Conflict between Insolvency and Bankruptcy Code of India (IBC) and International Valuation Standards (IVS): Challenges and Pathways for Harmonization

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Abstract

Insolvency and Bankruptcy Code (IBC), 2016 is a landmark legislative reform in modern India. The International Valuation Standards (IVS) aim to provide a common framework for valuers worldwide, covering all asset classes. All valuations under this code are supposed to be done in compliance with IVS. While achieving the goal of insolvency in India, a number of conflicts are observed between IBC and IVS while performing valuation exercises for this purpose. Many challenges have also evolved in harmonizing IVS and IBC. This paper tries to highlight these conflicts and challenges by going deep into their root causes. Finally, the author tries to sort out the possible pathways to harmonize IBC and IVS in India.

Keywords:

Insolvency;
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1. Introduction

The Insolvency and Bankruptcy Code (IBC) of India, introduced in 2016, represents a landmark legislative reform aimed at streamlining the insolvency process and ensuring timely resolution of bankrupt businesses. As India's insolvency framework has matured, the need for accurate and reliable valuation has become more evident, as valuation plays a crucial role in ensuring fair treatment of stakeholders, particularly creditors, shareholders, and other claimants. On the other hand, the International Valuation Standards (IVS) provide globally accepted guidelines for valuing assets and businesses, which ensure consistency and reliability in financial reporting, insolvency cases, and asset management.

However, the application of IVS in the Indian insolvency context, governed by the IBC, presents certain challenges and conflicts. These conflicts primarily arise due to differences in valuation principles, methodologies, and the treatment of distressed assets between IVS and the IBC. This article explores these conflicts, examines the challenges posed by the Indian regulatory environment, and proposes pathways for harmonizing the two frameworks.

1.1 Overview of the Insolvency and Bankruptcy Code (IBC) of India

The IBC was enacted to consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms, and individuals in a time-bound manner. The key objectives of the IBC are:

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Maximization of Value: The IBC seeks to maximize the value of the debtor's assets during insolvency resolution.

Timely Resolution: It provides a strict timeline of 180 to 270 days for resolving insolvency cases.

Creditors' Committee: The IBC empowers a Committee of Creditors (CoC) to decide the future of the debtor by voting on proposed resolution plans.

Liquidation and Resolution: If the resolution fails, liquidation is the last resort, where assets are sold to recover dues for creditors.

Under the IBC, valuation plays a pivotal role in both resolution and liquidation processes. Resolution professionals appoint registered valuers to determine the fair value and liquidation value of assets, which serve as benchmarks for creditors to evaluate the resolution plans.

However, the IBC's focus on time-bound resolutions and maximizing creditor recoveries can sometimes conflict with the broader valuation principles prescribed by the IVS, particularly in distressed scenarios.

1.2 Overview of International Valuation Standards (IVS)

The International Valuation Standards Council (IVSC) is an independent, not-for-profit organization that develops valuation standards to ensure transparency, consistency, and comparability across global markets. The IVS aim to provide a common framework for valuers worldwide, covering all asset classes, including real property, plant and equipment, businesses and business interest, financial instruments, and intangibles.

The key principles of setting the IVS include:

Purpose: To promote and maintain a high level of public trust in global and local valuation practice.

Valuation Standards: To create principle based valuation stadradands so tha it could adequately address the development of a credible opinion of value and the communication of that opinion to the intended user(s).

Development and Revisions of Standards: To create and revise the standards, when necessary, by way of a transparent and dynamic process after appropriate exposure.

Jurisdiction: To allow supremacy of legislative and regulatory requirements that are in conflict with the standards in the form of departure.

The core principles of valuation under IVS revolve round ethics, competency of valuer, complaince with standards, basis of value, date of value, the use of appropriate assumptions and conditions, intended use, intended user(s), scope of work, identification of subject of valuation, reliable data, robust valuation methodology, communication of valuation and record keeping.

2. Review of related articles

Ivo KOSTOV (2022) in his study examined the novelties in the latest edition of the IVS and tried to make a connection with the Bulgarian Valuation Standards (BVS), their updates, as well as the overall improvement of the valuation practice in Bulgaria. He used the methodology which included a historical approach, a systematic approach, a method of analysis and synthesis, and a method of induction and deduction. He formed the main conclusion covering the possible changes in the BVS based on the International Valuation Standards.

Sandeep A. NARAYAN et al (2020) in their article analyzed the causes of partial failure of adoptability of International Valuation Standards in small pacific islands with specific reference of Fiji. They highlighted three key categories of challenges faced by property valuation firms in Fiji viz. (i) availability and reliability of data, (ii) inconsistency in application of valuation methodology, (iii) inconsistency of application of IVS in reporting.

Y L GAMBO (2014) examined how Nigerian valuers response to international valuation standards application in practice. He further investigated the extent of their compliance with the provision of the practice standards. His study revealed the fact that very few valuers in Nigeria used International Valuation Standards. I He recommended that the regulatory bodies should play a key role to impose IVS in Nigerian Valuation market.

