Quality of Earnings analysis – new rules from the SBA

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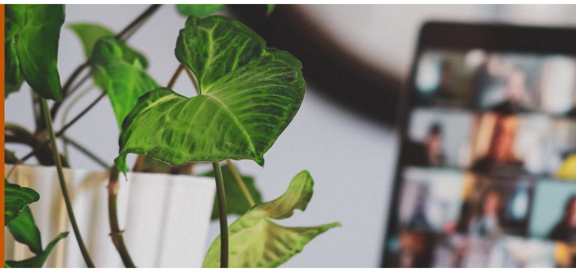

Historically, many lenders, buyers, and investors viewed a Quality of Earnings (QoE) analysis as a best practice for larger transactions. Under the U.S. Small Business Administration's (SBA) new guidance, qualifying transactions will now require a more formal level of financial due diligence as part of the underwriting process.

The (SBA) recently issued SOP 50 10 8.1, which introduces new QoE requirements for certain SBA 7(a) change-of-ownership transactions beginning October 1, 2026. Under the revised guidance, certain acquisition and business expansion transactions with an applicable business purchase price of $3 million or greater will require an independent QoE report obtained for the benefit of the lender.

The SBA guidance indicates that a QoE report should evaluate the sustainability and reliability of the earnings supporting the acquisition and includes procedures such as:

- Reconciling accountant-prepared financial statements, tax returns, internal financial records, and IRS transcript data
- Developing a normalized earnings analysis and documenting EBITDA adjustments and add-backs
- Evaluating revenue quality, customer concentration, contract continuity, and other factors affecting future performance
- Assessing whether earnings and margins are likely to be sustainable after the transaction closes
- Performing a cash proof that reconciles cash receipts and disbursements to reported financial results for both the trailing twelve-month period and prior fiscal years
- Documenting findings for use by lenders in their underwriting and credit approval process

For business owners planning an eventual exit, buyers pursuing acquisitions, lenders financing transactions, and advisors supporting M&A activity, understanding these requirements early can help identify potential issues before they become obstacles during diligence.

The Johnson O'Connor Transaction Advisory team has extensive experience assisting buyers, sellers, lenders, and investors with Quality of Earnings analyses and transaction-related financial due diligence. We welcome the opportunity to discuss how these new SBA requirements may impact your upcoming transactions.

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