STATEMENT OF BEST PRACTICES 1:

"ROLE OF IPS IN AVOIDANCE PROCEEDINGS"

Sections 25 and 35 of the Insolvency and Bankruptcy Code, 2016 (Code) enumerate the duties of a Resolution Professional (RP) and a Liquidator, respectively. These duties include certain actions in respect of avoidance transactions *(preferential transactions, undervalued transactions, extortionate transactions, and fraudulent trading).*

Sections 43, 45, 49, 50 and 66 of the Code mandate the RP and the Liquidator to file applications with the Adjudicating Authority (AA) seeking appropriate reliefs and directions permissible under the Code where the RP and Liquidator comes across any transactions that can be classified in the said provisions.. Section 47 of the Code, inter alia, provides that the AA shall require the Insolvency and Bankruptcy Board of India (Board) to initiate a disciplinary action against the RP or the Liquidator, as the case may be, where he has not reported undervalued transactions to the AA.

Regulation 35A of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 requires the RP to form an opinion whether the Corporate Debtor (CD) has been subjected to any avoidance transaction on or before the 75th day of the insolvency commencement date (ICD). Where he is of the opinion that the CD has been subjected to any transactions covered under the aforesaid sections, he shall make a determination, on or before the 115th day of the ICD, under intimation to the Board. Further, he shall apply to the AA for appropriate relief on or before the 135th day of the ICD. These provisions aim to claw back the value lost through avoidance transactions, in sync with objective of maximisation of value of the assets of the CD.

Therefore, the following **six** types of transactions/conduct can be identified as covered under the Code, and related avoidance proceedings which are essentially aimed at **compensating** the estate of the insolvent company –

(i) Preferential transactions u/s 43
(ii) Undervalued transactions u/s 45
(iii) Transactions defrauding creditors u/s 49
(iv) Extortionate credit transactions u/s 50
(v) Fraudulent trading u/s 66(1)
(vi) Wrongful trading u/s 66(2)

It may be noted that each of the above are concerned with a distinctive behaviour. The features have also been discussed in UNCITRAL Guide and may be briefly discussed here for the purpose of clarity –

(i) **Section 43** - Preference is about „who‟. If the debtor is being biased and is making payment to a creditor, to the exclusion of others, such that the creditor is wrongly benefitted, it amounts to a preference. Intention is not a factor in „preferences‟ – under UK law, what matters is a „desire to prefer‟. However, avoidance is subject to transaction falling within look back period. The Hon‟ble SC in *Jaypee* has already dealt in detail the features of a preferential transaction.

(ii) **Section 45** – Undervalued transactions are about „how much‟. Where the value received by the debtor is less than the value compromised by the debtor, the same can be a targeted transaction u/s 45.

(iii) **Section 49** – Scope of section 49 is different from that of section 43 and 45, in the sense that there is an element of deliberate intent, viz., the intent to defraud. For either sec. 43 or sec. 45, intent does not matter, but the moment an ulterior intent is added to a transaction covered by sec. 45, sec. 49 comes into picture. Thus „intention to defraud‟ is an essential element in sec. 49. Though transaction defrauding creditors can be of varied types, however, sec. 49 makes reference to sec. 45. **Note that there is no look back period prescribed for cases under s. 49**.

However, Section 49(1) begins as "Where the corporate debtor has entered into an undervalued transaction as referred to in sub-section (2) of section 45", Section 45(1) read with Section 46 talks about preferential transaction in the last 2 years. Thus, an interpretation can be drawn that even for the Section 49 purpose; look back period can be taken as 2 years.

(iv) Section 50 – The same deals with transactions undertaken at unconscionable terms.

(v) Section 66(1) – The provision deals with fraudulent trading, therefore, „intent to defraud‟ is essential. Here, what needs to be proved is that the business as such is conducted in a wrongful manner, whereas in section 49, it is the specific transaction which is undertaken to defraud creditors. This requires a broad understanding of how business is being run vis-à-vis how the business is to be run. The law does not prescribe any look back period for the same.

(vi) Section 66(2) – The provision deals with wrongful trading, that is, the conduct might not amount to fraud, but may fall short of principles governing duties of directors to act diligently in the vicinity to insolvency.

The point which is being emphasised is that there can be an array of transactions, which can escape the provisions of section 43, 45, and 49, however can only appropriately fall under section 66(1)/(2), as the sweep of the latter provisions is expansive provided one can prove the intent to defraud. Also, while section 43/45 have a look-back period criterion, there is no such criterion under section 66(1)/(2). Though, in section 66(2), the look-back period can be circumstantial. Therefore, while initiating the process for identifying the transactions, these points may be kept in mind.

