

Background Guidance on Quality Control by Insolvency Professionals

BACKGROUND

The objective of the Insolvency and Bankruptcy Code 2016 (IBC/Code), as economic beneficial legislation, is to provide effective legal framework for resolution of distressed businesses by reorganising such businesses. IBC's first order objective is rescuing a company in distress and liquidation can be viewed only as the last resort. The second order objective is maximizing value of assets of the company and the third order objective is promoting entrepreneurship, availability of credit and balancing the interests of all stakeholders. IBC provides for bifurcating the interests of the company from that of its promoters to ensure revival and continuation of the company by protecting it from its own management and from liquidation.

Insolvency professional (IP), in the capacity of Resolution Professional (RP) or Liquidator is one of the key pillars as envisaged under IBC, for achieving the said objectives. The legal framework under IBC requires an IP to establish fair and transparent conduct of insolvency resolution process, casting upon an IP, inter alia, following responsibilities reflective of qualitative aspects in such processes (in a non-exhaustive manner):

Provisions under IBC, 2016

- (a) Section 17 and Section 18 require that the IRP/RP is vested with the powers of the board of directors of the Corporate Debtor (CD). The officers and managers of the CD shall report to the IRP, providing him access to documents and records of the CD. The IRP/RP shall act and execute in the name and on behalf of the CD, all deeds, receipts, and other documents and take such actions, in the manner and subject to such restrictions, as may be specified by the Insolvency and Bankruptcy Board of India (IBBI).
- (b) Section 20 requires that the IRP/RP shall make every endeavour to protect and preserve the value of the property of the CD and manage its operations as a going concern. IRP/RP shall have the authority to appoint professionals, to enter contracts on behalf of the CD or to amend or modify the contracts or transactions, to raise interim finance, to issue instructions to personnel of the CD as may be necessary for keeping the CD as a going concern and to take all such actions as are necessary to keep the CD as a going concern.
- (c) Section 23 requires RP to conduct the entire Corporate Insolvency Resolution Process (CIRP) and manage the operations of the CD during such processes. Further RP is required to continue to manage the operations of CD after the expiry of such process, until an order approving the resolution plan under subsection (1) of section 31 or appointing a liquidator under section 34 is passed by the Adjudicating Authority (AA). Further, in case there is a change in IRP to RP or from RP to RP/Liquidator, the incumbent IP shall provide all the information, documents and records pertaining to the CD in his possession and knowledge to the successor IP.
- (d) Section 28 requires IRP/RP, during the CIRP, to take prior approval of the Committee of Creditors (CoC) for certain actions.
- (e) Sec 29 requires that IRP/RP shall provide to the resolution applicant, an access to all relevant information in the form of Information Memorandum in physical and electronic form to formulate a resolution plan.
- (f) Sec 30 requires that the IRP/RP shall examine each resolution plan received by him and shall present the same to the committee of creditors for approval.
- (g) As per Section 208(2), an IP is obliged to take reasonable care and diligence while performing his duties, to comply with all requirements and terms and conditions specified in the byelaws of the insolvency professional agency of which he is a member; to allow the insolvency professional agency to inspect his records; to submit a copy of the records of every proceeding before the Adjudicating Authority to the Board as well as to the insolvency professional agency of which he is a member; and to perform his functions in such manner and subject to such conditions as may be specified.

Provisions as per Code of Conduct under Schedule-I of IBBI (IP) Regulations

- (h) Clause 5 provides that an IP must maintain complete independence in his professional relationships and should conduct the insolvency resolution, liquidation or bankruptcy process, as the case may be, independent of external influences.
- (i) Clause 12 provides that an IP must not conceal any material information or knowingly make a misleading statement to the IBBI, the AA or any other stakeholder, as applicable.
- (j) Clause 13 provides that an IP must adhere to the time limits prescribed in the Code/IBC and the rules, regulations and guidelines thereunder for insolvency resolution, liquidation or bankruptcy process, as the case may be, and must carefully plan his actions, and promptly communicate with all stakeholders involved for the timely discharge of his duties.
- (k) Clause 15 provides that an IP must make efforts to ensure that all communication to the stakeholders, whether in the form of notices, reports, updates, directions, or clarifications, is made well in advance and in a manner which is simple, clear, and easily understood by the recipients.
- (l) Clause 16 provides that an IP must maintain 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 to sufficiently enable a reasonable person to take a view on the appropriateness of his decisions and actions.

