

# Due Diligence Checklist - What to Prepare for Selling a Business

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One of the final phases of selling a business is due diligence. By this point, you've already received an offer. The buyer has spent a great deal of time evaluating the business and decided it's worth buying. After negotiating back and forth, the two of you finally agree on a deal. Yet, the deal is subject to certain contingencies before it is finally closed.

## What is due diligence when selling a business?

Due diligence is the process in which the buyer requests any documents or other information for review and verification. Any discrepancies, inaccuracies or potential liabilities uncovered during this process may cause the buyer to react – by either demanding a lower purchase price or cancelling the deal altogether. Due diligence is, in almost all sales, a condition of the buyer's offer. The business conditions must meet the buyer's expectations before the deal is finally closed. If there are any problems uncovered, this is the time they must be addressed.

## What should be included in a due diligence checklist?

A due diligence checklist should cover several aspects of the prospective business, including financial documents, legal issues, operations, employee relations, as well as all assets, products and customer data. Due diligence is a complex process and should not be conducted without the assistance of your accountant and attorney.

## **1. Prepare all financial information.**

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This includes audited financial statements over the last three years. Keep in mind that most small business financials have been compiled by the seller with the goal of minimizing taxes, so they will need to explain everything in detail, including the owner's benefit (SDE) and cash flow. Your accountant should meet with the seller's accountant to review, verify and possibly recast all the numbers.

- Financials: Income statements, cash flow statements, balance sheets, general ledger, accounts payable and receivable
- Credit report
- Tax returns for at least the past three years
- All debts, their terms and any contingent liabilities
- Analysis of gross profit margins
- Analysis of fixed and variable expenses
- Gross profits and rate of return by each product
- Inventory of all products, equipment and real estate, including total value

## **2. Prepare documents related to the business's structure and operations.**

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Expect the buyer to ask how the business is structured and how it makes its money. This could include any information about competitors, market penetration or trends in the industry that could determine the company's future earnings potential. The buyer may ask to review and verify your business model, customer base, products and services, as well as labor, materials and operational costs.

- Company's articles of incorporation and amendments
- Company's bylaws and amendments
- Summary of current investors and shareholders
- All company names and trademark brand names
- All states where the company is authorized to do business
- All products and services, including production cost and margins
- Business compliance requirements

- Marketing plan, customer analysis, competitors, industry trends
- Company's brand identity, including logo, website and domain

### **3. Prepare all material contracts.**

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Does your business have any partnerships or joint ventures with other companies? Does your business have any existing loan agreements, lines of credit, equipment leases or other indentures? Expect the buyer to ask about any obligations or agreements in place that they may be expected to comply with or respond to in order to do business.

- All nondisclosure or non-compete agreements, any guarantees
- Company purchase orders, quotes, invoices or warranties
- Security agreements, mortgages, collateral pledges
- Letters of intent, contracts, closing transcripts from mergers or acquisitions
- Distribution agreements, sales agreements, subscription agreements
- All loan agreements, material leases, lines of credit or promissory notes
- Contracts between officers, directors or principals of the company
- Stock purchase agreements or other options

### **4. Prepare all customer information.**

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Prepare all customer lists and databases. Expect to be asked about your largest customers in terms of sales, as well as what they've purchased over the last 2-3 years. Also, expect to be asked how customers are acquired and retained, as well as whether or not they're on renewable subscription agreements.

- All customer databases, subscriber lists and sales records
- Copies of standard communications and correspondence
- All advertising programs, marketing programs and events
- Purchasing policies and refund policies
- Any customer research data, white papers or research
- All attorneys and law firms representing the company, area of practice
- Pending litigation or threats of litigation
- Any unsatisfied judgements
- All insurance coverage and policies
- All professional licenses and permits

## **5. Prepare all employee information.**

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Prepare your company's employee roster and an organizational chart. Identify your key employees and what their responsibilities entail. You may be asked whether or not any of your employees plan to leave the company after it's sold and whether or not you recommend they be offered some sort of incentive to stay.

- Employee roster and organizational chart
- Employee contracts and independent contractor agreements
- Payroll information and employee tax forms
- Human resources policies and procedures
- Employee benefits, retirement plan and insurance

## **6. Expect to be asked about any legal issues.**

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Expect buyers to ask if there are any outstanding legal issues or ongoing litigation that they need to know about. They may want to know who represents the company and if the company has proper insurance in place. They may also want to know if the company has all the proper licenses and permits in place.

## **7. Prepare a list of physical assets and real estate.**

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Prepare a full inventory of all your company's property and its current market value, including automobiles, equipment, real estate and inventory.

- Real estate, including office locations, warehouses, current leases and titles
- A schedule of all fixed assets, including product inventory, furniture, fixtures and equipment
- Any automobiles or boats

## **8. Prepare a list of all intellectual property.**

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This includes trademarks, copyrights, patents or other exclusive intellectual information that is owned by the company.

- All company's patents, trademarks and copyrights
- Product inventions, formulas, recipes, or technical know-how
- All rights owned data and digital information

- All work-for-hire or consulting agreements

Preparing for due diligence not only can help seller avoid potential roadblocks to a sale, it provides valuable insight when preparing the final purchase and sale agreement. It offers sellers a clearer and well-rounded picture of the company they are about to sell, whether or not the asking price is fair, and its future earning potential. With the assistance of an experienced business broker, as well as your attorney and accountant, you should be able to address any issues and determine the best solution.

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