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THE VALUATION PERSPECTIVE

RESEARCH JOURNAL OF ICAI REGISTERED VALUERS ORGANISATION (ICAI RVO)

(A Section 8 Company promoted by ICAI & Registered as an RVO with IBBI)

ABOUT ICAI RVO

ICAI Registered Valuers Organisation (ICAI RVO) is a Section 8 Company incorporated by the Institute of Chartered Accountants of India (ICAI), to enrol and regulate Registered Valuers or Valuer Members, as its members, in accordance with the Companies (Registered Valuers and Valuation) Rules, 2017, and functions incidental thereto.

Established on 23rd February 2018, ICAI RVO received recognition by IBBI (RVO No. IBBI/RVO/2018/006) for the 'Securities or Financial Assets' class in May 2018, and for 'Land and Building' and 'Plant and Machinery' in August 2023, reflecting its commitment to continuous growth as a leading Registered Valuer Organisation. With this, ICAI RVO is empowered to enrol & regulate members across all Three Asset Classes.

ICAI RVO now boasts a strong membership base of over 1,178 Registered Valuers and 5,499 Primary Members, and has firmly established itself as the leading RVO in the 'Securities or Financial Assets' class, accounting for nearly 50% of all Registered Valuers recognised by IBBI in this category. Following its recognition by IBBI in August 2023 for the remaining two asset classes, 'Land & Building' and 'Plant & Machinery', ICAI RVO has begun steadily expanding its presence across these asset classes as well, further advancing its role as a comprehensive and trusted Registered Valuers Organisation.

This growth stands as a testament to our dedication to enhancing the skills and expertise of our members while simultaneously driving broader advancements in the valuation industry.

ICAI RVO: Empowering Valuers, Enriching Knowledge

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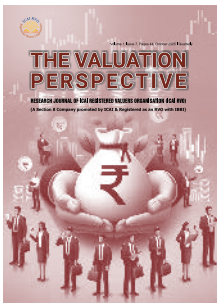

OCTOBER 2025
IN THIS ISSUE...

MESSAGE

FROM THE DESK OF CHAIRMAN, EDITORIAL BOARD, ICAI RVO

Prof. Anil Saini

Dear Professionals,

As we progress into a new era of economic and industrial complexity, the valuation profession is being redefined—not just by technological progress, but by the increasing demand for specialisation across domains. Today, valuation is no longer a uniform discipline; it is a multi-dimensional practice that requires precision, contextual expertise, and a forward-looking mindset. India's economic revival, alongside a growing startup ecosystem, increasing ESG priorities, and the digitization of assets, has elevated the importance of valuation in financial decision-making. Today, stakeholders seek valuers not just for numerical assessments but for valuable insights grounded in extensive sector expertise, clear regulatory understanding, and a global outlook.

In this evolving scenario, being excellent at valuation means becoming a specialist. Whether in infrastructure, fintech, healthcare, or intellectual property, the future belongs to professionals who can combine technical valuation skills with domain-specific understanding. The profession is increasingly being called upon to address unique industry challenges, value new-age assets, and offer strategic clarity in high-stakes transactions.

At ICAI RVO, we are committed to helping our members succeed in this evolving role. We focus on creating opportunities for continuous learning and professional growth. Our training programs are designed to help valuers build expertise in different domains, follow the latest regulations, and handle complex assignments with confidence. We also engage regularly with industry experts and regulatory bodies to ensure our members stay updated and well-prepared.

With that spirit, I am pleased to present ICAI RVO's Journal **Volume 1, Issue 7 of *The Valuation Perspective.*** This issue features thoughtful articles on 'Decoding Rule 11UA: Practical Hurdles and Interpretative Perspective', 'Exchange Control Oversight and Valuation Scrutiny Wake-up Call', 'The Great Indian Turnaround IBC Rescues Companies and Secures The Economy', 'Valuation and Accounting for Employee Stock Option Plan', and 'The Generative AI Co-Pilot: A New Frontier for Professional Excellence'.

Let this edition be both a resource and an inspiration as you continue your journey as informed, ethical, and forward-thinking valuation leaders. Together, let's shape a profession that not only keeps pace with change but helps define the direction of the evolving economy.

Happy Reading!!

Prof. Anil Saini
Independent Director & Chairman,
Editorial Board, ICAI RVO

FROM THE DESK OF CHAIRPERSON, ICAI RVO

Shri Rajeev Kher

Dear Members,

It is with immense pleasure and a deep sense of responsibility that I present to you this edition of the ICAI Registered Valuers Organisation's Journal "The Valuation Perspective". Over the years, this publication has served as a platform for knowledge dissemination, thought leadership, and exchange of ideas in the evolving field of valuation. This edition reflects the collective endeavours of ICAI RVO towards strengthening professional standards, advancing capacity building, and fostering a culture of transparency and excellence. With the closure of the financial year, it is my privilege to share the highlights of our journey and our aspirations for the future.

Leadership in SFA and Membership Growth: Since its inception in 2018, ICAI RVO has emerged as a pre-eminent institution within the Securities or Financial Assets (SFA) domain. Today, it represents over 1,200 Registered Valuers and 5,400 Primary Members. Notably, more than half of all Registered Valuers in the SFA category are affiliated with ICAI RVO, underscoring our credibility and leadership. The organisation is also the second-largest RVO in India, both in terms of individual professionals and Registered Valuer Entities, reaffirming its pivotal role in shaping the national valuation landscape.

Trainings, Conferences, and Programs: In pursuit of its mandate of continuous professional development, ICAI RVO has curated and delivered an extensive suite of training and capacity-building programs encompassing Educational Courses, Certificate of Practice (COP) Trainings, Continuing Education Programmes (CEP), thematic Webcasts, and specialised workshops. A landmark achievement was the inaugural batch for the Plant & Machinery asset class, broadening the scope of professional training offered. A notable highlight of the year was ICAI RVO's association in RESOLVE-2024, the International Convention on Insolvency and Valuation organised by ICAI, which brought together eminent stakeholders from across the globe. In addition, regular webinars and webcasts served as dynamic vehicles for dissemination of contemporary knowledge, including insights drawn from inspection and peer review processes.

Capacity Building and Technological Advancements: The year has been marked with significant strides towards capacity building and the integration of technology in professional learning. We released the first edition of Background Material for the 50-Hour Educational Course for 'Land and Building' and 'Plant & Machinery' asset classes. Our knowledge repository has expanded to 59 publications, including 12 quarterly journals. The revamped Learning Management System (LMS), equipped with Mock Tests, structured Study Material, and accessible to non-members on a subscription basis, embodies our vision of leveraging technology to democratise access to quality knowledge.

ICAI RVO remains committed to upholding professional standards, fostering growth, and contributing to national prosperity through knowledge, technology, and transparency in valuation.

With your support, we will continue to strengthen ICAI RVO as India's premier Registered Valuers Organisation.

Wishing you all a very Happy Deepavali.

Rajeev Kher
Chairperson, Governing Board,
ICAI RVO

MESSAGE

FROM THE DESK OF THE PRESIDENT, ICAI & DIRECTOR, ICAI RVO

CA. Charanjot Singh Nanda

Dear Readers,

It is my privilege to connect with you through this edition of the **ICAI Registered Valuers Organisation's Journal,** which continues to serve as a premier platform for thought leadership, knowledge exchange, and dissemination of best practices in the evolving field of valuation. Over the past year, ICAI RVO has not only reinforced its leadership but also substantially expanded its reach and influence across the India's professional landscape.

ICAI RVO's pioneering role in the **Securities or Financial Assets (SFA)** class remains a defining hallmark of excellence, with over half of all Registered Valuers in this category being affiliated with the organisation. This significant representation highlights the trust and credibility ICAI RVO has built among professionals and stakeholders alike. At the same time, notable strides have been made in expanding into the **"Land and Building"** and **"Plant and Machinery"** asset classes. These developments reflect a clear commitment to diversifying expertise and providing comprehensive support across all key valuation domains.

A landmark achievement this year has been the publication of the **first edition of study material for the 50-Hour Educational Course in both "Land and Building" and "Plant and Machinery" asset classes.** This academic resource, together with the launch of the inaugural Educational Course batch and the first Continuing Professional Education (CPE) training for **"Plant and Machinery"** asset class, reflects a strategic focus on building knowledge, enhancing skill sets, and pursuit of professional excellence.