Monitoring by Insolvency Professional Agency (IPA)

- (m) The Code under Section 204(c) mandates monitoring by IPA of the performance of IPs with respect to legal compliance and empowers IPAs to call for information and records.
- (n) Clause 8 of IBBI (Model byelaws and Governing Board of IPAs) Regulations 2016, provide for constitution of Monitoring Committee by an IPA.

Further, clause 15 of such regulations provide for formulation of Monitoring Policy by an IPA for the purpose.

- (o) The objective of monitoring of IPs is to ascertain whether the conduct of IPs is in overall interest of the stakeholders, CD as going concern and to ensure that the position of trust held by IPs is not abused by them and in cases where it is, to ensure appropriate action is taken.

Inspections of IPs by IBBI and IPA

- (p) Section 196(1) of the Code/IBC empowers IBBI to carry out inspections and investigations, monitor the performance and call for any information or records, inter alia, from IPs.
- (q) As per Section 208(2)(c) of the Code/IBC, IPAs are authorized to conduct the inspection of IPs enrolled with it.
- (r) Further as per Clause 18 of the Code of Conduct an IP must appear, co-operate and be available for inspections and investigations carried out by the IBBI, any person authorised by the IBBI or the IPA with which he is enrolled.

In view of many duties and responsibilities cast upon IPs, it is of paramount importance for an IP, whether part of an IPE or not, to observe and maintain high standards of quality in connection with any professional assignment. Such an approach shall enthuse confidence in other stakeholders about IP's services on the one hand and support IP to face any regulatory or legal challenge, on the other.

INTRODUCTION

1. The purpose of this Background Guidance on Quality Control is to help IPs in maintaining and enhancing quality of their services while discharging responsibilities in relation to the professional assignments under IBC and related activities thereto. IPs may apply the guidance provided in this document as they deem appropriate depending upon circumstances of each case.

2. This document is to be read in conjunction with the requirements of the IBC, 2016, any regulations and circulars/notifications issued thereunder. In case of any variation, the provisions of such law, regulations, notifications shall prevail over the requirements as per this document. Further, the document is based upon recommendations of study group constituted by IIIPI and does not carry the authority and views of IIIPI.
3. This document, in the following paras, provides uses two types of statements viz.:
 - i. Requirement, which is mentioned as text in bold font, and is desirable for IP to comply with the specific provision.
 - ii. Reference matter, which is mentioned as normal text explaining the context relevant for proper understanding of the said 'Requirement' as referred in Clause 3 (i).
4. The IP should establish a system of quality control designed to provide it with reasonable assurance that the IP and its personnel comply with professional standards, best practices, regulatory and legal requirements, and that action taken are appropriate in the circumstances.
5. A system of quality control consists of policies designed to achieve the objectives set out in paragraph 4 above and the procedures necessary to implement and monitor compliance with those policies.
6. The nature of the policies and procedures developed by an individual IP to comply with this document will depend on various factors such as the size and operating characteristics of the CD, and whether he is part of an IPE.
- (c) Engagement documentation: The record of work performed, results obtained, and conclusions the IP reached (terms such as “working papers” or “workpapers” are also sometimes used). The documentation for a specific engagement is assembled in an engagement file;
- (d) Insolvency Professional (IRP/RP/ Liquidator/Administrator, Bankruptcy Trustee, Authorized Representative, etc.): The person who is registered with IBBI as IP and is in full time practice and who has been appointed as such.
- (e) Engagement team: All personnel performing an engagement, including any experts or professionals including accountants, legal counsels or other professionals, as envisaged under the Code, contracted or hired by the IP in connection with that engagement.
- (f) Inspection: In relation to completed engagements, procedures designed to provide evidence of compliance by engagement teams with the IP's quality control policies and procedures.
- (g) Monitoring: A process comprising an ongoing consideration and evaluation of the IP's system of quality control, including a periodic inspection of a selection of completed engagements, designed to enable the IP to obtain reasonable assurance that its system of quality control operates effectively.
- (h) For definition of other terms used in the document but not defined under this clause, the Code and/or Regulations made thereunder should be referred to.

