DUE DILIGENCE OF [COMPANY]

Due Diligence Checklist

Attached is a 42 page Checklist (including Index) reproduced from the "Due Diligence Guide" prepared by the Securities Institute of Australia.

Obviously it is a general guide and some items included may not be relevant to those companies being investigated. Similarly, the Checklist is not intended to be an exclusive list and it may need to be broadened to encompass all the activities of the companies within the Group.

The Guide is sent merely as a guideline to ensure that most of the information needed for the Due Diligence process will be collated and ready for the Due Diligence Team when it commences work.

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CHECKLIST

INDEX

I. GENERAL BACKGROUND

1. The following basic information about each Company needs to be obtained:

   (a) History of business, any predecessor companies and changes in capital structure, capitalisations or insolvency proceedings.

   (b) Description of products/services, markets, principal customers, subsidiaries and their lines of business.

   (c) List of officers and directors, with their affiliations, ages and number of years in office.

   (d) Number of people employed and their major areas of activity.

   (e) Capitalisation and share distribution, including the number of shareholders and names of principal shareholders, rights of each class of capital, and shareholders agreements.

   (f) Terms of outstanding warrants, options and convertible securities. Find out if these would have to be dealt with by issuing additional shares.

   (g) If the shares are publicly traded, the exchanges on which they are traded. Obtain any stock exchange filings.

   (h) Press clippings and media releases.

   (i) Organisation chart.

   (j) Names, addresses and contact personnel of company's professional advisers, including legal, auditors, principal bankers and investment bankers.

   (k) Location of company's financial and legal records.

   (l) State of incorporation and date of incorporation.

   (m) Key statistics and financial information.

2. If any subsidiaries are not wholly owned, obtain the details of outside ownership. Consider completing a separate checklist for any major subsidiaries with significant minority interests.

3. Ascertain whether the company has a significant investment in any other companies (especially those carried on the balance sheet under the equity method of accounting).

4. Information to enable an understanding of the general nature of the transaction:

   (a) Terms.

   (b) Accounting treatment.

   (c) Arrangements that have been made with any brokers or advisers.

   (d) Details of any recent similar transactions.

(e) Ascertain the real reason why the transaction has been proposed.

(f) Determine how long the transaction has been contemplated and if other previous transactions of a similar nature have fallen through.

(g) Consider whether management has done anything to make the company appear more attractive such as reducing discretionary expenditures for advertising, maintenance, research and development, new product introductions, capital improvements or deferring raises or bonuses.

5. Isolate the aspects of the business that appear to be dominant in the industry (e.g. technology, product design, marketing, production). Note what appear to be key factors for success in the industry and how the company compares in these areas. Identify what factors (if any) make the company more attractive than other companies in the industry.

6. Determine if the company can maintain a competitive advantage over other companies, identify developments that could cause the company to lose its competitive advantage including principal business risks and assess the likelihood of their occurrence.

7. Determine if the company would provide a "bridgehead" to other desirable industry segments. Identify and evaluate the possibilities.

8. Determine whether a drastic change in the company's management or business approaches will be necessary Ascertain the likely consequences on present employees or customers' goodwill and whether they would be able to adjust.

9. Determine if the company's officers or directors have been involved in criminal proceedings, regulatory violations or significant litigation.

10. Obtain information or make an assessment regarding:

(a) The image of the company and its products and services compared to those of industry leaders.

(b) The reputation of present owners directors, management, and professional advisers.

(c) The trend of market share.

(d) Recent major developments among competitors.

(e) The extent of government or other regulation under which the company operates.

(f) Other external factors affecting the company, such as the impact a significant change in economic conditions may have.

(g) New developments, planned or in progress, including:

- The relationship of programs to the company's position in the industry.

- The state of definition and discipline in specific plans.

- Capital equipment needs and commitments.

(h) Special skills and advantages, such as:

- Technical position.
- Market dominance.
- Cost structures.
- Management/employee capabilities.
- New product success.

(i) Major litigation, pending or potential.

(j) Cyclical factors affecting the industry.

(k) Credit rating.

(l) Major operations discontinued in recent years or that may be discontinued in the near future.

(m) Contracts and leases nearing expiration.

(n) Labour negotiations pending.

(o) Trade association membership.

(p) International trends in similar industries.

(q) Major customers.

(r) Major suppliers.

II. MANAGEMENT AND CONTROL

Management Approach

1. Determine the basic approach of management (e.g. entrepreneurial, authoritative, management-by-objectives) and the extent of centralisation or decentralisation of authority.

2. Determine whether the organization is structured overall to best meet the requirements of each area for management and supervision, e.g. by activity, product service, function, location.

3. Assess whether the company's past management approach will be suitable and cohesive with that of any new structure.

4. Review to what extent management could be integrated or permitted to operate autonomously. Determine whether there are any areas in which functions of the company could be revised for the company's best advantage.

5. Consider to what extent existing management will remain in the employ of the company. Assess the ability to replace management expertise in any areas.

6. Consider the record of the management team as a whole, including:

   (a) The success of the company relative to the industry.

   (b) Whether the success of the company can be attributed to good management or a good market and industry.

   (c) The strategies that management is using to increase market share and profitability.

   (d) The intelligence demonstrated in taking advantage of anticipated changes in the marketplace and the environment.

   (e) The work environment that management has created in the company. Determine if people are working well together and complementing the work of others.

   (f) Whether the management is as small in scale and as low in cost as possible. See if the company makes any effort to measure the ratio of administrative managers to total personnel and otherwise reduce administrative overhead.

   (g) Whether management seems to work as an integrated unit or is constancy dealing with crises and emergencies.

   (h) Determine whether the right decisions are being made at the right level of management and if executives are spending most of their time preventing problems from arising, or if they are utilising their time continually solving the same problems.

7. Determine the extent and effectiveness of basic concepts and tools of good management, including:

   (a) Documented objectives.

   (b) Strategic and tactical plans.

(c) Responsive organizational structure and controls.

(d) Effective policies and procedures.

(e) Adequate management information systems.

(f) Budgetary control and responsibility accounting.

(g) Standards of performance and control.

(h) Management and manpower development.

Planning

8. Consider:

(a) The company's attitude towards the planning process, annual and long-term

(b) Whether plans are well thought out.

(c) Whether plans and budgets are effective management tools.

9. Determine who in the organization is responsible for long-range plans and whether the plans are documented and communicated to the people responsible for implementing them.

10. Determine whether:

(a) In the budgeting process, the sales forecasts are based on real assessments of the market, rather than on percentage increases. Determine how costs are estimated and how far down the company the budgeting process extends.

(b) Budgets embody realistic assumptions of the availability of manpower, productive capacity and working capital.

(c) Long-term plans are integrated with capital budgeting and financial planing.

(d) Long-term plans reflect competitive reactions

(e) These plans include alternative strategies. Determine if they are sufficiently flexible in relation to the operating environment.

11. Determine whether:

(a) Objectives are described so achievement can be monitored.

(b) Senior management judge operating personnel in working toward and achieving specified objectives.

(c) The company has a history of meetings its goals.

(d) The budgeting and internal accounting functions are integrated so that actual performance is reported on the same basis and under the same Commons as the budgets were prepared.

(e) Actual is compared to budget, and if there is a formal procedure for documenting variances.

