NEW ZEALAND
GOVERNMENT PROCUREMENT

# Due Diligence

## Construction Procurement Guidelines

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MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
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**Construction Procurement Guidelines**

The purpose of the Construction Procurement Guidelines is to provide government agencies with guidance on the government's standards of good practice for the development of their construction procurement strategy. The Guidelines are intended to support government agencies to improve the quality and consistency of their construction procurement practices.

The Guidelines consist of a suite of sections, each covering a subject matter area. They are considered to be live documents which we may update and add to, from time to time, to ensure they remain current and relevant. You can download the latest version of each section, along with any accompanying tools and templates, from www.procurement.govt.nz.

To provide feedback on the Guidelines, email procurement@mbie.govt.nz.

**Major infrastructure project guidance**

Major infrastructure projects by their very nature are large scale and complex – they have bespoke issues, risks and challenges that may require more sophisticated project planning, management, procurement and governance approaches. The New Zealand Infrastructure Commission - Te Waihanga, publishes major infrastructure guidance for projects with a total cost of ownership of greater than $50m.

For more information about major infrastructure project guidance and the support provided by the Infrastructure Commission, see www.infracom.govt.nz or contact the Infrastructure Commission at info@infracom.govt.nz.

**Disclaimer**

The information presented in this guideline is intended for general use only. It should not be construed as legal advice, and should be read in conjunction with any relevant policy, legislation and regulations. While every effort has been made to ensure the accuracy, currency and completeness of this guideline, MBIE cannot accept any liability for the accuracy, currency or completeness of material contained herein. MBIE cannot be held responsible for, and makes no warranties as to: the suitability of the information in this guideline for your specific circumstances; or any actions taken by third parties as a result of you relying on information contained in this guideline.

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# Due diligence

## Overview

Completing due diligence is a critical part of selecting a supplier who has the capacity and capability to deliver what your agency needs. The real test is if the supplier can deliver not only now, but throughout the life of the contract. You complete due diligence by undertaking several activities to independently verify a supplier:

- is who they claim to be
- has the necessary capacity and capability to deliver, directly or through sub-contractors
- has the financial ability to deliver
- has appropriate practices and processes to support delivery
- doesn't expose you to an unacceptable level of risk.

Due diligence, even when done well, doesn't eliminate risk. However it should enable you to reduce the likelihood and impact of the key risks by identifying mitigations for them.

> Before awarding a contract, agencies must complete due diligence on their preferred supplier, appropriate to the scope, risk and value of the proposed contract.

Depending on the procurement approach selected, you may also use due diligence checks during the tender, including for shortlisting. All due diligence actions should be documented.

For more information, see:

- MBIE's Conducting due diligence checks
- MBIE's Due diligence checklist

## Right size your approach

Due diligence isn't a "one-size-fits-all" activity and can differ significantly from project to project based on the importance of contract scope to the result wanted, risk profile and value of the proposed contract.

When planning for due diligence, consider what information and evidence you require, and the suppliers' ability to respond (particularly when dealing with small and medium-sized enterprises and sole traders). You should structure activities to reduce unnecessary burden on suppliers while still meeting your needs.

> **Contracting supplier**
>
> It's important to know exactly who the contracting supplier is and the relevance of the parent company (if any). The approach to due diligence will depend on whether the contracting entity and parent company are registered in New Zealand or overseas.

# Capability, capacity and past performance

Exercising due diligence on capability, capacity and past performance mainly involves validating claims and information provided by a supplier. Related activities could include:

- reference checks
- site visits
- media checks
- Companies Office checks
- compliance certificate checks
- registration and membership checks
- clarifications of methodology and approach to delivery
- product testing
- security checks.

## Capability, capacity and performance red flags

Possible red flags associated with a supplier that may lead to a high risk for a project include (as appropriate to the level of due diligence being conducted for your project):

- lack of relevant licences (or licence is recently acquired)
- limited or no verifiable history of providing the proposed goods, services or works
- unwillingness to commit specific personnel to the project
- history of operational or regulatory issues
- exaggerated claims about client-base or inability to provide the contact details of authentic references
- examples of past performance come from one or very few customers, or are from work delivered by personnel no longer employed by the supplier
- company-wide hiring freeze
- conflicts of interest.

