

From Chairperson's Desk

Standardising Valuation

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) seeks to resolve a distressed corporate debtor (CD) in a time bound manner for ensuring the maximisation of value of assets of the CD. In a significant shift from earlier regimes, the decision what to do with the distressed firm has been entrusted upon the creditors. For the body of the creditors i.e. committee of creditors (CoC) to arrive at an optimum decision, an accurate valuation of the CD is essentially required. The valuation also determines the entitlement of various stakeholders (like dissenting creditors and operational creditors) in a resolution plan. Recognising this, the Insolvency and Bankruptcy Board of India (IBBI/Board) in its regulations provided for valuation by the Registered Valuer (RV).

The Companies Act, 2013 has introduced the concept of 'RV' under section 247 of Chapter XVII to set certain valuation standards and regulate the practice ensuring transparency, accountability and better governance during a valuation exercise. The Central Government, thereafter, designated the IBBI as the Authority under section 458 of the Companies Act, 2013 and notified the Companies (Registered Valuers and Valuation) Rules, 2017 (Valuation Rules) to provide a comprehensive framework for development and regulation of the profession of valuers. The Valuation Rules prescribes that valuation standards are to be notified by the Government. However, pending such notification, an RV is required to undertake valuation as per internationally accepted valuation standards or valuation standards adopted by any Registered Valuers Organisation (RVO).

Currently, RVs follow a wide range of standards, approaches, and methodologies while assessing the value of assets. As a consequence, in the corporate insolvency resolution process (CIRP) of a particular CD, two RVs appointed by the Resolution Professional (RP) might adopt different standards and approaches for valuing the same assets. This inconsistency in valuations, along with multiple interpretations might cause confusion, undermine the credibility of the valuation process, and disrupt the decision-making process.

Furthermore, the valuations typically rely on various assumptions such as growth rates, discount rates, and terminal values etc. These subjective hypotheses can vary from one valuer to another, leading to inconsistencies in the valuation outcomes. Moreover, different valuation techniques, like discounted cash flow, comparable company analysis, replacement cost, residual income etc. can produce different conclusions. The selection of the valuation methodology can be subjective and varies between valuers, leading to different valuation results due to varying approaches and assumptions.

Regulation 27 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) has strived to square away the difference in two valuations and provides for appointment of a third valuer if there is substantial difference between the valuations arrived by first two valuers and considering average of the two closest estimates. However, third valuer also might come up with entirely different value depending on different standards, approaches, methods, and assumptions.

To bring uniformity, Regulation 35 of the CIRP Regulations mandates the valuers to assess value of the CD '*computed in accordance with internationally accepted valuation standards, after physical verification of the inventory and fixed assets of the corporate debtor*'. The Institute of Chartered Accountants of India (ICAI) has issued ICAI Valuation Standards in August, 2018 to set up concepts, principles and procedures which are generally accepted internationally having regard to legal framework and practices prevalent in India. The two worldwide followed standards are International Valuation Standards issued by the International Valuation Standards Council and the Royal Institution of Chartered Surveyors Red Book. Notably, no definite standard has been prescribed under IBC to conduct the valuations.

The uniform valuation standards with international acceptance are necessary in order to establish consistent, uniform, and transparent valuation and ensure comparability and credibility of valuation assessments under IBC. Standardized methodologies and defined techniques, clear guidelines on selecting appropriate valuation approaches, such as asset-based, market-based, and income-based, depending on the nature of the assets and the businesses are required. Moreover, there is need to quantify the permissible assumptions, limiting subjectivity, chartering scope of work with accountability etc. to achieve consistent, fair, and more transparent valuation outcomes, benefiting all stakeholders involved in the insolvency resolution process. Uniform valuation standards would help in identifying potential biases or errors in the valuation process, thus minimizing the risk of misrepresentation. Valuation reports prepared in adherence to established standards would add an additional layer of validation and provide a reliable basis for negotiation in resolution plans.

It is felt that a before-hand discussion with CoC on valuation methodology adopted by valuers prior to finalisation of valuation reports and sharing those reports would provide clarity for conclusion drawn and help in improving the quality of valuation reports. The Ministry of Corporate affairs (MCA) in its discussion paper dated January 18, 2023 has also proposed to disclose the valuation in the information memorandum to bring transparency, eliminate any information asymmetry and increase participation of resolution applicants with availability of better information.

To achieve successful insolvency resolutions, it is imperative to enhance the effectiveness, reliability, and usefulness of the valuation procedure under the IBC. This can be accomplished by implementing a well-structured and comprehensive standards framework for valuations. Standardized valuations would enable stakeholders to make well-informed decisions, instil confidence in the resolution process, and maximize value for all parties concerned in the resolution of distressed enterprises.

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