

15 Due Diligence

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¶ 15.01 INTRODUCTION

Due diligence is the investigation and analytical process that follows an offer or letter of intent and should always precede a commitment to invest. The purpose is to determine the attractiveness and risks of the potential investment, as well as to ferret out and surface particular issues that will require resolution in order for the investment to be brought to a successful conclusion. Done properly, due diligence will enable investment professionals to organize their thought processes effectively in order to address and adequately prioritize the decision-making process that leads to optimizing any deal terms while identifying and addressing risks associated with the transaction.

The due diligence process should be individually tailored to each transaction, and should reflect the unique nature of the investment. Certain components of the process, such as the composition of your team, are within your control, while others depend on factors beyond your control. These external components will be driven by, among other things, the time constraints surrounding the potential transaction, the imperatives of the other parties, and the available resources that inevitably dictate the adequacy of the effort for the work to be performed. The size of the deal does not necessarily indicate the level of due diligence, but the ability to prioritize and expend resources will.

Bankruptcy acquisitions have many qualities that make the due diligence process different from an investment made outside the realm of bankruptcy, even one involving distressed assets. Indeed, within the bankruptcy process itself, the transactions can and often do vary. An investment may revolve around a company's single asset, a specific type of asset such as inventory, one of the debtor's subsidiaries, or an entire operating company.

Regardless of the type of asset, the bankruptcy process also brings to the equation substantive issues that affect the transaction. They arise in conjunction with the application of the Bankruptcy Code and may differ markedly from a non-bankruptcy acquisition. Most asset sales in bankruptcy, for example, have as a condition of sale an "as is, where is, with no express or implied warranties" provision.¹ This, along with the terms of many reorganization plans that extinguish

¹ Chapter 16 discusses provisions found in purchase agreements.

rights, could hinder the buyer's remedies for latent defects² discovered (and discoverable) only after the transaction has closed. On the other hand, bankruptcy sales can be made "free and clear" of liens and encumbrances, transferring rights of those with interests in the asset to the proceeds of sale.³ Another important distinction between bankruptcy and nonbankruptcy sales is that the former require a court order, which can provide significant protection to the buyer against claims that could, and should, have been raised before the transaction was finalized.

Although bankruptcy raises distinct issues for the due diligence professional, it does not change many of the underlying characteristics of the due diligence process, which is for the most part "forum neutral." Most, if not all, of the topics covered in this chapter and the accompanying checklist apply to any due diligence situation. To be sure, there are some nuances that are peculiar to due diligence in bankruptcy, but these nuances are "shadings" rather than underpinnings.

This guide to due diligence is written from the perspective of the person who is making the acquisition, so references to "you" or "your" mean the buyer. This is not meant to limit the usefulness of the information but to remind the reader that our perspective is from the viewpoint of the hypothetical purchaser. This outlook should be kept in mind when evaluating the details or techniques necessary to analyze any transaction.

When we use "Company," we mean the seller, other entities that may have an ownership interest in the target, and any subsidiaries and predecessors of the target company. Also, when we refer to "year," unless otherwise stated, we are referring to the Company's fiscal year.

Due diligence is more than collecting information and simply checking boxes. Most acquisitions are based on the value of future cash flows. Although it is important to ascertain and understand the specific assets you are buying or the liabilities you are assuming, it is equally important to analyze the information in the context of how future cash flows will be affected by the issues examined during due diligence.

The due diligence process may uncover information that will require addressing the critical question of whether or not to proceed with the transaction. Our experience is that using the due diligence "out" to end an acquisition process is increasingly rare, especially in competitive situations. More typically, the negative value impact of items uncovered in due diligence can be addressed by one (or a combination) of the following alternatives: adjusting the purchase price, increasing the amount and timing of holdbacks, or drafting representations and warranties to be made by the Company in a manner that provides additional comfort to the buyer.

² A latent defect is an item's flaw that is hidden or a weakness or imperfection that the buyer could not discover by reasonably inspecting it, but the seller knows about. This includes a land title's hidden defect such as an inaccurate property description. If a latent defect exists, and the asset is not being sold as is where is with no representation or warranties, the purchaser may be able to unwind the sale. If the seller knew of a flaw, an "as is" purchase might also be rescinded.

³ Chapter 4 discusses sales free and clear.

¶ 15.02 A DUE DILIGENCE OVERVIEW

Successful due diligence requires the buyer to draw meaningful and correct conclusions from a large amount of disparate information in a short amount of time. A successful transaction involves:

- Assembling the due diligence team and identifying the Company's team
- Determining the scope of the work to be performed
- Creating the Due Diligence Checklist
- Executing the Due Diligence Checklist
- Conducting interviews
- Gathering information from sources external to the Company
- Drawing conclusions from data synthesis and analysis

Each of these points is discussed in more detail below, but keep in mind that the concept of caveat emptor is a fundamental, if largely unwritten, component of any bankruptcy business acquisition. The buyer must fully understand what it is trying to accomplish, the risks it is assuming, and the conditions that will present themselves as decisive in terms of considering what could be deal breakers. Through effective due diligence the buyer should be able to control the risks it is expected to assume.

[1] Assembling Your Due Diligence Team and Identifying the Company's Team

Professionals of all stripes play a role in due diligence. On both sides you may have management, financial advisers, and attorneys. There may be functional specialists as well, such as experts in information technologies, environmental regulations, human resources, and operations. Each of these participants is critical to the due diligence process.

The skills that each set of professionals brings to the process are seriously undermined unless there is effective coordination and communication, designed to prevent overlap and ensure that no stone remains unturned. The members of a successful legal and financial team, for example, will complement each other. Where the lawyers see an issue they think poses a problem in effectuating the transaction, the financial team may see an opportunity to negotiate a better price or obtain other favorable deal terms.

[2] Determining the Scope of Work to Be Performed

Determining the scope of work to be performed depends on several factors, but two are especially significant: the type of acquisition and the time frame within which the transaction must occur. Both of these play important roles in dictating the depth and breadth of review, analysis, and outside input.

[a] Type of Acquisition

The type of acquisition—whether an entire operating company or just its assets—will dictate the methodology to be used during the due diligence process. Acquiring the stock of an entity is typically riskier than just purchasing assets from a bankruptcy estate. In the former, there may be numerous unknown liabilities and corporate issues that the buyer must seek to uncover. Successor liability issues are also of substantial concern because they could represent a “black hole” of issues that are not readily apparent at first blush.⁴ However, creative thinking and an awareness of potential legislative changes may help the buyer determine whether the risk of unknown liabilities is reflected in the purchase price, or if some postpurchase adjustment or “carve out” can be considered in the event that any stated contingencies arise.

On the other hand, when assets are acquired free and clear of encumbrances of any kind, the nature of the due diligence work to be performed is not as daunting a task. The assets themselves are far easier to identify, as are the potential questions, concerns, and pitfalls that surround the transaction.

[b] Need for Speed

Distress often provides opportunities, but not without risks. Insolvency can cause value to erode by the minute. At the same time, bankruptcy’s legal requirements, such as notification of the sale to all parties in interest, and those parties’ subsequent right to a possible hearing, can certainly diminish your power over the pace of the transaction.

Speed helps mitigate the consequences of the negative value impact. Buyers’ opportunities lie in the effective management of (1) the Bankruptcy Code’s notification requirements, (2) customer attrition, (3) employee attrition, and (4) the Company’s cash flow situation. All of this should cause the buyer to reflect upon what the assets are really worth if too much time passes between the due diligence period and the closing. Also, because Code § 363 sales involve an auction process, you might find the time available for due diligence dramatically shortened by either the emergence of another buyer or the court’s scheduling dictates.

The value of a certain asset, such as customer lists and related accounts receivable, may depend on the ability of a company in chapter 11 to keep operating as a viable concern. As a result, a bidder may be inclined to give short shrift to notice and drafting, which is unfortunate since this is likely the best way to limit successor liability claims. Inadequate notice may also prevent the buyer from extinguishing liens and claims on the assets.⁵ A shorter due diligence period raises the risk that the buyer will not identify items that would cause concern or mandate a price adjustment had more time been available to identify these deficiencies.

⁴ Successor liability is discussed in Chapter 4 and Chapter 24.

⁵ See Chapters 4 and 19.

[3] Creating the Due Diligence Checklist

The Due Diligence Checklist that accompanies this chapter lists just about every item that could be requested by a buyer, although obviously not all items apply to every target Company. Based on the buyer's specific requirements, the condition of the Company in terms of any level of distress, how close it may be to a "meltdown," and related time constraints, the buyer should thoughtfully choose which items it includes (and which it excludes) in the Due Diligence Checklist.

The Company should be directed to respond to each item. The Company may gather the data requested in either a physical data repository or a virtual data room that can be accessed by the buyer's team of professionals.

An important caution: Be careful not to impose what the Company might perceive as unrealistic expectations in terms of the information you want and the time within which you expect to receive it. The Company could easily fall into "deal fatigue" and as a result provide little or nothing in the way of meaningful information.

[4] Executing Due Diligence

In addition to completing the collection of items on your checklist, due diligence also requires conducting interviews with Company management and others who may possess knowledge about the proposed transaction, acquiring information from sources external to the Company, and drawing conclusions from the synthesis and analysis of the compiled data.

[a] Conducting Interviews

Interviews are crucial to effective due diligence efforts and customarily will occur throughout the process as necessary.

At the outset, an interview between the buyer's due diligence team and Company management is essential. The executives of the Company can provide a guide to the current strategic direction of the Company, while middle management can offer information related to day-to-day operations.

