



**Submission**

**New Zealand Productivity Commission  
Local government funding and financing  
29 August 2019**

### **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 policy. 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 transition from cash to accrual accounting from 1988 to 1990. Between 1990 and 2003, she continued consulting part-time while raising children. Over that time, she undertook 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 2003–2004 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 McGuinness Institute welcomes the opportunity to respond to the New Zealand Productivity Commission's *Local government funding and financing* draft report. We support the purpose and general direction of the report and commend your inquiry into this area. We would first like to acknowledge our support for local government and its pivotal role in New Zealand's public policy framework. Given that local government will bear much of the cost of the physical impacts of climate change (i.e. increased frequency of extreme weather events), the Institute supports the increase in funding for local government set out in the 2019 *Wellbeing Budget*, which will provide additional funding for local government to develop strategies to manage natural hazards and the risks of climate change (Crown, 2019, p. 92).

The Institute has taken a key interest in local government and we have threaded this throughout our work programme over the last few years. The Institute broadly supports the Commission's draft report recommendations which are outlined further in Section 1.1 below. Section 1.2 lists some of our recent publications that form the attachments to this submission. Throughout this submission we will refer to these publications to provide more detailed evidence for our observations and recommendations. Section 1.3 outlines the areas of the draft report that we focus on. Section 2 outlines our high-level observations and recommendations, and Section 2.5 lists our high-level observations and recommendations specific to climate change.

We are interested in transparency, accountability, future-thinking and long-termism with a view that comparable, timely, cost-efficient and useful reporting ensures that both the public and private sector are better prepared in the face of uncertainty.

### TCFD workshops

It may also be worth noting that the Institute, alongside Simpson Grierson, is hosting two workshops in Auckland and Wellington where Michael Zimonyi (Climate Disclosure Standards Board) among other speakers will be discussing the TCFD and its practical implementation. The workshops will also be the official New Zealand launch of the 2019 *TCFD Good Practice Handbook*. See the McGuinness Institute [website](#) for more information.

#### Auckland

**Date:** Wednesday, 16 October 2019

**Location:** Simpson Grierson, Level 28, 88 Shortland Street, Auckland 1141

**Time:** 9.00 am – 3.00 pm

#### Wellington

**Date:** Thursday, 17 October 2019

**Location:** Simpson Grierson, Level 24, HSBC Tower, 195 Lambton Quay, Wellington 6011

**Time:** 9.00 am – 3.00 pm

## 1.1 Broad support for draft report recommendations

The Institute is broadly supportive of the work presented by the Productivity Commission in this draft report. In particular, we support the following specific recommendations:

R5.4: The local government reporting framework (including the financial disclosures, Funding Impact Statement and performance measures for service delivery) should be subject to a fundamental, first principles review.

R5.7: The Local Government Act 2002 should be revised to clarify and streamline the required content of Long-Term Plans so as to reduce duplication, ease the compliance costs on councils, and help make them more accessible documents.

R6.4: The Government should consider implementing a system of payments to territorial authorities, based on new building work put in place in each territorial local authority, to incentivise councils to increase the supply of infrastructure-serviced land to match growth in demand.

R6.7: The Government should legislate to enable councils in tourist centres to choose to implement accommodation levies to recover the tourism-induced costs of providing local mixed-use facilities not otherwise charged for.

Councils in tourist centres should make greater use where possible of user pays for mixed-use facilities.

R6.8: The Government should provide funding from the international visitor levy for councils responsible for small tourist hotspots which cannot reasonably recover all their operating costs of providing mixed-use facilities from tourists through user pays or accommodation levies.

R6.10: Central and local government should strive to achieve a more constructive relationship and effective interface...

R8.1: The Government and local government should work together to establish centres of knowledge and guidance about climate-change adaptation for councils.

R8.2: The Government should implement a review of existing legislation and policy to ensure that considerations about climate-change adaptation are integrated and aligned within that legislation and policy where relevant.