Education, Training, and Capacity Building remain the cornerstones of ICAI RVO's mission. Through structured learning programs, interactive sessions, and continuous engagement, the organisation ensures that its members are not only technically proficient but also uphold the highest standards of integrity and professional responsibility. This approach reinforces ICAI RVO's position as a thought leader and a benchmark institution within the valuation profession.

Looking forward, ICAI RVO remains committed to fostering professional excellence and ethical rigor and promoting innovation and collaborative learning to strengthen the credibility of the valuation profession and its role in India's economic development, all while simultaneously consolidating its membership across all asset classes.

I express my gratitude to all members and stakeholders for their continued trust and support. Let us move forward with renewed determination, working collectively to elevate the standards of the profession and advance ICAI RVO's vision of excellence, integrity, and national significance.

Wishing you and your family a joyful and prosperous festive season.

CA. Charanjot Singh Nanda
President, ICAI and Director,
ICAI RVO

UPCOMING TRAINING PROGRAMMES OF ICAI RVO

Date	Training Programme	Tentative Fees		Conducted by
		For Members of ICAI RVO	For others	
25-10-2025	Master Class on Valuation (Securities or Financial Assets)	₹472/-	₹944/-	ICAI RVO
29-10-2025	Continuous Educational Programme (Securities or Financial Assets)	₹236/-	₹472/-	ICAI RVO
30-10-2025 to 09-11-2025	50-Hour Educational Course (ON-LINE) (Securities or Financial Assets)	₹15,000 + GST @18%		ICAI RVO
12-11-2025	Continuous Educational Programme (Land & Building and Plant & Machinery)	₹236/-	₹472/-	ICAI RVO
13-11-2025 to 23-11-2025	50-Hour Educational Course (ON-LINE) (Land and Building)	₹15,000 + GST @18%		ICAI RVO
13-11-2025 to 23-11-2025	50-Hour Educational Course (ON-LINE) (Plant and Machinery)	₹15,000 + GST @18%		ICAI RVO
26-11-2025	Continuous Educational Programme (L&B, P&M and SFA)	₹236/-	₹472/-	ICAI RVO
26-11-2025	Training Programme for grant of Certificate of Practice (COP)	₹590/-	Not Applicable	ICAI RVO
05-12-2025	Continuous Educational Programme (Securities or Financial Assets)	₹236/-	₹472/-	ICAI RVO
11-12-2025 to 21-12-2025	50-Hour Educational Course (ON-LINE) (Securities or Financial Assets)	₹15,000 + GST @18%		ICAI RVO
23-12-2025	Continuous Educational Programme (Securities or Financial Assets)	₹236/-	₹472/-	ICAI RVO

Note: The schedule provided above is tentative and subject to change. For latest details, please visit https://icairvo.in

Please note:

- For each virtual training program, we can accommodate only as many participants as prescribed in IBBI Guidelines (CEP-200, COP-50, Educational Course-50, Refresher Training Programme-50). However, there is no limitation for live webcasts.
- The registration will be confirmed on first come first serve basis only on payment of fees through ICAI RVO portal. No other mode of payment will be accepted.
- For better clarity and clarification of your doubt, please read FAQs https://icairvo.in/faq-by-icai-rvo.aspx

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ARTICLE

DECODING RULE 11UA: PRACTICAL HURDLES AND INTERPRETATIVE PERSPECTIVES

CA. Hitendra Ranka

(The author is a Chartered Accountant, Insolvency Professional and a Registered Valuer. He can be reached out at hitendra.ranka@rankaassociates.com)

This article critically examines the limitations in applying Rule 11UA for valuing unquoted equity shares. It highlights the practical complexities and inconsistencies arising from the prescribed valuation formula and explores interpretative methodologies that align legal compliance with underlying economic realities striving for adherence to the statutory framework while enabling a more accurate and meaningful valuation approach.

1. INTRODUCTION: GOVERNING PROVISIONS

Section 56(2)(x)(c) of Income Tax Act, 1961 states that Income shall be chargeable to Income-Tax under the head Income From Other Sources (IFOS) where any person receives from any person(s) on or after April 1, 2017 any property other than immovable property,

(A) without consideration, the aggregate fair market value of which exceeds fifty thousand rupees, the whole of the aggregate fair market value of such property;

(B) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration.

Further, Rule 11UA(1)(c)(b) of Income Tax Rules, 1962, provides methodology to determine fair market value (FMV) of valuation of unquoted equity shares.

The fair market value of unquoted equity shares shall be the value, on the valuation date, of such unquoted equity shares as determined in the following manner, namely: the fair market value of unquoted equity shares = (A + B + C + D - L) × (PV)/(PE),

Where,

A = book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property) in the balance sheet as reduced by,—

i) any amount of income-tax paid, if any, less the amount of income-tax refund claimed, if any; and

ii) any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;

B = the price which the jewellery and artistic work would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer;

C = fair market value of shares and securities as determined in the manner provided in this rule;

D = the value adopted or assessed or assessable by any authority of the Government for the purpose of payment of stamp duty in respect of the immovable property;

L = book value of liabilities shown in the balance sheet, but not including the following amounts, namely:—

i) the paid-up capital in respect of equity shares;

ii) the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;

iii) reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;

iv) any amount representing provision for taxation, other than amount of income-tax paid, if any, less the amount of income-tax claimed as refund, if any, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;

v) any amount representing provisions made for meeting liabilities, other than ascertained liabilities;

vi) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;

PV = the paid-up value of such equity shares;

PE = total amount of paid-up equity share capital as shown in the balance sheet;

Further, Rule 11UA(1)(c)(c) of the Income Tax Rules, provides methodology to determine FMV of unquoted shares and securities other than equity shares in a company which are not listed in any recognised stock exchange shall be estimated to be price it would fetch if sold in the open market on the valuation date and the assessee may obtain a report from a merchant banker or an accountant in respect of such valuation, as mentioned in Rule 11UA(1)(c)(c).

2. INTERPRETATIONAL VARIANCES ARISING FROM ADJUSTMENTS UNDER RULE 11UA

2.1 Does an adjustment for Guideline value is required for ROU asset recognised as per Ind AS 116, Leases?

The Right of Use (ROU) asset, as per Indian Accounting Standards (Ind AS) 116, represents the lessee's right to use an underlying asset (such as land or building) for a specified lease term. The ROU asset is initially measured at the present value of future lease payments and is recognised on the balance sheet along with a corresponding lease liability. The ROU asset is subsequently depreciated over the lease term or the useful life of the asset, whichever is shorter.

Now, the question arises here is whether such ROU asset be considered as immovable property and whether any adjustment for guideline value (i.e., assessed or assessable by any authority of the Government for the purpose of payment of stamp duty in

respect of the immovable property) should be carried out as per Rule 11UA.

Possible views:

i) A ROU asset, as recognised in accordance with Ind AS 116 – Leases, merely represents the lessee's right to use an underlying asset (such as land or building) for a specified lease term. Crucially, it does not equate to ownership of the asset, nor does it confer discretionary rights to sell, transfer, or dispose of the underlying property. It is akin more to an intangible right than an ownership stake in an immovable property. Accordingly, it should be treated same as intangible asset, to be reflected at its book value in FMV computations under Rule 11UA.

ii) Alternatively, the ROU Asset can be considered at the guideline value of the underlying asset, aligning with the principles of conservatism and the concept of substance over form. This perspective becomes particularly relevant in the case of long-term leasehold lands such as 99 years leases granted by Government agencies which in practical terms, function similarly to freehold ownership. In many cases, such leasehold land is allotted by central or state governments for specific purposes such as infrastructure development, industrial parks, set of specific industries etc. Although these leases are technically not freehold, the rights conferred upon the lessee are extensive: including rights to construct, use and even transfer the leasehold interest in some cases. These rights span the entire economic life of the asset, leaving only limited administrative restrictions. Hence such long-term leasehold arrangements may be viewed as equivalent to ownership of immovable property. In such cases, continuing to reflect the asset at its historical cost, particularly if allotted decades ago at nominal or concessional rates may not reflect its actual economic value.

