



STUDY GROUP REPORT

AVOIDANCE TRANSACTIONS UNDER IBC, 2016- IMPROVING OUTCOMES

Study By
Indian Institute of Insolvency Professionals of ICAI (IIPI)



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NEW DELHI



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FOREWORD

The Indian Institute of Insolvency Professionals of ICAI (IIPI) is pleased to present the publication “Avoidance Transactions under IBC 2016 - Improving Outcomes” by the Study Group constituted by IIPI in this regard. This publication was released by Sh. Sudhaker Shukla, Whole Time Member, IBBI on the occasion of International Conference on Avoidance Transactions under IBC organized by the IIPI on 29th March 2023.

The purpose of this publication is to understand and analyze the underlying reasons contributing to delays or sub-optimal outcomes of avoidance transactions under IBC. The guidance in this document is based on best practices, nationally and internationally and are directory in nature. We hope that this report will help the IPs to tackle such challenges/transactions independently within the scope of law and regulations as envisaged under IBC.

I sincerely appreciate and thank all members of the Study Group for working hard and providing their valuable contribution to prepare the draft report.

I also appreciate the efforts put in by CA. Rahul Madan, Managing Director, and the Research Department of IIPI for providing their technical and administrative support in bringing out this publication.

Further, after gaining more experience, this report shall be reviewed from time to time. I am sure that the professional members of IIPI and other stakeholders of IBC will find this publication immensely helpful.

Date: 29th March 2023

Place: New Delhi

Dr. Ashok Haldia

Chairman, IIPI-Governing Board

PREFACE

The Study Group constituted by the Indian Institute of Insolvency Professionals of ICAI (IIPI), on “Avoidance Transactions under IBC 2016 - Improving Outcomes” is pleased to present this report.

The Study Group was given a mandate to deliberate and recommend on best practices to be followed by IPs while carrying out their responsibilities in connection with Insolvency Resolution process under CIRP and/or Liquidation Process within the framework of IBC. The study group, consisting of members having rich experience in handling the cases/litigations related to Avoidance Transactions and in managing insolvency and liquidation has attempted to develop a comprehensive document on the subject after wider consultation intra-group and with other stakeholders.

This “Avoidance Transactions under IBC 2016 - Improving Outcomes” has been created with the objective to understand and analyze the underlying reasons contributing to delays or sub-optimal outcomes and to recommend ways to deal with such challenges with a fair and transparent conduct of insolvency resolution process. This report shall provide a framework to IPs while taking important decisions which includes forming opinion, determining the amounts involved in respect of preferential, undervalued, extortionate and fraudulent transactions or PUF/ Avoidance transactions,

The study group is thankful to Dr. Ashok Haldia, Chairman, IIPI for providing an opportunity to develop the knowhow as above and providing his insights. The group is particularly thankful to C.A. Kamal Garg for his exemplary efforts in creating the initial draft of the report. In addition, the group expresses gratitude to several other professionals including experienced IPs, experts and other professionals who have contributed directly and indirectly to the development of this report on “Avoidance Transactions under IBC 2016 - Improving Outcomes”.

Sarath Kumar

Kamal Garg, IP

Nipun Singhvi, IP

Date: 29th March 2023

Place: New Delhi

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ABBREVIATIONS

AA	Adjudicating Authority
CD	Corporate Debtor
CIRP	Corporate Insolvency Resolution Process
COC	Committee of Creditors
HC	High Court
IBBI	Insolvency and Bankruptcy Board of India
IBC / Code	Insolvency and Bankruptcy Code 2016
ICA	Indian Contract Act, 1872
ICAI	Institute of Chartered Accountants of India
IIIP-ICAI	Indian Institute of Insolvency Professionals of ICAI
IP	Insolvency Professional
IPA	Insolvency Professional Agency
IRP	Interim Resolution Professional
NCLT	National Company Law Tribunal
NCLAT	National Company Law Appellate Tribunal
PG	Personal Guarantor
PUFE	Preferential, Undervalued, Fraudulent and Extortionate
RP	Resolution Professional
SC	Supreme Court

