

Virginia

Regulatory Hot Tip 2012 – 1

Professional Insurance Agents Association of Virginia and DC, Inc.

DUE DILIGENCE – CORPORATE BOOKS AND RECORDS

If you are considering acquiring someone else's insurance assets, specifically its book of insurance business, or selling your own, due diligence must become your new best friend. In a recent 2011 Hot Tip, we discussed due diligence generally, and divided the due diligence process into six different categories: Corporate Books and Records; Entity Culture or Personality; Client, Prospects, Past Client, Vendor Lists; Regulatory Matters; Employment Issues; Existing Contracts; and Miscellaneous. Today, we will examine the first category, Corporate Books and Records, in more detail.

Whether you are buying or selling a business, it is important to review the Corporate Books and Records during your due diligence process. If you are selling your business, you should do this to ensure a smooth transition free of any unsuspected legal impediments. If you are acquiring a business, this due diligence process is essential to make certain you are actually getting what you think you are getting.

There are a multitude of reasons for conducting due diligence by examining Corporate Books and Records. These reasons range from finding out the true owners of the business to determining whether the entity was formed properly and

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has filed all of its tax, licensing, and organizational documents as well as maintained its governing documents appropriately. What this all boils down to is whether the entity is in “good standing” to do business in Virginia. When examining Corporate Books and Records, remember that your personal checklist will be unique to your prospective deal. Your list should focus on the individual sale or acquisition at hand. Because each deal has its own characteristics and nuances, a generic checklist can never provide for every aspect of your inquiry. The following, however, is a foundational tool for conducting your evaluation of a business’s Corporate Books and Records.

When learning about a business, the first thing you need to know is general information such as the organizational structure of the business. For a corporation, this includes, but is not limited to: (1) the exact corporate name, address, phone numbers, fax numbers, and web address; (2) the company’s organizational chart; (3) names of officers and directors; (4) names of attorneys and accountants; (5) the company’s list of shareholders and number of shares held by each, including the rights of each class of shareholders; (6) copies of agreements relating to options, voting trusts, warrants, puts, calls, subscriptions, and convertible securities; and (7) the existence of any consents to do business on behalf of the company.ⁱ For a limited liability company, partnership, or sole proprietorship, you would look for similar information, but not all of the above would apply depending on the type of entity you are researching.

Next, you need to understand the mechanics of the business by examining corporate documents such as (1) the company’s Articles of Incorporation (with all amendments); (2) the company’s bylaws (with all amendments); (3) the company’s minute book, including all minutes and resolutions of shareholders and directors, executive committees, and other governing groups; (4) a Certificate of Good Standing (from the state where the company is incorporated); (5) copies of active status reports in the state of incorporation for the last three years; (6) a list of all states where the company is authorized to do business and annual reports for the last three years; (7) a list of all states, provinces, and countries where the company owns or leases property, maintains employees, or conducts business; and (8) a list of all of the company’s assumed names and copies of registrations thereof.ⁱⁱ Again, for a limited liability company, partnership, or sole proprietorship, you would search for similar documents with different names depending on the target entity.

After you understand the organization and mechanics of the business, you need to learn about its finances as well as the company's compliance with financial regulation by examining documents such as: (1) audited financial statements for at least three years, if available, together with auditor's reports (these will generally only be available for publicly traded corporations); (2) if audited statements are unavailable, unaudited financial statements for the last three years; (3) auditor's letters and replies for the last five years; (4) the company's credit report, if available; (5) any projections, capital budgets and strategic plans; (6) analyst reports, if available; (7) a schedule of all indebtedness and contingent liabilities; and (8) tax filings with attached schedules for the last three years.ⁱⁱⁱ Don't forget to consult your accountant or financial advisor for other helpful documentation that you should review before making a decision.

Finally, it is helpful to examine documents demonstrating the business's continuing viability such as: (1) a schedule of inventory; (2) a schedule of accounts receivable; (3) a schedule of accounts payable; (4) a description of depreciation and amortization methods and changes in accounting methods over the past five years; (5) any analysis of fixed and variable expenses; (6) any analysis of gross margins; (7) the company's general ledger; and (8) a description of the company's internal control procedures.^{iv}

While conducting an examination of a company's Corporate Books and Records may seem like a lot of unnecessary work, it is a crucial step in the due diligence process. The Virginia State Corporation Commission's Clerk's Office has helpful information as well as links to many of the documents listed above, just visit <http://www.scc.virginia.gov/clk/index.aspx>. Avoid the temptation to gloss over or ignore this crucial step to ensure a successful business venture. When it is all said and done, you will be glad you took the time before the deal rather than having to handle problems afterwards that could have been avoided altogether.

ⁱ KeyBank, <https://www.key.com/pdf/acquisitionchecklist.pdf>.; FindLaw, http://smallbusiness.findlaw.com/business-forms-contracts/be3_8_1.html.

ⁱⁱ Id.

ⁱⁱⁱ Id.

^{iv} Id.