

FINANCIAL DUE DILIGENCE: QUALITY OF EARNINGS

Before buying or selling a company, it's important to have financial due diligence performed to ensure the company is a viable business opportunity and appropriately priced. A Quality of Earnings (QoE) analysis is one piece of financial due diligence that is typically completed along with a financial statement audit to provide a snapshot of the company's true value.

WHAT IS A QUALITY OF EARNINGS REPORT?

A QoE report takes a deep dive into the company's financial statements, highlighting how the company is generating value. It provides a detailed analysis of the key components of the company's accounting policies, revenue and expenses.

As part of the financial due diligence process, a QoE report complements an audit by concentrating on the income statement, determining the company's earnings and cash flow potential. A QoE analysis uses historical results, or EBITDA, excluding non-recurring revenue and expenses to account for "adjusted EBITDA". This gives a better picture of what EBITDA will look like on a go-forward basis.

WHAT DOES A QOE REPORT SHOW?

The QoE analysis may identify issues related to:

- Inaccurate revenue recognition
- Inconsistent application or changes in accounting policies or procedures between periods
- Financial reporting policies that are not in accordance with Generally Accepted Accounting Principles (GAAP)
- Insufficient supporting documentation for management's adjustments to EBITDA
- Issues related to inventory valuation
- Significant changes in allowances between periods
- Changes with key customers
- Inaccurate capitalization policies for fixed assets

WHAT ARE THE BENEFITS?

Similar to receiving an inspection before buying a home, a QoE analysis and financial due diligence help uncover weaknesses in the company to identify risks for buyers and opportunities to increase value for sellers. A QoE identifies business or financial reporting issues that may affect the company's valuation. The results help avoid surprises for the buyer and seller.

A Quality of Earnings report helps determine if the target company is a viable opportunity and can make for a smooth closing process.

Sellers have begun to seek QoE reports for their company to prepare for the due diligence process and also provide credibility and transparency to their financial statements.

TIMING

The period for QoE analysis is most often the last one or two years and the last 12-month interim period, as opposed to an audit which is the most recent fiscal year end.

SCOPE

Anders is experienced in performing due diligence for M&A transactions. We can offer any level of detail the buyer or seller is seeking. The scope will vary as agreed upon with the client.

An acquisition assistance report generally includes:

- Company background
- Shareholders or members
- Management team
- Balance sheet accounts with details of receivables and agings
- Inventory schedules
- Accrual accounts
- Income statement and balance sheet schedules and trends
- Review of cost of sales, operating expenses and compensation
- A quality of working capital adjusted to exclude cash and debt and adjustments, as needed
- Quality of earnings with notes supporting adjustments

Partnering with an experienced professional services firm to make informed business decisions is important. The health of your organization depends on it. We offer valuable insights on a wide range of issues that impact the growth and visibility of your organization.

To understand the true value of your business, please contact:

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