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Financial due diligence checklist

Key components, best practices,
and template



Introduction

The [importance of comprehensive due diligence](#) during mergers and acquisitions (M&A) has never been more critical. In a volatile economic climate, validating the target's financial health and uncovering hidden liabilities is essential to making sound investment decisions.

To ensure a structured and comprehensive financial review, M&A professionals use financial due diligence checklists.

In this article, we'll cover the basics of a financial due diligence checklist, explain why it's important, and share best practices for conducting the review process. Additionally, we provide a financial due diligence checklist template to help you create one tailored to your specific needs.

What is a financial due diligence checklist?

A financial due diligence (FDD) checklist is a list of key financial elements to check when buying, investing in, or partnering with a company.

It helps you understand the target's real financial situation — income, expenses, assets, and debts. By knowing the details, a buyer can assess the potential risks and pitfalls and can then decide whether to go ahead with the deal and at what price.

An FDD checklist helps ensure nothing is overlooked during the financial due diligence process, which helps avoid unpleasant surprises, like hidden liabilities or financial losses.



Here are the main situations where a financial due diligence checklist comes in handy:

Mergers and acquisitions

Buyers use financial due diligence checklists to validate the target company's financial performance, identify risks, and confirm the accuracy of reported figures. It supports valuation, negotiation, and deal structuring decisions.

Investments

Investors rely on the checklist to assess the financial stability, revenue drivers, and growth potential of a target before investing. It helps determine whether the opportunity aligns with their risk and return expectations.

Strategic partnerships

In strategic partnerships or joint ventures, the FDD helps both sides evaluate each other's financial health and long-term viability. This builds transparency and reduces the risk of future disputes.

Financing

Companies use the checklist to prepare for raising capital or securing loans. It ensures all financial data is accurate, complete, and ready for lender or investor review.



Why is FDD critical in M&A and investment deals?

If a buyer fails to carry out in-depth financial due diligence, then they won't know the true picture of what they're investing in. This leads to the deal's failure, accompanied by potentially large financial losses and legal liabilities.

That's exactly the case with [HP's acquisition of Autonomy](#) in 2011, which led to an \$8.8 billion write-down after HP accused Autonomy's leadership of accounting fraud. With proper financial due diligence before the deal, especially in reviewing Autonomy's accounting methods, HP could have avoided such a negative outcome.



Key objectives of a financial due diligence checklist

A financial due diligence checklist aims to:



Understand the target’s financial health

You get a clear picture of how the company is doing financially by looking at cash flow, debt, and assets. It shows whether the business is stable or struggling behind the scenes.

Confirm the accuracy of financial information

The checklist helps you ensure all the numbers, like revenue, profit, and expenses, are accurate and reliable. It’s about checking that the company’s financial story adds up.

Identify financial risks and red flags

The checklist helps you spot warning signs like tax issues, hidden debts, or unusual expenses early in the deal process. Identifying these issues early can save you from costly surprises later.

Evaluate profit quality and sustainability

It’s not just about a company’s profit but how it's made. The checklist helps to see if earnings are steady and likely to continue.

Check compliance with laws and regulations

You want to know that the company plays by the rules, especially when it comes to taxes and financial reporting. This reduces the risk of potential fines or legal trouble in the future.

Support the valuation process

Accurate financial data helps determine the company’s true worth. It keeps you from overpaying or undervaluing the deal.

Core components of the financial due diligence checklist

A financial due diligence checklist typically outlines the following areas:

Revenue and earnings review

This involves close analysis of how the company makes money, how much it earns, and how these numbers have changed over time. This includes checking different sources of revenue, looking at historical performance, and identifying seasonal trends that affect income.

Profit and loss statements

This is about reviewing income and expense reports to identify patterns, irregularities, or areas of concern. This helps assess how the business makes and spends money and whether its cost structure is sustainable.

Balance sheet health

A balance sheet evaluates the target's financial position by examining its assets, liabilities, and equity. Key focus areas include working capital (short-term financial health), long-term obligations, and the level of net debt.

Cash flow analysis

This is about understanding how cash moves in and out of the business. It includes analyzing operational (core business cash flow), investing (spending on assets or investments), and financing activities (loans, equity, and debt repayments).

Tax compliance and exposure

This step involves reviewing the target company's tax situation to check for unpaid liabilities, audit risks, and whether its tax structure is efficient and compliant with local and international laws.

