Buyer's Side (or Merger Participant's) Financial Due Diligence Investigation Checklist

Note: If the proposed transaction is a merger rather than a purchase/sale, the due diligence procedures in this checklist are appropriately performed by both the acquiring and target merger participants.

Due Diligence Procedures for Assets of Target Business

1. Cash is generally not included in sale. However, cash accounts should be reviewed for large and unusual transactions in the period preceding the deal. In a merger, cash may either be included or "stripped out" of the target.
2. Accounts Receivable, if included in sale:
   a. Obtain and review aged accounts receivable schedule.
   b. Review status of customers or clients with large balances.
   c. Look for and inquire about any receivables from owners, officers, employees, or affiliates.
   d. Determine if receivables have been factored (borrowed against). This can be done by conducting UCC filing search. (usually completed by the closing attorney
   e. Obtain seller/merger participant's representation that all borrowings secured by receivables have been fully disclosed.
   f. Consider subjecting receivables balances to ratio analysis (see Appendixes 3A and 3B for guidance on using ratio analysis).
3. Inventories:
   a. Consider taking physical inventory to establish existence and condition of inventory.
   b. During the physical inventory, be alert for old, obsolete, or damaged goods. Make sure those items are written down to salvage value.
   c. If work-in-process is significant, it should be scrutinized to make sure that it is properly valued and that its carrying amount is recoverable.
   d. Determine whether there is any inventory held on consignment or consigned to others and whether it was accounted for properly.
   e. Compare inventory values on financial statements to insured values.
   f. Review insurance loss payable provisions to uncover borrowings against inventory.
   g. Consider subjecting inventory balances to ratio analysis.
4. Equipment:
   a. Review repair and maintenance accounts to see if needed work has been postponed to dress up earnings in presale period.
   b. If equipment is specialized and expensive, consider engaging professional appraiser to assess value and condition.
   C. Obtain seller/merger participant's representation that all liabilities secured by equipment have been fully disclosed.
   d. Review insurance policies to compare insured values to values represented by seller (or assumed by buyer).
   e. Review loss payable endorsements to uncover borrowings secured by equipment.

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5. Leased Equipment:
    a. Verify with lessor (preferably in writing) that leases can be assigned to buyer (or merger survivor), if that is the intention.
    b. Verify that financial projections reflect any assumed purchase options at end of lease terms.
    c. Obtain seller/merger participant representation that all leases have been fully disclosed and that leased equipment has not been shown as owned on balance sheet.
    d. Review the actual lease agreements.
6. Real Estate Assets:
    a. Consider engaging professional appraiser to assess value and condition of properties.
    b. If appropriate, charge seller/merger participant with making needed repairs prior to closing or reduce purchase price/merger consideration accordingly.
    c. Consider engaging environmental engineer to assess potential environmental problems.
    d. Obtain seller/merger participant representation that all known actual and potential environmental problems have been fully disclosed.
    e. Review ownership documents and zoning standards for unanticipated restrictions on use of property.
    f. Review insurance policies and property tax statements to compare insured and assessed values to values represented by seller/merger participant (or assumed by buyer/co-participant).
    g. Obtain reports from title insurance company or have abstract of title prepared to verify ownership and check for liens against properties.
    h. Check public records for tax liens.
    i. Obtain seller/merger participant representation that all borrowings and liens against properties have been fully disclosed.
    j. If real estate is subject to favorable mortgages, verify with lenders that these can be assumed by buyer.
    k. If transactions will cause increased property tax assessments, make sure financial projections reflect higher tax expense amounts.
7. Leased Real Estate:
    a. Review the provisions of the lease agreement to obtain an understanding of the lease terms.
    b. Verify with lessor (preferably in writing) that leases are assignable to buyer.
    c. Investigate renewal terms for leases that will expire in the near future (often, renewal provisions will be significantly less favorable than existing terms). Adjust financial projections accordingly.
    d. Verify with lessor that there are no unpaid lease obligations beyond those disclosed by seller/merger participant.
    e. Check zoning standards for unanticipated restrictions on use of the leased premises.
    f. Obtain seller/merger participant representation that all leases have been fully disclosed and that leased real estate has not been shown as owned on balance sheet.

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8. Intangible Assets (Trademarks, Franchises, Patents, Customer Lists, Workforce in Place, etc.):

a. Make sure that all material statutory and no statutory intangible assets have been identified and that the proposed transaction includes legal transfers of all intangible assets and rights that buyer/merger survivor intends to acquire.

b. For "statutory" intangible assets, review patent documents, copyright registrations, etc., to verify that seller/merger participant is rightful holder.

c. Obtain seller/merger participant representation that statutory intangible assets in question have not been assigned to third parties or used as security for borrowings.

d. Consider obtaining certified copies of documents establishing existence of statutory intangible assets (patents, copyrights, etc.) from applicable governmental offices.

e. Determine remaining number of years of statutory protection for statutory intangible assets.

f. For franchises, verify that franchise rights can be assigned to buyer/merger survivor, determine if franchisor will charge a transfer fee, and determine remaining term under franchise agreement.

g. For "nonstatutory" intangible assets (such as secret processes and customer lists), determine if value is affected by expiring no compete agreements with a previous seller, predecessor entity, or former key employee, or by other foreseeable events or market conditions.

h. Determine tax accounting treatment of purchased statutory and nonstatutory intangible assets if they are material.

i. If relevant, determine financial accounting treatment for purchased statutory and nonstatutory intangible assets if they are material.