R8.3: National and local authorities should adopt anticipatory and flexible approaches to climate-change adaptation, in line with recognising the constantly changing nature of the risks. Any additional funding for climate-change adaptation should be conditional on the use of such approaches.

R8.4: The Government should provide legal frameworks that give councils more backing and knowledge to make land-use planning and infrastructure investment decisions that are appropriate in the face of constantly changing climate risks.

R8.5: The Government should extend the New Zealand Transport Agency's role in co-funding local roads to include assistance to councils facing significant threats to the viability of local land-transport infrastructure from sea-level rise and more intense storms and flooding due to climate change.

R8.6: The Government should create a new agency and a Local Government Resilience Fund. The new agency should work with at-risk councils and co-fund the redesign and possible relocation and rebuilding of wastewater and stormwater infrastructure when it becomes no longer viable because of sea-level rise and more intense flooding due to climate change.

## 1.2 McGuinness Institute publications

Key attachments that support this submission include:

1. [\*Report 17 – Building a Reporting Framework Fit for Purpose\*](#) (in press)
2. [\*Discussion Paper 2019/01 – The Climate Reporting Emergency: A New Zealand case study\*](#) (in press)
3. [\*Think Piece 32 – Exploring Ways to Embed Climate Reporting in the Existing Framework\*](#)

4. [Working Paper 2019/ 05 – Reviewing Voluntary Reporting Frameworks Mentioned in 2017 and 2018 Annual Reports](#) (in press)
5. [Working Paper 2019/06 – Analysis of Climate Reporting in the Public and Private Sectors](#) (in press)
6. [Working Paper 2017/01 – TacklingPovertyNZ 2016 Tour: Methodology, results and observations](#)

Other publications to note:

7. [LocalNZ: A Youth Statement on Regional Goals](#)
8. [TacklingPovertyNZ: Exploring ways to reduce poverty in New Zealand, 7–9 December 2015](#)
9. [Project TacklingPovertyNZ publications](#)

### 1.3 Relevant sections of the draft report

Although we do not directly answer the questions from the draft report, we indirectly answer some of the questions raised in the 2018 issues paper. We also respond to some specific sections and issues raised in the Commission’s draft report. Our areas of particular interest are as follows:

*Chapter 2: The context* – Section 2.3: Differing circumstances across local authorities

*Chapter 4: Pressures on funding and finance* – Section 4.3: Increasing responsibilities  
Sections 4.2, 4.6 and 4.7 High rates of deprivation, tourism and climate change and natural hazards respectively

*Chapter 8: Adapting to climate change (particularly climate reporting and New Zealand’s information infrastructure)* – Reporting of climate-related information and Legal liability risk in relation to climate change.

## 2.0 High-level observations and recommendations

### Background

The Institute’s earlier work on ‘Tackling Poverty’ emphasised that each local government faced its own complex and unique set of challenges and opportunities (see Section 4.2 of *Working Paper 2017/01 – TacklingPovertyNZ 2016 Tour: Methodology, results and observations*). These could be due to fundamental characteristics of the particular local government (e.g. proximity to natural resources or being located on New Zealand’s main trunk line.) Each local council also faces its own issues of varying degrees in terms of the quality of management and/or access to central government funding (direct financial funding from central government or support in the form of hospitals and power stations).

How each of these characteristics play out has a significant impact on each New Zealander’s wellbeing. Throughout all regions, the funding and the allocation of finance will be a key factor, however the issues facing each local government are asymmetric and will require specific solutions. There are three types of challenges that in our view illustrate the unique nature of local government, we illustrate these in the following examples.

- (i) The Marlborough District Council manages the resource use of water-spaces through complex applications from aquaculture companies such as New Zealand King Salmon (NZKS). The Council is not able to charge for water-space in order to fund the applications and regulations of the water use. In our view this places an unfair cost on the MDC while the benefits from aquaculture activities in the Marlborough Sounds go to central government.
- (ii) Queenstown Lakes District Council rate-payers largely fund the infrastructure that supports the local tourism industry, but tax benefits in terms of GST and income tax on local profits are directed back to central government, rather than benefitting the community directly. In our view this places an unfair cost on the QLDC. Regions in New Zealand that rely on tourism are often disadvantaged in terms of costs on rate-payers balanced with returns from GST and other forms of tax revenue.