Forecast validation

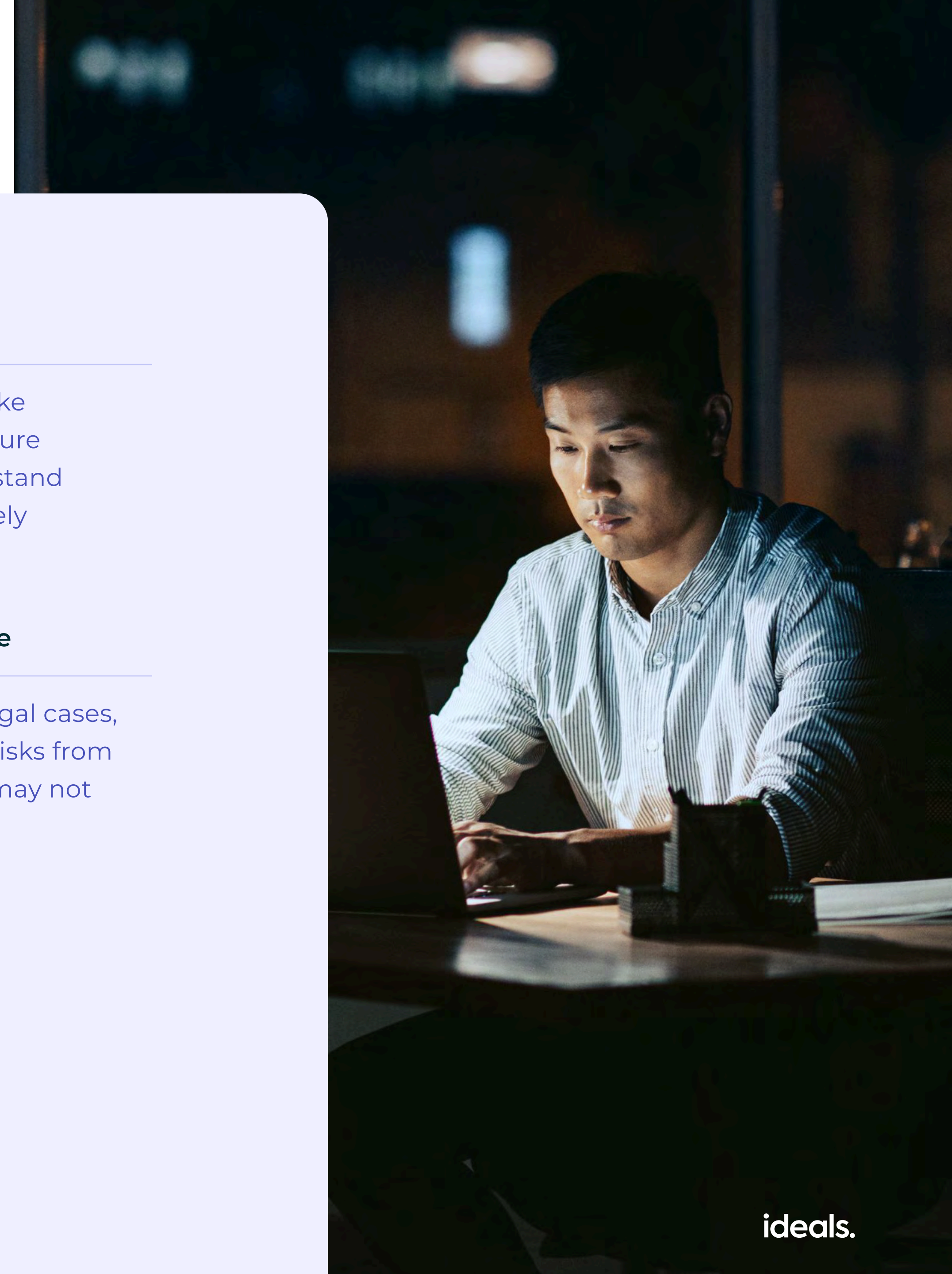
Examines the assumptions and methods used to create financial forecasts. This includes checking if the models are realistic, supported by data, and aligned with market trends.

Capital expenditures (CapEx)

Assesses past spending on fixed assets like equipment or property and identifies future investment needs. It also helps to understand whether CapEx is driving growth or merely maintaining operations.

Contingent liabilities and legal exposure

Identifies potential future costs due to legal cases, guarantees, or warranties. This includes risks from unresolved disputes or obligations that may not appear on the balance sheet.



Best practices for conducting financial due diligence

Financial due diligence is a complicated and time-consuming process. To ensure it is effective and comprehensive, here are the key recommendations to follow:



1. Focus on major risks first

Start the review by identifying the most critical financial risks, such as undisclosed liabilities, irregular revenue trends, or abnormal expense items. These red flags impact deal value or lead to post-close issues if missed. Once these are addressed, move on to standard financial checks like verifying routine revenue streams or cost structures.

2. Collaborate with experts

Involve financial advisors, auditors, and legal professionals early in the process. Auditors help confirm the accuracy of financial statements, advisors interpret finance trends and projections, and legal teams uncover risks hidden in contracts, liabilities, or regulatory compliance. Their expertise builds a complete picture of the target's financial health.

3. Use virtual data rooms (VDRs)

Organize all due diligence documents in a secure online data room that's accessible to authorized stakeholders. Virtual data rooms like Ideals simplify the review process by keeping all the documents in one place while allowing real-time collaboration and audit trails for accountability.

