

# Sample Due Diligence Checklist



## Background

Every company faced with a significant transaction or deal will be challenged with the process of due diligence. Unfortunately, too many companies wait until a potential acquirer, partner or investor is at the door before focusing on the daunting task of assembling due diligence documents. The resultant “fire drill,” coupled with the resource-intensive effort of executing the transaction according to the rigorous due diligence checklist, can increase the risk of incomplete disclosure, drive up direct and indirect costs, and result in missteps that damage the deal. The best approach is to begin the process as far in advance as possible, consult with experts to develop a targeted M&A strategy along with the executable due diligence checklist, and put it to the test before entering the market.

Ideally, it should be possible to have the following materials organized in a virtual data room for due diligence document review. Contact your ShareVault representative if you would like your virtual data room pre-populated with this organization.

### CORPORATE RECORDS

- Certificate/Articles of Incorporation, Determination or Organization (or similar documents), including any amendments thereto.
- By-Laws, operating agreements, partnership agreements (general or limited) or similar documents, including any amendments thereto.
- Minute Books, consents and resolutions (since inception) for Shareholders, Members, Board of Directors and any committees of the foregoing.
- Schedule of officers, directors and committees of the Board of Directors.
- Stock Book and Stock Ledgers.
- Shareholder agreements, proxies, voting trusts and similar agreements.
- Agreements to purchase or re-purchase any class of security.
- Agreements relating to registration or preemptive rights for any class of security.

## **CORPORATE RECORDS** (continued)

- As of the most current date, the following information:
  - i. Number of, and record ownership of, outstanding shares (common and preferred);
  - ii. Number of shares held in treasury;
  - iii. Options, warrants and other rights outstanding, including detail of holders, grants, grant dates, exercises, unexercised, vesting schedules, strike price, fair market value on grant date, and acceleration or cash out events; and
  - iv. Ownership by officers, employees and directors.

Stock option plans and stock option, warrant and other similar stock purchase agreements.
- Schedule of all dba's and fictitious business names, and all filings and registrations therefor.
- Schedule of predecessor corporations or entities.
- Offering materials and closing documents from prior financing.
- All applications and permits for issuance/transfer of securities, including any Form D or similar federal or state forms.
- List of jurisdictions (domestic and foreign) where the Company is (or should be qualified) to do business.

Schedule of locations (by street address, city, state and country) at which the Company has offices, conducts business or stores inventory or equipment, since inception.
- Schedule of owned real property.
- Schedule of leases and subleases for real property and facilities, including location, square footage, rent and lease term and renewal options.
- Schedule of material suppliers and other third-party service providers.
- Schedule of property, key man, liability, and worker's comp insurance policies (including current and pending insurance carrier, policy limits, deductibles, retroactive premium adjustments and other special arrangements), and copies of all such insurance policies and contracts.
- Press releases relating to the Company, its management or its products and services.

## **2. GENERAL FINANCIAL INFORMATION**

- Previous (up to 3 years if available) annual audited/unaudited financial statements as well as interim period (monthly/quarterly) for current year.

Current prospective financial data (i.e., budgets/forecasts) with detail of assumptions.
- External and internal auditors' reports (annual and quarterly), workpapers, permanent files, management letters and regulatory examination reports received/issued in the last 3 years.

Consolidating general ledger or trial balance for detailed accounts for the latest 2 fiscal years, current year quarters and stub period.
- Schedule of prepaid expenses and other assets (e.g., deferred charges and intangibles) with related amortization methods.
- Schedule of financing arrangements such as guarantees, pledges, factoring arrangements, credit lines, letters of credit, etc.

### 3. CASH/INVESTMENTS

- Latest annual and interim/current cash flow statements.
- Detail of latest quarterly and monthly cash and cash equivalents balances.
- Description of short-term and long-term investments and copies of investment statements for latest annual and interim periods.

### 4. ACCOUNTS RECEIVABLE

- Schedule of accounts receivable by category for the latest annual and interim periods and comparable periods.
- Credit policy and collection procedures.
- Latest annual and interim period aging analysis and trends, allowance for uncollectible accounts and past write-offs.

### 5. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

- Detailed schedule of accounts payable and accrued expenses for the latest annual and interim periods.
- Schedule of the top 5 vendors from latest 12-month period.
- Schedule of commitments to customers—product deliverables, consulting agreements, etc.

### 6. REVENUE

- Copies of the 5 largest contracts for the current year.
- Description of the procedures for contracting and billing maintenance.
- Detail of revenue for last 12 months.
- Pipeline information.
- Description of the sales force, including sales offices and service facilities, including compensation structure.
- List of any customers with annual revenue > 10%

### 7. PRODUCT EXPENSES AND OTHER OPERATING EXPENSES

- Operating expense detail for the last annual period and latest comparative interim periods.
- Listing of outside contractors.
- Current year and future years budget of operating expenses compared to current year/interim actual results.
- Detail listing of current and budgeted research and development expenditures.
- Detailed schedule of general and administrative expenses and payroll expense.
- Pipeline information.
- Description of the sales force, including sales offices and service facilities, including compensation structure.