Study on Avoidance Transactions under IBC 2016- Improving Outcomes

1. Background

- 1.1. The legal framework under IBC requires the IPs to establish/ demonstrate fair and transparent conduct of insolvency resolution process, casting upon an IP many responsibilities which are onerous at times. Such responsibilities, inter alia, include forming opinion, determining the amounts involved and filing application to Adjudicating Authority in respect of preferential, undervalued, extortionate and fraudulent transactions or PUFES/ Avoidance transactions.
- 1.2. Such exercise is intended to extract or disgorge the value from the erstwhile management or other wrongful beneficiaries in the direction of achieving value maximization for CD's business/assets. An IP can get transaction audit (contemporarily called as "forensic audit") of CD's books of accounts and other records from expert or can himself do the same, to establish and manage the requisite process.
- 1.3. The IBC 2016 is evolving and in the last few years many issues has got settled through rulings from various judicial authorities including from Hon'ble Supreme Court. However, in respect of Avoidance Transactions, though there has been a landmark ruling from Hon'ble Supreme Court, it seems that the litigations in this regard may be settled by various judicial authorities in near future
- 1.4. It is however, also observed that in last over 5 years' period despite institution of around 700 PUFES applications filed in NCLT involving over Rs.2 lac crores worth of claims very few (about 100) have been adjudicated upon. The challenges include delays in admission, adjudication, and recovery proceedings. It is therefore imperative to analyze the contributing factors of such delays and accordingly ideate for improvement in dispensation/outcome.
- 1.5. With above backdrop, IIPI constituted a study group to understand and analyze the underlying reasons contributing to delays or sub-optimal outcomes and to recommend ways to tackle such challenges. The scope of such study encompasses:

- Identifying the sample size to gather data of avoidance transaction filings.
- Gathering data/ suggestions from
 - (i) IBBI/IIPI (to the extent available)
 - (ii) IPs through google page survey.
- The above exercise is aimed at analyzing the extent and nature of underlying delays (pre-admission and post-admission), amounts involved. Post admission delays to be analyzed into reasons like lack of sufficient evidence, counter-litigation, others, etc.
- Finalizing report on outcomes and recommendations/ suggestions basis such outcomes.

1.6. A Study Group was also constituted to work on the above, with necessary support from IIPI with the following members:

- CA Sarath Kumar
- CA Kamal Garg, IP
- CA & Adv. Nipun Singhvi, IP

1.7. In pursuance thereof and in concurrence with the Study Group, a survey was carried out in the form of a questionnaire being circulated to the IPs and amongst other things, the following two questions were specifically asked to be responded by the IPs taking part in the survey:

- Challenges and Solutions (for improvement) in preparing (including collecting information) avoidance applications;
- Challenges and Solutions (for improvement) in concluding (including cooperation from stakeholders), post-filing of avoidance applications

1.8. Comprehensive data points related to avoidance applications so far, were sought from various sources for analysis and drawing references for the purpose of the Study.

2. Outcome of Survey

2.1. The qualitative comments on challenges/ suggestions on the subject matter as collected from respondents in the survey have been summarised below:

2.1.1. Challenges Highlighted:

- Limited funds for appointing good auditors;
- Lack of available information. Challenges in getting quality data from CD/ third parties including physical access to underlying assets;
- Time constraint exert pressure on both IPs and Transactions Auditors, compromising effective analysis. Inadequate time allowed available, coupled with hostile environment;
- Challenges in getting COC approval/ ratification for appointing Forensic Auditors;
- Delays at NCLT to decide upon the fate, due to frequent adjournments and counter litigation;
- The legal provisions stipulate that in order to file an application, RP needs to have a clear ground to believe about existence of such transactions, which takes time;
- The manner of continuing the applications after the plan is approved – Committee of Creditors (COC), Ex-RP and Resolution applicant (RA).