OBJECTIVE

The need for avoidance proceedings can arise in both CIRP and Liquidation proceedings.

The Code, read with Regulations, has demarcated the responsibilities of an insolvency professional in corporate insolvency resolution process (CIRP) and liquidation process. To enable the insolvency professional and the committee of creditors (CoC) to have a complete and clear understanding of their roles and responsibilities in a CIRP, the Board, on 1st March, 2019, issued an indicative charter of their responsibilities, prepared in consultation with the three Insolvency Professional Agencies (IPAs). Since the CoC does not exist in the

liquidation process, the Liquidator has independent and exclusive duties. The emerging jurisprudence is bringing further clarity about their roles in corporate insolvency proceedings.

It is understood that IPs seems to be following different practices for identification of avoidance transactions and filing applications before the AA. Further, certain conflicts may still arise in the conduct of the proceedings due to perceived overlaps in the domain of the RP and CoC.

Hence, the statements of best practices ("statement") have been developed which may be followed by the insolvency professionals while handling Corporate Insolvency Resolution process/Liquidation.

These guidelines are principle based which are recommendatory in nature leaving substantial discretion to RP/Liquidator the case in hand.

(a) What parameters to be used to form an opinion and then to determine each of the kinds of avoidance transactions?

An Insolvency Professional during his initial 30 days of Corporate Insolvency Resolution process i.e. in the capacity of IRP, should work more diligently and with utmost care because those initial days are very important to understand the reasons of failure of the Corporate Debtor i.e. whether was it normal business failure or it failed just because of avoidance, preferential, fraudulent transactions. The avoidance transactions may be of two types where value is to be recovered or where there is indirect implication in form of fraud/alterations of books etc. The first type (where value is to be recovered) should be focused. The primary parameters to form an opinion may include:

1. Whether the transfer of property happened for the benefit of creditor/surety and guarantor and whether such transfer have put him in beneficial position than what he would have received in the event of distribution of Assets
2. Whether the transfer is made in the ordinary course of business of the Corporate Debtor.
3. Whether the transfer is made for a consideration which is significantly lower than the consideration given by the Corporate Debtor,
4. Whether the transactions require the Corporate Debtor to make exorbitant payment in respect of credit provided and whether the transactions are unconscionable under the principal of law relating to contract.
5. Whether the transfer of property or the violation in question affects the interests of the Creditors and affects the Resolution process in terms of value.

For determining the avoidance transactions,

(i) The first and foremost act on the part of the IP should be to collect records of CD and take the same in his custody. The IP should then collect as much information as possible. An insolvency professional shall firstly understand the nature of business of the Corporate Debtor and specifically about the overall business of CD by communicating with customers, suppliers, employees, workers, creditors etc. IP may invoke section 19 of the Code in case of any non-cooperation.

(ii) The IP may also take assistance from the financial creditors because in many cases the financial creditors conduct forensic audit of the CD before filing application with AA. The findings of the forensic audit will serve great help to the IP.

(iii) The assessment shall broadly be intended to check the following –

- Verification of end-use of funds granted by lenders
- Identification of cases involving siphoning of funds, misrepresentation of financial information
- Violation of RPT norms – this would cover verification of related party transactions taken directly/indirectly, transactions done by with or by [subsidiaries, step-down subsidiaries, in India and overseas]. In reported transactions with "related parties", a liberal view is to be taken, such that transactions not adhering to arms-length basis are reported. This would also entail understanding group structures/cross-holdings/box-structures
- Verification and tracing movement of unsecured loans/inter-corporate deposits, especially those raised in group concerns
- Concentrating transactions
- Verification of receivables including large amount of write-off.

(iv) An indicative list of transactions/documents which may be reviewed (either through himself or by appointing a suitable professional) are –

- transactions with related parties
- Large transactions with unrelated parties
- Salaries/benefits to KMPs
- Movement of cash
- transactions with group companies (to see the diversion of funds)
- Sale of assets, transfer of contracts
- Investments made by the company
- Inventory details
- suspicious movements in the financials
- Transactions routed through related parties and potentially linked parties and whether these were at arm"s length and specific purpose.
- Purchases and sales made from/ to relatively unknown parties at rates which are higher than market rate.
- Perusal of payments made which prime facie indicate diversion of funds under different activities like selling and general expenses, repairs and maintenance, legal expenses, high salaries and other perks to Directors and KMP, high raw material costs and purchase of fixed assets etc.
- Large amount of write off of account recoverable made without adequate justifications.
- Misrepresentation in statements / data provided to banks for acquiring higher limits and availing withdrawals from banks
- Non-existence of parties from whom money is to be recovered/ outstanding.
- Major change in accounting policies including revaluation of assets and in provisioning and depreciation. Impact of these on the financials of the corporate debtor.
- The transaction involved transfer of property or any other asset and investment of corporate debtor to third parties and terms of the said transaction.

