



CLIENT:

ADDRESS:

FINANCIAL DUE DILIGENCE CHECKLIST

No	Requirements	Comments / References
1	Financial Analysis Overview	
1.1	Obtain for the past five years: <ul style="list-style-type: none"> • audited financial statements; • comparative financial results by major divisions; • the most recent unaudited financial statements; • tax returns; • projected operating and financial statements; • the chart of accounts and a description of accounting practices. 	
1.2	Check industry sources for pertinent data on: <ul style="list-style-type: none"> • economic situation and market trend; • accounting, auditing and tax implications; • management methods; • employee benefits. 	
1.3	Review the following agreements, where applicable, and note pertinent points for file: <ul style="list-style-type: none"> • bonus or profit sharing plans; • union contracts and employment contracts; • long term leases; • sales and marketing contracts, dealership agreements, royalty agreements and suppliers' contracts. 	

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1.4	Calculate and analyse the following ratios: <ul style="list-style-type: none"> • return on total assets (%); • return on net assets (%); • return on ordinary shareholders' funds; • earnings per share; 	
	<ul style="list-style-type: none"> • gross profit margin (%); • net earnings margin (%); • growth in sales (%); • growth in net profit (%); • growth in earnings per share (%); • interest cover (times); • inventory turnover (times); • trade receivables turnover (times); • current ratio; • quick assets ratio; • debt to equity ratio; • net tangible assets per share. 	
2.	Accounting Policies	
2.1	Determine whether the accounts are in accordance with Corporations Act 2001, accounting standards and UIGs and whether they are reasonable in the circumstances and have been consistently applied.	
3.	Operating Results	
3.1	Carry out analyses of the profit and loss accounts for the last five financial years and the most recent interim period. Include trends in sales, gross profit, net income, earnings per share, dividends and return on equity, interest expense and growth rates.	

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3.2	Determine the affects of acquisition, dispositions, changes in accounting policies, all extraordinary and abnormal items, significant items in the other income and expense categories, impact of income taxes and changes in tax rates.	
4.	Financial Position	
4.1	Cash Review cash position, present and projected, including:	
	<ul style="list-style-type: none"> • list banks where accounts are kept; • monthly cash balances, unusual fluctuations, significant outstanding cheques or deposits in the reconciliations. 	
5.	Accounts Receivable	
5.1	Obtain aged trial balances of all the amounts receivable and compare to aging percentages for previous years. Obtain explanations for major variations.	
5.2	Obtain particulars on customers re: <ul style="list-style-type: none"> • terms of sales and credit policies; • list of large customers and volume of annual sales and unusual arrangements etc; • unfilled orders. 	
5.3	Analyse returns and allowances as % to sales for the year and enquire about major fluctuations.	
5.4	Enquire whether any receivables are discounted or factored to finance companies.	
5.5	Evaluate how the company determines doubtful debt provisions and assess its adequacy.	
5.6	Assess effectiveness of credit control department.	

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5.7	Evaluate the appropriateness and adequacy of calculating other provisions (e.g. discounts, returns, allowances).	
6.	Inventory	
6.1	Analyse inventories recorded at balance dates showing the various classes of inventory and inventory provisions. Obtain explanations for major variations.	
6.2	Enquire whether perpetual records are kept.	
6.3	Evaluate the internal control and procedures in place over the physical movement of inventories and the updating of accounting records.	
6.4	Enquire as to the regularity of physical inventories and comparison to perpetual records, the procedures and explanations for resolving variances.	
6.5	Determine whether all items are counted, regardless of condition.	
6.6	Ascertain basis of the valuation policies and methods for each class of inventories, if standard costs used determine basis, regularity of revisions, cost components and accounting treatment of variances.	
6.7	Determine whether an adequate allowance for inventory shortages has been taken up in the interim accounts based on historical experience.	
6.8	Determine whether a review for excessive and obsolete inventories and inventory items carried in excess of net realisable value has been done for interim accounts purposes.	
6.9	Ascertain whether the company does forward billing to customers and holds the assets for delivery later. Assess the impact of this practice.	

