HARD COPY

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of, LYNN TILTON PATRIARCH PARTNERS, LLC, PATRIARCH PARTNERS VIII, LLC, PATRIARCH PARTNERS XIV, LLC and PATRIARCH PARTNERS XV, LLC Respondents.	Administrative Proceeding File No. 3-16462 Judge Carol Fox Foelak

DECLARATION OF AKIVA SHAPIRO IN SUPPORT OF RESPONDENTS' MOTION *IN LIMINE* TO EXCLUDE THE EXPERT TESTIMONY OF STEVEN L. HENNING

I, Akiva Shapiro, under penalty of perjury, affirm as follows:

1. I am an attorney in the law firm of Gibson, Dunn & Crutcher LLP, attorneys for the above-referenced Respondents. I submit this omnibus declaration in support of Respondents' Motion *in Limine* to Exclude the Expert Testimony of Steven L. Henning.

2. Attached hereto as Exhibit 1 is the Expert Report of Steven L. Henning, dated July 10, 2015.

3. Attached hereto as Exhibit 2 is the Rebuttal Expert Report of Steven L. Henning, dated August 31, 2015.

4. Attached hereto as Exhibit 3 is the curriculum vitae of Steven L. Henning.

5. Attached hereto as Exhibit 4 is a list of cases in which Steven L. Henning has testified as an expert at trial and/or deposition.

6. Attached hereto as Exhibit 5 is a list of publications of Steven L. Henning.

7. Attached hereto as Exhibit 6 are the financial statements of Zohar CDO 2003-1, Limited ("Zohar I"), dated Aug. 8, 2013.

8. I declare under penalty of perjury that the forgoing is true and correct to the best of my knowledge.

Dated: New York, New York
August 31, 2016

Akiva Shapiro

Exhibit 1

UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16462

In the Matter of

LYNN TILTON;
PATRIARCH PARTNERS, LLC;
PATRIARCH PARTNERS VIII, LLC;
PATRIARCH PARTNERS XIV, LLC;
AND
PATRIARCH PARTNERS XV, LLC,

Respondents

EXPERT REPORT

OF

STEVEN L. HENNING, Ph.D., CPA

July 10, 2015

EXPERT REPORT
OF
STEVEN L. HENNING, Ph.D., CPA

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16462

A. INTRODUCTION

The Division of Enforcement ("Division") has retained me in the above-referenced matter as an expert on U.S. generally accepted accounting principles ("GAAP") and financial reporting. I have been engaged to formulate and express opinions on whether the financial statements of certain Collateralized Debt Obligations ("CDOs"), collectively denoted the Zohar Funds, were prepared in accordance with GAAP. It is my opinion that they were not.

I began my career in public accounting in 1983 and I am a licensed Certified Public Accountant in Wisconsin and New York. My background includes experience in public accounting, private industry, academia, and at the SEC. I am a partner at Marks Paneth LLP ("MP"), a public accounting and business consulting firm. Since 2004, I have practiced as an accounting expert in litigation matters that address allegations of improper financial reporting, and I have assisted domestic and foreign companies with financial and regulatory reporting matters, including compliance with internal control requirements and conducting investigations on behalf of audit committees related to suspected management and employee fraud. MP employs approximately 500 professionals, some

35 of whom work in the litigation services practice under my direction, including a number who have attained the Certified Fraud Examiner (CFE) designation.

My hourly billing rate on this engagement is $500 per hour. Attached to this report are the following exhibits:

- a copy of my curriculum vitae (Exhibit A);
- a listing of cases in which I have testified as an expert at trial or by deposition (Exhibit B);
- a listing of all publications that I have authored or co-authored (Exhibit C);
- a listing of materials I considered in the formation of my opinions (Exhibit D).

I am performing this expert witness engagement in accordance with the AICPA's *Statement on Standards for Consulting Services: Definitions and Standards.* These standards require me to be impartial, intellectually honest, and free of conflicts of interest. In performing my work I have applied the requirements of GAAP and SEC regulations.

This report describes my work to date and summarizes the opinions I have formed at this time and the bases for these opinions. Prior to the time I testify at the hearing in this matter, I may review evidence that is provided to me, as well as reports of other experts. Therefore, the opinions expressed herein may change as a result of my review of additional evidence. Accordingly, I reserve the right to supplement, update or otherwise modify this report at a later date.

B. SUMMARY OF OPINIONS

Based on my work to date, I have formed the following opinions with respect to the financial statements of Zohar CDO 2003 – I, Limited (Zohar I), Zohar CDO 2005 – II, Limited (Zohar II) and Zohar III, Limited (Zohar III) (collectively, the "Funds") from inception of the Funds into 2015 as listed in the Appendix.

- The Funds' financial statements departed from GAAP because Patriarch did not perform GAAP-compliant impairment analyses. The Funds' financial statements were false and misleading because they also disclosed that a GAAP-compliant impairment analysis was performed when, in fact, it was not.

- The Funds' financial statements were false and misleading because they disclosed that the fair value of the loans was approximately equal to the carrying value when there was no basis to make that disclosure.

- The fact that the Funds' financial statements and accompanying certifications recently eliminated the statements referencing GAAP compliance is an acknowledgement by the Respondents that the prior reporting departed from GAAP.

C. BASES FOR OPINIONS

The bases for my opinions are discussed on the following pages under the following captions:

I. Company Background and the Role of Tilton

II. The Respondents' Departures from GAAP

Steven L. Henning

Steven L. Henning

I. Company Background and the Role of Tilton

Patriarch Partners, LLC ("Patriarch") is a Delaware Limited Liability Company with a principal place of business in New York, New York. Tilton is the chief executive officer ("CEO") and directly or indirectly owns 100% of Patriarch.[1] Tilton is the manager for Patriarch VIII, Patriarch XIV, and Patriarch XV (collectively, the "Patriarch Collateral Managers").[2] The Patriarch Collateral Managers are directly or indirectly controlled by Tilton.[3]

The Patriarch Collateral Managers have been registered as investment advisers with the Securities and Exchange Commission ("SEC") since March 2012.[4] Patriarch Partners VIII, LLC is the collateral manager for Zohar I.[5] Patriarch Partners XIV, LLC is the collateral manager for Zohar II.[6] Patriarch Partners XV, LLC is the collateral manager for Zohar III.[7] Tilton makes all significant decisions relating to the investments made by the Funds.[8]

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[1] Tilton testimony dated February 12, 2013, pp. 33 and 38.
[2] See the Collateral Management Agreements at MIS-SEC-CLO-0013236-69; MIS-SEC-CLO-0017579-610; and KRU00005034-68.
[3] Form ADV filed by Patriarch Partners XV LLC shows, in Schedule A that Zohar Holding, LLC is the 75% or more owner and control person of each of the Patriarch Collateral Managers. Schedule B of that form shows Tilton is the 75% or more owner and the controlling person of the Patriarch Collateral Managers. See: http://www.adviserinfo.sec.gov/IAPD/Content/ViewForm/crd_iapd_stream_pdf.aspx?ORG_PK=160755&RGLTR_PK=50000&STATE_CD=&FLNG_PK=03135E040008017B05E00F10055E3AF5056C8CC0&Print=Y.
[4] Patriarch Partners XV, LLC's registration is found at: http://www.adviserinfo.sec.gov/iapd/content/viewform/adv/Sections/iapd_AdvRegulatorStatusSection.aspx?ORG_PK=160755&RGLTR_PK=50000&STATE_CD=&FLNG_PK=03135E040008017B05E00F10055E3AF5056C8CC0. The Form ADV filed by Patriarch Partners XV, LLC lists Patriarch Partners VIII, LLC and Patriarch Partners XIV, LLC as relying advisors on Schedule A: http://www.adviserinfo.sec.gov/IAPD/Content/ViewForm/crd_iapd_stream_pdf.aspx?ORG_PK=160755&RGLTR_PK=50000&STATE_CD=&FLNG_PK=03135E040008017B05E00F10055E3AF5056C8CC0&Print=Y. The SEC staff has taken the position that an investment adviser may file (or amend) a single Form ADV on behalf of itself and each other adviser that is under common control with the filing adviser where the filing adviser and each relying adviser collectively conduct a "single advisory business." See: http://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf, p. 19.
[5] See the Collateral Management Agreement at MIS-SEC-CLO-0013236-69.
[6] See the Collateral Management Agreements at MIS-SEC-CLO-0017579-610.
[7] See the Collateral Management Agreements at KRU00005034-68.
[8] Tilton testimony dated February 12, 2013, p. 120.

The Funds' Financial Statements

Under the terms of the Indentures, each Fund is required to provide financial statements on a quarterly basis prepared in accordance with GAAP. Specifically, pursuant to section 7.9(a) of each Indenture:

> No later than the third Business Day prior to each Payment Date, the Issuer shall deliver to the Trustee, the Preference Share Paying Agent, the Credit Enhancer, each Rating Agency and each Noteholder, an Officer's certificate attaching (i) a consolidated balance sheet of the Issuer... and (ii) a consolidated income statement of the Issuer and its subsidiaries for the Due Period ending on such Determination Date, prepared in each case in accordance with U.S. generally accepted accounting principles and certified by the Issuer as presenting fairly, in all material respects, the financial position of the Issuer and its consolidated subsidiaries.

These financial statements are prepared by Patriarch's accounting department, approved by Tilton, and provided to the trustee, which makes them available to investors.[9]

Management's Responsibility for Financial Reporting

It is a basic tenet of financial reporting in the United States that management is ultimately responsible for an entity's financial statements.[10] Therefore, Patriarch and its management bore responsibility for the Funds' financial statements.

As managing member of the respective Patriarch Collateral Manager that issues each of the Fund's financial statements and CEO of Patriarch, the entity that prepares the Funds'

[9] Tilton testimony dated February 12, 2013, p. 66; Order Instituting Proceedings ("OIP"), ¶57.

[10] "Management is responsible for adopting sound accounting policies and for establishing and maintaining internal control that will, among other things, initiate, authorize, record, process, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements." AU Section 110.03, *Responsibilities and Functions of the Independent Auditor*. That responsibility does not change with the level of service provided to the Funds by outside accountants. Indeed, as the standards on *Compilation and Review of Financial Statements*, AR § 100.02 acknowledge, regardless of the different levels of service from an outside accountant, management still retains responsibility for the financial statements.

financial statements, Tilton cannot abdicate her responsibility for those financial statements.[11] As such, she had an obligation to ensure that they were prepared in accordance with GAAP and that they were not false and misleading.[12]

Rule 204-2 of the Investment Advisers Act of 1940 requires an investment advisor to maintain books and records related to its investment advisory business, including all financial statements.[13] Furthermore, an investment adviser has an ongoing obligation to supervise all persons acting on its behalf.[14] Tilton had the responsibility of a "supervisor" because she certified the financial statements of the Funds, and as controlling manager of Patriarch Collateral Managers, she had the ability and authority to affect the conduct of the employees who worked for her, including those who prepared the Funds' financial statements.[15]

Under the Investment Advisers Act of 1940, a person (*e.g.*, an adviser or an officer of the adviser) will not be deemed to have failed to supervise a person if (i) the adviser had established procedures and a system for applying such procedures that are reasonably expected to prevent and detect the conduct, and (ii) the person reasonably discharged his or her supervisory duties and had no reasonable cause to believe that the procedures were not being complied with.[16] That is not the case in this matter. As demonstrated herein, Patriarch did not establish any procedures

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[11] An investment adviser has a continuing responsibility to supervise all persons acting on its behalf. See http://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf, p. 39. That includes Tilton's responsibility related to the preparation by Patriarch of the Funds' financial statements.
[12] The SEC may sanction an adviser that "has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his [or her] supervision." See http://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf, p. 39.
[13] See 17 CFR 275.204-2, *Books and Records to be Maintained by Investment Advisers.*
[14] See http://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf, p. 39.
[15] For example, Whalen testified that Tilton had the authority to make the decisions and that he deferred to her. Examples include Whalen testimony dated January 17, 2013: pp. 33; 34; 60; 77; 98; 112; 164-165; and 169. Similarly, Mercado testified that Tilton made decision impacting Patriarch's preparation of the financial statements. Examples include Mercado testimony dated July 9, 2014: pp. 53; 55; 59; 61; and 90.
[16] See http://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf, p. 39.

to calculate the impairment or the fair value of the Funds' loans. Tilton put herself in charge of making accounting policies and decisions on the reporting of the loans, and did not defer responsibility for these decisions to others.[17]

Moreover, after she reviewed the financial statements, Tilton signed certifications that the Funds' Balance Sheets and Income Statements were prepared in accordance with GAAP.[18] Tilton signed approximately 100 certifications for the three Zohar Funds.[19] By signing the certifications and maintaining her authority over the presentation of the loans in the financial statements, Tilton certified GAAP compliance and thus retained responsibility to ensure the financial statements did not depart from GAAP. As described in more detail below, Tilton did not ensure the financial statements were GAAP compliant; the fact that the financial statements were not GAAP compliant rendered them false and misleading.

