

**WESTERN INDIA REGIONAL COUNCIL OF
THE INSTITUTE OF CHARTERED
ACCOUNTANTS OF INDIA**

**SEMINAR ON
DUE DILIGENCE
(FINANCIAL) BY
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CONTENTS

- What is Due Diligence?
- What are the Objective of due diligence?
- Need of Due diligence
- Situations Calling for Due Diligence
- Who conducts due diligence?
- Process of Due Diligence
- Types of Due Diligence
- Scope of Due Diligence
- Limitations of Due Diligence
- Risks Involved in Due Diligence
- Steps to Mitigate Risks
- Introduction to Financial Due Diligence
- Types of Financial Due Diligence
- Difference between Audit & FDD
- Process of Financial Due Diligence
- Checklist of Financial Due Diligence
- Quality Of Information

DEFINITION

- Generally , this is no exact definition of Due Diligence.
- However lots of attempt has been made to simply the said term



Due Diligence

due dil·i·gence

noun **LAW**

noun: due diligence

- 1 reasonable steps taken by a person in order to satisfy a legal requirement, especially in buying or selling something.
 - a comprehensive appraisal of a business undertaken by a prospective buyer, especially to establish its assets and liabilities and evaluate its commercial potential.

WHAT ARE THE OBJECTIVE OF DUE DILIGENCE?

- To enhance business solutions by prudently investigating into the affairs of business.
- A systematic and strategized approach to assessed all material facts related to the business .
- To assess the risks and opportunities of a proposed transaction.
- To identify the forthcoming adversities which may call for unseen liabilities .



NEED OF DUE DILIGENCE



- The exercise of Due Diligence is absolute necessity in event of following cases:
- Acquiring of interest by a strategic investor through Share holding.
 - Buying of any organization.
 - Investment by private equity funds/ VC's
 - Inbound and overseas investments

NEED FOR DUE DILIGENCE

- Investment banker considering underwriting a public security.
- Banker considering the grant of any Advance facilities or Restructuring any NPA.
- Seller of a business.
- Lead Investment Banker in case of IPO as per SEBI Norms.

WHO CONDUCTS A DUE DILIGENCE?



PROCESS OF DUE DILIGENCE

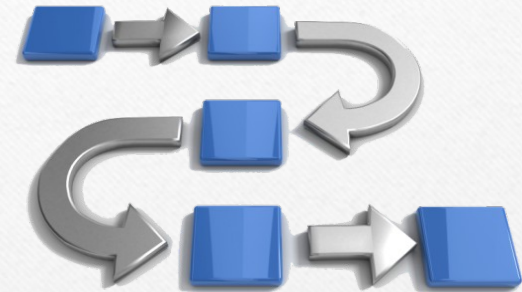


ILLUSTRATION OF SCOPE

- Generally Scope should include following points:
 - Areas to be covered
 - Manner of maintenance and collection of data
 - Final work product:
 - Due Diligence Report
 - Only Executive Summary
 - Comprehensive Observation with Executive Summary, detailed report on all segments, data sheets
 - Timelines - Time within which the exercise is to be complete

PROCESS OF DUE DILIGENCE

- **Step 1: Conception, Designing & Planning:**

Before initiation of any process, it is pertinent to have an overview of critical issues that is to be considered for fruitful execution of the proposed transaction. This stage will enable to outline the depth and intensity of due diligence exercise which is precise to proposed transaction.

STEP 1: CONCEPTION, DESIGNING & PLANNING

- Acquire critical documents providing information sort of Memorandum of Understanding about the proposed transaction.
- Identification of major concerns pertaining the proposed transaction.
- Charting of flow charts, process notes, casting off responsibilities
- Preparation of initial checklist for flow of information amongst team members.

STEP 1: CONCEPTION, DESIGNING & PLANNING

- Drafting of initial checklist for distribution amongst team members.
- Formation of Team based on capability and expertise of members as per requirement of the various components of the due diligence.
- Assistance of Expert professional.
- Understanding of specific industry regulations and various benchmarks applicable to the assignment.

STEP 2: DATA COLLECTION

- It involves Collating of information to complete a due diligence exercise through data using software which provides comprehensive and complete data information.
- The data collection is ideally to be done by such person who has the skills and attributes along with advanced experience of handling the data.
- Interest parties rely on valuable data to help them make informed and actionable business decisions. However, with so much data on and offline, identifying valuable, accurate and quality data is

STEP 2: DATA COLLECTION

- Generally data collection process consists of following ways : –
- Data provided in the form of documents/reports/books of accounts.
- Data collected on the basis of interviews with representatives to get clarity.
- Information obtained through informal meetings/discussions.

STEP 3: DATA ANALYSIS

- Due diligence continues to play a critical role in achieving maximum value in the transactional market. Utilizing data analytics during due diligence provides an organization with a key advantage in highly competitive M&A market in the near future.
- Data analysis activity involves a series of questions and attributes related to a transaction's value. Projecting analytics portray financial performance through a business strategy lens. Together, these tools provide a quantitative foundation for creating the purchase price, exposing risks, and identifying value-creation opportunities. These platforms also have the capability to analyze industry- or transaction-specific trends and investment considerations

STEP 4: DRAFTING OF REPORT

- At this stage i.e finishing point of the due diligence process, the team usually draft the due diligence report.
- The report prepared shall provide the relevant information in a format which should convey the observation in absorbable form.
- The report should be in synced with scope and objective of the assignment.

STEP 4: DRAFTING OF REPORT

- The due diligence report would characteristically consist of the following three sections: –
- Executive Summary: The same shall draw the attention of the Acquirer in relation of any issues requiring attention which could also act as deal breakers
- Main Body: This normally includes the order and headings of the terms of reference or the checklist.
- Supplements: This annexures which are relevant to a critical issue.