During the course of the management interview, the topic of the Due Diligence Checklist will arise. Anyone who has been on the receiving end of the checklist knows that often the Due Diligence Checklist is requested prior to the initial interview session. However, our experience suggests it is much more effective to have the first interview with management and thereafter develop the appropriate Due Diligence Checklist for the Company as a result of both the interview and initial facilities tour.

Developing good working relationships with the Company's team is critical. The information flow should be continuous throughout the due diligence process and continue right up to the date of closing, or, in some cases, even after closing. Fostering good relationships can often result in the buyer receiving higher-quality information in a timelier manner.

A common element of the process includes interviews with key employees and others related to the enterprise outside the Company. An initial interview may

have already occurred between the management of both the buyer and Company at the time of the original expression of interest.

Toward the end of the due diligence process, the buyer should request interviews with key customers to gain an understanding of their relationship to the Company and the potential relationship likely to be enjoyed with the buyer. Interviews with key suppliers to discuss pricing and volume synergies with the buyer will be helpful. Finally, the insurance agent/broker should be contacted to ensure that proper coverages are in place.

[b] Gathering Information from Sources External to the Company

Another source of data is external items such as third-party appraisals, public records, and bankruptcy court filings. This external information is important for two reasons. First, it gives you information that the Company does not have, which is far from uncommon for companies in distress, whether because of a purposeful intent to mislead or deceive or the disarray that often accompanies the distress. Second, external information helps corroborate the information the Company does provide during the due diligence process.

For example, lien searches can reveal UCC financing statements, real estate tax liens, personal property tax liens, and fixture filings. Bankruptcy court filings can be accessed electronically through PACER,⁶ which is available in most jurisdictions. These searches can provide the buyer with a host of useful documents such as the bankruptcy schedules and statement of financial affairs, which should disclose current asset values, pending litigation, and other activity that would not be present in traditional unaudited financial statements. Certain data that often are not publicly available are customer lists and other similar proprietary information.

A list of useful resources for external data is provided in ¶ 15.07 below.

[c] Drawing Conclusions from Data Synthesis and Analysis

The following sections discuss in more detail various components of the conduct of due diligence, including:

- Legal
- Business
- Operational
- Financial/accounting
- Technical
- Environmental
- Human resources

In addition to providing more detail about some of the specific due diligence categories, we have tried to illustrate the operation of the process and give examples of ways in which buyers can analyze the data they have gathered.

⁶ PACER is the electronic access to U.S. Appellate, District and Bankruptcy Court records. The web address for PACER is <http://pacer.psc.uscourts.gov>.

¶ 15.03 LEGAL DUE DILIGENCE

Legal due diligence is a process that involves investigation, verification, and identification of issues that might affect the transaction. The legal due diligence associated with the acquisition (which includes the legal work necessary to accomplish the transaction, such as preparing the § 363 motion) is ubiquitous. Depending on the nature of the transaction, legal due diligence will encompass:

- Corporate and organizational documents
- Financing documents, security interests, liens, and encumbrances
- Directors and officers, employees, benefit plans, and labor matters
- Properties, leases, and insurance
- Intellectual property
- Contracts and arrangements
- Litigation
- Filings and reports
- Licenses
- Product and technology
- Environmental
- Regulatory compliance (e.g., Hart-Scott-Rodino)
- Transaction documents

Other than the preparation of the transaction documents, the legal team's efforts mostly involve analyzing contracts, intellectual property, and other agreements that are expected to be assumed or acquired. A key issue involving contracts is the ability to assign executory contracts and whether the transfer of ownership could trigger any unfavorable economic consequences. The legal team should apprise the business team of any issues in a timely manner so there is sufficient time to address any problems during the purchase evaluation process.

For example, during legal due diligence involving intellectual property, the attorney does more than just determine if the patents, trademarks, and licenses are in place. The fundamental value associated with intellectual property is its ability to sustain competitive advantage. The due diligence professional must translate the findings for the rest of the due diligence team so that they can determine the economic impact of those findings. For example, if the patent on a proprietary product is expiring in the near future, it is reasonable to expect that margins will be compressed as competitors enter the market. A series of questions should ensue. Do the financial projections anticipate the financial erosion? Do opportunities exist in the Company's cost structure to make adjustments and preserve margins? Does the fact that the patent is expiring truly matter? Are there other types of intangibles, such as brand awareness or relationships with end users, that mitigate the negative impact of any patent expiration?

Additionally, legal due diligence addresses threatened or existing litigation matters such as contract defaults, employee lawsuits, and product liability issues.

Finally, legal due diligence must include an analysis of issues that are peculiar to bankruptcy. Examples of such issues would include whether executory contracts and unexpired leases should be assumed or rejected, whether the validity of any liens can be challenged, or whether the Company has claims against others arising in connection with its operation and sale under the Bankruptcy Code.

¶ 15.04 BUSINESS DUE DILIGENCE

Business due diligence is the gaining of a general understanding of the Company's products, sales and marketing, customers, and suppliers. Additionally, business due diligence requires understanding the competitive environment and specifically how the Company competes within its industry segment.

[1] Products

When assessing the Company's products and product lines, the due diligence team should attempt to identify and quantify the various risks and opportunities. Potential risks and opportunities might include:

Risk

Warranty exposure
Reliance on commodity/
raw material pricing
Nearing end of life cycle
Environmental matters

Opportunity

Rationalization with buyer's products
Volume discounts

Product life cycle extension
Environmentally safer production
methodologies

[2] Competition, Sales, and Markets

The Company likely has numerous competitors in its market, product line, industry, and geographic area. In order to assess the landscape in which the Company competes in its industry segment, the due diligence team should first identify the bases of competition. These bases of competition might include service, price, scale, technology, and geographic penetration. After identifying the bases of competition, the Company's performance should be ranked against its competitors.

Sales and market information may be gleaned from a variety of sources, including market studies, feasibility studies, market analyses, press releases, co-marketing agreements, and win-loss sales reports. These sources provide the buyer with information about the path that the Company has chosen to pursue. Equally important is learning how external forces are affecting that chosen path, and which of those forces the Company can control (or the buyer can manage) more efficiently and effectively. This analysis also allows the buyer to see where changes or better choices could be made and what their impact might be.

The complexion of the customer base, such as the number of customers, the magnitude of volumes, the frequency of returns, and the amount of discounts given, all speak to the quality and value of the customer base. How the sales are generated is another important consideration. Sales can be achieved using an outside sales force, an internal sales force, through mass markets, or on a one-off basis.

Finally, the buyer will want to investigate what new products are being developed and when they will be in production, presumably justifying any additional sales growth and increased margin forecasts.

[3] Customers

During the due diligence process, a meeting with key customers may be opportune. The buyer can learn of quality, service, or other issues that the customers may have with the Company. The buyer also may use this opportunity to assure the customers that they will continue to receive service with no contemplated price increases or changes in terms.

The buyer should analyze whether customers are concentrated in a particular industry, geographic location, or business sector. Concentrations in any one of these areas carry potential risks. The buyer should identify key customer contracts and determine if they are assignable, if a change of ownership creates a default, or if in some other way the customer has an “out.” Are there unappealing terms of the contract that the buyer might want to renegotiate? The customer may require volume discounts or warranty reserves that the buyer may find onerous, or the contract may not provide that material surcharges can be passed on. Other contract provisions that should be considered are exclusivity, aftermarket support, returns, and allowances.

Unique issues emerge in retail acquisitions. Foremost is the importance of good public relations in the very early stages of any bankruptcy case. The Company’s customers, upon learning of the bankruptcy, might assume that the Company has gone out of business. The customers need to be assured that the Company is, in fact, still operating and that it wants to continue to serve them as well as, or better than, it did prior to the bankruptcy.

[4] Suppliers

During the due diligence process, it is helpful to identify key products that are purchased and who supplies them. In addition, understanding the Company’s relationship with its suppliers is critical, particularly due to the distressed nature of the Company. Questions you should ask include:

- What are the key products the Company purchases and who supplies them?
- Has the Company been forced to find secondary sources for its materials, supplies, and services? Can the buyer find those secondary sources, if needed?
- After entering bankruptcy, did the Company suffer price increases or have stricter terms imposed, such as cash on delivery or cash in advance of ship-

ment? Will the supplier reverse or ease those terms on the strength of the buyer's creditworthiness?

If there are only a few suppliers of goods or services that the Company needs, or they are unique, there is a greater challenge to the Company in keeping the suppliers on board after the acquisition, and they must be interviewed to get their support. The buyer should confirm whether the suppliers could be easily replaced and how long the replacement would take.

The buyer also should determine whether suppliers have possession of the Company's tools and molds and, if so, whether it is realistic to expect that these will be returned upon demand.⁷ On the other hand, if the supplier owns the tools and molds, there will be additional cost to the buyer if it wants to change suppliers. The buyer should discern if the Company has duplicate tooling available to the buyer if a dispute arises.

¶ 15.05 OPERATIONAL DUE DILIGENCE

[1] Personnel

The due diligence process provides an excellent opportunity to observe key managers and assess their skills. The buyer can use this observation period to determine if personnel changes are needed and to begin to create a management team able to obtain anticipated synergies.

[2] Information Technology

The information technology and systems due diligence should be augmented with a technology professional who will assess the presence and adequacy of the Company's software, hardware, reporting, and security and provide recommendations for enhancements or upgrades that are necessary or beneficial.

[3] Capital Expenditures

The level of maintenance capital expenditures should be consistent with keeping current fixed assets in a state of repair so they can efficiently meet current production requirements. Through physical inspection as well as the review of maintenance logs, the buyer can be assured that capital items are in good repair. This type of analysis is particularly important in bankruptcy because capital expenditures are often delayed due to cash flow constraints.

Growth capital expenditures are normally required to expand the Company's existing capacity to increase production of its current products or to increase functionality to manufacture new products. Determining the Company's growth capital expenditures is helpful when analyzing the Company's projections.