- Major liabilities including contingent liabilities, disputes, legal cases, tax liabilities, penalties that has not been adequately reported in financial statements and appropriate action not taken.
- bank statements of the CD
- search from publicly available information i.e. details of charges, hypothecation etc.
- send letters to the debtors for account receivables because there may be chances that the debtors are only shown in the books of accounts to manipulate the books.
- verify the orders passed by authorities against Corporate Debtor which may help to identify the areas of concern.
- physical verification of assets
- Fixed Assets of substantial value sold or disposed off
- Tracing Inventory towards Invoicing or stock and in particular write off of Inventory
- Cash transactions
- Purchase from unregistered dealers / service providers, which may be fictitious parties
- The gap between the value of the claims received and the value of assets available

If Books of accounts are not available, the insolvency professional shall collect bank transactions and identify suspicious movements, search from publically available information i.e. details of charges, hypothecation etc.

It is pertinent to understand that in some cases an Insolvency Professional while verifying the avoidance transactions should go beyond the look back period i.e. of 2 years to understand how the money has come to the company and how it has been utilised. Those transactions which have been looked beyond 2 years may fall under Section 66 (fraudulent transactions).

(b) What process to be followed to form an opinion if a CD has been subjected to any avoidance transaction, and make a determination of the same and then file an application?

The following procedure may be followed:

I. Collate records/information– Seeking information would be the first step – IP may invoke section 19 of the Code. The IP may also take assistance from the creditors because in many cases the financial creditors conduct forensic audit of the CD before filing application with AA. The findings of the forensic audit will serve great help to the IP. If required, IP can take information/discuss with statutory auditors.

II. Assessment- (as stated above in point (a))

III. „Sifting‟ – studying various records, as above

IV. Forming prima facie view – sensing the depth

V. Short listing potentially vulnerable transactions

VI. Classification of transactions

VII. If required, professional expertise – transaction audit for the aforesaid process- - through CoC meeting with fees approval

VIII. Audit findings - The RP/Liquidator should be able to agree with the findings and do an independent assessment of the findings as well.

IX. Discussion with CoC/creditors/statutory auditors/directors- *the findings of a Transaction report may be discussed with the COC for their views/ comments/ opinions before filing the application with the NCLT, but the filing should not be dependent on the COC / RP should not be bound by the views of the COC, as it is the Primary Statutory Duty of the RP to file the application for avoidance*

X. communicate the findings with the person in default and given opportunity of being heard

XI. Decision on application – respondents to the application to be decided appropriately.

(c) Should every RP in every CIRP examine and investigate if the CD has been subjected to any avoidance transaction?

Filing application against avoidance transactions is one of the *duties* of the resolution professional/liquidator, as mandated under law –

- Section 25(2)(j) stipulates that it is the duty of the resolution professional to file for avoidance of transactions, if any. Note that the RP has to confirm in Form H of the CIRP Regulations, as to whether the RP has made a determination if the CD has been subjected to any transaction of the nature covered under s. 43, 45, 50 or 66.

- Section 35(1)(l) enjoins upon the liquidator to investigate the affairs of the corporate debtor to determine avoidable transactions.

- Further, section 47(2) empowers the AA to require the Board to initiate *disciplinary proceedings* against a RP/Liquidator, if the said RP/Liquidator, *even after having sufficient information or opportunity to avail information of such transactions*, did not report such transactions to the AA

Therefore, it is expected from Resolution professional in every CIRP and the liquidator in every liquidation to examine and investigate if the CD has been subjected to any avoidance transaction. However, transaction audit may not be required in every case. It may depend on case to case basis and the RP/Liquidator shall make his judgement on the basis of documentation available, volume of transactions, complexity etc.

(d) Whether it is necessary to conduct / order a transaction audit or forensic audit for determination? If so, what are the responsibilities of the auditor and IP respectively?

The transaction audit may not be required in every case.

