
STANDARD DUE DILIGENCE PROCESSES

DUE DILIGENCE PRESS SERIES ON
DUE DILIGENCE STANDARDS: STANDARD 101.0



**DUE
DILIGENCE
PRESS**

*The Language
Of Due Diligence*

Published by:

Due Diligence Press

Mailing Address: 1153 Bergen Parkway, Suite M271, Evergreen, Colorado 80439 USA

Email: standards@duediligencepress.com

Telephone: (303) 430-2888

Standard Due Diligence Processes

Due Diligence Press Series on Due Diligence Standards¹

Standard 101.0

First Edition, March 2010

Price: US\$35.00

Copyright ©2010 Due Diligence Press. All rights reserved.

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning, or otherwise, except as permitted under the United States Copyright Act, without the prior written permission of the Publisher.

Limit of Liability/Disclaimer of Warranty: While the publisher and author have used their best efforts in preparing this book, they make no representations or warranties with respect to the accuracy or completeness of the contents of this book and specifically disclaim any implied warranties of merchantability or fitness for a particular purpose. No warranty may be created or extended by sales representatives or written sales materials. The advice and strategies contained herein may not be suitable for your situation. You should consult with a professional where appropriate. Neither the publisher nor author shall be liable for any loss of profit, or any results of the application of the Due Diligence Standards in any situation, or any other commercial damages, including but not limited to special, incidental, consequential, or other damages. Participants in the development of the Due Diligence Standards have acted as individuals and the content of this document does not necessarily reflect their views or due diligence practices of their affiliations.

Proprietary elements of this Due Diligence Standard™ are the subject of various intellectual property rights. Due Diligence Press is not responsible for identifying any or all such intellectual property rights.

Various trademarks, copyrights, service marks and other intellectual property contained within are used with permission by, and are the property of, Due Diligence Press, Due Diligence Sciences, LLC, Due Diligence, Inc., Due.Com, Inc., and/or Charles F. Bacon.

Communications, including suggestions for improving this standard, should be directed to: Due Diligence Press, publishing@duediligencepress.com

ISBN: pending

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

¹ “Due Diligence Standards” and “Due Diligence Standard” are the proprietary intellectual property of Due Diligence Sciences, LLC and Charles F. Bacon.

Contents

| | |
|--------------------|---|
| Foreword | 4 |
| Introduction | 5 |

Chapters

| | |
|--|----|
| I Purpose and Scope..... | 8 |
| II Normative Reference..... | 10 |
| III Synopsis of the Due Diligence Process Standards | 10 |
| IV Due Diligence Process Requirements | 12 |
| V Foundations | 15 |
| VI Planning..... | 20 |
| VII Determining, Prioritizing and Gathering Data | 28 |
| VIII Data Analysis..... | 30 |
| IX Reporting the Results of the Due Diligence Process..... | 33 |
| X Reviewing the Results of the Due Diligence Process..... | 37 |

Appendices

| | |
|---|----|
| A Data Sources and Types | 38 |
| B Terms and Definitions | 42 |
| C Due Diligence and Risk Management | 49 |

FOREWORD

Due Diligence Press is a unique publisher, with a mission that includes advancing the success of business, professional, non-profit, academic, government and non-government organizations; through producing and publishing due diligence books, journals, magazines, articles and other works in the topical areas of due diligence systems, due diligence processes, due diligence best-practices, due diligence services, due diligence products, and the Science of Due Diligence^{TM2}.

Standards and guidelines are created through development teams consisting of participating companies and individuals recognized for their best-practices and expertise in specific enterprise functions or areas.

The development team participants include both large and small enterprises working together to establish standards and guidelines intended to create and improve due diligence systems, processes and best-practices; and especially to create decision-making systems and to improve performance and results using the Science of Due DiligenceTM.

Due diligence standards and guidelines are developed with an objective of promoting the success of enterprises operating worldwide.

² “The Science of Due Diligence” is the proprietary intellectual property of Due Diligence Sciences, LLC and Charles F. Bacon.

INTRODUCTION

Due diligence is not just for mergers and acquisitions anymore. Old 20th century practices no longer meet the challenges of defining and running an organization in the 21st century. Due diligence thinking and methods must be revamped to serve in today's fast-paced and perilous environment.

Decisions are what modern business is all about. Without a good dynamic knowledge base that accommodates change and complication, decision-making is binary at best. On/Off, Black/White, Good Decision/ Bad Decision... all are replete with attendant risk and danger. If decisions were airplanes, many would choose not to fly.