2.1.2. Solutions Suggested :

- A capacity may be strengthened by providing more Benches/ Members and Staffs;
- The Lenders (FCs) should be advised to share details/ information available with them including Certificate of Compliance in terms of RBI Circular No. RBI/2015-16/100 DBR.No.CID. BC.22/20.16.003/2015-16 dated 1st July 2015, para-No. 4.1. (i). reg. “Monitoring of End Use of Funds”;
- Law may provide for RPs to form prima-facie opinion on avoidance transactions rather than establishing it clearly
- Funding needs to be provided both for forensic auditor’s fees and competent counsel’s fees;

- Separate funds to be earmarked in the plan as well as liquidation estate for continuing the PUFÉ applications.
- Section 19(2) applications need to be disposed of quickly
- Assigning / Estimating value to PUFÉ transactions identified during CIRP in case of plan approval (as suggested by Hon'ble NCLAT in DHFL case).
- Appropriate direction to Central Government in case of fraudulent transactions (Section 213 of Companies Act, 2013 as directed in few cases by NCLAT) be amended in the law so that the RP and transaction auditors are not part of trial in case same is to be filed with Special Courts;
- PUFÉ application should be proceeded ex-parte in case of non-appearance after 3 notices from AA so that the matters can be disposed in time bound manner;
- Proper documentary proofs and evidence need to be worked on by the IRP/ RP/ Liquidator (s), COC and auditors, to avoid delay and uncertainty;
- Auditors to join in proceeding before AA for effective outcome.

3. Study Group's Recommendations

3.1. Statistical Analysis : The data on avoidance transactions (till March 2022) has been received from various sources, which has been analysed and was discussed amongst the Study Group Members. The moot points are:

- Overall, since inception of IBC, 787 applications for avoidance transactions have been filed with the AA till March 31, 2022, involving dues of Rs .2.21 lacs crores. Average amount per application works out to Rs.280 crores.
- Of these applications, 73 applications involving dues of Rs.0.15 lac crore only have been disposed with average amount per application at Rs.207 crore. The balance (714) applications were ongoing as on March 31, 2022. Against this, recovery stands at Rs.4,549 crore across 12 applications. However, the recovery is mainly attributed to only one application (viz. Jaypee Infratech Limited) showing recovery by way of recouping land parcels, valued at Rs.4,500 crores.
- Average time taken in disposing application is 323 days, whereas ongoing applications have taken 793 days as on the cut-off date.
- Range (size-wise) of such applications as above have been analysed as well. It transpires that 71% of lower (size)-end applications (nos.) have an average application size (amount) of Rs.21 crore, whereas remaining 29% of applications have an average size of Rs. 925 crore.
- Besides, division of such applications into various stages of CIRP and into nature (P/U/E/F/combination thereof) has also been made. It is evident that majority (~70%) of applications (nos.) involve a combination of P/U/ E/F elements rather than singular element.
- Then analysis of above data basis the originating NCLT bench, has been made. As per the data, NCLT benches at New Delhi and Mumbai together have received 53% of total applications so far, having value of 63% of total claims under avoidance transactions. Other locations in the order of such parameter, are Kolkata (10% nos.) and Chandigarh (8%). Chennai (7%) comes next.

3.2. Quality of Forensic Reports: Besides what is deliberated in Para 2 earlier and Para 3.1 above, the study group members highlighted another major concern about the quality of the forensic audit reports.

- 3.2.1. The study group members were of the view that in many cases the forensic audit reports were rejected by the AA and accordingly the recovery as contemplated from the underlying PUF transactions could not be materialized.

