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**Preliminary Due Diligence Questions to Be Anticipated**

**For [Seller], From [Buyer] or [Investors]**

*In Contemplation of a Business Sale or Purchase*

*(Asset Purchase or Stock Purchase)*

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1. ***Company Preparation***

* ***Valuation – Seller’s Expectations & Action Items***
  + Realistic Value:
    - Have realistic expectations as to the fair market value of the Business. A person selling a business he/she has built over many years, is like a person selling a house he/she has lived in for many years: Seller doesn’t see the shortcomings, marks of age, peeling paint, need for “facelift”.
    - If there is not a person in place, groomed to replace the business owner, the company will experience an immediate drop in value when owner leaves. Therefore, a buyer will be willing to pay less than your perceived value.
    - Can’t value it on what it “could be, if grown”. Instead, that is what the buyer will accomplish by paying you a lower price and growing it to a higher price.
    - Can’t draw out value when you leave for “salary not taken”.
  + Use a professional valuation expert.
    - Don’t use your own accountant, except to determine “Book Value”.
    - Valuation is a specialty, even among accountants. (One can even earn a valuation certification, CVA.).
  + Understand and accept the valuation’s “deductions” for issues such as:
    - Privately held company,
    - Percentage Ownership of less than 100%,
    - Company with only one business development person, creative person, or operational person, who is leaving. (Protect from this by placing others into management.)
    - Your “accrued, but unpaid, salary”, or your “below market salary”, does not add value to, or allow add-backs to, the financial statements or the value of the company.
    - Many more, discuss with valuation expert.
  + If selling to other shareholders, check the Shareholder Agreement, LLC Agreement, or Buy Sell Agreement, for any mandated valuation method, and might even be something crazy like “book value”
  + Make the valuation happen in advance, by doing everything to maximize value!
* ***Company Processes and Documentation***
  + Have processes in place that streamline the company’s business.
  + Document the processes to create organizational knowledge.
  + Train others in them. If they are resistant to helping create, or to follow, processes, get new employees.
  + Be prepared to provide the documentation to the Buyer for DD review.
  + Hire, groom and train your replacements.
* ***Management In Place***
  + Have excellent Management in Place to fill your shoes.
  + Keep only great employees in “line positions” and in management.
  + Houseclean before company up for sale.
  + Buyer will want to meet management.
* ***Company and Principal Info***

Seller please provide:

* + Full Name of Business, date and state of incorporation, FEIN.
  + Full Name of all officers, directors with middle initials, and socials.
  + List of all shareholders, and their percentages of ownership. Are the majority shareholders active?
  + What percentage of vote is required to pass an issue of Shareholders? Or Directors?
  + Ownership/Stock Records in Order, provide a clear stock ledger or LLC ledger of the history and the current ownership as it stands today
  + Address of company, addresses of other offices, and addresses of all property owned or rented by company.
  + Copy of articles of incorporation, and all amendments.
  + Annual Reports filed with Secretary of State /Department of Corporations.
  + Corporate Minute Books in order.
  + Resolutions approving corporate actions.
  + Resolutions electing officers and directors.
  + Qualifications to do business in other states in which business is done.
  + Trademark protection of business name.
  + County and City licenses.
  + Founder’s Shareholder Agreement.
* ***Lease / Landlord:***Seller, please provide (These may be mostly irrelevant if the buyer is not assuming the lease):
  + Landlord’s name and contact information.
  + Copy of Lease.
    - Length of lease?
    - Time remaining?
    - What is security Deposit? Refundable?
    - Monthly rent?
    - Escalating rent rate clause in the lease?
    - Amount of expected rent in next lease term?
    - Is the lease assignable?
    - Default provisions, timing? Delayed payments permitted, and under what circumstances?
    - What options is landlord considering as lease waivers for seller?
    - Who pays utilities under the existing lease? Under a new lease?
    - If the lease is for a building owned by the Seller, provide research on market rate for rent, to confirm that lease rate is within market range.
* ***Assets & Equipment List.***  Seller, please provide:
  + List of all assets, intellectual property, real estate, equipment, tools, computers, inventory
  + Equipment, leasehold improvements, and other assets list with acquisition dates or refurbishment dates; and supporting documentation.
  + General Description of the intellectual property to be transferred, such as customer lists or trade secrets.
  + Trademark Info on filed Trademarks, issue info.
  + Patent Info on filed Patents, issue info.
  + Depreciation Schedules from tax returns for both equipment & improvements.
  + Warranty documents on equipment and improvements.
  + Any Debt on assets and any UCC Financing Liens Filed?
* ***Financial Statements & Tax Returns.*** Seller, please provide:
  + Financial Statements for the past [ ] years,
    - Balance Sheet
    - Income Statement
    - Statement of Changes [ may be optional]
    - Statement of Shareholder’s Equity
    - Salary info to selling shareholder
  + Business Tax Returns for [ ] years
  + Depreciation schedules
* ***Debt & UCC Filings.*** Seller, please provide:
  + List of all debt
  + List of any other liabilities, such as:
  + Documentation of any Debt, such as loan agreements.
  + Copies of, or Information as to, on any UCC financing statements filed by lender, or any other liens filed on the equipment, the improvements, or the leased property.
  + Clear any UCC Financing Liens if possible, discharge UCC and other lines that are no longer active or relevant. Search on yourself in advance to find and clean liens
* ***Shareholder Equity and Lists***
  + Please provide list of all shareholders
  + Stock ledgers / Stock certificate copies
  + Shareholder Agreement
  + Percentages of vote required to pass an issue of shareholders, and what items require or allow shareholders’ vote.
  + For Stock Sold to Outsiders:
    - Offering Memo – Disclosure document
    - Investor Agreement
    - Shareholder Agreement
    - SEC filing on Form D for private placement
    - State Securities Filings
* ***Employees***
  + Clean house, and get rid of ineffective people, as they detract from the value of the company
  + Employment Agreements in place with those higher level people and those who work with trade secrets
  + Decision on who will stay and who will go AFTER the acquisition
  + Benefits information and contributions
  + Employee Benefit Plan Trust documents
  + Union information, if applicable
* ***Legal Liability***