The RP/Liquidator may consider the following factors while deciding whether it is appropriate to conduct a transaction audit –

(i) Complexity of group architecture
   a. as in, how large the company is and how large the group is
   b. business of the corporate debtor – sometimes companies have sophisticated business models, to which the RP/Liquidator may not be well versed with

(ii) Complexity of subject transactions
   a. number of transactions, which prima facie, appear to be vulnerable

b. sweep of such transactions (such transactions would generally cover multiple entities)

(iii) Amount estimated to be recovered

(iv) Relative costs (essentially 2 types – audit costs and litigation costs)

(v) RP/Liquidator‟s self-assessment as to whether the evidence collected by him will be sufficient to make a good case.

Generally, a distinction is drawn between transaction audit and forensic audit. Though transaction audit and forensic audit are inspired by same principles, but transaction audit has a specific purpose, that is, to determine existence of any of the six categories of transactions/conduct as noted above. Forensic audit is generally arranged by lenders with wide scope of work that includes end use of funds made available to corporate debtor. Forensic audit need not to be ordered by RP/ Liquidator. If lenders want to carry it, the same may be carried out at their own cost.

With regard to the responsibilities of the auditor and IP:

The IP is primarily responsible for bringing the avoidable transaction to the notice of CoC and Adjudicating Authority. The auditor appointed needs to conclude on the findings, which shall help RP to enable filing application. It may be noted that the primary responsibility would lie with the RP/Liquidator; the transaction auditor, being a professional expert, only facilitates the function of the RP/Liquidator. The duties of the auditor should be mutatis mutandis per Sec 143 of the Companies Act.

Responsibility of Transaction Auditor:

- Analysing the financials statements of CD for the period covered for transaction audit in detail and in accordance with scope of work defined in appointment letter;
- Maintaining the confidentiality of the information collated during the audit;
- Transaction Auditor should properly classify in his/her report about the basis of classifying the transaction as avoidance and the same should be properly documented;
- The report should be conclusive classifying the transactions under relevant sections of IBC;
- Transaction Auditor may be called in CoC Meeting or by AA for seeking any clarification on his/her report. The auditor should be present at every such meeting/hearing.

Responsibility of IP:

- Providing assistance and information to Auditor required for conducting audit;
- Studying and Understanding the report submitted by the auditor;
- Based on the transactions identified in the report, IP should identify the respondents to be made party;

A format detailing the scope of transaction audit is enclosed as **Annexure-A**

(e) Who can help an IP in detection of avoidance transactions? Is that person a professional? What should the amount of fee / expenses on such professional services? What care should be taken to avoid conflict of interests?

The Insolvency professional may take assistance from a transaction auditor whose fees and expenses shall depend on case to case basis depending upon the nature of work, complexity of the case, look back period etc. Approval of committee of creditors shall be taken by the resolution professional regarding the fees. The resolution professional may get the budget approved in the first CoC or can get the approval on each matter depending upon the case and the pertinent situations.

In some cases, where CoC is not cooperative, the resolution professionals shall record all the deliberations in the minutes.

To avoid conflict of interests, the following should be specifically noted –

(i) IBBI Circular No. IP/005/2018 dated 16th January, 2018 on "Disclosures by Insolvency Professionals and other Professionals appointed by Insolvency Professionals conducting Resolution Processes

(ii) Regulation 7 of the Liquidation Regulations

(iii) Para 23B of the Code of Conduct as under the Insolvency Professional Regulations.

As a matter of good practice, the following may be also be noted –

(i) The RP/Liquidator should not appoint the auditors who have already conducted the audit of the same CD.

(ii) A duly signed "Declaration of Independence" should be obtained from the proposed auditor to be appointed in line with IBBI Circular dated 16th January, 2018 (as noted above).

(iii) Further, during the CoC meetings the interested members shall not participate in the discussions and decisions.

(f) Is detection of avoidance transactions a core function of an IP? Can it be outsourced to any other person?

Detection of avoidance transactions is one of the important functions of the Insolvency professional. It is more of a quasi-judicial function to find out irregularities and fraud committed in the working of the Company leading to siphoning of funds from the Company"s accounts and to get people responsible for such act to be punished. It is an important aspect in IBC that is to be dealt with diligence.

After identification of suspicious transactions, the resolution professional may appoint a professional who shall be independent to the resolution professional and to the Corporate Debtor to conduct transaction audit of the Corporate Debtor.

The utmost responsibility shall be of the resolution professional and the auditor will facilitate the resolution professional. However, RP/Liquidator shall not be held liable for not being able to discover/unfold certain transactions which even the transaction auditor could not unfold by way of reasonable assessment and which can only be discovered through „investigative powers‟. Bona-fide actions of RP/Liquidator are protected under Section 233 of the Code.

