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Implications of Companies Act, 2013

Valuations

The Companies Act, 2013: An overview

The Companies Act, 2013 ('2013 Act'), enacted on 29 August 2013 on accord of Hon'ble President's assent, has the potential to be a historic milestone, as it aims to improve corporate governance, simplify regulations, enhance the interests of minority investors and for the first time legislates the role of whistle-blowers. The new law will replace the nearly 60-year-old Companies Act, 1956 ('1956 Act').

The 2013 Act provides an opportunity to catch up and make our corporate regulations more contemporary, as also potentially to make our corporate regulatory framework a model to emulate for other economies with similar characteristics. The 2013 Act is more of a rule-based legislation containing only 470 sections, which means that the substantial part of the legislation will be in the form of rules. There are over 180 sections in the 2013 Act where rules have been prescribed and the draft rules were released by the MCA in three batches. It is widely expected that the 2013 Act and indeed the rules will provide for phased implementation of the provisions and in line with this, 98 sections of the 2013 Act have been notified and consequently the corresponding section of the 1956 Act cease to be in force.

The 2013 Act has introduced the concept of a 'Registered Valuer' under a separate chapter which intends to cover all kinds of valuation requirements. As per Chapter XVII Section 247 of the Act, where a valuation is required to be made in respect of any property, stocks, shares, debentures, securities or goodwill or any other assets or net worth of a company or its liabilities under the provision of this Act, it must be valued by a Registered Valuer. The concept of valuation as a code is new for the 2013 Act. The rationale behind introducing this is to set certain valuation standards and regulate the practice which will bring transparency and better governance during a valuation exercise. Chapter XVII Section 247 of the 2013 Act is read with Rule 17 of Draft Rules, which lay down the criteria for registration, rights of the valuer, approach and methods to be used by registered valuers and contents of the Valuation Report. These Draft Rules are currently open for suggestions and are hence subject to change.

Salient Features of a Registered Valuer

- As per the 2013 Act, all valuations need to be carried out by a Registered Valuer and for valuation requirement of a company, the Registered Valuer shall be appointed by the Audit Committee or in its absence, by its Board of Directors.
- The Draft Rules define "Registered Valuer" and state that a person to be eligible to act as a valuer, must register with the Central Government or institution or agency notified by the Central Government by filing an application for registration as a valuer.
- Further, the Draft Rules also prescribe that a person who shall be eligible to apply for becoming a Registered Valuer are as follows:
  - a Chartered Accountant, Company Secretary or Cost Accountant who is in whole-time practice, or retired member of Indian Corporate Law Service or any person holding equivalent Indian or foreign qualification as the Ministry of Corporate Affairs may recognize by an order.
  - a merchant banker registered with the Securities and Exchange Board of India.
  - a member of the Institute of Engineers and who is in whole-time practice.
  - a member of the Institute of Architects and who is in whole-time practice.
  - a person or entity possessing necessary competence and qualification as may be notified by the Central Government from time to time.

As per the 2013 Act,

- a valuer is expected to assume the following responsibilities while carrying out a valuation engagement:
  - must exercise due diligence and care.
  - must make an impartial, true and fair valuation of assets that are being valued.
  - must make the valuation in accordance with the prescribed rules.
  - is prohibited to undertake valuation of assets in which he has a direct or indirect interest or becomes interested at any time during or after the valuation of that asset.
- A valuer violating the provisions of the requirements shall be punishable with a fine of Rs 25,000 extending up to Rs 1 lakh.
- A valuer, sentenced to a term of imprisonment for any offence or found guilty of misconduct in his professional capacity shall be removed from the register of valuer and he will cease to act as a valuer.
- In case of intention to defraud the company or its members, imprisonment has been additionally provided as a penal provision.
- The Draft Rules provide for removal and restoration of names of valuers from register maintained by the Central Government or any authority, institution or agency.
- Also, as per the Draft Rules, a valuer in case aggrieved by an order of the Central Government can file an appeal against the order to the Tribunal.

Responsibilities of a Registered Valuer as per Act and Draft Rules

References made in various Clauses in the 2013 Act for Valuation Requirement

Clauses as per Companies Act 2013	Valuation Requirement/ Purpose
Section 62	Valuation for Further Issue of Share Capital
Section 192	Valuing Assets involved in Arrangement of Non-Cash transactions involving directors
Section 230/ 232	Valuation under Scheme of Compromise/Arrangement or Scheme of Corporate Debt Restructuring
Section 236	Valuation for Purchase of Minority Shareholding
Section 260	Valuation in respect of Shares and Assets to arrive at the Reserve Price for Company Administrator
Section 281	Valuing assets for submission of report by Company Liquidator
Section 305	Report on Assets for declaration of solvency in case of proposal to wind up voluntarily
Section 319	Valuing interest of any dissenting member under Power of Company Liquidator to accept shares etc., as consideration for sale of property of company

"The Draft Rules are in sync with global best practices, and are welcome. Hopefully it improves the standards of the rigour followed in arriving at the valuation opinion, independence of valuers and transparency in reporting amongst the valuation fraternity. It would be interesting to see how the professional judgment of valuers, so crucial in providing a valuation opinion, evolves when interpreting and applying the rules in practice."

