

**Concept Paper  
On the  
findings of the  
Peer Review of the Valuation Reports**



**ICAI Registered Valuers Organisation  
and  
Valuation Standards Board  
The Institute of Chartered Accountants of India**

## **Preamble**

A Workshop was organised to share findings of Peer Review for the three Asset Classes, i.e., Financial or Securities Assets Class, Land and Building and Plant and Machinery as per Companies (Registered Valuers and Valuation) Rules, 2017 by ICAI Registered Valuers Organisation in association with Insolvency and Bankruptcy Board of India (IBBI) at ICAI Delhi.

The workshop was addressed by CA. Atul Kumar Gupta, President ICAI and Director ICAI RVO and Sh. Sudhaker Shukla Whole Time Member (Registration and Monitoring Wing), Insolvency and Bankruptcy Board of India, Shri Pawan K. Kumar, Executive Director, IBBI

It was discussed that it has become a common phenomenon to assume valuation to be subjective. This means, valuer can play with the numbers, can exercise his judgement to accommodate end result intended by the recipient. It was also discussed that Valuation is Objective science and the examples to support this claim is that in many valuation reports the arbitrary assumptions made are as follows:

- Growth rate is assumed at 10%
- Terminal growth rate is assumed at 5%
- Beta is assumed at 1.
- Product Life Cycle is assumed as indefinite.
- Assuming Book value of Debt to be Market Value of Debt

Further, it was found that although all Registered Valuers claim to have prepared their valuation report in compliance with the law and practice, however, the reports lacked in many aspects. Also, there is no standardization in the disclosures required to be made OR assumptions used in preparing the report.

It was desired by IBBI, ICAI RVO and Chairman and Vice Chairman, Valuation Standards Board of ICAI that a Concept Paper may be prepared to help the Registered Valuers to make them aware about the findings of the Peer Review, to make them understand the process of Valuation so that the Registered Valuers comply with the requirements of Law and Rules in letter and spirit.

# **Concept paper on findings of the Peer Review of the Valuation Reports**

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## **Concept paper on findings of the Peer Review of the Valuation Reports**

### **1. Definition of Peer Review**

Peer Review System (PRS) is a mechanism of evaluating the professional/audit and assurance activities/services carried out by a Firm by peers by looking into the systems and procedures adopted and records maintained while carrying out professional/audit and assurance activities with the objective to evaluate and suggest improvements of systems, procedures and quality of reporting. The purpose of PRS is to improve the quality of service rendered by Firms by way of enhancing credibility, transparency and adopting best practices and imparting knowledge and skills.

### **2. Objective of Peer Review- Registered Valuers Organisation**

The purpose of the Peer Review System statement is to impart a framework for, planning, performing, reporting and administration of the peer review process.

Peer Review System is directed towards maintenance as well as enhancement of quality of professional/valuation related services and to provide guidance to members to improve their performance and adhere to various statutory and other regulatory requirements. Essentially, through a review of professional services engagement records, peer review identifies the areas where a RV/Firm may require guidance in improving the quality of his performance and adherence to various requirements as per applicable technical Standards as well as proper and regular application of such frame across engagement test sample for Review.

### **3. Objective of Peer Review- Registered Valuers**

The main objective of Peer Review System is to ensure that in carrying out the professional/valuation related activities/services, the registered valuers:

- a) comply with Technical, Professional and Ethical Standards as applicable including compliance of other regulatory provisions and requirements thereto and

- b) have in place proper systems including documentation thereof, to adequately exhibit the quality of the professional/valuation related activities/services.

#### **4. Key Aspects in a Valuation Report**

The key aspects in a Valuation Report

- Appointing Authority
- Valuation Date and Date of Report
- Purpose of Valuation
- Scope of work – Key elements
  - ✓ Client
  - ✓ Intended User
  - ✓ Intended Use
  - ✓ Detailed asset description
  - ✓ Definition of value
  - ✓ Premises of value
  - ✓ Restriction of Use
  - ✓ Date of valuation
- Disclosure of
  - ✓ Conflict of Interest
  - ✓ Reliance on the work of another expert
  - ✓ Valuation Methodology/Approach/Workings – case to case basis, keeping in mind aspects of confidentiality, sensitivity, nature of work
- Key Aspects considered for Valuation
- Disclaimers/Caveats/Limitations
- Identity of the Valuer and Team Members

#### **5. Matters to be taken care of by the Valuer before accepting the engagement**

Following issues must be identified before accepting the engagement of valuation:

- Subject and interest to be valued
- Scope of work
- Date of valuation
- Standard of value