3.2.2. The RP/Liquidator should apply his mind and exercise his discretion while considering such audit report for forming opinion and determining the PUF transactions, based on reasons to be recorded in writing while filing the application u/s 25(2)(j). For instance:

3.2.2.1. In *Jayesh Shanghrajka v. Divine Investments M.A. No. 1893 of 2019* Hon'ble NCLT - Mumbai observed that:

"Further, even the auditor in its report has not categorized any transaction as fraudulent under section 66 of the Code. Not only this, but also the applicant has not even furnished the Forensic Audit Report for the perusal of this Bench which he should have done during filing of this application itself. He has blatantly mentioned that the forensic audit report gave him a reasonably strong hints of Vulnerable Transactions or other transactions that may be either regarded as breach of applicable law, or deleterious of the interests of creditors or stakeholders, or otherwise, transactions not designed to be in good faith. This Bench, basing merely on hints cannot declare the said transactions to be fraudulent ones."

3.2.2.2. In *Punjab National Bank v. Carnation Auto India (P.) Ltd. IB NO. 302 (ND) of 2017 NCLT - New Delhi* held that where liquidator filed application under section 66 on basis of a forensic audit report, application filed by liquidator was to be dismissed, as forensic audit report was weak and improperly conducted.

3.3. Templates of forensic/transaction audit: Templates of forensic/ transaction audit, to cover avoidance transactions over the look-back period, should be designed. Best practices should also be laid out to support these templates. Such best practice to include quicker turnaround time/ decisions by COC for providing information/reports in respect of such applications Some of the indicative parameters and perceptions around which the templates/ best practices can be formulated are suggested as follows:

3.3.1. Management's position to override of controls: Fraudulent financial reporting often involves management's override of controls that otherwise may appear to be operating effectively. Such frauds can be committed by management using techniques like:

- Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives;
- Inappropriately adjusting assumptions and changing judgments used to estimate account balances;

- Omitting, postponing, or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period;
- Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements;
- Engaging in complex transactions which are structured to misrepresent the financial position or financial performance of the entity;
- Altering records and terms related to significant and unusual transactions.

3.3.2. Misappropriation of assets: Misappropriation of assets involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it may also involve management personnel who are usually more equipped to disguise or conceal misappropriations in ways that are difficult to detect. Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization. Misappropriation of assets can be accomplished in a variety of ways including:

- Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts);
- Stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological/sensitive data in return for payment);
- Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for inflating prices, payments to fictitious employees);
- Using an entity's assets for personal use (for example, using the entity's assets as collateral for a personal loan or a loan to a related party);

3.3.3. Inquiries: The forensic auditor should make inquiries from management, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. The auditor may direct the inquiries about the existence or suspicion of fraud to the following:

- Operating personnel not directly involved in the financial reporting process.
- Employees with different levels of authority.
- Employees involved in initiating, processing or recording complex or unusual transactions and those who supervise or monitor such employees.
- In-house legal counsel.
- Chief ethics officer or equivalent person.
- The person or persons charged with dealing with allegations of fraud.

3.3.4. Business Rationale for Significant Transactions: Indicators that may suggest that significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual, or may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets, include:

- The form of such transactions appears overly complex (for example, the transaction involves multiple entities within a consolidated group or multiple unrelated third parties).
- Management has not discussed the nature of and accounting for such transactions with those charged with governance of the entity, and there is inadequate documentation.
- Management is placing more emphasis on the need for a particular accounting treatment than on the underlying economics of the transaction.
- Transactions that involve non-consolidated related parties, including special purpose entities, have not been properly reviewed or approved by those charged with governance of the entity.
- The transactions involve previously unidentified related parties or parties that do not have the substance or the financial strength to support the transaction without assistance from the entity under audit.

