

## Due Diligence: What to look for under the hood

Featured in the April 2016 edition of the [Edge International Communiqué](#)

By Sam Coupland



In recent months I have been working with a number of firms going through the process of either merging firms or involved in a sale and purchase. That this activity has increased in recent years should not be a surprise as the ability for firms to grow organically to achieve economies of scale or fill excess capacity – be it office space or management structure – is far from certain. Many firms have weathered a turbulent couple of years and are at the point where they need to do something substantial, as chipping away at the edges has not yielded the desired results.

Purchase price or merger terms in a Heads of Agreement are usually relatively straightforward. Fortunately most firms have a realistic assessment of what they bring to the table and what they would be prepared to pay if they were purchasing their business. The biggest risk is that the parcel of fees in the acquired or merging firm are retained. This risk can be mitigated by the terms of the deal having sufficiently motivating financial handcuffs to retain partners for a period and encourage them to tend their client base appropriately.

What is often a little haphazard is the due-diligence process. Given that in all mergers or acquisitions the partners from the acquired firm will be coming across (I am yet to see a deal where the incumbent partners are not integral to getting the deal across the line), it is essential that both parties conduct their own due diligence as opposed to one party sitting meekly on the sidelines providing the information requested by the other party.

The following is a due-diligence checklist that I recommend all parties use as a starting point. You may well have more to add, but this would be my base level of what should be covered. Some of it can be done via meetings and some by reviewing documentation.

### Areas to be reviewed

#### Strategic Considerations

- Capital expenditure – past 5 years and planned future expenditure
- Planned future acquisitions
- Business plan

#### Partnership

- Demographics of partnership
- Entry and exit of partners
- Performance management of partners

### Information required

- Meeting to discuss capital expenditure and planned future acquisitions
- Business Plan
- Current partnership agreement
- Age, practice area, date joined firm of all equity and salaried partners
- Equity share of all equity partners

## Areas to be reviewed

- Voting rights of partners

## Financial considerations

- History of consistent earnings
- Inter-company transactions
- Extraordinary (or non-recurring) expenditure and income
- External funding
- External funding
- External funding
- Financial modeling - Profitability of merged entity

## Management / Other

- Management structure – current and post merger
- Role of the board in running the business
- Committees of the board– eg: compensation
- Premises
- Professional indemnity claims

## Performance management

- Assessment of practice areas
- Structure of practice groups
- Integration of practice groups

## Personnel

## Client base

- Spread of clients – fees generated by top 25 and 26 – 50
- Panels

## IT capability

- Ease of integration of practice management systems, databases, other IT
- New systems installed – past year
- Proposed new systems

Good luck!

## Information required

- Pathway to full equity partnership – admission criteria and process
- Partner performance criteria
- Partner drawings – past 2 financial years
- Management roles of partners
- Financial accounts for the past 2 years
- Cashflow – past 2 financial years and current year budgeted
- Terms and security for all loans, borrowings, and debt
- Taxation Depreciation Schedules for the past three financial years
- Monthly WIP and debtor balances by practice group for past 2 years
- Aged WIP, debtors and creditors list – current month
- Management organization chart
- Role of individuals in management – job description and experience
- Plan for integration (if required) of new firm management personnel
- Meeting and documentation to address questions on the operation of the board
- Lease details for all premises
- Details of any outstanding PI claims
- Income by practice area and office for past 2 years
- Originator reports – fees by responsible partner
- Organization chart for each practice group
- Hours, rates, write-offs by practice area – past 2 years
- Expense allocation to practice areas
- Work plans / budgets / performance criteria for fee earners
- Total FTE personnel by office – fee earners and non fee earners
- Restraints for all key personnel
- Internal and external training curriculum
- Details of bonus or incentive plans and who is covered
- Staff satisfaction surveys or exit interviews
- Client by rank for past 3 years
- Details of all panels – duration, other firms, fees from panel clients, rates, relationship partner(s)
- Departmental marketing plans
- List of all IT systems used
- Lease commitments for all IT – amount, duration
- Meeting to address IT issues