- Dun & Bradstreet reports that a corporation fails every three minutes, a new business is formed every five minutes, a share ownership change happens every six minutes, and a company changes control every 15 minutes.
- A McKinsey study concluded approximately 60% of mergers fail financially.
- According to the US Small Business Administration, about one out of every ten small businesses fail each year.
- Financial Times studies show that 70% of acquisitions do not deliver intended value.
- Price Waterhouse Coopers says: "Real due diligence analyzes and validates all the financial, commercial, operational and strategic assumptions underpinning the decision. It looks at past trading experience and also uses this to form a view of the future. The components ... are revenue and market due diligence, synergy validation, maintainable earnings, future cash flows and all operational issues, as well as decision structuring."

Why do leaders make decisions? Because they have to. As the cliché so aptly warns, "not to decide is to decide". A good decision can maximize profits, increase productivity, expand distribution channels, gain capital capacity, extend market reach, improve cost efficiency, acquire technology, make management look better, reduce risks, aid diversification, and control markets. Bad ones don't. Generally, an organizational decision is driven by at least one leading goal, hopefully, balanced against other trade-offs. The end result is expected to justify the costs.

Alas, regardless of noble purpose, decision-making end results frequently are ignoble. There is no consensus to explain this high rate of misstep, but there is an abundance of opinion. Mounting piles of theoretical literature and empirical evidence point out that corporate decisions are often implemented for wrong reasons and often without necessary critical information.

Today's due diligence does not work. Due diligence has long been used to help identify and reduce risks. The term suffers from a narrowed perception as a necessary evil, and limited to only a few portions of the entirety of organizational decisions. Whatever inference one attaches to the term due diligence, the data indicates it isn't working very well.

Current due diligence practice is showing its age, having been in place for more than 50 years. Today, in most applications, traditional due diligence activities suffer from the seeming contradictory shortcomings of being both statutory and formulaic, but also irregular and inefficient. Likewise, parties get to pay premium prices for lack of accountability and vast expenditures of time.

The traditional due diligence process also is fundamentally dependent on human effort, typically provided by professionals with accounting, legal and financial backgrounds, but with no standardized procedures or specific training and little if any sense of the interdependency of their disciplines. Despite otherwise adequate professional experience, this effort always suffers from inconsistency, tunnel vision, and is characteristically consigned to a junior team.

In the traditional decision environment, the all- too-frequent reality is that senior management has already “made the decision”, but in an almost “data-free” environment. In effect, they bought the car and now that the tires are getting kicked, they don’t want to hear about the bad transmission or leaky gaskets because that would tarnish the fun of decision-making without discipline.

Over the past decades, countless checklists and very little else has been published as even the most minimalist guidelines for due diligence. No comprehensive document encompasses due diligence. No formal due diligence discipline exists. No formal due diligence education focus exists. What is needed is a formal due diligence discipline, starting with the Science of Due Diligence™ and a due diligence standards methodology.

Due diligence has traditionally been a process of collecting and analyzing data before reaching decisions with the goal of attempting to understand the advantages, disadvantages and risks associated with the decisions.

Although the term “due diligence” is most often associated with mergers and acquisitions, in a broader context, every important decision (e.g., hiring employees, selecting suppliers, selecting software, etc.) should be supported by substantial, valid due diligence processes and data. The type and nature of each due diligence process is influenced by the varying needs and particular objectives of the organization.

Unfortunately, traditional due diligence processes have historically been limited in their application, and have been exceedingly inconsistent, immensely inefficient and decidedly focused on only extremely limited aspects of the due diligence process (e.g., legal issues, statutory requirements, regulatory requirements, etc.). This has led to most often producing erroneous or incomplete data, leading to inaccurate assumptions, upon which management decisions were based with disastrous consequences. Recognizing this industry-wide problem, Charles F. Bacon initiated the process to create due diligence standards for more consistent and efficient due diligence.

Designed to provide a solid foundation upon which to base any and all due diligence process, these standards are intended to serve a broad range of interests, including executives, managers, boards of directors, shareholders, attorneys, accountants, business brokers, commercial bankers, investment bankers, mergers and acquisitions firms, private investors, venture capitalists, and any other parties interested in the new due diligence process.

This standard was developed with the goal of improving due diligence through providing a structured, systematic due diligence program of planning, identifying, prioritizing, collecting and analyzing appropriate, relevant, necessary data; providing a consistent, more efficient, and methodical approach supporting fundamental decision management.

The adoption of a formal due diligence program should be a strategic initiative by the decision-makers of every organization with an aim of adding structure to the decision management process. Once established, the due diligence program should become an integral, ever-present facet of the organization's strategy, assisting management through every decision; and will create significant improvement in the organization's capabilities, risk reduction, agility, morale and profitability.

This Due Diligence Standard specifies the minimum requirements for modern due diligence processes where an organization or entity has identified the need to have a precise system of making accurate decisions.

