

Appendix D

Due Diligence Examination Outline

The goal of due diligence is to understand fully the business of the issuer, to identify the risks and problems it will face, and to assure that the registration statement is complete and accurate. Thoughtful analysis concerning the particular issuer as well as the experience, knowledge and care of the underwriters and their counsel in this process represent the critical ingredients of due diligence. A checklist of topics and procedures merely serve as an aid in the due diligence process when used in conjunction with thoughtful analysis and the review of applicable registration forms, rules and guides promulgated by the SEC.

The SEC and NASD Regulation both have acknowledged that attempts to define or standardize the elements of the underwriters' due diligence obligations have not been successful. The appropriate due diligence process will depend on the nature of the issuer, the level of the risk involved in the offering, and the investment banker's knowledge of and relationship with the issuer.

Checklists of the items to be covered in a due diligence investigation can be useful tools. It is not possible, however, to develop a checklist that will cover all issues or all offerings. Due diligence is not a mechanical process. The use or absence of use of a checklist does not indicate the quality of due diligence. Conversely, deviation from any checklist that is used does not taint a due diligence review any more than the following of a checklist validates such a review.

In view of the above, the following outline should not be considered a definitive statement of, or a standard recommended by, NASD Regulation regarding the due diligence issues and procedures that would be required or appropriate in any particular initial public offering.

I. Before Commitment Is Made to Establish Investment Banking Relationship With Prospective Investment Banking Client (the "Company")

A. Staffing the Review

1. Assign personnel who have particular competence in the business in which the issuer is engaged.
2. Consider retaining outside consultants to analyze the technology employed by the Company and others in the Company's industry.

B. Assessing Integrity of Management

1. Inquire of appropriate parties whether the corporation is being run by the type of persons with whom the investment banker would wish to be associated.
2. Determine whether any of the Company's officers, directors, or principal shareholders have been charged or convicted of any charges involving fraud, embezzlement, insider trading, or any other matter concerning dishonesty.

C. Review of Industry

1. Examine prospectuses, Form 10-Ks, and annual reports prepared by other corporations in the industry.
2. Examine research reports on major corporations in the industry as well as reports on the industry itself.
3. Become familiar with applicable regulations governing the industry.
4. Study the accounting practices followed in the industry, including any differences in accounting practices followed by different companies.
5. Determine financial ratios of the industry as a whole.
6. Become acquainted with new developments in the industry by examining trade publications.
7. Determine the industry size and growth rate.
8. Assess whether the industry is subject to cyclical influences.
9. Determine whether seasonality of demand affects the industry.
10. Determine the stage of the industry in the industry life cycle (e.g., growth, maturity).
11. Evaluate short-term and long-term prospects for the industry.

II. After Commitment is Made to Establish Investment Banking Relationship

A. Submission of Questionnaire to Officers and Directors

The specific information to be sought includes:

1. Relationship to underwriters.
2. Voting arrangements.

3. Transactions with the companies.
4. Past and present occupations.
5. Record and beneficial ownership of the stock.
6. Compensation, direct and indirect.
7. Principal shareholders.
8. Knowledge of pending or threatened litigation.

B. Submission of Request for Company Documents

1. Regarding legal status.
 - a. Charter documents (articles of incorporation and bylaws) and all amendments.
 - b. Minute books for meetings of directors, shareholders, executive committee, stock option committee and the like for the past five years.
 - c. Copies of applications for permits to issue stock permits, and exemption notices.
 - d. Specimen stock certificates.
 - e. Copies of voting trust and voting agreements.
 - f. Documents previously filed with the SEC, including prospectuses, Form 10, 10-K, 9-K, 8-K, proxy statements, and supplementary sales literature.
 - g. Contracts or arrangements restricting the transferability of shares.
 - h. Shareholders' list indicating names, ownership, and how shares are held.
 - i. Licenses to conduct business.
 - j. Foreign qualifications, if any.
 - k. All documents filed with any state agency affecting corporate status, including annual reports.