3.3.5. Risk Factors Relating to PUFAs Aspects:

- (a) Fraudulent Financial Reporting:** The following are examples of risk factors relating to misstatements arising from fraudulent financial reporting:

Incentives/Pressures

Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as (or as indicated by):

- High degree of competition or market saturation, accompanied by declining margins.
- High vulnerability to rapid changes, such as changes in technology, product obsolescence, or interest rates.
- Significant declines in customer demand and increasing business failures in either the industry or overall economy.
- Operating losses making the threat of bankruptcy, foreclosure, or hostile takeover, imminent.
- Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth.
- Rapid growth or unusual profitability especially compared to that of other companies in the same industry.
- SNew accounting, statutory, or regulatory requirements.

Excessive pressure exists for management to meet the requirements or expectations of third parties due to the following:

- Profitability or trend level expectations of investment analysts, institutional investors, significant creditors, or other external parties (particularly expectations that are unduly aggressive or unrealistic), including expectations created by management for example, overly optimistic press releases or annual report messages.
- Need to obtain additional debt or equity financing to stay competitive-including financing of major research and development or capital expenditures.
- Marginal ability to meet exchange listing requirements or debt repayment or other debt covenant requirements.
- Perceived or real adverse effects of reporting poor financial results on significant pending transactions, such as business combinations or contract awards.

Information available may indicate that the personal financial situation of management or those charged with governance is threatened by the entity's financial performance arising from the following:

- Significant financial interests in the entity.

- Significant portions of their compensation (for example, bonuses, stock options, and earn-out arrangements) being contingent upon achieving aggressive targets for stock price, operating results, financial position, or cash flow²⁴
- Personal guarantees of debts of the entity.
- There is excessive pressure on management or operating personnel to meet financial targets established by those charged with governance, including sales or profitability incentive goals.

Opportunities

The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:

- Significant related-party transactions not in the ordinary course of business or with related entities not audited or audited by another firm.
- A strong financial presence or ability to dominate a certain industry sector that allows the entity to dictate terms or conditions to suppliers or customers that may result in inappropriate or non-arm's-length transactions.
- Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate.
- Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult "substance over form" questions.
- Significant operations located or conducted across international borders in jurisdictions where differing business environments and cultures exist.
- Use of business intermediaries for which there appears to be no clear business justification.
- Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification.

The monitoring of management is not effective as a result of the following:

- Domination of management by a single person or small group (in a non owner-managed business) without compensating controls.
- Oversight by those charged with governance over the financial reporting process and internal control is not effective.

There is a complex or unstable organizational structure, as evidenced by the following:

- Difficulty in determining the organization or individuals that have controlling interest in the entity.

- Overly complex organizational structure involving unusual legal entities or managerial lines of authority.
- High turnover of senior management, legal counsel, or those charged with governance.

Internal control components are deficient as a result of the following:

- Inadequate monitoring of controls, including automated controls and controls over interim financial reporting (where external reporting is required).
- High turnover rates or employment of accounting, internal audit, or information technology staff that are not effective.
- Accounting and information systems that are not effective, including situations involving significant deficiencies in internal control.

Attitudes/Rationalizations

- Communication, implementation, support, or enforcement of the entity's values or ethical standards by management, or the communication of inappropriate values or ethical standards, that are not effective.
- Non-financial management's excessive participation in or preoccupation with the selection of accounting policies or the determination of significant estimates.
- Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or those charged with governance alleging fraud or violations of laws and regulations.
- Excessive interest by management in maintaining or increasing the entity's stock price or earnings trend.
- The practice by management of committing to analysts, creditors, and other third parties to achieve aggressive or unrealistic forecasts.
- Management failing to remedy known significant deficiencies in internal control on a timely basis.
- An interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons.
- Low morale among senior management.
- The owner-manager makes no distinction between personal and business transactions.
- Dispute between shareholders in a closely held entity.
- Recurring attempts by management to justify marginal or inappropriate accounting on the basis of materiality.