DEFINITIONS

7. In this document, the following terms have the meanings attributed below:
 - (a) Board: Insolvency and Bankruptcy Board of India (IBBI)
 - (b) Code/IBC: Insolvency and Bankruptcy Code, 2016

ELEMENTS OF A SYSTEM OF QUALITY CONTROL

8. The IP's system of quality control should include policies and procedures addressing each of the following elements:
 - a. Leadership responsibilities for quality.
 - b. Ethical requirements.

- c. Human and technological resources.
 - d. Engagement performance.
 - e. Monitoring.
9. The quality control policies and procedures should be documented and communicated to the IP's personnel. Such communication describes the quality control policies and procedures and the objectives they are designed to achieve and include the message that each individual has a personal responsibility for quality and is expected to comply with these policies and procedures. In addition, the IP recognizes the importance of obtaining feedback on its quality control system from its personnel. Therefore, the IP should encourage its personnel to communicate their views or concerns on quality control matters.
10. The IP should establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Such policies and procedures should require the IP to assume ultimate responsibility for the system of quality control.
11. The IP's leadership and the examples he sets significantly influence the internal culture. The promotion of a quality-oriented internal culture depends on clear, consistent, and frequent actions and messages across all levels of the management emphasizing the quality-control policies and procedures, and the requirement to:
- a. Perform work that complies with professional standards, best-practices, and regulatory and legal requirements; and
 - b. Ensure that actions taken are appropriate in the circumstances. Such actions and messages encourage a culture that recognizes and rewards high quality work. They may be communicated by training seminars, meetings, formal or informal dialogue, mission statements, newsletters, or briefing memoranda. They are incorporated in the internal documentation and training materials, and in staff appraisal procedures such that they will support and reinforce the IP's view on the importance of quality and how, practically, it is to be achieved.
12. Of particular importance is the need for the IP's leadership to recognize that the IP's business strategy is subject to the overriding requirement to achieve quality in all the engagements that the IP performs. Accordingly:
- a. The IP assigns its management responsibilities so that commercial considerations do not override the quality of work performed;
 - b. The IP's policies and procedures addressing performance evaluation, compensation, and promotion (including incentive systems) with regard to its personnel, are designed to demonstrate the IP's overriding commitment to quality; and
 - c. The IP devotes sufficient resources for the development, documentation and support of its quality control policies and procedures.
13. Any person or persons assigned operational responsibility for the quality control system by the IP, should have sufficient and appropriate experience and ability, and the necessary authority, to assume that responsibility.
14. Sufficient and appropriate experience and ability enables the responsible person or persons to identify and understand quality control issues and to develop appropriate policies and procedures. Necessary authority enables the person or persons to implement those policies and procedures.

ETHICAL REQUIREMENTS

15. The IP should establish policies and procedures designed to provide it with reasonable assurance that the IP and IP's personnel comply with relevant ethical requirements as has been notified by IBBI/ IPA and others as applicable.
16. Some of the ethical requirements for IPs have been prescribed under Code of Conduct as per First Schedule of IBBI (Insolvency Professionals) Regulations, 2016. Such requirements have been categorised into areas of:
- a. Integrity and Objectivity;