STEP 5: SUBMISSION OF DUE DILIGENCE REPORT

- The due diligence report is to be presented before the Acquirer including its legal and business advisers or any other person as per pre determined terms.
- The submitted report enables interest parties in a transaction to take on critical decisions pertaining to the said transaction. The report also contemplates the interested parties to take certain informed decisions as mentioned below:

STEP 5: SUBMISSION OF DUE DILIGENCE REPORT

- Taking corrective action on adverse issues before the concluding of the Transaction –
- Providing a window for negotiating of more favorable terms.
- Incorporation of specific conditions to the transaction.
- Rearrangement of proposed transaction.
- Striking off deal in case of adverse findings.



LIMITATIONS OF DUE DILIGENCE

RISKS INVOLVED IN DUE DILIGENCE



For Professionals

- Unable to meet the needs of the parties
- Financial indemnification of the consequential loss.
- Risk of Overdoing Due Diligence Effort.
- Inaccurate estimation risks attached to proposed transactions.

RISKS INVOLVED IN DUE DILIGENCE (CONT.)



For Acquirers/Investors

- The investor may pay higher than the fair price for acquisition
- The investment performance may not be up to the expectation or may perform badly
- A bad strategic investment may result in losing a considerable market share or reputation

STEPS TO MITIGATE RISKS



For Professional

- Clear understanding of the objectives including intricacies of the assignment is essential for successful execution.
- The Due Diligence Report should disclose all the limitations pertaining to the assignment.
- A proper engagement review should be carried out before accepting the assignment and deciding the scope

STEPS TO MITIGATE RISKS (CONT.)

For Professional

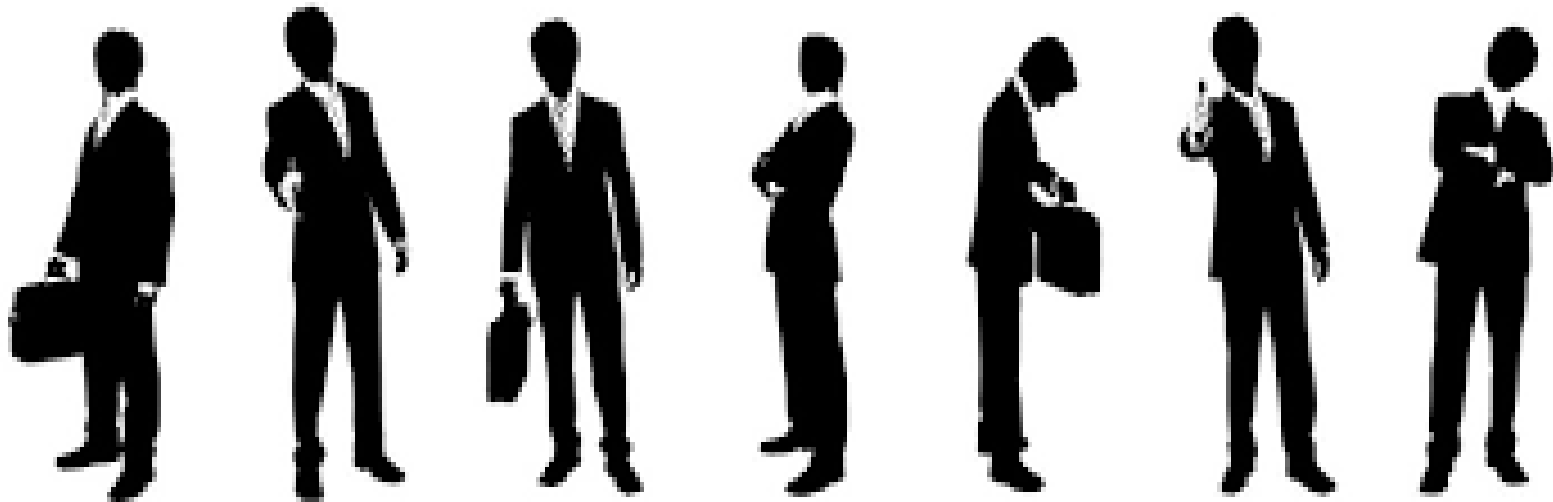
- Schedule meetings with other reviewers
- Collect from the client, reports of all other due diligences
- The due diligence team should consist of at least one person who is familiar with the industry in which the target is functioning.

STEPS TO MITIGATE RISKS (CONT.)

By Acquirer/Investor

- They should ensure that the scope is comprehensive
- Proper coordination amongst all service providers should be encouraged
- An integrated service provider may be hired
- To ensure that the target provides all necessary information





FINANCIAL DUE DILIGENCE

FINANCIAL DUE DILIGENCE



Introduction

“Financial due diligence has the highest significance –the final decision, for an investor, would be in the form of financial terms and information. It is therefore imperative that the results of all kinds of due diligence should be translated in monetary terms.”

INTRODUCTION TO FINANCIAL DUE DILIGENCE (CONT.)



- **Due diligence** is an investigation or audit of a potential investment or product to confirm all facts, such as reviewing all **financial** records, plus anything else deemed material.
- It refers to the care a reasonable person should take before entering into an agreement or a **financial** transaction with another party.

INTRODUCTION TO FINANCIAL DUE

DILIGENCE (CONT.)

- Financial due diligence involves an extensive investigation analysis of a business, verifying the critical matters affecting the business and the key indicators of sustainable profits and cash flows, recognizing the crucial risks and potential deal breakers of the transaction.