- The relationship between management and the current or predecessor auditor is strained, as exhibited by the following:
- Frequent disputes with the current or predecessor auditor on accounting, auditing, or reporting matters.
- Unreasonable demands on the auditor, such as unrealistic time constraints regarding the completion of the audit or the issuance of the auditor's report.
- Restrictions on the auditor that inappropriately limit access to people or information or the ability to communicate effectively with those charged with governance.
- Domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor's work or the selection or continuance of personnel assigned to or consulted on the audit engagement.

(b). Misappropriation of Assets:

Incentives/Pressures:

Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets. Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following:

- Known or anticipated future employee layoffs.
- Recent or anticipated changes to employee compensation or benefit plans.
- Promotions, compensation, or other rewards inconsistent with expectations.

Opportunities

Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:

- Large amounts of cash on hand or processed.
- Inventory items that are small in size, of high value, or in high demand.
- Easily convertible assets, such as bearer bonds, diamonds, or computer chips.
- Fixed assets which are small in size, marketable, or lacking observable identification of ownership.

Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:

- Inadequate segregation of duties or independent checks.
- Inadequate oversight of senior management expenditures, such as travel and other reimbursements.
- Inadequate management oversight of employees responsible for assets, for example, inadequate supervision or monitoring of remote locations.
- Inadequate job applicant screening of employees with access to assets.
- Inadequate record keeping with respect to assets.
- Inadequate system of authorization and approval of transactions (for example, in purchasing).
- Inadequate physical safeguards over cash, investments, inventory, or fixed assets.
- Lack of complete and timely reconciliations of assets.
- Lack of timely and appropriate documentation of transactions, for example, credits for merchandise returns.
- Lack of mandatory vacations for employees performing key control functions.
- Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation.
- Inadequate access controls over automated records, including controls over and review of computer systems event logs.

Attitudes/Rationalizations

- Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
- Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.
- Behaviour indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
- Changes in behaviour or lifestyle that may indicate assets have been misappropriated.
- Tolerance of petty theft.

3.3.6. **Related Parties - Records or Documents That the Forensic Auditor May Inspect:**

- Entity's Income Tax Returns.
- Information supplied by the entity to regulatory authorities.
- Shareholder registers to identify the entity's principal shareholders.
- Statements of conflicts of interest from management and those charged with governance.
- Records of the entity's investments and those of its pension plans.
- Contracts and agreements with key management or those charged with governance.
- Significant contracts and agreements not in the entity's ordinary course of business.
- Specific invoices and correspondence from the entity's professional advisors.
- Life insurance policies acquired by the entity.
- Significant contracts re-negotiated by the entity during the period.
- Internal auditors' reports.
- Documents associated with the entity's filings with a securities regulator (e.g., prospectuses).

3.4. **Forensic Accounting and Investigation Standards:** Forensic Accounting and Investigation Standards (FAIS) in the context of IBC, may be developed under aegis of IBBI. This would ensure uniformity and consistency in inputs, critical for better outcomes. For instance, such standards should provide for the following:

- the Professionals, with the minimum standards for undertaking FAI engagement;
- the Users of FAI services, with an indication of the quality of service that can be expected from such engagements;
- the Regulators and Governmental Agencies, with an appreciation of what can be expected from FAI services; and
- in General, guidance on matters of implementation and related practical issues

- 3.4.1. These Standards shall be principle-based, thereby providing adequate scope for professional judgment when applying such principles to unique situations and under specific circumstances.
- 3.4.2. Every professional conducting a forensic accounting and investigation engagement is bound by a written Code of Ethics (or Conduct), issued by a professional body and/or an organisation of which he is a Member, based on basic principles as follows:-
- **Independence:** be free from any undue influence which forces deviation from the truth or influences the outcome of the engagement and shall ensure that the appointment is made with due authority.
 - **Integrity and Objectivity:** avoid all conflicts of interest and shall not seek to derive any undue benefits or advantages from their position.
 - **Due Professional Care:** focus and attention are given to matters of importance, along with diligence in time-management, comply with Standards and ensure continuous communication to prevent any misunderstanding.
 - **Confidentiality:** It also includes the need to protect privacy rights of the suspect and to discover evidence in a manner which does not infringe upon the privacy rights of individuals.
 - **Skills and Competence:** undertake only those engagements for which they have the requisite competence.
 - **Contextualization of Situation:** FAI engagements cannot be conducted in isolation. The context of the situation and the environment where the transactions or operations take place is important to understand the complete picture.
 - **Primacy of Truth:** the primary objective of any Professional is to unearth the reality behind every allegation or dispute, which in turn shall be based on facts, figures and reliable evidential matter.
 - **Respecting Rights and Obligations:** it is critical to obtain and understand the views and standpoint of all parties. Just as much as the Professional has the right of examination to unearth the truth, the suspects have a similar right to defend their innocence.

