Standards for Distressed Business Valuation

QR quickreadbuzz.com/2015/04/01/standards-for-distressed-business-valuation/

National Association of Certified Valuators and Analysts

AIRA Issues New Standards for Distressed Business Valuation

In 2004, The Association of Insolvency & Restructuring Advisors (AIRA) launched the Certification in Distressed Business Valuation (CDBV). Before the inception of the CDBV program, there was no professional designation to recognize those skilled and experienced in distressed business valuation work or expert valuation testimony in bankruptcy litigation. Given the increasing number of professionals who are performing business valuation engagements, the AIRA Board approved Standards for Distressed Business Valuation to improve the consistency and quality of practice among its members. The aforementioned standards became effective March 1, 2014. Michael Pakter, a NACVA member and instructor and AIRA member, provides an overview of the distressed business valuation standards and shares his view on what standards professionals accredited by other organizations should consider following in a distressed business valuation engagement.

The Association of Insolvency & Restructuring Advisors[i] (AIRA) has developed, approved, and issued new Standards for Distressed Business Valuation for business valuation engagements accepted on or after March 1, 2014. The purpose of this article is to provide the reader with an overview of these new valuation standards.[ii] The new Standards are lengthy, approximately 41-pages long, and sets forth issues unique to valuation of distressed entities.

The AIRA recognizes a variety of professional organizations have defined professional standards for valuation engagements. The author is aware, for example, of valuation standards issued by the National Association of Certified Valuation Analysts (NACVA), the American Institute of Certified Public Accountants (AICPA), and the Appraisal Foundation[iii].

For the purposes of its new standards, the AIRA has no opinion neither regarding the priority of valuation standards among those organizations nor regarding the application to individual valuation engagements of any standards that may differ between organizations. The author submits that the selection of applicable valuation standards is impacted by the valuation analyst's professional certifications, his or her association memberships and credentialing, the asset, business, or interest being valued, the applicable forum, the existence of actual litigation, and so on.

Valuation standard setting organizations develop, approve, and issue valuation standards intended to apply to a wide array of valuation engagements and circumstances. AIRA believes it is in the best interests of the valuation profession that it provides guidance and standards on applying general valuation theory to the specialized circumstances found in distressed valuation engagements.

AIRA Standards are guidelines that valuation analysts should follow when performing valuations involving workouts, restructuring, and bankruptcy matters. Compliance is ***voluntary with AIRA*** and other professional standards and the responsibility of the valuation analyst. Refusing to comply does not violate any law or regulation, but a false claim of compliance may violate laws or regulations.

AIRA members are required to follow the AIRA Standards when performing engagements to estimate value that culminate in the expression of an opinion and/or conclusion of value in matters involving business turnaround, restructuring, bankruptcy, and insolvency. The author submits that non-AIRA members may benefit from considering the AIRA Standards in valuing distressed business or assets.

Because the AIRA Standards apply when the valuation analyst estimates value culminating in the expression of our opinion and/or conclusion of value, the author submits the AIRA Standards do not apply, but may be useful guidance, when performing a "calculation" of the value of a distressed business or asset.

The AIRA Standards note that traditional valuation methods may require significant adjustments to reflect the unique financial and/or operating situation of a distressed business as well as the legal context and intended purpose of the valuation. Comparative data may be driven primarily by healthy companies. The ability of distressed businesses to satisfy its obligations to equity holders, creditors, or other parties of interest likely is significantly impacted. Unique factors include volatility in cash flow, risk adjusted discount rates, the feasibility of securing revenue financing, and uncertainties in achieving financial and/or operational turnaround.

The AIRA Standards note that distressed business valuations may be performed for transactional, litigation, compliance, and planning purposes. In workouts, restructuring, and bankruptcy, valuations may be used to develop an opinion of value regarding reorganization value; the sale of assets or business segments; the solvency/insolvency of a business enterprise (at a point in time); the viability/feasibility of the debtor's plan of reorganization; the adequate protection of creditors; "fresh start" financial reporting, and/or the future availability of net operating losses or other tax attributes.

Bankruptcy, insolvency, and/or troubled debt restructuring consulting services often rely on valuations to:

- Identify an appropriate capital structure; develop a plan of reorganization; and advise creditors to accept or reject a plan of reorganization.
- Advise clients with forecasts and analysis of cash collateral, replacement collateral and collateral values.
- Prepare/evaluate cash flow projections and present value analysis to assess a distressed debtors company's viability/feasibility.
- Assess the debtor's going concern versus liquidation value under a proposed plan of reorganization for the "best interest of creditors" test.
- Evaluate avoidance and recovery actions based on determining the debtor's solvency/insolvency at the particular date.
- Evaluate the adequacy of protection afforded to creditors holding received claims by assessing the size of the debtor's equity cushion.
- Assessing the value of collateral.
- Evaluate whether the "absolute priority rule" is violated[iv].

The AIRA Standards note that determining value in one context is not necessarily determinative of value in a different context. The purpose, timing, and intended use of the valuation determines the context of the valuation results, methodology, and relevance of the valuation conclusion.

The AIRA Standards note that valuation in bankruptcy matters is determined under differing factual situations. A valuation at one stage of the case is not binding at a late stage of a case. Section 506(a) of the U.S. Bankruptcy Code provides that value must be determined in light of the purpose of the valuation and the proposed disposition and/or use of the subject property or a plan affecting a creditor's interests.

The AIRA Standards note that it is critical to review relevant case precedent in order to interpret the appropriate valuation standards, approaches, methods, and computations for each situation and/or litigation specific valuation performed. Courts must determine value on a case-by-case basis, taking into account the facts and competing interests in each case.

Michael D. Pakter is Managing Member of Gould & Pakter Associates, LLC, a Chicago-based forensic, business valuation, and litigation support firm. Mr. Pakter has more than 35 years' experience in accounting, financial analysis, financial forensics and investigations, including more than 15 years' experience in economic damages and business valuation issues. He is a Certified Public Accountant, additionally Certified in Financial Forensics and Management Accounting. Mr. Pakter can be reached at mpakter@licpa.com or at (312) 229-1720.

Notes

[i] The AIRA is a non-profit professional association serving financial advisors, accountants, crisis managers, business turnaround consultants, lenders, investment bankers, attorneys, trustees, and other individuals involved in the field of business turnaround, restructuring, bankruptcy, and insolvency, The AIRA has two certification programs: the Certified Insolvency and Restructuring Advisor (CIRA) and the Certification in Distressed Business Valuation (CDBV). The author has completed the AIRA's CIRA and CDBV certification programs.

[ii] The author has extracted significant portions of this article from the AIRA without providing specific section and/or page references. Readers are encouraged to read the entire text of the AIRA Standards, copies of which can be found at www.aira.org/aira/standards. The author has attempted to differentiate in this article between his opinions and the content of the AIRA standards.

[iii] The AIRA, like the NACVA, is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education of the National Registry of CPE Sponsors. The Appraisal Foundation is the foremost authority on the valuation profession in the United States. The Appraisal Foundation sets the congressionally authorized standards and qualifications for real estate appraisers, and provides voluntary guidance on recognized valuation methods and techniques for all valuation professionals. The Appraisal Foundation's Appraisal Standards Board promulgates and updates best practices as codified in the Uniform Standards of Professional Appraisal Practice (USPAP) and its Appraisal Qualifications Board promulgates minimum standards for appraiser certification and licensing.

[iv] The "absolute priority rule" specified the order in which creditors are paid their recourse in a bankruptcy case.

Image courtesy of stockimages/FreeDigitalPhotos.net