

An Introduction

As per Section 247 of The Companies Act, where a valuation is required to be made in respect of any property, stocks, shares, debentures, securities or goodwill or any other assets or net worth of a company or its liabilities under the provision of this Act, it shall be valued by a person having such qualifications and experience as prescribed in The Companies (Registered Valuer and Valuation) Rules 2017, and the registered valuer will be appointed by the audit committee or in its absence by the Board of Directors of that company.

As per Section 458, Central Government has delegated its power and function Insolvency and Bankruptcy Board of India (IBBI), to regulate the Registered Valuer profession.

The few members valuation reports reviewed and following finding and suggestions given for the improvements in the valuation report of the Registered Valuers. The Review and analysis were undertaken based on the present regulation Rule 8 of Companies (Registered Valuers and Valuation) Rules, 2017 mandates every Registered Valuer to comply with valuation standards as notified by the Central Government.

In simple words we can say that, where there is requirement of valuation in any provision of Companies Act, A report will be required from registered valuer. The profession of Registered Valuer will be regulated by IBBI.

Importance of Rule & Standards

As per the rule we need to follow the standards as mentioned in the Companies (Registered Valuers and Valuation) Rules, 2017

- (a) Internationally accepted valuation standards;
- (b) Valuation standards adopted by any registered valuers organization

Accordingly, IVS 2022 guidelines also considered for the review. All valuers require too aware of the IVS 2022 basics on:

IVS Framework

IVS General Standards

IVS Asset standards

The importance on IBBI Circular dated 01.09.2020 discussed in every CEP and insisted members to follow the circular.

The Valuation report to state with the following

- (a) Background Information of the asset being valued;
- (b) Purpose of valuation and appointing authority;
- (c) Bases of Value;
- (d) Premise of Value;

- (e) Identity of the RV and any other experts involved in the valuation;
- (f) Intended Users of the Valuation;
- (g) Disclosure of RV interest or conflict, if any;
- (h) Date of appointment, valuation date and date of report;
- (i) Inspections and /or investigations undertaken;
- (j) Business interest, ownership characteristics;
- (k) Nature and sources of information;
- (l) Significant Assumptions, if any;
- (m) Procedures adopted in carrying out the valuation and valuation standards followed;
- (n) Restrictions on use of report, if any;
- (o) Major factors that were taken into account during valuation;
- (p) Conclusion; and
- (q) Caveats, limitations and disclaimers.

Valuation Report

For a valuer, it is very important that he issues his report which should according to the valuation standards as prescribed by the Central Government. Central Government has not notified any valuation standard till date, so a valuer is required to adopt Internationally Valuation Standard or Standard issued by RVO. Only ICAI till date has issued its valuation standard.

As per sub section (3) of Section 247 The Companies Act 2013 “If a valuer contravenes the provisions of this section or the rules made thereunder, the valuer shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees:

Provided that if the valuer has contravened such provisions with the intention to defraud the company or its members, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and Subsection (4) of Section 247 of The Companies Act 2013 “ Where a valuer has been convicted under sub-section (3), he shall be liable to—

- (i) refund the remuneration received by him to the company; and
- (ii) pay for damages to the company or to any other person for loss arising out of incorrect or misleading statements of particulars made in his report.”

It is very important for a valuer to draft his/her/it's valuation report in such way that the report can justify the valuation so that he can avoid penal provisions. The report should cover all the vital points which are not just important to justify the valuation but also the standardized report help user to understand how the value is determined.

A valuer should while drafting report should always remember following points while drafting report:

Scope of Work A report must address the scope of work. A report should clearly state the following points:

- (a) the class or classes of instrument to be valued,
- (b) whether the valuation is to be of individual instruments or a portfolio, and
- (c) the unit of account.

Purpose -

A report should clearly state the purpose of Valuation. For example, if the purpose of valuation is further issue of share or it is for issue of shares for consideration other than cash etc. The purpose of valuation limits the use of report by the subject company in any other purpose as mentioned in the report. A report without purpose should not be issued.

Timelines –

A report must have various times line, for example Date on which assignment was accepted, Date on which measurement has done and Date on which report is signed.

Timelines not only help the user to establish the measurement date, but it also ensures the valuer that his/her/it's report will not be misused by any-one.

Titles -

A good report must have Titles. Titles not only help the user to understand the report correctly and directly refer to the material or important points in the report. Title also divides the report in parts which gives a systematic and simple look to the report.

