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**CPA DUE DILIGENCE CHECKLIST FOR THE SALE
AND ACQUISITION OF A BUSINESS**

<u>ITEM</u>	<u>RESPONSIBLE PARTY</u>
1. <u>Financial Information</u>	
(a) Review balance sheets and profit and loss statements for last five years. Are statements audited? Reviewed? Do the financial statements comply with GAAP?	_____
(b) Review copies of federal, state and local tax returns for last three years.	_____
(c) Do an independent verification of items on financial statements.	_____
(d) Review accounts receivable. Are bad debt reserves adequate? Review aging report. Any offsets against receivables?	_____
(e) Review inventory of raw materials and finished goods. Is inventory amount normal for this type of business? Is there obsolete inventory? How is inventory valued? Has cost of goods sold been overstated in the past?	_____
(f) Review work in process. Is work in process reflected on balance sheet assets?	_____
(g) Verify physical condition of plant, equipment, furniture and machinery. Are these items adequate for current business?	_____

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This checklist is a general list of items which the CPA and other professionals should do in a business acquisition. However, since every business is unique, this list should be modified to fit the specific facts of the acquired business.

Disclaimer: This checklist is not, nor is it intended to be, legal advice. You should consult with an attorney and other professionals before utilizing this checklist.

- (h) Review liabilities. Are the liabilities properly presented on the financial statements? Verify if any accrued vacation time or pension liabilities. _____
- (i) Review bank and cash equivalent accounts, and verify amounts. _____
- (j) Verify deposits for taxes, insurance, lease, utilities and other, and whether refundable. _____

2. **Tax Returns and Tax Payments**

- (a) Review federal and state income tax returns for each state in which the corporation is doing business, and verify if tax returns are properly filed. Is the corporation an S corporation? _____
- (b) Verify if payroll taxes are paid and the employees and independent contractors properly classified under IRS guidelines. _____
- (c) Verify if California State Board of Equalization tax returns are properly filed, as well as those for other states' sales and use taxes. _____
- (d) Verify personal and real property taxes and any supplemental taxes. Review copies of tax bills. _____
- (e) Verify if local business taxes have been paid for each jurisdiction in which the corporation is doing business. _____
- (f) Has the business and its employee benefit plans complied with ERISA? _____

3. **Liabilities**

- (a) Review copies of all promissory notes, deeds of trust, mortgages, security agreements, and other documents evidencing liabilities. _____
- (b) Are there any lawsuits against the business? _____
- (c) Obtain copies of UCC-1 financing statements and obtain UCC searches in all states in which there is a place of business. Be sure UCC search at Secretary of State's office is done under all names and d/b/a's. _____
- (d) Review any tax liens and do lien searches with the California Secretary of State's office and the California State Board of Equalization. _____
- (e) Review unsecured or secured promissory notes _____

and shareholder loans. Are there any oral loans?

- (f) Verify whether any mechanic's liens are recorded against real property.
- (g) Bank financing.
- (h) Pension plan liabilities.
- (i) What other possible unknown or contingent liabilities for the type of business being purchased? Potential personal injury claims or other tort claims.
- (j) Should a bulk sales notice be filed?
- (k) Verify if there is any underpayment of workers compensation insurance.
- (l) Other liabilities.

4. **Litigation**

- (a) Perform federal court, federal bankruptcy court and state court searches. Review copies of all pleadings.
- (b) Are there any threatened lawsuits or claims?
- (c) Evaluate risk exposure, and does financial statement need reserves?

5. **Claims Against Corporation By:**

- (a) Vendors of materials and services.
- (b) Suppliers.
- (c) Customers, such as product warranty claims.
- (d) Employees, such as wrongful termination, discrimination, and wage and hour claims.

6. **Environmental Reports**

- (a) Perform environmental audit by hiring an environmental engineer.
- (b) Review prior environmental audit documents.
- (c) Are there any underground tanks?
- (d) Hazardous materials used in the business, and if so, have they always been disposed of in accordance with environmental laws.
- (e) Verify if there are any notices from governmental agencies regarding environmental laws.

7. **Physical Inspection.** May have to hire an engineer to do.