(g) Whether the RP / Liquidator can himself be the transaction auditor. Whether the fee of RP / Liquidator includes the fee for determination and filing of application?

The role of resolution professional is to maximise the value of the Corporate Debtor. There may not be a need to appoint a transaction auditor in every case, and the RP/Liquidator may, on the basis of opinion framed by him, can proceed with the filing of application.

The RP / Liquidator cannot himself be the transaction auditor. After analysis of books of accounts, if the RP feels that there is a need to conduct the transaction audit/forensic audit he may appoint an independent professional to conduct the audit whose fees has to be separately approved in CoC.

Further, the RP cannot charge separate fees for determination and filing of application. The professional fees he receives cover the entire work.

(h) Is it necessary to share and consult the CoC or promoters of the CD to order an audit or for taking follow action on audit findings?

When one refers to section 20(2), it becomes clear that the „authority‟ to appoint professionals lies with IRP/RP. The law has identified areas where CoC consent has to be obtained - Section 28 also does not talk about obtaining CoC approval for appointment of professionals.

In other jurisdictions too, especially UK, there is no requirement before the office-holder to obtain creditor approval for appointing professionals [see sections 238, 239, etc.].

The CoC cannot contend that there is no explicit reference to „transaction audit/forensic audit‟ in the provisions and the RP is not entitled to exercise discretion in this regard. Transaction audit is an incidental requirement which enables the RP/Liquidator to perform his duties, hence, should not be denied by CoC on the above-stated ground.

However, CoC is required to approve the fees for such audit as per Regulation 34 of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations (“CIRP Regulations”) and hence the appointment needs to be discussed in meeting of CoC w.r.t. to the fixation of fees.

In Liquidation there is no concept of a CoC during liquidation. As we are aware, the law „shifts‟ the control from creditors to the Tribunal..

Section 35 entails „powers and duties‟ of the liquidator to appoint professionals, look for avoidance transactions, etc. Hence, the role of creditors is extremely limited and advisory in nature.

However, as a matter of good practice, the liquidator should keep the creditors informed.

Moreover, as per IBBI facilitation letter dated 1st March, 2019 regarding "charter of responsibilities" it was clearly mentioned that (i) Determination of transactions of the nature of preferential, undervalued, extortionate, fraudulent trading or wrongful trading;
(ii) intimation to the IBBI; and (iii) applying to the AA for appropriate relief is the responsibility of IRP/RP and CoC has no role into it.

The findings of the transaction audit may be discussed in the CoC meeting but it should not be a voting agenda and if in some cases the CoC or some of its members have vested interests, record everything and go ahead with the filing. Follow up action is not required. The CoC cannot direct the resolution professional. They can only discuss and the final decision is to be taken by the resolution professional.

(i) Whether the approval of CoC required for expenses to be incurred on audit /professional fee? Where the CD has resource constraint, should audit be avoided?

Regulation 31, 33 & 34 of Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 details about the Insolvency resolution process cost, cost of interim resolution professional and resolution professional costs;

Regulation 31 Insolvency resolution process costs

"Insolvency resolution process costs" under Section 5(13)(e) means
....

(c) Expenses incurred ***on or by*** *the interim resolution professional to the extent ratified under Regulation 33;*

(d) Expenses incurred ***on or by*** *the resolution professional fixed under Regulation 34.*

Regulation 33 Costs of the interim resolution professional.

1. *The applicant shall fix the expenses to be incurred on or by the interim resolution professional.*
2. *The Adjudicating Authority shall fix expenses where the applicant has not fixed expenses under sub-regulation (1).*
3. *The applicant shall bear the expenses which shall be reimbursed by the committee to the extent it ratifies.*
4. ***The amount of expenses ratified by the committee shall be treated as insolvency resolution process costs.***

Explanation- For the purposes of this regulation, "expenses" include the fee to be paid to the interim resolution professional, fee to be paid to insolvency professional entity, if any, and fee to be paid to professionals, if any, and other expenses to be incurred by the interim resolution professional.

Regulation 34 Resolution professional costs

The committee shall fix the expenses to be incurred on or by the resolution professional and the expenses shall constitute insolvency resolution process costs.

Explanation- for the purposes of this regulation, "expenses" include the fee to be paid to the resolution professional, fee to be paid to insolvency professional entity, if any, and fee to be paid to professionals, if any, and other expenses to be incurred by the resolution professional.

