

How to Buy a Business Checklist

BUSINESS START-UP

For more information, contact:

The Business Link Business Service Centre
100 – 10237 104 Street NW, Edmonton, Alberta

Tel: (780) 422-7722 or 1-800-272-9675

Fax: (780) 422-0055

E-mail: buslink@cbsc.ic.gc.ca

www.cbsc.org/alberta

A Member of the Canada Business Network

Contents

BUSINESS START-UP	1
Overview	3
Business Evaluation.....	3
Balance Sheet.....	3
Accounts Receivable	3
Inventory	3
Marketable Securities	4
Real Estate	4
Machinery and Equipment	4
Accounts Payable	5
Accrued Liabilities	5
Notes Payable and Mortgages Payable	5
Income Statement.....	6
Financial Ratios	6
Leases	6
Personnel	7
Patents	7
Taxes	7
Legal Issues	7
Insurance	8
Marketing	8

Overview

The purchase of an existing business most often involves the purchase of the operating assets only. Occasionally, a prospective purchaser may consider buying the shares if the business is already incorporated. Also, some buyers will not purchase receivables and other's may want to view those as a means of keeping the client attached to the business under their "new" ownership.

Regardless of which applies, you, as the purchasing party, can negotiate a deal that can include or exclude virtually any asset.

Business Evaluation

The first step a buyer must take in evaluating a business for sale is that of reviewing its history and the way it operates. There are many methods that one may use to determine the value of the business. Asset value methods, earning value methods and combined methods are the most commonly used. Buyers should utilize a number of these to arrive at a range of prices which can be used during the purchasing negotiation.

The business' financial statements, operating documents, and practices should be reviewed. A summary of the most common items to be reviewed is as follows:

Balance Sheet

Accounts Receivable

- Obtain an accounts receivable aging schedule and determine if there is concentration among a few accounts.
- Determine the reasons for all overdue accounts.
- Find out if any amounts are in dispute.
- Are any of the accounts pledged as collateral?
- Is the reserve for bad debt sufficient and how was it established?
- Review the business' credit policy.

Inventory

- Make sure the inventory is determined by physical count. Manufacturers should divide inventory into: finished goods, work in progress, and raw materials.
- Assess the method of valuation and why it was used. (LIFO, FIFO, etc.)
- Determine the age and condition of the inventory.

- How is damaged or obsolete inventory valued?
- Is the amount of inventory sufficient or too large to operate efficiently and for how long?
- Should an appraisal be obtained?

Marketable Securities

- Obtain a list of marketable securities.
- How are the securities valued?
- Determine the fair market value of the securities.
- Are any securities restricted or pledged?
- Should the portfolio be sold or exchanged?

Real Estate

- Obtain a schedule of real estate owned.
- Determine the condition and age of the real estate.
- Establish the fair market value of each of the buildings and land.
- Should appraisals be obtained?
- Are repairs or improvements required?
- Are maintenance costs reasonable?
- Do any of the principals have a financial interest in the company(s) that perform(s) the maintenance?
- Is the real estate, required to operate the business efficiently? Can a lease agreement be arranged to lessen cash required instead of purchasing?
- How is the real estate financed?
- Are the mortgages assumable?
- Will additional real estate be required in the near future?

Machinery and Equipment

- Obtain a schedule of machinery and equipment owned and leased.
- Determine the condition and age of the machinery and equipment and the frequency of maintenance.

- Identify the equipment and machinery that is state-of-the-art.
- Identify the machinery and equipment that is obsolete.
- Identify that the machinery and equipment is used in compliance with Canadian standards and determine if additional equipment and machinery is needed to comply.
- Will immediate repairs be required and at what cost?

Accounts Payable

- Obtain a schedule of accounts payable and determine if there is concentration among a few accounts.
- Determine the age of amounts due.
- Identify all amounts in dispute and determine the reason.
- Review transactions to determine undisclosed and contingent liabilities.

Accrued Liabilities

- Obtain a schedule of accrued liabilities.
- Determine the accounting treatment of:
 1. unpaid wages at the end of period
 2. accrued vacation pay
 3. accrued sick leave
 4. payroll taxes due and payable
 5. accrued Federal and Provincial income taxes
 6. other accruals like GST
- Search for unrecorded accrued liabilities. Example - severance pay.

Notes Payable and Mortgages Payable

- Obtain a schedule of notes payable and mortgages payable.
- Identify the reason for indebtedness.
- Determine the terms and payment schedule.
- Will the acquisition accelerate the note or mortgage or is there a prepayment penalty?

- Determine if there are any balloon payments to be made and the amounts and dates due.
- Are the notes or mortgages assumable?
- Have personal guarantees been provided?

