



Freedom to comply

Due diligence is forever evolving, but President Trump and artificial intelligence mean providers need to be very careful about scope, says **Jon Moulton**

Due diligence has expanded greatly over the years. In my days as an audit senior we were sometimes called in to do a 'special' or 'investigation' on a client's proposed acquisition. It was relatively exciting, but generally limited to a review of net assets and any odd accounting policies. These jobs were highly prized by staff as they raised an individual's profile and promotion prospects greatly. No one thought of charging a premium rate and personal computers did not exist.

It's far from clear whether acquisitions were more or less successful in those days than they are today.

But from the explosion of private equity that started in the 1980s came a demand for 'accountants' reports', which steadily increased in content as the larger accounting firms sought to deploy their highly profitable consulting arms and their extensive, if expensive, expertise.

Somewhere in the same timeframe the term 'due diligence' came into common parlance. It was imported from the US, where it was originally a legal industry term for checking contracts and title. It's an odd label to me – it seems imbued with a sense of 'if we have to'.

Ethical issues arose, particularly with vendor due diligence – where the seller hires accountants and others to perform due diligence that could be used by any buyer. Early on, auditors were often marking their own homework by performing due diligence on figures their firm had audited. And the level of fees for the accountant were often highly contingent on a deal happening, giving an all too obvious set of conflicts. These issues have now been almost totally eliminated thanks to rules set by professional bodies or stock exchange rules.

One idea I've never been able to get adopted is to get the seller's auditors to re-address their normal audit reports on statutory accounts to acquirers. A fee would be appropriate, reflecting the (hopefully slight) risk of being sued by the buyer – but no one has the nerve. It would save a lot of time, be a good starting point for due diligence and reduce duplicative cost. An apparent, persistent market failure is that due diligence practitioners get paid more for reviewing a set of numbers than an auditor does for a full audit with the additional workload of verification of those numbers. This seems odd to me.

Over the years there's been a steady expansion in the scope of due diligence. A full list nowadays includes at

least the following: financial veracity, forecast plausibility, tax, IT, legal, HR issues, pensions, diversity, environmental, property, insurance and governance. Unusual add-ons are things like reputation and culture audits.

The importance for these pieces of work obviously varies. The cost/benefit of each segment is hard to assess, but it needs doing. Just populating the checklist is wasteful of time and money. It often seems that a reduced scope would sensibly suffice, but in practice 'soup to nuts' is the normal due diligence scope.

Freudian slip-ups

I've recently seen very silly stuff – for example a buyer wants substantial psychiatric assessments of the top 20 staff. Given that many hugely successful businesses are run by people with 'unusual' characters, certainly in my experience, I'm far from sure that I would learn much from this process. The whole thing could be horribly biased on what he thinks are desirable traits. Another wanted the repair records of the executives' cars. I have no idea what that could mean to the deal.

Customer reference checks are a dangerous area in due diligence. Letting a consultant of unproven skill and diplomacy grill your customers has the potential to damage a customer relationship, and if the deal does not complete can obviously provide useful information to the failed buyer – and potentially others. Seller beware of that request.

As an accountant I'm bound to point out that most things that are wrong in a business show up in the accounts – especially in cash flow. Anyone who does not do a financial review first is not being efficient.

President Trump has now (unconsciously) affected a lot of things and due diligence is one. Over recent years environmental compliance and diversity has become a part of due diligence – driven by investor demand. A week or so ago, a substantial contract between a US federal body and one of my family office investments was stopped until we proved that we did NOT have a formal diversity plan. We didn't in that case – even though much of our portfolio does have such a plan.

I expect some interesting discussions on whether to upset investors or, alternatively, the US government. And it will not be long before artificial intelligence plays a big role in due diligence. But remember: garbage in = garbage out.

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