- (iii) The opposite is the case in low-income areas such as Manawatū, which tend to rely on industry employment and receive greater government support as well as lower rates. The Far North, because of its geographical isolation, is disadvantaged with the poor quality of its roads and its low internet capacity.

These differences may be particularly significant in terms of the Local Government Cost Index, discussed in Chapter 3 of the draft report and covered by Question 3.1.

We commend the identification of these issues in the draft report, as well as several of the recommendations proposed to address them. Broadly speaking, we recognise the necessity of a funding mechanism capable of balancing out these asymmetries and addressing the characteristics particular to each council.

Solutions will need to be specific and should target issues that burden councils with additional costs. This might include a tourist tax on flights or accommodation, or a water-space tax for salmon farming. Alternatively, government might fund specific councils based on poverty thresholds or on tourist numbers. The goal should be to ensure councils can maintain a minimum standard of physical and social infrastructure consistently across the country.

## **2.1 Maintain a place and a space for a long-term focus**

### **Provide guidance on what a ‘sustainable development approach’ means in practice**

Currently in New Zealand, the future focus is only included in legislation indirectly through the ‘sustainable development’ approach. For example, the Local Government (Community Well-being) Amendment Bill (which passed in May 2019) reinstated the requirement ‘for local authorities to play a broad role in promoting the social, economic, environmental, and cultural well-being of their communities, taking a sustainable development approach’ into the purpose of the Local Government Act 2002. (s 3(d)).

### **Require government departments to prepare 10-year plans to improve alignment**

Local authorities are required to prepare and publish ‘ten-year plans’ under law (NZ Government, 2017, p. 27) whereas central government has no legislative requirement to prepare and publish such a plan (although departments often prepare four-year plans as a standard protocol but these are not legally required) (NZ Government, 2017, p. 7; New Zealand Government, 2016, p. 8). A similar requirement for government departments would embed more alignment into central government. Government departments also undertake large infrastructural projects, and these are often missed or misunderstood by the public. A cohesive and aligned approach to planning across central and local government would be significantly beneficial.

### **Consider new instruments for long-term thinking**

We consider a ten-year planning horizon to be very useful, particularly given the time it takes to identify, agree, design and build infrastructure. However, we consider that longer term planning is concurrently needed (on a 30, 40 or 50 year timescale); particularly in areas we expect to see exponential change (e.g. climate change and cybersecurity).

A suggestion to address this type of longer-term planning is to structure plans around a fixed year in the future (in our case, we look out to the year 2058) and then work from year zero towards that point. This enables comparisons of thinking and actions over a much longer timescale (with that specific future year in mind). It moves planning away from an accountant’s approach towards that of futurist.

## **2.2 Debt**

In terms of critical information that is important to the public, debt would be high on the list. We consider debt levels to be an important indicator to the public of the extent to which local authorities will be able to cope with future challenges. Because of this, we believe the Department of Internal Affairs (DIA) should

prepare an inventory of local authority debt outlined in the notes to the financial statements as part of a consolidated annual report of all councils. See, for example, Appendix 2 in the OAG's 2012 Parliamentary paper *Matters arising from the 2012-22 local authority long-term plans* (OAG, 2012, p. 101).

As a further example, it is interesting to note the following comments from international credit rating agency Moody's after reaffirming Auckland Council's credit rating and asserting a stable outlook despite debt:

"The Council's high debt burden — as measured by net debt and indirect debt as a percentage of operating revenue — at 242% for the fiscal year ended 30 June 2018 (FY2018) — limits its ability to deliver its large infrastructure spending program without a material increase in debt.