DIFFERENCE BETWEEN AUDIT AND FINANCIAL

DUE DILIGENCE (FDD)

AREAS	AUDIT	FDD
Conducted by Whom	C.A, C.S, Cost Accountant	Any Professional having experienced specifically in M&A
Objective	To provide opinion whether the financial statements reflects true and fair view in accordance to standards issued by Governing body or Acts	Identification of hidden risks & deal breakers. Assessment of Quality and Sustainability of Earnings along with forecast growth. Assessment of others aspect effecting the transactions.

DIFFERENCE BETWEEN AUDIT AND FINANCIAL

DUE DILIGENCE (FDD)

Reporting format	Format and Schedules annexed to reports are prescribed by the relevant body or Acts.	Generally, it is a formal drafted report with an executive summary of key issues.
User of Report	Shareholders, Investors, vendors, and authorities, banks, customers and governing	Buyers, Sellers, Venture Capitalist, Investment bankers etc
Period covered	Usually a Fiscal year	Depending upon scope

TYPES OF FINANCIAL DUE DILIGENCE

Acquirer side

- Due Diligence commissioned by the acquirer
- Focused on areas of interest for potential acquirer as determined by scope
- Reporting – Generally issue based



TYPES OF FINANCIAL DUE DILIGENCE (CONT.)

Seller Side

- Independent due diligence commissioned by the vendor
- Key tool for maximising saleability of the business in a reduced timetable
- To identify potential issues and take corrective measures upfront



TYPES OF FINANCIAL DUE DILIGENCE (CONT.)

Full Scale

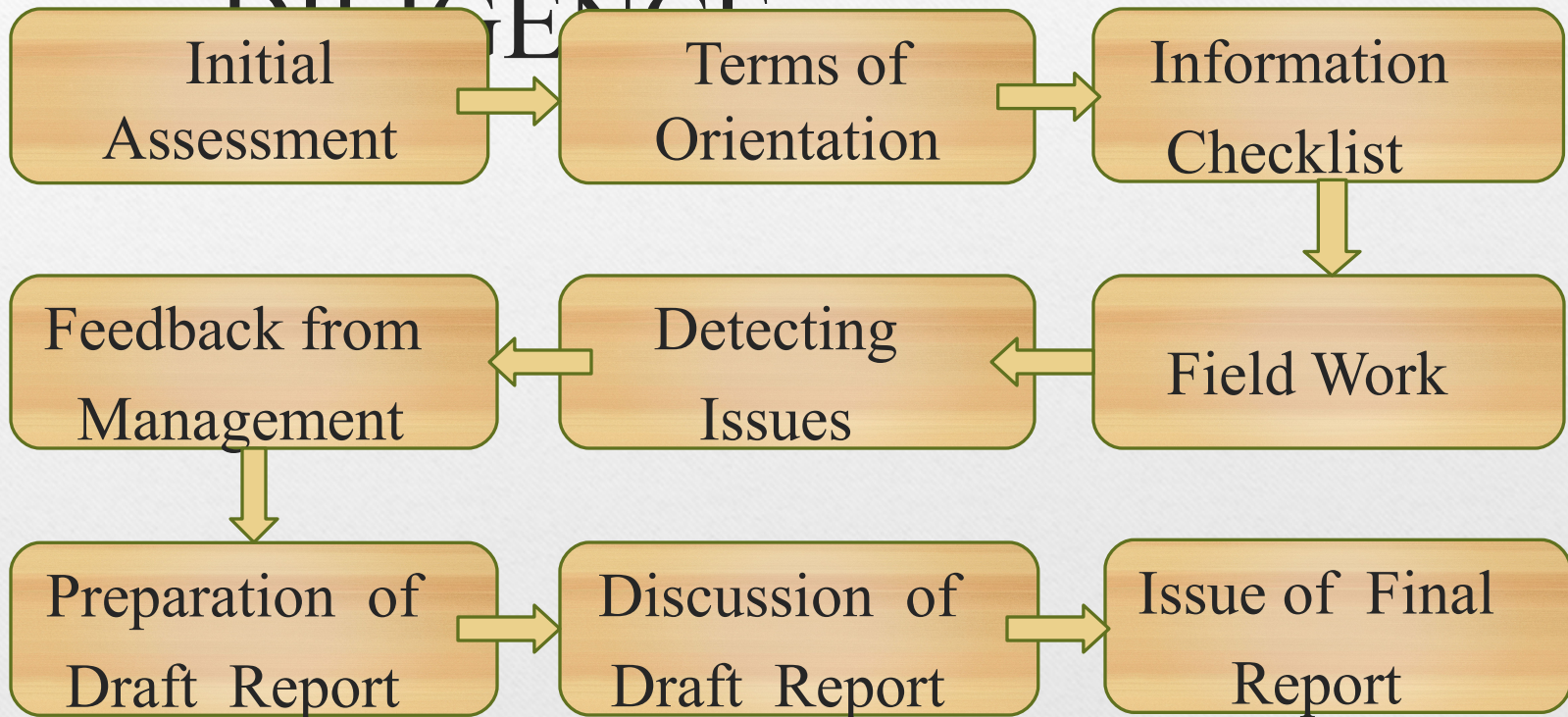
- Focus on all major aspects of financial statements
- Extent of focus and coverage is more comprehensive



PROCESS OF FINANCIAL DUE DILIGENCE



PROCESS
makes
PERFECT



CHECKLIST OF FINANCIAL DUE DILIGENCE

- i. Companies
- ii. Business Environment
- iii. Corporate & Strategic Information
- iv. Commercial Information
- v. Technical & Operation Information
- vi. Buyer Considerations: pre and post completion
- vii. Financial Information
- viii. Professionals
- ix. Articles and Publicity
- x. Technology
- xi. Balance Sheet Assets and Liabilities
- xii. Fixed Assets
- xiii. Litigation