Please provide any information as to any of the items below, of which you have knowledge, or indication, including any actions, pending actions, threat, or indication of actions of:

* + Law suits filed or pending, and status, plus amount and risk of loss
  + Threatened litigation
  + Regulatory compliance Actions
  + Tax actions
  + Have any tax liens (property or income) been filed on equipment or property, or against the principals?
  + Have any judgment liens been filed on equipment or property?
  + Criminal actions
* ***Intellectual Property and Business Agreements***
  + Non-Disclosure and Noncompete agreements signed by employees, contractors, and others
  + License Agreements
  + Trademark filed? Or name cleared?
  + Patents filed? Pending?
  + Distribution Agreements
  + Agreements With Suppliers
  + Sales contracts
  + Other Agreements with Customers
  + Agreements with Employees and 1099 Contractors
  + Government Contracts
  + Stipulations and Legal Settlements
  + Website issues
  + Who owns each item of IP? Is ownership documented? Assignments of IP? Licenses? Payments made.
  + Much more…..
* ***Revenue and Cost of Sales***
  + Customer Lists
  + Order Backlog
  + Sales in pipeline
  + Leads
  + Cost of Goods / Inventory
  + Obtain more detailed list from your accountant, and have your own accountant review for items a buyer might want to know.
* ***Technology***
  + Web presence and e-commerce capability
  + IT strength and Use of technology internally and externally
  + Interview IT staff
  + Back-Ups / Disaster Recovery
  + Does it: Increase Revenue***,*** Decrease Costs***,*** Increase Productivity, Increase Information about the company
  + Social Media Presence
  + Other Tech issues
* ***Contracts and Permits***
  + Obligations under Contracts; Time, Duration, $
  + Make a list of Contracts
  + Are all activities actions under valid permits?
* ***Regulatory Compliance***
  + Compliance with industry Regulations
  + Tax Compliance, including Sales Tax and Payroll Tax in other states?
  + Environmental

1. ***Transaction Preparation***

* ***Consulting Agreement for Seller Staying on With Buyer***
  + Decide part time or full time work for Seller. Another option is full time for a short time, and then part time.
  + Is Seller one of the Business Development people? If so, Seller is key to maintaining the revenue levels for the business being bought, unless buyer can assume the Biz Dev. Role. Will business be emaciated if Seller leaves? Seller’s continued Biz Dev. role affects the valuation of the company.
  + Determine how long is realistic for seller to stay to make the hand over to buyer
    - Not too long and not too short. If seller stays too long, can generate tension to buyer.
  + Consulting Fee reasonably commensurate to work to be done (not necessarily the same as prior salary, likely less).
  + Earn Out for Seller? Price and Duration.
  + Noncompete for Seller? Scope and Duration.
* ***Seller Financing - Installment Loan Agreement***
  + Separate from Consulting Payments, and these payments are due regardless of whether the Seller stays on board, consults, or otherwise helps the company, or leaves, or continues to generate business or not.
  + Length of payments.
    - Related to cash flow out to make payments.
    - Can base on profits, but should be a fixed amount.
    - Personal guarantee by buyer.
    - Buyer can’t skip payments if Business doesn’t’ do as well as expected.
  + Rate decision, fair to parties and transaction.
* ***Noncompete Agreement Buyer Will Impose on Seller***
  + Seller gives buyer a noncompete agreement. Differs if Seller is retiring, versus moving, versus going into other business.
  + Reasonable as to scope and duration.
  + Stronger noncompete allowed where seller selling business to buyer, than in a normal employee employer situation.
* ***Due Diligence on the Company***

Due Diligence is king! Run your own background check on yourself before the buyer runs one on you. Run a back ground check on the company or persons interested in buying you. Aurico Investigations in Arlington Heights, Jeff Hovland.

<http://smallbusiness.dnb.com/company> and other sites.

* ***Estate Planning and Tax Considerations Discussed With Your Tax Adviser***
* ***Disclosure Schedules Required for Sale Transaction Closing***

For an Asset Purchase Transaction:

* + List of assets included in the sale
  + List of assets excluded from the sale
  + List of liabilities included in the sale
  + List of liabilities excluded from the sale

For either an Asset Purchase or a Stock Purchase:

* + List of all assets and liabilities the company owns and owes
  + List of contracts, written and oral, into which the company has entered
  + List of officers, directors, and owners (and how much the owners each own)
  + List of locations of the business,
  + List of employees, List of Subcontractors
  + List of property owned, even if fully depreciated and not otherwise listed on the asset schedule
  + List of intellectual property owned, trade secrets, patents
  + List of customers
  + List of vendors
  + List of litigation cases against the company, pending and threatened
  + List of cases you have brought against others