt.nz/publications/ser/measuring-up-environmental-reporting/index.html>

Q7.

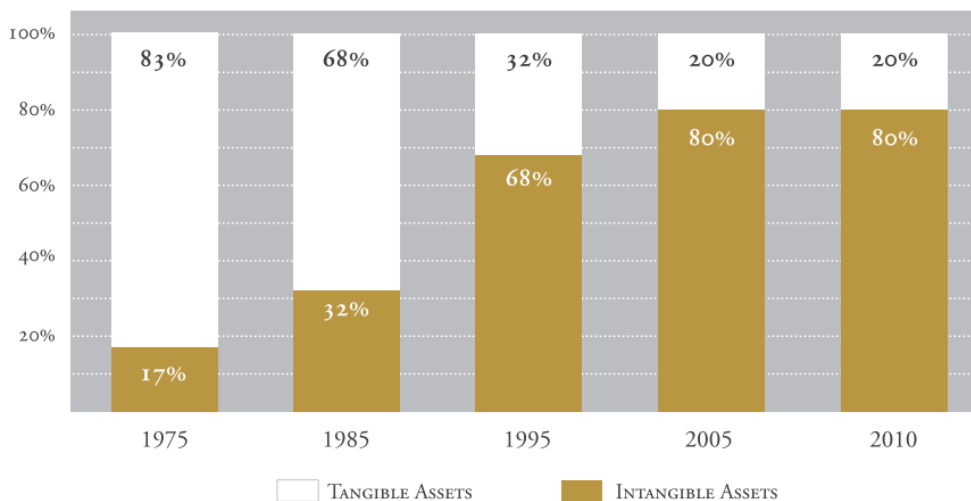
Do the Guiding Principles identified in the Discussion Paper provide a sound foundation for preparing an Integrated Report – are they collectively appropriate; is each individually appropriate; and are there other Guiding Principles that should be added? Why/why not?

The Guiding Principles outlined in the discussion document provide a suitable platform for preparing an integrated report. These principles help provide a narrative explanation of an organisation’s performance that combines quantitative and qualitative information, this is fundamental to an integrated reporting framework.

The Guiding Principles of *strategic focus, connectivity of information, future orientation and responsiveness and stakeholder inclusiveness* advance the purpose of robust integrated reporting. The Guiding Principle *Conciseness, reliability and materiality* demands greater attention. The intention of this principle, ‘An Integrated Report provides concise, reliable information that is material to assessing the organization’s ability to create and sustain value in the short, medium and long term’, should be read as focusing on the accountability and quality of the final report. This final Guiding Principle should be divided into two new components that communicate this theme:

- **Completeness** must be a core Guiding Principle of the Integrated Reporting Framework. As evidenced by Ocean Tomo’s *Intangible Asset Market Value Study*, referenced in the discussion document, intangible assets have become a massive component of company market value in recent years. The importance of non-physical and non-financial assets to materiality means that in order to reliably communicate information on an organisation’s ability to create and sustain value, completeness of information is a core requirement for the integrity of the integrated reporting framework.

Figure 6: Components of S&P 500 Market Value¹⁷



Source: Ocean Tomo

- **Assurance** is an integral part of the discipline of accounting and must be considered a Guiding Principle of the Integrated Reporting Framework. Given the aforementioned

¹⁷ Ocean Tomo (2010). *Ocean Tomo's Intangible Asset Market Value Study*: <http://www.oceantomo.com/media/newsreleases/Intangible-Asset-Market-Value-Study>

concern for the completeness of material information, assurance follows as a natural requirement. Given the discretion afforded to senior management in recognising materially relevant information for inclusion in the report, it is important that the framework addresses the importance of assurance. Because of the wide spectrum of information conveyed in an integrated report this may involve engagement with a number of different parties such as engineers, environmental scientists etc. to ensure materially relevant information is being reported.

Understandably, the protection of integrity and confidentiality of an organisations' information will be a noted concern of senior management with the broad level of information required for an integrated report.

Decision-makers need to be able to understand the whole picture, meaning that quality data needs to be both integrated and complete. It is not enough to rely on transactional reporting systems to meet these needs; good decisions need good analysis, and good analysis demands quality data. This requires data systems to be designed not just for transactional accountings systems, but to allow for the greater inclusion of qualitative data (a good estimate is better than no data). This will make greater demands on reporting systems to prevent the reporting of flawed data. Completeness and assurance afford similar high-level goals as *conciseness, reliability and materiality* but refocus the consideration on accountability, a crucial principle for ensuring the integrity and credibility of the integrated reporting framework.