## 8. TAXES

- Schedule of states and local jurisdictions in which the Company currently files tax returns and pays taxes, including income, property (personal and real), payroll and sales and use taxes.
- U.S. Federal income tax returns for the past 2 years, and all state tax returns filed during the past 2 years.
- Schedule of completed tax examinations/audits from the past 5 years and all tax examinations/audits in progress or scheduled to be performed. Include related correspondence and other written materials.
- Description of the Company's use of and policies regarding independent contractors. With respect to long-term contracts, include amount of payment in prior year.

## 9. INTELLECTUAL PROPERTY

- Schedule of owned or proprietary technology (including software, databases and systems).
- Schedule and copies (if applicable) of the following (common law, registered and issued, and foreign and domestic):
  - i. tradenames, brand names, trademarks, service marks, logos and slogans;
  - ii. internet domain names (including lower level domain names);
  - iii. patents, patent rights, innovations and designs;
  - iv. copyrights;
  - v. trade secrets and other industrial property rights, including all processes, know-how, technical data and shop rights; and
  - vi. registrations, issuances, applications, additions, affidavits, continuations, divisionals and other filings related to the foregoing items.
- Copies of searches, counsel's opinion letters and application file histories (or file wrappers) for the items requested in the preceding Item B.
- Schedule of all material ongoing or planned software, databases and/or network development projects.
- Schedule of third-party intellectual property sold, licensed or otherwise distributed by the Company.
- Schedule of third-party software and other intellectual property incorporated in, embedded in or otherwise necessary for the use of the Company's intellectual property.
- Product documentation and manuals for the Company's software, databases and networks (or other description of primary capabilities).
- Schedule of third-party intellectual property necessary for the Company to conduct business in the ordinary course.
- Schedule of software authors and other creators of the Company's software products and other intellectual property, with a notation next to each name indicating whether such author/creator made his/her contribution (a) as an employee within the scope of his/her employment, (b) outside his/her scope of employment or (c) as a consultant or other independent contractor.
- The name(s), address(es) and phone number(s) of counsel and any other person(s) responsible for application, maintenance and protection of trademarks, copyrights, patents and other intellectual property rights.
- Internal memoranda, correspondence and other documentation setting forth or relating to Year 2000 compliance of the operating codes, programs and other software, database, hardware and systems sold or licensed by or to the Company, or otherwise used by the Company in its business.

## 10. MATERIAL AGREEMENTS

- Agreements with customers and clients, including end-user license agreements, beta test agreements, warranties and guaranties.
- Consulting, development and work-for-hire agreements with, or for and on behalf of, customers and clients.
- Website hosting and connectivity agreements.
- Website linking, affiliate, co-branding, promotional, advertising, content provider and other agreements relating to Company's e-commerce initiatives.
- Electronic data interchange agreements and other internet, electronic mail and on-line service agreements.
- Trademark usage guidelines, privacy policy, terms of use, Aclick-wrap@ agreements and similar website use agreements and policies.
- Marketing agreements—distributorships, sales representatives, co-packaging, reseller (VAR), OEM, systems integrators, franchises and referral agreements.
- Agreements with employees, independent contractors or other third parties relating to the development for or on behalf of the Company of software products, websites and other intellectual property.
- Software escrow agreements or other arrangements providing third parties with source code access or use.
- Independent software vendor agreements.
- Agreements whereby the Company licenses software or other intellectual property from third parties, including run time licenses.
- Agreements for software support and maintenance by or for the Company.
- Assignments of software and other intellectual property rights.
- Leases with respect to tangible personal properties (including equipment).
- Agreements that involve the executory performance of services or delivery of goods or materials to the Company which are not terminable on 30 days prior notice without liability, or which contain provisions relating to ownership rights in intellectual property assets of the Company or the provider.
- Joint ventures, joint development agreements and other working arrangements.
- Non-competition, exclusivity and non-solicitation agreements, in favor of the Company or by which the Company is bound, or by which the Company's key employees or consultants may be bound to third parties.
- Confidentiality, assignment of invention and similar agreements with employees, independent contractors and other service providers.
- Other confidentiality and non-disclosure agreements, in favor of the Company or by which the Company is bound.
- Employment (including incentive and severance agreements), agency and independent contractor agreements.
- Indemnification agreements for the benefit of officers, directors and employees.

## 10. MATERIAL AGREEMENTS (continued)

- Agreements or arrangements with management, employees, shareholders and other affiliates (including any loans or management fee arrangements), or with which any of them have a relationship.
- Outstanding agreements or commitments for capital expenditures.
- Agreements with investment bankers, brokers and similar advisors.
- Intercompany agreements.
- Leases and subleases (including all amendments, supplement and addendums).
- Contracts, rights of first refusal or options to purchase, sell or lease real property.
- Loan agreements, lines of credit, indentures and other debt instruments, including notes payable and guarantees (by or in favor of the Company), and any other agreements collateralized or secured by the assets.
- Security agreements affecting assets or properties, and all currently-effective financing documents, such as sale and leasebacks and installment sales, and all liens and financing statements.
- Agreements relating to past, current or proposed mergers, acquisitions or dispositions, including transactions involving subsidiaries, divisions, product lines and other substantial assets.
- Powers of Attorney.
- Consents and approvals required under law or contracts, leases, licenses and other agreements necessary for the Company to complete the present transaction.
- Other material agreements to which the Company is bound or which are necessary for the conduct of the Company's business.