(f) Actual financial results are used to periodically update budgets and revise the annual or quarterly financial projections.

12. Ascertain what probes are used to monitor the marketplace, such as:

(a) Market share.

(b) Activities of competitors.

(c) Attitudes of customers.

Internal Controls

13. Isolate the extent to which these basic elements of control operate within the Organisation:

(a) The dudes and responsibilities within the company are organised to provide adequate segregation of duties.

(b) If the company is too small for adequate segregation of dudes, whether other elements of control have been substituted.

(c) The authority and responsibility of each function and person is clearly defined and understood.

(d) There is an adequate accounting system that provides control over all assets and transactions.

(e) There are documented statements of policies and procedures.

14. Identify any cost reduction or profit improvement programs.

III. INDUSTRY AND COMPETITORS

Product Lines

1. Determine customers' requirements for the company's products or services.

2. Review these basic buying considerations

   (a) Price.

   (b) Quality.

   (c) Service.

   (d) Availability.

   (e) Sales.

   (f) Engineering.

   (g) Credit terms.

   (h) Right of return or consignment.

   (i) Delivery time.

3. Examine the past and prospective pattern of changes in the industry.

4. Consider new uses for established lines.

5. Ascertain whether there are related segments the company is not serving.

6. Review the warranty terms that are customarily offered and their cost.

7. Identify any exposure to significant product or service liability concerns.

8. Determine if patent and trademark protection is adequate.

Markets

9. Consider whether the demand for the company's product/service is basic or created.

10. Determine the type and quality of customers e.g. individual consumers, industrial companies, Federal State or Local governments, service businesses.

11. Determine whether the company operates in a "mature" market.

12. Identify the importance of domestic and export demand and whether changes in trading activities in foreign countries (such as the European Economic Community countries in 1992) will affect demand.

13. Determine the factors that affect demand: for example:

    (a) Environmental issues.

    (b) General business conditions.

(c) Population changes.

(d) New products, product changes or technological innovation.

(e) Advertising or promotional pressure.

(f) Governmental factors (e.g. fiscal policy, import-export controls, defence activity).

(g) Customer growth.

(h) Energy availability.

(i) Ecological considerations.

14. Identify whether the market can be expanded by the efforts of the company.

15. Determine whether the market is segmented and how the company has responded to market segmentation. Consider:

(a) Type of customer.

(b) Geographic location.

(c) Product/Service.

(d) Channel of distribution.

(e) Pricing policy.

(f) Degree of integration.

16. Identify any seasonal sales patterns and shifts in established patterns.

17. Obtain a record of sales performance. Indicate the date the product/service was introduced and note any significant modifications. Relate trends to both external factors and company actions. Note the stages in the life cycles.

18. Obtain a projection of growth or contraction trends for the product/service lines and explanations for the trends.

19. Obtain a forecast of sales expectations and estimated share of market. Compare it to industry projections.

20. Obtain an estimate of the industry's ability to supply present and anticipated demand.

21. Review sales backlog receivable, sales correspondence, and continuity.

22. Analyse present and probable pricing policies for the lines, considering:

(a) The sensitivity of both the industry and company to price changes.

(b) Whether there is a price leader.

(c) Whether there is price cutting.

(d) Any excess capacity in the industry that might tend to depress prices.

(e) Whether the company has been able to pass along recent cost increases to customers.

(f) Regulatory factors such as Prices Surveillance Authority or Trade Practices Commission

23. Analyse present and potential domestic and export customers, including:

(a) The total number and major types of customers and the percentage of sales of each type.

(b) Geographical locations and percentage of sales by location.

(c) Names of principal customers, annual volume of sales, and buying habits.

(d) Any contractual relationships with customers.

(e) The extent of government contracting subject to cost regulations or price determination.

(f) A summary of special discounts and credit terms offered to significant customers.

(g) Possible loss of customers.

(h) Whether there is a disproportionate level of sale to a number of customers e.g. a high percentage of sales made to a few customers.

24. Compare the methods this and other companies in the industry use to distribute and sell including:

(a) The chancels of distribution and their relative importance.

(b) If the company does not sell directly to end users, conditions in customers' markets.

(c) The nature and importance of the field sales effort

(d) The manner of compensating sales personnel (i.e. whether fixed or incentive based).

(e) Advertising and sales promotion practices in this industry.

(f) Any changing patterns in the distribution process.

(g) Any trend among major customers toward integrating, purchasing substitute products or otherwise deviating from purchasing from the company.

25. Review advertising appeals, media. and other sales promotion programs for cost and effectiveness.

26. Analyse distribution and selling costs for the past few years to determine possible shifts in profitable customers and lines. Describe any unusual marketing methods, including licensing arrangements and joint ventured

27. Analyse the trend of bidding success and costs, including:

(a) Invitations received.

(b) Bids submitted.

(c) Contracts awarded.

(d) Average contract size.

(e) Cost-per-contract awarded.

28. Review trends in the major elements of marketing including:

(a) Market forecasts compared to actuals.

(b) Sales cancellations and returns and the reasons for them.

(c) Departmental costs compared to budget.

(d) Sales and expenses per salesman.

(e) Customer service costs.

(f) Shift in product mix profitability.

(g) Order processing costs.

(h) Customer complaints and lost customers.

(i) Discount pattern by customer groupings.

(j) New accounts opened.

Industry Conditions and Competition

29. Analyse the industry's composition and, in particular, recent changes in that composition considering:

(a) The number of companies that operate in this industry and whether that number has been declining or increasing.

(b) The recent merger, acquisition, and divestiture deals that have occurred in the industry.

(c) The trends in the prices paid for these deals.

(d) Recent plant closings or openings, or announcements of such.

(e) The degree to which foreign companies are entering this market, possibly through joint ventures.

(f) The number of market leaders or specialists in this industry and whether they have diversified into other businesses.

(g) Whether the industry has significant over/under capacity.

30. Develop an understanding of the factors critical to success in this industry by considering:

(a) The industry leaders and the reasons for their success.

(b) The principal bases of competition:

- Price (low gross margin)
- Quality (high gross margin)
- Service (high margin to wholesalers)
- Innovation (high R&D expenses)

(c) Whether the market leader has a unique strategy.

(d) Whether this industry has a high rate of business failure.

(e) The relative importance of high volume versus low cost.

(f) The power structure of the industry, e.g. do suppliers have more power than buyers or vice versa?

(g) The industry's reliance on and vulnerability to imports.

31. Obtain growth projections and other industry analyses and understand

(a) The growth trends in the industry, including those projected by the company and trade organisations.

(b) The treads in other related industries, including those projected by external consultants, economists, and industry analysts.

(c) Whether financial, investment or industry analysts have reported adverse conditions.

32. Determine the extent to which external factors influence the industry's health:

(a) Existing or pending litigation

(b) Governmental regulations, such as Trade Practices Act, Prices Justification Tribunal or surveillance bodies, tariffs.

(c) Environmental issues.

(d) Any potentially adverse political, social or economic conditions (e.g. trade restrictions, high interest rates, probability of nationalisation or expropriation, currency revaluations).

(e) Any external forces cutting off supply.

(f) The existence and power of any industry lobby groups.

IV. HUMAN RESOURCES

1. Obtain the number of employees by sex and age, grouped into operating activity and approximate total wage or salary cost of each category.