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6.10	Check cut-off procedures.	
7.	Investments	
7.1	Analyse investments at balance dates, showing the cost, carrying value and market value of each item and compare with previous periods. Obtain reasons for major variations.	
7.2	Ascertain policy for determining market value of listed and unlisted investments.	
7.3	Ascertain whether the company will be required to contribute further capital.	
7.4	Check whether any material change has occurred in the market value of investments since the end of the most recent interim period.	
8.	Property, Plant and Equipment	
8.1	Analyse property, plant and equipment at balance dates showing separately amounts at cost and valuation, with accumulated depreciation shown as deductions therefrom and obtain explanations for major variations.	
8.2	Evaluate policies and procedures in relation to: <ul style="list-style-type: none"> • capitalisation of expenditure; • adequacy of depreciation methods (e.g. straight-line, diminishing balance, commencement date); • determination of economic lives and residual values of assets and their revisions. 	
8.3	Obtain fixed assets register and check reconciliation with the fixed assets accounts in the general ledger.	

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8.4	Where physical inventories of fixed assets are carried out, check results of the latest physical inventory and determine whether differences were adjusted in the general ledger.	
8.5	Evaluate internal controls in existence for the authorisation of fixed asset additions and disposals and for expenditure on repairs and maintenance.	
8.6	Ascertain whether there are any surplus and/or idle fixed assets, including land and buildings.	
8.7	Obtain copies of recent market valuations of land and buildings and other fixed assets and determine whether such valuations are reflected in the accounts.	
9.	Intangibles	
9.1	Analyse intangible assets at balance dates showing the cost, accumulated amortisation and net book value of each class of other assets and obtain explanations for major variations.	
9.2	Determine how any goodwill and other intangibles arose and consider the acceptability of the basis upon which they are included in the balance sheet.	
9.3	Assess whether the company's amortisation rates appear reasonable in the circumstances.	
10.	Other Assets	
10.1	Analyse other assets at balance dates choosing the gross book value, accumulated amortisation and net book value of each class of other assets and obtain explanations for major variations.	
10.2	Assess amortisation rates for reasonableness.	

No	Requirements	Comments / References
11.	Creditors, Accruals and Provisions	
11.1	<p>For accounts payable and accruals:</p> <ol style="list-style-type: none"> a. obtain an analysis of the type (e.g. trade creditors, overheads, payroll and described payments practices for each; b. compare the balances in the various accounts with those at the end of the previous periods; c. determine whether advantage of discounts for prompt payment are taken up and review reconciliations of major suppliers for disputes; d. obtain a list of the company's major suppliers, together with the approximate annual amounts purchased. 	
11.2	Evaluate procedures and internal controls for ensuring that all material liabilities are properly taken up. Determine basis of each provision made and its adequacy.	
11.3	<p>Determine whether any material accrual or provision has either not been taken up or has been based on a significant element of management judgment, e.g.</p> <ul style="list-style-type: none"> • holiday pay, sick pay, long service leave, redundancy pay, compensation pay, bonuses, profit-sharing, workers compensation, product guarantees or service warranties, returnables, superannuation, commitments; • re-organisation or closure costs; • remedial and maintenance costs, penalties, damages or other cost increase in relation to completed contracts; • losses on purchase contracts or outstanding sales orders; • losses on legal claims or as yet unasserted claims. 	
12.	Debt Finance	

No	Requirements	Comments / References
12.1	Obtain list of all financial liabilities and determine the general terms of notes, bonds and mortgages payable and related charges, guarantees, due dates.	
12.2	Obtain credit reports or any reviews/ratings.	
12.3	Obtain the terms of leases, the nature of the property subject to the leases and determine whether renewal or purchase rights exist.	
12.4	Enquire into any quasi-financing agreements (e.g. put / call option contracts) and guarantees of debt of other entities.	
12.5	Obtain information on any established lines of credit, terms and unused amounts available and ensure that they reconcile with the forecast cash requirements.	
12.6	Enquire as to the existence of any off balance sheet items.	
13.	Contingencies and Commitments	
13.1	Analyse all significant contingencies and commitments at the end of the previous financial year and the most recent interim period.	
13.2	Evaluate the procedures and controls for ensuring that all contingencies and commitments are notified to an appropriate official and included in the analysis referred to above.	