## 11. PERSONNEL AND EMPLOYEE BENEFITS

- Schedule of officers, directors, employees, independent contractors and consultants, and their respective titles, length of service, current compensation and benefits, compensation history since employment or engagement, and contractual severance obligations.
- Schedule of employee benefit plans, including pension, bonus, commission, profit-sharing, stock option, deferred compensation, incentive, retirement, 401(k), medical, disability, salary continuation, executive benefit, fringe benefit, management perquisites or golden parachute/change-of-control payments (the "Plans").
- Copies of Plan documents, trust agreements and insurance contracts (including all amendments and Section 125 arrangements) and summary plan descriptions.
- IRS Form 5500's (including schedules and attachments) for past 2 years and most recent IRS determination letter.
- Description of special insured arrangements (e.g., retrospective rating arrangement, premium delay, etc.).
- Evidence of compliance with state or federal COBRA (including form of COBRA notice).
- Copies of requests for audits of employees made by the U.S. Department of Labor, OSHA, OFCCP and any other federal, state or local agencies during the past 2 years, and documents summarizing the results of any such audits and any disposition of violation or citations issued as a result of such audits.
- Policy and personnel manuals, including policies and procedures with respect to vacation and sick time, harassment and equal opportunity.

## 11. PERSONNEL AND EMPLOYEE BENEFITS (continued)

And, if the Company has more than 25 employees:

- Information on confidentiality or non-competition agreements to which key employees and consultants may be a party currently or from prior employment or engagements.
- Management perquisites or arrangements, contracts or loans between the Company and any shareholder, officer, director, employee or consultant or any entities or persons with which such persons have a relationship.
- Any information on retiree welfare benefits other than COBRA or state continuation coverage requirements.
- If there are at least 50 employees, evidence of compliance with FMLA.
- Financial statements for any plan assets for the past two years and any actuarial statements for the past two years.
- For welfare plans, an indication of premiums paid, claims incurred, claims paid, reserves and administrative expenses.
- FAS disclosure statements for the past two years.
- Any communications to or from any governmental or regulatory agency with respect to any plans.
- If the Company or any affiliate of such Company (at an 80% ownership level) has entered into any collective bargaining agreements with a union:
- Information with respect to any multi-employer plans that the Company or any affiliate has any obligation to contribute to or has had an obligation to contribute to during the past six years.
- With respect to such multi-employer plans, the following: record of contributions for the last three years, calculation of potential withdrawal liability pursuant to ERISA Section 4221(c), and a description of pending claims against the employer for complete or partial withdrawal.

If there are affiliate companies (at an 80% ownership level):

- Information with respect to any multi-employer plans that the Company or any affiliate has any obligation to contribute to or has had an obligation to contribute to during the past six years.
- COBRA and HIPAA compliance information.
- Any information on the transfer of plan liabilities from the Company to a related entity.
- Any defined benefit pension plan maintained or transferred out of the controlled group at anytime within the prior six years.



## 12. RIGHTS, PERMITS AND OTHER REGULATORY MATTERS

- Filings, registrations, reports and correspondence filed with local, state or federal regulatory agencies (e.g., DOL, EEOC, IRS, PBGC, FDA, NLRB, OSHA, FCC, BXA and EPA), and any reports issued by such agencies.
- Governmental licenses, permits, approvals and authorizations necessary to conduct business (including any export licenses).
- Export classification matrix and other product classification analysis (internal or from third party suppliers of customers), and product classification rulings from the BXA.
- Expert compliance procedures or manuals, including any procedures relating to encryption items.
- Summary of the transport, use, handling, location, storage, treatment and/or disposal of any hazardous substances (including by any predecessor).

## 13. LITIGATION, INVESTIGATIONS AND OTHER DISPUTES

- Schedule and description of pending or threatened litigation, claims and other disputes.
- Schedule and description of government, regulatory or administrative proceedings, inquiries or investigations.
- Pleadings, filings and correspondence relating to the matters requested in the preceding Items A and B.
- Legal opinions rendered to the Company in the last 3 years.
- Inquiries with respect to the Company's rights or ownership in or to internet domain names.
- Judgments, consent decrees, injunctions or other orders.
- Settlement agreements.
- Schedule of warranty claims.

## 14. PROPERTY AND EQUIPMENT

- Fixed asset policy including depreciation methods and lives used for book and tax purposes.
- Maintenance procedures and expenditures.
- Schedule of fixed assets for the latest annual and interim periods including date acquired, original cost, accumulated depreciation, net book value and appraised value (include appraisals).

## 15. PURCHASED AND DEVELOPED SOFTWARE

- Accounting policy for software development and purchased software.
- Schedule of purchased and developed software as well as the amortization schedule and write-offs for the latest annual and interim periods.