2. Regarding the Company's business.
 - a. Promissory notes (except immaterial routine notes from persons, other than officers, directors, or 10 percent shareholders), loan agreements, trust deeds, indentures and all relevant correspondence regarding same.
 - b. Financial statements and tax returns for the past five years.
 - c. Stock option agreements, profit sharing and pension plans, supplementary information booklets.
 - d. Annual reports.
 - e. Advertising materials, brochures, and other sales literature.
 - f. Leases and/or grant deeds.
 - g. Description of plants and properties.
 - h. Agreements with officers, directors, shareholders, or promoters (e.g., employment agreements, indemnification agreements).
 - i. Documents of agreements with affiliates (e.g., lease, purchase agreement, license, covenant not to compete, etc.), insiders and other related parties, and if affiliate is other than a natural person (e.g., trust, estate, partnership, joint venture, corporation) court orders, agreements, stock book, and other documents necessary to establish precise nature of affiliation and terms thereof.
 - j. All materials contracts.
 - k. Copies of licenses, permits, governmental approvals, quality ratings, franchises, patents, copyrights, trademark and service mark registrations, trade secret agreements and any opinions of counsel related thereto.
 - l. Distribution or agency agreements.
 - m. Consignment agreements.
 - n. List of major customers and suppliers, copies of their existing agreements, and copies of correspondence for the past year.
 - o. All documents relating to any complaints, investigations, claims, hearings, litigation, adjudications, or proceedings by or against the Company, including copies of the material pleading.
 - p. All documents relating to issuance of stock, including offering documents and documents relating to reliance on securities registration exemptions and any related litigation action or proceeding.
 - q. Business plans (past five years).
 - r. All written documents relating to employment policies and practices.
 - s. All correspondence between the Company and legal counsel regarding responses to requests for auditors information (for five years).
 - t. Copies of any pleading or other documents relating to any litigation, action, or proceeding related to any of the Company's affiliates, officers, directors, or beneficial owners of 10 percent or more of stock.
 - u. All insurance documents.
 - v. Affirmative action plans.
 - w. Any other documents that are material to the Company.

C. Review of Basic Corporate Documents

1. After gaining an understanding of the industry, examine specific Company documents filed with the SEC during the past five years, including:
 - a. Form 10-K.
 - b. Form 8-K.
 - c. Form 10-Q.
 - d. Registration statements and private offering memoranda relating to the sale of securities and any
 - e. Proxy statements for:
 - 1) Annual meetings,
 - 2) Acquisitions, and
 - 3) Other transactions requiring a shareholder vote.
2. Examine document and other communications sent to the shareholders during the past five years, including:
 - a. Annual reports and quarterly reports, with particular attention to the president's letter, which may provide insight into any major problems faced by the corporation.
 - b. Follow-up reports on annual meetings.
 - c. Shareholder letters.
3. Examine public documents on the Company.
 - a. News clippings.
 - b. Press releases.
 - c. Documents on file.
 - d. NEXIS computer searches.
 - e. Recent private placement memoranda and written rating agency presentation.

4. Evaluate restrictive covenants.
 - a. Examine indentures and loan agreements.
 - b. Consider the effect such covenants might have on the Company's operations and prospective financing.

D. Analysis of the Company and its Industry

1. Company analysis.
 - a. Compare the Company's prior business plan and financial plan with the actual results obtained.
 - b. Determine the Company's principal product lines. If the Company's principal products are newly developed, it may be desirable to retain an independent consultant who can advise on the technology, the feasibility of the product, and its potential market.
 - c. Examine the demographic and geographic markets in which the company sells its products.
 - d. Compile a list of principal customers by products.
 - e. Obtain samples of marketing and sales literature used for various products.
 - f. Determine the mechanism for distribution of company products or services, i.e., wholesale and retail distributors, personal service, or Internet.
 - g. Assess the technology position of the company.
 - h. Compile a list of trademarks, trade names, and service marks and assess the protection obtained for such marks and names.
 - i. Obtain copies of permits for conduct of business, including licenses, franchises, concessions, and distributorship agreements.

2. Strategic analysis.
 - a. What are the Company's long-term goals?
 - b. On what basis does the Company measure its performance?
 - c. What strengths does the Company intend to exploit to be successful in its industry?
 - d. What weaknesses does the Company have in the industry and what does it intend to do to overcome such weaknesses?
 - e. What are the current market opportunities and how does the Company plan to exploit such opportunities?
 - f. What are the risks that the Company faces in the industry? What is the likelihood that such risks will come to fruition? What would be the consequence to the Company if the risks came to fruition?
 - g. What are the Company's business strategies for success in the industry?
3. Financial analysis.
 - a. Compare basic financial ratios of the Company to the industry average.
 - (1) Debt to equity ratios.
 - (2) Liquidity ratios.
 - (a) Current ratio (Current assets/current liabilities).
 - (b) Quick ratio (Current assets minus inventory/current liabilities).
 - (c) Earnings/fixed charges.
 - (d) Price/earnings ratios.
 - (3) Asset utilization ratios.
 - (a) Sales turnover.
 - (b) Total assets turnover.

- (4) Profitability ratios.
 - (a) Return on assets.
 - (b) Return on equity.
- (5) Price-earnings ratios.

4. Prepare a written memorandum setting forth questions to be asked of management and areas to be explored in greater depth.

E. Visits to Principal Facilities

1. If the Company is a manufacturing concern, visit one or more of its principal plants. Inspect the facilities to become acquainted with the Company's products and the manner in which they are produced.
2. If the Company is not a manufacturing concern, visit one or more of the Company's offices to obtain an overview of the Company's day-to-day operations.
3. Does it appear the facilities are being fully utilized?

