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IIIPI's Template for Insolvency Professionals to report Avoidance Transactions to NCLT

Indian Institute of Insolvency Professionals of ICAI (IIIPI) has designed a “Template for forming opinion on avoidance transactions” in companies undergoing insolvency processes under the IBC and filing the same to NCLT. The ‘Template’ is aimed to facilitate the filing of Avoidance Transaction petitions before NCLTs, ensure uniformity and in expediting decision-making process in the court which shall ultimately enhance recovery by creditors. The said ‘Template’ was developed by a Study Group constituted by IIIPI in the Chairmanship of CA. Subodh Agarwal, Past-President of ICAI, who himself is an Insolvency Professional (IP), after consultations with group members, experts and stakeholders. Here we are publishing the Template for its wider dissemination for benefit of IPs.

Template for forming an opinion /filing of an application under Avoidance Transactions

(Reg. 35A under IBBI (CIRP) Regulations may be referred to)

(Amount in ₹ Crore)

| | Particulars | Comments/Inputs | |
|---|---|-----------------|-----------------|
| A | Name of Corporate Debtor (CD) | | |
| B | Date of filing of application under IBC for initiating CIRP | | |
| C | Insolvency Commencement Date (ICD) | | |
| D | Date of Categorization of CD as NPA first time by any Bank, if any. | | |
| E | (i). Whether CD has been recognized as Willful Defaulter (If yes, provide Effective Date). | | |
| | (ii). Whether CD has been referred to the prescribed forum for being recognized as Willful Defaulter (to be specified if the CD is not yet declared as willful defaulter) | | |
| | (iii) Reasons for default, if not recognized (or in the process of being recognized) as Willful Defaulter | | |
| F | List of Related Parties (as defined under IBC provisions), giving names and nature of relationship with CD. | | |
| G | Liquidation Value as assessed by Valuers 2 | | |
| H | <i>Total Claims Received/Accepted (category-wise)</i> | <i>Amount</i> | <i>Comments</i> |
| | a. Financial Creditors (FCs) | | |
| | i. Secured FCs | | |
| | ii. Unsecured FCs | | |
| | iii. Total FCs | | |
| | b. Operational Creditors (OCs) | | |
| | i. Trade Creditors | | |
| | ii. Employees & Workmen | | |
| | iii. Statutory Dues | | |
| | Other OCs | | |
| | Total OCs | | |
| | c. Other Claimants | | |
| | Total (a + b + c) | | |

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| I | <i>Notional Ranking of claims and allocation of liquidation value as per waterfall u/s 53.</i> | <i>Claim Amount (as admitted or quantified)</i> | | <i>Notional Allocation of Liquidation Value ²</i> | | |
|---|---|---|------------------------------|--|---|---|
| | Rank 1 (a): CIRP costs (provisional) Rank 2 (b)(i): Workmen dues for 24 months Rank 2 (b)(ii): Secured Creditors (relinquished security) Rank 3 (c): Employee dues for 12 months Rank 4 (d): Financial Debts of Unsecured Creditors Rank 5 (e)(i): Statutory Creditors Rank 5 (e)(ii): Secured Creditors (post security enforcement) Rank 6 (f): Other Operational Creditors | | | | | |
| J | <i>Transfers (other than made in ordinary course of business) made during the ‘relevant period’, by CD involving transfer of property (or interest therein) to creditor(s) on account of antecedent financial/operational debt of liability.</i> | <i>Date of Transfer</i> | <i>Name of Counter Party</i> | <i>Whether Related</i> | <i>Whether within look back period ¹</i> | <i>Antecedent Debt</i> |
| | a. Property/Interest b. Property/Interest c. Property/Interest (Add more rows, if needed) | | | | | |
| K | Opinion on Preferential Transactions during ‘relevant period’, referring to transfers (as per Clause J above) involving preference to one or more creditors vis-à-vis allocation of liquidation value (as per Clause I above). | | | | | |
| L | <i>Transfers (other than made in ordinary course of business) made during the ‘relevant period’, by CD involving transfer of property (or interest therein) to any person without or at significantly less consideration.</i> | <i>Date of Transfer</i> | <i>Name of Counter Party</i> | <i>Whether Related</i> | <i>Whether within look back period²</i> | <i>Whether Gift or Lack of adequate consideration</i> |
| | a. Property/Interest b. Property/Interest c. Property/Interest (Add more rows, if needed) | | | | | |
| M | Opinion on Undervalued Transactions during ‘relevant period’, referring to transfers (as per Clause L above) to any person, involving gift or significantly less consideration. | | | | | |

¹ A preference shall be deemed to be given at a relevant time, if— (a). It is given to a related party (other than by reason only of being an employee), during the period of two years preceding the insolvency commencement date; or (b). a preference is given to a person other than a related party during the period of one year preceding the insolvency commencement date.