Anchin, Block & Anchin, LLP ("Anchin"), an outside accounting firm hired by Patriarch, served two roles with respect to the services it provided to the Funds, described in two separate engagement letters.[20] One role included work that it performed on a quarterly basis with respect to the Funds' financial statements and the second role consisted of performing certain agreed-upon procedures on an annual basis.[21] Based on my review of the engagement letters and the testimony of Peter Berlant, the Anchin partner, and also based on my experience with such

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[17] Mercado testimony dated July 9, 2014, pp. 52-53.
[18] See the "Certificate as to Financial Statements" for any of the Zohar CDO 2003-1, Limited, Zohar II 2005-1, Limited, and Zohar III, Limited financial statements.
[19] See a complete list of the financial statements Tilton certified as compliant with GAAP that I reviewed in the Appendix.
[20] Government Exhibit 195 ABA-000009-11, Government Exhibit 189 ABA 000692-95.
[21] Berlant testimony dated June 18, 2014, p. 20. It is my understanding that the agreed-upon procedures performed by Anchin pursuant to Section 10.15(b) of the Indenture agreements is not a subject of this proceeding or this opinion.

professional matters, Anchin was not hired to ensure the financial statements were prepared in accordance with GAAP.

The first role consisted of certain general services such as performing certain bookkeeping services, financial statement services, providing business and financial advice and assisting Patriarch with certain third-party interactions. The financial statement services consisted of reading and commenting on the financial statements along with checking certain computations. The engagement letter for these services states the following regarding Anchin's responsibility:

> ...Such services shall not constitute a compilation, review or audit services as those terms are used in the professional literature published by the AICPA. Accordingly, we will not render any report with respect to such statements, computations or data **and will take no responsibility regarding** the accuracy or completeness of such statements, computations or data or **whether such statements or data comply with generally accepted accounting principles** or any other specified basis of accounting. Our responsibility shall be limited to advising you of any obvious errors which come to our attention as a result of our reading of such statements or data, and our services shall in no way relive you of any obligations that you may have with respect to the accuracy and completeness of any data which you ask us to read and comment upon. [22]

Berlant testified that when he read the Funds' financial statements, he focused on the dates that needed to be updated each period, made sure there were no addition or subtraction errors in the schedules, and made sure the schedules agreed with each other. He also made sure that the correct amounts were carried forward from one period to the next to ensure that the cumulative amounts were correct.[23] Berlant characterized his review as ministerial in nature and spent only an hour or two per quarter on the engagement.[24] Therefore, based on the engagement letter for the financial statement services, and the nature of the procedures performed by Berlant,

[22] Government Exhibit 195 ABA-000009-11. Emphasis supplied.
[23] Berlant testimony dated June 18, 2014, pp. 20, 50, and 51.
[24] Berlant testimony dated June 18, 2014, pp. 20 and 57.

it is my opinion that Anchin's work did not constitute an audit or a review and the work performed did not provide any assurance that the financial statements were GAAP compliant.

As discussed in the next section of this report, the Funds' financial statements that Tilton certified were in accordance with GAAP were, in fact, ***not*** in accordance with GAAP.

II. The Respondents' Departures from GAAP

On July 1, 2009, The Financial Accounting Standards Board launched an Accounting Standards Codification (the Codification) that became the single source of authoritative nongovernmental US generally accepted accounting principles. FASB statement No. 168, stated that all existing accounting standards documents are superseded and all other accounting literature not included in the codification are non-authoritative.[25]

Accounting for Loan Impairment

GAAP required Respondents to take a number of affirmative steps to account for loan impairment. Here I will detail these requirements, then explain how Respondents departed from them. GAAP requires a creditor to record a loss when it is probable that a loan is impaired as of the date of the financial statement. A loan is impaired, and must be measured for the amount of impairment loss when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contract with the debtor.[26] Probable is

[25] None of the codifications changed GAAP; the pronouncements were re-organized into accounting topics, so users would be able to easily research literature and information in a structured format.
[26] ASC 310-10-35-16.

defined as an area within a range of the likelihood that a future event or events will occur confirming the fact of the loss.[27]

At the outset, GAAP required Patriarch to develop a mechanism for determining whether to analyze loans held by the Funds individually or in homogenous groups of loans with similar characteristics.[28] When a loan is identified for individual evaluation, GAAP dictates such loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of a loan.[29] Collecting all amounts due according to the contractual terms of the loan means "both the contractual interest payments and the contractual principal payments of a loan will be collected as scheduled in the loan agreement."[30] When loans are grouped for evaluation of impairment, loans should be impaired when losses are probable and reasonably estimable. Under either scenario, however, Patriarch was required to evaluate the loans for impairment losses.

Under GAAP, an estimated loss from a loss contingency[31] shall be accrued by a charge to income if both of the following conditions are met:

> 1. Information available before the financial statements are issued or are available to be issued indicates that it is probable that an asset has been impaired or a liability had been incurred at the date of the financial statements. Date of the financial statements means the end of the most recent accounting period for which financial statements are being presented. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.

[27] That range is from probable to remote, as follows: 1) Probable. The future event or events are likely to occur; 2) Reasonably possible. The chance of the future event or events occurring is more than remote but less than likely; 3) Remote. The chance of the future event or events occurring is slight. ASC 310-10-35-18.
[28] ASC 310-10-35-2, 35-6 and 35-14.
[29] ASC 310-10-35-2, 35-4, and 35-10.
[30] ASC 310-10-35-10.
[31] In financial reporting, a loss contingency is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible loss that will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm the loss or impairment of an asset. [ASC 450-20-20-Glossary]

2. The amount of the loss can be reasonably estimated.[32]

To conduct an impairment analysis, GAAP required Patriarch to first identify loans that exhibited indicators of impairment.[33] This would include reviewing loans that are delinquent in their interest and/or principal payments.[34] As discussed above, a loan is impaired when, based on current information and events, it is probable that the creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement.[35]

When a loan is considered to be impaired, the impairment to be recorded is based on the difference between the amount at which the loan is currently reported and the present value of the expected future cash flows discounted at the loan's effective interest rate.[36] A loan that becomes impaired (because it is probable that Patriarch will be unable to collect all the contractual interest payments and contractual principal payments as scheduled in the loan agreement) should be carried at an amount that considers the discounted value of all expected future cash flows in a manner consistent with the loan's measurement before it became impaired.[37]

Because, as described below, Patriarch discloses that it bases its measure of loan impairment on a present value calculation, the estimates of expected future cash flows should be Patriarch's best estimate based on reasonable and supportable assumptions and projections.[38] If Patriarch estimates a range for either the amount or timing of possible cash flows, the likelihood

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[32] ASC 450-20-25-2.
[33] ASC 310-10-35-9, and 35-47.
[34] ASC 310-10-35-10.
[35] ASC 310-10-35-4a.
[36] ASC 310-10-35-22.
[37] ASC 310-10-35-25.
[38] ASC 310-10-35-26.

of the possible outcomes shall be considered in determining the best estimate of expected future cash flows.[39]

Furthermore, GAAP required Patriarch to consider all available information reflecting past events and current conditions when developing the estimate of expected future cash flows.[40] All available information would include existing environmental factors, for example, existing industry, geographical, economic, and political factors that are relevant to the collectability of that loan and that indicate that it is probable that an asset had been impaired at the date of the financial statements.[41]

The measurement method the company selects to determine if a loan is impaired must be applied consistently throughout the life of that loan. Any changes in methodology must be justified by a change in circumstance.[42]

GAAP also required Patriarch to disclose the "entity's policy for determining which loans the entity assesses for impairment under Section 310-10-35" and "the factors considered in determining that the loan is impaired."[43]

Patriarch's Approach to Loan Impairment

I will now explain how Respondents departed from the GAAP requirements detailed above. Patriarch explicitly disclosed that it conducts an impairment analysis on the Fund assets. Specifically, Patriarch disclosed in the notes to the Funds' financial statements that it employed the following impairment methodology:

[39] Id.
[40] ASC 310-10-35-27.
[41] Id.
[42] ASC 310-10-35-29.
[43] ASC 310-10-50-15.

> In the event the Company's expected realization of principal under a CDO is impaired, such that the anticipated future collections are determined to be less than the carrying value of the loan, the Company will record an impairment loss equal to the amount of the anticipated shortfall and will thereafter carry the loan at the reduced amount.[44]

In other words, Patriarch discloses that it will evaluate whether it will receive the interest and principal payments it is to receive on each loan. If it determines it will collect less than what the carrying value of the loan is, Patriarch will write down the loan to the reduced amount it expects to receive. Patriarch did not follow this methodology.

Carlos Mercado, Patriarch's Controller, testified that loans were only evaluated for impairment under very limited circumstances:

> Q What was the policy for determining whether or not loans were impaired?
>
> A Well, our policy has been that based upon the speculative nature of the investments that we make, you have to remember that all the assets that we invest in are distressed company assets. So given the speculative nature of the these investments, we would record an impairment loss at the point in time that we believe that an event has occurred that gives us a clear understanding of what a potential loss is on that asset. So our policy has been to wait until we have an event that sort of defines what's sort of a defining moment for that asset in which we can have a clear understanding of what the actual impairment loss would be.
>
> Q What do you mean by event?
>
> A Well, it could be a bankruptcy. For example, if an asset is placed -- if the company is placed into bankruptcy, that would be an event that would cause us to review the future sustainability of that asset.
>
> Q Any other events besides a bankruptcy?
>
> A If a company is placed into liquidation, that would be an event. I guess the only other event that comes to mind would be if we decide that company's debt has to be restructured for whatever reason as part of the restructuring process. We may take a loss on a portion of the debt.[45]

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[44] Zohar CDO 2003-1, Limited & Subsidiaries financial statements for November 7, 2012, p. 5.

[45] Mercado testimony dated July 9, 2014, pp. 48-49.

Moreover, Mercado was not aware of anyone at Patriarch performing any type of expected cash flow analysis.[46]

Tilton's testimony confirmed Mercado's description of the process:

> Q Okay. Who at Patriarch, if anyone, was responsible for determining whether the loan assets are impaired for financial statement purposes?
>
> A There's a practice in a course of, you know, performance that has been followed on how to fairly present the value of the portfolio, or to fairly present the portfolio since I can remember.
>
> . . .
>
> [W]e use a cost basis, which is to carry a cost, and realize gains and losses when we know, and impair when we forgive debt or extinguish debt.
>
> . . .
>
> Q Okay. So is there any sort of quarterly analysis of impairment of loan assets that's performed?
>
> A Well, there -- there is on debt forgiveness, and on loan extinguishment. And --
>
> Q Okay. But -- I'm sorry, go ahead.
>
> A And that would be in the work papers.
>
> Q Is there any analysis for impairment for reasons other than debt forgiveness or loan extinguishment to your knowledge?
>
> A This is the portfolio as a whole, and there is analysis done to understand the value of the portfolio as a whole, ... we impair that debt extinguishment and formal debt forgiveness.[47]

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[46] Mercado testimony dated July 9, 2014, p. 55.
[47] Tilton testimony dated June 24, 2014, pp. 143-144.