No	Requirements	Comments / References
13.3	<p>Check for likelihood of any significant contingency of commitment is not included in the analysis, in particular the following:</p> <ul style="list-style-type: none"> • endorsements, warranties, sureties or guarantees; • claims under costed contracts; • claims, including liquidated damages, for breach of contract; • other claims for damages; • liabilities in respect of notes, drafts and bills receivable which have been discounted or sold with recourse; • pending law suits, proceedings, hearings or negotiations possibly involving retroactive adjustments; • inadequate insurance cover for events that occurred up to the accounting date; • uncalled liabilities on investments; • adjustment of consideration for any business acquired or sold; • joint and several liability under group banking arrangements; and • options and working capital commitments. 	
14.	Commitments	
14.1	<p>Capital commitments, for the acquisition of fixed assets by purchase or by finance lease including fixed assets or investments either:</p> <ul style="list-style-type: none"> • contracted for, but not provided for, or • authorised by the Board of Directors but not contracted for. 	

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14.2	<p>Other financial commitments such as:</p> <ul style="list-style-type: none"> • significant commitments extending more than one year from the accounting date; • purchase commitments extending more than one year from the accounting date; • long term supply contracts on unfavourable terms resulting in a drain on resources; • commitments for the sale of the company's products at forward prices below the prevailing selling prices; • agreements to repurchase or sale contracts, in relation to: <ul style="list-style-type: none"> - foreign currencies; - commodities; • commitments not in the ordinary course of trading, such as: <ul style="list-style-type: none"> - leasing commitments, either in respect of finance leases or operating leases; - to borrow or lend money; - to acquire companies or net assets or to form a joint venture; and - to purchase or sell investments. 	
15.	Equity	
15.1	Obtain details of any preference shares outstanding and determine whether the terms of the shares specify special treatment.	
15.2	<p>For ordinary shareholders' equity:</p> <ol style="list-style-type: none"> a. obtain a shareholders' list; b. determine the rights for each class; c. determine any obligations to issue or repurchase shares; d. enquire about any unusual capital accounts (e.g. donated capital, appraisal surplus). 	
15.3.	Determine the extent to which the company's growth has been financed by internally generated cash. Analyse the implications and enquire about the company's policy on financing its operations.	

No	Requirements	Comments / References
15.4	Evaluate relationship with banks, lenders and the financial community in general.	
15.5	Review the capital budget and planned sources of funds.	
15.6	Determine whether the existing debt repayment schedule can be met from operating cash flow. If refinancing will be necessary, determine the effect of current interest rates.	
15.7	Determine whether the company has a dividend reinvestment plan in place.	
15.8	Where hybrid securities or “quasi-equity” issued evaluate the rights obligations attached to these securities and their impact on the company's future operations.	
16.	Forecasts	
16.1	Obtain available projections of earnings and cash flow. If possible, obtain the worst, best and most probable results and check if the same ratio analysis is applied to historical results to determine whether relationships are consistent.	
16.2	Determine and evaluate the reasonableness of the assumptions used. Identify any contingency or margin allowances that have been made.	
16.3	Ensure projections are consistent with industry and overall business expectations.	
16.4	If no projections are available, develop forecasts based on continuing historical growth trends, industry conditions and known factors.	
16.5	Adjust the projections for any items resulting from the proposed transaction.	

No	Requirements	Comments / References
16.6	Review cash flow projections to determine that investment in working capital, new plant and equipment and scheduled debt maturities is appropriately provided. Determine the net cash flow that would be available (preferably a range of minimum and maximum cash flows).	
17.	Financial Management	
17.1	Evaluate the overall credibility and reliability of the accounting system and reporting capabilities of the company.	
17.2	Ascertain the extent to which the company's earnings have been efficiently managed.	
17.3	<p>Ascertain whether any practices have been adopted to make the company appear more attractive, including:</p> <ul style="list-style-type: none"> • less conservative accounting policies; • fluctuations in discretionary expenses, such as advertising, personnel and maintenance; <ul style="list-style-type: none"> - biased accounting judgments, such as inappropriate provisions for sales returns, obsolete inventories or contingent liabilities; - expenses being paid by shareholders, either directly or indirectly; - inadequate compensation for shareholder-managers; - profit recognition manipulations; - below market rentals; - revaluations/over valuation of assets. 	

