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LIMIT RISKS AND KEEP SUCCESS FLOWING WITH A BUSINESS AUDIT

By Stacey DeKalb and Jason Engkjer, Lommen Abdo Shareholders

Owners pour endless amounts of time and resources into growing their businesses.

But, just like children, growing companies develop different needs as they expand. Sometimes it's hard to see what a growing company may need to foster continued success.

Conducting a business audit can help identify areas to target for improvement in a company's operation, including corporate structure, potential liability pitfalls and tax considerations. Here are five areas to consider auditing.

1) EVALUATE THE CURRENT STRUCTURE OF YOUR BUSINESS.

Review your corporate entity documents, including ownership and governance policies. Are they up-to-date? Ask whether the company is operating with the best entity form and corporate structure to meet your current needs. The driving factors in this evaluation are most often tax considerations and the separation of liability.

Management, together with the company's team of professionals, should help identify potential areas to improve operational efficiencies and, more importantly, to better separate liability. For example, do you have equipment, intellectual property, manufacturing, retail or other areas of operation you may want to consider spinning off into separate and distinct entities?

Do any of these areas present potential liability that, if triggered, could bring down or severely hamper the whole business? Could reorganizing the company's structure help alleviate these concerns?

An in-depth analysis of operations may identify areas to spin-off. Review the important tax considerations involved in a reorganization of the business and the differing administrative factors that impact a company's reorganization efforts.

Once you settle on the proper corporate structure, the business must coordinate with its trusted advisers -- attorneys, accountants, insurance and financial professionals -- to prepare the necessary documentation to guide the company through a reorganization.

2) ANALYZE THE COMPANY'S STANDARD BUSINESS CONTRACTS.

Do your company contracts fully articulate the parties' contractual rights and obligations? Do your contracts adequately protect your company's interests? What risks are inherent with the company's contractual relationships?

Proper contracts are generally the cornerstone of every successful business. A business audit helps identify areas for improvement.

Regardless of your industry, contracts should be regularly reviewed to not only keep pace with changing laws, but also identify weaknesses and areas to be corrected as the business grows. This review should include contracts with vendors, clients, distributors, independent contractors and joint ventures. Look at the contract from top to bottom including the recitals, definitions, term and termination, representations and warranties, indemnification provisions, limitations on liability, and miscellaneous boilerplate provisions.

The review may identify areas for revision, such as risk allocation provisions to help apportion exposure to potential losses. For example, when making representations and warranties, it may be appropriate to attempt limiting or qualifying their effect by narrowing their scope, identifying exceptions, adding materiality and knowledge qualifiers, or limiting their survival period. This review may also include indemnity provisions, additional insured language provisions and the proper insuring agreements.

Use the experience you've gained operating your business to tailor your standard contracts to the way you want and need to do business.

3) REVIEW YOUR EMPLOYMENT PRACTICES.

An employment audit can be quite comprehensive. You should review hiring and firing practices, personnel files, job descriptions, wage and hour practices, regulatory issues and perhaps more. Do a thorough review of your employment agreements and handbook, particularly with an eye toward dictating who owns any intellectual property assets created and the confidentiality of the work, assets created, customer lists, etc. This part of the audit should include a review of all confidentiality and non-disclosure agreements as well as non-compete and non-solicitation agreements.

4) CATALOG AND PROTECT INTELLECTUAL PROPERTY (IP).

A company's IP and other intangibles, such as computer code and technological know-how, may constitute a significant portion of the company's value. For example, your business's name may bear significant market value and it should be protected through proper registrations and policing. An IP audit provides the company with an opportunity to identify core IP assets, evaluate concerns with ownership or registration of those assets, and ensure that IP rights are properly protected. An IP audit generally requires three steps. First, investigate all potential IP assets, whether service or trademarks, chemical formulations, existing processes, product names. Second, identify all IP rights that apply to the assets identified. Finally, catalogue and develop a schedule for protecting the applicable IP rights. From there, develop practices for continued asset protection.

Information Technology (IT) and security concerns should also be reviewed and compliance strategies developed to avoid possible claims or unintended disclosures concerning proprietary information. This process should include developing appropriate compliance strategies to mitigate first-party and third-party risk with respect to the company's IP and IT assets. Ultimately, completing the IP audit will aid future efforts to police and protect the exploitation of IP rights.

5) REGULARLY REVIEW YOUR INSURANCE PROTECTION.

Do you really understand the types of insurance policies and coverages needed to protect your growing business? Auditing your insurance policies, including insurance coverages and policy limits, in conjunction with insurance experts who can make specific recommendations, can help identify areas of exposure. Companies often neglect, for example, insurance covering employment practices or cyber security.

It may work best to have an insurance evaluation done at the same time you address each segment to ensure you have the proper coverage in terms of the entities covered, the products and services covered and any additional insureds that should be named. You may have a trusted insurance agent you will invite to the table or ask for recommendations from people who work on these issues.

You may not want to tackle all of these audit elements at once, but rather, select a few critical areas to start with. That selection process itself is valuable because it requires you to prioritize which areas to tackle first. The best option for an audit is to set up a meeting with the key persons in your company and your professional team, including legal counsel, accountants, insurance advisers and financial professionals.

Create an action plan and prioritize according to the risk levels identified. Conducting periodic business audits will help make sure your company continues growing and avoids threats that can arise from issues you didn't even know were lurking.

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