F. Meetings with Principal Officers (after reviewing the registration statement but before engaging in a line-by-line discussion of the document)

1. Hold individual meetings with executive officers responsible for significant aspects of the Company's business.
 - a. Prepare a list of questions in advance to focus the discussions.
 - (1) How would you assess the flexibility of the production facilities?
 - (2) Do you anticipate advances in production techniques and, if so, is the Company prepared to make such advances?

- (3) Does the Company have any continuing obligations in connection with sales, such as an ongoing maintenance and repair obligation or a requirement to finance purchases by customers?
 - (4) How do you assess the quality and quantity of resources allocated by the Company to research and development?
 - (5) What are your financial projections?
 - (6) Have results met past projections?
 - (7) How do you assess the gross profit margin trends in your various product lines?
 - (8) How do you feel about the level of sales for each of the Company's product lines?
 - (9) How do you assess labor relations? Have there been any work stoppages and, if so, how have you dealt with them?
 - (10) What is the Company's overall advertising and marketing plan?
 - (11) What is the Company's acquisition policy? Explain the Company's recent acquisitions, if any.
 - (12) For what does the Company plan to use the proceeds of the public offering?
 - (13) How would you assess the inventory turnover?
 - (14) Have there been any delays in new product introduction?
 - (15) Has the Company changed accounting or legal representation within the last five years? If so, why?
 - (16) Has the Company lost any major customer, supplier or distributor within the last five years? If so, why?
 - (17) Are any of the existing shareholders antagonistic toward the current management of the Company? If so, please explain.
 - b. During the course of the interviews, ask the same questions of different corporate officials to evaluate the answers received and to obtain different perspectives on potential problems.
2. Hold at least one meeting with the Company's chief executive officer (CEO).
 - a. Ask the CEO to review the broad aspects of the Company's strategic and operational goals and its plan to achieve those goals.
 - b. Ask the CEO for his or her personal assessment of the Company's strengths and weaknesses.
 - (1) This interview should be as far reaching as circumstances warrant.
 - (2) It is essential to listen critically to the CEO's comments.
 3. Based on the meetings, assess the competence of the officers of the Company.
 - a. Are the administrators organized and knowledgeable?
 - b. Are the financial officers skilled?
 - c. Are the technical personnel well-qualified?
 - d. Is the management structure such that it can adjust to the Company's growth beyond the current stages of operation?

G. Meetings with Company's Accountants (Out of the Presence of the Company's Officials)

Questions to Ask:

1. How would you assess the Company's internal controls?
2. Are there any unusual accounting issues in regard to the Company or the industry?
3. Are reserves adequate?
4. How would you assess the Company's aged-analysis of accounts receivable?
5. Do you note any unusual fluctuations in inventory?
6. Is the Company's method of revenue recognition in line with industry practice and applicable accounting principles?
7. How do you assess the Company's segment reporting?
8. From your dealings with the Company's accounting and financial personnel, how would you assess their capability?

H. Meeting with Company's Counsel

Questions to Ask:

1. How would you assess the pending litigation and contingent liabilities of the Company?
2. How would you assess the pending administration and regulatory proceedings that the Company is facing?
3. How would you assess the status of the Company's proprietary information and intellectual property, including any copyrights, trademarks, service marks and trade secrets?

I. Meetings with Other Third Parties

1. Suppliers/creditors/distributors. Does the Company pay its bills/debts in a timely manner?
2. Competitors and customers.
 - a. What is the company's reputation?
 - b. How would you rate management's reputation?
 - c. What risks are present in the Company and its industry?
 - d. How would you rate the quality of the Company's products and services?

J. Legal Review

1. Review of basic corporate documents.
 - a. Articles of incorporation.
 - (1) Obtain copies of the articles of incorporation, including any restated articles and amendments.
 - (2) Determine whether all of these items were certified by the Secretary of State (by whatever name known) of the state in which the company is incorporated.
 - (3) Determine whether the purposes clause of the articles is broad enough under the applicable law to include all actions previously taken and presently being contemplated.
 - (4) List the dates of all amendments and summarize changes.
 - (5) Were such amendments validly authorized by the shareholders?
 - (6) Is the name as specified in the Charter the same as used by the Company?
 - (7) Do the powers of the Company suggest any restrictions?
 - (8) Is the authorized capital sufficient?

