

Quality of Earnings Checklist

8-Section M&A Due Diligence Guide

Use this checklist to run a complete Quality of Earnings analysis on a lower middle market acquisition. Each section mirrors the online guide at shepi.ai.

1. Data Request

Collect 3 years + TTM. Missing data is the #1 cause of QoE delays.

- Trial balances — 3 years plus TTM (monthly preferred)
- General ledger — full detail for the same periods
- Bank statements — all operating accounts for proof of cash
- AR aging — current and 12-month historical snapshots
- AP aging — current and 12-month historical snapshots
- Payroll register — for owner comp normalization
- Customer revenue detail — for concentration analysis
- Vendor spend detail — for related-party identification
- Tax returns — 3 years for book-to-tax reconciliation
- Loan agreements & lease schedules
- Capex history — to normalize maintenance vs growth

2. Revenue Quality

Test whether revenue is recurring, properly recognized, and well-diversified.

- Recognition policy review — earned vs billed vs collected
- Recurring vs non-recurring classification per stream
- Customer concentration: top 10 % of revenue, 3-year trend
- Pricing vs volume decomposition of growth
- AR aging buckets and collectability of >90 day balances
- Channel & geography mix shifts

3. EBITDA Adjustments

Standard add-back categories. Owner comp normalization is usually the largest line.

- Owner compensation normalization (above/below market)
- Personal expenses run through the business
- Non-recurring revenue (one-time projects, COVID grants)
- Non-recurring expenses (legal settlements, restructuring)
- Related-party transactions at non-market terms
- Run-rate adjustments for new contracts and lost customers

- Accounting cleanup (out-of-period entries, accruals)
- Stock-based compensation
- Rent normalization (owner-occupied real estate)

4. Working Capital

Drives the dollar-for-dollar purchase price adjustment at close.

- Trailing 12-month monthly NWC schedule
- DSO, DPO, DIO turnover trends
- Seasonality identification and normalization
- Peg calculation for the purchase agreement
- Treatment of cash, debt-like items, deferred revenue

5. Proof of Cash

Where commingled expenses and unrecorded liabilities surface.

- Reconcile total bank deposits to GL revenue + other receipts
- Reconcile total disbursements to GL expenses + other payments
- Identify unrecorded liabilities (checks not yet posted)
- Identify commingled personal expenses
- Verify intercompany / related-party transfer treatment
- Confirm period-end cut-off accuracy

6. General Ledger Review

Run each test across 100% of GL transactions, not a sample.

- Round-dollar transactions
- Period-end clustering of entries
- Duplicate detection (vendor + amount + date)
- Unusual manual entries to revenue, COGS, accruals
- Transactions over materiality threshold
- Account-level activity drift year-over-year

7. Risk Flags

Qualitative findings that drive R&W insurance, escrow, and indemnity terms.

- Customer concentration over 20% of revenue
- Vendor concentration creating supply risk
- Key person / employee dependency
- Recent loss of major customer or contract
- Outstanding litigation or regulatory issues

- Tax exposure (sales tax nexus, payroll tax)
- Going-concern indicators
- Quality of accounting controls

8. Final Deliverables

What the lender, buyer, and IC actually read.

- QoE report (PDF, lender-ready)
- Adjusted EBITDA bridge (Excel)
- Working capital schedule (Excel)
- Proof of cash reconciliation (Excel)
- Customer concentration analysis
- Flagged transactions with audit trail
- Full Excel workbook for buyer/lender review