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10-FACTOR ANALYSIS: VALUATION OF TRADE RECEIVABLES UNDER CIRP

Introduction

Companies (Registered Valuers and Valuation) Rules, 2017 has recognized three asset classes - Land & building, Plant & machinery and Securities & financial asset.

There is no definition of Securities & financial asset, neither in the IBC Code, 2016 nor in the Companies (Registered valuers & valuation) Rules, 2017.

According to IAS 32 Financial Instruments, "Financial asset" means namely an asset that is a contractual right to receive cash or another financial asset from another entity.

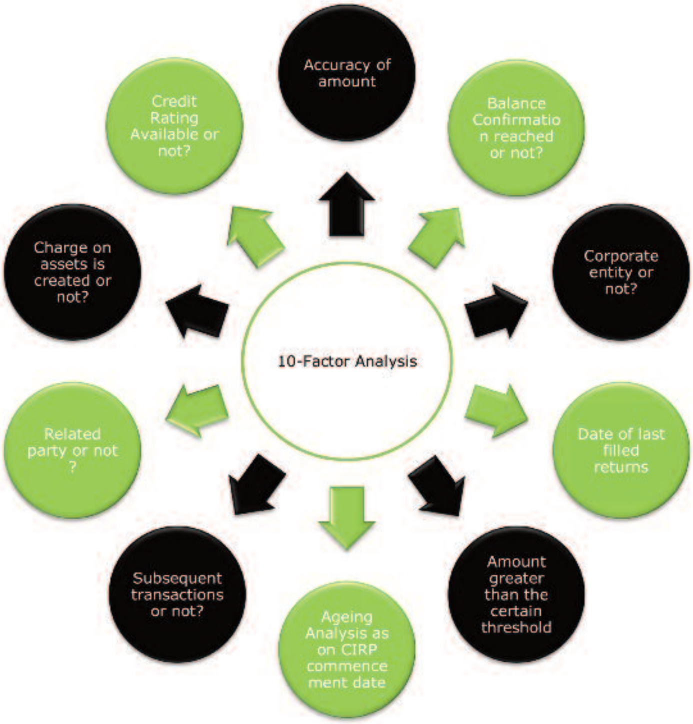
As per the sub-regulation (1) of regulation 35(2) of IBC:-

"Fair value" means the estimated realizable value of the assets of the corporate debtor, if they were to be exchanged on the insolvency commencement date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had acted knowledgeably, prudently and without compulsion"

And

"Liquidation value" means the estimated realizable value of the assets of the corporate debtor, if the corporate debtor were to be liquidated on the insolvency commencement date."

Considering the above factors and regulatory framework, the following key factors are suggested while valuing the trade receivables, which are as follows:



A) Accuracy of amount

This factor considers whether the parties and the balance shown against it, is accurate or not? Investigations need to be undertaken to determine genuineness of the parties standing as trade receivables viz. Bogus firms, list of defaulters on trade tax sites, Google search etc.

Moreover, by performing ledger scrutiny of the parties under the accounting data and last audited financials, we can satisfy ourselves that the balance of all the debtors in the list is arithmetically correct or not.

B) Balance Confirmation reached or not?

This factor considers sending balance confirmations to all the parties at all the available addresses by speed post.

If balance confirmation has reached, it means party is traceable and there is high probability of recovery from the party

If response to the balance confirmation is received then, valuation is done for that party as per the response received from such party.

C) Corporate entity or not?

This factor focus on the fact that whether the trade receivable is corporate entity or not.

Corporate entity means entity covered under Companies Act and LLP Act

Recovery from corporate entity is more feasible because Explanation 2 to the Section-11 of the Insolvency & Bankruptcy Code, 2016 states that- the CIRP proceedings can be initiated against othercorporate debtors for the recovery of dues, whereas for unregistered entity, recovery proceedings can be very time-consuming and challenging as it is through the process of local court proceedings.

D) Date of its last filled returns

The factor considers the last filled statutory return by the trade receivable party. Check for the last filed returns and event based forms under different Acts or Regulations like under The Companies Act, 2013, The Income Tax Act, 1961, Goods and Service Tax Laws, etc.

Remember, there are more chances of recovery from the trade receivable party which is a going concern entity.

E) Amount greater than the certain threshold?

This factor considers the concept the materiality. If the amount due from a trade receivable is below the certain threshold, then cost-benefit analysis does not justifies to initiate the recovery proceedings.