Tilton communicated this policy to others at Patriarch. For example, in a 2010 email, when a controller asked a question about the recorded value of certain assets, Tilton explicitly directed the controller "***[W]e do not write up or write down—we write off.***"[48]

This evidence makes clear that Patriarch did not perform an impairment analysis in each reporting period whereby it compared cash flows it anticipated to be received for each loan to its carrying value. Instead, Patriarch wrote off loans only when there was debt forgiveness or extinguishment. The impairment practice Patriarch used and to which Mercado and Tilton both testified does not comply with either Patriarch's disclosed impairment policy or GAAP.

Patriarch's impairment practice was plainly deficient especially considering that there were several indicators of impairment that should have been evaluated by Patriarch and Tilton.

First, according to testimony, certain contractually obligated interest payments were not being received by the Funds. For example, the former CEO of Global Automotive Services, Torben Von Staden, stated they deferred interest payments to the Funds when Global was short on cash.[49]

Scott Whalen, credit analyst at Patriarch, stated:

Q Okay. But some of the companies, some of the companies, the portfolio companies that you follow have, at times, failed to pay interest that was due?

A I don't specifically recall that. I mean, they haven't paid the full amount, but they haven't -- I don't recall of somebody not paying any at all.

Q Any at all, okay, but what did you mean by full amount?

A The full interest that was due them in that time period.

Q So some of the companies had failed to pay the full amount that was due?

[48] Tilton testimony dated June 24, 2014, p. 149. Emphasis supplied. Government Exhibit 201 (PP2_00580148 - 150).
[49] Von Staden testimony dated September 24, 2012, pp. 21-24.

A Correct.

Q Which companies, that you remember?

A MD Helicopters, ALF.

Q Anyone else?

A MAV, Mobile Armored Vehicles. I'm not sure, I think Harris from time to time, but I'm not sure.

Q So are the other three more than from time to time, more often than from time to time?

A Yes.

Q How often for MD?

A Frequently.

Q What about ALF?

A Frequently. And MAV, frequently.[50]

Whalen also testified that Tilton would ask why the interest was not being paid, and he would tell her that it was due to the financial health of the company.[51]

Tilton also acknowledged that MAV was not making interest payments on time. She testified:

> A I've considered defaulting MAV and making it a Category 1 for multiple reasons, including the failure to pay interest; but the primary reason would have been because I didn't believe that the future support and funding would have been worthy of future performance and maximizing the cash flows. So it was not on the basis of the not paying contractual interest because that was agreed to and amended, but it would have been on whether I believed the company could enhance its performance and maximize cash flows to the funds in the future.[52]

[50] Whalen testimony dated January 17, 2013, pp. 74-75.
[51] Whalen testimony dated January 17, 2013, pp. 75-76.
[52] Tilton testimony dated June 24, 2014, p. 196.

Second, loans were regularly restructured and/or modified by Patriarch based what Tilton believed the portfolio companies could pay.[53] Third, in early 2012, Tilton asked MBIA and certain other large investors for an approximate two year extension of the maturity on the notes of Zohar I from their current maturity of 2015 until 2017.[54] Each of these events is an indication of impairment that should have caused Patriarch to perform an assessment as to whether or not there was an impairment.

Violations of GAAP and Patriarch's Disclosed Impairment Methodology

Patriarch's approach to loan impairment, as detailed above, demonstrates that Patriarch did not prepare GAAP-compliant financial statements, even though Tilton certified they were prepared in accordance with GAAP. Additionally, Patriarch did not follow the impairment policy that it told investors that it followed.

As described above and based on the testimony and other evidence I have reviewed, Patriarch carried their loans at historical costs without ever performing any impairment analysis to determine if a change in the carrying value was required. Patriarch disclosed a methodology that could have been used to determine which loans it was going to assess for impairment, however, its methodology was not followed.

Specifically, although Tilton testified that a discounted cash flow analysis was performed, my review of evidence produced in this matter does not reveal that any type of cash flow analysis for impairment purposes was performed. Furthermore, evidence produced in this matter and the testimony I have reviewed does not reveal any loan write downs for impairment

[53] Whalen testimony dated January 17, 2013, pp. 163-165.
[54] OIP, ¶23.

purposes, but rather only that, in Tilton's own words, "***we do not write up or write down—we write off***."[55,56]

As shown above, Patriarch never performed an impairment analysis and only wrote off loans after a negative "event," such as a bankruptcy or liquidation had occurred. Patriarch's policy to wait for an "event" to occur such as a bankruptcy or a liquidating event when it is known for certain that loan has been "impaired permanently" before a recording an impairment loss is a violation of GAAP.[57] As described above, GAAP requires that once it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement, an impairment loss is to be recorded.

In addition, although Tilton reviewed financial information relating to the portfolio companies on a regular basis, there is no evidence that she used this information to consider impairment.[58] Tilton testified she receives financial performance and budget information, and information on operations and product design, among others.[59] It is my experience that this information is what one would use to estimate cash flows that a business is expected to generate and that this same information would be used in a loan impairment analysis.

In sum, GAAP required Patriarch to conduct a loan impairment analysis. Patriarch affirmatively disclosed that it would record an impairment loss when loans are impaired. But Patriarch conducted no such analysis, rendering the Funds' financial statements false and misleading.

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[55] Tilton testimony dated June 24, 2014, p. 149. Emphasis supplied. Government Exhibit 201 (PP2_00580148 - 150).
[56] Tilton testimony dated June 24, 2014, pp. 143-144.
[57] Mercado testimony dated July 9, 2014, p. 101.
[58] Tilton testimony dated February 12, 2013, pp. 90-91 and Tilton testimony dated June 24, 2014, pp. 31 and 32.
[59] Tilton testimony dated June 24, 2014, pp. 31-33.

Disclosure of the Fair Value of Financial Instruments

Having discussed Patriarch's failures with respect to a loan impairment analysis, I now turn to a discussion of Patriarch's disclosures in the Funds' financial statements that the fair value of the loans was approximately equal to the carrying value. As described below, it is my opinion that these disclosures were false and misleading because Patriarch had no basis to make that disclosure.

Patriarch reported in each financial statement for the Funds that the fair values of the loans to the portfolio companies, taken as a whole, were approximately equal to the carrying value (i.e., amortized cost net of allowance for loan losses) presented on the balance sheet.[60] In other words, Patriarch reported that the cost of the loans on the balance sheets was the same as the discounted present value of the cash it expected to collect on those loans. However, Patriarch did not calculate the fair value of the loans, either individually or in the aggregate.

Fair value of the loans to the portfolio companies has specific meaning in GAAP and it is calculated pursuant to a hierarchy as defined in the professional literature.[61] The fair value hierarchy in GAAP is intended to increase consistency and comparability in fair value measurements and related disclosures.[62] This hierarchy categorizes the inputs to valuation techniques used to measure fair value into three levels.[63] The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).[64] Patriarch

[60] See Note 3 to any of the Zohar CDO 2003-1, Limited, Zohar II 2005-1, Limited, and Zohar III, Limited financial statements for 2014 and earlier years.
[61] ASC 820-10-35-37.
[62] Id.
[63] Id.
[64] Id.

discloses in the Funds' financial statements that the fair value of the CDOs is calculated using Level 3 inputs.[65]

According to GAAP, Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity can access at the measurement date.[66] Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.[67] Patriarch discloses that derived fair value estimates cannot necessarily be substantiated by comparison to independent markets and, in many cases, could not be realized in an immediate sale of the instrument. As a result, substantially all of the Company's Collateral Debt Obligations were valued using Level 3 inputs.[68]

Level 3 inputs are unobservable inputs that are used to measure fair value to the extent that relevant observable inputs are not available. This allows for situations in which there is little, if any, market activity for the asset at the measurement date.[69]

Given the lowest priority of Level 3 inputs in the fair value hierarchy, fair value measurements in this category require a description of the valuation technique(s) and the inputs used in the fair value measurement.[70] This includes quantitative information about the significant unobservable inputs used in the fair value measurement.[71]

[65] In all of the Funds' financial statements, the disclosure of fair value using Level 3 inputs is found in footnote 3 to the financial statements.
[66] ASC 820-10-35-40.
[67] ASC 820-10-35-47.
[68] See Note 3 to the Funds' financial statements.
[69] ASC 820-10-35-52 and 53.
[70] ASC 820-10-50-2bbb.
[71] Id.

The Funds' Disclosures of Fair Value Calculations Were False and Misleading

The Funds' financial statements departed from GAAP because Patriarch had no basis to make the fair value disclosures that they did, given that no fair value analysis was performed on the loans that made up the Funds' assets. Patriarch disclosed the following regarding the calculation of the fair values of their loans:

> The term "Collateral Debt Obligations" refers to the assets that comprise the Company's portfolio of held-for-investment senior secured loans. The Collateral Debt Obligations are recorded at cost upon acquisition, which is equal to the amount of the cash paid to acquire the Collateral Debt Obligations.
>
> For financial accounting purposes, principal payments received from borrowers under the loan facilities reduce the carrying value of the respective loan assets. Advances to borrowers pursuant to revolving credit agreements increase the carrying value of the respective loan assets. In the event the Company's expected realization of principal under a CDO is impaired, such that the anticipated future collections are determined to be less than the carrying value of the loan, the Company will record an impairment loss equal to the amount of the anticipated shortfall and will thereafter carry the loan at the reduced amount.
>
> [...]
>
> For substantially all of the Collateral Debt Obligations, however, ***<u>fair values are based on estimates using present value of anticipated future collections or other valuation techniques</u>***. These techniques involve uncertainties and are significantly affected by the assumptions used and judgments made regarding risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experience and other factors. Changes in assumptions could significantly affect these estimates and the resulting fair values. Derived fair value estimates cannot necessarily be substantiated by comparison to independent markets and, in many cases, could not be realized in an immediate sale of the instrument. Accordingly, the aggregate fair value amounts determined by the Company do not purport to represent, and should not be considered representative of the underlying enterprise value of the Company. In addition, because of differences in methodologies and assumptions used to estimate fair values, the Company's estimate of fair values should not be compared to those of other financial institutions.[72]

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[72] Zohar CDO 2003-1, Limited & Subsidiaries financial statements for November 7, 2012, pp. 5-6. Emphasis supplied.

Contrary to these disclosures, there is no evidence that any analysis was prepared to determine the fair value of the loans. Mercado testified to the following:

> Q It says, The company believes that the fair value of the collateral debt obligation taken as a whole is approximately equal to -- in this case, it is $912 million and change -- carrying value presented on the balance sheet.
>
> What did Patriarch do to determine the fair value of its loan assets?
>
> A Well, our historical policy since the inception of the firm, which has been consistently applied, is that we use a lower cost of market. And these under FASB 157 are considered level three assets. So we don't have observable inputs, to use the language of the FASB 157, to be able to determine a market value, per se. So it has been our policy that the fairest way to address the carrying value of the portfolio is to show its historical costs. So, again, we don't write up the assets, and we don't write down the assets. We will essentially just write off at the time that we actually experienced an event that causes us to believe that the asset has been impaired permanently. And, likewise, we don't realize any gains on the assets until we have actually sold the asset completely.[73]
>
> [...]
>
> Q Do you know why the language was included in footnote three about present value of anticipated future collections if there was no fair value calculation done by using that method?
>
> A My understanding is this is a broad discussion valuation giving the possibility that under certain circumstances using present value anticipated future cash flows may be an appropriate methodology to utilize. But in our judgment, we felt that historical cost was a better methodology and more accurate, given the speculative nature of all the cash flows in the companies we were investing in.[74]

Furthermore, Mercado was not aware of any documents that have a fair value calculation.[75]

The footnote disclosure listed above explicitly states that Patriarch's fair values are based on estimates using present value of anticipated future cash collections or other valuation techniques. Mercado stated that the loans were not valued based on present value of anticipated

[73] Mercado testimony dated July 9, 2014, p. 101.
[74] Mercado testimony dated July 9, 2014, p. 105.
[75] Mercado testimony dated July 9, 2014, p. 103.

future cash flows, but rather that Patriarch utilized the historical cost of the loans for calculating their fair value.[76]

There is no basis for the assertion in the Funds' financial statements that cost and fair value are the same. Based on my review of the evidence and testimony, Patriarch does not conduct a fair value analysis because it does not estimate the cash flows expected to be collected on the loans. These disclosures make it appear that the Funds are conducting fair value analyses when they are not, rendering the Funds' financial statements false and misleading.