Investigations and Compliance –

A valuer must do investigation and to support these investigations, sufficient evidence should be collected by the valuer. A good report must be descriptive and should briefly cover the Due Diligence which has been done by valuer while determining fair value. Documents from credible and reliable third party must be assembled. To comply with these requirements, the following are to be considered:

- (a) All market data used or considered as an input into the valuation process must be understood and, as necessary, validated.
- (b) Any model used to estimate the value of a financial instrument shall be selected to appropriately capture the contractual terms and economics of the financial instrument.
- (c) Where observable prices of, or market inputs from, similar financial instruments are available, those imputed inputs from comparable price(s) and/or observable inputs should be adjusted to reflect the contractual and economic terms of the financial instrument being valued.
- (d) Where possible, multiple valuation approaches are preferred. If differences in value occur between the valuation approaches, the value must explain and document the differences in value.

Disclosing Vital Information (Key Inputs) –

The requirement to disclose this information in the valuation report will differ for different categories of financial instruments. Sufficient information should be provided to allow users to understand the nature of each class of instrument valued and the primary factors influencing the values. Information that adds little to a users' understanding as to the nature of the asset or liability, or that obscures the primary factors influencing value, must be avoided. The data is gathered from the management of subject company or from external sources and determining the level of disclosure that is appropriate, following points must be considered-

- (a) **Materiality:** The value of an instrument or class of instruments in relation to the total value of the holding entity's assets and liabilities or the portfolio that is valued.
- (b) **Uncertainty:** The value of the instrument may be subject to significant uncertainty on the valuation date due to the nature of the instrument, the model or inputs used or to market abnormalities. Disclosure of the cause and nature of any material uncertainty should be made.
- (c) **Complexity:** The greater the complexity of the instrument, the greater the appropriate level of detail to ensure that the assumptions and inputs affecting value are identified and explained.
- (d) **Comparability:** The instruments that are of particular interest to users may differ with the passage of time. The usefulness of the valuation report, or any other reference to the valuation, is enhanced if it reflects the information demands of users as market conditions change, although, to be meaningful, the information presented should allow comparison with previous periods.
- (e) **Underlying instruments:** If the cash flows of a financial instrument are generated from or secured by identifiable underlying assets or liabilities, the relevant factors that influence the underlying value must be provided in order to help users understand how the underlying value impacts the estimated value of the financial instrument.

Premise used in Valuation-

A Valuer in valuation report must mention the premise used while determining the fair value of an asset. There are two premises while doing valuation of an asset- (i) Going Concern and (ii) Liquidation

The premise help user to understand the situation. A distressed sale will most of the time be conservative and is not derived by income approach whereas in case of going concern a valuer prefer income approach apart from the two other approaches.

Valuation Approaches and Methods Applied –

The three valuation approaches described in IVS 105 Valuation Approaches and Methods may be applied to the valuation of financial instruments. According to IVS 105, three commonly used approaches are- (i)The market approach, (ii) The income approach or (iii) The cost approach.

A good valuer report should briefly explain the valuation approaches and the reason for selecting one or all approach or where any weighted is given. The reason or logic should be properly explained.

When using a particular valuation method or model, it is important to ensure that it is calibrated with observable market information, where available, on regular basis to ensure that the model reflects current market conditions.

As market conditions change, it may become necessary to change to a more suitable model(s) or to modify the existing model and recalibrate and/or make additional adjustments to the valuation inputs. Those adjustments should be made to ensure consistency with the required valuation basis, which in turn is determined by the purpose for which the valuation is required.

Caveats, Limitation and Disclosures–

A valuer must disclose the estimates, assumptions or any limitation. The valuer must disclose if he has considered a work from an expert or other valuer.

This not only provides a support to valuer on how he determined value of an asset but also helps a user to understand the basis of estimates and the assumption valuer has taken while determining the value.

Findings & Suggestions as per Review Reports:

1. Back ground information on asset not detailed
2. Bases & premise value to be given also lacking explanation of how the methodology was applied to the subject property
3. Date of appointment, Date of Inspection, Date of valuation and Date of Valuation Report to be given.
4. In some reports identity of valuer missing, the valuer has to mention his IBBI RV no / COP No to be mentioned in the report.
5. Business interest, ownership characteristics not detailed Inconsistencies, contradictions within the report
6. Assumptions not clearly stated
7. Errors in grammar, math, logic
8. Insufficient explanation of supporting evidence
9. No statement or disclosure on conflict of Interest is specifically mentioned.
10. Some important sources for land ownership not detailed or indicated.
11. In some report Purpose of Valuation is mentioned however name of appointing authority is not mentioned.
12. No mention of restrictions on use of the report, if any.
13. Some report Partly indicates the major factors that were taken into account during the valuation, valuer need to indicate the same in details.