For example: if a debtor with amount Rs. 1,96,762, then, it will not be considered for valuation since the amount is not material and recovery proceedings can be very time-consuming and challenging.

F) Ageing Analysis as on CIRP commencement date

This factor focuses on the importance of Ageing analysis of trade receivable parties. It is simply a time-based analysis with reference to due date to determine either how much time is left until due date or how much time has passed since due date. Most of the time age or aged or ageing analysis refers to the second type of analysis i.e. how much time has passed since due date and this analysis is used in context of receivables to determine steps required to recover debts from debtors.

I suggest to age debtors on the basis of outstanding balance – for less than one year, more than one year but less than three years and more than three years, considering the provision of the limitation Act, 1963.

The Limitation Act, 1963 defines limitation periods to impose time limits within which a party must bring a claim, or give notice of a claim to the other party. Note that the amount outstanding for more than three years is not recoverable as it is time-barred.

G) Subsequent transactions or not?

This factor focuses on the fact that whether trade receivables parties are in constant contact with the corporate debtor. Subsequent transaction refers to the transactions occurred in respect of realisation of amount after the date of commencement of the CIRP proceedings. There may be few such transactions between corporate debtor and persons in the list of trade receivables, in cases when corporate debtor is a going concern.

If the amount is subsequently realisation after the date of valuation means there is a high probability of recovery of remaining balance also.

H) Related party or not?

This factor classifies the trade receivables parties into related party and non- related parties - as per the definition of related party in the Companies Act, 2013 and the Insolvency and Bankruptcy Code, 2016.

I) Charge on assets is created or not?

This factor is considered important to consider the recoverability from the person in the list of trade receivables as only secured creditors/ charge holder can realize the assets on which charge is created.

If a company has charge on its assets, the recoverability would be less. Operational creditor - the realization amount is only liquidation value which is very less than the actual amount to be received.

J) Credit Rating Available or not?

Credit ratings are one of the important factors on the basis of which banks provide loans to the companies and therefore companies needs to acquire these ratings from the authorized credit rating agencies. But not all banks have this as a pre-requisite condition for the provision of loans. Also, Companies Act, 2013 requires the prescribed companies to acquire credit ratings from the specified agencies like as per the provisions of Chapter V– Acceptance of Deposits by Companies. Therefore, it can be one of the factors indicating chances of recovery from the trade receivable party

Scorecard:

Factors of Analysis	Scorecard		Exceptions
	1	0	
Acuracy of Amount	If the amount is accurate as per the result of procedures done to satisfy the same	Otherwise	
Balance confirmation reached or not	If balance confirmations reached	If balance confirmations not reached for any reason.	If Response for the balance confirmation is received, then in that case valuation of fair and liquidation will be according to such reply received from such person, ignoring this analysis
Corporate entity or not	If such person is a company or LLP	Otherwise	
Date of last filled returns	Latest financials available in accordance with CIRP commencement date	Otherwise	
Amount greater than certain threshold	If amount is greater than Rs. 5,00,000	If amount is greater than Rs. 2,00,000 but less than Rs. 5,00,000	If amount is less than Rs. 2,00,000, then the fair and liquidation to be considered as 'zero'
Ageing Analysis	If the outstanding amount is due for less than one year	If the outstanding amount is due for more than one year but less than three years	If the outstanding amount is due for more than three years, then the fair and liquidation to be considered as 'zero'
Subseqent transactions or not	If there are subsequent transactions with such person	If there is no subsequent transaction with such person	
Related Party or not	If a related party of the CD	If not a related party of the CD	
Charge on assets is created or not	If there is no charge created on such person's assets	If there is charge created on such person's assets	
Credit rating available or not	If credit rating is available	If credit rating is not available	

Conclusion:

The key objective of the IBC Code is maximisation of the value of assets of the persons in distress. One needs transparent and credible determination of value of the assets to facilitate comparison and informed decision making. The valuations serve as reference for evaluation of choices, including liquidation, and selection of the choices that decides the fate of the firm. If valuation is not right, a viable firm could be liquidated and an unviable firm could be rehabilitated, which could be unfortunate for an economy. Trade receivables constitute a major portion of total assets of the companies especially when loan is advanced against the hypothecation of trade receivables. Therefore, correct valuation methodology to value trade receivables helps in achieving the above stated key objective of the code- "Maximisation of value". Taking into consideration above factors while valuing trade receivables under IBC and liquidation can be good reference points.

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