

Buganov Oleg,
*applicant for higher education
of the Faculty of accounting and finance*
Trum Olena,
*applicant for higher education
of the Faculty of accounting and finance
Mykolayiv National Agrarian University,
Mykolayiv, Ukraine*

THE ESSENCE, PURPOSE AND STAGES OF DUE DILIGENCE

At the beginning of the XX century. the concept of «Due Diligence» was introduced and was used for legal purposes. At that time, the term meant the procedure by which a broker discloses information to an investor about an entity whose shares are traded on a stock exchange. Due Diligence has changed somewhat today. The tool is now used to collect and analyze information to assess the various risks involved in investing procedures [1].

Due Diligence is a mechanism that ensures the independent collection of objective information and the expert evaluation of the assets of the business being sold. The procedure allows the customer to obtain a reasoned answer in a short time about the expediency of financial investments in the object of investment (verification of the legality and commercial attractiveness of the planned agreement or investment project) [2].

Due Diligence also applies to the merger or acquisition of an entity, the purchase of valuable assets. It is needed in any situation where a professional's independent opinion is needed regarding a future agreement, whether investing, lending or even sponsoring a startup project. In addition, Due Diligence is a way to assure the customer that his or her potential partners are legitimate.

There are several situations in which companies need Due Diligence: equity participation of the new owner in the company; change of leadership; receiving sponsorship; loss of intellectual property; reduction of competitive positions; reducing the efficiency of the enterprise; litigation, seizure of the assets of the firm; detection of violations during the tax audit; labor disputes.

The tool can help you identify ways to improve the legal and financial standing of an entity. Due Diligence is one of the stages of the acquisition of assets, as it helps the investor to form an idea of the product of sale, the possible risks at the time of property appropriation, and the crisis situations that may arise after the conclusion of the transaction. The tool is based on the analytical evaluation of information on changes in the external and internal environment of the enterprise by checking all components of the business, in particular: legal, financial, accounting, tax, marketing, information, management, environmental, technical, operational nature.

Due Diligence often involves the following specialists:

– lawyer (responsible for conducting legal and legal expertise of the organization's activities to identify potential risks for the investor associated with its acquisition); financial analyst (his work includes the determination of the present

value of the investment object and its possible range of value in different options for the use of the asset in the future); the auditor (his competence includes the financial audit of the company's activity over several reporting periods, as well as identification of tax risks and possible ways to optimize the tax base).

They are mandatory participants in the holding process, however, other experts may be invited to join the working group. The team must include financial, accounting and legal staff, but it can also include economists, engineers, environmental experts and other professionals. Successful Due Diligence depends on the clear and consistent work of appraisers, auditors and lawyers, as well as on the timely submission of reliable information by the seller [3]. Some businesses, due to their savings, do Due Diligence on their own. Specialists from the relevant units are involved in this purpose. The application of this approach at the enterprise has both advantages and disadvantages.

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The advantages of refusing to hire specialists are: reducing the cost of the procedure; having in-house specialists of deep professional knowledge in the field of activity of their enterprise; an opportunity to evaluate your own business from the inside out and more accurately formulate possible risks and recommendations for their elimination.

The disadvantages of refusing to hire external experts are: diversion of employees from operational tasks; Due Diligence on its own only when acquiring a business in a similar field of activity; the risk of bias.

Thus, due diligence is advisable to be conducted in small enterprises, because comprehensive analysis of big business requires not only highly qualified specialists but also high research costs.

There are cases when evaluation companies are involved in the procedure, providing the customer with turnkey research results. Another option is to involve professionals from various law and audit firms specializing in Due Diligence services. The disadvantage of this approach is that it takes a lot of time to search, invite and agree on the terms of inspection with the experts of different companies, and the cost is higher than when ordering a turnkey study since the working group includes financiers, appraisers, lawyers, technical consultants, engineers, security specialists, whose services are paid for separately.

References:

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Scientific supervisor –**Dubinina Maryna**,
Head of the Department of Accounting and Taxation,
Mykolayiv National Agrarian University,
Mykolayiv, Ukraine