- (9) Verify the description of the Company's equity stock.
 - (10) Do the articles provide for preemptive rights?
 - (11) Does the authorized number of directors conform to the minutes?
 - (12) Do the articles provide for the accessibility of shares?
 - (13) Do the articles provide for restrictions on issuance of shares?
 - (14) What is the county of the principal place of business?
 - (15) Do the articles provide for indemnification of officers and directors?
- b. Bylaws.
- (1) Obtain copies of the bylaws, including all amendments certified by the corporate secretary.
 - (2) Review for powers of officers, roles of committees, powers to amend, restrictions on actions, and other governing provisions.
- c. Minutes.
- (1) Obtain minutes of all meetings of directors, committees of directors and shareholders, including copies of any written notices, waivers of notices, and written consents to action without a meeting, all for the past five years.
 - (2) Has the Company regularly held its annual meeting of shareholders? If not, explain the circumstances. If not, were notices duly given or waivers obtained? If notices or waivers were properly obtained, indicate whether such waivers were actually signed before or during the meetings, or whether they were executed after the meetings.
- (3) Indicate whether the Company holds regular periodic meetings of its directors.
 - (4) What is the normal frequency of such meetings?
 - (5) Were notices duly given or waivers obtained with respect to these meetings? If so, indicate whether such waivers were actually signed before or during the meetings, or whether they were executed after the meetings.
 - (6) If a meeting was not held, were resolutions adopted pursuant to proper unanimous written consent?
 - (7) Prepare a summary of the minutes for review by the underwriters.
- d. Meetings.
- (1) Indicate the date and place for meetings, both for directors and shareholders, as provided in the bylaws or articles of the corporation.
 - (2) What were the actual locations of the last three shareholders' meetings?
 - (3) What were the actual locations of the last two directors' meetings?
- e. Executive committee meetings.
- (1) If the Company has an executive committee, does it hold regular periodic meetings?
 - (2) If so, are minutes regularly prepared?
 - (3) If such minutes are prepared, is such preparation under the direction or approval of the office of general counsel?

- (4) If no meetings are held, are resolutions properly adopted pursuant to unanimous written consent?
- f. Directors' and shareholders' meetings/minutes.
- (1) How are the corporate minutes and/or unanimous written consents kept? If the minutes or consents are kept looseleaf, are the pages consecutively numbered?
- (2) Are previous minutes of meetings properly signed? Who signs the minutes?
- (3) Do all previous minutes reflect the presence of a quorum and the names of those in attendance?
- (4) Do all previous minutes indicate the approval of previous minutes?
- (5) Do all previous minutes indicate the time and place of the holding of the meeting?
- (6) Do all previous minutes indicate that either waivers were properly executed or notices properly given for the meeting?
- g. Voting trust agreements.
- (1) Obtain copies of any voting trust agreements, or shareholders' or similar agreement, and lists of the shares covered.
- (2) Do such agreements terminate by virtue of the offering?
- h. Minute books and stock records.
- (1) Where are the minute books of the Company physically kept?
- (2) Where are the stock record books of the Company physically kept?
- (3) Who is the stock transfer agent for the Company? (Indicate the transfer agent's complete address.)
- i. Annual reports.
- (1) Obtain copies of any document sent to shareholders, including the Company's annual reports, quarterly reports, following reports on annual meetings and shareholder letters and press releases sent within the last three years.
- j. Proxy statements.
- (1) Obtain copies of any proxy statements of the Company for annual meetings, acquisitions or other transactions requiring a shareholder vote within the last five years.
- (2) Obtain copies of the form of proxy used for the last annual meetings.
- k. Annual certified audits.
- (1) Obtain copies of the annual certified audits of the Company for the last three years, if any, unless contained in the annual report.
- (2) Has there been any change in the accountants?
- l. Election procedures.
- (1) Do election procedures for directors, as used by the Company, comply with all applicable laws and regulations, including the Company's bylaws?
- (2) Have directors been unanimously elected?
- m. Concurrent director/officer status.
- (1) Was any person who was both a director and an officer present at

- the meeting at which his or her salary was set?
- (2) Was such person counted as part of the quorum for such a meeting or did that person sign a unanimous written consent for same?
 - (3) If an affirmative answer is given to either (1) or (2), does such action create a legal problem under the applicable law?
- n. Power of board of directors.
Is it the Company's policy to get the board of directors' approval for:
- (1) Changes in reserves?
 - (2) Changes in surplus accounts?
 - (3) Declaration of dividends?
 - (4) Election of officers?
 - (5) The setting of officers' salaries and/or bonuses?
 - (6) Amendments to the by-laws of the corporations?
 - (7) The granting of powers of attorney?
- o. Policy-making authority of the board of directors.
- (1) As a practical matter, does the Company get the board of directors' approval for all major policy decisions?
 - (2) If not, how much leeway does the board of directors give the Company's management in the area?
- p. Indemnification.
- (1) Obtain copies of any insurance policies or other agreements, other than the bylaws of the articles of incorporation, which provide for the indemnification of any officer, director, shareholder, employee, or other agent of the company.
 - (2) Is the indemnification agreement or policy authorized by applicable jurisdiction?
 - (3) Is any indemnification in the bylaws consonant with law in the applicable jurisdiction?
- q. Rights of the various classes of stock.
- (1) State the voting rights of the various classes of stocks.
 - (2) Are any dividends on preferred stock presently in arrears? If so, indicate any additional preferences that come into being because of the arrearage.
 - (3) Indicate any potential voting right, other than noted in Section II.J.1.b. above, held by holders of preferred, convertibles, debentures, bonds, etc., that become effective on the happening of contingent events (such as failure to pay dividends or make payments).
- r. Dividends and other distributions
- (1) Indicate the Company's dividend record on common stock for the past five years.
 - (2) Indicate any other distribution of property to shareholders by the Company over the past five years.
 - (3) Has the Company ever paid a dividend or made another distribution to shareholders without meeting an earned surplus or other test under applicable state law to cover it? If so, explain.
- s. Pension plans/profit sharing plans/stock option plans.

