

Quality of Earnings



Quality of Earnings analysis varies in accordance with client-specific needs. GlassRatner is frequently called upon to provide QoE as follows:

- Quality of Reporting Earnings and Cash Flow
- Quality of Record Keeping and Accounting Systems
- Appropriateness of Accounting Policies and Procedures
- Quality of Collateral to Secure the Transaction
- Potential for Off Book Assets and Liabilities
- Quality of Internal Controls and Management Routines
- Projections of Future Financial Performance

Quality of Earnings (QoE) assessment is a subset of the larger Financial Due Diligence process. QoE assessment is largely focused on financial statements and related support documents of the target entity, both from a historical prospective and with respect to projections. QoE analysis is geared to answer certain types of questions, several of which are listed here by way of example:

- Do the historical earnings of the company accurately and completely represent the financial performance of the business, or are normalizing adjustments required for such items as nonrecurring, extraordinary, non-operating, contingent, and off-statement items and issues? QoE also seeks to identify any accounting errors.
- Is the business as healthy as its balance sheet might suggest, or are there issues related to bad accounts, deferred expenditures, obsolescence, and unfavorable terms with suppliers, landlords, and creditors?
- What do auditors, vendors, and customers have to say about dealing with the company and the integrity of its management?
- Do projections make sense relative to historical results, industry competition and trends, capabilities of the business, intellectual property rights, the economy, financial capacity, and timeframes?

Many more questions are asked in connection with a QoE examination. While conducting a QoE study, analysts are looking at such items as business risks, adequacy of financial and operating controls, quality of management reports and information, and management's financial reporting practices with respect to such items as estimates and levels of reserves.

A QoE study presents the information provided by the seller, but normalizes and explains issues and variances such as those mentioned above. This process is linked to the examination of source documents in support of historical and projected financial statements and is conducted at a line item level of detail. Professional skepticism is a healthy practice when performing QoE analysis. With professional skepticism, certain risks that might otherwise be overlooked are often identified. An example might be the loss of a major customer that has only recently occurred.