⁷ Provisions of the Code may be available to force a supplier to turn over tools and molds to the buyer.

For instance, assume the Company's forecast indicates that a significant portion of revenue growth will be coming from a new product, but your investigation shows that the Company does not yet have the machinery and equipment needed to make the product. Further, the lead-time to get the equipment is six to eight months at a minimum. As an obvious consequence, you can be sure the Company will not meet its forecasted revenues.

Similarly, if the projections require capacity (unit or space) that is beyond what is presently available, then efficiencies must improve, additional capacity must be found, or both, in order for these projections to be achieved.

[4] Process Analysis

In reviewing the Company's manufacturing and other processes, the due diligence team should seek out opportunities for synergy. This includes not just the benefits the buyer receives through the acquisition, but also the means by which the Company can enhance the buyer's operations. Specific examples of issues to consider include:

- Time and motion studies
- Partnerships with shipping (or other) companies for elimination of support departments for savings of time and/or resources
- Offshore opportunities
- Distribution opportunities
- Supply chain opportunities, including volume purchases
- Scale opportunities

¶ 15.06 FINANCIAL DUE DILIGENCE

Annual and monthly financial statements should be obtained for the prior three years. A variety of analyses can be performed, beginning with the appropriate ratio calculations. Trends should be analyzed, particularly in conjunction with any revenue fluctuations. Financial statements should be carefully analyzed to determine if the presentation fairly represents the Company's financial position and whether generally accepted accounting principles were followed and properly applied.

[1] Accounts Receivable

Analyze slow-paying customers to determine if that behavior is consistent with past experience or is a recent phenomenon. Partial payments on invoices often signal a dispute with the Company or credit problems with a customer.

Examine agings at various logical points in time, such as the latest month end, the previous four to five quarter ends, or the prior two years. Observing the agings over time allows analysis of any seasonal fluctuations. Be mindful of seasonal or industry-specific payment terms that might lead to erroneous conclusions.

Access the methodology for determining allowance for doubtful accounts and compare that methodology to the write-off history to determine if the existing level is appropriate or if changes should be made.

Assess selling terms to discover whether customers have demanded more from the distressed Company because of its lack of recent performance or if terms in the customer agreement cause a significant amount of discounts for volume, promotional credits, or other incentives that reduce the actual collection of the accounts receivable.

[2] Inventory

Inventory may be a large component of current assets on the balance sheet. Inventory components, raw material, work in process, and finished goods need to be analyzed both historically and prospectively. The buyer should look for shifts in the inventory mix, value, quantity, and condition. Raw material should be analyzed to determine if it is truly a raw, unprocessed material or a value-added item where, if determined to be obsolete or excess, its carrying value will never be realized.

Analyze the trends of the mix to highlight any changes from period to period—is the mix reasonable given the operations of the Company? There are three key issues to remain aware of when analyzing inventory: existence, obsolescence, and excess. Analyses that can be performed on inventory to corroborate the inventory's existence, obsolescence, and excess include:

- Inventory summary by major product lines or major products
- Inventory unique to a particular customer
- Inventory turns in general and within inventory categories

The existence of inventory can be confirmed by observing it while making plant tours, confirming the location of the major categories, physically testing a certain item's quantity against the perpetual inventory records, and obtaining a copy of the last physical inventory. Understand all adjustments made at year-end and changes in any reserve balances.

Other issues relating to inventory analysis include:

1. **Obsolete inventory.** Obsolete inventory can be readily identified by comparing the materials currently used in production, or forecasted to be in production, to the materials currently in inventory.
2. **Excess inventory.** Excess inventory can be found in raw material and finished goods. By obtaining the products and materials inventory electronically, you can quickly establish if inventory levels are greater than a year's supply.
3. **Out-of-balance inventory.** Companies that have been experiencing financial difficulties may have an inventory that is out of balance, e.g., a cabinetmaker with too many doors and not enough shelves. The buyer may have to make a capital infusion in order to rebalance the inventory.
4. **Consigned inventory.** If any inventory is consigned, it should be identified and properly segregated.

[3] Property, Plant, and Equipment

The due diligence process for property, plant, and equipment should focus on determining the existence, location, condition, and ownership of the Company's hard assets.

The buyer should obtain a fixed asset schedule, sort the assets by physical location and then by dollar amount, and test existence of those assets. A two-way road test can be done. In the first, randomly choose assets on the fixed asset schedule and trace them back to the physical location to ascertain existence. Conversely, randomly choose equipment on the plant floor and map it to the fixed-asset listing.

Through a plant tour and examination of the maintenance log, the buyer should determine if assets appear to be well maintained. If equipment is idle, it might be excess equipment that could be scrapped, or the value of the machine may be less than what is on the books.

Determine the Company's capitalization policy and whether it has been consistently followed. Changes in the policy require further analysis. Often a company will begin capitalizing lower cost items as opposed to fully expensing them in order to artificially inflate earnings.

[4] Assumed Liabilities, Contingent Liabilities, Accounts Payable, and Accrued Liabilities

In addition to reviewing and analyzing accounts payable and accrued expenses, it is also necessary for the legal team to ascertain whether any unrecorded or contingent liabilities exist. This issue becomes particularly important when the transaction is structured as a stock sale.

If the acquisition is a § 363 asset sale, actual notice must be given to creditors, including holders of contingent or disputed claims. The buyer should test whether the company's list of claimants is sufficiently comprehensive.

[5] Revenue and Cost of Goods Sold***[a] Revenues***

Revenues can be observed from a customer, product, channel, geographic, or other perspective as the situation might dictate. In order to arrive at informed conclusions, it is critical in the due diligence process to understand what factors drive revenues.

Two broad approaches may be used to analyze revenues: horizontal and vertical. The horizontal approach examines historical trends in order to determine what inferences may be drawn about the future. The vertical approach examines the components of revenues. When used together, these approaches can be highly effective.

Trend analysis over a five-year historical period is sufficient in most industries to gain an understanding of the dynamics impacting the Company. Trend

analysis becomes more useful when data is compared to industry composites or broader economic composites. Large percentage increases or decreases in revenues should be explored, especially if they are counter to the industry composite. Any abnormality in the trend should be examined to determine the cause.

The vertical approach illuminates characteristics of the customer base or product mix that drive revenues. Often the “Top 10” or “Top 15” customers or products are analyzed in detail because they make up a large percentage of the Company’s revenues. This higher percentage of revenues from key customers or products requires vertical analysis.

[b] Cost of Goods Sold

Understanding the Company’s cost structure and its composition can indicate where the business may be vulnerable and where cost-saving opportunities might exist.

For example: A company manufactures precision component parts primarily for the automotive industry. Six customers comprise over 80 percent of the revenues.⁸ A trend analysis shows that over the past five years, those six key customers’ revenues (expressed as a percentage of total revenues) grew from 60 percent to 80 percent, indicating that the company is dependent on a handful of six customers. The loss of a key customer or the erosion of profitability of a key customer would be detrimental to the business.

In our example, the buyer must determine the ease with which the key customers can change suppliers. In order to assess the risk of losing a customer, a switching cost analysis (i.e., how easily the company’s customers can switch suppliers and at what cost) can be undertaken.

In our hypothetical case, the buyer’s due diligence uncovers several further considerations:

- Each key customer has a long-term relationship with the company.
- The automotive part is a component of a production platform with a five-year life.
- The company is a primary supplier to each of the customers.
- The company’s engineering department has already undertaken the design of the succeeding production platform, ensuring that the key customer relationship continues.
- The company experiences a low incidence of returns or quality problems for its manufactured precision component parts.

These facts should provide comfort that the relationship will continue.

A closer examination of the hypothetical cost structure of each customer on a contribution margin basis shows that there is a wide disparity of cost components (material, labor, and overhead) among the customers. Customer A has a 19 percent

⁸ Using the 80/20 rule, in many situations, 80 percent of revenue is derived from 20 percent (or less) of the total number of customers. Key customers are any customers that constitute a small number of customers that generate the majority of the company’s volume.

cost of material (expressed as a percent of revenue) while customer B has a 40 percent cost of material. Although both customers' profitability would be impacted by increases in material cost, customer B is more vulnerable because a much larger component of cost is material. Assuming nothing could be done to reduce the amount of material used, the company or buyer could look elsewhere to reduce other cost components, such as those related to labor or overhead. For example, in our hypothetical case, there is an opportunity to move some production off shore to save labor costs. In addition, a strategic buyer is usually able to buy materials in higher quantities and receive quantity discounts, mitigating the vulnerability. In other situations, the buyer can use the analysis to identify customer contracts to be rejected.

The buyer could also analyze the profitability of the Company's key customers or key products. Each of these exercises should be undertaken on an actual and common-sized basis. The valuable conclusions that can be drawn from these elementary analyses can help the buyer quickly distill the "fit" of the acquisition.

[6] Operating Expenses

Operating expenses should be obtained in as much detail as possible, but within the limits of what is manageable. It is easier to analyze operating expenses when they are common-sized. (Convert the values to common-sized, isolate the highest value accounts or categories, and perform trend analysis on the specific items.) This type of analysis is fairly straightforward and can be fertile ground for identifying synergies and determining whether they can be realized.

Many companies classify expenses differently. Often expenses that should be classified in the cost of goods sold category are instead classified as general selling and administrative expenses. If the buyer is using its own financial statements for comparison to the Company, the analysis could be flawed if the expense classifications are not harmonized.

¶ 15.07 INFORMATION RESOURCES

Much of the information you need in the due diligence process will be obtained from the Company and the Company's management. Your Due Diligence Checklist will detail the information you want to acquire, which will be made available in a physical or virtual data room. The physical data room may be at the Company, its investment banker, or financial adviser.