"This situation is partly mitigated by its strong relationship and close alignment with the Crown and work underway to develop alternate funding strategies with the Crown and private sector to 1) build new infrastructure for the growing population, and 2) meet social and economic needs."

"Moody's also notes the strong operating cash flow of the Council, which enables roughly 80% of capital spending to be funded from surplus operating cash flow, as evidenced in FY2018, when only 8% of capital spending was funded by new debt."

But in its latest report Moody's says the Council could suffer a future credit downgrade if it faces reduced support from the government to deliver its infrastructure program, or a reduction in its rate-setting powers, without access to alternative revenue sources. (Forbes, 2019)

We recommend that debt issues such as this be explored further in the final paper as part of Chapter 3 – *Trends in local government revenue, expenditure, prices and debt*.

## 2.3 Consolidated annual report

### All of local government annual report

We recommend that the Department of Internal Affairs (DIA) produce a consolidated financial statement and a consolidated annual report of local government. This would consolidate all material risk of local government in the financial statements and other significant risks in the annual report. This would also consolidate the total debt of all local government entities in the notes to the financial statements (discussed in Section 2.2).

We appreciate that councils are separate legal entities but that does not mean, for governance purposes, the financial accounts could not be consolidated, and risks could be considered together. If a consolidated annual report was prepared it would enable local government to be viewed as a whole and would provide a platform for councils to explain changes to the public over time and how needs and risks are evolving. Due to the current silo-based approach to reporting, it is difficult for central government and others to understand and respond to the challenges 'the group' faces. We believe the present status quo in this sphere is not in the interest of the country.

Such an approach will ensure the New Zealand public has a robust, coherent, integrated and user-friendly information infrastructure. One of the specific benefits of a consolidated annual report is that it improves the accessibility and comparability of information. The Institute's research under *Project StrategyNZ*, reviewing government department strategies (GDSs), highlighted the lack of integration and cohesion across public sector publications (see also Figure 23 and Section 8.1 of *Discussion Paper 2019/01 – The Climate Reporting Emergency: A New Zealand case study* [referred to as 'discussion paper' for the remainder of the submission]). We need to have a discussion about what information is required for a functioning democracy and who needs to provide it. We consider that at present local government tends to have a lower profile due to it being so fragmented.

It may be of interest to the Commission that the Institute also advocates for Treasury to produce a consolidated annual report for central government (in addition to the current requirement to produce consolidated financial statements).

### **Contents of the annual report: TCFD recommendations**

The annual report is a crucial document for assessing risks, benchmarking goals and managing progress. Our underlying assumption for *Project ReportingNZ* is that all material information relevant to users (in this case the public) should be included in a single consolidated annual report.

The 2017 recommendations from the Task Force for Climate-related Financial Disclosures (TCFD) has received significant support from companies and governments globally. In response to the NZPC's *Low Emissions Economy* report, the New Zealand government indicated that:

[Response to Recommendation 7.3] The Government agrees that material financial risks and opportunities associated with climate change should be disclosed. In June 2017, the TCFD published a set of recommendations for disclosing clear, comparable and consistent information about the risks and opportunities presented by climate change. Several other governments have endorsed the TCFD's recommendations. The New Zealand Government also endorses them as one avenue for the disclosure of climate change financial reporting (MfE, 2019, p. 5).

While the Institute has a number of reservations surrounding the recommendations of the TCFD, (see Section 6.5 of the discussion paper), our view is that the four core elements; governance, strategy, risk management, metrics and targets provide a solid platform for the development of a climate reporting framework in New Zealand. We consider that this kind of information is best placed within the annual report. The Institute also supports the TCFD recommendation of developing scenarios and view this to be a key tool for local authorities to think about risk management and the future.

The Institute adapted the TCFD recommendations to create a three step approach to assessing the kinds of information required for both public and private sector entities to report on useful information that can inform public policy:

- Step 1: Risk identification (governance, strategy)
- Step 2: Risk management (risk management)
- Step 3: Risk measurement (metrics and targets)

2018 annual reports of companies on the Deloitte Top 200, state-owned enterprises, Crown agents and Crown entities, District Health Boards, Crown research institutes, Government departments and local authorities were assessed through this three step lens, see *Working Paper 2019/06 – Analysis of Climate Reporting in the Public and Private Sectors*.