2.2 When FMV of further investment in unquoted equity shares determined under this Rule is Negative

This issue may particularly arise when investments in unquoted equity shares are recorded at cost in the company's books. However, the fair market value of such investments, as calculated under Rule 11UA, can often be negative, especially for early-stage or loss-making startups still striving to establish their market presence.

Possible views:

i) If the Company is legally obligated to fund the Investee Entity in case of its negative net worth, the investment should be considered at a negative value. This will be the case when investment in unquoted equity shares of subsidiaries is held.

ii) However, if no such obligation exists, the investment should be considered at nil value owing to the reason that investment is in fully paid-up equity shares and no further liability exists to the holders. Moreover, from conservative basis also, this view can be considered.

2.3 Multi-tier Investments

We often come across scenario where the company (FMV of whose equity shares is to be determined) further holds investments in shares and securities of other companies which in turn further hold investments and so on. This is typically referred as Multi-tier or Layered Investment structure. Now the question here comes is till what level the further investments will be evaluated in determining the FMV of equity shares of the main company.

Possible view:

The determination of fair market value should be based on materiality and judgment. Typically, valuation can be considered up to two layers of investment. For instance, if FMV needs to be determined for company A, and company A holds an investment in company B, which in turn holds an investment in company C, with company C further holding investment in company D, then

separate FMV calculations will be required for companies A, B, and C, reflecting valuation up to two layers of investment. When assessing the FMV of company C, company D may also be considered if its valuation is highly material in relation to company A.

2.4 Scenario where the FMV of Unquoted Securities other than Equity Shares is to be determined

This is a scenario where FMV is to be determined pursuant to transfer of unquoted shares and securities other than equity shares. As per Rule 11UA(1)(c)(c), the FMV in such case will be the price it would fetch if sold in the open market on the valuation date. Now the company whose FMV is to be determined say further holds investment in equity shares of other companies.

Let's understand with example:

Compulsorily Convertible Debentures (CCDs) of company A are being transferred and hence FMV as per the above stated Rule is to be determined using generally accepted valuation principles and standards. Further, company A holds investment in equity shares of company B. Question arises whether investment in equity shares of company B held by company A will be valued using the method prescribed under Rule 11UA(1)(c)(b) or 11UA(1)(c)(c)?

Possible views:

i) Primary purpose here is to value FMV of CCDs which will be as per applicable and relevant valuation principles and methods and accordingly valuation of equity shares of company B is just incidental and accordingly should be valued using same principles rather than Rule 11UA(1)(c)(b), as the primary objective here is to determine the value of the convertible instrument of company A, and there is no direct linkage to formula as per 11UA in this context.

ii) Alternatively, it could be argued that the nature of the securities involved necessitates a bifurcated approach, where CCDs are valued based on established valuation practices, while the equity shares of company B held by company A are separately valued using the prescribed formula under Rule 11UA for unlisted equity shares. This view emphasises strict adherence to the Rule's textual interpretation, potentially leading to differing valuation outcomes depending on the adopted approach.

First view presented here is more practical and appropriate owing to the fact that company A's value may also be significantly driven by value of company B. In that case following method prescribed under 11UA for company B might provide absurd result. More so, when company B is also a significant operating entity and company A's overall value consists of value of holding in company B.

2.5 Treatment of Taxes Receivable (Advance Tax and TDS Receivable) and Provision for Tax

The Rule says that any amount of income-tax paid, if any, less the amount of income-tax refund claimed, if any shall be excluded from the A portion of the formula prescribed in 11UA. Further, it also states that any amount representing provision for taxation, other than amount of income-tax paid, if any, less the amount of income-tax claimed as refund, if any, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto should also be reduced from the L portion in the formula.

There were many ambiguities in the interpretation of these provisions which largely can be described as under:

- What tantamount to tax payable on book profits?
- Whether taxes paid considered above should be excluded while considering tax payable on book profits?
- Sch III requires advance tax and Provision for Tax (PFT) for FY wise to be presented net in the Balance sheet. However, in notes, gross amounts can be disclosed.

- How refund claimed amount will be determined and adjusted?
- Clarity in this matter have been finally made in Supreme Court's judgement in the matter of Bharat Hari Singhania and Ors. Etc. vs Commissioner of Wealth Tax. Even Schedule III of the Companies Act, 2013 also states that provision for tax and advance tax should be presented as net and then gross amounts can be disclosed in notes. The objective of provision is to adjust any excessive provision from liabilities while computing FMV as per this Rule.

Possible views:

i) Both taxes paid and provision for tax are two sides of the same coin. These cannot be interpreted on individual basis. Since taxes paid is presented as net of provision for tax Financial Year (FY) wise, in one view, no further adjustment is required assuming that there are no excess tax provisions and advance tax presented in FY are claimed / to be claimed as Refunds. As per this view, no adjustment either from asset / liability is required.

ii) Other view can be where taxes paid unless received are not considered as refund claimed and accordingly, total taxes paid need to be reduced in portion A of Rule 11UA. This will though reduce FMV from Income Tax perspective.

This can be better understood with example:

AY	PFT	AT	Net ~ PFT / (AT)
2024-25	40	20	20
2025-26	50	100	(50)
Total	**90**	**120**	**(30)**

Now here in Financial Statements (FS) as per Sch – III, this will be presented as below

Assets – Advance Tax (Net) - (50)

Liabilities – PFT (Net) - 20

Following will be the number adjustments under above two views –

i) No adjustment required.

ii) Reduce 50 from A.

2.6 Treatment of the ESOP Reserve Part of Other Equity

The ESOP reserve represents the cumulative cost recognised in the books as per the applicable accounting standards — Ind AS 102 or AS 15 (as applicable) relating to share-based payments. This cost corresponds to the fair value of employee stock options (ESOPs) granted to employees and is recognised over the vesting period based on the number of options expected to vest. The reserve reflects a non-cash compensation expense and is presented under "Other Equity" / "Reserves and Surplus" (as applicable) in the Balance Sheet.

Possible views:

i) ESOP reserve represents an amount earmarked specifically for employees (against options granted), and not available to existing shareholders, it can be interpreted as an obligation / liability and reduced from balance of other equity or reserves and surplus (as applicable) and adjusted amount should be reduced from L. However, under Ind AS 102 (or AS 15), share-based payments are not considered liabilities unless the settlement is in cash. For equity-settled ESOPs, the standard treats them as equity transactions. This view is inconsistent with the accounting standards unless the ESOPs are cash-settled, in which case a liability classification is appropriate. Moreover, this will reduce the FMV.

ii) Alternatively, it should be recognised as part of other equity or reserve and surplus (not a liability) because it's a non-cash charge that will eventually convert to equity share capital when options are exercised. The reserve reflects the fair value of options granted, and upon exercise, it is transferred from ESOP Reserve to Share Capital and Securities Premium. While this view aligns with accounting principles, it may increase FMV per share subject to the increase in paid-up capital (PE) of formula prescribed under Rule 11UA due to the consideration of issuance of new shares upon exercise of ESOPs which can lead to a dilution. This dilution, while increasing the PE in the formula, will decrease the FMV per share.

2.7 Treatment of equity and liability component of compound financial instruments

Ind AS 32, Financial Instruments, requires entities to separate the liability and equity components of convertible instruments like CCDs on initial recognition. Assuming CCDs with mandatory coupon are issued for say 5 years and convertible into fixed number of shares at the end of their term are in nature of compound financial instruments. The liability component of CCDs is computed by discounting the interest cash outflows for 5 years at an applicable incremental borrowing rate for a comparable loan. The equity component would be measured at the residual amount, after deducting the fair value of the financial liability component from the fair value of the entire compound instrument.

For example, company A has issued 100 million in CCDs, of which, based on Ind AS accounting principles, 70 million has been recorded as a financial liability and 30 million has been recorded as equity.

Now what should be the treatment of the 30 million recorded in other equity and 70 million recorded in financial liability:

Possible views:

i) In one view, since the purpose is to carry out the FMV of equity shares, total balance of CCDs (including equity component) should be considered as liability. This view is similar to treatment of ESOP reserve as explained above. However, this may distort the FMV especially in case where majority of funding happens in the form of convertible instruments (CCPS, CCDs) which are substantially akin to equity shares. With this view, the entire net worth will be attributed to equity shareholders which may not be commercially true when same computed on fully dilutive basis.

ii) Alternatively, the equity component can be included within reserves and surplus, while simultaneously increasing the number of outstanding equity shares to reflect the probable future conversion of CCDs attributable to the current equity portion.