- **Separating facts from opinions:** The Professional shall ensure that their personal judgement and biases find no place in this exercise. Personal perspectives shall be separated from professional judgement. This is particularly important when interviewing a witness or suspect.
 - **Quality and Continuous Improvement:** Professional shall have in place a process of quality control to ensure factual authenticity of evidence obtained as well as the accuracy of findings
- 3.4.3. The FAI professional should document the audit reports, initial correspondences, minutes of meetings with stakeholders, engagement letter, understanding of fraud risk and its relevance for the engagement, the fraud indicators observed, checklists, applicable laws and regulations, Chain of Custody of the evidence discovered, testing of hypotheses, etc.
 - 3.4.4. The FAI professional should ensure that the expected outcome is in line with the objectives and the defined scope and where there is any mismatch between any of these, clarity should be sought to resolve ambiguity.
 - 3.4.5. Such professional should identify all key stakeholders, the individuals covered under the scope and the direct and indirect users of the engagement report, such as law enforcement or regulatory agencies, lenders, other third parties.
 - 3.4.6. In conducting FAI engagements, the Professional may seek assistance, and place reliance on the work of an expert where the required skills are neither possessed by the Professional, nor available within the team. The work of the expert may be in the form of specific examination procedures covering a specialized area or field, (such as, Discovering Electronic evidence, Cyber security, Asset Valuations, Voice sampling, Signature verification) or advise from a Legal or industry specialist. The Professional shall seek the authority to select, appoint and engage the Expert. Where the findings of the Expert will form part of the report, the Professional shall participate in defining the scope and expected deliverables for the work to be conducted by the Expert.
 - 3.4.7. All communication with the Stakeholders, by the Professional, shall be clear, direct, independent, objective and effective, conducted with an open mind and take into account the relevant laws and regulations, principles of neutrality, confidentiality, natural justice, etc. However, the Professional may have to assess the requirement of communicating directly with other stakeholders for the purpose of enquiry, confirmation of facts, collection of evidence or such other matters, for effective

execution of the engagement. Where the Professional has agreed to communicate directly with external agencies, this understanding shall be formalized in the terms of engagement. Hence, what can be communicated may include the following:

- Non-cooperation/ denial of access to information;
- Intimidation/ life-threatening situations;
- Destruction of evidences, etc.

3.4.8. The professional should obtain evidence from reliable sources and ensure that evidence discovered is appropriate to the objectives of the assignment and suitable in a Court of law. Evidence shall support the basis of findings and allows reasonable conclusions to be drawn from those findings.

3.4.9. Discover appropriate and reliable evidence, which can stand on its own and does not require any follow-up clarification or additional information to arrive at the same conclusion as drawn by the Professional.

3.4.10. The professional should clearly identify and define the 'work procedures'. Work Procedures refer to a number of FAI activities to collect, analyse and interpret data and information, discover reliable and appropriate evidence in order to prove or disprove formulated hypotheses.

3.4.11. Generally, in FAI assignments, 'work procedures' are:

- first conducted behind the scenes (Phase 1) where there is little interaction with the individuals involved ; and
- thereafter (Phase 2), where there is a need to engage with the relevant stakeholders.