Accordingly, only the amount ratified by CoC will part of Insolvency Resolution process cost and therefore resolution professionals shall consult CoC and put forward the agenda for the approval of expenses or they can get the budget approved in the very first meeting depending upon the situations. The Resolution professionals shall make sure that the fees should be reasonable and should be free from all the coercions

The cases where CoC is not cooperative and does not ratify the fees of the Advocate/Transaction Auditor, the resolution professionals shall record all the deliberations in the minutes and shall file application to Adjudicating Authority regarding transactions that have been found out in initial assessment and CoC is not being cooperative.

(j) Whether the audit or audit findings are confidential? How long it should be confidential. Should it be disclosed under listing compliances?

The audit findings cannot be considered as a conclusive proof of the fraud, hence, the audit findings should be kept confidential, subject to the following –

(i) Disclosure to persons alleged in the audit findings – The relevant audit findings may be shared with the concerns persons (potential respondents who may be directors, promoters, of the CD) as a part of natural justice, so as to allow them to offer explanations.

(ii) Disclosure to members of CoC – Sharing audit findings with the members of CoC appears logical as ultimate beneficiary of the realisation(s) would be creditors only.

(iii) Disclosure to creditors not members of CoC – There can be operational creditors, who may not be the members of CoC, but have a right to representation. It appears that there is no reason to distinguish between members of CoC and representatives of a larger set of creditors.

(iv) Disclosure to public or under listing compliances – As stated, audit findings are not conclusive. Further, filing requirements under regulation 30 of LODR Regulations are applicable during CIRP, not during liquidation. In any case, mere audit finding is not a material development requiring reporting. Fraud is required to be disclosed, however, fraud is something which is to be established only by the AA.

(v) Disclosure to resolution applicants – The resolution applicants should be made aware of litigations, etc. pending against the corporate debtor. Here, also note

section 29(2) of the Code which permits provision of access to RA to all relevant information subject to requirements as to confidentiality.

Note that any disclosure or sharing of such audit findings/report should be done subject to a non-confidentiality undertaking (akin to regulation 5 of the Liquidation Regulations). *See also* IBBI Circular No. IP(CIRP)/007/2018 dated 23rd February, 2018 on "Confidentiality of Information relating to Processes under the Insolvency and Bankruptcy Code, 2016".

(k) Whether the audit findings are conclusive about avoidance transactions? What makes a determination concrete?

The conclusiveness of audit can only be determined after the decision of Adjudicating Authority.

However, the transaction audit report should be concrete and specific. The auditors should conclude the findings on the basis of available information. The audit report shall be the supporting document when the RP files application with AA.

(l) Is RP bound to file an application if CoC passes a resolution to file avoidance application? Should he not file an application where the CoC resolves not to file an application?

As per section 25 of the Code, it is the duty of the resolution professional to file application for avoidance transactions with Adjudicating Authority. The resolution professional will conduct his preliminary assessment and will file application, wherever necessary after deliberations with the CoC.

It may be discussed in the CoC meeting but it should not be a voting agenda and if in some cases the CoC or some of its members have vested interests, record everything and go ahead with the filing. The CoC cannot direct the resolution professional. They can only discuss and the final decision is to be taken by the resolution professional.

In the Code, there is no requirement of taking approval from the COC for filing the application determining avoidance transactions. The RP is required to only inform the COC about filing of such transactions with the AA.

Here, it might be important to note Para 16 of the IBBI (IPs) Regulations, 2016, which states that an IP must ensure that he maintains written contemporaneous records for any decision taken, the reasons for taking the decision, and the information and evidence in support of such decision. This shall be maintained so as to sufficiently enable a reasonable person to take a view on the appropriateness of his decisions and actions.

(m) Should there be a format of the application to be filed with the AA and the details to be provided for each kind of avoidance transaction to facilitate quick disposal by the AA?

The basic and minimum details should be similar in all applications to ease the working of Adjudicating Authority. The details are:

- Executive summary
- Relevant sections under which the application is filed
- Amount of default
- Persons responsible
- Nature of transactions
- details
- Documents to support the transaction
- Relief/guidance sought

(n) Should CIRP conclude when an application for avoidance transactions is pending before the AA?