The requirement for council-controlled organisations to produce an annual report is outlined in s 67 of the Local Government Act 2002, and content requirements are outlined in s 68. In terms of managing and reporting on risk, we view that preparing a *Statement of Climate Information* as part of the annual report is the best way to ensure consolidation of financial and non-financial information. Using these sections of the Local Government Act 2002 would provide another option for requiring the *Statement*. See Section 2.4 of this submission for more information.



## 2.4 Central repository for public sector annual reports

To further support the process of consolidation of public sector reporting, we recommend the creation and maintenance of a Crown Register of annual reports, as a public sector equivalent of the Companies Register. This could be achieved without legislative change by updating existing public sector reporting guidelines. This may also provide the opportunity to update and consolidate the existing guidance on the preparation of annual reports in the public benefit entity sector (see Section 8.1.3 of the discussion paper).

## 2.5 Climate change recommendations

### Background

Chapter 8 of the draft report provides an appropriate discussion of climate change as it relates to local government funding and financing. We support the discussion of the urgency and uncertainty involved in dealing with these issues and acknowledge the work that local authorities are already doing to prepare for the impacts of climate change. Our research indicates that out of five different types of significant entities operating in New Zealand, local authorities consistently provide the best climate-related disclosures in their publicly available reporting, including the most discussion of the New Zealand Emissions Trading Scheme (NZ ETS) (See *Working Paper 2019/05* & *Working Paper 2019/06*).

We particularly note the discussion of liability risk in light of the impacts of climate change. We have also identified this as an emerging issue in our own research – one that to date has affected the public sector more than the private sector (see Sections 3.3 and 6.2 of the discussion paper).

Below outlines some of the existing instruments and initiatives undertaken by local authorities that promote the consideration of climate impacts on communities, systems and infrastructure.

1. Under s 7(i) of the Resource Management Act (RMA) 1991, ‘all persons [including local authorities] exercising functions and powers under [the Act], in relation to managing the use, development, and protection of natural and physical resources, shall have particular regard to— the effects of climate change’.
2. Long-term plans (LTPs), with their 10-year scope provide another mechanism for local authorities to consider issues with longer-term impacts, such as climate change. LTPs are prepared, reviewed and are open to consultation every three years. The purpose of the plan is to ‘describe the council’s activities and the community outcomes it aims to achieve’; ‘provide integrated decision-making and coordination of the resources’; ‘provide a long-term focus’ and ‘show accountability to the community’ (Crown, 2011). The value of LTPs is emphasised in the Office of the Auditor General (OAG) report *Matters arising from our audits of the 2018-28 long-term plans*, which also acknowledges some of the challenges faced by councils in preparing their LTPs (OAG, 2019). In particular, the report recommends increasing leadership for climate change matters in terms of ‘what data is needed and who collects this; the quality of this data; and how councils should consider this in future accountability documents, including the long-term plan’ (OAG, 2019, p. 7). This recommendation is based on the observation that ‘from our review of the infrastructure strategies, we noted that councils have a limited understanding of the risks natural hazards and climate change pose to their infrastructure assets’ (OAG, 2019, p. 42). It may be of interest to the Commission that the McGuinness Institute advocates for central government to produce a similarly forward-focused document, to ensure local and central government strategies and goals are operating in succinct and cohesive manner.
3. Ministry for the Environment (MfE) has a section of guidance for local government on preparing for climate change (MfE, 2018a). It is difficult to determine what level of uptake this guidance has.
4. The 2018 LGNZ report *Vulnerable: the quantum of local government infrastructure exposed to sea level rise* found that impacts of sea level rise will have significant costs on infrastructure owned by local government (Hall & Simonson, 2019). See section 2.3.4 of discussion paper.

