Welch LLP®
Audit • Tax • Accounting • Advisory

FINANCIAL DUE DILIGENCE
QUALITY OF EARNINGS REPORT

Performing financial due diligence is essential before buying a company. You can gain greater comfort over high risk areas and also get insight on the nature of a company's earnings. A Quality of Earnings (QoE) or similar type of report may be required to obtain financing in order to fund the acquisition.

WHAT IS A QUALITY OF EARNINGS REPORT?

A QoE report is typically completed as a component of the overall financial due diligence before an acquisition takes place.

Accounting net income is not always an accurate indication of the operating performance of a company and its working capital. A QoE report provides a detailed analysis of the key components of a company's financial performance and changes in operations, customers, products, vendors, accounting methods or significant accounting estimates. A QoE will aid you in understanding of the value of the organization by focusing on key risk areas.

The report distinguishes between revenues and expenses that are recurring or "normal" from those that are not. The QoE also examines historical data to determine important metrics such as gross margin, customer concentration, collection risks, etc.

When you aim to purchase a business based on a multiple of Earnings Before Interest, Taxes, Depreciation or Amortization (EBITDA) or the value of certain assets and liabilities, this type of analysis can be enlightening.

WHAT IS INCLUDED IN A REPORT?

Welch Risk Advisory takes a tailored approach to QoE reports. We work with our clients to understand the potential terms of a deal and the rationale for acquiring the target company, in order to identify the key areas of risk where we may perform additional analysis to provide you comfort.

The QoE analysis helps to uncover subjectivity in the target company's financial reporting practices and highlights earnings uncertainty to potential buyers or creditors.

Typically, our QoE report will include such items as:

- Normalized EBITDA and working capital required to operate the business
- Trends or fluctuations in financial information
- Revenue and gross margin by product, customer or segments
- Operating expenses
- Key balance sheet findings including key related party transactions
- Unusual or non-recurring items

We then focus on the key areas. For example, customer concentration may lead to further analysis on the terms of customer contracts. Misallocation of expenses may lead to a deeper analysis on contribution margin.

By tailoring each engagement to the key areas of risk, we provide the most value to our clients.

WHAT IS THE DIFFERENCE BETWEEN A QoE AND AN AUDIT?

A QoE report is not an audit report. An audit report provides reasonable assurance that management has presented the company's financial statements fairly using appropriate accounting principles. An audit report would not comment or analyze on the sustainability of EBITDA, trends, forecasts or normalized working capital.

A QoE focuses on the sustainability of a company's earning power and the specific operational risks it faces. Due diligence reports, such as a QoE, complement financial statement audits and other necessary steps before acquiring a business (such as legal due diligence).

Our QoE reports are designed to arm a purchaser with key information about the target company, so that the acquiring company can make an informed purchase. This report is also valuable to potential financers of an acquisition (banks or other funding sources), as they gain insights into the operating cash flows of the underlying business.

TALK WITH AN ADVISOR TODAY.

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