<u>Changes to the Fund Financial Statements</u>

As a final matter, the Division has asked me to provide an opinion on the effect of the recent changes in the Funds' financial statement disclosures. The Funds' 2015 financial statement disclosures were changed significantly from those of the prior years without an accompanying change in the methods of accounting. In addition, the *Certificate as to Financial Statements* signed by Tilton was also changed from prior years. The relevant changes in presentation follow.

In the actual certification cover page in 2015, the stated basis of accounting was changed from U.S. generally accepted accounting principles to a different basis of accounting. The new basis of accounting was described as follows in the 2015 certification, yet there was no disclosure explaining the reason for the change or that a different methodology was used:

- These financial statements have been prepared under a basis of accounting in which the Company's investment in Collateral Debt Obligations ("CDOs") are recorded at cost and the company's equity interests in portfolio companies are not recorded on the consolidated balance sheet.[77]

[76] Mercado testimony dated July 9, 2014, p. 104.
[77] See the Zohar CDO 2003-1, Limited May 7, 2015 financial statement; the Zohar II 2005-1, Limited April 8, 2015 financial statement; and the Zohar III, Limited March 6, 2015 and June 8, 2015 financial statements.

In the notes to the 2015 financial statements the references to GAAP were eliminated along with the reference that the requirements imposed by Section 7.9(a) of the indemnification agreements were met, yet there were no disclosures explaining the reason for the change or that a different methodology was used.[78] The 'Basis of Accounting' section in 2015 financial statement disclosures states:

- These financial statements have been prepared under a basis of accounting in which the Company's investment in Collateral Debt Obligations ("CDOs") are recorded at cost and the company's equity interests in portfolio companies are not recorded on the consolidated balance sheet.[79]

In Note 3 to the financial statements all references for measuring fair value and the required disclosures were eliminated in 2015, yet there were no disclosures explaining the reason for the change or that a different methodology was used.[80]

Based on my experience, it is my opinion that the changes in the disclosures that eliminate references to GAAP-compliant financial statements, without changes in the underlying methodologies, are an acknowledgement by the Respondents that the prior reporting was not in accordance with GAAP and the changes were made in order to correct these disclosures. GAAP is a commonly accepted and widely understood framework by which financial reports are prepared. Therefore, in my experience, an entity would not remove a reference to financial statements being GAAP-compliant without changing the underlying methodologies used unless, in fact, those statements were not prepared in accordance with GAAP, as was previously disclosed. Based on my review of the evidence in this matter, I have not seen any indication that Patriarch changed the methods it used to prepare financial statements in 2015. In sum, it is my opinion that this elimination of the references to GAAP in the 2015 financial statements and the

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[78] Id.
[79] Id.
[80] Id.

accompanying certifications was an acknowledgement that the prior reporting departed from GAAP.

Exhibit 2

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UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16462

In the Matter of

LYNN TILTON;
PATRIARCH PARTNERS, LLC;
PATRIARCH PARTNERS VIII, LLC;
PATRIARCH PARTNERS XIV, LLC;
AND
PATRIARCH PARTNERS XV, LLC,

Respondents

REBUTTAL EXPERT REPORT

OF

STEVEN L. HENNING, Ph.D., CPA

August 31, 2015

REBUTTAL EXPERT REPORT
OF
STEVEN L. HENNING, Ph.D., CPA

ADMINISTRATIVE PROCEEDING
File No. 3-16462

This rebuttal report supplements my expert report of July 10, 2015 to address the opinions expressed by Dr. J. Richard Dietrich, Defendants' designated expert on the financial statements prepared by the Zohar Funds (the "Funds") in this matter, in his August 10, 2015 report. After reading Dietrich's report and considering all of the documents referred to therein, I reaffirm my opinions as stated in my report:

- The Funds' financial statements departed from GAAP because Patriarch did not perform GAAP-compliant impairment analyses. The Funds' financial statements were false and misleading because they also disclosed that a GAAP-compliant impairment analysis was performed when, in fact, it was not.

- The Funds' financial statements were false and misleading because they disclosed that the fair value of the loans was approximately equal to the carrying value when there was no basis to make that disclosure.

- The fact that the Funds' financial statements and accompanying certifications recently eliminated the statements referencing GAAP compliance is an acknowledgement by the Respondents that the prior reporting departed from GAAP.

I have refrained from addressing herein matters that were already covered in my report and not addressed by Dietrich in his responsive report. Therefore, I have limited my comments to the following matters:

- Under GAAP, an impairment analysis is performed based on conditions that exist as of the balance sheet date. The equity component of the loans to portfolio companies is not recorded on the balance sheets of the Zohar Funds, and its value is dependent on future events that do not reflect conditions that exist at the balance sheet dates. Thus, it would have been improper under GAAP to consider the equity component of the loans to portfolio companies in performing an impairment analysis.

- No matter which "unit of account" Patriarch chose, it did not perform a GAAP-compliant impairment analysis.
- Patriarch had no basis to disclose that the fair value of the loans to portfolio companies approximated their carrying value because it did not perform any fair value assessment.
- Other items, including:
    - The hypothetical alternative views about what Patriarch could have done to analyze loan impairment are not acceptable accounting treatments in this matter, nor is there any evidence that Patriarch in fact performed any of these alternative analyses;
    - The responsibility placed on Berlant by Dietrich goes beyond both what Berlant was hired to do and what he actually did; and
    - The elimination of the reference to GAAP in the 2015 Zohar Funds' financial statements confirms that the balance sheets and income statements in prior Zohar Funds' financial statements did not comply with GAAP.

Attached hereto is a listing of additional materials I considered in preparing this report. Prior to the time I testify at trial, I may review additional documents that are provided to me, including transcripts of experts' testimony and exhibits marked in connection therewith. Therefore, I reserve the right to supplement, update, or otherwise modify this report at a later date.

The Future Value of Equity Plays No Role in Impairment Analyses, Which Reflect Conditions in Place as of Particular Financial Statement Dates

In connection with my opinion that Patriarch failed to conduct a GAAP-compliant impairment analysis, Dietrich criticizes me for considering only the debt portion of the asset. Dietrich argues that the collateral debt obligations[1] include both debt and equity components.[2] Furthermore, Dietrich asserts that my failure to consider the business purpose of the Zohar Funds demonstrates a lack of understanding of the methods by which the Zohar Funds can receive value from the investments.[3] Dietrich's criticisms have no impact on the accounting for the collateral debt obligations because equity value is created only in the future if the loans are repaid in full. Thus, for purposes of a GAAP-compliant impairment analysis, it would be improper to consider the equity component because that equity has no value as of the balance sheet date.[4]

The Zohar Funds' financial statements disclose that the collateral debt obligations are comprised of loans:

> 4. Carrying Value of Collateral Debt Obligations
>
> The term "Collateral Debt Obligations" refers to the assets that comprise the Company's portfolio of held-for-investment senior secured loans. The Collateral Debt Obligations are recorded at cost upon acquisition, which is equal to the amount of cash paid to acquire the Collateral Debt Obligations.
>
> For financial accounting purposes, principal payments received from borrowers under the loan facilities reduce the carrying value of the respective loan assets. Advances to borrowers pursuant to revolving credit agreements increase the carrying value of the respective loan assets. In the event the Company's expected

[1] The Zohar I and Zohar II financial statements, in footnote 2.4, refer to the investments as Collateral Debt Obligations. The Zohar III financial statements refer to the same category of investments as Collateral Debt Instruments. The wording in those footnotes across time and funds remains relatively unchanged. In this report I use 'loans to portfolio companies' to mean the same thing as 'collateral debt obligations.'
[2] Dietrich Report, p. 3.
[3] Dietrich Report, pp. 3-4.
[4] ASC 310-10-35-4 (a) and (b).

> realization of principal under a Collateral Debt Obligation is impaired, such that the anticipated future collections are determined to be less than the carrying value of the loan, the Company will record an impairment loss equal to the amount of the anticipated shortfall and will thereafter carry the loan at the reduced amount.[5]

Thus, by their own disclosures, the Zohar Funds record the assets as held-for-investment senior secured loans at the cost paid to acquire them. These amounts, or carrying values, are adjusted upward for advances to borrowers and downward for repayments of principal.[6] In addition, the balance sheet amounts for these assets consist of principal amounts owed to the funds by the portfolio companies as well as accrued interest and fees receivable. Other than cash or other assets, there are no additional assets listed. In sum, the loans to portfolio companies are recorded on the financial statements as loans, with no value assigned to equity.

Dietrich's criticism of my opinion that Patriarch failed to conduct a GAAP-compliant impairment analysis appears grounded in his assumption that I failed to consider the equity value associated with the loans to portfolio companies when considering impairment. The reason I did not consider such equity value is because to have done so would be improper under GAAP. While any equity held by the Zohar Funds may have economic value in the future, impairment analysis is performed <u>as of the balance sheet date</u>, based on the recoverability of the assets <u>recorded on the balance sheet</u>.[7] As noted above, Patriarch does not include the equity interests in portfolio companies on the Zohar Funds' balance sheets so the impairment analysis could not possibly consider whether the equity interests are impaired.[8] Moreover, Patriarch's disclosure of the impairment analysis it purports to perform limits the analysis to the loans and has no mention

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[5] This disclosure was taken from the Zohar II 2013-4-10 financial statements. This wording is similar across the Zohar Funds' financial statements over time.
[6] Zohar II 2013-4-10 financial statements, Footnotes 2 and 3.
[7] ASC 310-10-35-4 (a) and (b).
[8] Patriarch did not include the equity interests in the collateral debt obligations on the Zohar Funds' balance sheets. In the 2015 financial statement certifications, Patriarch explicitly disclosed that the balance sheet did not include the equity interests. Had the equity been included in pre-2015 financial statements, Patriarch would have recorded reconciling entries removing the equity. Based on my review, Patriarch did not do so. This is further evidence that the equity interests were not included on the balance sheet prior to 2015.

of equity or any other asset. As noted above, Patriarch discloses: "In the event the Company's expected realization of principal under a Collateral Debt Obligation is impaired, such that the anticipated future collections are determined to be less than the carrying value of the loan, the Company will record an impairment loss equal to the amount of the anticipated shortfall and will thereafter carry the loan at the reduced amount."[9]

Even if GAAP allowed Patriarch to consider the value of equity in assessing the impairment of the loans to portfolio companies, Dietrich and Patriarch agree that the equity has no value until the loans are repaid. For example, Dietrich states "that Patriarch's management views a CDO/CI as deriving value from multiple options it can exercise because: (a) the Indenture provides the ability for Patriarch Partners to restructure loan terms, (b) the intent of restructuring is to allow 'the company the time to build to pay the debt in full and create equity value for the benefit of the Note holders,' and (c) equity value is created only if the loans are repaid in full."[10] (Emphasis added; footnote reference omitted). Similarly, Tilton stated that "no credit [is] given for that equity until such time as it is monetized into cash" and that "[i]t's there for future value to be monetized if there's successful turnaround and successful sale."[11] And, regarding her business model, Tilton said that "[l]oans are being made to these operating companies most of the time because they are in periods of transition and they have not effectuated a turnaround...[T]he reason we try to keep the equity in the funds or in affiliated funds, because the number one reason is debt and equity in distressed companies cannot co-exist...[W]hen I'm adding cash to a company, it means it needs cash, which means it's not in a period of turnaround where the equity has value."[12] (Emphasis added).

