

The Due Diligence Self-Assessment

Questions You Should Answer Before Your Buyer Asks

Confidential and Proprietary Information

Have you taken proper steps to protect your business's confidential and proprietary information?

You probably know that you should have a good confidentiality agreement in place before you provide prospective buyers with access to confidential information about your business. For similar reasons, buyers will seek to confirm that you have taken all appropriate steps to protect the value of your trade secrets, inventions and other proprietary information that contribute to the value of your business.

- **Employee Agreements:** Have you obtained confidentiality and assignment of inventions agreements from all employees who have had access to proprietary information or who have been involved in the development of inventions or other trade secrets of your business?
- **Patents and Trademarks:** Do you have patents for your critical technologies and inventions that adequately protect your business from new competition? Have you taken steps to protect the value of your important business, product and website domain names? Do you have registered trademarks for your corporate name, logo and website?

Employment and Minority Stockholder Arrangements

Have all of your promises to partners and employees been clearly documented in writing?

Disputes over undocumented promises may seriously interfere with the sale process.

- **Employee Equity Grants and Bonuses:** If you have promised stock options or other equity awards to employees, have you implemented plans or executed agreements providing for the terms of the awards and the consequences of a sale transaction on vesting or other terms? Have you promised bonus payments to key employees upon the successful sale of the business? If so, are those agreements in writing?
- **Non-Compete Agreements:** Do you have legally enforceable non-competition and non-solicitation agreement with your key employees? It is not uncommon for buyers to require that these agreements be executed with key employees as a condition to the sale transaction.
- **Stockholder Interests:** Are your stock records in good order? Will the buyer be able to clearly determine the ownership rights and obligations of each stockholder? Have all issuance and transfers of stock been made in accordance with applicable law and any stockholder agreements?

Material Contracts

Are your material contracts freely transferable to a buyer of your business?

Do you have complete copies of all of your material agreements with key customers, suppliers, licensors and lenders? Do any third parties have the right to consent to the assignment of your rights and obligations under material contracts to a buyer of the business? Are any key intellectual property contractual rights terminable by a third party in connection with a sale of your business?

Accounting Issues

Are your accounting records properly maintained and accounting procedures well executed?

Good accounting records and procedures not only reduce your risk of unforeseen losses and theft, they also reduce the risk to a buyer and increase the value of your business.

- **Audited Financial Statements:** Are your financial statements prepared in accordance with GAAP? Have you had at least your most recent year of financial statements audited by an independent accounting firm? Many, but not all, buyers will require you to provide audited financial statements.
- **Financial Information:** Do you have complete and correct financial ledgers with respect to accounts payable, accounts receivable, sales and inventory that support the financial position and results of operations reported in your financial statements?
- **Accounting Policies:** Do you have and adhere to appropriate policies regarding revenue recognition, inventory valuation and bad debt reserves? Do you maintain adequate inventory controls?

Taxes

Has your business reported and paid all of its taxes?

You probably know that your business is required to file corporate income and franchise tax returns. A prospective buyer will likely also investigate these other areas of tax compliance:

- **Sales Tax Compliance:** Do you have locations, assets or employees in any other state? If so, are you registered to do business in each state? Do you sell your products or services in more than one state? If so, have you properly reported sales and paid sales tax in every state where you have sales? Do you have documentation to support any sales tax exemptions on which you have relied? Have you properly paid sales or use taxes on your purchases? Does your purchasing department or accounts payable clerk keep records to demonstrate that your business has paid any required taxes on its purchases? Do you require vendors to break-out sales tax on all invoices in order to comply with Massachusetts law?
- **Tax Withholdings for Foreign Employees:** Have you ever employed individuals who live outside the U.S. during their employment? Did you withhold all necessary taxes for the country in question from that employee's paycheck? Do you have copies of the employee's tax returns or other confirmation that all taxes required to be paid by the employee were paid?
- **Taxes of Independent Contractors:** Do you know the legal requirements for classifying a worker as an independent contractor? Did you know that improperly characterizing an employee as an independent contractor may subject your business to additional taxes and penalties? Do you issue a Form 1099 to all contractors and require that they pay all appropriate payroll taxes?
- **Exempt v. Non-Exempt Employees:** Have you properly classified your employees as exempt or non-exempt employees? Did you know that incorrectly classifying employees as exempt could subject your business to additional wage or overtime payments and penalties?

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The Due Diligence Self-Assessment is a reference tool designed by Mirus Capital Advisors to help business owners and management teams assess some of the important issues that should be considered before a prospective buyer begins the due diligence process. For further information, please contact:

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