



# Machinery of Government Supplementary Guidance Note: 'Due Diligence' on Proposed Machinery of Government Changes

## Purpose

This guidance note provides an introduction to the process of 'due diligence' for proposed machinery of government changes. It explains what is meant by due diligence in a machinery of government context, when it is done, and some general principles. It also includes a generic list of the sort of questions that will need to be worked through and the type of information that will need to be gathered as part of the due diligence process. The due diligence process is, however, highly context specific and both the process and the nature of what will need to be investigated will vary depending on a wide range of factors including the nature of a proposal, objectives, timescales, context and history.

This guidance note will help officials who are carrying out policy analysis and undertaking due diligence to support decisions about machinery of government change proposals. It will also help with planning and scoping work for a machinery of government project.

The State Services Commission (SSC) is currently updating its machinery of government guidance. This note provides supplementary information to the existing guidance document and should be read in conjunction with this.

## What is due diligence?

Due diligence is a term that has come from the commercial sector, where it is commonly used to refer to the investigation that is carried out once a transaction has been agreed but before it has been finalised (i.e., before the money has changed hands). It involves systematically gathering and considering a wide range of information to inform decision making.

In the machinery of government context, due diligence is an important aspect of the in-depth policy analysis that needs to be undertaken to support decisions on machinery of government changes. Change proposals might include:

- setting up a wholly new agency or substantial new agency function
- changing the form of an existing agency

- transferring an existing agency, or part of that agency (such as a business unit), or a substantial agency function, to a different agency
- disestablishing an agency or substantial agency function.

Sometimes proposals may involve a suite of changes, with combinations of the above.

Due diligence refers to the detailed examination of all aspects of a machinery of government change proposal in order to be as fully aware as practicable of the implications of a change before a decision is made. These aspects might include, for example, the investigation of risks and opportunities, financial implications, legal implications, regulatory impacts and wider implications for agencies involved in the potential change. It might also include reporting on better options for achieving the objectives of the proposals, and on appropriate processes and timing for changes.

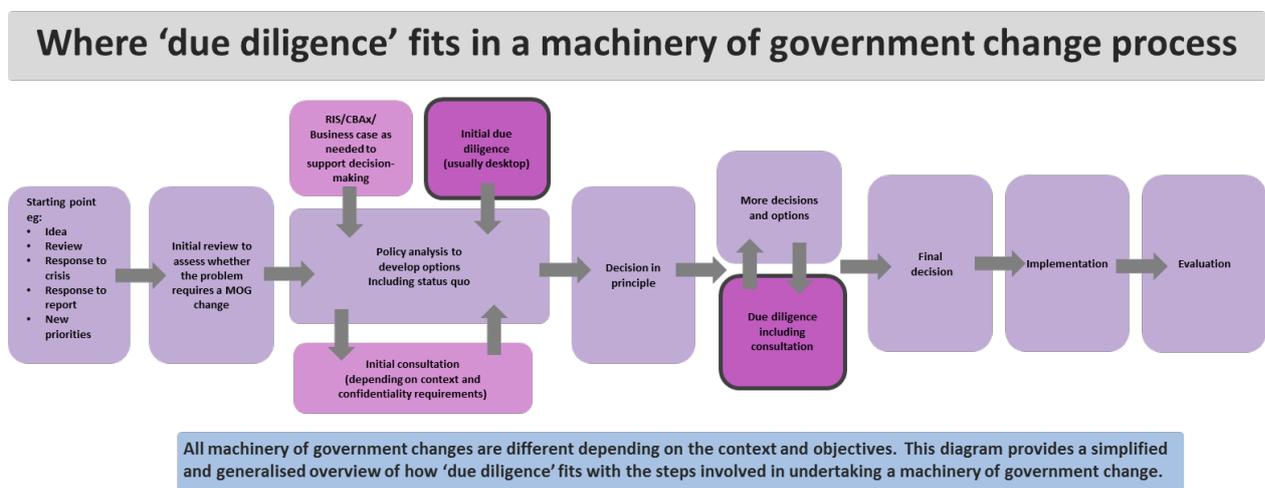
Due diligence involves gathering and analysing a wide range of information and carrying out consultation, investigation and analysis about the agencies that would be affected by the proposal. This might include, for example, analysing the strategic context, and governance implications; investigating employment agreements and legal issues; and exploring priorities for transitional arrangements and business continuity.

If a decision is made to implement the proposal, the information and analysis carried out as part of due diligence will provide a starting point for informing the process of planning and implementing change, for example through identifying key risks, actions and priorities.