2. Examine all union affiliations and contracts for significant agreements, including industrial awards.

3. Identify what labour unions are represented in the industry and the general area and if there is any special organising effort going on in the area.

4. Determine average pay scale and fringe benefits for employees.

5. Review the industrial relations history for the past five years (e.g. dates, issues, duration, and settlement terms

6. Determine whether there are any formal cases pending and how similar cases have been resolved in the past.

7. Investigate the incentive system, average rates (incentive and hourly), the date they were established, and date of the last updating of standards.

8. Review:

    (a) Labour morale and the handling of labour relations.

    (b) Working conditions, statistics on staff turnover and reasons for it.

    (c) Employment, recruiting sad personnel policies and procedures.

    (d) Accident frequency and safety inspection reports.

    (e) Medical and sick leave frequency.

    (f) The wage and salary administration system

    (g) Training programs and apprenticeship systems (i.e. their effectiveness and costs).

    (h) The productivity of the labour force.

    (i) Any unfilled positions.

    (j) The cost and effectiveness of the personnel department.

9. Review the general labour market, including:

    (a) The types of skills available in the area

    (b) Current pay rates and personnel practices of the industry, and of other companies operating in the immediate area.

    (c) Area transportation community recreation facilities, housing, and schools.

    (d) The overall labour situation.

(e) The demands made by unions in the last bargaining process and the demands that are likely to be made in the next.

10. Obtain information on management personnel:

(a) The Organisation of management functions and responsibilities.

(b) Management and key employees, including position, career path, age, compensation, retention outlook, and management training received.

(c) The terms of any employee service agreements or whether unwritten understandings exist.

(d) Any replacement candidates for present management.

(e) Recent key personnel losses to competitors.

(f) The character and attitude of key personnel

(g) Whether there has been a recent major "turnover" in key staff or whether these personnel are "stable".

11. Determine whether management or the company's founders have identified a key executive e.g. the Chief Operating Officer who has the ability to effectively run the company if the founder retires, sells his/her interest.

12. In evaluating employee benefit programs, review:

(a) The details and costs of pensions, post-retirement benefits, profit sharing, life insurance, disability insurance, medical benefits, travel, accident bonus, deferred compensation and severance plans.

(b) Whether superannuation funds are presently over or under traded (as determined by the most recently conducted actuarial valuation) and whether the performance of fund managers is satisfactory.

(c) Benefits and salary levels compared with those of other companies. Determine whether the company would need to upgrade its benefit programs or salaries. If so, estimate the cost.

(d) Vacation and sick pay policies.

(e) The number and average cost of company-provided cars.

(f) Employee share ownership schemes including any share option, share bonus or partly paid share plans. Examine the efficacy of the scheme and estimate resulting costs.

13. Determine whether there are any outstanding claims such as sexual discrimination illness, negligence.

V. OPERATIONS

Plant and Facilities

1. Obtain information on:

   (a) Location and description of plant and property.

   (b) Proximity to transportation facilities, materials sources, and labour supply.

   (c) Description of the area, including climate sad natural hazards.

   (d) Restrictions imposed by building codes and zoning laws.

   (e) Utilities, including availability, usage, and rates.

   (f) Property taxes and other fixed costs.

   (g) Title to property.

   (h) The adequacy of insurance coverage.

   (i) Any liens or actual or potential condemnation proceedings.

2. Obtain land information including:

   (a) Size.

   (b) Cost.

   (c) Assessed value and fair market (appraised) value.

   (d) Current and possible future use and value.

3. Obtain building information, including:

   (a) Description pictures and current use.

   (b) Cost, accumulated depreciation and depreciation rates and policies (or .lease terms).

   (c) Assessed and fair market (appraised) value.

4. Obtain machinery and equipment information, including:

   (a) A list of principal machinery and equipment showing cost, age and condition, accumulated depreciation, location, and departmental use.

   (b) Depreciation rates and policies (or lease terms).

   (c) Additions during last five years, by category.

   (d) Fair market (appraised) value.

   (e) Technological obsolescence.

(f) Health and safety considerations. Find out if the plant complies with regulations.

(g) Details of the level of maintenance that has been performed. Identify any major repairs pairs or improvements that will be required

5. Obtain a list of any surplus and idle buildings, plant and equipment.

6. Analyse estimated future plant, machinery, and equipment requirements.

7. Evaluate maintenance and housekeeping controls.

8. Obtain details of capitalisation versus expense policies for repairs and maintenance.

9. Assess the adequacy of auxiliary equipment such as tools, patterns, and material handling equipment.

Production

10. Ascertain the nature of the manufacturing process (e.g. assembly, machine shop, extraction metal forming).

11. Identify the important elements in the manufacturing process (e.g. capital investment, know-how, design of plant, skilled labour, pool of available labour).

12. Evaluate:

(a) The Organisation and departmentalisation of manufacturing

(b) The basis for and adherence to the production schedule.

(c) The use of economic production order quantities, bills of material, time and motion studies, formal machine scheduling routines based on capacities speed and similar techniques.

(d) Production methods, efficiency and layout.

(e) Safety and security measures.

(f) Storage and inventory requirements and warehousing facilities.

(g) Major and critical raw materials their availability, and price prospects.

(h) Make or buy practices, purchasing and inventory controls, and subcontracting done by others.

(i) Critical lead times for materials or tooling and significant current problems.

(j) Materials handling methods employed such as pallets conveyors, vacuum pipe, magnetic lifts, forklifts trucks.

(k) Quality control

(l) Industrial engineering

13. Gain an understanding of the general elements of production costs (materials, direct labour, indirect labour, manufacturing expenses) and the proportion of each to the whole. Relate these to industry norms.

14. Determine the relationship between fixed and variable costs, the break-even point and the relation of volume to the break-even level. Consider the effects of non-cash costs and cost accounting for idle capacity and volume variances on analysis of production costs.

15. Obtain a recent schedule of manufacturing overhead. Review it for any significant trends.

16. Review the trend over the past three years in the following elements of manufacturing

    (a) Defective production.

    (b) Idle time such as stoppage, delays, improper materials.

    (c) Labour efficiency.

    (d) Waste and scrap.

    (e) Absenteeism, accidents, grievances, and overtime.

    (f) Co-ordination of production planning with sales forecasts noting partial or short runs, peaks, and lulls.

    (g) Goods manufactured for others whose needs may change.

    (h) Labour turnover.

    (i) Excess production times and the reasons for them.

    (j) Delays in delivery time.

    (k) Returned goods.

    (l) Downtimes and the reasons for them.

    (m) Preventive and emergency maintenance costs

    (n) Engineering change notices.

17. Review the trend in the number of days it takes a customer's order to be processed through the plant.

18. Consider the impact possible changes in production methods make to the manufacturing process, e.g. obsolete equipment.

19. Evaluate the efficiency of the company's production process in relation to the industry.

20. Determine the factors that might lead to an increase in production costs.

Purchasing

21. In the purchasing function, investigate:

(a) The relative proportion of purchases represented by raw materials versus goods bought for resale.

(b) The percentage relation of material costs to sales over the last five years.

