Why Forensic Accounting Should Be Part of M&A Due Diligence

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Acquiring another business is one way that Los Angeles and Southern California business owners and entrepreneurs can grow their companies. This strategy may enable a company to achieve explosive growth very quickly and enter new geographic markets and customer segments more efficiently.

But embarking on a merger or acquisition is a major undertaking that will require a significant amount of corporate resources, including both money and time. Especially important is the acquisition due diligence process that should be undertaken as part of the overall M&A process. The primary goal of due diligence is to ensure that any representations made by the seller are true and accurate, and that achieving the synergies identified in the M&A planning and search process are realistic.

Your Team of M&A Experts

Companies planning a merger or acquisition should retain a team of M&A experts, including an investment banker, business broker, CPA, attorney who specializes in M&A, and an outsourced CFO services provider. Another often-overlooked expert who should often be added to the M&A team is a forensic accountant.

Forensic accounting is a specialty practice area of accounting in which one of its major focuses is on uncovering financial fraud. A forensic accounting engagement typically involves a detailed assessment of a company's accounting system and processes to determine whether or not the numbers that are presented actually reflect reality. This niche type of due diligence requires specialized expertise that a company's internal accountants including financial management staff, and even external accountants and CPAs, usually don't possess.

A forensic accountant can play a valuable role in the M&A due diligence process by:

- Helping ensure that you understand and agree with the general terms of the M&A agreement.
- Ensuring the accuracy of the target company's financial statements and providing a true analysis of these statements.
- Helping analyze the future growth prospects of the target company, including comparing cash projections to those of competitors.
- Reviewing existing contracts to gauge the accuracy of stated revenue and expenses.
- Providing proper research and investigation into the target company's background, including conducting background checks on key executives and managers.
- Reviewing the target company's existing tax structure and suggesting possible tax-saving strategies.

- Uncovering important and crucial facts about the target company that could have an affect on the purchase and/or purchase price.

- Helping make sure you understand such crucial aspects of the acquisition as accurate pricing, the immediate and future value of the business, and the correct way of structuring the deal.

In the course of performing a forensic accounting engagement for a target acquisition company, a forensic accountant can also identify the following:

- Inaccurate and/or unrealistic budgets and forecasts.
- Unrecorded and/or understated liabilities and overstated assets.
- Overstated sales and/or understated expenses.
- Management and executive inefficiencies.
- Business deficiencies in comparison to competitors or industry norms.

Benefits to Your Business

Hiring a forensic accountant to perform a forensic accounting engagement during the due diligence process of a merger or acquisition can result in a number of concrete benefits for your business. It will:

- Generate valuable information that helps you make better decisions.
- Give you a better understanding of the value of your business.
- Provide a true analysis of the financial statements and what is really behind the numbers.
- Help eliminate future misunderstanding and conflicts.
- Provide you with additional peace of mind by minimizing post-closing surprises.
- Translate financial statements into easy-to-understand language for non-accountants.

Perhaps most importantly, the forensic accountant's analysis could give you additional negotiating leverage to adjust the business' purchase price to reflect its fair market value. A forensic accountant is usually viewed by the seller as a neutral third party providing an expert opinion — unlike a traditional accountant, who is usually deemed by the seller to be a non-objective third party working on behalf of the buyer.

Concluding Thoughts

Embarking on a merger or acquisition is a major undertaking that will require a significant amount of corporate resources. The M&A due diligence process is especially important. An often-overlooked expert who should often be added to the M&A team of experts is a forensic accountant who can perform a detailed assessment of the target company's accounting system and processes. This niche type of due diligence requires specialized expertise that staff accountants and external CPAs usually don't possess.

About CFO Edge

CFO Edge, LLC delivers enterprise-class financial and operational performance solutions to executives throughout Southern California. Based in Los Angeles, our formerly-seated chief financial officers engage on demand as part-time CFOs, single-project CFOs, and interim CFOs to help business leaders successfully resolve pressing challenges and realize their financial and operational goals. At CFO Edge, we're passionate about helping our clients create, grow and sustain value. For more information, visit www.cfoedge.com or call 800.276.1750 Ext 101.