For some examples of Cabinet papers that address due diligence on machinery of government proposals, see:

- Public services to meet the needs of 21<sup>st</sup> century New Zealand: Due diligence report on proposals for structural change <http://www.ssc.govt.nz/sites/all/files/cab-paper-decision-structural-change-aug2011.PDF>
- Ministry of Business, Innovation and Employment: Due Diligence and Next Steps [http://www.ssc.govt.nz/sites/all/files/mbie-1792498\\_0.pdf](http://www.ssc.govt.nz/sites/all/files/mbie-1792498_0.pdf)

### When is it carried out?



Due diligence should be carried out every time a proposed change comes to a decision point (by Ministers, Cabinet committee or Cabinet), to ensure that decisions are made with as much knowledge as practicable of the implications and practical consequences.

In practice, due diligence is usually carried out at two key stages in a machinery of government change process:

- at an initial stage to inform the policy analysis being carried out to develop options – often this due diligence is a desktop exercise
- once in principle decisions have been made to proceed with a change.

Due diligence that is carried out in the early stages of a proposal, for example leading up to in principle decisions, will focus more on strategic and contextual issues as well as identifying major areas of risk and opportunity. Due diligence at this stage may be a desktop exercise. Later due diligence will involve working through the detailed operational and practical implications of a change, usually on-site. Often due diligence will be an ongoing process to support a series of decision points, leading up to a final decision.

Due diligence is part of a wider policy development process to support decision making – this process requires careful planning and project management with clear and realistic timelines.

The objectives and scope of each stage should be clearly established and communicated to ensure there is a shared understanding of what will be addressed. It can be helpful to specify and agree with decision makers the due diligence that is to be undertaken.

### **Who does it?**

Due diligence is generally carried out by the agency that is taking the lead on the policy work for the proposed change. SSC usually takes the lead role for machinery of government changes involving sectors or multiple agencies, but SSC's role will depend on the nature of the change that is under consideration and on other considerations such as confidentiality. Once in principle decisions have been taken, depending on the decision and how definite it is, responsibility for carrying out due diligence may shift to the Chief Executive who would be responsible for implementing the change.

Regardless of who is leading the change, SSC must be involved in all machinery of government change proposals, and in proposals that have implications for the State services workforce. Treasury must be involved in change proposals that have budget, appropriation or Vote implications or that give rise to fiscal risks.

Usually the due diligence process is carried out by a working group of officials. This may include seconded officials from different affected agencies. The working group may be supported by consultants and contractors who can provide an independent view and/or specialist expertise.

## General principles for carrying out due diligence:

As noted above, the due diligence process is highly context specific. However some general good practice principles are that:

1. Decisions should be based on relevant information that is as accurate and complete as practicable for the purpose and limitations should be clearly stated
2. Relevance is determined by a judgement as to whether the information might make a difference to the decision being taken
3. Decisions taken on the basis of incomplete information should allow scope for modification later depending on the results of due diligence
4. Due diligence is a continuing process and will need updating/amplifying to support each stage of decision-making and implementation
5. There should be agreement between decision-makers and officials on the proposals to be subject to due diligence and on the matters to be covered in the due diligence process
6. Confidentiality and communication on the due diligence process should be agreed and adhered to by the relevant parties.

## Constraints on information

The early stages of the due diligence process may be constrained by limited information, depending on the context – this may be because of the need to maintain confidentiality, and to avoid unnecessary effort and anxiety about an early stage proposal that may not proceed. In this case, initial due diligence may have to rely on what can be obtained using publically available sources and key contacts in the affected agencies. In other cases, proposals may involve widespread engagement and due diligence can draw on more comprehensive information.

Information constraints and their implications should be identified and noted as part of the process. If initial decisions are made on the basis of limited information, this will mean more work in later stages to gather and analyse information. As more information is acquired through the due diligence process, the assumptions underlying the proposal should continue to be revisited. The team carrying out due diligence should consider whether the assumptions are still valid, and if not, whether the proposal is still likely to achieve its objectives.

## Due diligence questions

Below is a generic list of questions that could be applied to due diligence processes that involve the type of change proposals listed on page 1 of this guidance. Not all questions will be relevant to all circumstances.

Many of the questions, especially those in the first three boxes, are covered in more detail in other parts of the Machinery of Government Guidance [<http://www.ssc.govt.nz/reviewing-mog>] – they are included here to support a complete assessment and ensure that key aspects are not overlooked.

