Due Diligence Factsheet

Finance and Tax

The following factsheet was drawn up by the trade body's Technical Committee, comprised of experts in financial, technical and legal aspects of angel investing. This factsheet on finance and tax has been produced by Jon Sutcliffe at Kingston Smith LLP and Adrian Walton at Smith & Williamson Ltd.

Minimising the risks

When considering whether to invest in a business it is vital that you negotiate a transaction with all relevant facts available to you and are fully aware of the risks involved. It is crucial that liabilities and other risks which may only come to light once the investment has been completed are identified at the time the transaction is being negotiated to ensure that your investment decision fully reflects these risks. Financial due diligence will provide assurances on the operation of the business, its assets and liabilities and the tax position. It will assist you in the following areas:

- Gain a stronger negotiating position
- Minimise the risks of failure
- Speed up the process
- Add value by recommending courses of action and possible areas of improvement to the new business

Key Questions

Based on our experience in acting for SME clients and investors looking to invest in such businesses we have developed a list of key questions that you should consider when embarking on financial due diligence:

1. Has the company prepared detailed and accurate financial projections that substantiate your required return?
2. Has the company used an outside, independent accounting firm to compile, review, or audit financials?
3. How good are the assumptions? (rate of growth, acceptance rate, pricing, multiple revenue streams, costs, timing of cash flows)
4. Are revenues realistic; how much can be supported by contracts or orders and to what extent is income "blue sky"?

5. When does the company reach cash flow positive, and what cash requirements will it take to get there?
6. Has the company already received funding, and, if so, how much; what are pre-money valuation and terms?
7. What are the follow-on funding requirements and sources? Has the company properly anticipated future needs, and is it already working on those?
8. What are the on-going financial commitments of the business (leases, debt repayments, salary costs) and to what extent are overheads variable to mitigate the impact of a slump in performance?
9. Is the balance sheet strong, are creditors being paid on time and have proper provisions been made for all liabilities?
10. Are the assets on the balance sheet stated at a reasonable value?
11. What is the planned exit route and to what extent does it rely on factors outside the control of management?

Tax Specific Questions

1. Does the Company qualify for EIS relief and has an application for clearance been made?
2. Have all taxes been paid on time?
3. Have all tax returns been filed on time?
4. Is the business eligible for R&D relief and has a claim been made?
5. Have there been any HMRC investigations and what were the results?
6. Are all salaries paid through payroll and is there a risk that freelancers and consultants used in the business should be treated as employees?
7. Is the Company registered for VAT?
8. Who is responsible for the tax compliance function (e.g., filing returns, making payments)?
9. Does the Company have any tax losses carried forward, and if so what are the nature of these losses (e.g., trading or non-trading/capital)?
10. Has the Company undertaken any tax planning or claimed special reliefs from taxation?