Rishabh RAJ (2024) discussed elaborately in his article the impact of IBC on distressed assets with special emphasis on Merger and Acquisition (M&A). Here he addressed the transition in distressed asset management issue following the introduction of IBC. He also examined the special issues related to valuation and how those were affecting the distressed assets under the IBC.

Pratik DATTA (2018) explained the problems of the value destruction and wealth transfer under IBC 2016. He developed the theoretical frameworks necessary to identify the sources of these two problems in an insolvency law through the article. He further proposed that the Indian lawmakers need to reconsider the design of this Code to properly address the concerns.

Hemant BATRA (2021) in his article discussed the challenges being faced and to be faced by the stakeholders in IBC 2016. He explained how the IBC have opened-up opportunities and prospects for merger and acquisition (M&A) deals in India. He showed how the two avenues viz. the fast-track process, where the corporate debtor's assets are unencumbered and where the assets are encumbered or a part of the business, and the creditors have already initiated a corporate insolvency resolution process (CIRP) against the corporate debtor shall help in Merger & Acquisition.

S SIVAKUMAR (2019) in his paper initially discussed the historical aspects of Insolvency and Bankruptcy Code. How the code being handled was also discussed by him. The importance of institutional mechanism also illustrated by him. He finally stressed on introduction of cross boarder insolvency, group insolvency as well as more use of technology in insolvency.

3. Key Areas of Conflict Between IBC and IVS

While both the IVS and IBC aim to ensure transparency and fairness in the valuation process, they differ in several fundamental ways, leading to potential conflicts. Some of the key areas of conflict include:

3.1 Basis of value: Liquidation Value (IBC) and Liquidation Value (IVS 102)

Under the Insolvency and Bankruptcy Code (IBC) and its regulations, the liquidation value is *the estimated realizable value of the assets of the corporate debtor, if the corporate debtor were to be liquidated on the insolvency commencement date.* Therefore, this *liquidation value* cannot be accepted as a 'Basis of Valuation' as its estimation depends on another value – 'Realizable Value'. If we accept realizable value as the basis of valuation, it needs to have a clear definition, Suprisingly this realizable value is not defined anywher in IBC or its regulations, rules, notifications, circulars etc. published by the Insolvency and Bankruptcy Board of India (IBBI) from time to time.

International Valuation Standards (IVS) emphasize the concept of "liquilation value" as the most appropriate valuation basis for distressed assets. Liquidation value (IVS 104.80) represents the amount at which an asset would be sold on a piecemeal basis either under orderly transaction or a forced transaction premise.

Although IVSC accepts supremacy of legislative, regulatory or other authoritative requirements over IVS in the name of departure, the conflict arises because IVS does not allow non-transparecy in valuation methodology. Ample scope of malutilisation of the definition of liquidation value provided by IBC and its regulations leads to serious conflict between IBC and IVS.

3.2 Averaging of Value

IBC accepts the averaging of the two closest estimates of a value submitted by the valuers to be considered as the fair value or the liquidation value, as the case may be.

IVS, on the other hand, allows weighting by which final single value conclusion could be reached by the process of analysis and reconciliation of different values but strictly without averaging.

3.3 Time Sensitivity and the 180-Day Resolution Window

The IBC's strict timelines (180 to 270 days) for completing the resolution process often place pressure on valuers to expedite the valuation process. This may lead to shortcuts or oversimplifications in the valuation methodology, which could compromise the quality and accuracy of the valuation. IVS, on the other hand, emphasizes thorough and comprehensive valuation processes that ensure accuracy and reliability, without necessarily being constrained by time.

While the IBC's objective of time-bound resolution is critical to improving the ease of doing business in India and preventing prolonged insolvency cases, this time pressure can result in valuations that are not fully aligned with the rigorous and methodical processes prescribed by the IVS.

3.4 Valuation of Intangible Assets and Goodwill

IVS provides detailed guidelines for valuing intangible assets, including goodwill, intellectual property, and brand value. It recognizes that intangible assets can have significant value, even in distressed companies, and these should be accounted for in the overall valuation of the business.

In contrast, the IBC tends to prioritize tangible, recoverable assets during the insolvency process, often overlooking the potential value of intangibles. This is particularly evident in cases where distressed companies have significant intellectual property or brand equity that is difficult to realize in a liquidation scenario. The undervaluation of such intangible assets can lead to suboptimal outcomes for stakeholders.

3.5 Fair Value and Stakeholder Impacts

Fair Value in IVS represents the price at which an asset would be exchanged between knowledgeable, willing parties. It is widely used in financial reporting and asset management to provide a true picture of the company's worth.