- (a) Condition of premises. _____
- (b) Condition of equipment and machinery. _____
- (c) Condition of inventory and raw materials. _____

8. **Personal Property Owned**

- (a) Verify if good title, such as by reviewing invoices. _____
- (b) Verify if any liens by doing a UCC search. _____

9. **Real Property Owned**

- (a) Obtain copies of deeds. Are there any restrictions, encumbrances or liens? _____
- (b) Obtain copies of old title insurance policies and surveys. Do you need a new title insurance policy? _____

10. **Intellectual Property Assets**

- (a) Patents. Verify that the corporation has good title to patents and that there are no infringement actions against the corporation. Verify that the corporation is not infringing on another person's patent. Does the business have all necessary patents to operate? _____
- (b) Trademarks and logos. Verify if there is a registration and whether there is good title to all trademarks and logos. Do a trademark search. _____
- (c) Review license and royalty agreements. _____
- (d) Does the business have continuing rights to its telephone numbers? _____
- (e) Verify rights in website and content of website. _____

11. **Trade Secrets and Technology.** Obtain any written information regarding same, such as diagrams, formulae, software, plans, media, processes, etc. _____

- (a) Obtain and review list of all licensed software and other technology. _____

12. **Personal Property Leases** (such as for equipment, telephone system, copy machines, etc.). Verify

same items as real property leases. _____

13. **Real Property Leases.** Review all leases and verify:

- (a) Term, rental amounts, options, and rental abatements: _____
- (b) No defaults and if lease is assignable. _____

14. **Employees and Other Personnel**

- (a) Review employment and management contracts. _____
- (b) Verify number of employees by department. _____
- (c) Obtain list of all employees with job classification and rate. _____
- (d) Verify bonus arrangements. _____
- (e) Verify profit sharing arrangements. _____
- (f) Review all pension, retirement, insurance and other benefit plans. _____
- (g) Review stock bonus or stock option plans. _____
- (h) Review confidentiality or non-competition agreements. _____
- (i) Verify what oral or written commitments exist regarding employee benefits. _____
- (j) Review copies of employee manuals and personnel policies. _____
- (k) Investigate if there are labor matters, labor disputes, employee complaints, union contracts, union organization efforts or votes. _____

- (l) Review worker's compensation insurance policy, and verify experience rating of such policy, and premium cost of worker's compensation insurance. _____
- (m) Obtain list of executive officers with payments and benefits over past three years. _____

15. **Contracts.** Review all written and oral contracts. Are contracts terminable at will or are they long-term contracts. Verify no defaults and that contracts are assignable. _____

- (a) Bank financing contracts. _____
- (b) Distributor contracts. _____
- (c) Manufacturer representative contracts. _____
- (d) Employment contracts. _____
- (e) Material supplier contracts. _____

- (f) Licenses and franchises. _____
- (g) Purchase orders and purchase sales contracts. _____

16. **Insurance Contracts**. Be sure all past years of businesses operations covered. Verify premium amounts, policy limits and deductibles.

- (a) Obtain copies of old insurance policies. Verify if you can obtain adequate insurance after closing the purchase. _____
- (b) Worker's compensation insurance. _____
- (c) Liability insurance. _____
- (d) Casualty insurance. _____
- (e) Life and accident insurance. _____
- (f) Product liability insurance. _____
- (g) Umbrella insurance policies. _____
- (h) Automobile. _____

17. **Customer Lists**

- (a) Review list of 20 largest customers. What assurances are there that these customers will continue? _____
- (b) Review all customer contracts, and remaining term of any contracts. _____

18. **Suppliers**

- (a) Obtain list of raw material suppliers and contracts with same. Are there any long-term contracts? _____
- (b) Who are the important suppliers of materials, and at what cost. _____

19. **Government Regulations and Filings**. Covers federal, state and local. Verify each of the following:

- (a) Required permits and licenses for water, air quality, hazardous waste, etc. _____
- (b) Required fire permits and special permits for dangerous operations. _____
- (c) Military/Department of Defense compliance. _____
- (d) Are U.L. listings or similar industry listings required in the business. _____
- (e) Special industry or governmental requirements _____

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- and other government permits.
- (f) Do the facilities comply with all building codes?

20. **Corporate Records**

- (a) Review Articles of Incorporation, Bylaws, and Amendments thereto, and corporate minute and stock books.
- (b) Review business licenses. Verify corporation is qualified in each state doing business and in each county doing business.
- (c) Review shareholder list and shareholder agreements.
- (d) Stock bonus and option agreements.
- (e) Voting trusts, proxies and similar agreements.
- (f) Subsidiaries or partnerships of corporation.
- (g) Verify if state and federal securities law filings are completed and if specific securities law exemptions are complied with.

21. **List of Professionals**. Obtain the names of the business's:

- (a) Accountant.
- (b) Attorneys.
- (c) Insurance Agent.

22. **Other Items To Do**

- (a) Discuss with company executives whether there are any other documents or items which would affect business, economy, competitive businesses, new or competing product lines, etc.
- (b) Interview company executives.

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