² In an application for avoiding a transaction at undervalue, the liquidator or the resolution professional, as the case may be, shall demonstrate that— (i). such transaction was made with any person within the period of one year preceding the insolvency commencement date; or (ii). such transaction was made with a related party within the period of two years preceding the insolvency commencement date.

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| | | | | | | |
|---|--|------------------------------|----------------------|----------------------------|--|-------------------------|
| N | <i>Transactions during the ‘relevant period’ involving receipt of financial or operational debt by CD where the terms of said such transactions require exorbitant payments (including interest thereon) to be made by CD or are unconscionable (unreasonable/excessive).</i> | <i>Amount of Debt</i> | <i>Counter Party</i> | <i>Date of Transaction</i> | <i>Whether within look back period³</i> | <i>Exorbitant Terms</i> |
| | a. Transaction - financial/Operational Debt b. Transaction - financial/Operational Debt c. Transaction - financial/Operational Debt (Add more rows, if needed) | | | | | |
| O | Opinion on Extortionate Transactions during ‘relevant period’, (excluding those in compliance with any law for the time being in force) referring to transfers (as per Clause N above) to any person, involving exorbitant payments by CD. | | | | | |
| P | <i>Business transactions of CD involving intent to defraud creditors of CD or for any fraudulent purpose.</i> | <i>Amount of Transaction</i> | <i>Counter Party</i> | <i>Date of Transaction</i> | <i>Nature/Details of Fraudulent Transactions</i> | |
| Q | Opinion on Fraudulent Transactions during reasonable look-back period* as determined by RP referring to transactions (as per Clause P above) specifying the person who were knowingly parties to the carrying on such transactions. | | | | | |
| R | Opinion on whether any director/partner of CD knew or ought to have known (before ICD) that there was no reasonable prospect of avoiding the CIRP of CD and such director/partner did not exercise due diligence in minimizing the potential loss to the creditors (referring to PUEF transactions), specifying the grounds/reasons of such opinion, during the look-back period as determined by RP. | | | | | |

Note:

The following may be noted while compiling information and forming opinion by the RP/Liquidator as per template given above:

1. The forensic/transaction audit for the purpose of making opinion on avoidance transactions, is optional, subject to discretion of COC and RP. However, wherever such audit is carried out, the guidance provided under Forensic Accounting & Investigation Standards (FAIS) by ICAI should be adhered to by the concerned audit professional.
2. The disclosure of Liquidation value for notional allocation, is subject to consideration of confidentiality.
3. Sources of Information for opinion are:

³ Where the corporate debtor has been a party to an extortionate credit transaction involving the receipt of financial or operational debt during the period within two years preceding the insolvency commencement date, the liquidator or the resolution professional as the case may be, may make an application for avoidance of such transaction to the Adjudicating Authority if the terms of such transaction required exorbitant payments to be made by the corporate debtor.

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- Internal : Earlier forensic reports, Statutory Audit reports, Financial statements, Cash flow statements, Bank Ledgers, Cash Ledgers, Journal registers, Account ledgers, Confirmation of balances, Contracts and agreements, Purchases and Sales invoices.
 - External : MCA data, Land registration data, Income tax returns, GST returns, Any other regulatory information.
4. For arriving at the reasonable look-back period for the purpose of determining fraudulent transactions, the RP/ Liquidator may analyze the financial data of CD, for last 8 years to spot any unusual trend(s). The following data points may be examined for the purpose:

| Item (Specify Audited/Unaudited) |
|-------------------------------------|
| Total fixed assets |
| Total Current assets D=(A+B+C) |
| -Inventories (A) |
| -Debtors (B) |
| -Other current assets (C) |
| Net worth |
| Other Long-term liabilities |
| Short Term liabilities |
| Finance Cost |
| Operating income |
| EBIDTA |
| Net Profit/ Net Loss for the Period |
| CASH FLOW: |
| Cash from Operating Activity |
| Cash from Investing Activity |
| Cash from Financing Activity |
| Net Cash Flow |
| Ratios |
| Inventory Turnover Ratio |
| Debtor Turnover Ratio |
| Operating Margin |
| % of promoter shareholding |

5. While expressing the opinion for various avoidance transactions, the findings should be referenced to the relevant evidence and information gathered, which should be annexed to the report.
6. While making a determination about the avoidance transactions, the following indicative behavioral criteria and red flag indicators for the transactions may be applied by the resolution professional. These criteria and indicators are meant for implementation guidance only and these neither in any way substitute the mandatory requirements of Chapter III and CIRP Regulations nor lay down any procedure for manner to be adopted for determination and opining on the ‘avoidance transactions’:

