<u>Insolvency and Bankruptcy Board of India (Use of Caveats, Limitations, and Disclaimers in Valuation Reports) Guidelines, 2020</u>

The Insolvency and Bankruptcy Board of India has notified guidelines regarding the use of Caveats, Limitations, and Disclaimers in Valuation Reports issued by Registered Valuers (RV). These guidelines shall come into force on or after October 01, 2020 and are in addition to Rule 8 of the Companies (Registered Valuers and Valuation) Rules, 2017 (Rules). RVs shall be required to prepare their reports in accordance with the guidelines as well as the Rule 8.

These guidelines have been formulated to ensure the credibility of the valuation reports and provide guidance to RVs in the use of Caveats, Limitations, and Disclaimers. The Guidelines also provide an illustrative list of the Caveats, Limitations, and Disclaimers which shall not be used in a valuation report.

The Guidelines provide for the following:

1. Contents of a valuation report

The following matters should be covered in the valuation reports in a clear, unambiguous and non-misleading manner, consistent with the need to maintain confidentiality:

(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.

2. Procedures involved in preparing a valuation report

In order to ensure transparency, pertinence and uniformity in valuation reports, guidelines have provided that RV should mention the following key elements:

(a) The principal procedures adopted by the RV in carrying out the valuation should be set out briefly in the report. Such procedures may typically include:
  - Review of past financials;
  - Review and analysis of financial projections;
  - Industry analysis;
  - SWOT analysis;

- Comparison with similar transactions;
- Comparison with other similar listed companies;
- Discussions with the management;
- Review of principal agreements/documents etc.;
- Site visit (external, internal or both) or desktop valuation;
- Any assumption made for internal condition must be stated like in case of desktop valuation, a RV must state that the basis of the report is photographs and documents provided and secondary research only; and
- Process of site identification, i.e., self-identified or with the help of clients representative or client itself.

(b) The RV should also include in his report:

- an affirmative statement that information provided and assumptions used by management/others in developing projections have been appropriately reviewed, enquiries made regarding basis of key assumptions in context of business being valued and the industry/economy; and
- an affirmative statement on adequacy of information and time for carrying out the valuations.

(c) The RV should mention any key factors which have a material impact on the valuation, including inter alia the size or number of the assets or shares of the company, its/their materiality or significance, minority or majority holding and changes on account of the transaction, any impacts on controlling interest, diminution or augmentation therein and marketability or lack thereof; prevailing market conditions and government policy in the specified industry as a disclaimer depending upon the factor.

(d) In case of valuation of tangible assets, there may be impact on the value due to faulty structural design or contamination. Based on the individual circumstances, the RV may decide on how to use such information in the valuation report.

3. Definition of Caveats, Limitations and Disclaimers

The guidelines have delineated the terms Caveats, Limitations and Disclaimers in the following manner:

(a) Caveats are warnings or cautions to the client/user of services.

(b) Limitation is a restriction on the scope of the RV's work including inspection or investigation of the data available for analysis that may be present and known to the RV at the outset of the valuation engagement or that may arise during the course of a valuation assignment.

(c) A disclaimer is a statement intended to specify or delimit the scope of rights and obligations that may be exercised and enforced by parties in a legally recognized relationship. It is a statement denying responsibility intended to prevent civil liability arising for particular acts or omissions. The following points may be considered while providing disclaimers in a valuation report. An RV may:

- identify the rights he/she wants to protect;
- identify the areas where he/she might be subject to liability;
- clarify that the contents of the valuation report pertain to specific use by the company; and
- caution the reader of the potential risks.

However, a disclaimer will not, by itself, be able to exclude a RV's liability in respect of negligence in performance of his duties.

4. Usage of Caveats, Limitations and Disclaimers

The guidelines dictate the following principles be followed regarding the usage of Caveats, Limitations and Disclaimers:

(a) **Clarity and specificity of Caveats, Limitations or Disclaimers:** Any caveats, limiting condition or other disclaimers to the report must be clear and specific.

(b) **Duty of "due care" of the RV:** In the preparation of a valuation report, the RV shall not disclaim liability for his expertise or deny his duty of "due care".

(c) **Management's responsibility:** it is recognized that a RV, shall prepare the valuation report of the company based on information and records concerned as provided by the management. The management remains liable for the correctness and veracity thereof. However, significant inputs provided to the RV by the management/owners should be considered, investigated and /or corroborated. In cases where credibility of information supplied cannot be supported, consideration should be given as to whether or how such information is used.

(d) **RV to assess reliability and credibility of projections**: RV factors his response and the valuation assessment on the reliability and credibility of the information. The various projections of business growth, profitability, and cash flows etc., which are used in the valuation report are the company's estimates. The RV should consider the reliability and credibility of projections after testing the assumptions made by the management / owners / company in given market conditions and after sufficient inspection, enquiry, computation and analysis. The RV may disagree with the projections if they are conjectural or bordering on the unreal and accordingly make necessary modifications.

(e) **Right to demand relevant information and basis of projections:** RV has the right to demand relevant information and basis of the projections before commenting. It is the duty of the entity being valued to be fair and to provide accurate information about the subject asset.

(f) **Duty of RV to carry out sufficient inspection, enquiry, computations and analysis:** In a valuation report, the RV can state that the assumptions are statements of fact provided by the company and not generated by the RV. This warning statement is necessary as data provided by the company is often construed be a part of the valuation report. However, RV remains responsible to carry out sufficient inspection, enquiry, computations and analysis.

(g) **Additional Information in the Valuation report:** All valuations are to be carried out in sufficient detail to comply with the requirements of "due care". However, it can be reasonably expected that circumstances may place certain limitations regarding access to information or the time available. The information or the time available to complete the valuation should be stated in the valuation report, together with appropriate explanation and implications. The effort, diligence and level of expertise applied by the relevant Registered Valuer, need to be stated in the valuation report.

Since valuation reports provided by an RV form the basis of several transactions as per law, the guidelines are likely to ensure that RVs do not evade their responsibilities and duties, by contorting the language of the valuation report. It is expected that these guidelines would effectively ensure the uniformity and reliability of valuation reports.

The detailed guidelines can be accessed at the following link:

5. https://ibbi.gov.in//uploads/legalframwork/e5e1300db2dd6a8bebe289ba579a7c14.pdf