22. Identify principal raw materials or products required, commenting on future price trends, market conditions, supply of raw materials, competitors' activity, and general economic conditions in suppliers' industries

23. Evaluate all principal suppliers, locations, and materials or products supplied.

24. Identify if there are multiple sources of supply for critical materials. Note any monopoly suppliers.

25. Determine the extent of reciprocal buying, if any.

26. Understand the company's policy on carrying inventories of regularly used materials or supplies. Determine the existence of inventory limits such as min-max levels and number of months' supply.

27. Consider the effect on the purchasing function of technological or product-line changes.

28. Determine the degree of centralisation/decentralisation and autonomy of the procurement function.

29. Gain an understanding of how the purchasing department is organised (e.g. by commodity, division, function).

30. Understand the relationship between production and procurement functions for short and long term planning.

31. Investigate the procurement procedures that are followed such as authorised requisitions, inquiry, priced purchase orders, receiving, and supplier payment.

32. Identify which of these preferred practices are used:

(a) A formal purchasing manual.

(b) Formal use of economic order quantities.

(c) Up-to-date vendor evaluation files (containing delivery and performance reliability records).

(d) A formal program of reviewing purchased materials (value analysis).

(e) A program to standardise materials and supplies throughout the company.

(f) Competitive bidding procedures.

(g) Use of vendors suggested by operating personnel after appropriate investigation.

(h) Lead times established by product and vendor. Determine the extent to which operating personnel consider these lead times in requisitioning materials and the percentage of urgent orders placed.

(i) Formalised make-or-buy analyses.

(j) Commodity specifications.

(k) Price standards and variance accounting.

(l) Use of inventory and usage records as purchasing grades.

33. Identify if there is any concentration of purchases of any items from individual vendors.

34. Review operating information and trends for the purchasing department, including:

(a) Trend of cash discounts earned.

(b) Operating costs compared to budget.

(c) Waste, scrap, and salvage disposals.

(d) Rejection of material on incoming inspection.

Inventories and Costing

35. Obtain information on:

(a) Trends in inventory levels by reporting category (e.g. raw materials, work in process, finished goods).

(b) Stratification by value of fast-moving, slow-moving, excess, and obsolete inventory.

(c) Seasonal inventory fluctuations.

(d) Inventory turnover (ratio of average inventory to cost of sales) by product line, in line of business, division or subsidiary.

(e) Basis of valuation (e.g. FIFO, average costs), any recent changes to that basis, and its effect on reported performance.

(f) Trends in customer service levels such as stockouts, substitutes, back orders.

(g) Sales and write-offs of obsolete stock over the past few years.

(h) Inventories of plant equipment parts.

(i) Returnable packages, sacks, containers, pallets.

(j) Arrangements for and experience with inventory held by others, whether under consignment or otherwise.

(k) Extent of any "field warehousing" financing activity.

36. For cost accounting procedures, determine:

(a) Whether the cost system is job cost or process cost.

(b) The costs that are included in overhead.

(c) Whether unfavourable volume variances from idle plant overstate inventory unit costs.

(d) How overhead is distributed.

(e) Whether standard costs are used, and how under- and over-absorbed costs are allocated to inventory and cost of sales.

(f) In ascertaining lower of cost or market, how market is determined (i.e. on a unit basis, by class or product, or on the inventory as a whole).

(g) The treatment of inter company profit in inventory and its effect on ratio analysis by line of business.

37. Obtain information on long-term contracts, including:

(a) Contracts entered into, noting products, types of customer, price terms, payment schedules, extent of subcontracting and dollar volume.

(b) The method of recording income and provision for losses.

(c) Cost-estimate procedures and an analysis of cost overruns and underruns.

(d) Bidding procedures and strategy.

(e) Any disputes or litigation with customers or subcontractors.

38. Review trends of important controllable elements, including:

(a) The frequency and adequacy of physical counts and extent of adjustments required.

(b) The accuracy and quality of perpetual inventory records.

(c) Management reports such as turnover, discontinued lines, asset percentage.

(d) Inventory security and insurance coverage.

Research and Development

39. Understand the quality of product, process and market research in the company. Compare it to that of the industry as a whole.

40. Identify the industry's basic source of effective research.

41. Review industry expenditures for research and how the company's research expenditure compares.

42. Identify the company's policy regarding R&D. Review the percentage of sales it has been spending on R&D, any significant new products under development and the known R&D activities of competitors.

43. Evaluate the company's technical activities and services by classification (e.g. contract services, customer services, company R&D, manufacturing engineering, tool design, product engineering).

44. Review the current and proposed staffing and personnel requirements for each activity.

45. Identify the methods of authorisation, funding and reporting for product engineering, and company R&D, related to overall research plans and market requirements.

46. Assess the calibre of the research staff. Find out if the staff has dealt with long-term research as well as day-to day product engineering.

47. Assess the effectiveness of the R&D program and identify whether the research program actually produced new products during the past five years.

48. Understand the relationship of customer services to market activity, product sales and profitability.

49. Assess the type, condition and adequacy of engineering space and laboratories.

50. Identify if proprietary rights on all products under development are adequately secured.

51. Identify any patents and trademarks held or that have been applied for.

52. Ensure the company is protected in foreign as well as local markets.

53. Identify any agreements under which the company is licensee or licensor. Ascertain the level of the estimated royalties.

54. Ensure no key patents are held by shareholders, management or other individuals. Ascertain whether the company's rights to these patents are satisfactory.

55. Identify if any infringement suits or claims are outstanding.

Environment

56. Where applicable, make enquiries of national, state and local environmental regulatory agencies coming compliance by the company and its facilities.

57. Determine whether it is necessary to consult with environmental legal counsel concerning the application of laws and regulations to the company.

58. Evaluate the impact on operational costs and efficiencies of.

    (a) Noncompliance with applicable regulations.

    (b) Ensuring compliance.

    (c) The use of by-products and recyclable materials in the production process.

    (d) Recycling by-products and other materials for sale to third parties.

VI. LEGAL

1. Consider the legal structure of the group and the relationship of the company being reviewed with subsidiaries and/or parent and holding companies.

2. Review the minutes of meetings of the Board of Directors and minutes of committee meetings to ascertain whether there are any current or contingent legal proceedings to which the company is a party or is likely to become a party. Obtain a representation from the company if these minutes are not available.

3. Consider the circumstances surrounding the prior issuance of all securities of the company and whether they are likely to impact the results of the due diligence investigation

4. Identify any charges pending against the company by any governmental agency or public authority and the nature of such charges, including outstanding taxation obligations. Determine whether such obligations are likely to give rise to any penalties for non-compliance

5. Ensure that this transaction will not raise any trade practices problems and is in compliance with the applicable Companies Code and Trade Practices regulations and requirements.

6. Ensure that where applicable the transaction is being carried out in accordance with prevailing Stock Exchange and ASC regulations.

7. Where the company has in-house legal advisers, assess whether it would be more effective to use external legal advisers.

8. Obtain a copy of the most recent legal representation letters sent to the company's auditors and identify any evidence of current or contingent legal proceedings involving the company.

9. Review compliance with special acts of Parliament (State or Federal) that are applicable to operations.

10. Ensure that the company is in compliance with environmental, opportunity employment and other regulatory requirements. If not, ascertain what efforts have or need to be made to ensure satisfactory compliance and the cost of such compliance.