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17.4	<p>Check for private company adjustments, including:</p> <ul style="list-style-type: none"> • stock valuations discrepancies; • private expenses through company; • unrecorded income re tax purposes; • abnormal salaries, superannuation and other benefits for the proprietor and family; • interest on shareholders' loans not at arm's-length; • personal security or guarantees given to secure the company's debts and obligations. 	
17.5	<p>Independent review:</p> <ul style="list-style-type: none"> • enquire if an audit committee or equivalent exists and evaluate its independence. Ascertain the committee's review scope of audit of financial statements; • evaluation effectiveness in responding to findings of internal and external audit; • evaluate directors' independence from management and controlling shareholders; • adequacy and frequency of Board meetings and information provided for decision making; • determine whether Board is actively involved in major decisions affecting the organisation. 	
17.6	Investigate the auditing firm's reputation.	
17.7	<p>Review the working papers of the auditors to note</p> <ul style="list-style-type: none"> • adequate of auditing work.; • adjustments proposed by the auditors; • problem areas; • any differences of opinion between the company and its auditors; • matters raised in audit management letters. 	
17.8	<p>Review the adequacy of the internal auditing department. Ascertain what the department's major recent findings were and the company's handling of those findings. Determine to whom the internal auditing department reports.</p>	

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17.9	Evaluate the internal accounting controls and the company's attitude toward strong controls.	
17.10	Evaluate the strength of the financial management and controllership function.	
17.11	Determine: <ul style="list-style-type: none"> • the frequency with which internal reports are issued; • time lapse between the end of the period and when the reports are used; • whether the internal reporting timetable and content are consistent with any monthly closing requirements. 	
17.12	Review how centralised the accounting function is and whether subsidiaries have autonomous accounting departments that may not be functioning uniformly and, if so, how overall control is exercised.	
17.13	Investigate: <ul style="list-style-type: none"> • whether interim reports are prepared on a consolidated basis or only by autonomous entities; • the manner in which foreign subsidiaries or branches report. 	
17.14	Ascertain whether management reports compare results to budget and prior years and determine the reasons for variances. Determine whether exception reporting is used.	
18.	Information Technology	
18.1	Ascertain all significant accounting and operational functions currently on computer and determine plans to computerise others.	
18.2	Assess the adequacy of the IT installation and whether the IT function is centralised. Ascertain whether the needs of user departments are satisfied by this function.	

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18.3	Obtain a list of hardware used by the company and lease terms. Determine whether the equipment is up-to-date and identify the company's short and long term hardware plans.	
18.4	Determine whether the IT function could be rationalised.	
18.5	Determine whether there is any intangible software value.	
19.	Risk Management	
19.1	Review the insurance currently in effect and the extent to which the company is assuming self-insured retentions. Review any loss experience for insured and uninsured claims and the reporting and reserving practices.	
19.2	Determine whether the company has been unable to insure unusual risks or products or events and whether the company will be able to obtain necessary insurance in the future.	
19.3	Ascertain whether insurance coverage is determined on a "claims made" basis. Determine whether any insurance policy aggregates have been penetrated or exhausted.	
19.4	Identify any liabilities that have been assumed or transferred through contractual arrangements.	
19.5	Identify any unusual circumstances which may give rise to claims in the future which are as yet unreported.	
19.6	Establish whether a decision has been made as to any guarantees that may be given by previous shareholders. Assess whether the company, or individuals assuming liability for prior acts, will be financially sound enough to back up its indemnifications.	

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19.7	Identify any potential for cancellations of coverage such as Director's and Officer's liability insurance or potential bonding problems due to a highly leveraged condition.	
19.8	Determine whether the company entered into any special service agreements that have to be maintained or renegotiated.	
19.9	Identify any outstanding premium adjustments and determine whether there will be credits or charges for them.	
19.10	Review the methods by which accruals and tax deductions for premiums are handled.	
20.	Taxation	
20.1	Ascertain the principal taxes to which the company is subject and the amounts paid for the past five years.	
20.2	Consider recent changes in the tax law that would affect the company.	
20.3	Ensure deferred taxes are provided on a comprehensive basis.	