Some information will not channel through the data room, but should be made available from the Company's financial, legal, and other professional advisers.

The buyer should make every effort to corroborate and cross-check due diligence information. There are any number of reasons that a Company's information should not be taken at face value and relied on by the buyer in deciding to go forward with the acquisition. The Company's management might be interested in bidding on the Company, its records might be in disarray because of its financial distress, or there may have been fraud or other malfeasance, to cite just a few examples.

Listed below are some sources of information in a bankruptcy business acquisition. Many of these sources also allow online access.⁹ Much bankruptcy information, for example, can be obtained through PACER, the federal courts' online document system. Always keep in mind this caveat: Be aware of the sources of your data and their underlying motives.

[1] Bankruptcy Court Documents

- Docket report listing documents filed in the case
- Schedules and statement of financial affairs
- Monthly operating reports
- Claims register of filed claims
- Transcripts of § 341 meeting or Rule 2004 examinations (if available)
- Pleadings, motions, orders, and other documents filed with or entered by the court
- Applications for professional employment
- Notices of appearance
- Notices reflecting transferred claims

[2] Nonbankruptcy Public Records

- Uniform Commercial Code financing statements
- State and federal tax liens and attachments on real and personal property
- Real property chains of title
- Real property mortgages, judgment liens, and similar encumbrances
- Fixture filings
- Lawsuits and other state or federal court actions
- Patents, trademarks, and other intellectual property

[3] Fee-Based Information Sources

There are many private companies that compile and make available information about businesses, such as Dun & Bradstreet, Hoover's, MergerStat, and Capital IQ. Private investigative services can also be used for employee background checks or other information specific to the transaction.

¶ 15.08 CONCLUSION

The due diligence process is as much about corroboration as about performing analysis that focuses on whether expected cash flows can be achieved. The due diligence team's key contribution to the acquisition process is translating its findings into value. Throughout the due diligence process, each discrete analysis or inquiry should conclude with an answer to this question: Do the findings support the purchase price?

⁹ In larger cases, the debtor (Company) frequently maintains its own website with answers to common questions, press releases and pleadings filed in the case.

¶ 15.09 DUE DILIGENCE CHECKLIST

Document Requests and Procedures

BY WILLIAM A. BRANDT, JR., R. BRIAN CALVERT,
CLARE M. PIERCE AND CATHERINE E. VANCE

This checklist was developed on the premise that there is no such thing as a “one-size-fits-all” list of documents and activities that composes a successful due diligence process. Our approach is comprehensive, providing you with what you need to be aware of in the various phases of due diligence so that you can create transaction-specific checklists tailored to each potential acquisition.*

Extensive as this checklist is, it is not exhaustive—that would be impossible. As we discuss in the accompanying chapter, some transactions will require additional functional expertise, and you will need to customize your due diligence checklist, supplementing it with industry-specific information.

Some of the information on your checklist will be unavailable, whether because documents have been lost, the parties are acting under an oral contract or other unwritten arrangement, or a host of other reasons. Whatever the reason, the Company should be prepared to provide as much detail as possible in order to fill in any information or documentary gaps or the buyer should seek external sources for information.

Note that when we use “Company” in this checklist, we are also referring to the seller, any other entity that has an ownership interest in the target company, and any subsidiaries and predecessors of that target company. Also, when we refer to “year,” unless otherwise stated, we are referring to the Company’s fiscal year.

* We must acknowledge that we cannot possibly thank the many people who helped us create this checklist and its accompanying chapter. Nor can we name them. Our work here is the culmination of many years’ collective experience, which has included not just actual case work but also literature, seminars, and even discussions among colleagues about the issues involved in due diligence. Although gratitude to anyone in particular is not possible, we do earnestly acknowledge those who helped shape, however indirectly, what we contribute here.

SUMMARY DUE DILIGENCE CHECKLIST

- I. Corporate and Organizational
- II. Securities
- III. Financing Documents
- IV. Financial Statements
- V. Financial Analysis
- VI. Operations
- VII. Employee Information
- VIII. Tax Matters
- IX. Business Analysis
- X. Sales and Marketing
- XI. Officers and Directors, Employee Benefit Plans, and Labor Matters
- XII. Properties, Leases, and Insurance
- XIII. Electronic Data Processing
- XIV. Intellectual Property (Patents, Trademarks, Copyrights, and Trade Secrets)
- XV. Contracts and Arrangements
- XVI. Litigation
- XVII. Environmental and Related Matters
- XVIII. Acquisition Documents and Sales of Securities
- XIX. Transactions with Officers and Other Insiders
- XX. Filings and Reports
- XXI. Regulatory Compliance
- XXII. Consents
- XXIII. Miscellaneous

DUE DILIGENCE CHECKLIST

I. Corporate and Organizational

- A. Certified copies of the articles of incorporation or equivalent organizational documents of the Company as currently in effect, including all amendments thereto.
- B. Certified copies of the bylaws of the Company as currently in effect, including all amendments thereto.
- C. Minute books for directors' meetings and other committee meetings, actions by written consent, and shareholder meeting minutes for the last five years.
- D. Summary capitalization table evidencing stock ownership of the Company and access to stock books and stock transfer ledgers of the Company.
- E. List of states and foreign countries in which the Company is qualified to do business, including names and addresses of registered agents, and list of states and foreign countries in which the trade names of the Company are registered.
- F. Long-form good standing certificates, including payment of taxes in the state of incorporation and every state and foreign country in which the Company is qualified to do business.
- G. List of states and foreign countries in which the Company owns real and/or personal property.
- H. List of states and foreign countries in which the Company conducts business.
- I. List of states and foreign countries in which tax returns are filed because of the ownership of property or conduct of business by the Company.
- J. List of states and foreign countries, if any, in which the Company is not qualified to do business and does not file tax returns, but in which it maintains an office, inventory, or employees or agents who solicit orders.
- K. Current organizational chart for the Company and subsidiaries, operating divisions, and hierarchy of officers.
- L. Partnership and joint venture agreements and identity of partners and joint venturers.
- M. Intercompany and intracompany transactions or contracts, including:
 - 1. Transactions or contracts between the Company and its insiders;
 - 2. Transactions or contracts between the parent and its subsidiaries;
 - 3. Employee stock option plan, bonus, option, or other agreements to issue equity interests with respect to the Company or any subsidiary, and the aggregate number of equity interests subject thereto;

4. Intercompany and intracompany correspondence and memoranda;
5. Non-arm's-length transactions or contracts with affiliates, including:
 - a. Transactions or contracts that are out of the ordinary course of business;
 - b. All names under which the Company or any predecessor thereof has done business in the past five years.
- N. List of all assumed names and trade styles under which the Company and/or its shareholders operate.
- O. List of subsidiaries of the Company. (This subsidiary list is a separate informational document. Remember that your entire due diligence checklist may also apply to each of the Company's subsidiaries depending on the nature of the transaction.)

II. Securities

- A. Statement of outstanding and treasury shares of common stock, preferred stock (including a complete description of the rights attaching to such preferred shares), and any other securities of the Company and each subsidiary.
- B. Shareholders' list, including:
 1. Name and address of each shareholder of the Company, its subsidiaries, and of any voting trustees;
 2. Shareholders' affiliations with the Company;
 3. The type(s) of security held, the date of issue by the Company, including the consideration received by the Company therefor, and the number of shares of such security owned by each such shareholder or trust.
- C. List of holders of any options or rights to purchase any securities of the Company (including warrants). For each such holder, provide:
 1. Holder's name;
 2. Number of options held;
 3. Option prices;
 4. Dates of grant, expiration, and vesting;
 5. Number of shares owned, excluding those subject to option.
- D. Copies of all stock option agreements, stock option plans, and warrants.
- E. Copies of all shareholder agreements and all other agreements with respect to securities of the Company or its subsidiaries, including but not limited to voting rights agreements, stock subscription agreements, restricted stock agreements, registration rights agreements, preemptive rights agreements, and agreements among shareholders to which the Company is not a party.

- F. All reports to shareholders of the Company prepared within the past three years.
- G. Indication of whether there are any shareholders or stock certificates whose whereabouts are unknown, or any shareholders from whom it will be difficult to obtain approval of the transaction or stock certificates, as applicable.
- H. A description of all contractual restrictions on transfer of the Company's capital stock or assets.

III. Financing Documents

- A. Schedule of current indebtedness of the Company (including capitalized leases, guarantees, and other contingent obligations), including the title, authorized amount, and amount outstanding, indicating interest rates and maturity dates.
- B. Any presentations given to creditors in connection with obtaining credit or prepared for potential lenders in connection with any proposed financings.
- C. All currently effective loan agreements, indentures, debt instruments, lines of credit, and other financing instruments, including capital leases, and all related material documentation, to which the Company is a party.
- D. A list of all mortgages, liens, pledges, security interests, charges, or other encumbrances to which any property (real or personal) of the Company is subject, and all related material documentation.
- E. All correspondence with lenders and other debt security holders for the past five years, including consents, notices, or waivers of default from lenders with respect to borrowings by the Company.