- (1) Obtain copies of (i) all pension plans, (ii) all profit sharing plans, and (iii) all stock option plans.
- (2) If the Company has a pension plan, indicate the date on which there last was a compliance with the Federal Pension Plan Disclosure Act. (Compliance is obtained by giving a printed copy of the plan to the employees covered thereby.)
- t. Reports filed with governmental agencies.
 - (1) Review all material reports filed with any governmental agency (state or federal) during the last 12 months.
 - (2) Indicate whether the narrative in all reports filed with any governmental agency, as well as the Company's annual report, is checked for accuracy by the office of general counsel.
- u. Related parties.
 - (1) Does the Company do business with which any officer or director, including spouses and other close relatives, has an interest?
- v. Insurance.
 - (1) Is the Company self-insured?
 - (2) If so, to what extent?
 - (3) Indicate the insurance coverage of the Company, giving the name of the carrier and the policy numbers of each type of coverage.
- w. License to do business.
 - (1) Indicate the states in which the Company does business.
 - (2) Obtain copies of certificate of good standing to determine if the Company is properly licensed in each state it is doing business.
- (3) Is the Company licensed to do business in any states in which it presently is not doing business? If so, indicate the tax consequences for each jurisdiction.
- x. Corporate opportunity doctrine compliance.
 - (1) Indicate any possible violation of the corporate opportunity doctrine known to the Company's counsel.
- y. Contingent liabilities.
 - (1) List all material contingent liabilities of the Company not otherwise set forth in this audit.
- 2. Documents regarding securities.
 - a. Stock options/stock purchases/stock bonuses.
 - (1) Obtain all forms of stock option plans, stock purchase plans, and stock bonus plans, and all forms of stock option agreements, or escrow agreements that have been or may be used under any such plan, as well as all other documents relating to the issuance of securities by the Company, including other purchase agreements, registration rights agreements, and offering circulars.
 - b. Sources of capital.
 - (1) List each issue of stock, bonds, debentures, options, warrants, other convertibles, etc., indicating the amount, the authorized amount, and the applicable permit or registration of each (both state and federal), and if there is no permit and/or registration, state the claimed state and Federal exemption.

- (2) List the states where such securities described in Section J.2.a., above, were issued and state the date of blue-sky authorization. If no such authorization, give the applicable exemption.
 - (3) Indicate the date of each federal registration, if any, and the term for which registered.
 - (4) Obtain copies of any agreements pursuant to which such securities were issued (e.g., stock option plans, underwriting agreements, placement agreements, bond indentures, etc.).
 - (5) Do any such agreements provide for registration rights? If so, describe.
 - (6) Obtain copies of all applications for permits, private placement memoranda and registration statements.
- c. Payments for stock.
- (1) Do the Company's records indicate all of its outstanding stock was properly issued for value?
 - (2) Is any of the Company's stock not fully paid? If so, explain; do statutes, articles and by-laws permit?
- d. Stock issuance/transfer restrictions.
- (1) Do all issuance and transfers comply with any rights of first refusal, preemptive rights, or other restrictions contained in the articles, bylaws or other documents, such as placement agreements?
3. Review of material contracts.
- a. Various material contracts.
 - (1) Obtain bank lines of credit agreements, including any amendments, renewal letters, notices, default waivers, etc.
 - (2) Obtain other outstanding loan agreements, guarantees, indentures, or agreements with respect to indebtedness.
 - (3) Obtain all outstanding material leases for real and personal property.
 - (4) Obtain material contracts with suppliers and customers.
 - (5) Obtain any model sales contracts, license agreements, and dealer agreements used by the Company.
 - (6) Obtain agreements for loans and any other agreements (including consulting and employment contracts) for officers, directors, or employees, whether or not now outstanding.
 - (7) Obtain schedule for all insurance policies in force covering property of the Company and any other insurance policies, such as "key man" policies or products liability policies.
 - (8) Obtain partnership or joint venture agreements.
 - (9) Obtain copies of any bonus plans, retirement plans, pension plans, deferred compensation plans, profit sharing and management incentive agreements.
 - b. Mortgages, notes payable, and other liabilities.
 - (1) List all mortgages (including deeds of trust) of the Company on which