Under the IBC, the determination of fair value can be subject to conflict, as creditors often seek valuations that maximize their recoveries. This can lead to undervaluing the assets, particularly when resolution professionals focus primarily on liquidation value, leading to disputes among stakeholders. The IVS's focus on ensuring transparency and objectivity in determining fair value sometimes conflicts with the more pragmatic, creditor-centric approach under the IBC.

3.6 Subjectivity in Valuation and Discrepancies Between Valuers

The IBC requires two registered valuer's valuation reports. However, in practice, these valuations often differ significantly due to subjective judgments made by valuers. Such discrepancies can create confusion and lead to litigation, as creditors and other stakeholders may challenge the valuation reports. The IVS emphasizes consistency and comparability in valuations, but the subjective nature of distressed asset valuation can lead to conflicts between valuers operating under the IBC framework.

4. Challenges of Harmonizing IVS and IBC

Efforts to harmonize the IVS and IBC frameworks face several challenges. These challenges stem from the intrinsic differences between the two systems and the practical realities of implementing international standards in a domestic legal environment.

4.1 Inconsistent Application of Valuation Standards

In India, registered valuers under the IBC are expected to adhere to the Valuation Rules 2017 issued by the Insolvency and Bankruptcy Board of India (IBBI). While these rules are aligned with global best practices, they do not fully incorporate the IVS. This results in inconsistent application of valuation principles, especially when dealing with complex or distressed assets.

4.2 Lack of Specialized Expertise in Distressed Asset Valuation

Valuing distressed assets requires specialized expertise, and there is currently a severe shortage of trained professionals in India who are proficient in applying both IVS and IBC requirements. Most of the registered tangible assets valuers in India have backgrounds in enginerring or architecture and very little knowledge in economics and accountancy, which may limit their ability to accurately assess the value of intangible or complex business assets.

4.3 Legal and Regulatory Barriers

The legal environment in India often prioritizes creditor recoveries and timelines, which may conflict with the more comprehensive and deliberative valuation processes recommended by IVS. Additionally, the IBC's legal framework provides limited recourse for challenging valuation disputes, which can result in suboptimal outcomes for certain stakeholders, particularly minority shareholders.

4.4 Different Priorities: Global vs. Local Stakeholders

IVS is designed for global consistency in financial reporting and valuation. In contrast, the IBC's focus is on the local legal and financial environment, prioritizing creditor interests and expedited resolutions. This difference in priorities can make it difficult to fully harmonize the two frameworks.

5. Pathways for Harmonizing IVS and IBC

While the challenges of harmonizing IVS and IBC are significant, there are several pathways that can help bridge the gap between these two frameworks.

5.1 Define realizable value

To resolve the conflict between liquidation value as defined by IBC and IVS, the definition of realizable value could be introduced in the regulations of IBC. The forthcoming edition of IVS to be adopted on 31st January 2025 has already amended the definition of the same following the feedbacks received from India.

5.2 Introduction of weighting in place of averaging

The Sec 35(1)(c) of the Regulations of IBC could be amended by introducing weighting in place of averaging. The sub-section might be re-written as - *the weighted average of the two closest estimates of a value as reasonably decided in the meeting of committee of creditors where the valuers explained the methodology being adopted by them to arrive at valuation, shall be considered the fair value or the liquidation value, as the case may be.*

5.3 Strengthening Valuation Governance and Oversight

The Indian regulatory authorities, particularly the IBBI, could strengthen governance and oversight mechanisms to ensure that valuers adhere to both IBC and IVS standards. A panel of Valuation Reviewers could be created to check the complaince of the valuation reports with IVS before subnission to RPs.

5.4 Enhancing Training and Education for Valuers

To address the shortage of specialized expertise, efforts should be made to provide training and education to registered valuers in India on both IVS and IBC requirements. The IBBI and its RVOs could collaborate with international organizations such as the IVSC to offer certification programs focused on distressed asset valuation and global best practices.

5.5 Revising the Role of Valuers in the IBC Process

The IBC could be amended to provide more clarity on the role of valuers in the resolution process. By defining clear standards for when and how valuers should apply different valuation methodologies, the IBC could help reduce conflicts between IVS and insolvency law. Additionally, introducing an independent appeal process for resolving valuation disputes could enhance fairness and transparency.

6. Conclusion

The conflict between the Insolvency and Bankruptcy Code (IBC) of India and the International Valuation Standards (IVS) presents a significant challenge in ensuring accurate, fair, and transparent valuations in insolvency proceedings. While the IBC's focus on liquidation value and expedited resolutions, the IVS promotes consistency and objectivity in valuation, can sometimes undermine these principles.

To address these conflicts, India must consider amending the IBC, strengthening governance and oversight mechanisms, enhancing education and training for valuers. By taking these steps, India can better align its insolvency framework with global standards, ultimately ensuring fairer outcomes for all stakeholders involved in the insolvency process.

The harmonization of IVS and IBC is not only necessary for improving the valuation process in India but also for fostering greater trust and confidence in the Indian insolvency system at a global level.

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