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Due diligence

A company analysis is instrumental in identifying risks and uncovering potential



What is due diligence?

legal audit or due diligence started to be used in connection with foreign investors' entry into the Czech Republic where this term designated performance of an in-depth and complex examination of a company in connection with a planned transaction, most frequently a sale or a purchase.

The requirement for performance of legal due diligence is made from the side of an investor mainly during preparation of acquisitions, prior to purchase or sale of real estate (e. g. plots of land) or for the purpose of identifying potential risks which may be hidden or associated with the planned transaction. Due diligence is also an important tool for determining a purchase or a sale price and formulating contractual guarantees.

What is the objective?

The main objective and of course also benefit which performance of due diligence pursues is to define potential risks in execution of the relevant business transaction or in the existing method of business activities management (including definition of potential responsibility), to formulate precise recommendations in accordance with applicable law, or possibly also to state a method how to eliminate the identified risks and adopt recommendations or specific processes for prevention of their occurrence in future.

If a certain business transaction is examined, a report on due diligence conclusions can be suitably supplemented with a schedule of procedure in such transaction which may at the same time serve as a business transaction plan and especially as subsequent verification of the correctness of its performance and achievement of the planned result.

The scope and depth of due diligence depend on the size of the planned investment.

Most frequent uses

Due diligence can be recommended particularly during company acquisitions, because a properly conducted legal audit should bring to an investor's attention principal legal deficiencies and risks

which an acquisition entails. In this connection due diligence involves examination of a company's legal existence, acquisition of title to property, examination of labour-law matters, obligations, validity of issued permits and/or licences, current or pending legal disputes etc. The scope and depth of due diligence depend on the size of the planned investment.

It may appear that performance of due diligence when purchasing a company serves solely the investor. But a properly conducted legal audit is also beneficial for the seller, because when selling a company with "certification" in the form of a legal examination that the company in question is not encumbered with legal defects or risks, or the risks are specifically described, it will enable the seller to obtain a higher price on the market. If a legal audit determines that the relevant company which is the subject of the planned transaction is without legal defects, the seller gains a certain assurance that there will later not be claims made against him by the buyer arising from the seller's liability for legal defects.

Other uses

A legal audit is not used only during acquisitions or investment into further development but also during "regular" activities connected with a company's business, particularly with the aim to make the current processes in a company more efficient or to map out areas which may bring cost savings. It includes, for example, examination of legal disputes in progress, complex review of contractual documents which are used with business partners and similar activities.

Due diligence can be recommended particularly during company acquisitions.

When ordering a legal audit it is of course also possible for purely practical reasons (such as lack of finances or time) to limit the audit only to examination of a certain aspect or to a specifically defined partial area of commercial undertaking or business activity in which the client is specifically interested. The result should then be precise and practically oriented recommendations for adoption of rectification of the discovered deficiencies, formulation of recommendations for the future and possibly preparation of sample documents. What usually proves beneficial is preparation of a "package" for the employment or certain specific area of contractual documents.

However, due diligence is not executed only as a legal audit but it is also possible to carry it out with the focus on the financial, tax or personnel area.

In practice for projects, such as a planned purchase of a company, clients often choose complex due diligence. In order to achieve a specific cost saving they mostly only opt for closely focused human resources due diligence combined with a so-called employees' working day report.

In conclusion

Due diligence constitutes a company analysis, particularly in the area of law, taxes and finances, whose aim is to define both strong and weak points of a company and risks associated, for example, with its acquisition. But due diligence also represents a means of inspecting and examining efficiency of procedures and processes within existing business activities and may thus bring considerable cost savings in the future.

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