Income Statement

The potential earning power of the business should be analyzed by reviewing profit and loss statements for the past 3 to 5 years. It is important to substantiate financial information by reviewing the business' federal tax returns. The business' earning power is a function of more than bottom line profits or losses. The owner's salary and fringe benefits, non-cash expenses, and non-recurring expenses should also be calculated.

Financial Ratios

While analyzing the balance sheet and the income statement, sales and operating ratios should be calculated in order to point out areas requiring further study. Key ratios are the current ratio, quick ratio, accounts receivable turnover, inventory turnover and sales/accounts receivable. The significance of these ratios, the methods for calculating them, and industry averages are available through publications such as Dun & Bradstreet and Robert Morris Associates. Look for trends in the ratios over the past 3 to 5 years.

Leases

- What is the remaining term of the lease?
- Are there any option periods, and if so, is the option exercised only by the choice of the tenant?
- Is there a percent of sales clause?
- What additional fees (such as a common area maintenance or merchants association dues) are paid over and above the base rent?
- Is the tenant or landlord responsible for maintaining the roof and the heating and air conditioning system?
- Is there a periodic rent increase called for to adjust the rent for changes in the consumer price index or for an increase in real estate tax assessments?
- Is there a demolition clause?
- Under what terms and conditions will the landlord permit an assumption or extension of the existing lease?
- Is a personal guarantee required?

Personnel

- What are the job responsibilities, rates of pay and benefits of each employee?
- What is each employee's tenure?
- What is the level of each employee's skill in their position and are they employed under an employment contract?
- Will key employees stay after the business is purchased?
- Are any employees part of a union, or is any union organizing effort likely?
- Have there been layoffs in the past year which could trigger lawsuits?

Patents

A list of trade names, trademarks, logos, copyrights and patents should be obtained, noting the period of time remaining before each expires.

Taxes

- Are CPP, EI, GST, and Income Tax payments current?
- What was the date and the outcome of the last audit?

Legal Issues

- Are there any suits now or soon to commence?
- What Occupational Health and Safety, W.C.B., environmental and other regulatory requirements must be met and are they currently being met?
- Are all registration requirements and regulations being met?
- Are all local zoning requirements being met?
- Review the articles of incorporation, minute books, by-laws, and/or partnership agreements.
- What are the classes of stock and the restrictions of each, if any?
- Has any stock been cancelled or repurchased?
- Is the business a franchise? If so, review the franchise agreement.

Insurance

- What coverage has been provided for business assets, general and professional liability, business loan, business interruption, and “Key Person” insurance?
- Was there a past or is there a current claim?

Marketing

- Are any of the products proprietary?
- Describe any new upcoming products and projected sales.
- What is the business’ geographic market area?
- What is the business’ percentage of market share?
- What are the business’ competitive advantages/disadvantages?
- What are the current market trends?
- Is the business name included? Is it registered?
- Is there a customer list or database and is it included?

Competitors

- Who are the business’ competitors?
- What is their market share?
- What are each competitor’s competitive advantages/disadvantages?

Business Web Site

- Is the transfer of the domain ownership part of the agreement?
- If so, the administrator must be changed with domain registration company.
- Who currently hosts and maintains the company website?
- Will you have the technical support to do so after the sale?
- All service agreements regarding the website must be changed to reflect the new ownership.

Additional Resources

- *The Complete Idiot’s Guide to Buying and Selling a Business for Canadians / Larry Easto and Ed Paulson 1999*
HD 1393.4 C3 E27 2000 c.3 (*The Business Link* Library)

- *Business Buyer's Kit / Michael Smorenburg 1998*
HD 1393.25 S653 1998 (*The Business Link* Library)
- *Buying and Selling a Small Business / Michael M. Coltman 1994*
HD 1395.25 C722 1994 (*The Business Link* Library)

The Business Link Website:

http://www.cbsc.org/alberta/search/display.cfm?Code=4009&coll=FE_FEDSBIS
_E

Disclaimer:

The information presented in this document is intended as a guide only, and while thought to be accurate, is provided strictly "as is" and without warranty of any kind. **The Business Link**, its employees, its directors and members, its agents or contractors will not be liable to you for any damages, direct or indirect, or lost profits arising out of your use of information provided within this document, or information provided within **The Business Link's** web sites.

This material may be used, reproduced, stored or transmitted for non-commercial purposes, however, The Business Link's copyright is to be acknowledged. You may not use, reproduce, store or transmit this material for commercial purposes without prior written consent from **The Business Link**.

© 2006 **The Business Link**

The Business Link Business Service Centre
100 – 10237 104 Street NW, Edmonton, Alberta T5J 1B1
Tel: (780) 422-7722 or 1-800-272-9675 Fax: (780) 422-0055
E-mail: buslink@cbsc.ic.gc.ca Web: www.cbsc.org/alberta