

# Guide to Conducting **Due Diligence** when Acquiring a Small Business



Buying a business is an important decision and requires careful consideration in many aspects such as financial, legal, operational, product, and human capital. Conducting a thorough due diligence is an important task that cannot be overlooked. Failing to do so may cause you to make a wrong investment decision, which can cause you to lose money, or even land you with an unknown debt or lawsuit. Also, the business might not fit your existing business or goals as well as you originally thought. Conduct due diligence so you don't get stuck with a business that has no future.

Conducting due diligence can be a daunting task and it is best not to conduct it alone. You can seek help by contacting us or your lawyer who have experience in this area. We can help to look for red flags that you may have missed on your own and help review the financial documents to help you make the right financial investment. When considering a business opportunity, go through the checklist below to collect as much information about the business as possible, which you can then discuss with us or your lawyer for assessment.

## CHECKLIST

Item		Yes	No
	<b>If the business is conducted through a company</b>		
1	Has a company search been done to verify the vendor?	<input type="checkbox"/>	<input type="checkbox"/>
2	Are all ASIC compliance requirements up-to-date?	<input type="checkbox"/>	<input type="checkbox"/>
3	Does the company have any overseas operations?	<input type="checkbox"/>	<input type="checkbox"/>
	<b>Financial health</b>		
4	Have you obtained the last four years' financial statements for the business? TIP: The financial statements should contain a breakdown of: liabilities (including contingent liabilities); inventory; and accounts receivable and payable	<input type="checkbox"/>	<input type="checkbox"/>
5	Have you obtained information on the business' capital structure and, where possible, a current list of vested interests (such as shares, options, warrants, etc) and outstanding debt instruments?	<input type="checkbox"/>	<input type="checkbox"/>
6	Have you obtained an up-to-date copy of the business' credit report, if available?	<input type="checkbox"/>	<input type="checkbox"/>
7	Has a comparison between the business' gross profits and the industry trends been done?	<input type="checkbox"/>	<input type="checkbox"/>
8	Have you considered the financial projections and major growth drivers of the business in the next four years?	<input type="checkbox"/>	<input type="checkbox"/>

Item		Yes	No
	<b>Taxation considerations</b>		
9	<p>Have you obtained the last four years' tax returns, including supporting schedules and workpapers of the business, such as capital allowance schedules, business activity statements, fringe benefits tax returns, etc?</p> <p><b>ALERT:</b> Consideration must be given to the duties of a director under the tax law. New directors need take action within 30 days of their appointment if the company has outstanding pay-as-you-go (PAYG) withholding or superannuation contribution amounts, or face the possibility of becoming personally liable to pay a director penalty.</p>	<input type="checkbox"/>	<input type="checkbox"/>
10	Have you obtained confirmation that all tax obligations such as income tax, GST, PAYG withholding, stamp duty and payroll tax are up-to-date and paid?	<input type="checkbox"/>	<input type="checkbox"/>
11	Have you familiarised yourself with the tax obligations of the entity to be purchased?	<input type="checkbox"/>	<input type="checkbox"/>
12	Have you reviewed all correspondence with the ATO and determined whether the business has any private tax rulings, tax elections, amended notices of assessment, etc that may apply?	<input type="checkbox"/>	<input type="checkbox"/>
13	Are you aware if the business is currently being audited by the ATO or has been audited in the last four years and, if so, what the outcome was?	<input type="checkbox"/>	<input type="checkbox"/>
14	Have you considered the stamp duty implications of the purchase of the business?	<input type="checkbox"/>	<input type="checkbox"/>
15	<p>Have you considered whether the purchase of the business will be a supply of a going concern, i.e. GST-free?</p> <p><b>ALERT:</b> Where a business is sold through an asset sale, the purchaser does not inherit any tax liabilities of the business. However, where a business is sold through the sale of units or shares, the purchaser inherits the tax liabilities of the business. Where a business is sold through the sale of units or shares, it will not qualify as a supply of a going concern, i.e. the purchase of the units or shares will be an input taxed financial supply.</p>	<input type="checkbox"/>	<input type="checkbox"/>
	<b>If you are buying the business through an asset sale</b>		
16	<p>Has a fixed asset register been obtained detailing all the assets being sold?</p> <p>TIP: The register should detail the following information about the assets:</p> <ul style="list-style-type: none"> <li>- the original purchase price;</li> <li>- the purchase date;</li> <li>- the depreciation method used;</li> <li>- the depreciation rate used;</li> <li>- the effective life of the asset; and</li> <li>- the written-down value.</li> </ul>	<input type="checkbox"/>	<input type="checkbox"/>
17	Have you checked the ownership and condition of the assets being sold? Are copies of instruction manuals available?	<input type="checkbox"/>	<input type="checkbox"/>
18	<p>Where assets are leased by the business, have you obtained copies of the leases?</p> <p><b>TIP:</b> If you are taking over the existing leases, consideration should be given to whether the leasing terms are reasonable.</p>	<input type="checkbox"/>	<input type="checkbox"/>
19	Are the assets adequately insured until settlement of the purchase?	<input type="checkbox"/>	<input type="checkbox"/>
20	Has the purchase price been apportioned across the assets being purchased?	<input type="checkbox"/>	<input type="checkbox"/>

