Quality of Earnings vs. Financial Statement Audit: Understanding the Difference

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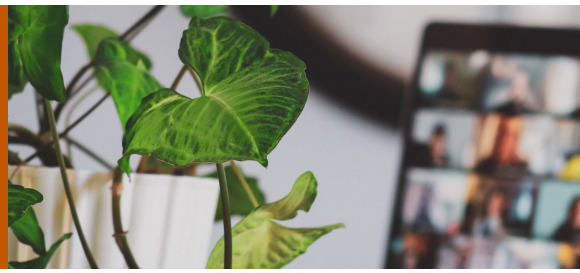

Business owners often assume a financial statement audit and a Quality of Earnings (QoE) analysis provide the same level of insight. While both involve a review of financial information, they serve very different purposes.

A financial statement audit is designed to determine whether historical financial statements are fairly presented in accordance with applicable accounting standards. A Quality of Earnings, or QoE, analysis is more transaction-focused. It evaluates the sustainability and quality of the earnings that drive business value, particularly in the context of a potential sale, acquisition, or financing event.

Audit	Quality of Earnings (QoE)
Focuses on whether financial statements are fairly presented in accordance with accounting standards	Focuses on the sustainability and quality of earnings that drive business value
Historical in nature	Forward-looking with a transaction focus
Provides reasonable assurance over the financial statements	Analyzes normalized EBITDA, cash flow, working capital, and earnings adjustments
Intended for shareholders, lenders, boards, and other stakeholders	Intended for buyers, sellers, lenders, investors, and private equity groups
May identify accounting errors or control deficiencies	Identifies deal risks, opportunities, add-backs, and value drivers

A common misconception is that a company with audited financial statements does not need a QoE. In reality, most M&A transactions still require a QoE because buyers are trying to understand not only whether the numbers are fairly stated, but also what level of earnings and cash flow is likely to continue after closing.

Both can be valuable, but they are not substitutes for one another.

The Johnson O'Connor transaction advisory team has extensive experience assisting buyers, sellers, lenders, and investors throughout the M&A process. We would welcome the opportunity to discuss how a Quality of Earnings analysis can support your goals.

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