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| S. No. | Type of Transaction | Behaviour criteria ⁴ | Red Flag Indicators ⁵ |
|--------|---|--|--|
| 1. | Preferential Transactions ~ Section 43 | <ul style="list-style-type: none"> ◆ Preference is about ‘who’; ◆ Intention is not a factor | <ul style="list-style-type: none"> ◆ Whether transaction in question was made in ordinary course of CD’s business; ◆ Whether transaction in question was carried in transparent manner e.g. by making necessary disclosures in the financial statements; ◆ Whether any breach of covenant(s) or condition(s) precedents with regard to other counterparties has been noticed/ reported; ◆ Whether any legal proceeding(s) have been initiated against the CD involving transfer of CD’s assets; and ◆ Whether an independent valuation report was obtained wherever applicable. |
| 2. | Undervalued Transactions ~ Section 45 | <ul style="list-style-type: none"> ◆ Undervalued transactions are about ‘how much’ ◆ Intention is not a factor | <ul style="list-style-type: none"> ◆ Whether transaction in question was made in ordinary course of CD’s business; ◆ Whether sale/transfer was conducted in transparent manner e.g. by way of competitive bidding or tendering, etc; ◆ Whether other (than the transferee) buyers had shown interest; ◆ Whether any legal proceeding(s) have been initiated against the CD involving transfer of CD’s assets; and ◆ Whether an independent valuation report was obtained. |
| 3. | Transactions defrauding creditors ~ Section 49 | <ul style="list-style-type: none"> ◆ there is an element of deliberate intent, viz., the intent to defraud | <ul style="list-style-type: none"> ◆ Refer S. No.: 5 and 6 mutatis mutandis |

⁴ Based on Statement Of Best Practices: "Role Of Insolvency Professionals (IPs) In Avoidance Proceedings" (Joint paper by all the IPAs) [<https://www.iiipicai.in/wp-content/uploads/2021/08/Paper-I-Statement-of-Best-Practices-on-Role-of-IPs-in-avoidance-proceedings.pdf>]

⁵ Based on Avoidance Transactions – Red Flags, published by IBBI [<https://ibbi.gov.in/uploads/legalframework/72438989cca02508e20db38d5f18958e.pdf>]

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| | | | |
|----|---|---|--|
| 4. | Extortionate credit transactions ~ Section 50 | <ul style="list-style-type: none"> ◆ transactions undertaken at unconscionable terms | <ul style="list-style-type: none"> ◆ Whether the rate of interest agreed for the borrowing in question, comparable with other borrowings by the CD in recent past; ◆ Whether the rate of interest agreed for the borrowing in question, comparable with borrowings by other industry peers enjoying similar credit risk rating; and ◆ Whether other terms of borrowings e.g., processing fee, repayment tenor, securities, etc. are comparable with other borrowings of the CD or that by industry peers enjoying similar credit risk rating |
| 5. | Fraudulent trading ~ Section 66(1) | <ul style="list-style-type: none"> ◆ ‘intent to defraud’ is essential; ◆ 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 | <ul style="list-style-type: none"> ◆ Whether any statutory audit report of previous year(s) with respect to CD was qualified by the auditors; ◆ Whether any statutory audit report of previous year(s) with respect to CD contained any significant disclaimer(s) made by auditors; ◆ Whether an undue gain has been accrued to any person owing to the transaction in question: ◆ Whether any breach of covenant(s) or condition(s) precedents with regard to other counterparties has been noticed/ reported; ◆ Whether any legal proceeding(s) have been initiated against the CD involving transfer of CD’s assets; ◆ Whether the director(s) concerned were party to or otherwise aware of the transactions in question; and ◆ Whether the director(s) concerned upon becoming aware of fraudulent transactions took any corrective action to minimize the loss arising as a result. |

| | | | |
|----|----------------------------------|---|--|
| 6. | Wrongful trading ~ Section 66(2) | ◆ conduct might not amount to fraud, but if the directors have continued to trade, taking advantage of the limited liability of equity holders, exposing creditors to deeper losses, the conduct may fall short of principles governing duties of directors to act diligently | |
|----|----------------------------------|---|--|

7. Facts stated in the Template shall be supported by relevant and reliable evidence corresponding to ‘avoidance transaction(s)’. Such evidence shall be annexed to the Template.
8. Various procedures to obtain evidence can include inspection, observation, confirmation, recalculation, reperformance and analytical procedures, often in some combination, in addition to inquiry. Some evidence is obtained by performing audit procedures to test the accounting records, for example, through analysis and review, re-performing procedures followed in the financial reporting process, and reconciling related types and applications of the same information. Information from sources independent of the Corporate Debtor that the resolution professional may use audit evidence may include confirmations from third parties, analysts' reports, and comparable data about competitors (benchmarking data)
9. Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity. Inquiry is used extensively throughout the determination of avoidance transactions audit in addition to other procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process. Responses to inquiries may provide information not previously possessed or with corroborative evidence. Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.
10. The Guidance may be taken from FAIS 510 in context and hence where the Resolution Professional may not be in a position to make the determination for ‘avoidance transactions for any reasons, including the following:
 - (a) Non-availability of evidence, or incomplete evidence.
 - (b) Non-availability or non-cooperation of Stakeholders.
 - (c) Any other extenuating circumstances.

then in such circumstances the Resolution Professional would need to record the reasons for non-completion of the engagement and clearly report such limitations in the template.