14. Instead of conclusion paragraph, some reports with declaration and certification, Conclusion is not provided. Conclusion paragraph to be provided in the report.

— Review of the Valuation Reports was mainly based on but not limited to Rule 8 of the Companies (Registered Valuers & Valuation) Rules, 2017.

— Important Findings of the Review Reports are as follows:

⊞ For asset class Securities or Financial Assets

♣ Past history of the company should be disclosed in the report to substantiate the professional judgement, especially when the company is listed and/or Multinational Company.

♣ In case of Multinational Company audited financials should be commented in line with AS 21 (consolidation of Holding, Subsidiaries & Associate companies, section 441 read with section 444 of the Companies Act, 2006, of UK.

♣ Where Key Managerial Person (KMP) is playing major role in valuing the shares, comments and its impact, if any, on valuation should be mentioned in the report.

♣ In case the company is Wholly Owned Subsidiary (WOS), Valuation Report should mention the layers of shareholding to substantiate the beneficial owner and at least minimum of one layer should be mandatorily mentioned as per Valuation Rules.

♣ In case IVS are followed for valuation methodology, Valuation Report shall have the mention some details as required in the particular IVS. For e.g., in case IVS 105 has been followed, the report should have a mention of following as part of selection process:

- Appropriate bases of valuation determined by terms & purpose of valuation
- Respective strength and weakness of possible valuation approaches and methods
- Appropriateness of each method in view of the nature of assets and the approaches or methods used by participants in relevant market.

♣ Bases of Valuation not arrived as per Valuation Standards for liquidation value.

♣ Stereo type notes have been given for all Assets.

♣ Mere percentage has been applied.

♣ Figures are computed based on provisional balance sheets.

♣ Valuation Reports does not mention of Liabilities.

♣ Margin money with bank has been mentioned as NIL. Since no creditors can be settled as on date of CIRP other than through water fall line of settlement. Hence, margin money lying in bank cannot be directly settled and shall be made available to RP for settlement under waterfalls.

⊞ No mention of Valuation Standards.

⊞ No statement or disclosure on conflict of Interest is specifically mentioned.

- ⊞ Some important dates are missing.
- ⊞ Some important sources for land ownership not indicated. Indicated, basis of choosing any particular method and not considering other method missing.
- ⊞ Purpose of Valuation is mentioned however name of appointing authority is not mentioned.
- ⊞ No mention of restrictions on use of the report, if any.
- ⊞ Partly indicates the major factors that were taken into account during the valuation.
- ⊞ Conclusion is not provided.
- ⊞ There is no mention of caveats, limitations and disclaimers in the valuation report.
- ⊞ The Valuation Report lays emphasis on technical aspects of valuation while missing out on many critical inputs which are mandatory for making and IVS compliant report Or C(RVV)R-2017 Compliant Report.

→ **Suggestions of the Reviewers:**

- ⊞ The Report should identify the Registered Valuer. There should be a para of identity of valuer and other experts (if any) involved or assisted by.
 - ⊞ Basis (Premise) of value should refer
 - ♣ IBBI (CIRP) Regulations, 2016.
 - ♣ Definition of "Fair Value" and "Liquidation Value" should be provided in the Report.
- ⊞ Since the corporate debtor is under CIRP, the report should consider Ongoing Liquidation Value Basis.
- ⊞ Disclosure/disclaimer should not mention "Validity of Report is 3 years from the date of Report", as this provision is the requirement to maintain records for 3 years and not validity of Report or validity of valuation.
- ⊞ The valuer shall not disclaim liability for his/its expertise or deny his/its duty of care, except to the extent that the assumptions are based on statements of fact provided by the company or its auditors or consultants or information available in public domain and not generated by the valuer.
- ⊞ Valuation Report should mention about the liabilities also, since valuation of liabilities are more crucial for a company under liquidation to map the available liquidation value of assets for settlement of creditors under water fall mode. The liquidation value is the minimum value to be arrived to settle operational creditors.

Conclusion-

A good valuation report must give a conclusion remark at the end of report, so that a user can quickly go through the gist of the report.