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Valuation of a Note Receivable

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There are certain situations where the fair market value of a note can be less than the face value. For example, if Company A holds a note receivable from Company B, and Company B has demonstrated financial hardship or inability to repay the note, then the value of the note is potentially impaired.

One approach to determining the value of the note would be to value the expected cash flow from the note using an appropriate discount rate.   Determining the right discount rate requires specialized expertise and is subjective. The following risk-return attributes should be considered in the note valuation: creditworthiness of the creditor, default provisions, security, liquidity, payment history, interest rate, term and size of the note. Also, the debtor's financial history and outlook should be considered as well in determining the proper rate to apply to the expected cash flow from the note.

The return on corporate bonds can be a good source to assist in determining an appropriate discount rate. Corporate bonds are rated based on the financial condition and creditworthiness of the company repaying the bonds. Credit rating agencies such as Moody's Investor Service and Standard & Poor's publish the rating of corporate bonds. The debtor's financial condition and other factors can be compared to the companies issuing the corporate bonds to help select an appropriate bond return rate to use as a basis for the discount rate to value the note from the debtor.

If you encounter a situation where you need to have a note valued,please contact a member of the Schneider Downs Business Advisory Group, and we will be happy to assist you in the valuation of your company.

You've heard our thoughts… We'd like to hear yours

The Schneider Downs Our Thoughts On blog exists to create a dialogue on issues that are important to organizations and individuals. While we enjoy sharing our ideas and insights, we're especially interested in what you may have to say. If you have a question or a comment about this article – or any article from the Our Thoughts On blog – we hope you'll share it with us. After all, a dialogue is an exchange of ideas, and we'd like to hear from you. Email us at contactSD@schneiderdowns.com.