[9] Zohar II Financial statements, 2013-4-10, footnote 2.4. Emphasis added.
[10] Dietrich Report, p. 9.
[11] Tilton testimony dated February 12, 2013, p. 136.
[12] Tilton testimony dated February 12, 2013, pp. 156 and 157.

In short, Dietrich and Tilton are both referring to a hypothetical value that equity may possess sometime in the future. They both argue that an increase in the value of the equity held will offset any potential loss in the value of the loans held for investment. This argument makes no sense because, as Dietrich and Tilton agree, the equity has no value until the loans are repaid in full or the equity is monetized by future sale. Avoiding a write-down of the loans because of this possibility is contrary to the GAAP guidance on impairment that requires the analysis to reflect conditions that exist as of the balance sheet date.[13]

Dietrich additionally argues that the Zohar Funds may recover the carrying value of the collateral debt obligations through either selling the assets of the portfolio company and/or subsequently issuing equity to a third party.[14] In offering these hypothetical sources of funds to repay the carrying value of the loans, Dietrich offers no assessment of whether a market for such alternatives exists and whether recovery of the carrying value could be achieved. Again, such alternatives are based on potential future transactions and do not reflect conditions that exist at the balance sheet date as is required under GAAP.

In sum, Dietrich's claim that I failed to consider the equity component is flawed. The equity component of the loans to portfolio companies is not recorded on the balance sheets of the Zohar Funds and its value is dependent on future events that do not reflect conditions that exist at the balance sheet dates. Thus, it would be improper to consider the equity component in a GAAP-compliant impairment analysis.

[13] ASC 310-10-35-4 (a) and (b).
[14] Dietrich Report, pp. 9 and 10.

No Matter What Unit of Accounting Patriarch Used, It Did Not Conduct a GAAP-Compliant Impairment Analysis

Dietrich also asserts that I failed to consider other choices for the unit of accounting, notwithstanding other choices that were available.[15] His assertion is incorrect. In my initial Expert Report, I explain how Patriarch needed to develop an approach for determining whether to analyze loans individually or in homogenous groups of loans.[16] Dietrich frames his discussion by explaining there are two approaches to evaluate loans for impairment. One approach is to apply GAAP at the overall portfolio level and the other approach is to apply GAAP on a loan-by-loan basis.

I considered the guidance in GAAP that allows loans to be evaluated for impairment using larger groups of smaller balance homogeneous loans (that Dietrich refers to as the "portfolio" approach) or individually.[17] Dietrich favors an approach that considers the total portfolio collectively. Specifically, Dietrich opined that "it would be reasonable for the Funds to consider impairment of the *Collateral Debt Obligations/Collateral Investments* on the balance sheet at a portfolio level."[18] Dietrich's opinion is flawed for at least two reasons. First, it would be unusual under GAAP for a company to conduct an impairment analysis on large, non-homogenous loans using a portfolio approach. Second, Dietrich offers no evidence that this is how Patriarch or Tilton actually evaluated the loans. In fact, as described in my initial Expert Report, neither Tilton nor Patriarch performed any evaluation of the loans for impairment under either the portfolio approach or on a loan-by-loan basis.

When a company assesses loans on an overall portfolio approach for calculating loan losses it is my experience, and the requirement of GAAP, that this approach is used when the

[15] Dietrich Report, p. 12.
[16] Henning Expert Report, p. 11.
[17] Henning Expert Report, footnote 28, p. 11.
[18] Dietrich Report, p. 15.

loans are smaller balance homogenous loans for things such as credit cards, consumer purchases or residential mortgages.[19] Under this approach, an allowance for loan losses is recorded when the loss is probable and the amount of the loss can be reasonably estimated.[20] This type of analysis typically is applied to pools of loans that are collectively evaluated for impairment.

However, in the case of the Zohar Funds, the loans are large non-homogenous loans that have characteristics that are unique to each borrower. The loans in the Zohar Funds are to diverse industry groups and are of different sizes. Tilton testified that there was a "diversity to the type of companies." She explained how it was a range of companies from manufacturing helicopters, makeup companies, building companies, staffing, heath care, engineering services and automotive companies.[21] Given the diversity of the portfolio companies, it would seem improbable that Patriarch could have analyzed the entire portfolio of loans as a homogeneous pool. Indeed, Patriarch did not explain its approach that way, analyze it that way, or document it that way.

Finally, Patriarch's disclosures do not imply any evaluation of the portfolio as a whole in determining impairment. For example, the footnote disclosures for one of the Zohar II financial statements state the following with respect to impairment:

> In the event the Company's expected realization of principal under <u>a Collateral Debt Obligation</u> is impaired, such that the anticipated future collections are determined to be less than the carrying value of <u>the loan</u>, the Company will record an impairment loss equal to the amount of the anticipated shortfall and will thereafter carry <u>the loan</u> at the reduced amount.[22] [Emphasis added]

The Patriarch disclosures consistently use the phrases "a CDO" and "the loan," implying an analysis performed at the individual loan level.

[19] ASC 310-10-35-13 (a).
[20] ASC 450-20-25-2. This approach is akin to the old FAS 5 approach for calculating loan losses.
[21] Tilton testimony dated February 12, 2013, p. 54.
[22] Zohar II 2013-4-10 financial statements, footnote 2.4. The wording in this footnote across time and funds remains relatively unchanged.

In any event, whether on a portfolio basis or a loan-by-loan basis, there is no evidence that Patriarch ever performed any impairment analysis. Dietrich refers to two Excel spreadsheets which provide information about each portfolio company's performance, debt, enterprise value and equity ownership percentages held by the Zohar and other funds.[23] Specifically, Dietrich states that in the Excel spreadsheets "the value of the debt is compared to the value of the Portfolio Company as an 'enterprise' at a projected future realization date."[24] He offers his opinion that "this analysis conforms to guidance that '[a] creditor shall apply its normal loan review procedures' in evaluating a loan's collectability."[25]

As a threshold matter, Dietrich is incorrect about what GAAP requires regarding normal loan procedures. Dietrich cites to the GAAP provision that states a company may "apply its normal loan review procedures in making that judgment" to determine whether it is "probable that it will be unable to collect all amounts due according to the contractual terms of the loan."[26] However, Dietrich fails to recognize that the "normal loan procedures" must still permit a GAAP-compliant impairment analysis, including the ability of a company to assess the probability of collecting all future amounts due according to the contractual terms of the loan.

Thus, Dietrich's opinion that Patriarch's normal loan review procedures (i.e., the analysis from the Excel spreadsheets he examined) can be used to evaluate a loan's collectibility is flawed for several reasons.

First, Dietrich contradicts his own argument that an impairment test should be performed at the portfolio level by shifting to the loan-by-loan approach because he compares each loan to the enterprise value of the portfolio company. Second, in using the spreadsheets to "infer" that

[23] Dietrich Report, footnote 39, p. 14.
[24] Dietrich Report, pp. 14-15.
[25] Dietrich Report, p. 15.
[26] ASC 310-10-35-17.

they satisfy the requirement for a GAAP-compliant impairment test, Dietrich fails to acknowledge that anticipated future collections on the loans are not part of this purported analysis at all.[27] He acknowledges that the value of the loans are compared to the "projected" future enterprise value, thereby using hypothetical values not in existence at the balance sheet date (as is required by GAAP).[28] Third, the spreadsheets reveal that the Zohar Funds own less than 100% of the equity of the portfolio companies in the majority of cases, yet Dietrich compares the value of the debt to the total enterprise value in all of the cases to infer that there is no impairment.[29] Fourth, even if these Excel spreadsheets could be read to establish a pattern of "normal loan review procedures" (which I do not believe they do), they provide no information on the collectability of amounts due on the loans as required by GAAP.[30] For these reasons, Dietrich's opinion that Patriarch's normal loan review procedures can be used for a loan impairment analysis does not comply with the requirements of GAAP as explained in my initial Expert Report.[31]

Dietrich also asserts that I cannot conclude that the financial statements are false and misleading because I do not conclude that the amounts shown in the Zohar Funds' financial statements are materially misstated.[32] My opinion regarding the false and misleading financial statements relates to the fact that Patriarch made the disclosure that it conducted a specific impairment analysis, but it did not perform the analysis that it purports to have done. Based on

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[27] Dietrich Report, pp. 14-15.
[28] In the Excel spreadsheets, enterprise value is calculated as a multiple of EBITDA (e.g., earnings before interest, depreciation income taxes and depreciation and amortization). EBITDA is a proxy measure intended to capture all cash flows coming to the company, not just those attributable to the cash collections on the loans.
[29] See for example, one of the Excel spreadsheets that Dietrich refers to in his report at PP2_00148151.
[30] See ASC 310-10-35-14 and 35-16, which state "A loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. All amounts due according to the contractual terms means that both the contractual interest payments and the contractual principal payments of a loan will be collected as scheduled in the loan agreement..."
[31] Henning Report, pp. 10-13.
[32] Dietrich Report, pp. 16-17.

my experience, it is my opinion that this untrue disclosure renders the financial statements false and misleading regardless of whether the amounts stated in the financial statements would have been different had Patriarch performed a GAAP-compliant impairment analysis.[33]

Dietrich Offers No Evidence That Patriarch Conducted a Fair Value Analysis

Similarly, Dietrich misconstrues my opinion in my initial Expert Report regarding Patriarch's disclosures that the fair value of the loans is approximately equal to the carrying value of the loans.[34] Dietrich offers various reasons explaining why a company may not be able to calculate fair value, but ignores the evidence that suggests Patriarch did not even attempt to determine fair value. Dietrich also asserts, similar to his opinion regarding a GAAP-compliant impairment analysis, that I cannot conclude the financial statements are false and misleading because I do not conclude that the fair value of the loans is in fact different from the amounts stated in the financial statement.[35]

Fair value is a measurement framework that prescribes how to determine market-based measures.[36] As described in my initial report, fair value is determined pursuant to a specific hierarchy as defined in the professional literature.[37] My opinion regarding the false and misleading financial statements relates to the fact that Patriarch made the disclosure in the Zohar Funds' financial statements that the fair value of the loans is approximately equal to their carrying value when Patriarch had no basis to make the disclosure. This false and misleading disclosure would have led readers to believe that Patriarch applied the fair value hierarchy as

[33] Dietrich argues that the readers of the financial statements could have made their own judgments about impaired loans by reading the information in the Trustees Reports. [Dietrich Report, p. 17]. The financial statements should stand on their own, and indeed, readers would have every reason to believe that all relevant information regarding impaired loans would have been measured and recognized by GAAP given Patriarch's disclosures regarding its impairment testing.
[34] Dietrich Report, pp. 17-18.
[35] Dietrich Report, p. 18.
[36] ASC 820-10-05-1.
[37] Henning Report, pp. 20-21.

required by GAAP when the evidence shows that Patriarch did not. Based on my experience, it is my opinion that this untrue disclosure renders the financial statements false and misleading, regardless of whether the fair value would have differed from the amounts stated in the financial statements had Patriarch actually performed a fair value analysis.

Other Items

Alternative Views:

Dietrich offers alternative approaches for the reporting of the loans. As a threshold matter, I have seen no evidence that Patriarch ever used any of the alternative approaches suggested by Dietrich. My additional thoughts on these alternative approaches follow.