IV. Financial Statements

- A. Audited financial statements, both consolidated and consolidating, for the Company and its subsidiaries for the past three fiscal years.
- B. Assurance of buyer's access to auditors' workpapers corresponding with Section IV.A., above.
- C. All unaudited interim financial statements of the Company for the prior 24 to 36 months.
- D. Separate consolidating statements for significant subsidiaries or divisions.
- E. Detailed supporting workpapers for all asset and liability accounts as of specified dates (which will vary depending on the transaction) and the corresponding balance sheets.
- F. Summary of accounting policies, including:
 - 1. The effect of any recently issued or proposed standards or regulations of the FASB, IRS, or other regulatory body that could have a material effect on the financial position or the results of operations;

2. Internal accounting controls in key areas (e.g., receivables, payables, inventory);
 3. Brief description of the nature of prepaid or deferred income or expenses.
- G. Cash flow and working capital analysis as of the most recent date practicable.
- H. Schedule of revenue by customer by product line, as applicable.
- I. Brief description of contingent liabilities involving the Company.
- J. Financial reports and related materials prepared for the Company's board of directors or a committee thereof within the last three years.
- K. Significant correspondence with independent public accountants, including management letters from auditors concerning internal accounting controls in connection with audits, within the last three years.
- L. Schedule of property, plant, and equipment, and accumulated depreciation broken down by category (e.g., land, buildings, equipment, etc.) for the last year, including:
1. Beginning balances;
 2. Additions (or provisions);
 3. Retirements or dispositions;
 4. Ending balances.
- M. Brief description of depreciation policy.
- N. Capital expenditure programs.
- O. Reports and studies prepared by outside consultants with respect to the Company's business or financial condition within the last three years.
- P. Brief description of outstanding commitments for capital expenditures appropriate to the size of the transaction.
- Q. Any documents relating to material write-downs or write-offs of notes, accounts receivable, or other assets, other than in the ordinary course of business.
- R. Monthly roll-forward schedule from a specified period (which will vary depending on the transaction) supporting credits owed to customers for unused minimum volumes. Schedule should show beginning credit, monthly usage, and monthly credits added.
- S. Reports, studies, and projections prepared by management with respect to the Company's business, financial condition, or planned operations, including business plans, within the last three years.
- T. Details and narratives, flowcharts, etc., of management reporting system.
- U. Description of monthly financial reporting packages distributed to senior management.
- V. Accounting department organizational chart.

- W. Names of accountants, length of relationships, and whether the accountants own any interest in, or hold any position with, the Company or its subsidiaries.
- X. Financial projections (income statement, balance sheet, cash flow) for three years following the conclusion of the most recent fiscal year.

V. Financial Analysis

- A. Documentation of the procedures and walk-through of the accounting cycles, including purchasing through cash disbursement and sales through cash receipts, by selecting a relevant number of transactions.
- B. Trend analysis.
 - 1. Perform analytical procedures on the most recently available internally prepared financial statements and investigate any significant changes in trends compared to the last available financial statements.
 - 2. Review budgets prepared for previous periods and compare to actual results achieved.
 - 3. Ascertain if there have been any significant changes in accounting principles, policies, or estimates for the last three years.
 - 4. Compare year-to-date performance to financial projections used in determining the purchased price offered.
- C. Cash.
 - 1. Obtain list of banks and for each bank list:
 - a. Address of bank;
 - b. Account numbers.
 - 2. Obtain schedule of monthly bank balances during the prior 12-month period, which delineates the nature of the cash account, i.e., demand deposits, time deposits, and CDs.
 - 3. Note minimum and maximum balances and trends.
 - 4. Describe policy regarding investment of idle balances.
 - 5. Determine whether seasonal bank borrowings are necessary.
 - 6. Identify restrictions on cash balances, compensating balance requirements, and line of credit arrangements.
 - 7. Obtain explanation of unusual receipts or disbursements, including, for example, insurance claim recovery.
 - 8. Review projected cash flow for the next 12-month period. Compare previous projected cash requirements to actual results.
 - 9. Evaluate cash management technique and ability to meet current and future cash requirements.
- D. Marketable securities.
 - 1. Obtain a schedule of marketable securities.

2. List original cost, date purchased, interest rate, maturity date, and basis of recording.
 3. Obtain current fair market value.
- E. Accounts receivable.
1. Document credit, revenue recognition, and collection policies and procedures.
 2. Obtain an analysis of total accounts receivable broken down by customers, employees, officers, family members, etc.
 3. Obtain a reconciliation of subsidiary accounts receivable records to general ledger account; obtain explanations for unusual reconciling items.
 4. Identify current credit policies, trade terms, and special trade terms (e.g., deferred payment terms or agreements to accept return of goods). Compare with customary credit terms in the industry.
 5. Obtain "aged" trial balances as of current and prior year dates or other appropriate period. Discuss large or overdue accounts. Determine the methodology for computing inventory reserves and tax deductibility.
 6. Document the significant inventory write-offs over the past three years.
 7. Obtain analysis of accounts in dispute.
 8. Schedule ratio of returns and allowances to sales by month for the last 12 months. Inquire about unusual fluctuations.
 9. Review adequacy of the allowance for doubtful accounts, giving consideration to the current accounts receivable aging actual write-off experience and receivables collected problems.
 10. Inquire as to the methods used to establish the allowance for the doubtful accounts. Obtain credit reports for significant customers with collection problems.
 11. Calculate number of days' sales in receivables for each month-end for the past several years.
 12. Obtain summary of all receivables outside the normal course of business.
 13. Inquire into sales cut-off procedures.
- F. Inventories.
1. Obtain inventory summary by major product lines or major products for the current and prior year. Include balance in raw materials, work in progress, and finished goods.
 2. Obtain results of the latest physical inventory, which compares book amounts to perpetual records. Obtain explanations of significant book to physical adjustments.
 3. Inquire whether consigned-in inventory is excluded and whether consigned-out inventory (e.g., warehouses, consignees, processors, etc.) is included in book inventory.

4. Determine policy regarding obsolete and slow-moving inventory. Review results of latest review for obsolete, unusable, and slow-moving stock on hand.
 5. Describe the method of inventory control.
 6. Review cost system, noting:
 - a. Detail supporting standards;
 - b. Use of variances;
 - c. Timely updating of standards;
 - d. Overhead components;
 - e. Relationship among labor, material, and overhead.
 7. Obtain a schedule of inventory turnover rates and gross profit percentages by product line for the past several years.
 8. Physically observe the general condition and quality of inventory.
 9. Ascertain whether inventories are stated at the lower of cost or market and describe the methods used to calculate.
 10. Review long-term supply contracts.
 11. If inventory is valued on a LIFO basis, obtain a schedule summarizing the individual LIFO layers.
- G. Property, plant, and equipment ("PP&E")
1. Obtain a summary of PP&E and related accumulated depreciation broken down by category (e.g., land, buildings, equipment, etc.). Summary should show:
 - a. Beginning balances;
 - b. Additions;
 - c. Retirements and dispositions;
 - d. Ending balances.
 2. Inquire into significant fluctuations of balances, additions, and retirements and dispositions.
 3. Obtain a current listing of PP&E showing location, original cost, age, current book value, and method of depreciation.
 4. Inquire as to replacement values by reviewing recent tax assessments and appraisals.
 5. Obtain listing of leased PP&E showing location, annual rentals, expiration dates, renewal options, and age.
 6. Review accounting policy regarding repairs versus capital expenditures.
 7. Review cost of maintenance and repairs for the past several years.
 8. Inquire into PP&E that has become obsolete.
 9. Physically inspect PP&E.
 10. Review depreciation methods (book and tax).
 11. Review controls over capital asset appropriations and dispositions.

12. Identify differences between book and tax basis of PP&E.
 13. Inquire about costs expected to be incurred to comply with government regulations.
- H. Prepaid expenses, deferred charges, and other assets.
1. Obtain a schedule of major prepaid expenses, deferred charges, and other assets.
 2. Analyze current listing of prepaid assets to determine future benefit to the buyer.
 3. Review method and period of amortization or write-off.
 4. Ascertain beneficiary of "key man" life insurance.
 5. Confirm current insurance coverage.
- I. Intangibles.
1. Obtain a listing of all patents, copyrights, trademarks/trade names, and any other intangible property in which the Company has rights and analyze legal and functional expiration dates.
 2. Analyze impact that intangibles have on revenue and profits.
- J. Investments.
1. Obtain schedule of investments showing name, percentage of ownership, cost, and current market value.
 2. Determine the method of valuation (equity or cost).
 3. Obtain market quotation for investments that are publicly traded.
 4. Obtain schedule of advances to affiliates or unconsolidated subsidiaries.
 5. Identify book/tax difference.
 6. Obtain schedule of dividend and interest income.
- K. Current liabilities.
1. Obtain schedules of current liabilities by category (e.g., trade and accrued liabilities) and payment practices.
 - a. Compare the current accounts payable listing to the two prior years' balances and perform appropriate analytical procedures to ascertain reasonableness of the current balance.
 - b. Review trend of number of days in accounts payable.
 - c. Analyze the treatment of liabilities associated with the deferred compensation plans, pension plans, and profit sharing and other employee benefit plans.
 2. Outline short-term financing methods.
 3. Obtain reconciliation of detailed accounts payable records to general ledger and obtain explanations for unusual or unresolved reconciling items.
 4. Identify normal and special trade terms (e.g., discounts)
 5. Inquire as to whether liabilities include:

- a. Accrued salaries, wages, vacation pay, commissions, bonuses, and payroll taxes;
 - b. Amounts withheld from employees;
 - c. Unemployment and workers' compensation;
 - d. Customer advances or credit balances;
 - e. Security or customer deposits;
 - f. Dividends;
 - g. Advances from officers, employees, or owners;
 - h. Judgments, damages, and other claims;
 - i. Interest payable;
 - j. Warranty and product liabilities;
 - k. Accrued taxes.
6. Inquire as to proper receiving cut-off. Obtain listing of open or unmatched receivers.
 7. Consider a search for unrecorded liabilities.
 8. Ascertain conditions that could result in the withdrawal of commitments of unused lines of credit.
- L. Revenue. (Keep in mind that revenue issues permeate the due diligence process and are, therefore, implicitly included throughout this checklist.)
1. Document revenue recognition and return policies.
 2. Analyze historical reconciliation of gross to net sales.
 3. Reconcile revenue reported to bank deposits.
- M. Cost of goods sold.
1. Document policies and procedures used to determine cost of goods sold.
 2. Analyze historical components of costs of goods sold.
 3. Perform product costing analysis and review bills of material for major products at each location.
 4. Analyze scrap and rework reports.
 5. Analyze historical headcount and compensation by functional department.
 6. Identify components of production costs, materials, labor, and overhead. Compare to industry norms.
 7. Identify fixed and variable costs, break-even, and the relation of volume to break-even.
 8. Identify effects of noncash costs and cost accounting for idle capacity and variance accounting.
 9. Obtain a breakdown of manufacturing overhead.
- N. Operating expenses.
1. Analyze historical operating expenses by functional department.
 2. Trace owners' salaries to payroll reports.
 3. Analyze salary and wage increases over the past three years.
 4. Determine any additional benefits provided to the owners.