**Due diligence areas for investigation**

**Purpose**

**Initial due diligence questions to support policy analysis and options development:** These questions should be given detailed consideration at an early stage (i.e. before in principle decisions have been taken) and will provide context for later stages of decision-making. Many of these questions should be revisited at a later stage as further information is acquired, to test the ongoing validity of assumptions and whether the proposed changes are still likely to achieve the objectives.

- Strategic fit and rationale:
- What are the key issues that the proposal aims to address and how will the proposal address these?
  - How does the proposal align with the Government’s broad objectives for the relevant sector(s) and for the public sector as a whole?
  - Have non-structural options to address the issues, such as improved inter-agency collaboration, been considered?
  - In what other ways could these issues be addressed? (For example, if the proposal is for a new agency, could the relevant functions be carried out by an existing agency?)
  - What are other relevant contextual, environmental and historical issues and how are they being addressed?
  - What opportunities are created by the proposal?
  - What are the risks?
  - What are the views of key stakeholders on the opportunities and risks of the proposal?
  - Is there a requirement for savings?
  - What are the main assumptions about how the proposal will work – for example if savings are expected, how will they be generated and how long will it take for savings to be realised?
  - What are the costs and benefits of the proposal? (For example what might be the impact of disruption on productivity, how might it affect engagement and turnover, what are the likely costs of redundancies?)
  - If a transfer of agencies or functions is being considered, how compatible are the respective strategic intentions and objectives of the affected agencies and/or functions?
  - What is the proposed timeline and are there any problems with this?

Primarily to test whether the proposed change makes sense given the strategic context, including the Government’s objectives, whether costs are likely to outweigh benefits, and where boundaries should be drawn.

- Nature and scope of functions, powers, responsibilities, accountabilities:
- Which of these are statutory and which are non-statutory?
  - Are there any special characteristics or flow-on obligations (e.g. special governance arrangements or accountability arrangements such as statutory officers or statutory reporting requirements)?
  - What are the relevant regulatory duties? What are the potential regulatory impacts?
  - For existing agencies, what needs to be retained and what needs to be transferred?
  - Are there existing agencies with similar functions, powers, responsibilities or accountabilities that could carry out this role instead, by establishing more effective inter-agency collaboration?

Identifying functions, powers, responsibilities and accountabilities will help determine organisational form and develop a full and clear understanding of what is being taken on. Important for understanding the need for legislative change (beyond an Order in Council) and how this could affect timescales.

Due diligence areas for investigation	Purpose
<p>Governance fit including Ministerial portfolio arrangements:</p> <ul style="list-style-type: none"> <li>• What roles are being proposed?</li> <li>• Do the functions need to be undertaken by government, do they need to be at arms-length from Ministers, do they need to be stand-alone?</li> <li>• Who do the new agencies/functions need to work with?</li> <li>• What impact will the proposal have on the wider sector?</li> <li>• What are the implications for Ministerial portfolios (in relation to the agency or agencies and between Ministerial portfolios)? Has Cabinet Office been consulted (i.e. if changes to portfolio arrangements are being considered)?</li> </ul>	<p>Mainly informs decisions on organisation type, and on whether and where it sits in the State services.</p> <p>For more information on organisational form choices, see <a href="http://www.ssc.govt.nz/reviewing-mog">http://www.ssc.govt.nz/reviewing-mog</a></p>
<p><b>Due diligence questions to support later decisions:</b> While these questions need to be considered at an early stage to develop an initial understanding of major issues and risks, they will generally be worked through in detail at a later stage, once in principle decisions have been made. This stage of due diligence may require the investigation of more than one option.</p>	
<p>Operational aspects:</p> <ul style="list-style-type: none"> <li>• What are the core business processes, services, and information flows?</li> <li>• For existing agencies, how different is the status quo from the proposed future arrangements?</li> <li>• For existing agencies, what will be continued, what will be reduced and/or stopped? Are there opportunities for consolidation of roles and functions?</li> <li>• What staff numbers, assets and facilities will be needed for the agency to deliver the relevant functions?</li> <li>• For existing agencies, what is the current property footprint relevant to the proposal – i.e. locations, distribution? How does this fit with the Government’s property strategy and has the Government Property Group been consulted?</li> <li>• What delegations are needed?</li> <li>• What arrangements are needed for key information and corporate systems e.g. HR, financial, ICT, records and are there specific issues with any of these?</li> <li>• Are there shared corporate services arrangements that are affected by the change?</li> <li>• Is there potential for shared corporate services in the new arrangements?</li> <li>• What will be needed on day one?</li> <li>• Funding and appropriations</li> </ul>	<p>To inform understanding of internal capability needs, costs, timescales, what assets are needed and how the agency or function needs to connect with other agencies to deliver services, and to inform organisational design and structure.</p>