Held to Maturity Securities

Dietrich suggests that Patriarch could have chosen to account for the loans using the held-to-maturity guidance in GAAP, which specifies both management's intention and ability to hold the loans until maturity. Notably, Patriarch did not use this method to account for the collateral debt obligations, as it disclosed in all of the Zohar Funds' financial statements that it accounted for the loans as held-for investment assets.[38] Thus, whether Patriarch could have chosen to account for the loans using the held-to-maturity guidance in GAAP is simply not relevant to this case.

Moreover, Dietrich states that "if, based on available evidence, management's best estimate indicates that the asset will recover to its amortized cost basis, then no 'other-than-temporary-impairment' is deemed to have occurred."[39] What Dietrich does not say is that this GAAP guidance still requires a company to perform an analysis to determine whether anticipated

[38] See Footnote 2.4. of the Zohar Funds' financial statements.
[39] Dietrich Report, p. 19.

future collections will enable recovery of the carrying value of a loan.[40] As cited herein, there is no evidence that Patriarch prepared this analysis at any time.

Equity Method and Consolidation

Dietrich argues that the Zohar Funds, either individually or collectively, may control or exert significant influence over a portfolio company.[41] When a company exerts significant influence or control over another company it may have to account for the investment in a manner that differs from the way Patriarch accounted for its investments in the portfolio companies. For example, using the equity method Patriarch would include each Zohar Fund's ownership percentage of the portfolio company's income in the Zohar Fund's financial statements. For consolidation, Patriarch would incorporate the entire balance sheet and income statement of the portfolio company into the financial statements of the Zohar funds. However, Patriarch did not disclose or acknowledge the use of the equity method or the consolidation of any of the portfolio companies in any of the Zohar Funds' financial statements. Furthermore, even if Patriarch had considered using either of these alternative approaches, Dietrich does not explain how these methods would have any impact on Patriarch's false and misleading disclosures about impairment and fair value.

Special Purpose Financial Statements

Dietrich also states that since the Zohar financial statements are special purpose statements and are not intended to be a complete presentation of GAAP financial statements, "a reader would be aware that the reporting company's objectives differ in at least some aspects from those of companies that present general purpose financial statements."[42] Irrespective of

[40] ASC 310-30-35-8.
[41] Dietrich Report, p. 19.
[42] Dietrich Report, p 20.

Dietrich's opinion, the Zohar financial statements prior to 2015 make clear representations in the certifications that the balance sheets and income statements are prepared in accordance with GAAP. As described in my initial Expert Report and herein, those disclosures regarding impairment testing and fair value were false and misleading.

Berlant's Work on Zohar's Financial Statements:

Dietrich asserts that Peter Berlant, an Anchin, Block & Anchin, LLP partner who performed some services with respect to the Zohar Funds, would have known that certain loans might be impaired based on his knowledge of how Patriarch calculated revenue and how the Zohar funds calculated gain and loss. He argues that this knowledge would have been required to check for arithmetic errors. I disagree with Dietrich's conclusion. Whether one has an understanding of how revenue is arrived at, how gains and losses are recorded, or whether there is an impaired loan has no bearing on one's ability to check for arithmetic errors. As described in my initial Expert Report, Berlant characterized his work as ministerial in nature and noted that he spent only an hour or two per quarter on each engagement.[43] Berlant testified that Patriarch relied on him to catch the little errors and it was "not reliance in an audit perspective or review perspective or even a compilation perspective."[44]

As stated in my initial Expert Report, Berlant was engaged to perform limited general services such as certain bookkeeping services, financial statement services, providing business and financial advice and assisting Patriarch with certain third-party interactions. The financial statement services consisted of reading and commenting on the financial statements along with checking certain computations.[45] Dietrich's claims about Berlant's work and inferences to be

[43] Henning Expert Report, pg. 9.
[44] Berlant testimony dated June 18, 2014, p. 58.
[45] Henning Expert Report, p. 9.

drawn from that work goes beyond both what Berlant was hired to do and what Berlant actually did. Dietrich does not refute my opinion on the limited nature of Berlant's engagement. Indeed, he does not contend that Berlant was hired to ensure that the financial statements conformed to GAAP.

Changes to 2015 Financial Statements

Dietrich criticizes my opinion that the changes in the Zohar Funds' certifications in 2015 that eliminated references to GAAP are an acknowledgement that the prior financial statements did not conform to GAAP. Dietrich claims that his application of rules of logic find my opinion to be unsupported.[46] He further argues that just because the certifications in 2015 do not reference GAAP does not mean that they are not prepared in accordance with GAAP in the prior periods.[47]

In spite of his arguments to the contrary, in my initial Expert Report I reported that the basis of accounting referred to in the 2015 certifications report the loans at cost.[48] As described both in my initial Expert Report and herein, this basis of accounting for the loans does not comply with GAAP. Dietrich's rule of logic is based on facts that are not relevant to this case. His logic fails when applied to the facts of this case for this reason: the basis of accounting that the certifications referenced in 2015 is not GAAP compliant. Since I have seen no evidence that the underlying financial reporting changed in 2015 from prior periods, logic dictates that the financial statements in prior periods also did not comply with GAAP. Dietrich does not address the issue of whether the basis of GAAP that was disclosed in 2015 was GAAP compliant.

Steven L. Henning

[46] Dietrich Report, p. 21.
[47] Id.
[48] Henning Report, p. 25.

Additional Materials Considered

PP2_00148151
PP_01529914
Expert Report of J. Richard Dietrich dated August 10, 2015

EXHIBIT A

STEVEN L. HENNING, Ph.D., CPA
CURRICULUM VITAE

685 Third Avenue
New York, NY 10017
212-201-3179 (direct)
shenning@markspaneth.com

PROFESSIONAL EXPERIENCE

2004 to present	**Marks Paneth LLP**
2006 to Present	Partner, Litigation and Corporate Financial Advisory Services
2004 to 2005	Director, Litigation and Corporate Financial Advisory Services
2011 to present	**OpportunIP LLC**
	Chief Executive Officer
2002 to 2003	**Southern Methodist University**
1997 to 2001	Assistant Professor
	Received university-wide and other teaching awards
2001 to 2002	**United States Securities and Exchange Commission**
	Academic Fellow, Office of the Chief Accountant
1994 to 1997	**University of Colorado**
	Assistant Professor
	Received university-wide and other teaching awards
1990 to 1994	**University of Wisconsin**
	Teaching Assistant
1987 to 1990	**Ryder System, Inc.**
	Manager, Acquisitions and Corporate Financial Planning
1983 to 1987	**Ernst & Whinney, Milwaukee, WI (now Ernst & Young)**
1987	Audit Manager
1985 to 1987	Audit Senior
1984 to 1985	Advanced Staff Accountant
1983 to 1984	Staff Accountant

EDUCATION

Ph.D., University of Wisconsin-Madison, 1994
MBA, University of Miami (FL), 1990
BBA, University of Wisconsin-Milwaukee, 1983

PROFESSIONAL LICENSES AND CERTIFICATIONS

Certified Public Accountant, New York, 2005 (#093395) and Wisconsin, 1986 (#10060)
State of New York Unified Court System, 2012, Eligible to Receive Appointments
(Receiver and/or Accountant, Fiduciary ID #: 642609)

PROFESSIONAL MEMBERSHIPS

American Institute of Certified Public Accountants
American Accounting Association
New York State Society of Certified Public Accountants
Wisconsin Institute of Certified Public Accountants

PROFESSIONAL ACTIVITIES

2006 to present — **NASDAQ Listing Qualifications Panel**
Panel of independent experts that makes final determination of listing status on appeal after company is delisted by NASDAQ

2009 to 2010 — **Anti-Money Laundering & Counter Terrorist Financing Committee**
Committee assesses and communicates the business impact of AML/CTF regulations and laws (Vice Chair)

2005 to 2007 — **SEC Regulations Committee**
Committee acts as the primary liaison between the accounting profession and the SEC on technical matters relating to SEC rules and regulations

2005 to present — **JHI Sarbanes-Oxley Special Interest Group Chair**
The group is the primary resource for Sarbanes-Oxley implementation and compliance issues for the more than 140 member firms of the JHI association of member firms

2004 — **United States Department of Justice**
Continuing Education Course Presentation to the Criminal Division (April 2004)

2003 to 2005 — **Editorial Review Board, Accounting Horizons**
A journal of the American Accounting Association intended to serve researchers, practitioners, standard setters, teachers and students.

2003 to present	**Center for Advanced Technologies** Director on board of non-profit organization advancing knowledge about valuing and monetizing intellectual property
2002 to 2004	**American Accounting Association** SEC Liaison Committee (Chair, 2003 to 2004)
2001 to 2004	**American Institute of Certified Public Accountants** Valuation of Private Equity Securities Taskforce (subcommittee of AcSEC)
2003 to present	**IASeminars Ltd. Training** Taught SEC, FASB and PCAOB courses to foreign registrants
2002 to 2003	**United States Securities and Exchange Commission** Consulted with SEC on auditor oversight issues
2001 to 2005	**Appraisal Issues Taskforce** Taskforce commissioned by the SEC to advance understanding of fair value and reporting issues in mergers & acquisitions
2000 to 2001	**Goldman, Sachs & Co.** Taught math and accounting camp for new investment banking associate and analyst hires from around the world

PUBLICATIONS AND PRESENTATIONS

Published articles (co-authored) in the following journals: Journal of Accounting Research; Journal of the American Taxation Association; Review of Quantitative Finance and Accounting; Journal of Business, Finance and Accounting; Journal of Hospitality Financial Management; The Metropolitan Corporate Counsel; and Issues in Accounting Education

Presentations of scholarly work at annual meetings of the American Accounting Association, at the Financial Accounting Standards Board (FASB), and at more than a dozen universities

COMMUNITY SERVICE

Stamford, CT Youth Sports Coach, 2004 to present
Habitat for Humanity, 2002 to 2003
Faculty Mentor, 1998 to 2001 and 1995 to 1997

EXHIBIT B

CASES IN WHICH STEVEN L. HENNING HAS TESTIFIED AS AN EXPERT AT TRIAL AND/OR DEPOSITION

<u>Iroquois Master Fund, Ltd. v. Quantum Fuel Systems Technologies Worldwide, Inc.</u>
United States District Court for the Southern District of New York
No. 1:13-CV-03860-CM
Expert Witness for the Plaintiff, Iroquois Master Fund, Ltd.
Testimony at Deposition on December 16, 2013
Testimony at trial on May 20, 2014

<u>In Re: Securities and Exchange Commission v. Stephen M. Kovzan (Defendant)</u>
United States District Court for Kansas
No. 2:11-CV-02017
Expert witness for the Plaintiff, Securities and Exchange Commission
Testimony at deposition on July 9, 2013
Testimony at trial on November 19 and 20, 2013

<u>Sol Davis, et al. v. Connecticut Community Bank, N.A., Owner of Westport National Bank</u>
United States District Court for Connecticut
No. 3:10 cv 261 (VLB)
Expert witness for the plaintiff accountholders
Testimony at deposition July 18, 2012

<u>The Research Foundation of State University of New York v. Nektar Therapeutics</u>
United States District Court for the Northern District of New York
No. 1:09-CV-1292(GLS) (DRH)
Expert witness for the Defendant Nektar Therapeutics
Testimony at deposition on July 6, 2012

<u>In Re: Securities and Exchange Commission v. Rajnish K. Das and Stormy L. Dean (Defendants)</u>
United States District Court for Nebraska
No. 8:10-CV-00102-LSC-FG3
Expert witness for the Plaintiff Securities and Exchange Commission
Testimony at deposition on July 26, 2011
Testimony at trial on February 17 and 21, 2012