5. Trace total salaries to payroll reports.
6. Analyze other income/expenses over the past three years to determine recurrence and trends.
7. Perform analytical procedures on expenses reported in the current income statement, which are also being accrued.
8. Inquire of management and the Company's outside counsel regarding any existing unrecorded commitments or legal contingencies and review the last two years' legal invoices.
9. Verify any other operating expenses that were represented by the Company to be nonrecurring.
10. Review and document accounting procedures related to vendor credits (advertising, warranty, holdbacks, or volume).

VI. Operations

A. Production

1. Describe and understand the nature of the manufacturing process.
2. Determine whether there are trademarks, patents, licenses, or similar agreements.
3. List important factors in manufacturing process and assess company know-how, capital investments, and skilled labor force.
4. Assess use of production schedules.
5. Determine the use of economic order quantities, bills of material, time and motion studies, etc.
6. Assess production methods and just-in-time concepts.
7. Assess storage and warehousing facilities.
8. Assess availability of raw material.
9. Assess schedule of backing orders.
10. Assess lead times.
11. Assess quality control.
12. Assess industrial engineering practices.
13. Assess extent of rejects and seconds.

B. Capacity and efficiency.

1. Assess efficiency of equipment.
2. Estimate remaining economic life of machinery and equipment.
3. Determine the percentage of production capacity utilized during the past several years.
4. Develop trend information for:
 - a. Idle time;
 - b. Waste and scrap;
 - c. Accidents, absenteeism, and overtime;
 - d. Delays in delivery time;

- e. Returned goods;
- f. Downtimes.
- 5. Assess the availability of land, labor, materials, and utilities.
- 6. Assess expansion requirements.
- 7. Inquire about zoning requirements and environmental regulations.
- C. Purchasing.
 - 1. Identify principal raw materials.
 - 2. Evaluate future price trends.
 - 3. Analyze raw material supply.
 - 4. Evaluate principal suppliers, locations, and materials or products supplied; determine financial viability of major suppliers.
 - 5. Determine the availability of other sources of supplies.
 - 6. Review order procedures, requisitions, purchase orders, matching function, and payment.
- D. Research and development.
 - 1. Describe research and development effort.
 - 2. Evaluate dependence on the development of new and unique products.
 - 3. Obtain a list of patents and expiration dates.
 - 4. Determine extent of Company's use of patents owned by competitors.
 - 5. Evaluate the importance of research and development within the industry.
 - 6. Evaluate the results of research and development over the past three to five years in terms of new products, new materials, and new methods.
 - 7. Obtain list of major projects currently being worked on, indicating state of completion, actual expenditures to date, and estimate of future expenditures.
 - 8. Analyze research and development costs as a percentage of sales for the past several years.

VII. Employee Information

Determine:

- A. Headcount by location and department.
- B. Hours in standard week and overtime by department.
- C. Average wage rates by job classification and location, and anticipated increases.
- D. Forms of compensation and bonus arrangements.
- E. Retirement benefit plans and other benefits by employee class.
- F. Warrants and stock options, if any, available to employees.
- G. Structure and expenses associated with sales commissions.
- H. Vacation, sick pay, and severance agreements.

VIII. Tax Matters

A. Documents.

1. Copies of all federal, state, local, and foreign payroll, income, and franchise tax returns, and any amendments thereto, filed by the Company and its subsidiaries for the past five years concerning the business, assets, or income of the Company.
2. All correspondence with the Internal Revenue Service (the “IRS”) or state or local tax authorities concerning adjustments or questioning compliance.
3. List of returns and the years thereof that have been audited by federal, state, or local tax authorities, and copies of determination letters related thereto.
4. Schedule of the amount, origin, and status of any U.S. net operating losses or credit carryforwards, including information on any ownership changes or other events to date that might affect such items.
5. Copies of any tax indemnification, tax sharing, or tax allocation agreements involving the Company and other members of any affiliated group, including any joint venture agreements that have the effect of tax allocation agreements, and a statement setting forth how such agreements were carried out for the past five years.
6. Agreements waiving statutes of limitations or extending the time during which suit may be brought with respect to taxes.
7. Copies of all legal or accounting tax opinions received by the Company during the past seven calendar years relating to the Company’s tax reporting.
8. Any notices of deficiency, assessments, pleadings filed, or other documents filed or received involving a potential or proposed increase in tax liability (federal, state, or local).

B. Tasks

1. List state and local taxes to which the Company or any subsidiary is subject with respect to the business, assets, or income of the Company, showing assessment date, date return is to be filed, and date tax is due.
2. Describe and provide copies of all agreements, consents, elections, and waivers filed or made with the IRS or other taxing authorities, including, without limitation, those relating to IRC 341 and the relevant statutes of limitations.
3. List and describe all pending or threatened disputes with regard to tax matters involving the Company or any of its subsidiaries.
4. Consider the acquisition effect on the status of carryovers.
5. Determine where the Company has nexus and whether it has fulfilled its reporting obligations.

IX. Business Analysis**A. Customers and Products**

1. Obtain a listing of the largest customers and determine revenue and gross profit trends.
2. Analyze a listing of all new customers in the past fiscal/calendar year.
3. Analyze a listing of all lost customers in the past fiscal/calendar year.
4. Analyze a listing of customers that were one-time buyers in the prior two years that bought at least \$_____ in product (amount to be determined based on the transaction).
5. Prepare a calculation of gross profit per product line/service type for the previous three years and note trends.
6. Analyze sales backlogs for the past three years and identify trends.
7. Analyze customer contracts, if any, regarding pricing, delivery, quality, discounts, and expiration dates.
8. Analyze historical customer contracts, comparing contracted purchases to actual purchases.
9. Obtain a summary of special discounts and credit terms offered to significant customers.
10. Determine significant sales contracts (extract of key terms).
11. With the seller's permission and at the end of the due diligence, call a number of key customers and randomly selected customers, as appropriate to the transaction, to discuss their opinion of the company's past performance and service trends and future role as a supplier to them.

B. Suppliers

1. Obtain a listing of the 15 largest suppliers and any other suppliers who account for at least 5 percent of total purchases for the previous three year-ends and perform the following:
 - a. Determine if a trend of increasing or reducing balances exists for these companies.
 - b. Determine why the Company no longer purchases from any past major suppliers.
 - c. Analyze contracts with suppliers regarding future purchases.
2. Determine if the Company is taking advantage of quantity discounts, term discounts, or rebates.
3. Determine if any inventory can be sent back to suppliers via put-back provisions or other agreements.

X. Sales and Marketing

- A. All market studies, feasibility studies, analyses, and similar reports concerning the Company prepared within the past three years. All

marketing and other descriptive brochures regarding the Company prepared within the past three years.

- B. All press releases issued by the Company during the past three years, and any press clippings that refer to the Company, if available.
- C. Copies of all reseller partnership agreements, including details of end user agreements sold through the partner and including related revenues generated from end user.
- D. Copies of all comarketing agreements.
- E. Any market studies performed by the company, including any market share statistics and including geographic segmentation, if measured.
- F. Copies of meeting minutes from customer or market focus groups over the past three years.
- G. Meeting minutes from product advisory group meetings for the past three years.
- H. Copies of all win-loss sales reports for sales activity over a period appropriate to the transaction.
 - I. Marketing budget for prior three years and brief description of variances in relation to the budget.
 - J. Product price lists, including any discounts applied based on length of contract term and/or minimum chart volumes.
- K. Overview of sales organization, including product line breakdown, if applicable. Include organizational chart that shows sales management, quota-carrying representatives, and other administrative staff by category. Show tenure for sales management and quota-carrying representatives.
- L. Sales plan overview, including quota targets by sales representative and/or line of business as well as how targets were derived (e.g., average deal size, expected number of transactions, product mix, etc.).
- M. Sales compensation plan overview, including detailed plan documents. Overview should include targeted annual earnings at plan and allocation of compensation between base salary and variable commission.
- N. Sales pipeline, including prospect name, as of most recent date, including an explanation of the various stages of prospect/opportunity (e.g., A, B, C, D prospects) by product line. Include next steps and whether access to key decision maker has been gained. Average length of sales cycle.
- O. Materials related to sales methodology or training programs.
- P. Schedule of sales representatives for most recent three-year period showing total bookings and quota targets by representative and corresponding commissions paid.

- Q. Recent analyses of the Company or its industries prepared by investment bankers, engineers, management consultants, accountants, or others, including marketing studies, credit reports, and other types of reports, financial or otherwise.
- R. Identify any return allowances, documenting any trends observed.
- S. Obtain an analysis of the last two years' advertising expenditures segregated by advertising type (media, point of sale, etc.) and the budget for next year.