CHECKLIST OF FINANCIAL DUE DILIGENCE

- xiv. Debtors/Creditors
- xv. Investments
- xvi. Working Capital
- xvii. Off Balance Sheet Items
- xviii. Profit & Loss Items
- xix. Insurance
- xx. Property Issue
- xxi. Taxation – Direct and Indirect
- xxii. Other Claims
- xxiii. Deferred Revenue Expenditure
- xxiv. Other Areas
- xxv. Cash Flows
- xxvi. Quality of Earning

CHECKLIST OF FINANCIAL DUE DILIGENCE



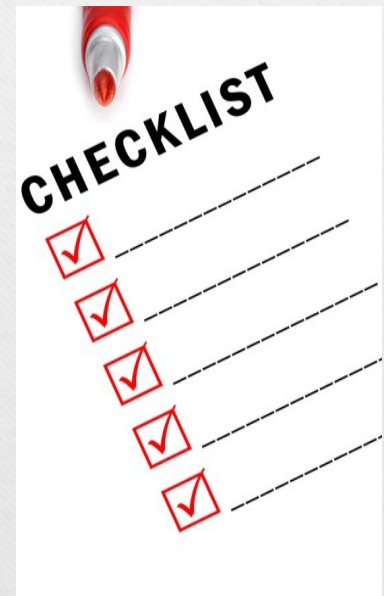
Companies

- Audited financial statements for each of the Company for the last three financial years, with the auditor's opinion and all annexures/schedules.
- Un-audited financial statements for each of the Company for the most recent period or quarter end.
- Comparison of Previous 2/3 years budgets with actual performance.

CHECKLIST OF FINANCIAL DUE DILIGENCE (CONT.)

Companies (Cont.)

- Financial Reports submitted before management and the Board of Directors of the Company during the past 2/3 years
- Detail of capital expenditures for the last three (3) calendar years. Receivables aging schedule.



CHECKLIST OF FINANCIAL DUE DILIGENCE (CONT.)



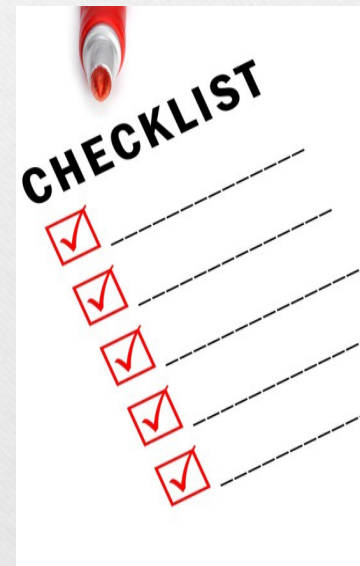
Companies (Cont.)

- This would involve understanding the business model of the target and the value chain of its business. Other than the main value creating functions viz. procurement and its logistics, production, marketing and sales and distribution logistics, attention is also given to the functions that support these activities

CHECKLIST OF DUE DILIGENCE (CONT.)

Companies (Cont.)

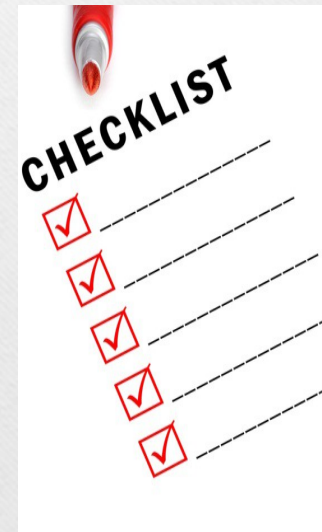
- Has the target company complied with statutory requirements?
- Are any payments made to relatives of key managerial personnel, etc
- Schedule of inter-company balances and trading.



CHECKLIST OF DUE DILIGENCE (CONT.)

Companies (Cont.)

- Location of all statutory books of the target and its subsidiaries
- Details of charges over assets of the group. Copies of correspondence with lenders.
- Any abnormal factors affecting the business?



CHECKLIST OF DUE DILIGENCE (CONT.)



Business Environment

- This would typically assess the effect the external factors have upon business.
- This when compared with the internal strengths and weakness, provides a good understanding of the state of business. External factors generally include markets, competition, regulation and technology.

CHECKLIST OF DUE DILIGENCE (CONT.)



Corporate & Strategic Information

- General information on the business/history
- Overview of company's corporate structure - subsidiaries/parent/dormant companies, joint ventures etc (chart format)
- Organisational charts and key management resumes
- List of any associations company is currently endorsed by; accreditations, awards, memberships

CHECKLIST OF DUE DILIGENCE (CONT.)

Corporate & Strategic Information (Cont.)

- Strategic business plans (current and future), including succession planning
- SWOT analysis (if available)
- What is the company's vision?
- Are there any existing strategic alliances, joint ventures or other partnerships/agreements in place?



CHECKLIST OF DUE DILIGENCE (CONT.)

Corporate & Strategic Information (Cont.)

- If so, obtain details of incorporations, acquisitions, disposals, joint ventures, strategic alliances, windings up



CHECKLIST OF DUE DILIGENCE (CONT.)

Commercial Information

- Market potential – existing, diversification, domestic, foreign, etc.
- How are products/services currently priced?
- What factors affect the pricing of purchases and are processes generally stable?



CHECKLIST OF DUE DILIGENCE (CONT.)

Commercial Information (Cont.)

- Details of marketing activity & advertising used by the company
- Details of existing products & services. Any threats?
- Current distribution channels.
- Promotion – how are products & services promoted?

CHECKLIST OF DUE DILIGENCE (CONT.)

Commercial Information (Cont.)

- Who are the most significant competitors? How will they react?
- Sales by top 10/20 customers; who are the principal customers?
- Degree of customer concentration.
- Significant customers movement in last 2/3 years



CHECKLIST OF DUE DILIGENCE (CONT.)

