



## A FIO PARTNERS PERSPECTIVE:

### Due Diligence In Layman's Terms

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When nonprofit organizations consolidate, such as when they enter into partnerships, networks, parent corporations or mergers, it is important for the parties to the agreement to understand fully the condition of their potential partners before the final agreements are signed. This process of testing the "fitness" of the partners is called "due diligence." Due diligence is designed to ensure that indebtedness and legal entanglements of each party are fully disclosed and that the assets claimed by each party actually exist.

This is accomplished by an exchange of documents. This exchange occurs by the transfer of an agreed upon list of documents to a secure setting such as a locked conference room. Representatives of the parties are then provided with access during a specified timeframe to review the documents. The representatives may be paid attorneys or accountants, or may be Board members with similar credentials. The representatives generate a list of questions that are submitted to the other party or parties. A timeframe is set for the answers to be returned. This process continues until the questions of all parties are satisfied.

The process of due diligence is designed and agreed to by the parties. Depending upon the amount of financial risk entailed, the materials exchanged by the parties may vary. The materials may also vary by industry. For example, organizations that provide services funded by Medicaid have a specific set of documents that pertain to this type of funding. It is an important step, then, for the parties to agree on the full set of documents to be exchanged.

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The timing of due diligence is usually part of the overall decision making process. Some organizations refuse to take part in any decision making until due diligence is complete. Others, particularly in instances in which the outcome is highly unlikely to be derailed by due diligence discoveries, position it close to the end of the decision making process. There is no rule about this; generally the consultant working with the group can help make the decisions about timing.

A general list of typical due diligence documents is provided below. This list must be adjusted for degree of risk inherent in the proposed project and by industry. Higher risk projects such as mergers require a higher level of detail. It is provided to acquaint the lay person with the typical scope of due diligence reviews and is not meant to be legal advice applicable to any particular situation.

### **Due diligence documents to be exchanged**

Any initial list of due diligence documents should be reviewed by each party's attorney who may suggest additional elements.

#### A. General corporate records

1. A description of the organization and ownership of the organization, including full disclosure of any organizational or contractual relationships between and among the organization's Board of Directors.
2. A list of jurisdictions in which the organization is qualified to do business or is otherwise operating.
3. The organization's charter documents
4. An organizational chart
5. A list of officers and directors and affiliations

#### B. Employees

1. All employment, severance or similar agreements with any officer, director or employee
2. All consulting and management agreements entered into and currently in force.

- C. State Licensure and Other Health Care Approvals.
  - 1. All current state licenses, permits, operating certificates, accreditation and approvals for conducting business.
  
- D. Regulatory Oversight
  - 1. Any state or federal audit or investigation report relevant to any operations of the organizations.
  - 2. All state and federal survey reports, including statements of deficiencies, plans of correction, and complaint investigations.
  
- E. General Business Operations
  - 1. Statistical information concerning the membership and services provided the previous three years.
  
- F. Financial Information
  - 1. Financial statements for the last three fiscal years, including the most recent period. Such statements should disclose changes in accounting methods from one period to the other.
  - 2. Current accounts payable
  - 3. Current year's budget with accompanying detail.
  - 4. Management letters from accountants who conducted audits of financial statements described above.
  - 5. Description of all outstanding indebtedness, including pension obligations, notes, mortgages, and other instruments related thereto.
  
- G. Claims, Litigation and Arbitration
  - 1. All documentation associated with any complaints or charges related to organizational operations. All correspondence from the Attorney General's Office.
  - 2. A summary and status of any ongoing or threatened investigation or claims, adverse actions, or litigation or arbitration, against any employee, officer, or director, including reports from loss prevention or similar entities during the last three years.
  - 3. Description and status of all recent, current or threatened claims, citations, complaints to regulatory authorities, or proceedings pertaining to alleged failure to comply with applicable federal, state, or other laws or regulations.
  
- H. Strategic Plans
  - 1. Copies of the current or most recent strategic planning documents.