Item		Yes	No
<b>If you are buying a business through a sale of units or shares</b>			
21	Have you obtained a listing of all current shareholders or unit-holders?	<input type="checkbox"/>	<input type="checkbox"/>
22	If you are purchasing the business through the sale of units. has the trust made a family trust election (FTE)?	<input type="checkbox"/>	<input type="checkbox"/>
23	<p>If you are purchasing the business through the sale of shares, has the company made an interposed entity election (IEE)?</p> <p><b>ALERT:</b> The existence of an FTE and IEE restricts who may receive a distribution from the trust or company, and to whom a trust may distribute any income derived. Generally, a trust will be denied a tax deduction for carried-forward losses or bad debts, unless certain tests are passed. Similarly, where the substantial shareholder of a company changes, the company can be denied a tax deduction for carried-forward losses or bad debts, unless the same business test is satisfied.</p>	<input type="checkbox"/>	<input type="checkbox"/>
<b>Employee obligations</b>			
24	Have you obtained a list of the employees, including their salaries and other entitlements?	<input type="checkbox"/>	<input type="checkbox"/>
25	Are there any key staff who would be imperative to the smooth, continued running of the business?	<input type="checkbox"/>	<input type="checkbox"/>
26	Are you aware of all employment conditions, including key workplace agreements, any incentive bonus plans, staff rotation policies, disciplinary procedures, standards of conduct, etc?	<input type="checkbox"/>	<input type="checkbox"/>
27	Have all outstanding employee entitlements, such as superannuation guarantee and annual leave, been accounted for?	<input type="checkbox"/>	<input type="checkbox"/>
28	Are the WorkCover premiums up-to-date?	<input type="checkbox"/>	<input type="checkbox"/>
29	<p>Are you comfortable with the current business culture, the level of staff relations and turnover over the last four years?</p> <p><b>ALERT:</b> Where a business is sold through an asset sale, the purchaser can choose not to take on the employees of the vendor. However, where a business is sold through the sale of units or shares, there will be a continuity of employment and the buyer is responsible for any employee liabilities accrued.</p>	<input type="checkbox"/>	<input type="checkbox"/>
<b>Trading stock</b>			
30	Does the trading stock include any obsolete stock?	<input type="checkbox"/>	<input type="checkbox"/>
31	<p>Has the trading stock been valued at market value?</p> <p><b>TIP:</b> Where the purchase of the business includes trading stock, the trading stock must be valued at market value on the day of disposal, which is normally the date of the purchase contract.</p>	<input type="checkbox"/>	<input type="checkbox"/>

Item		Yes	No
	<b>Business premises</b>		
32	Have you sighted copies of all real estate lease agreements, deeds, mortgages and any relevant documents relating to the premises?	<input type="checkbox"/>	<input type="checkbox"/>
33	If the same business premises are to continue, has the vendor facilitated a lease assignment and have all documents been signed by you?	<input type="checkbox"/>	<input type="checkbox"/>
34	If there are improvements to the business premises, has a register been obtained detailing the improvements? <b>TIP:</b> The register should detail the following information: the cost of the improvements; and date of construction or acquisition.	<input type="checkbox"/>	<input type="checkbox"/>
	<b>Other considerations</b>		
35	Do you know why the vendor is selling? <b>TIP:</b> You should be wary of a vendor who does not disclose important information. Sources of information can include social media, the internet and press items.	<input type="checkbox"/>	<input type="checkbox"/>
36	Is there a documented business plan?	<input type="checkbox"/>	<input type="checkbox"/>
37	If you are acquiring the business with other people, do you have the necessary agreements in place?	<input type="checkbox"/>	<input type="checkbox"/>
38	Are the business operations subject to any government regulations? If so, are all relevant government licences, permits or consents up-to-date?	<input type="checkbox"/>	<input type="checkbox"/>
39	Does the business have any pending or ongoing lawsuits, or any recently finalised litigation cases?	<input type="checkbox"/>	<input type="checkbox"/>
40	Have you given thought to whether the structure (company, partnership or trust) that the business operates through is suitable for your needs?	<input type="checkbox"/>	<input type="checkbox"/>
41	Have you searched the local council and other government agency records to ensure there are no plans or council orders that could disrupt the business or lead to a potential drop in sales?	<input type="checkbox"/>	<input type="checkbox"/>
42	If a restrictive covenant, earn-out clause or claw-back clause is included in the purchase contract, have you ascertained the legal and tax implications?	<input type="checkbox"/>	<input type="checkbox"/>
43	Have you identified the key customer and supplier contracts and the likely impact a change of ownership might have on these agreements?	<input type="checkbox"/>	<input type="checkbox"/>
44	Have you examined current production, distribution, sales and marketing strategies (including websites) of the business and the likely impact of a change of ownership?	<input type="checkbox"/>	<input type="checkbox"/>
45	Do you know who the main competitors are?	<input type="checkbox"/>	<input type="checkbox"/>
46	Have you considered potential future issues that could negatively impact the viability of the business (e.g. changing technology, trends, etc)?	<input type="checkbox"/>	<input type="checkbox"/>