11. Identify whether the company has or is likely to experience legal action in relation to industrial disputes or trade union intervention.

12. Obtain confirmation that share capital has been validly issued and that the corporation is in good standing in the state of its incorporation and all states in which it is doing business

13. Identify any legal problems competitors have experienced and determine whether they will eventually confront the company

14. Determine whether the company has adequate insurance coverage with regard to public and professional indemnities Ascertain whether such coverage has an effect on c performance and warranty clauses in current or pending contracts.

15. Identify any outstanding legal matters that may be relevant to the transaction Consider whether such matters are likely to significantly impact on the results of the due diligence investigation

16. Check the Memorandum and Articles of Association of the company.

17. Check whether there is a current Shareholders' Agreement.

18. Determine whether there are any service agreements with the directors of the company.

19. Check the legal/beneficial ownership of shares in the company.

20. Check statutory registers **-** i.e. charges, options, directors, and other officers of the company.

21. As part of the investigation into any litigation the company is involved in or may become involved in, check if any winding up proceedings have been instituted.

22. Identify any encumbrances over the property of the company (i.e. mortgages).

23. Identify the financing arrangements relating to the company (i.e. bank facilities).

24. Identify any intellectual property rights owned by the company, and any licenses it may, have given in respect of them.

25. Identify any share investments or other interests the company holds in companies that are not part of its group.

26. Determine whether the company is a guarantor under any agreement.

27. Compile a list of the loans made by the company as well as the loans in which the company is the borrower, and the security given as part of the loan agreement.

28. Determine whether the company is involved in any Joint Venture Agreements.

29. Obtain copies of any major or long term contracts and of any contract containing unusual or onerous obligations and any agreements outside the ordinary course of business.

30. Determine whether all these procedures and investigations need to be carried out for the subsidiaries of the company.

31. Investigate whether the company has any interest in land and whether it is freehold or leasehold.

VII. FINANCIAL CONSIDERATIONS

Financial Analysis Overview

1. Obtain for the past five years:

   (a) Audited financial statements.

   (b) Recent corporate returns.

   (c) Comparative financial results by major divisions.

   (d) The most recent unaudited financial statements.

   (e) Tax returns.

   (f) Projected operating and financial statements.

   (g) The chart of accounts and a description of accounting practices

   (h) Sales backlog information

2. Check industry sources for pertinent data on:

   (a) Market trends.

   (b) Economies of the industry.

   (c) Accounting and auditing implications.

   (d) Taxes.

   (e) Management technology.

   (f) Employment benefit plans.

3. Obtain the terms of the following agreements, where applicable, and of any other pertinent contracts or agreements (making or obtaining extracts, if possible):

   (a) Bonus or profit-sharing plans.

   (b) Royalty agreements.

   (c) Union contracts and employment contracts.

   (d) Long-term leases.

   (e) Sales contracts and dealership agreements.

   (f) Supplier contracts.

   (g) Major marketing agreements.

4. Calculate the following ratios on a company basis, and on a divisional basis appropriate:

   (a) Return on total assets

(b) Return on net assets (%).

(c) Return on ordinary shareholders' funds.

(d) Earnings per share.

(e) Gross profit margin

(f) Net earnings margin (96).

(g) Growth in sales %

(h) Growth in net profit

(i) Growth in earnings per share

(j) Interest cover (times).

(k) Inventory turnover (times).

(l) Trade receivables turnover (times).

(m) Fixed assets turnover (times).

(n) Effective tax rate (%).

(o) Gross cash flow to net profit (times).

(p) Current (or working capital) ratio.

(q) Quick assets (or liquid) ratio.

(r) Debt to equity ratio.

(s) Net tangible assets per sham

(t) Other.

Accounting Policies

5. Determine whether the company's accounting policies are in accordance with accounting standards, whether they are reasonable in the circumstances and have been consistency applied.

Operating Results

6. Obtain or prepare detailed comparative analyses of the profit and loss accounts for the last five completed financial years and the most recent interim period. Where available, budgets for die periods under review should also be included.

7. Obtain or prepare an analysis of gross profit by product, reconciled to the gross fit reported in the financial statements.

8. Examine operating results, analysing for unique or non recurring items:

(a) Trends in sales, gross profit, net income, earnings per share, dividends, and return on equity. Determine compound growth rates.

(b) The effects of acquisitions, dispositions, and changes in accounting presentation (either discretionary or from changes in generally accepted accounting principles).

(c) The cost of goods sold, selling expenses, and general and administrative expenses. Review these expenses for significant trends, especially controllable costs such as advertising, travel and entertainment, and repairs

(d) All extraordinary and abnormal items for the periods reviewed.

(e) Significant items in the other income and expenses categories.

(f) Annual interest expense and other fixed charges.

(g) Compensation paid to officers and key personnel.

(h) Legal retainers, consultants' fees and similar arrangements.

(i) The impact of income taxes and changes in effective tax rates.

(j) Variations from budgets

Financial Position

▪ **Cash**

9. Review cash position, present and projected, including:

(a) Listing banks where the company maintains accounts and related balances at balance sheet date.

(b) Analysing total cash by function of account.

(c) Reviewing monthly cash balances and inquiring about unusual fluctuations and significant outstanding cheques or deposits in the bank reconciliations.

(d) Determining whether idle cash balances are promptly invested.

(e) Determining whether seasonable bank borrowings are required.

(f) Evaluating the company's cash management techniques and controls including approved lists, credit limits.

▪ **Accounts Receivable**

10. Obtain an analysis of the total receivable balance for amounts due from customers, officers, employees and others.

11. Obtain "aged" trial balances of all the amounts analysed above. Compare them to aging percentages for previous years and note any deterioration in the overall age of receivables. Obtain explanations for major variations between years.

12. Enquire about customer receivables including:

(a) Terms of sales.

(b) The number of customers.

(c) The names of large customers and volume of annual sales to each by product line. Find out if there are any unusual arrangements with any of these customers.

(d) Turnover.

(e) Credit policies.

(f) The amount of unfilled orders.

(g) The effectiveness of the credit department.

(h) The real significance of credit limits.

13. Schedule the ratio of returns and allowances to sales by month for the year and enquire about fluctuations. Indicate any evidence of dissatisfaction with the company's products.

14. Determine whether any receivables are discounted to finance operations or factored. The amount if any, should be noted.

15. Ascertain the purpose and repayment terms of loans (other than minor amounts) to officers, employees and others. Determine whether these loans are appropriately classified (e.g. intercompany and/or whether there are any collection problems.

16. Understand how the company determines the level of doubtful debt provisions and assess the adequacy of this provision.

17. Determine how the company establishes credit terms.

18. Evaluate the collection efforts and effectiveness of debt recovery procedures.

19. Review the basis, appropriateness and adequacy of calculating other provisions (e.g. discounts, returns).

▪ **Inventory**

20. Obtain or prepare an analysis of inventories recorded on the balance sheet showing the various classes of inventory and inventory provisions. The analysis should show the figure at the end of the previous financial years and the most recent interim period

21. Obtain explanations for major variations between the balances at the above dates.

22. Ascertain whether perpetual records are maintained for the various classes of inventory.

23. Ascertain whether appropriate controls and procedures are in place over the physical movement of inventories and the updating of accounting records for the following;

(a) Purchases.