EXHIBIT B

In Re: Securities and Exchange Commission v. Piyush G. Patel; David J. Kirkpatrick; Eric Jaeger; Lawrence Collins; Michael A. Skubisz; And Jerry A. Shanahan
United States District Court for New Hampshire
No. 01:07-00039-SM
Expert witness for the Plaintiff Securities and Exchange Commission
Testimony at depositions on June 30 and October 14, 2011

Chemtech Royalty Associates, L.P., By Dow Europe, S.A., as Tax Matters Partner, v. United States of America
United States District Court for the Middle District of Louisiana
Nos. 05-944-RET-DLD, 06-258-RET-DLD, 07-405-RET-DLD
Expert witness for the Defendant United States of America
Testimony at deposition on January 30, 2009
Testimony at trial June 23, 2011

In Re: Vanderbilt Mortgage and Finance, Inc. (Plaintiff) v. Cesar Flores and Alvin E. King (Defendants) and Maria M. Trevino and Arthur Trevino (Intervenors) v. Clayton Home, et al.
United States District Court for the Southern District of Texas, Corpus Christi Division
No. 2:09-CV-00312
Expert witness for defendants Flores and King and the intervenors
Testimony at deposition on August 9, 2010

In Re: Scientific-Atlanta, Inc. Securities Litigation
United States District Court for the Northern District of Georgia, Atlanta Division
No. 1:01-CV-1950-RWS
Expert witness for the plaintiff investors
Testimony at deposition on March 25, 2009

In Re: MBNA Corp. Securities Litigation
United States District Court for the Northern District of California
No. 1:05-CV-00272-GMS
Expert witness for the plaintiff investors
Testimony at deposition on October 2, 2008

In Re: JDS Uniphase Corporation Securities Litigation
United States District Court for the Northern District of California
No. C 02-1486 CW (EDL)
Expert witness for the plaintiff investors
Testimony at deposition on March 20, 2007
Testimony at trial October 29, 2007

EXHIBIT B

<u>In Re: Williams Companies, Inc. Securities Litigation</u>
United States District Court for the Northern District of Oklahoma
No. 02-CV-72-TCK
Expert witness for the plaintiff investors
Testimony at deposition on April 4, 2006

<u>Oldco Units, LLC v. BDO Seidman, LLP</u>
Judicial Arbitration and Mediation Services, New York
Testimony at deposition on June 29, 2004
Testimony at arbitration hearing on August 26, 2004

EXHIBIT C

PUBLICATIONS

1. Henning, S.L., 2015. The Challenge and Responsibility of Protecting Client Data. Metropolitan Corporate Counsel, Vol. 23, No. 1 (January).

2. Henning, S.L., 2014. Managing Intellectual Property in a Knowledge Economy. Metropolitan Corporate Counsel, Vol. 22, No. 2 (February).

3. Henning, S.L. and Y. Misuraca, 2013. Increased Regulation Drives Demand for Forensic Accounting Services. Metropolitan Corporate Counsel, Vol.21, No. 12 (December)

4. Sacks, G.D., and S.L. Henning, 2013. Reaping the Full Benefits of Intellectual Property. Metropolitan Corporate Counsel, Vol. 21, No. 2 (February).

5. Henning, S.L., 2012. U.S. and China Look to Each Other for Opportunity, Growth and Investor Returns. Metropolitan Corporate Counsel, Vol. 20, No. 12 (December).

6. Henning, S. L., 2012. Exchanges Need to Take Initiative to End New Scam: Fraudulent listings of Chinese Companies on U.S. Exchanges. Financial Fraud Law Report Vol. 4, No. 4 (April): 291-299.

7. Henning, S. L., and G. D. Sacks. 2011. Empowering Intellectual Property. Metropolitan Corporate Counsel Vol. 19, No. 2 (February): 23.

8. Henning, S. L. 2010. The Case for the "Gold Standard": Why the U.S. Must Adopt International Financial Reporting Standards. Executiveview.com (Winter 2010).

9. Shearer, Robert and Members of the National Knowledge and Intellectual Property Taskforce. Creating New Wealth From IP Assets. Hoboken, NJ: John Wiley & Sons, Inc., 2007 (contributing author).

10. Collins, D., and S. L. Henning. 2004. Write-down timeliness, line-of-business disclosures and investors' interpretations of segment divestiture announcements. *Journal of Business, Finance and Accounting* 31 (November/December): 1261-1299.

11. Henning, S. L., W. H. Shaw, and T. Stock. 2004. The amount and timing of goodwill write-offs and revaluations: Evidence from U.S. and U.K. firms. *Review of Quantitative Finance and Accounting*, forthcoming.

12. Henning, S. L., and W. H. Shaw. 2003. Is the selection of the amortization periods for goodwill a strategic choice? *Review of Quantitative Finance and Accounting* 20: 315-333.

13. Henning, S. L., B. L. Lewis, and W. H. Shaw. 2000. Valuation of components of purchased goodwill. *Journal of Accounting Research 38* (Autumn): 375-386.

14. Henning, S. L., W. H. Shaw, and T. Stock. 2000. The effect of taxes on acquisition price and transaction structure. *The Journal of the American Taxation Association* 22 (Supplement): 1-17.

15. Henning, S. L., and W. H. Shaw. 2000. The effect of tax deductibility of goodwill on purchase price allocations. *The Journal of the American Taxation Association* 22 (Spring): 18-37.

16. Henning, S. L., and W. H. Shaw. 2000. Future stock performance of oil and gas firms conditional on the imputed value of reserves. *Review of Quantitative Finance and Accounting* 15: 127-135.

17. Clikeman, P. M., and S. L. Henning. 2000. Evidence of the socialization of undergraduate accounting students. *Issues in Accounting Education* 15 (February): 1-17.

18. Henning, S. L., D. R. Hermanson, S. H. Ivancevich, and D. M. Ivancevich. 1996. The economic impact of international differences in the accounting for goodwill: How are acquirers of U.S. hospitality interests affected? *Journal of Hospitality Financial Management* 4: 21-31.

Exhibit 6

ZOHAR CDO 2003-1, LIMITED

CERTIFICATE AS TO FINANCIAL STATEMENTS

I, Lynn Tilton, managing member of Patriarch Partners VIII, LLC, Collateral Manager of Zohar CDO 2003-1, Limited, an exempted company organized and existing under the laws of the Cayman Islands (the "Issuer") do hereby certify that I am duly authorized to execute and deliver this Certificate pursuant to Section 7.9(a) of the Indenture, dated as of November 13, 2003, by and among the Issuer; Zohar CDO 2003-1, Corp., a Delaware corporation (the "Co-Issuer"); Zohar CDO 2003-1, LLC, a Delaware limited liability company (the "Zohar Subsidiary"); MBIA Insurance Corporation (the "Credit Enhancer"); CDC Financial Products Inc. (Class A-1 Note Agent); and U.S. Bank National Association, a national banking association organized under the laws of the United States, (the "Trustee"), as trustee, (as the same may be amended or otherwise modified from time to time, the "Indenture"). Capitalized terms used herein that are defined in the Indenture shall have the same meanings as therein defined.

I attach the following:

1. Pursuant to Section 7.9(a)(i) of the Indenture: a consolidated Balance Sheet of the Issuer and its subsidiaries as of the August 8, 2013 Determination Date specifying the amount of the share capital of the Preference Shares as of such Determination Date and the Issuer's Consolidated Total Capitalization as of such Determination Date and the Closing Date, prepared in accordance with U.S. generally accepted accounting principles (the "Balance Sheet").

2. Pursuant to Section 7.9(a)(ii) of the Indenture: consolidated Income Statements of the Issuer and its subsidiaries for the period comprising all Due Periods ending on such Determination Date (the period beginning on November 13, 2003 and ending on August 8, 2013 as well as the period beginning on May 9, 2013 and ending on August 8, 2013), prepared in accordance with U.S. generally accepted accounting principles (the "Income Statements").

3. Notes which are considered integral to the presentation of the Balance Sheet and Income Statements and, therefore, form part of the Balance Sheet and Income Statements.

I certify that I have reviewed the Balance Sheet and Income Statements and that such Balance Sheet and Income Statements present fairly, in all material respects, the financial position of the Issuer and its consolidated subsidiaries.

IN WITNESS WHEREOF, I have executed this Certificate on this 15th day of August 2013.

Lynn Tilton

ZOHAR CDO 2003-1, LIMITED & SUBSIDIARIES

CONSOLIDATED BALANCE SHEET
August 8, 2013
(unaudited)

ASSETS			
Collateral Debt Obligations (Note 3)		$	450,365,893
Cash (Note 4)			38,817,356
Accrued Interest and Fees Receivable (net of $0.9 million allowance for uncollectables)			6,249,455
		$	495,432,704
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current Liabilities			
Accrued Interest Expense		$	1,715,424
Other Accrued Expenses			17,374,958
Total Current Liabilities			19,090,382
Notes Payable (Note 6)			462,175,538
Stockholders' Equity (Note 7)			
Preference Shares ($1,000 Par Value)			20,000,000
Capital Surplus (Deficit)			(5,833,216)
Total Stockholders' Equity			14,166,784
		$	495,432,704
Issuer's consolidated total Capitalization:	August 8, 2013	$	476,342,322
	November 13, 2003	$	127,000,000

The accompanying notes are an integral part of this Consolidated Balance Sheet.

Zohar CDO 2003-1, Limited & Subsidiaries

Consolidated Income Statements

(unaudited)

	For the Period Beginning November 13, 2003 and Ending August 8, 2013	For the Period Beginning May 9, 2013 and Ending August 8, 2013
Interest and Fee Income	$ 326,885,559	$ 5,116,861
Gain or (Loss) on Settlement of Collateral Debt Obligations	16,611,734	-
Gain on the Expiration of Revolving Commitments	1,507,360	-
Total Investment Income	345,004,653	5,116,861
Interest Expense	138,673,378	1,715,424
Net Investment Income	206,331,275	3,401,437
Operating Expenses		
Collateral Management Fees (Note 8)	123,364,403	2,997,887
Professional Fees	14,183,205	930,665
Trustee and Administration Expense	2,472,070	58,471
Other Expenses	42,144,813	442,546
Total Operating Expenses	182,164,491	4,429,569
NET INCOME (LOSS)	$ 24,166,784	$ (1,028,132)

The accompanying notes are an integral part of these Consolidated Income Statements.

ZOHAR CDO 2003-1, LIMITED & SUBSIDIARIES

NOTES TO CONSOLIDATED BALANCE SHEET AND INCOME STATEMENTS

(unaudited)

NOTE 1 – ORGANIZATION

Zohar CDO 2003-1, Limited (the "Company") is an exempted company organized and existing under the laws of the Cayman Islands. The Company was established as a special purpose vehicle to invest in senior secured loans (hereinafter, the "Collateral Debt Obligations").

The portfolio purchases were funded by the issuance of various classes of secured notes and equity interests. The Company's investment activities and financial management are subject to an Indenture dated as of November 13, 2003 by and among the Company; Zohar CDO 2003-1, Corp., a Delaware corporation (the "Co-Issuer"); Zohar CDO 2003-1, LLC, a Delaware limited liability company (the "Zohar Subsidiary"); MBIA Insurance Corporation (the "Credit Enhancer"); and U.S. Bank National Association, a national banking association organized under the laws of the United States, (the "Trustee") (as the same may be amended or otherwise modified from time to time, the "Indenture").

The Indenture exists primarily for the benefit of secured parties, which include the holders of various classes of secured notes issued by the Company (See Note 6). The Indenture, among other things, imposes specific investment guidelines and strict priorities for the application of cash proceeds generated by the Collateral Debt Obligations.

Substantially all of the loan assets are held-for-investment. As such, the Company does not engage in trading activities or banking in the normal course of business. The day-to-day management of the Company's investments is conducted by Patriarch Partners VIII, LLC ("Patriarch Partners," in its capacity as the "Collateral Manager") pursuant to a Collateral Management Agreement dated as of November 13, 2003 by and among the Company, the Zohar Subsidiary, and Patriarch Partners (the "Management Agreement").