2.8 When the Capital structure consists of CCPS also

Compulsorily Convertible Preference Shares (CCPS) are hybrid financial instruments and have increasingly become a preferred mode of investment in the current market environment. While CCPS exhibit characteristics similar to equity shares, they offer preferential rights in terms of dividends and liquidation, distinguishing them from ordinary equity instruments. A key challenge arises in determining the fair market value of equity shares under Rule 11UA, particularly with respect to how CCPS should be treated in the capital structure during such valuation.

Possible views:

i) One view, though conceptually straightforward but often impractical, is to classify CCPS as liabilities when computing the fair market value (FMV) of equity shares. However, this approach may not accurately reflect the true economic substance of the instrument. Furthermore, such classification could result in a disproportionately higher FMV for equity shares compared to a valuation method that considers equity on a fully diluted basis.

ii) An alternative and more nuanced view consider the presentation of CCPS under Ind AS, where they are often classified as "equity instruments entirely in nature," especially when they involve fixed-to-fixed conversion terms and do not carry any obligation for mandatory dividends or interest payments. From this standpoint, treating CCPS as liabilities may be inappropriate, which aligns with the economic substance of CCPS as quasi-equity instruments, appears more appropriate and reflective of market realities. Again, here also, conversion ratio if different from 1:1, will need to be appropriately adjusted for.

2.9 How should share application money pending allotment be classified under Rule 11UA?

In our view, since share application money has been received but no allotment has taken place, the amount should be classified as a liability as no shares have been issued as of the valuation date.

2.10 Treatment of investment in share warrants of listed entity

Sometimes company invest in share warrants of a listed entity as per the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 (SEBI -ICDR) applicable. In such scenarios, an initial investment to the extent of 25% of share price is made and balance is paid on exercise which is within 18 months. How this need to be treated under this Rule.

Possible views:

i) In one view, this can be revalued considering quoted price of the share on the date of valuation and considering in proportion to initial money paid against these warrants. Let's say the investment in the warrant was made when the price of the share was ₹100, and ₹25 was paid initially. On the valuation date, if the price of the share goes down to ₹80, then the fair value of such warrants shall be ₹20 (calculated as ₹25/₹100×₹80=₹20).

ii) Another view, could be since warrants give holders an option to convert these into shares at future date at the exercise price as determined now, this can be valued using the value it will fetch in open market since these are considered as other than equity shares and accordingly, an option pricing model can be used for its analysis. However, please note that this is very complex and judgement should be applied considering the materiality.

2.11 Adjustment related to DTA / DTL

Deferred Tax Asset / Deferred Tax Liability (DTA / DTL) represent timing differences that result in future tax benefits (reduced tax outflows) and future tax obligations (increased tax outflows), respectively. These are recognised on a net basis as either assets or liabilities in accordance with the relevant accounting standards and principles.

Possible views:

i) One view is that a DTA is a notional or non-cash asset and therefore should be excluded from the computation of assets under Rule 11UA. Similarly, any DTL should also be excluded on the same grounds.

ii) An alternative perspective suggests that DTA / DTL, being audited carried-forward balances with a reasonable certainty of future reversal, are akin to other ascertained liabilities or provisions. Therefore, they should be considered legitimate components of the balance sheet and not be adjusted or excluded in the computation of FMV under Rule 11UA.

2.12 Treatment of Contingent Liability in Rule 11UA Calculation:

How should contingent liabilities disclosed in the audited or provisional financial statements of the Company be treated while performing valuation under Rule 11UA of the Income Tax Rules?

Possible views:

i) If the audited or provisional books of the Company merely disclose a contingent liability, then no adjustment is required in the Rule 11UA calculation. This is because the Company has only provided a disclosure, and the financial statements do not reflect any actual obligation. Since both the management and the auditor have taken a considered view on such disclosure, we should not override their assessment by recording any obligation related to the contingent liability in our Rule 11UA valuation.

ii) However, if the Company has already recorded an obligation in its financial statements for the given contingent liability, that itself serves as confirmation that a probable obligation exists. In such a case, it is no longer considered a contingent liability, and accordingly, no further adjustment is required in the Rule 11UA calculation.

3. CONCLUSION

The primary objective of Rule 11UA is to prevent tax abuse and avoidance, not to penalise genuine transactions that reflect economic substance. This article examines possible interpretations of the Rule, with a focus on minimising valuation distortions in practical scenarios. While not exhaustive, the perspectives shared aim to provide balanced guidance until the law evolves further taking into account developments such as Ind AS framework, modern capital structures owing to investments by private equity and venture capital firms.

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EXCHANGE CONTROL OVERSIGHT AND VALUATION SCRUTINY- WAKE-UP CALL

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The recent ruling in HDFC Bank Ltd. vs. Directorate of Enforcement ([2025] 174 taxmann.com 707) by the Appellate Tribunal for SAFEMA has far-reaching implications for stakeholders in cross-border transactions, especially with professional Valuers engaged in share valuation and authorised dealers. It marks a watershed moment. The tribunal's decision reinforces the responsibility of Authorised Dealers (ADs), valuation professionals, and financial institutions under the Foreign Exchange Management Act (FEMA), 1999. This article analyses the case and its implications for valuation practice and regulatory compliance.

1. INTRODUCTION: BACKGROUND OF THE CASE

The case emerged from the Supreme Court-monitored investigation into Amrapali Group's affairs. JP Morgan invested ₹85 crore in Amrapali Zodiac Developers Pvt. Ltd. through a subscription to equity shares at a premium of ₹1071.81 per share. After the lock-in period, these shares were repurchased through shell entities at prices ranging from ₹2290 to ₹2910 per share, despite Amrapali having no history of distributable profits. HDFC Bank facilitated an outward remittance of ₹140 crore to JP Morgan based on a valuation certified by a Chartered Accountant using the Discounted Cash Flow (DCF) method. The core issue centered on the Discounted Cash Flow (DCF) methodology used to justify share values of Rs. 2,290-2,910 per share (face value Rs. 10) for exit, compared to the original investment price of Rs. 1,071.81 per share, despite the company showing no distributable profits during the holding period.

The Enforcement Directorate alleged violations of:

- Section 6(3)(b) – governing the transfer or issue of securities to persons outside India.
- Section 10(5) – placing a duty on Authorised Dealers to verify the bona fides of foreign exchange transactions.
- Section 47(3) and Regulation 11(2)(b) of the 2000 FEMA Regulations – relating to conditions under which sale proceeds of securities may be remitted.

While the Tribunal reduced the penalty on HDFC Bank from ₹14 crore to ₹1.4 crore, it upheld the finding of non-compliance, citing that the bank blindly relied on the valuation report without exercising the statutory due diligence required under FEMA.

2. KEY TAKEAWAYS FOR VALUATION PROFESSIONALS

i. Due Diligence Is Not Optional

The tribunal categorically rejected HDFC Bank's defense that it had "no authority to question" the valuation report. The judgment states:

"The appellant could not have relied on the report of the CA with blind eyes rather call for information for compliance of Section 10(5) of the Act to make proper analysis of the value of the share because exemption of prior approval of RBI was not absolute but conditional."

The tribunal emphasised that under Section 10(5) of FEMA, authorised persons must ensure transactions don't involve contraventions. This creates a proactive obligation to investigate suspicious circumstances. This establishes that authorised dealers cannot simply act as "post offices" for remittances. They must exercise independent judgment and seek additional information when valuations appear questionable, particularly when there are obvious red flags such as astronomical price increases without corresponding business justification.

Valuers must go beyond mathematical models. In this case, the DCF method was applied without credible financial data. The investee company had no history of profits, yet a premium exit value was certified. The tribunal noted this as a misuse of the DCF method to justify inflated valuations.

ii. Access to Information and Professional Skepticism

The judgment reveals that the professional conducting the valuation was denied proper access to records by JP Morgan's office yet proceeded with the valuation. The tribunal noted:

"The partner of the Chartered Accountant Firm informed that JP Morgan office did not allow to take any of the details/abstract from the share purchase agreement at the time of exit."