David Nevin Panna, Partner & Practice Leader – Valuation Services, Grant Thornton India LLP

"It is the first time that the concept of Registered Valuers has been introduced. This will give a definite direction to the valuers and define clearly their roles and responsibilities. Clarifications on the open issues of the Draft Rules would further enable effective implementation of the provisions of this Chapter."

Darshana Kadakia, Partner – Valuation Services, Grant Thornton India LLP

Methods of Valuation as per the Draft Rules

A valuer should keep the following considerations in mind while providing valuation services:

- Nature of the business and the history of the enterprise from its inception
- Economic outlook in general and outlook of the specific industry in particular
- Book value of the stock and the financial condition of the business
- Earning capacity of the company
- Dividend paying capacity of the company
- Goodwill or other intangible value
- Sales of the stock and the size of the block of stock to be valued
- Market prices of stock of corporations engaged in the same or a similar line of business
- Contingent liabilities or substantial legal issues, within India or abroad, impacting the business
- Nature of instrument proposed to be issued, and nature of transaction contemplated by the parties

As per the Draft Rules, '*Valuation Date*' means the date on which the estimate of value is applicable which may be different from the date of the valuation report or the date on which the investigations were undertaken or completed.

The Draft Rules cover most of the frequently used methods of valuation as well as permit valuers to apply other methods as appropriate and justified.

- The Draft Rules also prescribe certain valuation methods that a valuer can adopt while performing a valuation.
- A registered valuer shall decide the approach to valuation based upon the purpose of the valuation in accordance with applicable standards, if any and can choose from Asset, Income and Market Approach.
- One or more of the following prescribed methods or any other method accepted or notified by the Reserve Bank of India, Securities and Exchange Board of India or Income Tax Authorities or that may deem fit to adopt by the Valuer can be used and justified in the report:
  - Net Asset Value Method
  - Market Price Method
  - Yield Method / Profit Earning Capacity Value (PECV)
  - Discounted Cash Flow Method (DCF)
  - Comparable Companies Multiples Methodology (CCM)
  - Comparable Transaction Multiples Method (CTM)
  - Price of Recent Investment Method (PORI)
  - Sum of the Parts Valuation (SOTP)
  - Liquidation Value
  - Weighted Average Method

Methods of Valuation as per the Draft Rules

Contents of the Valuation Report (as per Form No. 17.3) as per the Draft Rules

Valuation Report - Title [Pursuant to section 247(2)(c) and rule 17.7]	
Contents	**Sub-Contents**
1) Valuer Details	a) Name of the Valuer b) Address of the Valuer c) Registration number of the Valuer d) e-mail ID
2) Description of Valuation Engagement	a) Name of the client b) Other intended users c) Purpose for valuation
3) Description of Business/ Asset / Liability being valued	a) Nature of business or asset / liability b) Legal background c) Financial aspects d) Tax matters
4) Description of the Information underlying the Valuation	a) Analysis of past results b) Budgets, with underlying assumptions c) Availability and quality of underlying data d) Review of budgets for plausibility e) Statement of responsibility for information received
5) Description of specific Valuation of Assets used in the Business	a) Basis or bases of value b) Valuation Date c) Description of the procedures carried out d) Principles used in the valuation e) The valuation method used and reasoning f) Nature, scope and quality of underlying data g) The extent of estimates and assumptions together with considerations underlying them
6) Confirmation	that the valuation has been undertaken in accordance with these Rules

7) Further it is certified that valuation has been undertaken after taking into account relevant conditions/regulations/rules/notifications, if any, issued by the Central/State Government(s) from time to time.

8) Valuation Statement :

Date **Signature of Valuer**

Place

Contents of the Valuation Report (Contd.)

Apart from this, some key/additional information to be included in the Valuation Report:

i. The valuation report must clearly state the significant assumptions upon which the value is based. When reporting, there may be instances where there are confidential figures, these must be summarised in a separate exhibit.

ii. In the valuation report, the Registered Valuer must set out a clear value or range of values along with the reasoning.

iii. In case the Registered Valuer has been involved in valuing any part of the subject matter of valuation in the past, the past valuation report(s) should be attached and referred to herein. In case a different basis has been adopted for valuation (than adopted in the past), the Valuer should justify the reason for such differences.

- Professional opportunities likely to emerge with the increase in the number of valuation requirements as per the new concept of Registered Valuer.
- The system of valuation will offer more transparency and fairness which will in turn uplift the shareholders confidence.
- The Appointment of the Valuer by the audit committee or the Board of Directors for all the requirements could be time consuming and may delay the valuation exercise. The management of the company should also be empowered to appoint valuers where the valuation requirement is for annual updation of value or for internal evaluation purpose or such other cases.
- The law states that the Valuer should exercise due diligence while performing the valuation. "Due Diligence" should be more specifically defined in terms of what additional steps a valuer needs to follow. Due diligence is a very broad term and might imply various types of due diligences e.g. tax, financial or commercial which need specific expertise which might not be available with the valuer.
- Other finance professionals such as person holding post-graduate/ masters degree/ diploma in business management (MBA) or finance from India or equivalent foreign qualification, Chartered financial analyst (CFA) from India or equivalent foreign qualification or consulting firms providing financial advisory services should be included in the definition of a Registered Valuer.

Analysis and Areas requiring Clarification/ Limitations of the Act/Draft Rules

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