GENERAL

sample financial due diligence engagement letter

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Introduction

In the fast moving world of mergers and acquisitions, investors, private equity firms, and corporate buyers rely heavily on a clear, concise, and legally sound **sample financial due diligence engagement letter** to define the scope, expectations, and responsibilities of the parties involved. A well crafted engagement letter is more than a formality; it is the cornerstone of a successful due diligence process, setting the tone for transparency, confidentiality, and professional conduct. This article will explore why such a letter is indispensable, break down its essential components, provide a detailed template you can adapt, and share best practices for customizing the document to fit any transaction.

What Is a Financial Due Diligence Engagement Letter?

A financial due diligence engagement letter is a formal agreement between a client (typically a buyer, investor, or lender) and a service provider—often an accountant, auditor, or financial advisory firm—that outlines the terms under which the provider will conduct a thorough review of a target company's financial statements, operating metrics, and underlying assumptions. The letter clarifies the scope of work, deliverables, timelines, fees, confidentiality obligations, and any limitations or exclusions. By establishing clear expectations from the outset, the letter helps prevent misunderstandings, protects intellectual property, and ensures compliance with regulatory and contractual standards.

Why a Sample Engagement Letter Is Essential

While many professionals draft engagement letters ad hoc, having a ready made **sample financial due diligence engagement letter** offers several advantages:

- Consistency – A template ensures that all critical elements are present and consistently phrased, reducing the risk of omissions.
- Efficiency – Clients and advisors save time by customizing a proven structure rather than starting from scratch.
- Risk Mitigation – Clearly defined responsibilities and limitations protect both parties from legal disputes.
- Professionalism – A polished, well structured letter reflects the advisor's expertise and enhances client confidence.

Key Components of a Robust Engagement Letter

While every transaction has unique nuances, most engagement letters share common sections. Below is a breakdown of each element and its purpose.

1. Parties and Effective Date

This section identifies the client and the service provider by legal name, address, and contact details. It also states the effective date of the engagement, which marks the start of the due diligence period.

2. Purpose and Scope of Work

Here, the letter defines the primary objective—such as “to conduct a comprehensive financial due diligence review of Company X” – and delineates the specific areas to be examined: historical financial statements, cash flow projections, debt schedules, tax compliance, working capital analysis, and any industry specific metrics. It may also list any exclusions, such as legal or operational due diligence.

3. Deliverables and Timeline

Deliverables could include a written report, a summary of findings, and a list of key risks. The timeline section sets milestones: data request date, draft report due date, final report delivery, and any follow up meetings. Clear deadlines help manage expectations and keep the project on track.

4. Fees and Payment Terms

Fees can be structured as a fixed fee, hourly rates, or a combination. The letter should specify the billing frequency, any retainer required, and the conditions under which additional fees may be incurred (e.g., discovery of new issues requiring extra analysis).

5. Confidentiality and Data Security

Due diligence involves sensitive information. This clause obligates both parties to maintain confidentiality, restrict data sharing to authorized personnel, and comply with data protection laws such as GDPR or CCPA. It may also address the retention and destruction of data after the engagement ends.

6. Client Responsibilities

The client must provide accurate, complete, and timely data, grant access to relevant personnel, and ensure that the information supplied is free from material misstatements. This section clarifies the client’s obligations to facilitate the due diligence process.

7. Advisor Responsibilities

Here the advisor commits to performing the due diligence with due care, professional skepticism, and adherence to accounting standards. It may also detail the advisor’s right to engage subcontractors or specialists if needed.

8. Limitations and Exclusions

Because due diligence cannot guarantee the absence of all risks, the letter should explicitly state any limitations. For example, the advisor may not be responsible for undisclosed liabilities discovered after the engagement concludes.

9. Termination Clause

Both parties should have the right to terminate the engagement under specified circumstances, such as material breach or failure to meet deadlines. The clause should outline the notice period, any termination fees, and the handling of partially completed work.

10. Governing Law and Dispute Resolution

Specifying the governing jurisdiction and preferred dispute resolution method (e.g., arbitration) helps resolve conflicts efficiently and predictably.

11. Signatures

The final section contains signature lines for authorized representatives of both parties, indicating their agreement to the terms.

Sample Financial Due Diligence Engagement Letter

Below is a comprehensive, ready to customize sample engagement letter. Copy the text into your word processor, adjust the placeholders (e.g., **[Client Name]**, **[Service Provider]**), and tailor any section to your specific transaction.

Sample Letter (Plain Text Format)

Financial Due Diligence Engagement Letter

Effective Date: [Insert Date]

Parties:
[Client Name]
[Client Address]
[Client Contact Information]
and
[Service Provider Name]
[Service Provider Address]
[Service Provider Contact Information]

1. Purpose and Scope of Work

The Service Provider shall conduct a comprehensive financial due diligence review of [Target Company Name] ("Target"), focusing on the following areas:

- Historical financial statements (income statement, balance sheet, cash flow statement) for the past three fiscal years.
- Analysis of revenue streams, cost structures, and gross margin trends.
- Evaluation of working capital requirements and liquidity position.
- Assessment of debt covenants, interest coverage, and repayment schedules.
- Review of tax compliance, deferred tax assets/liabilities, and potential tax exposure.
- Examination of internal controls and accounting policies.
- Identification of material risks and recommendations for mitigation.

Exclusions: This engagement does not include legal due diligence, operational due diligence, or valuation of intangible assets.

2. Deliverables and Timeline

The Service Provider will provide the following deliverables:

- Draft Due Diligence Report – due no later than [Insert Date].
- Final Due Diligence Report – due no later than [Insert Date].
- Executive Summary of key findings – due no later than [Insert Date].

The engagement will commence on the Effective Date and is expected to conclude by [Insert End Date], subject to the timely receipt of all required information.

3. Fees and Payment Terms

Fees for the engagement shall be as follows:

- Fixed fee: $[Amount] payable upon execution of this letter.
- Hourly rate for additional work: $[Hourly Rate] per hour.
- Reimbursement of out of pocket expenses (e.g., travel, data storage) upon receipt of receipts.

Invoices will be issued monthly and are payable within 30 days of the invoice date.

4. Confidentiality and Data Security

Both parties agree to maintain the confidentiality of all information exchanged during the engagement. Data shall be stored securely, and access shall be limited to authorized personnel. Upon termination of the engagement, all confidential materials shall be returned or destroyed, as directed by the Client.

5. Client Responsibilities

The Client shall provide:

- Complete and accurate financial statements and supporting schedules.
- Access to key personnel, including CFO, controller, and department heads.
- Any additional documentation requested by the Service Provider within a reasonable timeframe.
- Cooperation in arranging site visits or virtual meetings.

6. Advisor Responsibilities

The Service Provider commits to:

- Conduct the due diligence with due professional care and skepticism.
- Maintain confidentiality and comply with all applicable data protection laws.

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