This establishes that proceeding with valuations without adequate access to supporting documentation can result in regulatory consequences, not just for the relying party but potentially for the valuer as well. The CA lacked access to the full Share Purchase Agreement and critical financial information. Professional skepticism was missing. A valuer must refuse or qualify a report if access to data is restricted.

iii. Valuation Reports Have Regulatory Consequences

When valuation reports are used for FEMA compliance, they must withstand regulatory scrutiny. A certificate under FEMA is not a formality—it's a declaration of fair market value with wide legal implications.

iv. DCF Is Not a Catch-All Method

DCF requires robust and defensible cash flow projections. In the absence of revenue or realistic future profitability, applying DCF can be misleading. Alternative methods such as Net Asset Value (NAV) or Comparable Companies Method (CCM) might be more appropriate in such cases.

3. LESSONS FOR VALUATION PRACTICE

i. Documentation, Access Requirements and Disclosures Are Critical

The case underscores that valuers must:

- Demand complete access to all

relevant documentation

- Explicitly state limitations in valuation reports when access is restricted
- Refuse to proceed with valuations when critical information is withheld
- Maintain detailed working papers documenting all requests for information and responses received
- A conclusion that is logically defensible and consistent with market realities.

ii. DCF Methodology Scrutiny

The tribunal's criticism of the DCF application provides important guidance:

- Ensure cash flow projections are based on realistic business assumptions
- Verify that projected profits align with the company's actual business model and track record
- Question astronomical valuations that lack fundamental business justification
- Consider alternative valuation methods as cross-checks

iii. Professional Skepticism in Cross-Border Transactions

The judgment highlights the need for enhanced professional skepticism when:

- Valuations involve recently incorporated entities with limited operating history
- Share prices show dramatic variations within short timeframes without business justification
- Transactions involve complex structures with shell companies
- Foreign investors seek to exit at multiples significantly higher than entry valuations

iv. Investigations and Compliance:

This mandates that a valuer must thoroughly verify the information provided. If there are missing data or restrictions (as in this case), the valuer must raise these concerns and qualify the report. Blind acceptance of incomplete or unverifiable data is not acceptable under this standard.

4. REGULATORY COMPLIANCE AND PROFESSIONAL ACCOUNTABILITY

The case highlights the critical role Valuers play in upholding the integrity of cross-border transactions. Where transactions involve repatriation or remittance under FEMA, valuation professionals must:

- Maintain independence and objectivity.
- Refuse engagements where access to data is incomplete.
- Avoid issuing reports that cannot be defended in a regulatory forum.

5. DCF METHOD: VALUATION BEST PRACTICES AND COMPLIANCE CONSIDERATIONS

DCF is a widely accepted and powerful valuation tool. However, it demands rigorous application. Based on ICAI Valuation Standards and best practices, the following considerations must be kept in mind:

5.1 DO's for DCF Valuation (Expanded)

i. Do ensure cash flow projections are supportable and market-based

DCF valuation hinges on the accuracy and credibility of forecasted cash flows. Projections should be derived from robust financial models that consider historical data, industry benchmarks, macroeconomic trends, and management plans. Reliable data is the backbone of accurate financial projections because it ensures that the forecasts are grounded in reality rather than guesswork.

- ICAI Ref: VS 103, Para 62–64 emphasizes basing projections on actual business data (e.g., profit & loss, cash flow, and balance sheets), applying critical analysis to assumptions used.

Choosing the Right Type of Cash Flow for Valuation

When conducting a valuation, selecting the appropriate form of cash flow is a critical decision that directly influences accuracy and credibility. The chosen cash flow type must align with the nature of the asset, and inputs such as the discount rate must remain consistent with this selection. IVS 103 Valuation Approaches : Appendix (2025) para A20.05 explains key factors a valuer must consider:

- **Cash Flow Level:** While cash flow to the entire asset is typically preferred—since it reflects value independent of capital structure—other forms, like cash flow to equity or dividends, may be used in specific contexts.
- **Tax Basis:** Cash flows can be presented pre - or post-tax. The tax assumptions must match the valuation basis, often using a general market participant rate instead of an individual owner's tax rate.
- **Nominal vs. Real Terms:** Real cash flows exclude inflation, while nominal ones incorporate inflation expectations. Consistency is crucial—if inflation is built into projected cash flows, it must be reflected in the discount rate as well.
- **Currency Considerations:** The currency used for projections can significantly impact assumptions around inflation and risk, particularly in high-inflation or emerging markets. Forecast currency risk is distinct from geopolitical or country-related risks.
- **Cash Flow Type:** The forecast might include different forms of cash flow, such as probability-weighted outcomes, most likely scenarios, or fixed contractual flows. The choice should reflect the expected economic reality of the asset.

ii. Determine an appropriate explicit forecast period.

The projection horizon should align with how long it will take the business or asset to reach a steady or normalised performance level. This typically spans 3 to 10 years but should be determined based on industry dynamics, asset lifecycle, and growth expectations.

- ICAI Ref: VS 103, Para 67 outlines that the projection period depends on the nature of the asset, its economic life, and data reliability.
- When Forecasting May Be Skipped in Valuation
- If an asset is already at a stable growth and profit level, an explicit forecast period may not be required. In such cases, valuers can rely solely on the terminal value, using what's known as the income capitalisation method.
- Also, while the time an investor plans to hold the asset shouldn't determine its value, it may influence the forecast period if the goal is to estimate the asset's investment value.

iii. Do match the discount rate to the risk profile of the asset.

The discount rate should reflect the time value of money and the specific risk profile of the asset being valued. This involves using WACC, cost of equity, or other methods depending on the cash flow type (FCFF or FCFE). The discount rate should incorporate the asset-specific risks and not be arbitrary.

- ICAI Ref: VS 103, Paras 69–73 provide guidance on selecting discount rates, recommending methods like CAPM or build-up approaches for estimating cost of capital.

Considering Risk in Cash Flow Forecasts and Discount Rate

Valuers must assess the risk of achieving forecasted cash flows when determining the discount rate, ensuring that such risks are properly reflected.

Key procedures include[2]:

- Comparing forecast components with historical data, industry trends, and regional growth expectations.

[1] IVS 103 Valuation Approaches: Appendix (2025) para A20.10 & A20.11

- Clarifying if forecasts are probability-weighted, most-likely, or based on other models.
- Evaluating the range (dispersion) of outcomes if using expected cash flows.
- Reviewing past forecast accuracy, considering qualitative factors and market indicators.
- Factoring in environmental and other relevant risks.

If risks aren't fully captured in the discount rate, valuers must either[3]:

- Adjust the forecast, with justifications and supporting analysis, or
- Adjust the discount rate, explaining why forecast changes weren't viable and supporting the adjustment with available data.

iv. Calculate and explain terminal value explicitly.

The terminal value is often the largest component of a DCF valuation and should be computed using justified assumptions about long-term growth. Approaches such as Gordon Growth Model or Variable Growth Model or Exit Multiple or Salvage Liquidation Method are accepted, depending on the context.

- ICAI Ref: VS 103, Para 74–83 elaborate on the need to use consistent assumptions and align with industry practices in terminal value calculation.

v. Do apply professional skepticism in evaluating management forecasts.

Valuers must critically assess management's projections, identify any inherent bias, and, where needed, make adjustments. They are not certifying the accuracy of projections but must perform adequate due diligence. Valuers must conduct their work with professional skepticism—maintaining a questioning mindset and critically assessing all information. This attitude helps detect possible misstatements, unreliable data, or misleading representations. It also safeguards against hasty assumptions, faulty judgments, and missed red flags during evidence collection and analysis throughout the valuation process. The valuer must apply an appropriate level of professional scepticism at every stage of the valuation.

- ICAI Ref: VS 103, Para 66 states that while the valuer may rely on projections, they must not be deemed responsible for them and must conduct reasonable analysis.

A valuer must apply professional judgment when selecting valuation approaches, methods, and procedures. If external constraints overly restrict these choices, the resulting valuation may fail to comply with International Valuation Standards (IVS)[4].

vi. Cross-Check with Other Methods:

No single valuation method should be regarded as infallible. Applying a secondary approach alongside the primary method serves as a validation tool, enhancing the credibility of the conclusion. For instance, after deriving a value using the Discounted Cash Flow (DCF) method, a valuer may cross-check with a Market Approach (e.g., Comparable Companies or Transactions) or an Asset Approach (e.g., Net Asset Value).