XI. Officers and Directors, Employee Benefit Plans, and Labor Matters

- A. Name and address of each director and officer (and, if applicable, principal occupation) of the Company and of each subsidiary, and aggregate compensation from the Company at present and for the previous fiscal year.
- B. All liability insurance policies for directors and officers of the Company or its subsidiaries.
- C. Number of persons employed by the Company and by each subsidiary in terms of function (executive, sales, clerical, research, labor, or other appropriate classification). Note if any employees are on leave.
- D. Organizational charts at both summary and detailed management levels. For lowest level of management note the number of staff positions being managed. Include name, title, location (city and state), base salary, other compensation arrangements, and terms of the employment contract for any management position.
- E. Employment agreements and offer letters regarding current employees.
- F. Copies of all employee agreements, including:
 - 1. Consulting agreements;
 - 2. Confidentiality agreements;
 - 3. Noncompete agreements;
 - 4. Assignments of rights, invention agreements, or any other agreement regarding the use of proprietary information, inventions, and related issues;
 - 5. Management agreements.
- G. Agreements providing for severance benefits, acceleration benefits, or other benefits upon termination of employment or in connection with a change in control.
- H. Loans to and guarantees for the benefit of directors, officers, or employees.
- I. Name and address of each person who has power of attorney to act on behalf of the Company or any subsidiary, and copies of such powers of attorney.
- J. List of all labor union contracts and collective bargaining agreements to which the Company or any subsidiary is a party, the

- number of employees covered by each such agreement, and the anticipated expiration dates thereof, with copies of such contracts.
- K. Brief description of “labor unrest” situations, all pending or threatened labor strikes, or other trouble experienced by the Company and its subsidiaries during the past five fiscal years.
 - L. Brief description of the current status of all unfair labor practices complaints lodged during the past three fiscal years involving the Company and its subsidiaries.
 - M. Brief description of any pending or threatened requests for arbitration, grievance proceedings, labor disputes, strikes, or disturbances affecting the Company or any subsidiary, and history of recent union negotiations.
 - N. All performance bonus plans, including Key Employee Retention Plans (“KERP”), adopted by the Company’s board of directors during the past five years (or, in bankruptcy, approved by the court).
 - O. Brief description and copies of all employee benefit plans, group life insurance plans, major medical plans, medical reimbursement plans, supplemental unemployment benefit plans or welfare plans (for hourly employees), salary continuation plans, or other perquisites, and a brief description of policy regarding bonuses, salary review, severance pay, moving expenses, tuition reimbursement, loans, advances, vacations, holidays, sick leave, golden parachutes, and other benefits.
 - P. For each pension or profit-sharing plan, including multiemployer plans, if any, copies of plan documents, including amendments (and a description of any changes in these plans proposed, agreed upon, or under consideration); actuarial reports, if applicable; trust instruments and trust balance sheets, if any; summary plan descriptions; the latest application for determination to the IRS; any IRS determination letter; and the latest annual report on Form 5500, 5500-C, or 5500-K and related audits. With respect to each such pension plan that is a multiemployer plan, furnish a statement of the employer’s withdrawal liability within the meaning of ERISA § 4211.
 - Q. Details on any terminated pension plans and unfunded pension liabilities.
 - R. List of all employees of the Company who received compensation exceeding \$_____ (to be determined based on the transaction), giving name, date of birth, date hired, position, and compensation for the last fiscal year, and, to the extent available, similar information for all other employees and retired employees who are receiving or will be entitled to receive any payment not described previously.
 - S. Description of all deferred compensation programs affecting officers, directors, or employees of the Company, including the

amount accrued and/or paid during the most recent fiscal year under such programs, and amounts of accruals thereunder through a recent date.

- T. Description of the manner in which the Company fulfills its workers' compensation and unemployment compensation insurance obligations in each state (i.e., insured or self-insured), with the date of the most recent workers' compensation audit and the results thereof.
- U. Documents representing or relating to workers' compensation or disability policies, and any material claims with respect thereto, including all EEO-1 surveys for the past two years.
- V. Employee handbooks, manuals, guidelines, and bulletins, and any memoranda pertaining to the Company's policies on vacation, termination, promotion, and the like.
- W. Review of documentation and compliance with Immigration Reform and Control Act of 1986.

XII. Properties, Leases, and Insurance

- A. List of real estate owned, leased, or used by the Company, stating whether owned or leased (and, if leased, whether as lessor or lessee) and brief description of property, structures, zoning, estoppel letters, reversions or remainders, lease provisions (including assignment and renewal), use, and location; copies of mortgages, deeds, surveys, maps, profits, rights of way, easements, leases, and other contracts.
 - 1. Copies of title insurance policies or lawyers' abstract reports covering owned and/or leased real estate.
 - 2. Copies of zoning variances and local permits.
 - 3. List of agreements with railroads, pipeline agreements, agreements relating to water rights (such as certificates of appropriation), mining claims (patented and unpatented), and royalty agreements.
 - 4. Copies of surveys of owned and/or leased real estate.
- B. List of fixed assets, machinery, and equipment (whether owned, leased, or used by the Company), giving for each material asset or group of assets cost, depreciation reserve, method of depreciation, insured value, estimated remaining useful life, condition suitability for use, and (if available) appraised value.
 - 1. List of automobiles, trucks, and other registered equipment owned, leased, or used by the Company, giving a brief description of equipment and lease provisions (if any), year manufactured, state of registration, registration number, cost, estimated remaining useful life, and insured value.
 - 2. List of premises at which any assets of the Company are currently located or are located from time to time, including ter-

- minals, plants, storage facilities, sales offices, and warehouses, and written agreements with respect thereto.
3. Brief description of portfolio investments of the Company (except in subsidiaries), including cost basis and current value.
 4. All currently effective purchase contracts, leases, or other arrangements concerning material items of equipment used by the Company.
 5. All professional appraisals of any material property of the Company.
- C. List and brief description of all liens, security interests, or mortgages on the property of the Company or any of its subsidiaries, and location and name of office where documents or financing statements relating thereto are filed.
- D. Copies of all material leases of or security agreements for personal property of the Company, including conditional sales contracts, equipment leases, chattel mortgages, accounts receivable, financing agreements, and factoring agreements.
- E. List of all insurance policies relating to the business, assets, or properties of the Company, including directors' and officers' liability insurance, errors and omissions policies, professional liability, and general liability, giving insurance company, policy number, term of coverage, property or risk covered, appraisal value of covered property (where appropriate), extent of coverage, annual premium, and amount of premiums that are prepaid or are unpaid from prior years. Obtain copies of all such policies.
- F. A description of all significant insurance claims currently pending.
- G. Schedule of the Company's loss experience per insurance year for the past five years.
- H. Copies of title insurance policies for all owned and/or leased real estate.
- I. A description of all contractual restrictions on transfer of the Company's capital stock or assets.

XIII. Electronic Data Processing

- A. Identify all accounting and operational functions currently computerized (i.e., mainframes and/or micros) and determine those functions processed off-line.
- B. List all equipment and identify for each the manufacturer, model number, types of file storage, and input and output devices.
- C. Determine whether equipment is owned or leased.
- D. For leased equipment, document lease terms, annual rentals, escalation clauses, purchase options, and related information.
- E. Identify short- and long-term software and hardware plans.

- F. Ascertain how the EDP function would be integrated with that of the buyer.
- G. Describe adequacy of internal controls, segregation of duties, input controls, processing controls, access controls, documentation controls, physical security controls, and system development and modification controls.

XIV. Intellectual Property (Patents, Trademarks, Copyrights, and Trade Secrets)

- A. Schedule of patent registrations and applications identifying each patent by title, registration (application) number, date of registration (application), and country.
- B. Schedule of trademark and service mark registrations and applications identifying each mark and including date of registration (application), registration (application) number, status (e.g., registered, renewed, abandoned, Section 8 and 15 affidavits submitted, etc.), and country or state where registered. In those instances where registration has not been sought, identify the mark or trade name and its date of first use anywhere in the United States.
- C. Schedule of copyright registrations and applications identifying each copyright by title, registration number, and date of registration.
- D. Manual or other written document detailing the procedures for maintaining the secrecy of trade secrets.
- E. Description of any software in which the Company has rights, whether as owner or licensee.
- F. Licensing agreements, merchandising agreements (naming the Company as licensee or licensor) or assignments relating to patents, technology, trade secrets, trademarks, service marks, and copyrights.
- G. Communications to or from third parties relating to the validity or infringement of the Company's patents, technology, trade secrets, trademarks, service marks, and copyrights.
- H. Studies or reports relating to the validity or value of the Company's patents, technology, trade secrets, trademarks, service marks, and copyrights, and the licensing or merchandising thereof.
- I. Agreements pursuant to which any patent, trademark, service mark, or trade name has been sold or transferred by or to the Company and evidence of recording thereof.
- J. List of Internet domain names.

XV. Contracts and Arrangements

- A. All standard forms of agreements with customers used by the Company as well as copies of all actual customer agreements for active relationships.

- B. All warranty agreements of the Company, including all forms of product warranties currently in force with respect to completed and executory material contracts.
- C. A list and description of all significant oral contracts and commitments.
- D. All currently effective guarantees given by the Company concerning the payment or performance of obligations of third parties.
- E. All sales agency and distribution agreements.
- F. A list of all contracts and commitments under which a default has occurred or is claimed to have occurred, setting forth:
 - 1. The nature of default;
 - 2. The name of party in default;
 - 3. The monetary amount claimed;
 - 4. The current status of contract or claim.
- G. All agreements to which the Company is (or was within the past five years) a party and in which any officer, director, employee, or shareholder of any other companies has (or had) an interest, whether directly or indirectly.
- H. Determination of the Company's ability to perform significant contracts.
- I. Copies of agreements with data center/hosting partners.
- J. Copies of all contracts with advertising or public relations agencies.
- K. Copies of all standard forms of sales and purchase orders.
- L. List of all significant suppliers (representing in excess of 5 percent of annual purchases) of the Company, with an indication of the amount paid to each such supplier during the Company's most recent fiscal year and the estimated number of alternative suppliers.
- M. All executory contracts, as amended to date, with each of the Company's significant suppliers (representing in excess of 5 percent of annual purchases), and all related open purchase orders.
- N. Brief description of contractual or customary credit terms available from suppliers and manufacturers, and copies of all agreements with suppliers and manufacturers.
- O. List and brief description of all agreements and arrangements with distributors, dealers, sales agents, or representatives, with copies of all such written agreements.
- P. List and brief description of all agreements and arrangements whereby the Company or any subsidiary acts as a distributor, with copies of all such written agreements.
- Q. List and brief description of all agreements relating to the supply of raw materials and supplies, with copies of all such written agreements.

