Factor 1
Accountants & Advisers

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 Factor1 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
	If the business is conducted through a company		
1	Has a company search been done to verify the vendor?	☐	☐
2	Are all ASIC compliance requirements up-to-date?	☐	☐
3	Does the company have any overseas operations?	☐	☐
	Financial health		
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	☐	☐
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?	☐	☐
6	Have you obtained an up-to-date copy of the business’ credit report, if available?	☐	☐
7	Has a comparison between the business’ gross profits and the industry trends been done?	☐	☐
8	Have you considered the financial projections and major growth drivers of the business in the next four years?	☐	☐

Item		Yes	No
	Taxation considerations		
9	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? **ALERT:** 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.	☐	☐
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?	☐	☐
11	Have you familiarised yourself with the tax obligations of the entity to be purchased?	☐	☐
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?	☐	☐
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?	☐	☐
14	Have you considered the stamp duty implications of the purchase of the business?	☐	☐
15	Have you considered whether the purchase of the business will be a supply of a going concern, i.e. GST-free? **ALERT:** 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.	☐	☐
	If you are buying the business through an asset sale		
16	Has a fixed asset register been obtained detailing all the assets being sold? TIP: The register should detail the following information about the assets: - the original purchase price; - the purchase date; - the depreciation method used; - the depreciation rate used; - the effective life of the asset; and - the written-down value.	☐	☐
17	Have you checked the ownership and condition of the assets being sold? Are copies of instruction manuals available?	☐	☐
18	Where assets are leased by the business. have you obtained copies of the leases? **TIP:** If you are taking over the existing leases. consideration should be given to whether the leasing terms are reasonable.	☐	☐
19	Are the assets adequately insured until settlement of the purchase?	☐	☐
20	Has the purchase price been apportioned across the assets being purchased?	☐	☐

Item		Yes	No
	If you are buying a business through a sale of units or shares		
21	Have you obtained a listing of all current shareholders or unit-holders?	☐	☐
22	If you are purchasing the business through the sale of units. has the trust made a family trust election (FTE)?	☐	☐
23	If you are purchasing the business through the sale of shares, has the company made an interposed entity election (IEE)? **ALERT:** 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.	☐	☐
	Employee obligations		
24	Have you obtained a list of the employees, including their salaries and other entitlements?	☐	☐
25	Are there any key staff who would be imperative to the smooth, continued running of the business?	☐	☐
26	Are you aware of all employment conditions, including key workplace agreements, any incentive bonus plans, staff rotation polices, disciplinary procedures, standards of conduct, etc?	☐	☐
27	Have all outstanding employee entitlements, such as superannuation guarantee and annual leave, been accounted for?	☐	☐
28	Are the WorkCover premiums up-to-date?	☐	☐
29	Are you comfortable with the current business culture, the level of staff relations and turnover over the last four years? **ALERT:** 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.	☐	☐
	Trading stock		
30	Does the trading stock include any obsolete stock?	☐	☐
31	Has the trading stock been valued at market value? TIP: 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.	☐	☐

Item		Yes	No
	Business premises		
32	Have you sighted copies of all real estate lease agreements, deeds, mortgages and any relevant documents relating to the premises?	☐	☐
33	If the same business premises are to continue, has the vendor facilitated a lease assignment and have all documents been signed by you?	☐	☐
34	If there are improvements to the business premises, has a register been obtained detailing the improvements? **TIP:** The register should detail the following information: the cost of the improvements; and date of construction or acquisition.	☐	☐
	Other considerations		
35	Do you know why the vendor is selling? **TIP:** 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.	☐	☐
36	Is there a documented business plan?	☐	☐
37	If you are acquiring the business with other people, do you have the necessary agreements in place?	☐	☐
38	Are the business operations subject to any government regulations? If so, are all relevant government licences, permits or consents up-to-date?	☐	☐
39	Does the business have any pending or ongoing lawsuits, or any recently finalised litigation cases?	☐	☐
40	Have you given thought to whether the structure (company, partnership or trust) that the business operates through is suitable for your needs?	☐	☐
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?	☐	☐
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?	☐	☐
43	Have you identified the key customer and supplier contracts and the likely impact a change of ownership might have on these agreements?	☐	☐
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?	☐	☐
45	Do you know who the main competitors are?	☐	☐
46	Have you considered potential future Issues that could negatively impact the viability of the business (e.g. changing technology, trends, etc)?	☐	☐