UNIVERSITY OF TOLEDO INTERNAL AUDIT DEPARTMENT
MANAGE MERGERS AND ACQUISTIONS

Control practices

The following control objectives provide a basis for strengthening your control environment for the process of managing mergers and acquisitions. When you select an objective, you will access a list of the associated business risks and control practices. That information can serve as a checklist when you begin reviewing the strength of your current process controls.

This business risk and control information can help you assess your internal control environment and assist with the design and implementation of internal controls. Please note that this information is at the generic business process level and many companies will need to go beyond generic models to address the specific business processes that support the financial and nonfinancial disclosures being made. You can combine the insight of this business risk and control information with your industry-specific knowledge and understanding of your company's environment when conducting internal control assessments and designing and implementing recommendations.

Effectiveness and efficiency of operations

A. Mergers and acquisitions expenditures are authorized properly.

Reliability of financial reporting

A. Authorized expenditures are recorded in purchase accounting for the proper period.
B. Tangible and intangible assets receive proper valuation.
C. Purchase accounting is applied properly.
D. Financial results of the companies are combined accurately.

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Effectiveness and efficiency of operations

A. Mergers and acquisitions expenditures are authorized properly.

Business risks

- The company will incur unnecessary mergers and acquisitions expenditures.

Control practices

1. Ensure that a member of management at an appropriate level authorizes contracts and purchase orders with service providers before the beginning of due diligence activity and other processes related completion of the transaction. These approvals may be for the entire transaction cycle or for certain segments. For example, an approval could be designated as effective only through phase I diligence or until the signing of a letter of intent.
2. Depending on the size of the transaction, ensure that the board of directors or the shareholders, or both, review transaction terms and approve closing the deal.
3. After due diligence activities and related negotiations are complete, ensure that a member of management at an appropriate level approves the transaction and executes the related documents.

Reliability of financial reporting

A. Authorized expenditures are recorded in purchase accounting for the proper period.

Business risks

- Purchase accounting will not reflect authorized transactions.
- Financial statements will be incorrect as a result of inaccurate recording of mergers and acquisitions expenditures.

Control practices

1. Ensure that the accounting department receives copies of documents authorizing the transaction before entering purchase accounting data into the system.
2. Ensure that senior management reviews and approves purchase accounting entries and confirms that supporting documentation is sufficient.
3. Ensure that personnel preparing purchase accounting entries receives from the executive managing the deal a list of deal expenditures and records all expenditures properly, either as part of purchase price or period expense.
4. Ensure that management at an appropriate level approves late invoices (those received after the transaction closes) for inclusion in purchase accounting.

B. Tangible and intangible assets receive proper valuation.

Business risks

- Wrong assumptions will be used during valuation.
- Tangible assets will be valued incorrectly during acquisitions accounting.
- Intangible assets will be identified, valued, and allocated inappropriately.

Control practices

1. Employ persons with appropriate valuation skills and credentials to identify and valuate intangible and net assets. For complex and significant transactions, an independent third party is recommended.
2. Ensure that the significant assumption and the results of the valuations are reviewed and approved by senior management.

C. Purchase accounting is applied properly.

Business risks

- Purchase accounting will not comply with GAAP.

Control practices

1. Ensure that the accounting department obtains assistance from legal counsel to confirm that the transaction terms properly apply purchase accounting and that the department obtains senior management approval.
2. Ensure that the accounting department assigns any goodwill to appropriate reporting units in accordance with GAAP and that the department obtains approval from senior management.
3. Ensure that senior management approves the determinations of useful life assigned to intangible assets.
4. Perform a critical review of the items capitalized in the purchase price to ensure conformity with GAAP.

D. Financial results of the companies are combined accurately.

Business risks

- Historical financial statements of the target will be inaccurate and incomplete.
- Adjustments to the financial statement will be made without proper approval.
- Transactions at the acquired entity will not be recorded in accordance with the company's accounting policies.
- Financial statements will be incorrect as a result of inaccuracies in the target's transaction records, historical financial statements and adjustments to the financial statements.

Control practices

1. Ensure that persons with appropriate expertise in the financial statements of the target perform a due diligence review.
2. Ensure that potential errors and omissions identified in the due diligence process are discussed with target management.
3. Ensure that the company's external auditors perform a closing balance sheet audit.
4. For immaterial acquisition transactions without the services of external auditors, ensure that the acquiring company performs a complete review of financial statements to identify any inaccuracies or omissions.
5. Ensure that all adjustments are approved by the appropriate level of management and that the supporting documentation is adequate.
6. Ensure that due diligence and closing balance sheet reviews identify differences between the target and the acquiring company's accounting policies.
7. Ensure that senior management at the acquiring company reviews differences in accounting policies and approves or changes differing policies.