5. In the absence of a declaration of a climate emergency by central government, local government appetites for climate action are evident in the declaration of climate emergencies by several councils throughout New Zealand. The councils include Nelson City Council, Christchurch City Council, Kāpiti District Council, Auckland Council, Wellington City Council, Dunedin City Council, Hawke’s Bay Regional Council, Porirua City Council, Hutt City Council and Queenstown Lakes District Council (Desmarais, Tso & Boyack, 2019).

### **2.5.1 Statement of Climate Information in annual reports**

In the discussion paper, the Institute outlines four high-level design goals to structure our recommendations for improving New Zealand’s climate reporting framework:

- Goal 1: Improve the quality and accessibility of climate-specific information in New Zealand.
- Goal 2: Ensure those who are responsible for governance in New Zealand think long-term and are future-focused.
- Goal 3: Cater to the disclosure needs of broader stakeholders in New Zealand.
- Goal 4: Improve the existing international framework of reporting standards to cover climate-related information.

We consider our goals for New Zealand’s climate reporting framework to align with the Commission’s draft report, given the crucial role of transparency in driving practical change. Below we outline some of our more relevant recommendations (See Section 8 and Appendix 1 of the discussion paper).

The Institute recommends that a *Statement of Climate Information* be required as part of annual reports for both public and private sector entities. There are two mechanisms briefly outlined below that identify areas of legislation that could be amended to require the *Statement of Climate Information*. See Section 8.1 and Appendix 2 of the discussion paper for more information on what a *Statement of Climate Information* might look like. The guidelines on reporting climate-related information developed by the EU are particularly interesting due to their conception of a ‘double materiality perspective’ that differentiates between the impact of an entity on the environment and the impact of the environment on an entity (European Union, 2019, p. 5; see also Section 7.6 of the discussion paper). Such a model may be useful for integrating into the annual reporting and long-term planning of local government.

### **2.5.2 Climate Change Response (Zero Carbon) Amendment Bill**

The reporting provisions of the Zero Carbon Bill as outlined in s 5ZV deliberately apply only to the public sector, making it the perfect opportunity to strengthen climate-reporting requirements for local authorities. Furthermore, s 5ZW of the Zero Carbon Bill enables regulations that could request recurring climate-related information such as the *Statement of Climate Information*, which could become an annual requirement to be submitted to the Climate Change Commission and ideally made publicly available through a Crown Register (see Section 2.4 of this submission).

### **2.5.3 Risk assessment**

One of the most significant challenges facing local authorities with vulnerable infrastructure is understanding their risk exposure. The following options are aimed at improving the information available to them in planning for the impacts of climate change.

#### **Natural hazard risk database**

Explore the possibility of creating an open source database of natural hazard risk for all New Zealand properties. This links to the proposal for ‘a centre of knowledge and guidance about adaptation’ in Box 8.2 of the draft report, as well as to Recommendation 8.1. There is also interest in this idea from the Insurance

Council, given that international assessments of New Zealand's risk are unlikely to accurately represent our risk with a useful level of detail.

**National climate change risk assessment and adaptation plan under the Zero Carbon Bill**

Require the national climate change risk assessment and national adaptation plan proposed under the Climate Change Response (Zero Carbon) Amendment Bill to be prepared every three years, within 12 months of the publication of the atmosphere and climate domain report prepared under the Environmental Reporting Act 2015 (MfE, 2018b, p. 46). Three-yearly reports provide an appropriate frequency for data collection considering the high level of uncertainty over climate-related risks and impacts.

**National environmental standard for flooding, fire and sea-level rise**

Issue a national environmental standard for flooding, fires and sea-level rise under s 43 of the Resource Management Act (RMA) as a way of providing certainty to local and central government regarding climate change risk policy. This could be positioned as a further development to the elevation of natural hazards in the 2017 amendments of the RMA and aligned with the second stage of a resource management review intended to focus more directly on climate change in 2019 (Parker, 2018, p. 12).

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