- the anticipation is that final payment will not be made within the 36 months of the date of this examination.
- (2) Indicate whether such mortgages overlap any other security interest given by the Company.
 - (3) List all notes and other liabilities in excess of \$5,000.
- c. Reports on dividends.
- (1) Does the Company make reports (both federal and/or state) on dividends paid to its shareholders?
 - (2) If so, give the date of the last such report.
- d. Corporate negotiable insurance.
- (1) Indicate each institution in which the Company has authorized its agents to execute negotiable instruments, showing the authorized agents, their titles, and the limit of their authority.
 - (2) For each of the authorizations, indicate the date of the corporate resolution authorizing the signature.
- e. Authority of corporate agent.
- (1) Is a notice of limit of agent's authority given to each new account with which the Company does business?
 - (2) If not, what steps are taken to ensure that each agent of the Company does not exceed his/her authority?
- f. Business outside the United States.
- (1) If the Company does any business outside the United States, determine whether or not any activities of the Company might reasonably be construed as a violation of any statutory or regulating limitation on doing business with specified nations or limitation on certain trading, such as trading in gold and foreign exchange.
 - (2) What steps have been taken to ensure that the Company does not violate any prohibitions concerning transactions between designated foreign companies or concerning transfer with respect to securities registered in the name of designated nationals, as well as importation of and dealing on certain classes of merchandise?
 - (3) List all corporations incorporated in a foreign country in which the Company owns 10 percent or more of the capital stock, and for each such corporation indicate (i) any outstanding powers of attorney (ii) any guarantees undertaken (iii) any liabilities created, and (iv) and contract commitments undertaken.
- g. Prepaid items.
- (1) List all prepaid items on the Company's book of assets when such prepayments exceed \$100,000 and will continue in excess of this amount for more than 12 months.
- h. Bad debts.
- (1) Indicate the percentage of accounts receivable that became bad debts in each of the last three years.
 - (2) Ascertain trends regarding bad debts.
- i. Security interests.
- (1) What security interest, if any, is typically used to secure open accounts?

- (2) Are such security devices properly perfected?
- (3) In how many states does the Company presently have perfected security interest?
- (4) What steps are taken to ensure the timely filing of continuation statements required under Article 9 of the Uniform Commercial Code?
- j. Warehousing.
 - (1) Does the Company, as either buyer or seller, utilize the facilities of on-premises warehousing for financing purposes?
 - (2) Does the Company, as either buyer or seller, utilize warehouse receipts in financing?
- k. Labor contracts.
 - (1) List all labor contracts to which the Company is a signer, indicating the bargaining unit covered, the union, the termination date, and a general statement of the company's relationship with the union, indicating specifically any major problem areas.
 - (2) If there are material problems, obtain copies of each labor contract.
- l. Individual employment contracts.
 - (1) Does the Company have any individual employees with a written employment contract?
 - (2) If so, obtain copies of all forms used for employment contracts (including forms of contracts used for executives).
- m. Minimum wage compliance.
 - (1) Is the Company considered to be engaged in interstate commerce?
 - (2) Are any employees or employees of subcontractors working on the premises currently being paid less than the applicable minimum wage per hour? If so, what justification can be given for a lower rate of pay?
- (3) Are any employees covered by a state minimum wage law requiring the payment of more than the federal minimum wage per hour? If so, indicate with appropriate citation the state law, the bargaining units covered, and any other pertinent information.
- (4) Is overtime paid? If not, explain when it is not paid.
- n. Child labor.
 - (1) Does the Company employ any person under eighteen years of age on a permanent basis?
 - (2) What safeguards are taken to ensure that the Company does not violate either the federal or state "Child Labor Act"?
- o. Compliance with fair labor standards.
 - (1) Has any governmental agency checked the Company within the last three years in regard to compliance with the fair labor standard act or other litigation regarding employees?
 - (2) If so, indicate the approximate date and result of the investigation.
- p. Compliance with antidiscrimination statutes.
 - (1) Does the Company have procedures to assure compliance with antidiscriminatory statutes relating to age, sex, and race; and does it keep adequate records to demonstrate compliance (e.g., application forms,

- records of employees, and work assignments, etc.)?
- (2) Does the company, in fact, have an age limit cutoff beyond which general hiring is not done? If so, what is the age limit?
 - (3) What steps have been taken to ensure the compliance by the Company with federal statutes prohibiting age discrimination in hiring?
- q. Salary withholding information.
- (1) Does the Company maintain an up-to-date file of Form W-4 (withholding information) for each employee?
 - (2) Has the Company failed to comply with withholding requirements?
- r. Worker's compensation.
- (1) Does the Company maintain the worker compensation insurance required by the state on each employee?
 - (2) If not, explain.
- s. Other. Assess compliance with state and Federal laws related to the environment, occupational health and safety, and antitrust/unfair trade practice regulations.
- t. Material payments on contracts.
- (1) List all contracts, presently in force, on which the Company, directly or indirectly, is bound, that will not be completed within 24 months, and each that involves payments (or performance of services or delivery of goods) to or by the Company of a material account.
 - (2) Make a schedule of all leases for real and personal property requiring payment of a material amount.
- u. Contract forms and significant provisions.
- (1) Do the contract forms presently in use by the Company meet the requirements of the Uniform Commercial Code?
 - (2) What precautions are taken to ensure that, upon acceptance, additional terms are not inserted by the other party and made part of the agreement?
 - (3) Obtain copies of all significant contract forms utilized by the Company.
 - (4) Are any required anti-discrimination provisions included?
- v. Current breaches of material agreements.
- (1) If any party is presently in breach of any material agreement with the Company, indicate:
 - (i) the default,
 - (ii) the contract penalty for the breach, if any,
 - (iii) what action presently is being taken and
 - (iv) what action is being contemplated.
 - (2) Does the Company take action in the event of breaches by others?
- w. Sales of the Company's products.
- (1) Indicate how the Company's sales are made (i.e., through sales agents, distributors, independent contractors, etc.).