# Financial and commercial

Financial due diligence tends to focus on four main elements:

| | |
|---|---|
| **Working capital** | Does the supplier have enough funding to meet working capital requirements? |
| **Financial capacity** | Does the supplier have a strong enough balance sheet to absorb project overruns? |
| **Revenue** | Would the supplier be over-reliant on the project for solvency? |
| **Profit** | Does the supplier earn enough EBITDAS (earnings before interest, taxes, depreciation, amortisation and shareholder salaries/dividends) to fund debt, asset investment and shareholder salaries/dividends? |

Commercial due diligence instead tends to focus on the following main elements:

| | |
|---|---|
| **Ownership and governance** | Is ownership clear and are governance arrangements sufficient to make sure the project is a success? |
| **Trading history** | Does the supplier's registration date align with their claimed experience and past projects? |
| **Plans and forecasts** | Do the supplier's plans and forecasts stand up to market realities? |
| **Legal and insolvency** | Has the supplier experienced significant (or regular) legal and/or insolvency proceedings? |
| **In good standing** | Is the supplier in good standing with insurers and creditors, and able to obtain all necessary credit, bonds, insurance etc? |
| **Their own due diligence** | Does the supplier exercise appropriate due diligence on their own contracts? |

Financial and commercial due diligence looks mainly at past information, and provides no guarantee of future success/performance.

## Stages of financial and commercial due diligence

Financial and commercial due diligence is typically done in two stages, because it keeps things manageable, such as asking for information that's relevant to each stage to reduce the burden on both parties:

1. **Initial due diligence:**

    - is done at the registration of interest (ROI), or shortlisting stage to assist selection
    - can consist of a high-level, desktop analysis of accounts and the tenderer's response to submission form questions, or a more detailed review
    - is to identify any red flags and/or key risks/issues that may require further analysis in this or the final stage.

### Financial and Commercial Due Diligence Submission form

The Financial and Commercial Due Diligence Submission form, for use in the initial stage, has a standardised format for the collection of information from tenderers. The use of a standardised format supports best practice while reducing the burden on suppliers responding to multiple tenders.

The form is for use on infrastructure projects which meet or exceed the new construction works value threshold (Rule 7). Projects below the threshold could use parts of the form, but not necessarily all the information, or level of analysis, will be required if the project is of a limited scope or considered low-risk.

The information collected should be reviewed by a commercial financial expert who understands financial statements from private businesses, and preferably the construction sector. At a minimum the main elements covered above should be addressed.

For more information, see: Financial and Commercial Due Diligence Submission form

2. **Final due diligence:**

- is done at the request for proposal/request for tender stage, with the preferred supplier(s) only
- typically consists of a more detailed analysis of accounts and the tenderer's response to submission form questions, including detailed investigation into risks/issues identified during the initial stage
- should be analysed/ investigated to a degree consistent with the project scope, risk profile and value, and the nature of risks/issues identified. Analysis and investigation may include:
    - interviews
    - requests for further information
    - checks of insurance certificates
    - insolvency, bankruptcy and court register checks
    - credit and Personal Property Security Register checks
    - checks of retention practices
    - letter of comfort from supplier's bank
- should include expert advice, particularly on financial and commercial matters, for large, high risk or complex projects.

**Access to non-public information**

You may need to obtain information that's not in the public domain to exercise due diligence. In some cases you may consider signing a non-disclosure agreement or getting information about privately-held companies directly from independent experts.

## Financial and commercial red flags

Possible red flags associated with a supplier that may lead to a high risk for a project include (as appropriate to the level of due diligence being conducted for your project):

- cash flow or balance sheet insolvency
- any significant or unexplained changes in financial performance and/or position
- steady decline in financial performance and/or position
- seeking advance payments outside industry norms for goods or services
- high levels of unsecured receivables/payables, especially between related parties
- over-reliance on non-tangible assets to support balance sheet solvency
- unclear ownership and/or company directors with a history of closing and re-opening businesses under a new name (could be noticeable if the supplier's registration date does not align with their claimed work history)
- inability or unwillingness to provide evidence that appropriate retention practices exist and are followed, including holding sufficient funds and how/where they are held (best practice is to hold funds in accounts separate to those holding operating capital)
- whether the auditor considers the supplier a going concern or not (for audited accounts)
- a history of adverse court, regulatory or tribunal findings
- unable to confirm acceptance of performance bond requirements (either from a bank registered in New Zealand or insurance provider with a minimum Standard and Poor 'A' rating and above))
- unwillingness to provide a parent company guarantee if required by the contract
- unwilling to produce insurances certificates of currency
- over reliance on one or two key clients for financial viability.

# What to do if you find issues

You need to consider what to do if issues are found when completing your due diligence. Remember, not all issues are significant.

If you identify issues but you think they aren't serious:

- consider what additional information you need to confirm whether the issues are serious or not (consider checking with Treasury, the Government Chief Information Officer, and New Zealand Government Procurement and Property)
- consider what you can do to avoid or prevent any risks being realised and affecting your project

If the issues identified are serious you should consider whether it's appropriate to exclude the supplier from participating in a contract opportunity (Rule 44). It's good practice to notify a supplier of their exclusion and the reasons for it.

For more information, see Rule 44: Reasons to exclude a supplier