Commercial Information (Cont.)

- Any special terms given to customers?
- What are customer retention rates?
- How is new business developed?
- Approximately what share of the market does the target business hold?



CHECKLIST OF DUE DILIGENCE (CONT.)

Commercial Information (Cont.)

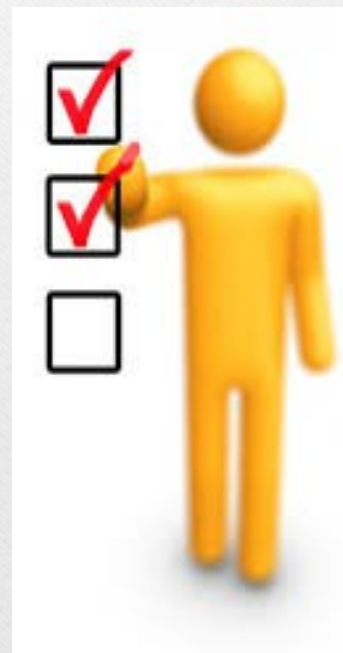
- Prospects list - Are any new customers under development?
- What does the current order status and backlog look like?
- What are the company's core competences?



CHECKLIST OF DUE DILIGENCE (CONT.)

Commercial Information (Cont.)

- What part of the product lifecycle is the business in?
- What differentiates the target business from its competition?
- Ensure you know what the most profitable products / niches / sectors/ customers.



CHECKLIST OF DUE DILIGENCE (CONT.)

Commercial Information (Cont.)

- Details of any warranties/guarantees for services offered.
- Details of all products/services under development.
- Summary of results of all tests, evaluations, studies, surveys, market research reports.



CHECKLIST OF DUE DILIGENCE (CONT.)

Commercial Information (Cont.)

- Who are their principal suppliers and distributors?
- Are there alternative sources of supply?
- Management's assessment of Key Purchase Criteria Are there any unusual payment terms to suppliers?



CHECKLIST OF DUE DILIGENCE (CONT.)

Commercial Information (Cont.)

- Customer due diligence (are they solvent, reliable) – how will they react?
- How will suppliers react?
- Supplier due diligence (supplier churn)
- Details of memberships or, or representation on and trade associations or industry bodies pertaining to supplier.



CHECKLIST OF DUE DILIGENCE (CONT.)

Commercial Information (Cont.)

- Details of subcontractors.
- Information on market and competitors, including market shares and competitor profiles
- Assessment of markets. Size? Are markets expanding? Are there new products/geographical markets to explore?



CHECKLIST OF DUE DILIGENCE (CONT.)

Commercial Information (Cont.)

- What are the major factors driving the size and growth of the markets?
Barriers to entry?
- What R&D/development would be needed to improve the target's competitive position or take it into new markets?



CHECKLIST OF DUE DILIGENCE (CONT.)

Commercial Information (Cont.)

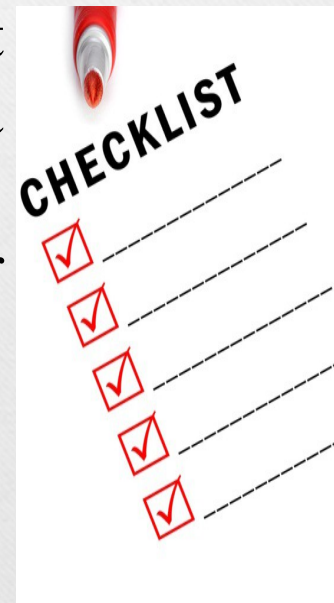
- Competitive forces – e.g. consolidation, restructuring, diversification. How cyclical is the market? Impact of economic variables.
- Market positioning vs. competitors.
- Sources of competitive advantage.
- Copies of any recent industry or product surveys.



CHECKLIST OF DUE DILIGENCE (CONT.)

Commercial Information (Cont.)

- Copies of any recent reports on the target or its products produced by the target or a third party.
- Membership of any trade association or professional body, by the target company.
- Has the sales mix changed over the last 3 years? If so why?



CHECKLIST OF DUE DILIGENCE (CONT.)

Technical & Operation Information

- Obtain full details of the IT systems and backup arrangements?
- Is IT system compatible with acquirer's business and is it adequate for current/future needs?
- Where is secure data located and who has access?
- Obtain a copy of the physical security, disaster recovery, back up/redundancy, and prevention features.

CHECKLIST OF DUE DILIGENCE (CONT.)

Technical & Operation Information (Cont.)

- Has any bespoke software (Customised Software) been developed and, if so, are you familiar with it?
- What IT/network security is in place, including that used for online transactions?
- Staff security - What are the credentials of the systems administration staff and have they undergone criminal checks where necessary?
- Are there any staff on call 24/7?

CHECKLIST OF DUE DILIGENCE (CONT.)

Technical & Operation Information (Cont.)

- Are all licenses currently active?
- Details of any system maintenance and support guarantees/agreements/ contracts.
- Details of production processes?
- What are their KPI's and how do they ensure performance and quality management?
- Is there a written quality policy (ISO?)

CHECKLIST OF DUE DILIGENCE (CONT.)

Technical & Operation Information (Cont.)

- Brief description of any unique production methods.
- Summary of recent production problems.
- Constraints on production capacity.
- Alternative arrangements for materials which are single sourced
- Any supply chain disruptions?

CHECKLIST OF DUE DILIGENCE (CONT.)

Buyer Considerations: pre and post completion

- Be clear exactly what it is you are buying
- Consider the implications/benefits of moving the business. Can it be moved?
- Are there any investment schemes/grants that you should be aware of?
- Is sufficient funding in place to complete this transaction?

