



WHY IS DUE DILIGENCE IMPORTANT FOR YOUR INVESTMENTS



What is Due Diligence? There is no legal definition to the term “due diligence”. It can simply be referred to as the process where business buyers and professional advisers conduct enquiries for the purposes of timely, sufficient and accurate disclosure of all material statements / information or documents which are required for and pertinent to the consummation of a corporate transaction.

During the Due Diligence process, sharing or disclosure of confidential information is inevitable. As an investee company, you would want to ensure that the recipients to the information / documents be bound by confidentiality or non-disclosure obligations during the review process. Such obligations are often spelt out in the form of a non-disclosure agreement / confidential agreement signed off by the parties involved.



How do you plan a legal due diligence? A well-structured and coordinated effort from the due diligence working group can help to plan foresight and ease unnecessary hiccups during the inquiry process. By focusing on key issues pertinent to the transaction contemplated, determining the deliverables and anticipating possible findings for an area of similar businesses will be most useful and effective in ensuring a smooth due diligence process. Below are some typical factors to consider:

|| Types of Corporate Proposals ||

Due Diligence exercises are typically required for most corporate proposals, including any merger or acquisition exercises or a listing / other capital market exercises which demand high standards of disclosure. Having said so, there can be instances where investors opt not to conduct an in-depth Due Diligence (commonly seen in a private equity acquisition) considering the limitation in time, investors can rely on warranties and representations given by the business owner or the seller coupled with appropriate and acceptable indemnities.

|| Reporting Method ||

Effective due diligence reporting is of high importance for professionals to be able to deliver and for clients to apprehend the findings in the most efficient manner. In most instances, the reporting method would be a determining factor to the time and cost involved. To suit the needs of the client, Due Diligence reporting can be in the form of a lengthy report with inclusion of detailed findings / regurgitation of information or an executive summary of findings based on the discretion of the professionals as to what information warrants reporting, and usually presented as a “Red-Flag” or “Exceptions-Only” report.

|| Materiality Thresholds ||

As there are no specific guides to a Due Diligence enquiry, experienced professionals would have been able to gauge the appropriate and applicable thresholds based on their educated guess. Materiality thresholds have been increasingly important as technology has made it possible for an entire information database to be accessible by a buyer without effort of distinguishing what are to be and not to be disclosed. Thus, materiality thresholds are usually determined pivoting on the nature of business or the corporate exercise contemplated.

|| Scope of Due Diligence ||

It would be prudent to have a Due Diligence enquiry / requisition list setting out the various information and documents required for review during the investigation. The scope of Due Diligence varies on a transaction-to-transaction basis depending on the nature of business of the target company. In some instances, the purpose of the Due Diligence might merely be to identify issues that could impact the transaction valuation, structure and/or deal timing. At times, the scope also depends on the type of companies.



Why is Due Diligence important?

High standards of disclosure, Due Diligence and accountability from all parties involved in the preparation and execution of corporate proposals are crucial to any business venture. In most instances, high degree of reliance is placed on information that is disclosed, whether by the regulators, the investors or a potential buyer or joint venture partner to the business.

In the context of Malaysian capital market, Due Diligence exercises are of particular importance as the regulators place heavy reliance on findings by the professionals while determining the likelihood of approving a corporate proposal. The Capital Markets and Services Act, 2007 (“**CMSA**”) imposes criminal and civil liabilities on persons in relation to the information submitted or disclosed in a corporate proposal. However, the CMSA also provides for a defence if it is proven that such persons (including professional advisers) have made due enquiries as were reasonable in the circumstances and had reasonable grounds to believe that there was no contravention of the relevant provisions under the CMSA.

While most Due Diligence exercises might consume reasonable amount of time, it no doubt helps clients to unfold and verify many investment uncertainties and, in some instances, mitigates and even eliminate business risks. As a first-time investor / business owner, not only a due and proper inquiry into the business venture brings you more assurance, it can save you from having to dissipate your funds for something you might have prevented in the first place.



As diligent opportunists / investors, perform your utmost care and engage with professionals to conduct all necessary due inquiries into your potential business ventures before investing!

All information in this Newsletter is correct as at **31 March 2018** unless otherwise stated.

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