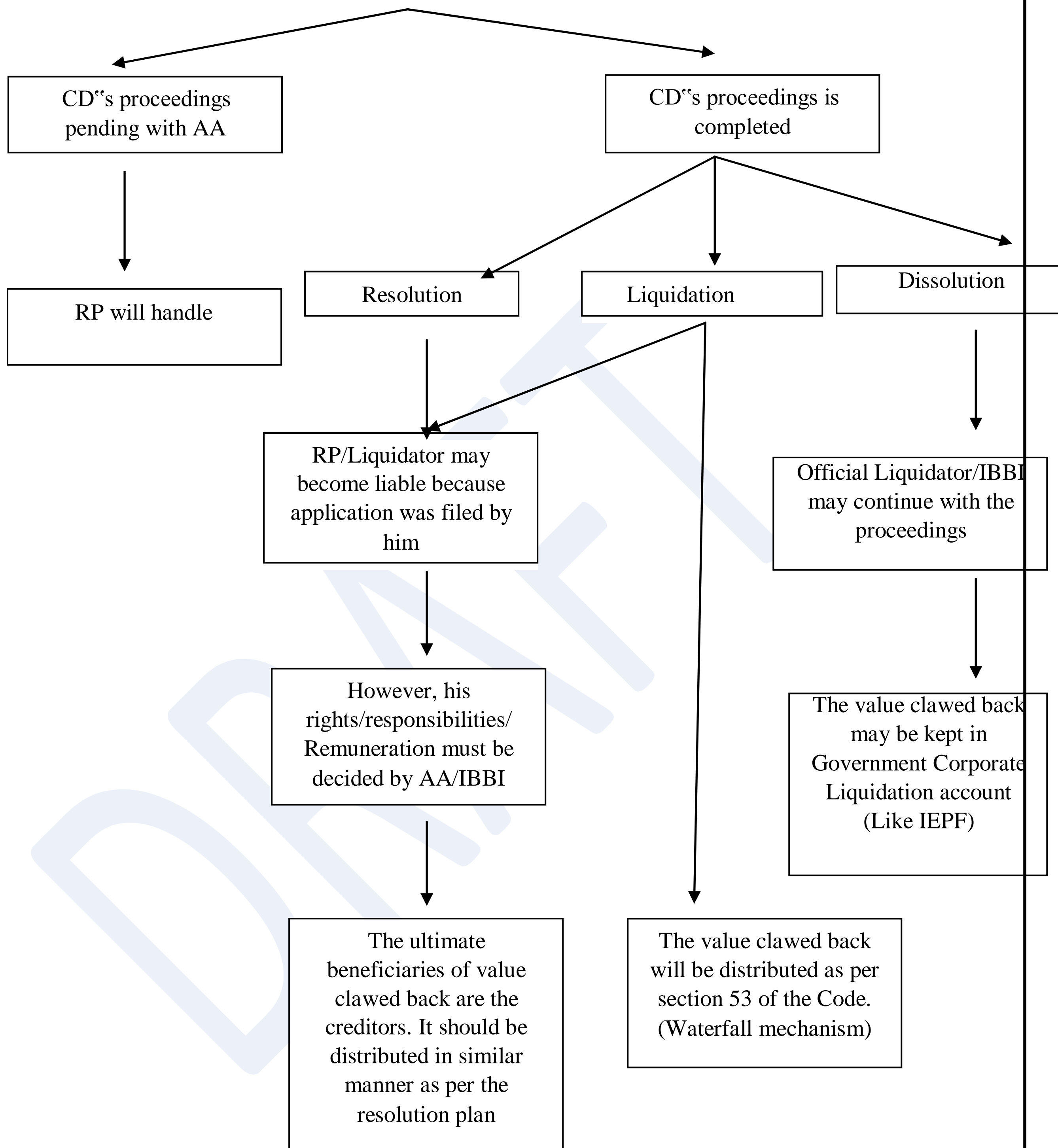
The pendency of proceedings will not bar the resolution/liquidation or Voluntary Liquidation of the Corporate Debtor. The application for avoidance transactions is against the promoters/directors/related parties, however the resolution/liquidation is for the Corporate Debtor. Therefore, these two should be treated separately and even if the corporate debtor is resolved/ liquidated, the application of avoidance transactions will be carried on.

However, this leads to number of questions i.e.,

- Who will handle the proceedings & who will be ultimate beneficiary of the money recovered after resolution/liquidation/dissolution
- How long the proceedings will be undertaken
- In what capacity and remuneration the IP/liquidator will be working and who will pay the remuneration
- How the value clawed back will be utilised.

The law does not presently deal with the questions, though it is provided that the avoidance proceedings should not affect the CIRP proceedings (section 26), and that CD can be liquidated notwithstanding pendency of any such application (Reg. 44(1) of Liquidation Regulations).