CHECKLIST OF DUE DILIGENCE (CONT.)

Buyer Considerations: pre and post completion (Cont.)

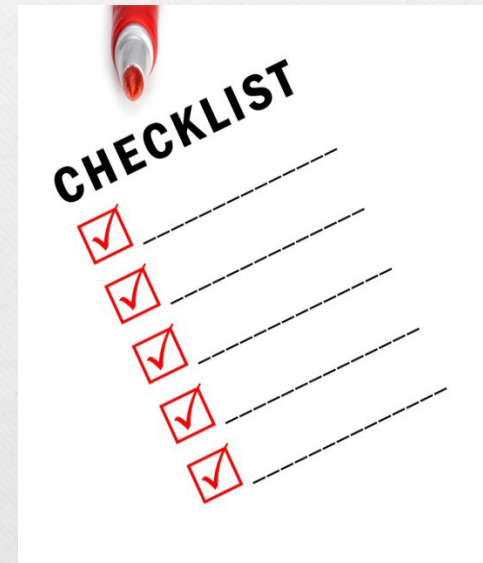
- Ensure there is hard evidence from financial backers confirming funding
- What is their credit score?
- Do you they have credible referees in place if required?
- How do you plan to structure the deal? (Payment terms)



CHECKLIST OF DUE DILIGENCE (CONT.)

Buyer Considerations: pre and post completion (Cont.)

- Liaise with customers and suppliers to provide assurances.
- Plans regarding up / middle / down sensitivities in your Business Plan?



CHECKLIST OF DUE DILIGENCE (CONT.)

Buyer Considerations: pre and post completion (Cont.)

- Is there a cultural synergy of staff on both sides?
- Is there a financial fit?
- Is there a Geographic fit? (Commuting distances to be considered)
- What are the synergies with the businesses operationally/strategically
- Does the buyer's business culture fit with that of the target business?

CHECKLIST OF DUE DILIGENCE (CONT.)

Buyer Considerations: pre and post completion (Cont.)

- Ensure you have written strategic and operational plan post-acquisition for at least the first 100 days.
- What do you plan to do with the staff?
- What will you expect from the current owners/key staff post-completion?



CHECKLIST OF DUE DILIGENCE (CONT.)

Buyer Considerations: pre and post completion (Cont.)

- Retention is likely on a consultancy basis to assist in a smooth hand-over period. Consideration should therefore be given to appropriate remuneration. If appropriate, have employees been adequately informed of details of the transaction?
- Are there any personal issues associated with the deal?, (e.g. relocation, travel allowances)

CHECKLIST OF DUE DILIGENCE (CONT.)

Financial Information

- Annual reports, including year-end financial statements for the past three years (audited if available).
- Current financial statement / Management Accounts (P&L, Balance Sheet) Has the target business received outside funding?
- Projection/forecast data
- Current year budget and reasons for variances in earlier projections

CHECKLIST OF DUE DILIGENCE (CONT.)

Financial Information (Cont.)

- Financial/Business Plan for the next 3-5 years including stated objectives.
- Analysis of Financial ratios and their implication.
- Has there been significant capex over the past 3 years?
- Immediate CAPEX requirements
- Are there any exceptional cash inflows/outflows?

CHECKLIST OF DUE DILIGENCE (CONT.)

Financial Information (Cont.)

- What are the principal uses of cash generated by operations?
- Bank details, overdraft facilities, loan details and details on all other borrowing facilities including loan agreements, notes, mortgages and security agreements and all financing arrangements, including sale and leaseback arrangements, capital leases and hire purchases

CHECKLIST OF DUE DILIGENCE (CONT.)

Financial Information (Cont.)

- Credit arrangements, other credit facilities
- Have there been any changes in the financial position over the past 5 years and if so, why?
- Details of any contingent liabilities?
- Are there any other considerable investment areas,
- What is the true Net Asset Value position of the target business?

CHECKLIST OF DUE DILIGENCE (CONT.)

Financial Information (Cont.)

- Accounting procedures adopted by the company.
- Stock valuation method and full inventory details.
- Any redundant stock? What is their definition of redundant stock?
- Obtain a copy of auditor's letters and reports
- Departmental budget information

CHECKLIST OF DUE DILIGENCE (CONT.)

Financial Information (Cont.)

- All director costs/add-backs and non-recurring costs accounted for?
- Details of accounting systems used
- Ensure cash book and bank book reconciliations are accurate and up-to-date
- What are current cheque signatory limits? Details of all completed and outstanding loans/HP agreements/leases.

CHECKLIST OF DUE DILIGENCE (CONT.)

Financial Information (Cont.)

- A summary of the month-end bank and cash book position for the current year and previous two years.
- Copies of the latest bank reconciliation with supporting bank Statement.
- Details of any financial guarantee or indemnities given to secure credit to third parties.
- Has the target applied for a received any government grants?

CHECKLIST OF DUE DILIGENCE (CONT.)

Professionals.

- A schedule of all law firms, accounting firms, consulting firms, and similar professionals engaged by the Company during past five years.

Articles and Publicity

- Copies of all articles and press releases relating to the Company within the past three years.

CHECKLIST OF DUE DILIGENCE (CONT.)



Balance Sheet Assets and Liabilities

- Cash balance and bank reconciliations
- Analysis of other current assets like loans and advances, deposits, cash/bank balances.
- Review of loan agreements to see compliance with the terms of the lenders guidelines and also if any conversion clause exists.
- Inventory (ageing, valuation, write off/provisioning policies)

CHECKLIST OF DUE DILIGENCE (CONT.)



Balance Sheet Assets and Liabilities (Cont.)

