AJC

CHARTERED
PROFESSIONAL
ACCOUNTANTS
& BUSINESS
ADVISORS

xero SILVER PARTNER

DUE DILIGENCE

Acquisition Audit

1276 Kumul Hwy, 1st Flr Govant Bldg
Port Vila, Vanuatu
T +678 24 404

Damien Mullins
Senior Audit and Accounting Manager

ajc-vanuatu.com

Overview

CHARTERED
PROFESSIONAL
ACCOUNTANTS
& BUSINESS
ADVISORS

SILVER
PARTNER

- Due Diligence - What is it?
- When and Whom
- Why
- What – The Engagement
- How – The Engagement
- Cost
- Conclusion

What is it?

CHARTERED
PROFESSIONAL
ACCOUNTANTS
& BUSINESS
ADVISORS

SILVER
PARTNER

DUE DILIGENCE = ACQUISITION AUDIT

DD is essentially an audit of a potential business acquisition.

The goal is to increase trust/confidence and reduce information asymmetry between buyer and seller

Information asymmetry occurs where one party to a transaction has more or better information than the other.

This asymmetry creates power imbalance in transactions, which can sometimes cause the transactions to fail or achieve a sub optimal result (eg. overpaying for a business, or purchasing a business that subsequently turns out to have serious problems)

When

CHARTERED PROFESSIONAL ACCOUNTANTS & BUSINESS ADVISORS

DD occurs anytime from the initial expression of interest up to (and sometimes beyond) the letter of offer.

Whom

CHARTERED PROFESSIONAL ACCOUNTANTS & BUSINESS ADVISORS

SILVER PARTNER

Usually an external expert or team of experts (Chartered Accountant, Lawyer, Engineer, Expert in the Industry).

Will involve the buyer and seller, as well as customers, staff, regulators, Govt agencies.

Why bother with DD?

CHARTERED PROFESSIONAL ACCOUNTANTS & BUSINESS ADVISORS

xero SILVER PARTNER

Mitigate risk and evaluate opportunities

Arrive at an accurate valuation

Determine whether the business fits your needs/aspirations

Increase the likelihood of arriving at a purchase price agreeable to both parties

Helps the decision between a share purchase versus a business acquisition (asset purchase) without acquiring the Limited Liability structure (and any associated liabilities)

Why bother with DD?

CHARTERED PROFESSIONAL ACCOUNTANTS & BUSINESS ADVISORS

Provides a level of comfort to external investors and lenders who may also be involved in the acquisition

Due diligence allows the buyer to better understand the company he/she wants to acquire and validate any assumptions, (number of customers, suppliers, profitability, quality of employees, seasonality of sales, cost structures …) and thus be in a **better negotiating position** for the final purchase price and be prepared for the takeover and implementation of the post-acquisition business plan.

Starting the DD process

CHARTERED PROFESSIONAL ACCOUNTANTS & BUSINESS ADVISORS

SILVER PARTNER

There is not a one size fits all due diligence plan. It is a personalized and tailor-made mission.

The scope will depend on factors such as timeframes, size and complexity of the target business, available budget for the DD engagement and the expertise of the auditor/accountant involved.

Independence and discretion are vital.

Detailing and agreeing on the level of DD in a preliminary interview between the buyer and the auditor/accountant is essential.

The DD engagement

CHARTERED PROFESSIONAL ACCOUNTANTS & BUSINESS ADVISORS

SILVER PARTNER

3 main areas

Financial – business performance, debtors, creditors, stock, employee entitlements, maintainable earnings, forecasts

Commercial – property, plant and equipment, supplier and customer relationships and agreements, business IP and other assets, market trends and issues, systems and processes, employees

Legal – tax obligations, licences, unrealised claims/risks, contingent and personal liabilities, warranties and claims, transfer of contracts and employee entitlements, regulatory issues and requirements

The DD engagement

CHARTERED PROFESSIONAL ACCOUNTANTS & BUSINESS ADVISORS

SILVER PARTNER

In Vanuatu, 3 anchor points:
VAT
VNPF
SEVERANCE

A significant risk that is difficult to detect are **omitted liabilities**

Development of a report for the buyer according to the parameters established at the beginning.

Verification and analysis of the financial elements and the key items used in the calculation of the valuation of the target. Indicators that could assist in arguing for a lower price ….probability of forecasts, market data and trends, etc

Items to validate

CHARTERED PROFESSIONAL ACCOUNTANTS & BUSINESS ADVISORS

- Financial results
- Taxation
- Cash management, short-term loans and lenders
- Operating funds (working capital)
- Assets
- Liabilities
- Inventories
- Financing, long-term loans and creditors
- Current orders
- Human resources, managers, working conditions, vacation time and pensions
- Capital, property, organization structure
- Market, competition, clientele

How much does a DD cost?

It depends on the 'scope' of the engagement

The cost can be relatively high and sometimes seen as prohibitive but is often offset by the savings it achieves.

Minimum Vt100K for a basic DD covering financial statements only, mid-sized company would cost minimum Vt500k.

The outputs of the due diligence must be utilised by the new owner to fully maximise the benefits post-acquisition (business plans, restructuring, etc).

Most times, it assists in the negotiation of a price reduction for the acquisition which will offset part or all of the cost of the DD engagement

Conclusion – Message to Buyers

CHARTERED PROFESSIONAL ACCOUNTANTS & BUSINESS ADVISORS

SILVER PARTNER

Due diligence can have a significant financial cost but the benefits it provides to the buyer, whether it be savings in the initial acquisition price, through to post-acquisition benefits (identification of potential cost savings, synergies in the case of a merger, risk mitigation) more than outweigh the cost of the engagement.

DD is a task performed primarily by professional accountants and auditors (CA, CPA), with the involvement of additional professionals in specific circumstances

Conclusion – Message to Buyers

CHARTERED PROFESSIONAL ACCOUNTANTS & BUSINESS ADVISORS

It provides the buyer with peace of mind, better post-acquisition planning, reduced risk, and can be seen as a type of insurance against potential post-acquisition disasters.

DD, like valuation, is not an exact science. There is a level of subjectivity and professional opinion involved.

The buyers themselves should be very involved in the due diligence process and raise their own concerns or areas of focus, and should engage the help of independent external advisors to support them, not act as a substitute for themselves.