No	Requirements	Comments / References
20.4	<p>Review:</p> <ul style="list-style-type: none"> • previous year's assessments that are still open; • adjustments the company was required to make as a result of the most recent examination; • the balance sheet accrual for open years to ascertain whether it has been adjusted to give effect to the adjustments for years already examined; • any examinations currently in progress. Ascertain whether there have been any preliminary findings or matters under appeal; • a schedule reconciling book income to taxable income for the last five years; • amounts and expirations of any carryovers or net operating or capital losses, dividend franking tax credits, foreign tax credits and other tax credit carryovers. Consider how the transaction will affect the status of these carryovers; • the tax basis of the company's assets; • agree amounts owing with ATO records. 	
20.5	<p>For other taxes, determine:</p> <ul style="list-style-type: none"> • ascertain whether company is required to file payroll or other business tax returns in other states and, if so, whether they have been filed and taxes have been paid; • whether local taxes have been accrued and paid currently. Identify any of these taxes that are in dispute; • whether there are or have been any tax audits; • whether all payroll taxes have been withheld from employees and forwarded promptly; • whether there are any problems with other taxes to which the company is subject, such as stamp duties, customs duties, FID; • obtain copies of previous tax returns for GST, FBT, payroll tax, etc and see if liabilities have been taken up; • has company complied with Superannuation Guarantee obligations. 	

No	Requirements	Comments / References
20.6	<p>Determine whether the company has any significant foreign taxes or any significant local tax problems relating to its foreign operations, such as:</p> <ul style="list-style-type: none"> • foreign tax credits; intercompany pricing and reallocation of income or expenses between related entities; • any transfers of assets/liabilities to a foreign corporation. 	
20.7	Determine all other areas of potential tax exposure or savings including details of the franking account.	
20.8	Enquire whether the company obtained any private rulings.	
20.9	Assess the internal tax function to ascertain to what extent the company relies on outside advisers for tax planning and return preparation and whether the tax function has technical expertise or merely serves compliance functions.	
20.10	Determine whether company has borrowed monies to fund the payment of dividends or repayment of capital;	
20.11	Determine whether company is liable to withhold tax on payments of interest, dividends, royalties, insurance premiums, etc to non-residents. Are all liabilities taken up?	
20.12	If company owns land, confirm all land tax liabilities up to date.	
21.	Capital Gains Tax	
21.1	What records has the company maintained to track the date of acquisition and cost base/reduced cost of assets?	
21.2	Have any assets been transferred between group companies or any of the shareholders of the company? If so, please provide details.	

No	Requirements	Comments / References	
21.3	<p><i>CGT loss carry forwards</i></p> <p>What is the amount of any CGT loss carry forward? When did those losses arise? Please also confirm that a “disqualifying event” has not occurred for CGT purposes.</p>		
21.4	<p><i>CGT notices/elections</i></p> <p>Please provide copies of all election notices/agreements that have been lodged or retained as required for any prior disposals/transfers etc.</p>		
22.	<p>Tax Losses</p>		
22.1	<p>Where tax losses have been transferred on or after 22 February 1999, there is a potential reduction in the cost base of the shares of the company transferring losses. Please provide details of what records have been maintained to track the reduction, if any, in the tax cost base.</p>		
22.2	<p>What records have been maintained to determine whether the continuity of ownership test or the same business test have been satisfied.</p>		
22.3	<p>Please advise if the integrity measures relating to unrealised losses apply to the company.</p>		
23.	<p>Debt Forgiveness</p>		
23.1	<p>Have any other debt owed by the company (or share giving rise to debt dividend) even been forgiven (actually or constructively), assigned or converted to equity since 27 June 1996?</p>		
23.2	<p>How was this treated for the purposes of the commercial debt forgiveness rules? What was the market value of the debt at that time?</p>		