- Review of all other current liabilities & provisions to see that all known liabilities are fully recorded and all provisions are made.
- Shareholders agreement .
- Off balance sheet liabilities-bank guarantees, commitments, legal claims and contingencies

CHECKLIST OF DUE DILIGENCE (CONT.)

Fixed Assets

- Full fixed asset register (and general description/location) to include impression counts, age, serial numbers if relevant
- List of vehicles owned, leased or hired
- Any recent valuations on the plant & equipment.

CHECKLIST OF DUE DILIGENCE (CONT.)

Fixed Assets

- Have there been any recent acquisitions or disposals of equipment unaccounted for?
 - Investments made, carrying value, valuation policies and potential diminution in the value of the in
- Analysis of fixed assets Capitalisation, depreciation and replacement policies; Capex plan, capital commitments.



CHECKLIST OF DUE DILIGENCE (CONT.)

Fixed Assets (Cont.)

- Obtain a copy of title deeds for these assets
- Is there any committed capital expenditure or requirements to do so?
- Details of intra-group assets
 - Litigated assets & property.



CHECKLIST OF DUE DILIGENCE (CONT.)



Fixed Assets (Cont.)

- Adjustments for capitalization expenses, etc.
- Capitalization of Capital Work-In-Progress (CWIP).
- Physical verification of Fixed Assets.

CHECKLIST OF DUE DILIGENCE (CONT.)

Litigation

- A schedule of all pending litigation.
- A description of any threatened litigation.
- Copies of insurance policies possibly providing coverage as to pending or threatened litigation.

CHECKLIST OF DUE DILIGENCE (CONT.)

Debtors/Creditors

- Ensure the vendor verifies that all orders relate to dispatches
- Are there any bad debts or potential bad debts (details)?
- Is the target business dependent on one or two key suppliers or customers and how will they react to a change in ownership?



CHECKLIST OF DUE DILIGENCE (CONT.)

Debtors/Creditors (Cont.)

- Obtain copy of agreements related to outsourced requirements
- Review vendor's delivery dates and customer assurances
- Obtain up-to-date list of debtors and creditors
- Obtain details of any retrospective rebates with suppliers or loss of discount schemes.

CHECKLIST OF DUE DILIGENCE (CONT.)

Debtors/Creditors (Cont.)

- Debtor/creditor days. Any changes projected?
- Receivables (ageing analysis, recoverability, bad debts and provisioning policy)
- Sundry creditors (ageing analysis, subsequent payment of creditors dues)



CHECKLIST OF DUE DILIGENCE (CONT.)

Investments

- Investments carried at cost though realizable value is much lower.
- Investments carrying a very low rate of income/return.
- Clear title to all Investments.



CHECKLIST OF DUE DILIGENCE (CONT.)

Working Capital

- Uncollected/ uncollectible receivables
- Obsolete, slow & non-moving inventories or inventories valued above Net Realizable Value
- Adjustment for Inventories with old names/logos in the case of hotel industry
- Inventories in case of discontinued products
- Group company balances under reconciliation, etc.



CHECKLIST OF DUE DILIGENCE (CONT.)



Off Balance Sheet Items

- Target co. may not bring in to notice, any show cause notices which have not matured into demands as contingent liabilities. These may be material & important.
- Target co. may have given “Letters of Comfort” to banks & FIs. Since these are not “guarantees”, these may not be disclosed in its balance sheet

CHECKLIST OF DUE DILIGENCE (CONT.)

Off Balance Sheet Items (Cont.)

- Commitments including long term contracts
- Agreement to buy back shares sold at a stated price
- Future lease liabilities



CHECKLIST OF DUE DILIGENCE (CONT.)



Profit & Loss Items

- Identifying seasonality in sales, dependency on customers
- Assessing the impact of customers gained / lost on the bottom line
- Dependency on customers/suppliers
- Revenue recognition and cut off procedures

CHECKLIST OF DUE DILIGENCE (CONT.)

Profit & Loss Items (Cont.)

- Items of one off / non recurring nature
- Impact of stand alone costs
- Agreed upon escalation in costs like raw material, rent, etc.



CHECKLIST OF DUE DILIGENCE (CONT.)

Profit & Loss Items (Cont.)

- Provisioning policy for employee benefits, warranties, etc
- Provisioning for bad and doubtful debts and advances
- Transactions with related parties whether at arms length



CHECKLIST OF DUE DILIGENCE (CONT.)

Insurance

- If applicable, obtain copies of policies, claims and correspondence relating to the following:-
 - i. Professional indemnity insurance
 - ii. Employee liability
 - iii. General liability
 - iv. Personal
 - v. Property

CHECKLIST OF DUE DILIGENCE (CONT.)

Insurance (Cont.)

- vi. Director / Key-man
- vii. Summary of any claims
- viii. Worker/compensation
- ix. Business interruption
- x. products liability
- xi. Life/health insurance
- xii. Worker's compensation



CHECKLIST OF DUE DILIGENCE (CONT.)

Insurance (Cont.)

- Ensure the above are all adequately informed of new ownership.
- When where insurance policies last reviewed?



CHECKLIST OF DUE DILIGENCE (CONT.)



Insurance (Cont.)

- A schedule and copies of the Company's general liability, personal and real property, product liability, errors and omissions, key-man, directors and officers, worker's compensation, and other insurance.
- A schedule of the Company's insurance claims history for past three years.

CHECKLIST OF DUE DILIGENCE (CONT.)

Property Issue

- Details of premises used by the target giving complete address,
- A description of its function, terms of ownership, location, size, description, dilapidation clauses, rent and rates payable and any recent valuations carried out.
- Do recent valuations differ significantly from book value?

CHECKLIST OF DUE DILIGENCE (CONT.)

Property Issue (Cont.)

