

DUE DILIGENCE

Due diligence is an investigation of a business or person prior to signing a contract, or an act with a certain [standard of care](#).

It can be a legal obligation, but the term will more commonly apply to voluntary investigations. A common example of due diligence in various industries is the process through which a potential acquirer evaluates a target company or its assets for an [acquisition](#). The theory behind due diligence holds that performing this type of investigation contributes significantly to informed decision making by enhancing the amount and quality of information available to decision makers and by ensuring that this information is systematically used to deliberate in a reflexive manner on the decision at hand and all its costs, benefits, and risks.

Business transactions and corporate finance

Due diligence takes different forms depending on its purpose:

- The examination of a potential target for merger, acquisition, privatization, or similar corporate finance transaction normally by a buyer. (This can include self due diligence or "reverse due diligence", i.e. an assessment of a company, usually by a third party on behalf of the company, prior to taking the company to market.)
- A reasonable investigation focusing on material future matters.
- An examination being achieved by asking certain key questions, including, how do we buy, how do we structure an acquisition, and how much do we pay?
- An investigation of current practices of process and policies.
- An examination aiming to make an acquisition decision via the principles of valuation and shareholder value analysis.

The due diligence process (framework) can be divided into nine distinct areas:

- Compatibility audit.
- Financial audit.
- Macro-environment audit.
- Legal/environmental audit.
- Marketing audit.
- Production audit.
- Management audit.
- Information systems audit.
- Reconciliation audit.

Acquisition Due Diligence Checklist | Acquisition Analysis

The following *due diligence checklist* is useful as a general list of items to investigate as part of an acquisition analysis, though the full range of questions will probably not be needed. Some questions may need to be added for an industry-specific acquisition, while far fewer will be needed for an asset acquisition.

Target Company Overview

Why selling?

Prior sale efforts

Business plans

Complexity

Market review

Ease of entry

Related acquisitions

Reporting relationships chart.

Geographical structure

Organizational legal structure chart

Employees

Types of employees

Key employees

Customer linkages

Total compensation.

Pay level philosophy

Pay history

Pay freezes

Employment agreements

Unions

Discrimination claims

Injury records

Employee manual

Employee Benefits

Benefits

Pension plan funding

Vacations.

Financial Results

Annual financial statements

Cash flow analysis

Cash restrictions

Expenses categorized as non-operational

One-time events

Disclosures

Public filings

Management letters

Revenue

Backlog

Recurring revenue stream.

Customer changes.

Available regions/channels

Pricing philosophy

Estimating

Contract terminations

Accounts receivable

Cost Structure

Expense trends.

Questionable expenses

Loans to employees

Fixed assets

Intellectual Property

Patents.

Trademarks

Licensing income

Licensing expense

Fixed Assets and Facilities

Valuation.

Inspection.

Utilization.

Replacement rate

Maintenance.

Liabilities

Accounts payable

Leases

Debt.

Debts to related parties

Unrecorded liabilities

Collateral.

Equity

Shareholder list

Classes of stock

Conversion rights.

Options and warrants

Unpaid dividends

Stock buyback obligations

Taxes

Is the company continuing to pay taxes?

Is the company paying the correct amount of taxes?

Are there undisclosed tax liabilities that have never been paid?

Selling Activities

Organization.

Productivity

Compensation plan

Skills match

Marketing Activities

Comparative analysis.

Coordination

Branding.

Materials Management

Supply chain

Supply restrictions

Transportation costs.

Spend management

Supplier terminations

Supplier contracts

Inventory systems

Inventory obsolescence

Information Technology

Systems in place

Licenses.

Outsourcing agreements

Capacity.

Customization

Interfaces.

Legacy systems

Disaster recovery plan.

Legal Issues

Current lawsuits

Prior lawsuits

Legal invoices

Contracts review

Charter and bylaws

Board minutes

Shareholder meeting minutes

Audit committee minutes