3.4.12. Testifying before a competent authority:

- Pursuant to the directives received from the Competent Authority, the Testifying Professional may be required to provide testimony as a Fact Witness or as an Expert Witness on the matter under investigation.
- The former (by a Fact Witness) is limited to presenting facts as observed, without expressing any opinion. The latter (by an Expert Witness) includes the expression of an opinion through the application of assumptions and analysis on the facts and by reaching a conclusion on the outcome of the work completed.

- The Testifying Professional shall be independent and be objective in approach and ensure that there is no conflict of interest.
- The Testifying Professional shall adhere to the statutory provisions for deposition, as per applicable law and adhere to the relevant Standards issued by the IPA etc. on the matters relating to accounting are concerned.

3.4.13. Reporting:

- Reporting results of the work procedures completed and the findings from those procedures, is the concluding part of the assignment. Since one engagement may include multiple transactions, multiple reports may have to be issued, one for each transactions .
- The Professional shall issue a written report which is precise and unambiguous;
- The report shall be addressed to the Primary Stakeholders and shared with other stakeholder(s) if required or otherwise permissible;
- The report shall include certain key elements to enable the recipient to understand the purpose of the assignment, the extent and scope of work performed by the Professional, any limitations, assumptions or disclaimers, the facts and evidence discovered and the conclusions drawn;
- Where the form and content of the report is mandated by the stakeholders, or specified by the statutory or regulatory requirements, the Professional shall report in line with those requirements, while keeping in mind the key elements.
- The report shall highlight any key assumptions made and whether any limitations were faced by the Professional during the course of the assignment.
- The report shall not express an opinion or pass any judgement on the guilt or innocence. Determination of culpability is either a disciplinary process internal to the organization under review, or a judicial process depending on the specific situation under review. The report can, at best, highlight the circumstances and facts that may aid a stakeholder decision or further a civil or criminal investigation.

- In circumstances where the assignment could not be completed due to unforeseen or unavoidable reasons, the Professional shall provide a status report with an assessment of the results, including due limitations and disclaimers, and reasons for the incomplete nature of the assignment.

3.5. Additional Suggestions:

- Need for guidelines for information flow to RP and Auditors, in the context of avoidance transactions.
- Guidelines should be made available for fixation of minimum fee for forensic/transaction auditor to ensure quality and independence.
- In addition to Executive Development programs of IIPAI on Forensic Skills being conducted currently, similar certificate course/training program can be developed by in association with Committee of IBC of ICAI (CIBC-ICAI), focussing on IBC related Forensic Audit skills for even non-IP CAs.
- Minimum (say, 2 days) training programme should be made mandatory to be attended by any professional who desires to undertake PUFE transaction audit assignment.
- Special focus on drafting applications and presentation before the AA, may be emphasized while imparting such training as above. This would improve the quality of applications/proceedings.
- Weightage to forensic skills/knowhow in granting CPE credit, under additional criteria, being rolled by IIPAI for its members.

3.6. Mechanism to review the observations made by the 'forensic auditors':

IBBI should also put in place a mechanism to review the observations made by the 'forensic auditors' contained in their audit reports.

3.7. Other Measures to Enhance Effectiveness

- 3.7.1. Avoidance proceedings should be permitted to be commenced by creditors (and, in some cases, the COC) with the prior consent of the IP. Requiring such consent ensures that the IP is informed as to what creditors propose, giving him the opportunity to engage with COC meaningfully
- 3.7.2. Where the consent of the IP is required, but not obtained, the creditor/COC may be permitted to seek court approval to commence avoidance proceedings. The IP has a right to be heard in any resulting court hearing to explain why it believes the proceedings should not go ahead. At such a hearing, the court might give leave for the avoidance proceeding to be commenced or may decide to hear the case on its own merits. Such an approach may work to reduce the likelihood of any unethical conduct by the concerned parties.



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