ANDERS AUDIT AND ASSURANCE

FINANCIAL DUE DILIGENCE: QUALITY OF EARNINGS

Before buying or selling a company, having financial due diligence performed by an experienced, independent third-party is a critical step that can increase buyer confidence, uncover unknown issues and risks, and increase the speed and ease of the sale process. It may also result in better terms and send a signal that the buyer and seller are serious about completing a transaction. A Quality of Earnings report (QoE) is one important component of financial due diligence that is often completed along with a financial statement audit or review to provide the parties with an accurate picture of the company's sustainable level of ongoing earnings and quality of its balance sheet.

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 income and value. It provides a detailed analysis of the company's accounting policies, financial statements, key performance indicators, and cash flow generating capability.

The main differences between a financial audit or review and QoE are that audits are backward-looking and primarily determine whether the financial statements conform to Generally Accepted Accounting Principles (GAAP), while a QoE complements an audit by incorporating important adjustments to the financial statements, examining a variety of risks, and may also cover forward-looking projections.

The QoE analysis may identify issues related to:

- Analysis of financial reporting policies in accordance with GAAP
- Analysis of revenue recognition policy and identification of potential changes to recognized revenue
- Financial statement analysis to identify potential operational changes and strengths and weaknesses of the operations
- Analysis of key performance indicators
- A review of certain balance sheet items, such as receivables and accruals
- Analysis of working capital trends
- Analysis of proposed normalizing adjustments to EBITDA
- Analysis of sources of revenue as well as concentration and backlog analysis
- Review of historical trends related to revenue, gross profit, and operating expenses
- Review of target's state and federal income tax returns and sales and use tax exposure
- Possible analysis of the company's forward-looking projections
- Reviewing the draft letter of intent and purchase agreement

WHAT ARE THE BENEFITS?

Similar to receiving an inspection before buying a home, a QoE can uncover weaknesses in the company and identify key risks for the buyer as well as opportunities to increase value for the seller. A QoE can also identify business or financial reporting issues that may affect the company's value. The results can help to avoid surprises for both the buyer and seller. It can also assist the buyer with financing efforts and help them get approval from their board, investment committee, or lender.

Anders clients have the benefit of working with an integrated team of industry specialists from several departments, including audit, transaction advisory, and valuation, each able to bring their expertise to the project to drive the best results for our clients.

SCOPE OF WORK

Our QoE analysis can examine a wide range of topics and provide various levels of detail, depending on the needs of the buyer and/or seller. The period examined in the QoE analysis is generally the most recent one to two fiscal years as well as the trailing twelve-month interim period.

CALCULATIONS OF VALUE AND BUSINESS VALUATIONS

A key step in the acquisition or sale process is to gain insight into the value of the company. When there is not a requirement for a full valuation, Anders can provide a calculation of value, which can assist in pre-acquisition analysis and planning. While not as in-depth as a full business valuation, a calculation of value involves a combination of analysis and opinion, combining facts and judgment. In cases where a calculation of value is not the right option, our team of valuation professionals can perform a full business valuation with a detailed report.

FINANCIAL REPORTING AND TAX TREATMENT

Financial reporting and the purchase price allocation are important parts of a business combination. Under Accounting Standards Codification 805, Business Combinations, a buyer must recognize the assets acquired and liabilities assumed at fair value. Recognized assets include tangible assets, such as real and personal property, and intangible assets, such as trade names, technology, and customer relationships, among others. Intangible assets are often the most challenging to value but can comprise the bulk of the acquired value in many of today's deals. Having an experienced valuation advisor on your side can ensure all assets and liabilities are properly valued.

In addition to financial reporting, understanding tax treatment and ramifications, and tax credit eligibility is critical to a successful acquisition or sale. Valuation becomes important when the acquirer must allocate the purchase price to legal entities and categories/classes.

A Quality of Earnings Report prepared by an experienced, independent team like Anders can benefit the buyer and seller in many ways. Partnering with Anders can lead to a faster and more efficient negotiation and transaction process.

LEARN MORE ABOUT OUR SERVICES.

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