- R. Copies of all forms of product warranties or guarantees, if any, given by the Company or any of its subsidiaries.
- S. Copies of all agreements and other documentation relating to the acquisition of any business constituting a part of the Company, or sale or proposed sale of any business owned by it, in the past five years.
- T. Copies of joint venture or partnership agreements to which the Company or any subsidiary is a party.
- U. Copies of all franchise or distribution agreements between the Company or any of its subsidiaries and any third party concerning the manufacture, sale, or distribution of the Company's or its subsidiaries' products or services. If any such agreements are oral, a summary of the terms thereof.
- V. Documents providing for any material contingent and/or earnout payments to be made to or by the Company.
- W. Agreements with competitors.
- X. Agreements restricting the Company's right:
 - 1. To compete;
 - 2. To acquire any product or other asset or any services from any other person, to sell any product or other asset to or perform any services for any other person, or to transact business or deal in any other manner with any other person;
 - 3. To develop or distribute any technology;
 - 4. To solicit employees, consultants, independent contractors, or customers.
- Y. Contracts with investment bankers and brokers.
- Z. Listing of agreements requiring consents or approvals or resulting in changes in rights in connection with change in control transactions.
- AA. Copies of all agreements not previously listed with suppliers, independent agents, salespersons, or others involving the payment of commissions or other consideration or discounts with respect to the manufacture, sale, or distribution of the Company's or its subsidiaries' products or services. If any such agreements are oral, a summary of the terms thereof.
- BB. Brief description of any contracts restricting the ability of the Company or any subsidiary to compete in any line of business with any person or entity, or committing the Company or any subsidiary to continue in any line of business.
- CC. Any facts or circumstances that may give rise to the cancellation or termination of, or claim for damages or loss under, any of the agreements, arrangements, or understandings referred to herein.
- DD. List and description of all leases, licenses, agreements, and contracts involving the payment of more than \$_____ (amount will depend on the transaction) in the aggregate, currently in the

process of negotiation.

- EE. Copies of agreements granting to the Company any right of first refusal to acquire any business or assets, or pursuant to which the Company has granted any such rights.
- FF. Copies of all material research and development agreements.
- GG. All technology license agreements to which the Company is a party as licensor or licensee.
- HH. List and description of partnerships with associated customer numbers and revenues.
 - II. Copies of partner agreements.
 - JJ. Agreements relating to indemnification.

XVI. Litigation

- A. Brief description of each threatened or pending claim, lawsuit, arbitration, or investigation involving a claim for relief against the Company, any subsidiary, or any of their respective officers or directors.
- B. Brief description of any pending or threatened:
 - 1. Claim or litigation involving alleged violations of laws or regulations for the health or safety of employees or others;
 - 2. Governmental or administrative proceeding;
 - 3. Equal employment opportunity claim or litigation;
 - 4. Antitrust claim or litigation;
 - 5. Claim or litigation seeking injunctive relief;
 - 6. Claim or litigation that any activity of the Company has infringed or otherwise violated any intellectual property interest;
 - 7. Other material claim or litigation to which the Company or any subsidiary is a party.
- C. A copy of all complaints, answers, other material pleadings, and correspondence concerning any litigation not fully covered by insurance.
- D. All letters from Company counsel to accountants relating to litigation or contingent liabilities involving the Company.
- E. All correspondence relating to actual or alleged infringement by the Company of intellectual property rights of others.
- F. All judgments, orders, decrees, injunctions, settlements, or other such obligations to which the Company is subject.
- G. List and brief description of all outstanding judgments, decrees, or orders.
- H. Copy of most recent response to auditors' request for information about litigation and/or contingent liabilities of the Company.
 - I. Any litigation with respect to material governmental permits, licenses, etc., of the Company.
 - J. Any litigation involving an officer or director of the Company

- concerning bankruptcy, crimes, securities law, or business practice within the past five years.
- K. Description of any investigations of the Company, pending or threatened, by any federal, state, local, or foreign authorities.
 - L. Any litigation with respect to material insurance arrangements, including property damage, third-party liability, product liability, and key employee insurance.
 - M. List and a brief description of potential claims, damages, injuries, losses, or lawsuits for which the Company, or any person or entity acting on its behalf, has either provided notice to any insurer pursuant to any insurance arrangements or has sought coverage under such insurance arrangement.
 - N. Description of self-insurance programs, retrospective premium programs, or captive insurance programs in which the Company has participated.
 - O. All correspondence with, reports of or to, filings with, or other material information about any other regulatory bodies that regulate a material portion of the Company's business.

XVII. Environmental and Related Matters

- A. All internal Company and third-party reports concerning environmental matters relating to current or former Company properties (either owned or leased).
- B. Copies of any applications, statements, or reports filed or given by the Company or any of its subsidiaries with or to the federal Environmental Protection Agency (the "EPA"), any state department of environmental regulation, or any similar state or local regulatory body, authority, or agency.
- C. All notices, complaints, suits, or similar documents sent to, received by, or served upon the Company or any of its subsidiaries by the EPA, any state department of environmental regulation, or any similar state or local regulatory body, authority, or agency.
- D. All Company or outside reports concerning compliance with waste disposal regulations (hazardous or otherwise).
- E. Copies of all permits, shipping authorizations, manifests, and waste stream authorizations.
- F. Description of any processes of facilities currently or previously operated by the Company or any subsidiary (or by others on property currently owned by the Company or any subsidiary) that generate or are suspected of generating any toxic or other hazardous material.
- G. All pollution control capital expenditure reports, including budget requests, for the past five years.
- H. All annual reports, manifests, or other documents relating to haz-

ardous waste or pesticide management over the past five years.

- I. All documents relating to equipment using PCBs, spills of PCBs, or worker exposure to PCBs, and all documents relating to the existence or removal of asbestos.
- J. Any public records reflecting existing or recent environmental problems.

XVIII. Acquisition Documents and Sales of Securities

- A. All agreements pursuant to which the Company has acquired securities or has issued (or may be obligated to issue) securities.
- B. All private placement memoranda, prospectuses, or other documentation relating to the offering or acquisition by the Company of securities.
- C. All reports to, documents filed with, and correspondence with the Securities and Exchange Commission for the past five years.
- D. All reports to, documents filed with, and correspondence with any state securities commission.
- E. All agreements and other documentation concerning any sale of material assets, including any agreements in principle, to which the Company is a party.
- F. Copies of all agreements and plans entered into by the Company or any of its subsidiaries relating to the acquisition of, or merger with, a business, or an interest in any business, whether by acquisition of shares, acquisition of assets, or otherwise.

XIX. Transactions with Officers and Other Insiders

- A. List and statement of amounts and other essential terms of any indebtedness or other obligations of or to the Company or its subsidiaries to or from any officer, director, shareholder, employee, or other insiders.
- B. List and description of assets or properties used by the Company in which any officer, director, shareholder, employee, or other insider has any interest.

XX. Filings and Reports

- A. Copies of any recent filings with governmental agencies.
- B. Other necessary filings and reports as discussed elsewhere in this checklist.

XXI. Regulatory Compliance

- A. List of all federal, state, local, and foreign governmental permits, licenses, and approvals (excluding those listed elsewhere herein) either held or required to be held by the Company or its subsidiaries for the conduct of their businesses.
- B. All correspondence, reports, and notices from any federal, state,

local, or foreign governmental agency relating to laws and regulations with which the Company must comply. Examples include:

1. The Health Insurance Portability and Accountability Act of 1996 (HIPAA) and all regulations promulgated thereunder;
2. The Federal Food, Drug, and Cosmetic Act and all regulations promulgated thereunder;
3. The Occupational Safety and Health Act and all regulations promulgated thereunder;
4. The Environmental Protection Act;
5. The Employee Retirement Income Security Act of 1974, as amended;
6. The Securities Exchange Act of 1934;
7. The Sarbanes-Oxley Act;
8. The Equal Employment Opportunities Act;
9. Labor practices regulation;
10. Special requirements for regulated industries;
11. The Age Discrimination Employment Act of 1967, as amended;
12. Title VII of the Civil Rights Act of 1964, as amended;
13. The Hart-Scott-Rodino Act.

XXII. Consents

- A. List and brief description of any of the Company contracts, leases, security agreements, licenses, authorizations, etc., that may require the consent of any third party (including any governmental agency or instrumentality) to the proposed transactions.
- B. Any other notification required to be given to or consents required from any third party (including any governmental agency or instrumentality) in connection with the proposed transactions.

XXIII. Miscellaneous

- A. Schedule of law firms and accounting firms that have represented or advised the Company within the past five years.
- B. All other documents the Company considers material to its operations or the sale of the Company.
- C. Information related to any contingent liability of the Company.
- D. List of memberships in trade associations.
- E. List of all requirements and obligations imposed on the Company by the proposed or effective rules and regulations of the Federal Trade Commission or any other governmental agency.