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Due diligence and the transaction process

- **Last time you explained some basic background about due diligence. We left off when I asked what exactly a due diligence assignment involves and how it fits into the acquisition process. Can we pick up again from there?**

  Of course. Sorry I had to rush off. For our purposes, the acquisition process can be considered as consisting of 5 stages, with due diligence in the middle, as follows: target identification, initial agreement, due diligence, final agreement/completion, and integration.

- **So the due diligence team only really get involved after the outline of the deal has been agreed.**

  These stages are not distinct; they overlap and seep into each other. The bulk of due diligence work does come after initial agreement, but various issues at this stage will have considerable bearing on it so you are well-advised to involve the investigating accountant earlier. Similarly, a good due diligence report should also identify issues relevant to the post-completion stage.

- **OK, I see. I guess involving the accountants early will help to ensure that the due diligence goes smoothly and quickly.**

  And efficiently, yes, enabling the work to be properly focused and keeping costs down. The most important consideration, though, is to ensure that you and due diligence team are clear about what work is to be performed and what deliverables provided.

- **I can imagine. So what are the elements a due diligence engagement usually includes?**

  Well, in outline a “typical” (if there is such a thing) engagement might include:

  Preliminary appraisal

  This is a high-level appraisal to identify any major fundamental issues that may derail the entire deal. It is also useful in determining the scope and focus of the remainder of the engagement.

Fact-finding, analysis and interpretation

This includes reviewing existing information such as details of the structure, key personnel, products and activities, financial statements and underlying records, accounting and operating manuals, records underlying cash flows, assets and liabilities, projections/forecasts and regulatory documentation. A lot of the field work will also be interviewing the key people, not just in the finance department but in all areas of the target company.

The team will analyze the information in the context of a thorough understanding of the business and its environment. They will calculate historical growth rates and other key data to assess the quality of earnings and projections. Sensitivity to changes in the main assumptions, and related risks will also be assessed.

Reporting

The team will compile a report to provide you with relevant information and an expert professional commentary highlighting risks, uncertainties and areas for further consideration. It may also include an opinion and conclusions on the target company.

- **Clearly there's a lot of work there! Is that where it ends?**

  The results of the due diligence exercise are likely to inform the process of finalizing the terms of the sale and purchase agreement to a considerable extent. In particular indemnities and warranties are often required to mitigate risks highlighted by the due diligence report.

  Finally, the ultimate success of the deal often depends heavily on the successful integration of the target business and due diligence can be a useful early warning tool.

- **All in all, then, due diligence is pretty important. What are the key considerations to bear in mind when instructing a firm to conduct due diligence work on my behalf?**

  Time's up for today, I'm afraid, but this will be the topic for our next, and final discussion.