**Due diligence areas for investigation**

**Staffing:**

- For existing agencies, what is the current workforce composition including potential risks in relation to succession, capability and engagement?
- Collective/individual agreements
- Outstanding disputes and grievances
- Union relationships and consultation
- Health and safety
- Transfers
- Redundancy forecasts
- Contractors/consultants

**Legal issues:**

- Specific legislation that is administered by/relates to agencies that are part of the proposal
- Legislation needed to give effect to the changes i.e. new legislation, and amendment/repeal of existing legislation
- Property, including leases
- Litigation (pending, threatened, settled)
- Intellectual property
- Tax
- Insurance
- Employment contracts and requirements of State Sector Act
- Appointments of boards, shareholders etc.
- What delegations are needed (e.g. from Minister, from the board of a separate legal entity, from the chief executive of relevant agencies, from the chief executive of other agencies)
- Contractual issues such as new contracts, arrangements for existing contracts, penalties (e.g. for breach of contract)
- Indemnities

**Purpose**

What the agency needs to deliver the relevant functions and where responsibilities lie, to inform understanding of costs, timelines and risks, for example high turnover of key skills.

May affect the scope of what gets transferred. Affects pricing/funding to be sought and timescales. Need to ensure clarity around who has responsibility for anything not required for the new organisation. Helps avoid unforeseen consequences and nasty surprises.

Due diligence areas for investigation	Purpose
<p>Finance, planning and reporting:</p> <ul style="list-style-type: none"> <li>• Existing state</li> <li>• Future requirements and obligations</li> <li>• Existing contractual arrangements and funding agreements, including property or equipment leases and provision of goods and services</li> <li>• Outstanding audit reviews</li> <li>• Assets and liabilities</li> <li>• Is a new Vote needed (i.e. if a new department is being established), are new appropriations or changes to existing appropriations needed?</li> <li>• If an agency is being disestablished, a final report under Subpart 1 of Part 5 of the Public Finance Act is needed</li> </ul>	<p>Future requirements are sometimes material to decisions on form.</p> <p>If existing functions are inadequate this can have a major impact on the ability to implement decisions.</p> <p>Ensure clear understanding of what is needed to deliver on obligations, including information flows, quality standards and issue resolution especially in shared services arrangements.</p>
<p>Organisational culture and performance:</p> <ul style="list-style-type: none"> <li>• If a merger/transfer is proposed, what are the strengths and weaknesses of the amalgamating agencies?</li> <li>• What are the existing organisational cultures and what is the desired new culture? How will this be addressed by the proposal?</li> </ul>	<p>Informs implementation priorities and change management for the transition and the new leadership team.</p>
<p>Relationships and communications (internal and external):</p> <ul style="list-style-type: none"> <li>• What consultation will be needed? What are existing consultation arrangements (e.g. with unions)?</li> <li>• Who are the different parties that will need to be communicated with and what are their expectations?</li> <li>• What are existing stakeholder networks, partnership arrangements etc.?</li> </ul>	<p>Communications planning is a vital part of implementation.</p> <p>It is essential to engage with affected parties and address anxieties and concerns about the change.</p>
<p>Transitional issues:</p> <ul style="list-style-type: none"> <li>• What are the key issues for each transition phase over the next 3-6 months and the next 1-2 years? (For larger changes, there will be a need to consider transition phases over a longer period)</li> <li>• What are the key risks in relation to the transition and how will they be managed?</li> <li>• Are there issues with current practice and delivery and how will these be addressed during the transition?</li> <li>• What are the cost estimates for the transition and how will these be funded?</li> <li>• What transitional arrangements will be needed, i.e. structures, change management, leadership teams, consultant support, legal support?</li> <li>• How will business continuity be ensured?</li> <li>• What are the timelines?</li> <li>• What existing governance arrangements are in place (e.g. boards etc.), will these continue and in what form?</li> <li>• What arrangements are in place for stakeholder engagement and will these continue and in what form?</li> <li>• Will an establishment board be needed?</li> </ul>	<p>Ensure clear understanding of what will stop, and what must be retained or protected during transition, and how the transition will be implemented and managed.</p>