The due diligence processes requirements contained in this standard are aimed primarily at creating an exact decision management process of organizations through establishing a formal, consistent, structured, and coordinated due diligence method for planning, identifying, prioritizing, collecting, analyzing and presenting data upon which specific decisions are to be based. The requirements specified in this Due Diligence Standard are intended to be sufficiently generic as to be applicable to all organizations, regardless of industry, location, type and size.

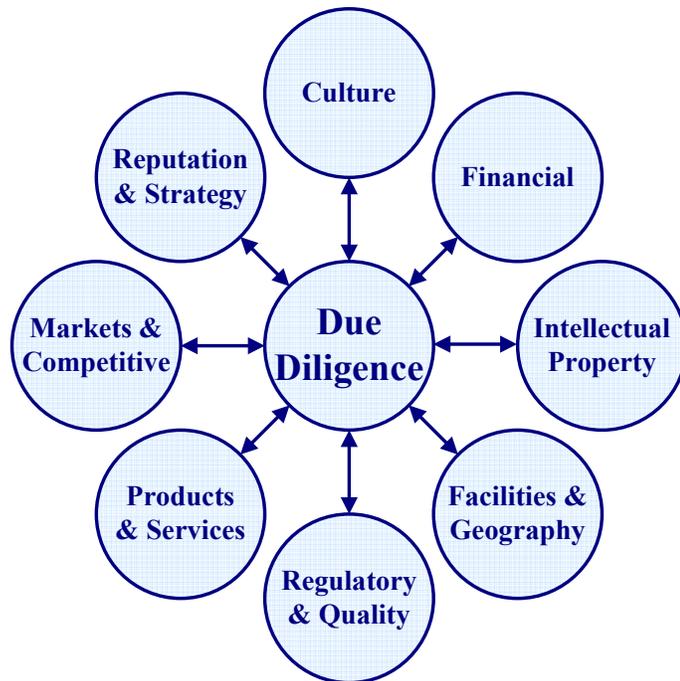


Figure 1: Due Diligence Factors Affecting Companies™³
(Source: Due Diligence Sciences LLC)

The Due Diligence Standards:

1. address shortcomings of traditional due diligence activities,
2. have been developed over a period of more than 15 years,
3. provide a comprehensive foundation for pre- and post-decision activities, and
4. alleviate the consequences of old-style due diligence.

This standard also recognizes that the cost of a due diligence process should not exceed the benefits derived therefrom, and that the benefits consist of improving decision makers' confidence in the process and understanding of the real and potential advantages, disadvantages, and risks associated with decisions.

This standard is intended to promote the concept of modern due diligence.

³ "Due Diligence Factors Affecting Companies" is the proprietary intellectual property of Due Diligence Sciences, LLC and Charles F. Bacon.

Corporate decision makers can use modern due diligence to help find the “Due Diligence Sweet Spot” (see Figure 2) of high performance, profitability, position, and growth. As united goals, these can make firms prosper rather than result in underperformance, divestiture, or failure.

A modern corporate due diligence system and strategy will help improve financial performance, strengthen competitive positions, expand organizations more effectively, preserve human performance and develop internal know-how.

With these improvements, companies will be better able to grow and succeed.

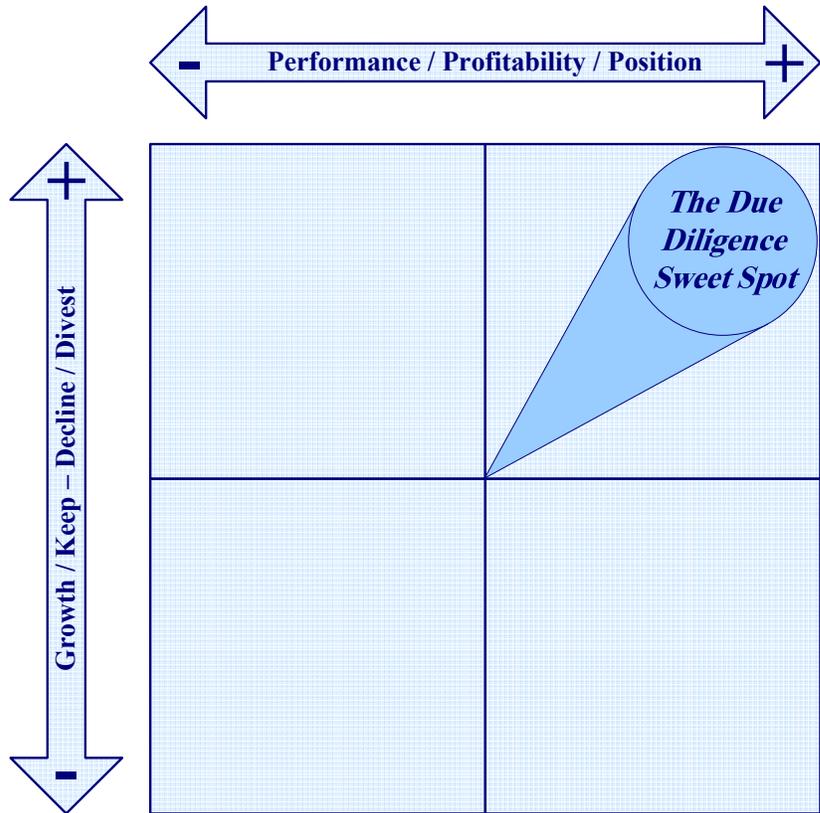


Figure 2: The Due Diligence Sweet Spot™⁴
(Source: Due Diligence Sciences LLC)