In valuation practice, rules of thumb or benchmark indicators are sometimes applied as a reasonableness check against values derived from other approaches. These may include industry norms such as transaction multiples based on capacity, turnover, or other sector-specific benchmarks. While such indicators can provide useful insight into the value of a business or ownership interest, they should not be used as the sole basis for determining value.

However, ICAI VS 301: Business Valuation para 42-46 clarifies that results from rules of thumb must be given limited weight unless supported by other valuation methods and demonstrably relied upon by knowledgeable market participants. Further, valuers are required to clearly present in their reports the rationale and support for the methods used.

When different methods yield results within a

[2] IVS 103 Valuation Approaches: Appendix (2025) para A20.37
[3] IVS 103 Valuation Approaches: Appendix (2025) para A20.38
[4] IVS 103 Valuation Approaches para 10.11

reasonable range, it strengthens confidence in the valuation outcome and demonstrates robustness. Conversely, significant divergences signal the need for deeper analysis. The valuer must examine whether gaps arise from unrealistic assumptions, data limitations, or inherent constraints of a particular method. In such cases, transparent disclosure and a reasoned justification of the final conclusion are essential.

Cross-checking is not only good practice but also aligns with the principle of professional judgment under ICAI VS, which requires method selection based on facts and circumstances also calls for applying professional scepticism to assumptions and forecasts.

By incorporating cross-checks and clearly explaining variances, valuers deliver conclusions that are defensible, credible, and capable of withstanding scrutiny from regulators, investors, and courts.

5.2 DON'Ts for DCF Valuation

i. Don't base projections on unrealistic or biased assumptions and blindly extrapolate past performance into future cash flows.

Historical trends may not continue due to changing economic, competitive, or regulatory environments. Projections must reflect realistic expectations, not optimistic assumptions based on past results. Avoid excessive optimism or projections that are not aligned with current market and economic conditions.

- ICAI Ref: VS 103, Para 64 warns that the future should not be a linear extension of the past and must factor in expected changes.

ii. Don't include control premium if DCF already reflects control value.

The DCF model typically assumes that the owner has control over cash flow decisions. Adding a control premium separately would result in double counting.

- ICAI Ref: VS 103, Para 59 explicitly mentions that DCF already reflects the value of control, and adding a premium is inappropriate.

iii. Don't mismatch types of cash flows and discount rates.

Internal consistency between cash flow type and discount rate should be avoided. Applying WACC (which reflects overall capital structure) to equity cash flows or using cost of equity for enterprise cash flows leads to erroneous results.

- ICAI Ref: VS 103, Para 57(c) states that Free Cash Flows to the Firm (FCFF) must be discounted using WACC, while Free Cash Flows to Equity (FCFE) should use the cost of equity.

iv. Don't overlook working capital and capital expenditure in cash flow projections.

Ignoring these elements overstates available free cash flows. Adjustments for changes in working capital and necessary reinvestments are crucial for a fair DCF model. Further for arriving at the cash flows, non-cash expenses, such as depreciation and amortisation, shall be added back. Cash flow should reflect ongoing investments and cash needs.

- ICAI Ref: VS 103, Para 63 requires incorporating working capital, tax, and CapEx to arrive at true free cash flow.

v. Don't use terminal value as a plug.

- Terminal value should not be used to compensate for unrealistic short-term projections or to force alignment with a desired value.

vi. Don't ignore the impact of taxes and reinvestment needs.

- Cash flows must be net of taxes and adjusted for capital expenditure and working capital.

vii. Don't use terminal value as a plug.

- Terminal value should not be used to compensate for unrealistic short-term projections or to force alignment with a desired value.
- Terminal value, a key component of DCF, can be estimated using methods such as: Gordon Growth

(assumes perpetual growth at a stable rate), Variable Growth (allows for differing growth rates over time before stabilising), Exit Multiple (applies valuation multiples (e.g., EV/EBITDA) based on market comparable), or Salvage/Liquidation Value. The choice depends on the business nature, industry conditions, and data availability.

viii. **Don't omit disclosure of key inputs and sensitivities.**

- Summary lists three key DCF components: cash flow projections, discount rate, and terminal value. Each requires disclosure to understand the derived value.
- Sensitivity analysis is implied as part of due diligence and robust reporting, especially where projections are based on volatile or critical assumptions.

ix. **Don't rely solely on software or automated models without applying judgment.**

DCF valuation involves numerous assumptions and qualitative judgments. Over-reliance on tools without analytical review leads to superficial or misleading conclusions.

- ICAI Ref: VS 103, Para 65 advises use of ratio and trend analysis and comparison with industry benchmarks to validate projections.

  In all cases the valuer must apply professional judgement and professional scepticism in the selection and use of valuation models and the application of inputs used in the valuation model[5].

6. Valuation Process Quality Control

Robust quality control is an essential element of sound valuation practice. IVS[6] require that valuation process quality controls be in place to ensure that valuations are performed objectively, transparently, without bias, and in compliance with IVS.

The extent of such controls should be aligned with the intended use of the valuation, the intended users, the characteristics of the asset or liability being valued, and the complexity of the engagement. Quality controls must specifically assess the reasonableness and independence of the judgments applied in determining value.

Equally important, these controls should be formally documented, with sufficient detail to allow another valuer in applying professional judgment and to understand their design & effectiveness. IVS further recommends periodic assessment of these controls to confirm their ongoing integrity and completeness.

Where valuation risks are identified, the valuer may design additional monitoring procedures to strengthen compliance and safeguard objectivity. Ultimately, the valuer must conclude that, given the controls in place, the level of valuation risk is appropriate for the intended purpose and users of the valuation.

7. CONCLUSION

The HDFC Bank judgment serves as a crucial reminder that regulatory compliance cannot be achieved through mechanical adherence to documentation requirements alone. It demands substantive analysis, professional judgment, and active engagement with the underlying business realities of transactions.

For chartered accountants, the decision underscores the importance of maintaining professional independence and exercising appropriate scepticism, even when facing client pressure or access restrictions. It is a reminder of the ethical and statutory obligations that come with professional roles. Valuation professionals must uphold the highest standards of diligence, especially when their opinions form the basis for regulatory decisions.

This judgment should serve as a catalyst for reinforcing internal controls, improving documentation standards, and developing a culture of accountability across the valuation and banking ecosystems. As the regulatory environment continues to evolve, success will require not just technical compliance but a commitment to the spirit of regulations designed to protect India's foreign exchange reserves and prevent economic crimes.

The reduction in penalty from Rs. 14 crores to Rs. 1.4 crores, while significant, should not overshadow the fundamental finding of contravention. It serves as both a warning and an opportunity for the industry to elevate its standards and practices to meet the expectations of an increasingly sophisticated regulatory environment.