4. Ensure confidentiality and access control

In a virtual data room, admins authorize who can view, download, or edit sensitive information to prevent leaks and ensure confidentiality. They can also assign access levels based on roles and monitor activity logs to see who interacts with what.

5. Watch out for missing or old records

One of the most common challenges in financial due diligence is incomplete or outdated documentation. This includes missing financial statements, outdated tax filings, or inconsistent reporting periods. Identifying these gaps early helps avoid delays and allows the buyer to request updated information or adjust the valuation.

Financial due diligence checklist template

The following pages contain an example of a financial due diligence checklist.

You can use it for inspiration when drafting your own.

Important:



This is just a guideline. Checklist categories and items may be expanded or shortened depending on the deal's specifics. Financial due diligence is also highly impacted by the industry, deal size, and region where a transaction takes place. It's important to follow professional legal advice when undertaking due diligence.



Stage 1. Pre-deal

- Objectives and scope

☐ Define the scope of financial due diligence based on deal rationale
- Target company overview

☐ Gather initial financial and business background documents (e.g., pitch decks, teasers)
- Access and NDA

☐ Ensure NDAs are signed, confirm access to VDR
- Key risk identification

☐ Identify key financial red flags or assumptions to verify
- Diligence team setup

☐ Assemble a cross-functional due diligence team
- Deal-specific adjustments

☐ Modify the checklist for deal size, region, and industry nuances

Stage 2. During review

- Financial statements

☐ Review audited financial statements (three–five years)
- Quality of earnings (QoE)

☐ Analyze revenue recognition, non-recurring items, and customer concentration
- Working capital

☐ Assess historical working capital trends and normalize for the deal
- Debt and liabilities

☐ Confirm debt structure, off-balance sheet liabilities, contingent liabilities
- Revenue and profit drivers

☐ Break down revenue by product, customer, and geography, and perform margin analysis
- Cash flow

☐ Review operating, investing, and financing cash flows
- Forecasts and projections

☐ Analyze management forecasts and assumptions
- CapEx and investments

☐ Evaluate historical and planned capital expenditures
- Tax matters

☐ Examine historical tax filings, losses carried forward, compliance status
- Compliance and accounting

☐ Review accounting policies (GAAP/IFRS), auditor letters, compliance issues
- Intercompany transactions

☐ Identify and analyze intra-group transactions and pricing
- Contracts and obligations

☐ Review major financial commitments (leases, supply contracts, warranties, etc.)
- Red flags and anomalies

☐ Track any unexpected patterns, inconsistencies, or gaps

Stage 3. Post-review

- Preliminary findings

☐ Summarize key risks, opportunities, and areas for further investigation
- Adjustment proposals

☐ Propose purchase price adjustments
(such as net debt and working capital adjustments)
- Integration implications

☐ Identify key financial elements impacting post-deal integration
- Follow-up requests

☐ Send detailed questions or missing document requests to the target
- Final report

☐ Draft and deliver a final financial due diligence report to the deal team
- Archive documentation

☐ Save all reports, findings, and support documents in a secure archive

Here are a few more recommendations for maintaining and updating your financial due diligence:

- **Review post-deal.** After every completed deal, add lessons learned or missed items.
- **Create deal templates.** Save industry-specific versions. For instance, FDD will be different for SaaS, logistics, and consumer goods industries.
- **Track regulation changes.** Monitor for updates in accounting or tax laws that may impact checklist items.
- **Leverage feedback.** Ask your deal team and external advisors for suggestions after each diligence process.
- **Version control.** Use shared tools, such as Notion, Excel, Google Sheets, or a virtual data room with versioning to track updates.

Simplify financial due diligence with Ideals

Financial due diligence can be significantly streamlined when using Ideals Virtual Data Room (VDR).

The platform's key benefits include:

Secure document storage

All the required documents are stored on the cloud and secured with the help of various features, such as encryption, redaction, watermarking, fence view, and more.

Full control of access rights

Virtual data room administrators set access permissions for each user. Therefore, they decide who can view, edit, or download each file or document.

User activity monitoring

Thanks to detailed audit trails, you can always see who accessed what files and when. It ensures data integrity and also helps to track potential investors' interest or concerns.

Effective collaboration

Deal sides can communicate in the dedicated Q&A section. This way, a seller can efficiently solve and keep a record of all the arising questions, which can help improve due diligence outcomes.

Due diligence checklist

With the due diligence checklist functionality, Ideals allows you to upload existing XMSL checklists without conversion, make real-time edits, and track actions.



Final thoughts

A well-structured financial due diligence checklist helps to ensure nothing is overlooked during the review process of the target's financials. Therefore, the deal is more likely to be closed at the most favorable terms and reduce the risk of unpleasant surprises in the future.

Use our financial due diligence checklist template to create and customize one for your deal. For an even more straightforward and secure due diligence process, opt for using a virtual data room.



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