A further comment impacting on the Guiding Principles will be discussed in the following question on Content Elements.

Q8

Do the Content Elements identified in the Discussion Paper provide a sound foundation for preparing an Integrated Report – are they collectively appropriate; is each individually appropriate; and are there other Content Elements that should be added? Why/why not?

The Institute agrees that the Content Elements and their sequence provide a sound foundation for preparing an Integrated Report. We have one point of disagreement with the Content Elements outlined in the discussion document. The Institute strongly supports the integration of extended timeframes and forecasting into the reporting framework, however, we believe that the appropriate place for addressing future elements is in the Guiding Principles. The *Future outlook* Content Element should be combined with, and reinforce, the *Future orientation* Guiding Principle. We note that the discussion document describes the elements as 'fundamentally linked to each other', but consider that including *Future outlook* as a specific Content Element risks undermining *Future orientation* in the Guiding Principles. These aspects should be incorporated into the Guiding Principle and addressed at each stage of the integrated report.

Q9

From your perspective:

(a) *Do you agree with the main benefits as presented in the Discussion Paper? Why/why not?*

(b) *Do you agree with the main challenges as presented in the Discussion Paper? Why/why not?*

(c) *Do you agree that Integrated Reporting will drive the disclosure of information that is useful for integrated analysis (from the perspective of investors)? Why/why not?*

The benefits and challenges arising from integrated reporting should be given equal weight in discussion. We believe an undue focus has been given to the challenges presented by this initiative. Further, the points noted in the broad level argument for integrated reporting on page two of the discussion document are not posited as benefits or outcomes in this section. By divorcing operational benefits and challenges from higher-level benefits and challenges the key motivating argument behind this initiative is lost. As stated in our response to Question 3, a consistent conceptual approach must be employed throughout the development of the framework in order to involve a wider social cross-section. Any discussion of the benefits from integrated reporting must address global benefits and challenges.

The Institute's *Integrated Annual Report Survey of New Zealand's Top 200 Companies* asked respondents to identify the key challenges and opportunities they saw in integrated reporting. The three most significant challenges identified were:

1. Time constraints,
2. Adequate guidance from standard setters, and
3. Generating new information in-house.

The four most significant opportunities from integrated reporting were:

1. Positioning the company as socially responsible,
2. Positioning the company as environmentally responsible,
3. Producing a long-term sustainable strategy/s, and
4. Communication with employees.¹⁸

This suggests that the primary benefits currently pursued through integrated reporting are public relations and publicity or marketing purposes. Given the role that senior management will take in determining the materiality of information for use in the report, and the crucial role of the board in accelerating the adoption of integrated reporting (as examined in Eccles & Serafeim), it is important that broader social and environmental benefits are not overlooked when making a business case for integrated reporting.

¹⁸ Sustainable Future Institute (2011). *Integrated Annual Report Survey of New Zealand's Top 200 Companies*.: http://sustainablefuture.info/Site/Publications/One_Integrated_Report.aspx Pages 23-4.

Q10

(a) *Do you agree that the actions listed in the Discussion Paper should be the next steps undertaken by the IIRC? Why/why not? Are there other significant actions that should be added?*

(b) *What priority should be afforded to each action? Why?*

Q11

Do you have any other comments that you would like the IIRC to consider?

As noted elsewhere in this submission, developing a sound integrated reporting framework will be an iterative process that will develop considerably as a result of the feedback received on the discussion document, and the lessons learnt from the pilot programme. We agree with the exploratory future direction outlined in the document. The involvement of SMEs and not-for-profit and public sector entities in subsequent pilot programmes is necessary to properly test the integrated reporting framework. It is important to consistently present the case of integrated reporting as both a business case and for socially responsibly governance and the global benefits this entails. This is vital for extending its mandate and interest beyond the business community.

We welcome the opportunity to provide feedback to the International Integrated Reporting Committee and will continue to support this initiative. The Institute will continue to progress its *Project One Integrated Report* as a vehicle for furthering discussion on this topic in New Zealand.