The snapshot of way forward is produced below:



(o) In what circumstances and who should appeal against the order of the AA?

Generally an appeal is made when the applicant/respondent/interested party is not satisfied with the decision of the Adjudicating Authority.

The resolution professional, the committee of creditors, liquidator, respondents etc have the right to appeal against the order of Adjudicating Authority.

(p) Who will pursue the application where the term of RP/Liquidator is over, or the CD is dissolved?

Please see point (n) table.

(q) How the value clawed back should be used?

Please see point (n) table.

(r) Should Liquidator necessarily investigate if the CD has been subject to any avoidance transaction where the RP has already filed an application during CIRP? Should Liquidator examine if the RP has done a good job. What should he do if he finds that RP did not do a good job?

The Liquidator needs not to necessarily investigate if the CD has been subject to any avoidance transaction where the RP has already filed an application during CIRP. However, if the Liquidator finds some transactions of considerable value which is not covered in the application filed by RP, the Liquidator can investigate and file additional application. It is not the duty or function of the Liquidator to examine the performance of the resolution professional.

Further, with regard to find out that the RP did not do a good job, since decision-making is a subjective area, it is not recommended that the liquidator questions/examines the conduct of the RP. The Liquidator should continue with his job as required and not spend time evaluating actions of the RP. The role of the RP would have been evaluated by the CoC (before liquidation) and the AA. It is not in the Jurisdiction of the Liquidator to comment on the role work of the earlier RP.

However, the Liquidator shall have the right to require information/cooperation from the RP. In any case, IBBI has the right to seek explanations from the RP, if in the opinion of IBBI, the RP should have made the application.

DRAFT

Annexure A

Transaction Audit: Scope and approach of work [Indicative]

The following shall be the scope of work for transaction audit of______________[Name of CD] to be carried out by ____________ [Name of TA].

The period of review shall be __________ to__________[„Review Period‟].

(i) Verification of end use of funds granted by lenders (including working capital loans during the specified period)

(ii) Verification of revenue from operations, sales returns including order, invoices and controls in the billing process. The focus should be on inflated/ deflated billings.

(iii) Verification of purchases / major expenses during the audit period.

(iv) Identification of cases, if any, of:

   a. Diversion / mis-utilisation of bank funds

   b. Siphoning of funds

   c. Suspected/ padded up expenditures

   d. Misrepresentation of financial information submitted to various banks from time to time as per terms of loan agreement

(v) Verification of major transactions with related parties, or two-way deals of Rs.________and above with the same party or indirect payments made by customers of the borrower to the vendors of borrower. This would include the transactions done with or by the downstream entities [subsidiaries, step-down subsidiaries, in India and overseas] to report if, for investments, loans or facilities obtained on the credit of the Company [guarantee, letter of credit, etc], there is evidence of siphoning off of funds, etc, as referred to above. In reported transactions with "related parties", please take wide definition, such that transactions not adhering to arms-length basis are reported.

(vi) Verification of receivables with focus on receivables from related parties/ group companies

(vii) Review and map transactions related to new addition of fixed assets (above Rs.__________) purchased during Review Period.

(viii) Review and comment transactions of substantial amount (Rs.____________and above) with seem not to be normal transactions at arms‟ length

(ix) Verification of movement in unsecured loans during the Review Period.

(x) Verification of substantial debts raised in sister/associate/group companies.

(xi) Adherence to Escrow / Trust and Retention Account (TRA) arrangements made with lenders / consortium. Details of all transactions with banks outside the consortium

(xii) Commenting on concentrating transactions, that is, where the transactions are concentrated to sole customers/sole suppliers

(xiii) Review of minutes of Board Meetings and Internal Audit System.

(xiv) Any fraud or any malfeasance committed by the company, pertaining to willful defaulter guidelines.

(xv) The Auditor shall identify and classify each Transaction, on the basis of available information, audit findings and provisions of the Code, as –

a. Preferential transaction u/s 43

b. Undervalued transaction u/s 45

c. Transaction defrauding creditors u/s 49

d. Extortionate credit transaction u/s 50

e. Wrongful trading u/s 66(1)

f. Fraudulent trading u/s 66(2),

(xvi) The Transaction Audit Report shall have an executive summary of the said Transactions so as to enable the RP/Liquidator to appropriately make references, wherever required.

Timeline	
Payment terms	

Inputs on the best practices may be send to iiipi.inspection@icai.in latest by 25th June, 2020.

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