(b) Transfers from raw materials to work in progress.

(c) Transfer from work in progress to finished goods.

(d) Transfer between various locations.

(e) Sales and profit recognition.

(f) Recording at the lower of cost or net realisable value.

24. Determine the regularity of physical inventories and the historical results for book to physical differences.

25. In the counting and summarisation of physical inventories, determine whether all items are counted, regardless of whether or not they are deemed to have value. If not, identify the reason for such omission.

26. Ascertain whether the reasons for significant book to physical differences are adequately assessed

27. Ascertain whether adjustments are made in the accounting records for book to physical differences.

28. Obtain or prepare a full description of the valuation policies and methods for each class of inventories, including the following:

(a) Basis of valuation (e.g. lower of cost and net realisable value).

(b) Items reflected in cost of inventories (e.g. inward freight, volume rebates, import costs such as duties and commissions, fixed and variable overheads).

(c) Methods used to assign cost (e.g. standard cost, average cost, FIFO) and the methodology followed to determine such cost (e.g. if average cost is used describe how the average is determined).

(d) Whether a job cost or process cost system is used.

(e) The costs included in overhead.

(f) The distribution of overhead.

(g) If standard costs are used:

- how the standards are determined;
- how frequently the standards are revised;
- the extent to which variances are separately identified and quantified; and
- the treatment of variances for both interim and annual accounting purposes (i.e. the basis of apportionment between inventory and cost of sales). Note that variances which represent inefficiencies or abnormalities should not normally be allocated to inventory.

29. As a result of the historical experience in book to physical adjustments, determine whether an allowance for inventory shortages is established If so, identify the basis of such allowance If not, consider whether this is appropriately based on historical experience.

30. Ascertain whether the company performs, both on a product-by-product basis for finished goods and work-in-progress and on a part-by-part basis for raw materials, an in-depth review for excessive and obsolete inventories and inventory items carried in excess of net realisable value. If not, determine how the company assesses its requirements for inventory write-downs or provisions. Check how this is accounted for in interim reporting periods and whether this treatment is consistent.

31. Establish whether company produces the inventory under contractual commitment and whether its pacing policies enable an adequate recovery of costs.

32. In conducting this review, evaluate the company's use of such information as current year sales (units and dollars), sales forecasts, inventory quantities on hand, inventory turnover statistics inventory ageing, number of months supply on hand, unit cost, expected selling price, planned promotions, discontinued items, items being considered for discontinuation.

33. Determine whether the company engages in the practice of "billing the customer" and "holding" the merchandise until a later date. If so, and title has not passed, assess the impact of this practice.

34. Review purchasing cut off procedures and ensure that they are adequate.

▪ **Investments**

35. Obtain or prepare an analysis of investments recorded on the balance sheet showing the cost, carrying value and market value of each item. The analysis should show the figures at the end of the previous financial years and the most recent interim period.

36. Obtain explanations for major variations between the balances at the above dates.

37. Review the classification of investment for appropriateness.

38. Ascertain whether the Company has an acceptable policy for assessing the market value of listed and unlisted investments to determine whether any provisions are required Check for any evidence to suggest that this policy has not been appropriately applied.

39. Ascertain the liquidity of these investments and whether the company will be required to contribute further working capital.

40. Determine whether there has been any material change in the market value of investments since the end of the most recent interim period.

▪ **Property, Plant and Equipment**

41. Obtain or prepare an analysis of property, plant and equipment recorded on the balance sheet showing separately amounts at cost and valuation, with accumulated depreciation shown as deductions therefrom The analysis should show the figures at the end of the two previous financial years and the most recent interim period.

42. Obtain explanations for major variations between the balances at the above dates.

43. Ascertain whether the company has formal policies and procedures in relation to the following matters:

(a) Capitalisation e.g. capitalisation of capital expenditures above a certain amount' but expensing of lower expenditure).

(b) Depreciation methods (e.g. straight line, diminishing balance).

(c) Commencement of depreciation (e.g. from the month asset was placed into service).

(d) Assessment of economic lives and residual values of assets.

44. Ascertain whether asset lives and residual values are periodically reviewed to determine whether changes to depreciation rates are warranted. Check for any evidence that these rates are not reasonable

45. Where the company maintains a detailed fixed assets register, investigate the following:

(a) Whether the register is regularly reconciled with the fixed assets accounts in the general ledger.

(b) The frequency with which the reconciliation is canted out, and the date of the latest reconciliation.

(c) The results of the latest reconciliation.

(d) The resolution of any differences.

46. Where the company carries out physical inventories of fixed assets, investigate the following:

(a) The frequency with which they are conducted, and the date of the latest physical inventory.

(b) The results of the latest physical inventory.

(c) Whether differences between the inventory and book records were adjusted in the general ledger.

47. Determine whether controls are in existence for the authorisation of fixed asset additions and disposals and for expenditure on repairs and maintenance.

48. Check if the company has a written policy for differentiating between capital expenditure and repairs and maintenance. If so, determine whether the policy is consistently applied and formally reviewed. If not, find out the estimated impact on the accounts of any misallocations.

49. Determine whether controls are in existence for the accumulation and timely disposition of costs incurred on major capital expenditure or repair and maintenance projects, including any internally generated costs.

50. Ascertain whether the company capitalises interest costs on construction projects If so, decide whether the basis of capitalisation is appropriate in the circumstances.

51. Check that a listing of open capital work in progress is prepared and reviewed on a timely basis to assess the viability of the outstanding projects. Identify any projects still included in capital work in progress that have either been finalised or discontinued. Assess the financial impact of any such projects on the accounts.

52. Determine whether there are any surplus and/or idle fixed assets, including land and buildings.

53. Ascertain whether there have been any recent market valuations of land and buildings and other fixed assets. If so, obtain details and determine whether such valuations are reflected in the accounts. If not, consider whether it would be appropriate to seek instructions from the client to arrange for valuations to be carried out.

▪ **Intangibles**

54. Obtain or prepare an analysis of intangible assets on the balance sheet showing the cost, accumulated amortisation and net book value of each class of intangibles. The analysis should show the figures at the end of the two previous financial years and the most recent interim period.

55. Obtain explanations for major variations between the balances at the above dates.

56. Determine how any goodwill and other intangibles arose and consider the acceptability of the basis upon which they am included in the balance sheet.

57. Assess whether the company's amortisation rates appear reasonable in the circumstances.

▪ **Other Assets**

58. Obtain or prepare an analysis of other assets on the balance sheet showing the gross book value, accumulated amortisation and net book value of each class of other assets. The analysis should show the figures at the end of the two previous financial years and the most recent interim period.

59. Obtain explanations for major variations between the balances at the above dates.

60. Investigate the nature of any material assets.

61. Assess whether the company's amortisation rates appear reasonable in the circumstances.

▪ **Creditors, Accruals and Provisions**

62. For accounts payable and accrued expenses:

    (a) Obtain an analysis of the type (e.g. trade creditors, payroll, payables on reimbursable contracts) and described payment practices for each.

    (b) Compare the balances in the various accounts with those at the end of the previous month, quarter and year.

    (c) Determine whether the company takes appropriate advantage of discounts for prompt payment.

    (d) Obtain a list of the company's principal suppliers, together with the approximate annual amounts purchased. Note all delinquencies in settlement of venders' and suppliers' accounts.