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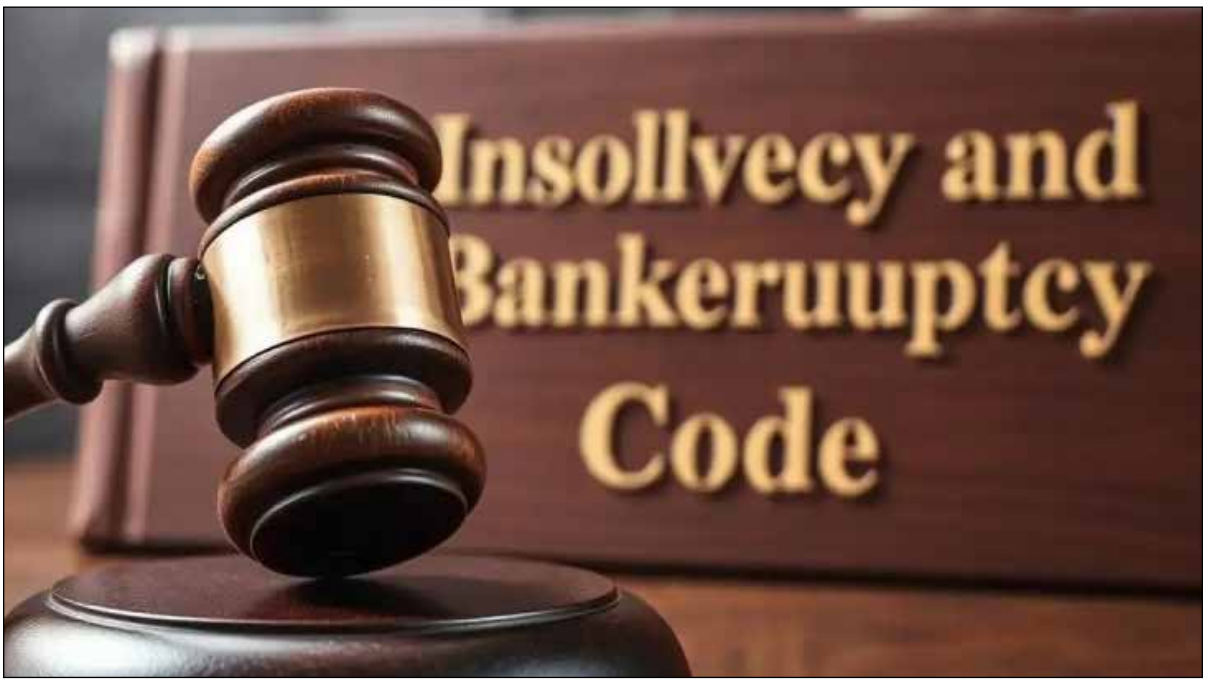
[5] IVS 105 Valuation Models (2025) para 10.05
[6] IVS 100 Valuation Framework (2025) para 20

ARTICLE

THE GREAT INDIAN TURNAROUND: IBC RESCUES COMPANIES AND SECURES THE ECONOMY



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India's Insolvency and Bankruptcy Code (IBC), 2016, represents a pivotal economic reform, replacing a fragmented and inefficient pre-existing insolvency regime with a consolidated, time-bound framework. The Code's core objective is the revival of distressed companies, shifting the paradigm from a 'debtor in control' to a 'creditor in control' model to maximize asset value. This is achieved through the Corporate Insolvency Resolution Process (CIRP), a market-driven mechanism where the Committee of Creditors (CoC) makes key decisions based on their commercial wisdom. Central to this process is the mandatory and crucial role of IBBI-Registered Valuers, who provide independent assessments of a company's Fair Value and Liquidation Value, forming the financial bedrock for all resolution plans. While facing challenges like procedural delays, the IBC has successfully improved recovery rates, instilled a new culture of credit discipline among promoters, and strengthened the nation's banking sector, thereby preserving economic value, and supporting overall financial stability.

1. INTRODUCTION: A SECOND CHANCE

Imagine a sprawling steel plant, once the heart of a thriving industrial community, now fallen silent. Its colossal furnaces are cold, its production lines still. Thousands of jobs hang in the balance, and a consortium of banks faces the staggering loss of billions of dollars in loans. This was the reality for giants like Bhushan Steel and Essar Steel, industrial titans on the brink of collapse, threatening to pull a significant part of the

Indian economy down with them. For years, such a scenario would have meant a slow, agonising death for the company, a protracted legal battle ending in the piecemeal sale of rusted machinery for a fraction of its worth.

Today, the Insolvency and Bankruptcy Code, 2016 (IBC)—a landmark law that is less about corporate death and more about a corporate rescue mission. The IBC is not a traditional bankruptcy law designed to liquidate companies; it is a modern, time-sensitive framework engineered for revival and resolution. It represents a fundamental shift in India's economic philosophy, moving from a system that often-protected failed promoters to one that prioritises the preservation of economic value. Before the IBC, the laws governing corporate failure inadvertently created a "debtor in control" model, where the very management, that ran a company into the ground, could cling to power for years, overseeing the steady erosion of its value. The IBC flipped this script, instituting a "creditor in control" model that displaces the old management and places the company's fate in the hands of those who have the most to lose: the lenders. This radical reorientation was more than a procedural tweak; it was an ideological statement that a business, as a vital economic entity, has a value, separate from its original owners. The IBC was designed to salvage that value for the good of the entire economy, a process critically dependent on the expertise of IBBI-Registered Valuers to accurately assess that value. This article explores how IBC fundamentally changed India's economic landscape.

2. BEFORE THE RESCUE: A SYSTEM IN DISARRAY

Prior to 2016, India's insolvency framework was a chaotic and fragmented landscape governed by a "patchwork of legislations". Ailing companies and their creditors were forced to navigate a maze of conflicting laws, including the Sick Industrial Companies (Special Provisions) Act (SICA), 1985, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, and various provisions within the Companies Act, 2013. The result was akin to a critically ill patient being sent to multiple doctors, each prescribing a different and sometimes contradictory treatment, while the patient's health continued to decline.

This systemic dysfunction had severe consequences that reverberated through the economy.

3. ENDLESS DELAYS AND VALUE EROSION

The most glaring failure of the old regime was the extraordinary delay in resolving cases. The average resolution took a staggering 4.3 to 4.5 years, earning the system the moniker of a "defaulter's paradise". While legal proceedings languished in overburdened courts, the physical assets of the distressed company—its plants, machinery, and inventory—would literally rust away. Also, equally devastating erosion of intangible value, as market position, brand reputation, and customer relationships disintegrated over time.

This environment created a perverse incentive structure that actively rewarded default. The pre-IBC system was not merely inefficient; it was a system where delay became a strategic weapon for unscrupulous promoters. A rational debtor, facing a weak creditor who knew a 4.5-year legal battle would yield a recovery of just 20-26 cents on the dollar, could exploit these delays. By prolonging the process, the debtor ensured that the company's value would decline further, strengthening their own negotiating position and often forcing creditors to accept a meagre settlement to avoid a total loss. This cycle didn't just fail to resolve insolvency; it actively undermined the culture of credit discipline, posing a systemic risk to the entire financial ecosystem.

4. THE NPA CRISIS

The direct consequence of this broken system was the ballooning Non-Performing Assets (NPAs) crisis that was crippling India's banking sector. With recovery rates hovering at an abysmal 20-26%, banks, particularly public sector banks, were saddled with mountains of bad debt that choked their ability to lend and fuelled economic stagnation. The old framework was endangering the health of the nation's financial backbone.

5. THE IBC PLAYBOOK: A GUIDE TO THE TURNAROUND

The IBC introduced a structured, time-bound, and market-oriented process for resolving corporate

distress, known as the Corporate Insolvency Resolution Process (CIRP). This playbook was designed to replace chaos with clarity, delay with speed, and bureaucracy with commercial decision-making.

Step 1: The Trigger

The process begins when a company defaults on a debt of ₹1 crore or more. An application to initiate the CIRP can be filed with the National Company Law Tribunal (NCLT)—the dedicated adjudicating authority—by one of three parties: a financial creditor (like a bank), an operational creditor (like a supplier), or the corporate debtor itself.

Step 2: The "Calm Period" - Moratorium

Once the NCLT admits the case, it immediately declares a moratorium. This acts as a crucial "pause" button, imposing a "calm period" during which all lawsuits, recovery actions, and enforcement of security interests against the company are halted. This prevents a chaotic "race to collect" by individual creditors, preserving the company's assets as a cohesive whole and allowing for an orderly resolution process.

Step 3: A New Crew Takes the Helm

The admission of a case triggers a fundamental shift in control.

- **The Resolution Professional (RP):** The NCLT appoints an independent, IBBI-regulated Insolvency Professional to oversee the process. This individual, first as an Interim Resolution Professional (IRP) and then confirmed as the Resolution Professional (RP), takes control of the company's management from the erstwhile promoters. The RP's primary duty is to run the company as a going concern, protect its assets, and facilitate the entire resolution process, acting as a neutral "turnaround CEO". A key early responsibility of the RP is to appoint IBBI-Registered Valuers to assess the company's assets.
- **The Committee of Creditors (CoC):** The RP constitutes a Committee of Creditors, which comprises the company's financial creditors (primarily banks and financial institutions). The CoC becomes the new supreme decision-making body, effectively acting as the "new board of directors" that will determine the company's ultimate fate. This transfer of power to a committee of commercial lenders, rather than a court, is a core innovation of the IBC, ensuring that decisions are driven by business logic and the goal of value maximisation is achieved.