- (2) Indicate the authority each type of selling agent possesses.
- (3) If sales agents have limited authority, what steps are taken to publish this authority to those with whom the agent deals?
- (4) If independent contractors are used, are they permitted to set prices? Are they given a sales quota? Are they truly independent contractors?
- x. Identification of agents.
 - (1) List the titles and positions of those who, under a reasonable interpretation of the statutory and case law of the jurisdiction in which they sell for the Company, could be considered agents of the Company.
 - (2) Do any such agents act through contractual relationships?
- y. Sales forms.
 - (1) Does the Company have sales forms that are considered to be offers tendered for acceptance by the purchaser, or
 - (2) Does the Company have forms that are considered offers to the Company when executed by a purchaser? If the latter is used, is acceptance accomplished at the home office or by the agent in the field?
- z. Direct sales.
 - (1) List those jurisdictions in which direct sales are made by the Company.
 - (2) List those jurisdictions in which direct sales are made through an independent contractor or distributor.
- (3) List those jurisdictions on which direct sales are made only via communications in interstate commerce.
- aa. Trade associations.
 - (1) Indicate whether the Company is a member of any trade association(s).
 - (2) List all such organizations with which the Company has any contract.
 - (3) Indicate the relationship between the Company and such organizations.
 - (4) Indicate whether any of the organizations above listed have been investigated by any state or federal group, either administrative, judicial, or legislative, for possible anti-trust violations during the last five years.
 - (5) If so, explain in detail the outcome of the investigation and what impact, if any, this had on the Company.
- bb. Material transactions with insiders and affiliates.
 - (1) Obtain material of any material transactions within the last five fiscal years with any insider (i.e., any director, officer or substantial owner of the Company's securities) or any associate of, or entity affiliated with, an insider.
- 4. Regulation and litigation.
 - a. Various items relating to regulation litigation.
 - (1) Obtain all letters sent to the Company's independent auditors in connection with its audits for the past five fiscal years, including "litigation letters."

- (2) Obtain copies of letters from the auditors to the Company regarding its internal management controls.
 - (3) Obtain active litigation files for material litigation, including letters asserting claims, complaints, answers, etc.
 - (4) Obtain any settlement documents for material litigation.
 - (5) Obtain any decrees, orders, or judgments of courts or governmental agencies.
 - (6) Obtain information regarding any material litigation to which the Company is a party or in which it may become involved.
 - (7) Obtain audited financial statements (five years).
 - (8) Obtain recent forward-looking budgets for the next two fiscal years prepared on a monthly basis (if available).
 - (9) Obtain recent five-year projections (if available).
- b. Pricing policies.
- (1) Does the Company, in its pricing policies, follow an industrial leader?
 - (2) If so, which competitor does the Company follow as leader?
 - (3) If not, how are the Company's pricing policies determined?
- c. Compliance with building codes.
- (1) Is the Company in compliance with all building codes (or other similar local governmental codes) that are applicable to it?
 - (2) If not, explain.
 - (3) Indicate the approximate date of the last time the Company's facilities were checked by local governmental authorities for possible violations of local governmental codes, and indicate the results of such investigation.
- (4) If any of the Company's facilities are borderline, indicate any remedial steps that should be undertaken at this time.
- (5) List any warnings that the Company has received within the past three years for the violation of any local governmental codes.
- (6) List the date and amounts of fines, if any, paid to any local governmental authority for violation of local codes, other than the traffic code, paid by the Company during the last three years.
- d. Contract defaults.
- (1) Is the Company presently in default under any contractual arrangement?
 - (2) If so, explain the default and indicate the penalties arising out of such default.
- e. Liens.
- (1) List all liens presently in force against the Company's property, both real and personal.
 - (2) Have any actions been taken in respect to any such liens?
- f. Legal action.
- (1) List all legal actions presently pending or known to be contemplated in which the Company might have an involvement.