63. Obtain an understanding of the company's procedures and controls for ensuring that all material liabilities and provisions are properly taken up. The basis of each provision made should be recorded in the working papers.

64. Check for any evidence to suggest that any necessary accrual or provision has either not been taken up or has been based on a significant element of management judgement. Examples of matters that should be considered are:

(a) Liabilities for holiday pay, sick pay and long service leave.

(b) Liabilities under product guarantees or service warranties.

(c) Liabilities under superannuation funds, including future commitments in respect of past service benefits.

(d) Liabilities for pensions or compensation for loss of employment which are neither provided in the accounts nor funded (inquire as to the currency of the latest actuarial assessment

(e) Liabilities for reorganisation or closure costs

(f) Liabilities for redundancy payments or compensation to employees affected by the transfer of an undertaking.

(g) Liabilities under bonus or profit-sharing arrangements.

(h) Liabilities for remedial and maintenance costs, penalties, damages or other cost increases in relation to completed contacts.

(i) Liabilities for workers' compensation not covered by insurance.

(j) Liabilities for returnable packages.

(k) Losses on purchase contacts or outstanding sales orders.

(l) Losses on legal claims or as yet unasserted claims.

Note: The above list is not exhaustive and other forms of liability relevant to the business should be reviewed as necessary.

▪ **Debt Finance**

65. For borrowings (short- and long-term):

(a) List the amounts of all financial liabilities and determine the general terms of notes, bonds and mortgages payable (e.g. lender, payment schedules, interest rates, seniority, personal guarantees and other pertinent information).

(b) Note the nature and exact amount of assets pledged as collateral.

(c) Note aggregate payments due.

(d) Determine whether any amounts are due to officers or shareholders and discover the nature of the advances and repayment teens.

(e) Determine the terms of the facilities and ascertain that all covenants have been complied with.

(f) Determine whether there are any restrictions in the facilities that would interfere with the acquisition.

(g) Obtain credit reports.

(h) Obtain any reviews/ratings for debt that is publicly held.

(i) Obtain the terms of leases. Determine the nature of the property subject to the leases and what renewal or purchase rights exist.

(j) Enquire into any quasi-financing agreements (e.g. put/call option contracts) and guarantees of debt of other entities.

(k) Obtain information on any established lines of credit, terms and unused amounts available and ensure that they reconcile with the forecast cash requirements.

(l) Enquire as to the existence of any off balance sheet items.

▪ **Contingencies and commitments**

66. Obtain or prepare an analysis of all significant contingencies and commitments at the end of the previous financial year and the most recent interim period.

67. Obtain an understanding of the company's procedures and controls for ensuring that all contingencies and commitments are notified to an appropriate of official and included in the analysis referred to above.

68. Check for any evidence to suggest that any significant contingency or commitment is not included in the analysis referred to above. Examples of matters that should be considered are:

(i) Contingent Liabilities

(a) endorsements, warranties sureties or guarantees;

(b) claims under costed contracts;

(c) claims for faulty goods;

(d) claims, including liquidated damages for bleach of contract;

(e) claims, under pollution control regulations;

(f) other claims for damages;

(g) claims under guarantees given by the company on behalf of subsidiary or associated companies pint ventures, directors or employees;

(h) Liabilities in respect of goods on hire purchase or hire purchase debts sold to a finance company with recourse;

(i) liabilities in respect of notes, drafts and bills receivable which have been discounted or sold with recourse;

(j) pending law suits, proceedings, hearings or negotiations possibly involving retroactive adjustments;

(k) inadequate insurance cover for events that occurred up to the accounting date;

(l) uncalled liabilities on investments;

(m) adjustment of consideration for any business acquired or sold;

(n) tax on undistributed profits of overseas companies;

(o) joint and several liability under group banking arrangements; and

(p) options and working capital commitments.

Note: The above list is not exhaustive and users of this checklist should be alert to the existence of other contingent Liabilities.

(ii) Commitments

(a) capital commitments for the acquisition of fixed assets by purchase or by finance lease including fixed assets or investments either:

- contracted for, but not provided for, or
- authorised by the Board of Directors but not contracted for, or

(b) pension commitments, whether legal or moral, whether provided for at the accounting date or not. Such commitments may include:

- future commitments in respect of past service or guarantees given;
- obligations to executives under specific arrangements not covered by a scheme;
- contractual obligations to staff generally or to certain groups of staff,
- obligations in relation to early retirement pensions;
- obligations to pay indemnities or compensation to staff on completing service contracts; and
- commitments to pay pensions to past directors.

Note: The above list is not exhaustive. Other forms of pension commitment may exist.

(c) other financial commitments such as:

- significant commitments in the ordinary course of trading for a longer term or for a greater amount than normally experienced, such as:

  (i) purchase commitments extending more than one year from the accounting date;

  (ii) 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 items previously sold;

- forward purchase or sale contracts, in relation to:

  (i) foreign currencies;

  (ii) commodities;

- commitments not in the ordinary course of trading, such as:

  (i) leasing commitments, either in respect of finance leases or operating leases;

  (ii) to borrow or lend money;

  (iii) to acquire companies or net assets or to form a joint venture; and

  (iv) to purchase or sell investments.

Note: The above list is not exhaustive and users of this checklist should be alert to the existence of other commitments.

- **Equity**

69. Obtain details of any preference shares outstanding and determine whether the terms of the shares specify special treatment

70. For ordinary shareholders' equity:

    (a) Obtain a shareholder's list.

    (b) Determine the rights for each class.

(c) Determine whether the company has any obligations to issue or repurchase shares.

(d) Enquire about the company's past dividend policy.

(e) Enquire about any unusual capital accounts (e.g. donated capital, appraisal surplus).

71. Determine the percentages of the company's capitalisation represented by the various types of long- and short-term obligations.

72. Determine interest and fixed charge coverages for the last five years.

73. Obtain the source and use of funds or cash flow statements for the last five years and analyse the company's sources of funds or cash flows.

74. Determine the extent to which the company's growth has been (or could have been, ignoring non-recurring transactions financed by internally generated cash. Analyse toe implications.

75. Enquire about the company's policy on financing its operations.

76. Enquire about capital budgeting procedures.

77. Evaluate the company's relationship with banks, lenders, and the financial community in general.

78. Review the capital budget and planned sources of funds.

79. 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.

80. Determine whether the company has a dividend reinvestment plan in place.

81. Where the company has issued hybrid securities or "quasi-equity", evaluate the rights/obligations attached to these securities and their impact on the company's future operations

Forecasts

82. Obtain available projections of earnings and cash flow. If possible, obtain the worst, best, and most probable results.

83. Subject the projections to the same ratio analysis applied to historical results and determine whether relationships ladyships are consistent.

84. Determine and evaluate the reasonableness of the assumptions used. Identify any contingency or margin allowances that have been made.

85. Ensure projections are consistent with industry and overall business expectations.

86. If no projections are available, develop forecasts based on continuing historical growth trends, industry conditions and known factors.

87. Adjust the projections for any items resulting from the transaction

88. Review cash flow projections (or develop them if unavailable) 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).

Financial Management

89. Form an opinion about the overall credibility and reliability of the accounting system and reporting capabilities of the company. Consider the effects of private versus public ownership, tax-oriented accounting and the attitudes of senior management.