- b. Independence and impartiality;
 - c. Professional competence;
 - d. Representation of correct facts and correcting misapprehensions;
 - e. Timeliness;
 - f. Information management;
 - g. Confidentiality;
 - h. Occupation, employability, and restrictions;
 - I. Remuneration and costs; and
 - j. Gifts and hospitality;
17. Besides, there may be additional or complementary ethical code that may be prescribed by IBBI/IPA including by way of non-mandatory guidance, which can act as reference for ensuring ethical conduct of IP and IP's personnel.
18. The policies and procedures on ethics should emphasize the fundamental principles, which are reinforced in particular by (a) the leadership, (b) education and training, (c) monitoring, and (d) a process for dealing with non-compliance. Given the criticality of 'Independence' during insolvency engagements, it is addressed separately hereinafter. These paragraphs need to be read in conjunction with the Code of Conduct.
- Independence**
19. The IP should establish policies and procedures designed to provide it with reasonable assurance that the IP, its personnel and, where applicable, others subject to independence requirements (including experts, employed by the IP), maintain independence wherever required. Such policies and procedures should enable the IP to:
- a. Communicate its independence requirements to personnel and, where applicable, to others (including experts, employed by the IP) subject to them; and
 - b. Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement in accordance with law as applicable.
20. Such policies and procedures should require:
- a. Personnel to provide the IP with relevant information about client engagements, including the scope of services, to enable the IP to evaluate the overall impact, if any, on independence requirements;
 - b. Personnel to promptly notify the IP of circumstances and relationships that create a threat to independence so that appropriate action can be taken; and
 - c. The accumulation and communication of relevant information to appropriate personnel so that:
 - i. The IP and its personnel can readily determine whether they satisfy independence requirements;
 - ii. The IP can maintain and update its records relating to independence; and
 - iii. The IP can take appropriate action regarding identified threats to independence.
21. The IP should establish policies and procedures designed to provide it with reasonable assurance that it is notified of breaches of independence requirements, and to enable it to take appropriate actions to resolve such situations. The policies and procedures should include requirements for:
- a. All who are subject to independence requirements to promptly notify the IP of independence breaches of which they become aware;
 - b. The IP to promptly communicate identified breaches of these policies and procedures to:
 - i. The personnel of IP who, needs to address the breach; and
 - ii. Other relevant personnel and those subject to the independence requirements who need to take appropriate action;

- c. Prompt communication to the IP, if necessary, by such personnel of the actions taken to resolve the matter, so that the IP can determine whether it should take further action.
22. An IP receiving notice of a breach of independence policies and procedures promptly communicates relevant information to personnel, as appropriate and, where applicable, experts contracted by the IP and its personnel (if any), for appropriate action. Appropriate action by the IP and personnel includes applying appropriate safeguards to eliminate the threats to independence or to reduce them to an acceptable level or withdrawing from the engagement in accordance with law as applicable. In addition, the IP provides independence education to personnel who are required to be independent.
 23. At the beginning of professional engagement assignment, the IP should obtain written confirmation of compliance with its policies and procedures on independence from all personnel required to be independent with a declaration that if the independence is ever breached during the engagement the same shall be communicated to IP immediately.
 24. Written confirmation may be in paper or electronic form. By obtaining confirmation and taking appropriate action on information indicating non-compliance, the IP demonstrates the importance that it attaches to independence and makes the issue current for, and visible to, its personnel.
- HUMAN AND TECHNOLOGICAL RESOURCES**
25. The IP should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards, best-practices, regulatory and legal requirements, and to enable the IP to complete the assignment that are appropriate in the circumstances.
 26. The IP should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient adoption of technological solutions necessary to perform its engagements in accordance with professional standards, best-practices, regulatory and legal requirements, and to enable the IP to complete the assignment that are appropriate in the circumstances.
 27. Such policies and procedures address the following personnel issues:
 - (a) Recruitment;
 - (b) Performance Evaluation;
 - (c) Capabilities;
 - (d) Competence;
 - (e) Career development;
 - (f) Promotion;
 - (g) Compensation; and
 - (h) Estimation of personnel needs.
 28. Addressing these issues enables the IP to ascertain the number and characteristics of the individuals required for the engagements. The IP's recruitment processes include procedures that help the IP select individuals with integrity as well as capacity and to develop the capability or competence necessary to perform the IP's work.
 29. Capabilities and competence are developed through a variety of methods, including the followings:
 - a. Professional education.
 - b. Continuing professional development, including training.
 - c. Work experience.
 - d. Coaching by more experienced staff, for example, other members of the engagement team.

...to be continued.