- (2) Ascertain the identity of legal counsel representing the Company in such matters.
- g. Assignment of patents, trademarks, and copyrights.
 - (1) Obtain the form used in which employees assign to the Company any patent, trademark, and/or copyright that might arise from inventions discovered while working for the Company, together with a list of the employees who have signed the contract. If a form is not used, should it be?
 - (2) Does the Company have nondisclosure agreements with employees?
- h. Surety bonds.
 - (1) Indicate those employees (by title or position) who are presently covered by a fidelity or other surety bonds.
 - (2) What are the amounts of any such bonds?
- i. Charitable contributions.
 - (1) Indicate the number and amount of charitable contributions made by the Company in each of the last two years in the following categories: (i) religious, (ii) educational, (iii) other.
 - (2) Does the Company have any policy regarding employee charitable contributions?
- j. Lobbying activities/political campaigns
 - (1) Indicate whether the Company is engaged in any lobbying activities or political campaigns and, if so, to what extent, and at what financial cost.
- (2) Does the Company retain any lobbying firms?
- k. Tax compliance.
 - (1) Does the Company file all required tax reports?
 - (2) If not, explain.
 - (3) How long are tax records kept?
 - (4) Does the Company have its tax records reviewed periodically for compliance with tax laws?
 - (5) How often are the tax reports reviewed and by whom?
 - (6) Does the Company utilize tax counsel in the planning phase of transactions?
 - (7) If so, is tax advice rendered by house counsel or outside counsel?
 - (8) How are audits by governmental tax authorities conducted?
- l. Year 2000 compliance.
 - (1) Assess the affect on the company of its compliance with the Year 2000 transition, taking into account the costs, potential disruptions of productivity, potential liabilities related to company products or services, and compliance by suppliers.
- m. Subsidiary information.
 - (1) Identify the Company's subsidiaries.
 - (2) Where material, provide the information above with respect to each subsidiary of the Company.

K. Review of Officers' and Directors' Questionnaire

1. Obtain from the Company's counsel the "officers' and directors' questionnaire" to gather information on the Company's officers and directors, their remuneration and employee benefits, and material transactions that they have had with the Company.
2. Compare the information disclosed in the questionnaire with the disclosure required by the applicable registration form, especially in regard to:
 - a. Insider transactions and loans.
 - b. NASD Regulation affiliations.
 - c. Litigation.
 - d. Cheap stock.
 - e. Stock ownership.

L. Check of Order Backlogs

1. Compare oral purchase orders or oral changes to written purchase orders.
2. Do cancellation provisions exist in standard purchase orders, including any penalties for cancellation?
3. Are there indications that outstanding offers may be "soft," or subject to cancellation?

M. Detailed Review of Draft of Registration Statement

1. Read the draft of the registration statement carefully for content.
2. Read the draft of the registration statement a second time against:

- a. The items of the applicable form (e.g., Form S-1, Form S-2, Form S-3, Form S-18) and
- b. Regulation S-K (to the extent covered by the applicable form).
 - (1) Item 501-Forepart of Registration Statement and Outside Front Cover Page of Prospectus.
 - (2) Item 502-Inside Front and Outside Back Cover Pages of Prospectus.
 - (3) Item 503-Summary Information, Risk Factors, and Ratio of Earnings to Fixed Charges.
 - (4) Item 504-Use of Proceeds.
 - (5) Item 505-Determination of Offering Price.
 - (6) Item 506-Dilution.
 - (7) Item 507-Selling Security Holders.
 - (8) Item 508-Plan of Distribution.
 - (9) Item 509-Interests of Named Experts.
 - (10) Item 510-Disclosure of Commission Position on Indemnification for Securities Act Liabilities.
 - (11) Item 511-Other Expenses of Issuance and Distribution.
 - (12) Item 512-Undertakings.
3. Review the registration statement on a line-by-line basis with appropriate individuals, including:
 - a. Officers of the Company responsible for preparing the registration statement.

- b. The Company's counsel.
- c. Representative of the Company's certified public accountants.
- 4. Based on the information elicited through discussions with various individuals, encourage that the registration statement be revised in an effort to improve upon its disclosure.
- 5. After a revised draft of the registration statement is available, see that it is distributed to all directors and key officials.
- 6. Review the Company's procedures for collecting and evaluating comments on the registration statement from those persons to whom it has been furnished.

N. Review of Other Documents

- 1. Review documents not previously furnished, including those of a confidential nature that the Company would prefer not to be taken from its offices, including:
 - a. Five-year plans.
 - b. Financial forecasts.
 - c. Budgets.
 - d. Periodic reports by operating units to senior management or the board of directors.
 - e. Letters of comment received by the Company in connection with prior registration statements.
 - f. At least the most recent management letter prepared by the accountants in connection with their audit.

O. Review During Negotiation of Underwriting Agreement

- 1. During negotiations on representations and warranties in the underwriting agreement, be sensitive to potential problems that arise and may need to be disclosed in the registration statement.
- 2. Review legal counsel's summary of the Company's minutes.

III. Summary Analysis

A. Prior to effectiveness of registration statement, prepare a memorandum summarizing the due diligence investigation, including the dates of any visits to principal facilities, meetings with management, and registration statement review sessions.

B. Have this memorandum reviewed by counsel for the underwriters.