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# Growth by Merger or Acquisition: Liability Considerations in Due Diligence

BUSINESS ADVISORS, DUE DILIGENCE , TRANSACTION ADVISORY SERVICES
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Firms that choose to grow through a merger or acquisition can gain access to new markets, fresh ideas, new products or processes, and talented employees. However, the evaluation of any potential target company is a critical step that requires financial, operational, and legal expertise.

From a financial perspective, at a minimum, due diligence should include a retrospective look at past performance, an in-depth evaluation of the latest fiscal period closed, and a prospective consideration of future profitability. While it may be tempting to focus analysis solely on bottom line revenue and cash flow, a comprehensive due diligence program is necessary to understand the underlying data used in profitability analyses and provide reasonable assurance that the assets and liabilities are accurately stated on the balance sheet.

There are several important issues to consider just related to the liabilities of the target company:

- Does the target company pay its bills on-time?
- Are there contractual arrangements that would result in large liabilities in the event of an acquisition (e.g., employment agreements, severance agreements, leases, guaranteed purchase agreements, or contingent compensation)?
- Are there significant commitments or contingent liabilities that are not reflected on the balance sheet (e.g., self-insurance, post-retirement benefits, pending or threatened litigation, investigations by regulatory authorities, or settlement agreements)?
- Is the target exposed to unique risks or liabilities that the acquirer is not exposed to, such as product liability, warranties, seasonality, or geographic risks?

Through a combination of analysis, inquiry, and testing, a professional can gain insight into the quality of financial information provided by a target company. One test that provides good insight into the books and records of the target is the test for unrecorded liabilities.

To perform the test for unrecorded liabilities:

- Review disbursement activity detail for a period after the last month closed.
- Select a sample of transactions, and request supporting documentation for the sample selection (including invoices and shipping documents).
- Determine when the liability was incurred (i.e., when title passed or services were rendered).

- Check for proper inclusion or exclusion in accounts payable or accruals as of the last month closed.

This test not only tests whether or not the liabilities as of the last month closed are accurately stated, but also gives insight into the accounting policies and procedures of the target. If the target improperly includes or excludes expenditures in accounts payable, that may point to larger accounting issues and could require further analysis.

The search for unrecorded liabilities is just one procedure in a comprehensive due diligence program that must be tailored to each individual target company. Schneider Downs has extensive experience in providing due diligence services. To learn more about how Schneider Downs can help you, please contactJoel Rosenthal at 412-697-5387.



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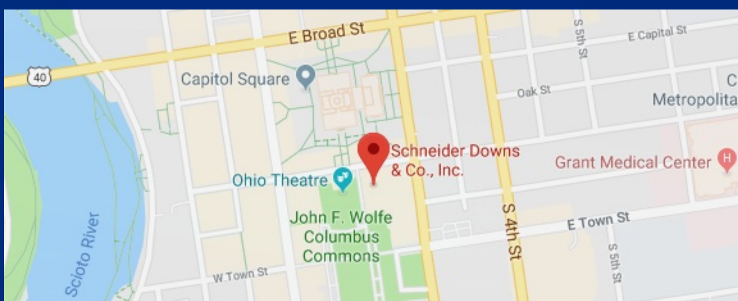


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