A modern corporate due diligence system adds new power to the organization, adding to the existing strengths of management and staff, creating more value for business units, as well as improving its abilities and success rate when acquiring or merging with new firms. In a nutshell, it also can help prevent the decision maker from making poor decisions.

⁴ “The Due Diligence Sweet Spot” is the proprietary intellectual property of Due Diligence Sciences, LLC and Charles F. Bacon.

| | |
|-----------|----------------------------|
| CHAPTER | |
| II | NORMATIVE REFERENCE |

This standard contains no specific additional provisions through reference.

| | |
|------------|--|
| CHAPTER | |
| III | SYNOPSIS OF THE DUE DILIGENCE PROCESS STANDARDS |

| Standards | | | |
|------------------------------------|---------------|---|-----------------|
| Category | Number | Standard | Location |
| Due Diligence Process Requirements | 101.1.1 | Due Diligence Process Evaluation and Determination | Chapter IV |
| | 101.1.2 | Due Diligence Process Inclusions | |
| | 101.1.3 | Contracting Due Diligence Processes to an External Organization | |
| | 101.1.4 | Contracted Due Diligence Organizations or Entities | |
| Foundations | 101.2.1 | Create Dedicated Due Diligence Department or Team | Chapter V |
| | 101.2.2 | Create Formal Due Diligence System | |
| | 101.2.3 | Due Diligence System Manager | |
| | 101.2.4 | Initial Corporate Due Diligence Audit | |
| Planning | 101.3.1 | Objectives | Chapter VI |
| | 101.3.2 | Resources | |
| | 101.3.3 | Personnel | |
| | 101.3.4 | Specialized Expertise | |
| | 101.3.5 | Contracted Organizations and Personnel | |
| | 101.3.6 | Testing Laboratory Services | |
| | 101.3.7 | Due Diligence Team Leader | |
| | 101.3.8 | Responsibility and Authority | |
| | 101.3.9 | Communication | |
| | 101.3.10 | Confidentiality and Proprietary Rights | |
| | 101.3.11 | Measuring and Test Equipment (M&TE) | |
| | 101.3.12 | Statistical Techniques | |

| | | | |
|--|----------|---|--------------|
| | 101.3.13 | Due Diligence Records Management | |
| | 101.3.14 | Control of the Due Diligence Plan | |
| Determining, Prioritizing and Gathering Data | 101.4.1 | Determining the Due Diligence Data | Chapter VII |
| | 101.4.2 | Data Sources and Types | |
| | 101.4.3 | Prioritizing Data | |
| | 101.4.4 | Providing Notice | |
| | 101.4.5 | Gathering Data | |
| | 101.4.6 | Statistical Methods | |
| | 101.4.7 | Data Source and Type Identification | |
| Data Analysis | 101.5.1 | Data Classification | Chapter VIII |
| | 101.5.2 | Complex Data | |
| | 101.5.3 | Analysis of Statistical Data | |
| | 101.5.4 | Data Validation | |
| | 101.5.5 | Calculations and Computations | |
| | 101.5.6 | Quantitative Data | |
| | 101.5.7 | Interpretation of Data | |
| | 101.5.8 | Interpreting Statistical Data | |
| | 101.5.9 | Opinions, Recommendations and Suggestions | |
| Reporting the Results of the Due Diligence Process | 101.6.1 | Due Diligence Report Content and Format | Chapter IX |
| | 101.6.2 | Presentation of Data | |
| | 101.6.3 | Report Distribution | |
| | 101.6.4 | Preliminary Reports | |
| | 101.6.5 | Amended Reports | |
| Reviewing the Results of the Due Diligence Process | 101.7.1 | Follow-up Plans Relating to the Due Diligence Process | Chapter X |
| Data Sources and Types | 101.8.1 | Data Types | Appendix A |
| | 101.8.2 | Data Sources | |
| | 101.8.3 | Data Types Origination Identification | |
| | 101.8.4 | Data Types Identification Considerations | |
| Terms and Definitions | 101.9 | Terms and Definitions | Appendix B |

The Complete Standard is available at [Standard Due Diligence Processes:](http://dueportal.com/publications/standard-due-diligence-processes/)
<http://dueportal.com/publications/standard-due-diligence-processes/>