

Backtest Indicates Accuracy of Audit Integrity Bankruptcy Risk Model

Audit Integrity invoked the wrath of Hertz Global Holdings, Inc. (HTZ) for including the company on its [list of companies at risk of bankruptcy](#). Now Audit Integrity provides more data in support of its approach:



Audit Integrity's new AGR Bankruptcy Risk Model, introduced in September 2009, has been shown to be a highly effective tool in predicting bankruptcy risk. The AGR Bankruptcy Risk Model has an out-of-sample accuracy ratio of 91%.

The percentile for the probability of bankruptcy: the AGR Bankruptcy Risk Model provides sufficient advance warning regarding companies' risk of bankruptcy.

Using 21 actual bankruptcies over the last 12 months beginning November 2008, the AGR Bankruptcy Risk Model correctly predicted (in the lowest two deciles) the majority of companies within the 12-month bankruptcy prediction time horizon.

12 months prior to bankruptcy, 16 out of 21 (76.2%) companies were ranked in the lowest two deciles; 6 months prior to bankruptcy, 19 of 21 (90.5%) of companies were ranked in the lowest two deciles; and 3 months prior to bankruptcy, 20 of 21 (95.2%) of companies were ranked in the lowest two deciles.

The probability of bankruptcy: the AGR input in the AGR Bankruptcy Risk Model is an important and relevant input. Its importance is underscored by the results of tests in which the AGR percentiles were altered to the highest possible (100th percentile) in order to reflect a hypothetical Conservative AGR company. From our data set of 15 sample companies with Very Aggressive AGR ratings and greater than 5% bankruptcy probability, the tests showed that the AGR input accounted for an average of 80% (or 3.97 percentage points) improvement in bankruptcy probability.

This test illustrates that the transparency of financial statements is an integral part to bankruptcy analysis, and is separate and independent from the other AGR Bankruptcy Risk Model inputs (namely, accounting and market-related inputs based on the Ohlson Model and the Merton DD model).

This confirms that, independent of the existence of certain fundamental and market signals, the accuracy and reliability of financial statements (as represented by AGR) is an important factor in measuring bankruptcy probability.

The full analysis is available [here](#).

<http://www.researchrecap.com/?s=audit+integrity&searchsubmit=Search>