- Purpose of valuation
- Premise of value
- Assumption, Limiting conditions and scope limitations
- Nature of Business
- Knowledge of the Industry
- Sources of information available
- Governing laws and Regulations

**6. Documentation required by a Valuer for valuation engagement.**

The information received and relied upon, as well as analyses thereon differ for every valuation engagement, However, the following documents/information/analyses shall, at the minimum, be documented:

- engagement or appointment letter which appoints the *valuer* to undertake the valuation;
- tabulation of data obtained during the course of valuation;
- workings undertaken to arrive at the value;
- copies of relevant circulars, extracts of legal provisions;
- the base/s, approach/es, and method/s, or a combination thereof, used to arrive at the value;
- assumptions, a change in which, may materially affect the value;
- a copy of the signed valuation report issued; and
- management/client representation letter or such communication received, if any.

The valuation documentation is not limited to records prepared by the *valuer* but may include appropriate records such as minutes of meetings, reports issued by other experts, and other independent industry/sector or other such data provided to the *valuer* by the client, if any.

The valuation analyst should retain the documentation for a period of three years as per the Companies (Registered Valuers and Valuation) Rules, 2017, for a period of eight years as per ICAI Valuation Standards 2018 and the Companies Act 2013 or for the time period specified by any other law to meet the needs of applicable legal, regulatory, or other professional requirements for records retention.

## **7. Minimum requirements, a valuer shall state in the valuation report**

A valuer shall, in his report, state atleast the following:-

- background information of the asset being valued;
- purpose of valuation and appointing authority;
- identity of the valuer and any other experts involved in the valuation;
- disclosure of valuer's interest or conflict, if any;
- date of appointment, valuation date and date of report;
- inspections and/or investigations undertaken;
- nature and sources of the information used or relied upon;
- procedures adopted in carrying out the valuation and Valuation Standards followed;
- restrictions on use of the report, if any;
- major factors that were taken into account during the valuation;
- conclusion; and
- caveats, limitations and disclaimers to the extent they explain or elucidate the limitations faced by valuer, which shall not be for the purpose of limiting his responsibility for the valuation report.

## **8. Assumptions and limitations to be considered in a Valuation Report**

An Illustrative list of assumptions and limiting conditions are given here below:

- Valuation report is considered valid for the valuation date only.
- All the statements given and presented represent the true and fair view.
- Opinions, conclusions, decisions represented by a valuer in terms of valuation are unbiased and fair.
- There is no personal interest in the assets, property, intangibles, intellectual rights etc., valued by a valuer.
- Statement that "we have relied on the information provided by the Management for the purpose of valuation.
- Public information and industry and statistical information have been obtained from sources believed to be reliable. However, no representation is made as to the accuracy or completeness of such information and has performed no procedures to corroborate the information.
- Do not provide assurance on the achievability of the results forecasted by [ABC Company] because events and circumstances frequently do not occur as expected;

differences between actual and expected results may be material; and achievement of the forecasted results is dependent on actions, plans, and assumptions of management.

- If an intangible asset is not able to generate benefits for the firm/ company and the benefits cannot be measured reliably then it is treated as expenditure and not an asset.
- Legal background, financial aspects and tax matters regarding business valuation.
- Description of principles used in business valuation.

## **9. Minimum Contents of the Valuation Report**

Minimum Contents of the Valuation Report are as follows:

- Context and Purpose
- Conditions and major assumptions
- Background of the Company
- Valuation date
- Valuation Methodology and Approach
- Source of Information
- Caveats
- Distribution of Report
- Opinion on the value of the business

## **10. Steps involved in Valuation Process**

The valuation process can be broken down into 3 distinct steps, as illustrated below:

### **STEP 1: Get a better understanding of the past work such as**

- Information Collection/Data Research
- Industry and Economy Analysis
- Business Analysis/Historical Analysis:
  - (i) Understanding the business
  - (ii) Understanding the Regulatory framework for the industry
  - (iii) Understanding the value drivers
  - (iv) Accounting analysis
  - (v) Accounting policy review



- (vi) Length of financial history
- (vii) Adjustments to financial statements
- (viii) Assets and liability analysis including contingent assets and liabilities
- (ix) Income and expenses analysis
- (x) Financial analysis
- Ratio analysis
- Trend Analysis
- Cash flow analysis
- Strategy Analysis
- Company Risk Analysis

### **STEP 2: Forecasting the future**

- Structured forecasting
- Income statement forecasts
- Balance sheet forecasts
- Cash flow forecasts

### **STEP 3: Valuation**

- Taking Assumptions
- Determining Cost of Capital/Discounting Rate
- Use of Valuation models
  - (i) Income Approach
  - (ii) Market Approach
  - (iii) Asset Approach
- Arriving at Final Value
- Preparation of Valuation Report

## **11. Key elements of a Valuation Exercise**

The key elements of a valuation exercise are:

- (a) an actual/ possible transaction;
- (b) valuation date; and
- (c) the parties (actual or likely) to the transaction.