- Sight of any recent independent or internal valuations or insurance reports.
- Copies of all appraisals.
- Are there any known planning permission issues related to neighbouring or adjoining properties?

CHECKLIST OF DUE DILIGENCE (CONT.)

Property Issue (Cont.)

- Tenure - freehold or leasehold?
- Obtain full deeds, lease agreements/terms, site plans, surveys/searches and other related property documentation
- If leasehold, who owns the property? What is the current rent, rates, utility costs, etc?
- Are there any structural issues?
- Have there been any disputes with neighbours?

CHECKLIST OF DUE DILIGENCE (CONT.)

Property Issue (Cont.)

- Maintenance agreements
- Availability of spare land
- Details of premises or land not currently in use
- Check for asbestos – has a risk assessment been completed?
- Has an environmental audit of the property been completed, including soil and water samples?

CHECKLIST OF DUE DILIGENCE (CONT.)



Taxation – Direct and Indirect

- This would involve various issues related to taxation to ensure that no undisclosed liabilities accrue to the target
- Assessment and validation of losses / other tax attributes
- Current compliance status;
- Tax benefits and their availability in future; and

CHECKLIST OF DUE DILIGENCE (CONT.)



Taxation – Direct and Indirect (Cont.)

- This would involve various issues related to taxation to ensure that no undisclosed liabilities accrue to the target
- Assessment and validation of losses / other tax attributes
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CHECKLIST OF DUE DILIGENCE (CONT.)



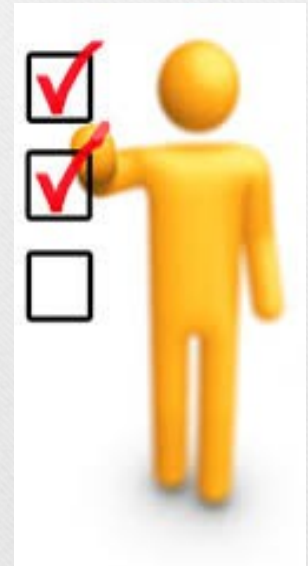
Taxation – Direct and Indirect (Cont.)

- Commentary on any other outstanding tax liabilities/material issues
- Non Deduction of TDS
- Timely filing of returns

CHECKLIST OF DUE DILIGENCE (CONT.)

Other Claims

- Environmental problems/claims, third party claims
- Huge labour claims under negotiation when the labour wage agreement has already expired
- Non-funded gratuity/superannuation/leave salary liabilities



CHECKLIST OF DUE DILIGENCE (CONT.)

Other Claims (Cont.)

- Non-compliance with enactments such as the Income Tax Act, FEMA/FERA Customs Act, etc. that could result in litigation & levy of penalties
- Product warranties, defects & other liability claims, product returns & discounts liquidated damages for late deliveries



CHECKLIST OF DUE DILIGENCE (CONT.)

Deferred Revenue Expenditure

- Deferred revenue expenditure included under advances or not normally deferrable



CHECKLIST OF DUE DILIGENCE (CONT.)

Other Areas

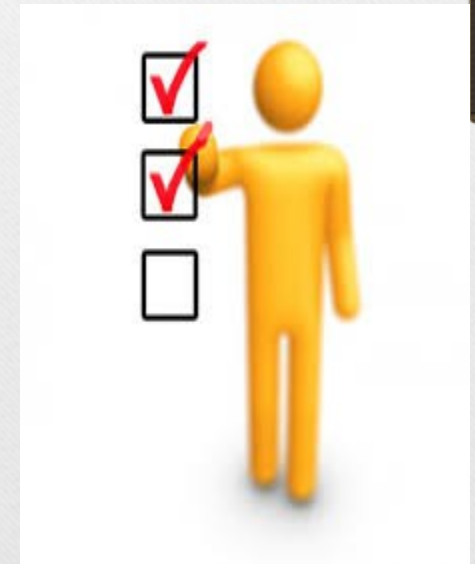
- Review of various agreements/arrangements with related parties and assessment of various transactions with them
- Evaluation of commitments to/from related parties



CHECKLIST OF DUE DILIGENCE (CONT.)

Other Areas (Cont.)

- Analysis of human resources with respect to head count and provision for retirement benefits in line with laws applicable
- Review of other arrangements necessary for conduct of business e.g. contractual labour, trade unions, etc.



CHECKLIST OF DUE DILIGENCE (CONT.)

Cash Flows

- Analyzing cash flows generated from operations and how the same are employed.
- Understanding the level, stability, timing and certainty of future cash flows .
- Analysis of working capital.



CHECKLIST OF DUE DILIGENCE (CONT.)



Quality of Earning

- Evaluation of the build up of operating profits.
- Identifying key sensitive parameters which would adversely impact the profitability of the business.
- The rate of growth in sales, EBITDA and earnings.
- Sustainability of earnings / cash flows.
- Normalised EBITDA.

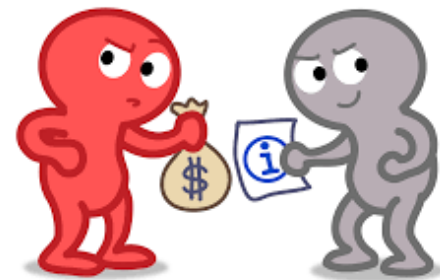
QUALITY OF INFORMATION

- Lack of critical information - product wise/
customer wise margins, monthly /quarterly working
capital etc.
- Public listed companies – Insider Trading
Regulations.
- Information largely received through oral
discussions.
- Reconciliation of MIS and audited financial
statements.



QUALITY OF INFORMATION (CONT.)

- Unaudited/provisional financial statements.
- Disclosure of related parties and transactions with such entities





JIGNESH NAGDA
CHARTERED ACCOUNTANT