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the Company's significant accounting policies follows:

1. <u>Special Purpose Statements (Balance Sheet Date and Income Statements Period)</u>

The balance sheet is presented as of August 8, 2013 (the "Balance Sheet") and the income statements are presented for the period beginning November 13, 2003 and ending on August 8, 2013 and the period beginning May 9, 2013 and ending on August 8, 2013 (the "Income Statements"). Such dates and time periods conform to specific reporting requirements set forth under Section 7.9(a) of the Indenture. Such periods do not coincide with the Company's fiscal year, which ends December 31.

Therefore, although both the Balance Sheet and the Income Statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"), and meet the requirements imposed by Section 7.9(a), these statements should not be regarded as a complete presentation of GAAP financial statements.

2. <u>Basis of Presentation</u>

The consolidated Balance Sheet and consolidated Income Statements include the accounts of the Company, the Co-Issuer and the Zohar Subsidiary, all of which are under common control. All significant inter-company transactions and balances have been eliminated in consolidation.

3. Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes and the disclosure of any contingent assets and liabilities. Actual results could differ from those estimates.

4. Carrying Value of Collateral Debt Obligations

The term "Collateral Debt Obligations" refers to the assets that comprise the Company's portfolio of held-for-investment senior secured loans. The Collateral Debt Obligations are recorded at cost upon acquisition, which is equal to the amount of the cash paid to acquire the Collateral Debt Obligations.

For financial accounting purposes, principal payments received from borrowers under the loan facilities reduce the carrying value of the respective loan assets. Advances to borrowers pursuant to revolving credit agreements increase the carrying value of the respective loan assets. In the event the Company's expected realization of principal under a CDO is impaired, such that the anticipated future collections are determined to be less than the carrying value of the loan, the Company will record an impairment loss equal to the amount of the anticipated shortfall and will thereafter carry the loan at the reduced amount.

5. Revenue Recognition

Interest and Fee Income - The Company recognizes interest and fee income on an accrual basis with respect to assets for which there exists reasonable certainty that such accrued interest and fee income will be collected in the future. With respect to assets for which the collection of interest and fees is doubtful, the Company recognizes such income when received.

Gains and Losses on the Settlement of Collateral Debt Obligations – The Company expects that a portion of the underlying obligors of the Collateral Debt Obligations will be unable to repay the full principal outstanding under their respective credit agreements. Given such element of uncertainty with regard to future collection, the Company employs the cost-recovery basis of accounting for the recognition of capital gain or loss. To this end, the Company does not recognize gain on Collateral Debt Obligations until the principal collected exceeds the carrying value of a respective Collateral Debt Obligation, and only to the extent that no contingent obligation exists to re-lend such principal to the respective borrower.

6. Income Taxes

The Company is exempt from Cayman Islands income tax, a status derived from the nature of its charter, activities, and sources of income. With respect to U.S. federal or state income tax, the Company is not liable for such taxes at the entity level. Instead, the tax is borne by the Company's owners in proportion to their ownership of their respective allocations of taxable income determined in accordance with U.S. tax laws. Since the Company bears no direct income tax liability and is not expected to become a taxpayer in the future, there is no provision for income taxes on its Income Statements or Balance Sheet.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes ("FIN 48"), an interpretation of FASB Statement No. 109, Accounting for Income Taxes (FASB 109), as permitted by FASB Staff Position FIN 48-3. FIN 48 is effective for the Company's annual financial statements in fiscal years beginning after January 20, 2009. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB 109. These provisions were subsequently incorporated into the codification of GAAP under topic 740.

The determination of uncertain tax positions for these financial statements prior to the implementation of FIN 48 uses the tax positions reported on the Company's tax returns which are based on the requirements for filing tax returns under the various taxing authorities for the applicable fiscal period. These filings may be subject to amendment or change during an examination by the various taxing authorities, which has not been considered in the determination of the Company's tax assets or liabilities included in these financial statements. The technical merits of the Company's tax positions are derived from sources of authorities in the tax law (legislation and statutes, legislative intent, regulations, rulings, and case law) and their applicability to the facts and circumstances of the tax positions.

The Company's U.S. tax accounting periods may differ from the periods of the Income Statements. In addition, the taxable income attributable to equity owners will differ, and may differ materially, from GAAP income. Furthermore, the status of the Company's debt and equity securities for U.S. income tax purposes may differ from their status according to GAAP.

NOTE 3 – COLLATERAL DEBT OBLIGATIONS

As of August 8, 2013, the Company had Collateral Debt Obligations with an aggregate commitment amount of $564,430,088 of which $555,496,385 represented funded principal. The difference of $8,933,703 represents the borrowers' unused availability pursuant to revolving credit agreements. Net repayments of principal have been applied to effect a reduction in the carrying value of the portfolio of Collateral Debt Obligations. At August 8, 2013, the Company had commitments to purchase $9,750,050 of additional Collateral Debt Obligations at a cost of approximately $9,750,050.

The carrying value of the Collateral Debt Obligations as of August 8, 2013, was $450,365,893. The Company has received from borrowers final payments in settlement of Collateral Debt Obligations; these transactions gave rise to a cumulative gain of $16,611,734 and gain of $0 for the period since inception and quarter ended August 8, 2013, respectively, for financial accounting purposes. In addition, the Company has recognized cumulative income of $1,507,360 and $0 for the period since inception and quarter ended August 8, 2013 from the expiration of revolving credit commitments.

Disclosure of Fair Value of Financial Instruments. The Company believes that the fair value of the Collateral Debt Obligations, taken as a whole, is approximately equal to the $450,365,893 carrying value presented on the Balance Sheet.

Fair value estimates are generally subjective in nature, and are made as of a specific point in time based on the characteristics of the financial instruments and relevant market information. Where available, quoted market prices are taken into account in the determination of fair value. For substantially all of the Collateral Debt Obligations, however, fair values are based on estimates using present value of anticipated future collections or other valuation techniques. These techniques involve uncertainties and are significantly affected by the assumptions used and judgments made regarding risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experience and other factors. Changes in assumptions could significantly affect these estimates and the resulting fair values. Derived fair value estimates cannot necessarily be substantiated by comparison to independent markets and, in many cases, could not be realized in an immediate sale of the instrument. Accordingly, the aggregate fair value amounts determined by the Company do not purport to represent, and should not be considered representative of, the underlying enterprise value of the Company. In addition, because of differences in methodologies and assumptions used to estimate fair values, the Company's estimate of fair values should not be compared to those of other financial institutions.

GAAP establishes a framework for measuring fair value and requires disclosures about fair value measurements, including a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels explained below:

Level 1 Valuations based on quoted prices available in active markets for identical investments.

Level 2 Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3 Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

The inputs or methodology used for valuing securities are not necessarily an indication of the risks associated with investing in those securities.

At August 8, 2013 substantially all of the Company's Collateral Debt Obligations were valued using Level 3 inputs.

The following table discloses a reconciliation of investments measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the period ended August 8, 2013.

Beginning Balance, May 9, 2013	$445,516,508
Total gains or losses (realized and unrealized)	0
Purchases and sales (including repayments), net	4,849,385
	$450,365,893
Ending Balance, August 8, 2013	

Gains and losses (realized and unrealized), if any, are included in the Gain or (Loss) on Settlement of Collateral Debt Obligations in the Consolidated Income Statements.

NOTE 4 – CASH ACCOUNTS

Pursuant to the Indenture, the Company's cash is held on deposit with the Trustee in various restricted accounts. The holding of cash as collateral for the secured parties, as well as the application of cash towards the payment of operating expenses, interest, debt, and dividends in accordance with a strict priority of payments, is governed by the Indenture.

NOTE 5 – OTHER ASSETS

Other Assets consist primarily of expenses paid in connection with the issuance of securities. For financial accounting purposes, the Company amortizes such costs over a period of five years. At August 8, 2013, Other Assets totaling $17,762,806 have been fully amortized.

NOTES TO CONSOLIDATED BALANCE SHEET AND INCOME STATEMENTS

(unaudited)

NOTE 6 – NOTES PAYABLE

Notes payable consisted of the following:

Description	Interest Rate	August 8, 2013			
		Commitment Amount	Principal Outstanding	Carrying Value	Fair Value
Class A-1 Floating Rate Senior Secured Term Notes due November 20, 2015 (the "Class A-1" Notes)	LIBOR + CL A Appl. Margin (0.80%) (or CP Funding Rate) (1)	$ 150,000,000	$ 130,312,652	$ 130,312,652	$ 130,312,652
Class A-2 Floating Rate Senior Secured Term Notes due November 20, 2015 (the "Class A-2" Notes)	LIBOR + CL A Appl. Margin (0.80%) (2)	32,000,000	27,800,032	27,800,032	27,800,032
Class A-3 Floating Rate Senior Secured Term Notes due November 20, 2015 (the "Class A-3" Notes)	LIBOR + CL A-3 Base Margin (1.40%) (3)	350,000,000	304,062,854	304,062,854	304,062,854
Total Class A Notes		$ 532,000,000	$ 462,175,538	$ 462,175,538	$ 462,175,538
Class B Zero Coupon Second Priority Secured Notes due November 20, 2018 (the "Class B" Notes) (4)	None	$150,000,000	$150,000,000	$ 0	$ 0
Class C Zero Coupon Third Priority Secured Notes due November 20, 2018 (the "Class C" Notes) (5)	None	$ 0	$ 0	$ 0	$ 0

(1) The weighted average interest rate for the period was 1.073600%.
(2) The weighted average interest rate for the period was 1.073600%.
(3) The weighted average interest rate for the period was 1.673600%.
(4) Additional Class B Notes may be issued, or Class B Notes may be called and replaced with Class C Notes based on the Company achieving, or failing to achieve, certain financial targets as described in the indenture.
(5) There are no Class C Notes currently outstanding. Class C Notes will only be issued in exchange for Class B Notes under the circumstances described in Note (4), above.

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The Notes were originally issued on November 13, 2003, and pay quarterly interest (plus any principal repayments required under the Indenture) on the 20th of February, May, August, and November.

NOTE 7 – STOCKHOLDERS' EQUITY

The Company is authorized to issue up to 20,000 Preference Shares, at an issued price of US$1,000 per share. As of August 8, 2013, the Company had 20,000 Preference Shares issued and outstanding. If certain conditions are met, the Indenture requires the Company to pay dividends on such Preference Shares; the total amount of cumulative dividends paid to the holders of the Preference Shares, however, may not exceed $30,000,000. In addition, the Indenture provides for the redemption of the Preference Shares at the issued price after the Company has met certain conditions, which include the full repayment of the Notes.

NOTE 8 – COLLATERAL MANAGEMENT FEES

Collateral Management Fees for the period and the quarter ended August 8, 2013 were $123,364,403 and $2,997,887 respectively. The Collateral Manager is a related party.

NOTE 9 – FINANCIAL HIGHLIGHTS

	For the Period Beginning November 13, 2003 and Ending August 8, 2013	For the Period Beginning May 9, 2013 and Ending August 8, 2013
Per Share Operating Performance (For a share of capital stock outstanding throughout the period):		
Net asset value, beginning of period	$ 1,000.00	$ 759.74
Income from investment operations:		
Net Investment income	10,316.56	170.07
Operating expenses	(9,108.22)	(221.47)
Total From Investment Operations	1,208.34	(51.40)
Distributions	(1,500.00)	-
Net asset value, end of period	$ 708.34	$ 708.34
Total Return*	183.3%	-6.8%
Supplemental Data:*		
Ratio to average net assets:		
Expenses	57.6%	30.2%
Net Investment Income	65.2%	23.2%

* Annualized for periods in excess of one year, not annualized for periods less than one year.

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NOTE 10 – SUBSEQUENT EVENTS

Subsequent events have been evaluated through August 15, 2013, which is the date the statements were available to be distributed.