**Major Findings  
of the  
Peer Review of Valuation Reports**

## **12. Major Findings of the Peer Review of Valuation Report**

- i. Valuation quality in general is affected by
  - a. Advocacy – Lack of independence.
  - b. Insufficient technical competence (e.g., Inadequate knowledge or insufficient technical skills )
  - c. Negligence (e.g., Inadequate valuation procedures or inadequate quality control)

Of the above three quality issues, NEGLIGENCE is the major quality issue observed during peer review.

- ii. NEGLIGENCE is being contributed by the following lapses observed
  - a. Vague or undetailed scope ( of work summary )
  - b. Insufficient explanation of supporting evidence
  - c. Lacking explanation of how methodology was applied to the subject property
  - d. Errors in grammar, math, logic
  - e. Inconsistencies, contradictions within the report
  - f. Assumptions not clearly stated
- iii. Insufficient explanation of supporting evidence
  - a. Valuation is an opinion of value, it needs to be properly supported for credibility. Must be supported by relevant evidence and logic -as necessary for the intended use.
  - b. Detailed listing on sources of data
  - c. Comprehensive Market data interpretation & Analysis
  - d. Steps involved in logical conclusion.
- iv. The Valuation is unbiased logical presentation of evidence that supports an opinion of value. Valuer's job is to present a report that clearly and competently explains a story of value.
- v. Some important sources for land ownership not indicated.
- vi. No statement or disclosure on conflict of interest is specifically mentioned.
- vii. Purpose of valuation is mentioned however name of appointing authority is not mentioned
- viii. Some important dates are missing.

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- ix. Valuation Standards not indicated.
- x. There is no mention of caveats, limitations and disclaimers in the valuation report.
- xi. Partly indicates the major factors that were taken into account during the valuation.
- xii. Conclusion is not provided.
- xiii. No mention of restrictions on use of the report, if any.
- xiv. Partly indicates the major factors that were taken into account during the valuation.
- xv. Bases of Valuation not arrived as per Valuation Standards for liquidation value.
- xvi. Stereo type notes have been given for all Assets.
- xvii. Mere percentage has been applied.
- xviii. Figures are computed based on provisional balance sheets.
- xix. Valuation Report does not mention of Liabilities.
- xx. Margin money with bank has been mentioned as NIL. Since no creditors can be settled as on date of Corporate Insolvency Resolution Professional other than through water fall line of settlement. Hence, margin money lying in bank cannot be directly settled and shall be made available to Resolution Professional for settlement under waterfalls.
- xxi. The deviations from Valuation Standards noted. The deviations generally observed when reviewing the valuation reports pertain to the following;
  - a) Use of different valuation standards: It is observed that in some tangible asset valuation reports, references were drawn to ICAI Valuation standards and definitions used from that standard, which was in contravention to adoption of IVS.
  - b) Scope of work was not elaborately captured in engagement letter NOR in transmittal letter/ Executive summary for valuation
- xxii. Restrictions on the use of report: A statement explicitly restricting the end use of the report to intended user and for intended purpose only was missing from valuation report.

### **13. Key Takeaways**

Some of the key takeaways of the exercise of Peer Review

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

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- 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 Companies (Registered Valuers and Valuation) Rules, 2017.
- 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.
- Definition of "Fair Value" and "Liquidation Value" should be provided in the Report.
- Since the corporate debtor is under CIRP, the report should consider
- Liquidation Value on Ongoing Concern 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.

### 14. Conclusion

Although all Registered Valuers claim to have prepared their valuation report in compliance with the Companies (Registered Valuers and Valuation) Rules, 2017, Valuation Standards etc, but it has been observed that the reports lacked an explicit declaration stating the same.

It was observed that the reports still follow the tabular form of reporting wherein they miss out on addressing this aspect. The reports do not confirm having 'Considered' all three

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generic approaches to value and do not cite reasons for 'selection' of any particular method or for 'disregarding' any approach.

Further, there is no standardization in the disclosures required to be made OR assumptions used in preparing the report.

Taking note of the findings of the Peer Review, the Registered Valuers should comply with the requirements of Law and Rules in letter and spirit.