90. Determine the extent to which the company's earnings have been effectively managed.

91. Determine whether any practices have been adopted to make the company appear more attractive, including:

    (a) Adoption of less conservative accounting policies.

    (b) Cutbacks in discretionary expenses, such as advertising, personnel development and maintenance.

    (c) Non-conservative accounting judgments, such as inappropriate provisions for sales returns, obsolete inventories or contingent liabilities.

    (d) Company expenses being paid by shareholders, directly or indirectly (e.g. lease arrangements).

    (e) Whether shareholder-managers are drawing inadequate compensation.

    (f) Profit recognition.

    (g) Revaluations/over valuation of assets.

92. Determine the extent (if any) of "private company adjustments", including:

    (a) Inappropriate stock valuations.

    (b) Private expenditures.

    (c) Unrecorded income.

    (d) Excessive salaries, superannuation and other benefits for the proprietor and family.

    (e) Interest on shareholders' loans.

    (f) Personal security or guarantees given to secure the company's debts and obligations.

93. Independent Review.

    (a) Does the company have an audit committee or equivalent that takes an active interest in the company's internal control system?

    (b) Is the audit committee independent of management?

(c) Does the committee adequately review the scope of audit of financial statements?

(d) Does the committee effectively respond to findings of internal and external audit?

(e) Is there evidence of frequent changes of, or an undue number of, independent legal or other professional advisers?

(f) Are the directors, as far as possible, independent of management and controlling shareholders?

(g) Are Board meetings held on a regular basis and supplied with adequate information upon which to make decisions?

(h) Is the Board actively involved in major decisions affecting the Organisation?

94. If the company is audited by an independent accounting firm, investigate the firm's reputation.

95. If possible the working papers of the company's auditors to note:

(a) The adequacy of auditing work.

(b) The adjustments proposed by the auditors.

(c) Problem areas.

(d) Any differences of opinion between the company and its auditors.

(e) Matters raised in audit management letters (on internal controls and accounting).

96. Review the adequacy and sophistication 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.

97. Assess the adequacy of internal accounting controls and the company's attitude toward strong controls.

98. Assess the strength of the financial management and controllership function.

99. Determine:

(a) The frequency with which internal reports are issued (monthly, quarterly, or not at all).

(b) The time lapse between the end of the period and when the reports are available, and whether the reports are used.

(c) Whether the internal reporting timetable and content are consistent with any monthly closing requirements.

(d) The changes that may be needed and the cost and training implications of these changes.

100. Review how centralised accounting function is and whether subsidiaries have autonomous accounting departments that may not be functioning uniformly and, if so, how overall control is exercised.

101. Determine the accuracy of interim reports.

102. Investigate:

    (a) Whether interim reports are prepared on a consolidated basis or only by autonomous entities.

    (b) The manner in which foreign subsidiaries or branches report.

103. Consider the way management information reporting is integrated with financial accounting. Ascertain whether management reports compare results to budget and prior and determine the reasons for variances.

104. Determine whether controllable and uncontrollable costs are separated in departmental reports.

105. Ensure management reporting provides the right information, in sufficient detail and timing to take corrective action as needed.

106. Determine whether exception reporting is used.

Electronic Data Processing

107. List all significant accounting and operational functions currently on computer. Determine if the company plans to computerise others.

108. Assess the sophistication of the EDP installation and the extent to which various needs are integrated, and whether the EDP function is centralised or utilises service bureaux.

109. Ascertain whether the needs of user departments are satisfied by this function.

110. Obtain a list of hardware used by the company and lease terms. Determine whether the equipment is up-to date.

111. Identify the company's short- and long-term hardware plans.

112. Determine whether the EDP function could be rationalised

113. Determine whether there is any intangible software value.

Risk Management

114. Review the insurance currently in effect and the extent to which the company is assuming large deductibles or self-insured retentions.

115. Determine whether the company has been unable to insure unusual risks or products or events (e.g. hazardous waste disposal, pharmaceutical products, satellite launching) and whether the company will be able to obtain necessary insurance in the future

116. Ascertain whether insurance coverage is determined on a "claims made" basis.

117. Identify any liabilities that have been assumed or transferred through contractual arrangements

118. Identify the financial techniques being utilised. Investigate the use of techniques such as premium financing, deferrals, use of captives.

119. Review any loss experience for insured and uninsured claims and the reporting and reserving practices

120. Determine whether any insurance policy aggregates have been penetrated or exhausted.

121. Identify any unusual circumstances which may give rise to claims in the future which are as yet unreported.

122. 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.

123. Identify any potential for cancellation of coverage such as Director's and Officer's liability insurance or potential bonding problems due to a highly leveraged condition.

124. Determine whether the company entered into any special service agreements that have to be maintained or renegotiated.

125. Identify any outstanding premium adjustments and determine whether there will be credits or charges for them.

126. Review the methods by which accruals and tax deductions for premiums are handled.

127. Consider whether the company has an internal risk management/insurance department. Assess the management of the function.

Taxation

128. Review the principal taxes to which the company is subject and the amounts paid for the past five years.

129. Obtain detailed reconciliations of the company's effective tax rate for the past five years.

130. Consider recent changes in the tax law that would affect the company.

131. Ensure deferred taxes are provided on a comprehensive basis.

132. Review:

    (a) Previous years' assessments that are still open.

    (b) Adjustments the company was required to make as a result of the most recent examination.

    (c) The balance sheet accrual for open years to ascertain whether it has been adjusted to give effect to the adjustments for years already examined.

(d) Any examinations currency in progress. Ascertain whether have been any preliminary findings or matters under appeal.

(e) A schedule reconciling book income to taxable income for the last five years. Determine that treatment has been proper.

(f) Amounts and expirations of any carryovers of 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.

(g) The tax basis of the company's assets.

133. For other taxes, determine:

(a) The state in which the company is domiciled and in what states the company has locations from which it conducts business. Ascertain whether it is required to file payroll or other business tax returns in those states and, if so, whether they have been filed and taxes have been paid.

(b) Whether local taxes have been accrued and paid currently. Identify any of these taxes that are in dispute.

(c) Whether there are or have been any tax audits.

(d) Whether the company is collecting and remitting all required sales excise taxes.

(e) Whether all payroll taxes have been withheld from employees and forwarded promptly.

(f) Whether there are any problems with other taxes to which the company is subject.

134. Determine whether the company has any significant foreign taxes or any significant local tax problems relating to its foreign operations, such as:

(a) Foreign tax credits.

(b) Intercompany pricing and reallocation of income or expenses between related entities.

(c) Any transfers of assets/liabilities to a foreign corporation.

135. Assess all other areas of potential tax exposure or savings including details of the Franking Account.

136. Determine whether the company obtained any private rulings.

137. Assess the internal tax function:

(a) If the company has a tax department, ascertain how many people are employed and what functions are performed.

(b) Ascertain to what extent the company relies on outside advisers for tax planning and return preparation.

(c) Ascertain whether the tax function has technical expertise or merely serves compliance functions.

(d) Determine how oriented the company is to tax savings.

(e) Ascertain whether the company maintains good tax records of items such as the tax basis of depreciable assets, basis of subsidiaries, accumulated earnings and profits, and deferred taxes.