Step 4: The Role of the Registered Valuer

To make informed decisions, the CoC needs a clear, independent, and credible assessment of the company's worth. This is where the role of the IBBI-Registered Valuer becomes paramount. Valuation is a mandatory and critical component of the CIRP, providing the financial foundation upon which all resolution plans are built and evaluated.

Within seven days of their appointment, the Resolution Professional must appoint two independent Registered Valuers. These valuers must be registered with the IBBI under the specific asset class relevant to the corporate debtor, such as Land and Building, Plant and Machinery, or Securities and Financial Assets. To ensure independence, valuers cannot be a relative of the RP, a related party of the corporate debtor, or a recent auditor of the company.

The valuers are tasked with determining two crucial metrics as of the insolvency commencement date, in accordance with internationally accepted valuation standards:

- **Fair Value:** This is the estimated price the assets would fetch in an orderly, arm's length transaction between a willing buyer and a willing seller, assuming proper marketing. It represents the optimistic, "going-concern" value of the enterprise.
- **Liquidation Value:** This is the estimated distress-sale price if the assets were sold off piecemeal. This represents the pessimistic, "worst-case scenario" value and serves as a critical baseline. Under the IBC, any resolution plan must ensure that operational creditors and dissenting financial creditors receive at least what they would have realised in case of a liquidation.

This process is fraught with challenges. Valuers often face significant hurdles, including limited access to documents and premises, uncooperative management, and compromised key personnel, all within a very limited timeframe. Valuing intangible assets like brands and patents, which are often not explicitly recognised in the IBBI's asset classes, presents a further layer of complexity and a significant regulatory gap. If the two valuations for an asset class differ by 25% or more, the RP may appoint a third valuer, with the final value being the average of the two closest estimates. The valuer's report, which must be kept confidential, is a common cause of disputes and delays, making accuracy and professional scepticism essential to avoid reputational loss and ensure a fair process.

Step 5: The Rescue Plan (Resolution Plan)

With the valuation in hand, the RP invites bids, known as resolution plans, from potential rescuers or "Resolution Applicants." These plans are comprehensive proposals that detail how the applicant intends to revive the company. This can involve restructuring debt, infusing new capital, changing management, or selling off certain assets, all while outlining how much of the outstanding debt will be paid to various classes of creditors.

Step 6: The Final Vote

The CoC evaluates the submitted resolution plans for their feasibility and viability, guided by the fair value and liquidation value reports, provided by the Registered Valuers. A plan must be approved by a supermajority vote of at least 66% of the CoC by voting share. This critical decision, based on the collective "commercial wisdom" of the lenders, is then submitted to the NCLT for final legal sanction. Once approved by the NCLT, the plan is legally binding on all stakeholders, including those who voted against it.

Stage of Process	Key Action	Statutory Timeline	Relevant IBC Section(s)
1. Initiation	Creditor/Debtor files application with NCLT.	N/A	Sections 7, 9, 10
2. Admission	NCLT admits or rejects the application.	Within 14 days of filing	Sections 7(4), 9(5), 10(4)
3. IRP & Moratorium	NCLT appoints Interim Resolution Professional (IRP); Moratorium begins.	On Admission (Day 0)	Sections 13, 14, 16
4. Public Announcement	IRP makes a public announcement inviting claims from creditors.	Within 3 days of appointment	Section 15
5. CoC Formation	IRP verifies claims and constitutes the Committee of Creditors (CoC).	Within 30 days of admission	Section 21
6. RP Appointment	CoC confirms IRP as RP or appoints a new RP.	In the first CoC meeting	Section 22
7. Resolution Plan	RP invites and receives resolution plans from applicants.	Within 90-180 days of admission	Sections 25, 29
8. Plan Approval	CoC approves a resolution plan with a ≥66% vote.	Within the 180-day period	Section 30
9. Final Adjudication	NCLT approves the plan, making it legally binding.	Total process must be completed within 180 days (extendable by 90 days).	Section 31
10. Outer Limit	The entire process, including extensions and litigation, must be completed.	330 days	Section 12

Table based on information from Insolvency and Bankruptcy Code, 2016

6. ANATOMY OF A TURNAROUND: THE ESSAR STEEL SAGA

The case of Essar Steel provides a powerful real-world illustration of the IBC in action, showcasing its strengths, its legal complexities, and its profound impact on India's corporate landscape. As one of the first twelve large NPA cases directed by the Reserve Bank of India for resolution under the new Code, Essar Steel was a true test of the IBC's mettle, involving a staggering debt of over ₹49,000 crore and a highly complex, valuable asset.

The initiation of the CIRP triggered an intense bidding war between global steel giants Arcelor Mittal and Numetal. This fierce competition immediately validated a core premise of the IBC: that a transparent and predictable framework could create a genuine market for distressed Indian assets, attracting serious international players willing to invest significant capital. However, the process was far from smooth. It was beset by legal challenges, most notably concerning the eligibility of the bidders under Section 29A of the Code, a provision designed to prevent defaulting promoters from buying back their companies at a discount.

Through this legal labyrinth, the Committee of Creditors (CoC) played a decisive role. After extensive negotiations and evaluations, the CoC, exercising its business judgement, voted overwhelmingly in favour of Arcelor Mittal's resolution plan, which promised the highest recovery for creditors. The plan, however, was challenged at the National Company Law Appellate Tribunal (NCLAT), which ruled that financial creditors and operational creditors must be treated equally in the distribution of proceeds, a decision that upended the established hierarchy of credit.

The matter inevitably reached the Supreme Court, which delivered a landmark judgement that defined the contours of the IBC. The Court decisively quashed the NCLAT's order, establishing two critical legal principles:

i) **Supremacy of the CoC's "Commercial Wisdom":** The Court ruled that the CoC's decisions on commercial matters, including the feasibility of a resolution plan and the manner of distributing funds among creditors, are paramount and not open to judicial review. The role of the NCLT and NCLAT is limited to ensure that the plan complies with the law, not to second-guess the business decisions of the lenders.

ii) **Flexibility of the 330-Day Timeline:** While affirming the importance of a time-bound process, the Court struck down the mandatory nature of the 330-day deadline. It reasoned that in exceptional circumstances, where delays are caused by prolonged litigation, the timeline can be extended to ensure that value maximisation and resolution are not sacrificed at the altar of a rigid deadline.

The Essar Steel judgement was a monumental victory for the IBC framework, empowering creditors and providing clarity.

7. THE SCORECARD: EIGHT YEARS ON

After eight years of operation, the Insolvency and Bankruptcy Code has a mixed but largely positive record. It has brought about transformational changes while simultaneously facing significant implementation challenges.

7.1 The Successes

The IBC's achievements are substantial and have reshaped India's economic environment.

- **Improved Recoveries and Value Preservation:** While headline recovery rates average around 32%, this figure is a significant improvement over the 20-26% experienced under the old regime. More importantly, this metric can be misleading. A more nuanced analysis reveals the IBC's true success in value preservation. The amount realised by creditors is consistently 160-170% of the estimated liquidation value. This demonstrates that the IBC's focus on "going-concern" resolutions is not just recovering a portion of bad debt but is actively saving and creating economic value that would have been completely destroyed in a liquidation-focused system. The high "haircuts" creditors take are often a reflection of the deeply distressed state of companies entering the process, not a failure of the process itself.
- **A Fundamental Behavioural Shift:** Perhaps the IBC's most profound impact is its deterrent effect. The credible threat of losing control of their company has fundamentally altered the behaviour

of corporate promoters. NCLT data reveals that thousands of cases, involving underlying defaults worth lakhs of crores, have been settled by promoters before the case is even admitted into the CIRP. This has instilled a new culture of credit discipline that was absent in the pre-IBC era.

- **Strengthening the Macro-Economy:** The IBC has been a key driver in cleaning up the balance sheets of the Indian banking sector. The Gross NPAs of scheduled commercial banks have fallen to a 12-year low. This financial cleanup, coupled with a more predictable resolution framework, contributed to a massive 79-position jump in India's ranking in the Business Ready, with the "Resolving Insolvency" parameter showing dramatic improvement.
- **Preserving Livelihoods:** By rescuing viable businesses, the IBC has also served as a powerful tool for job preservation. Studies have shown that firms resolved under the Code have seen a significant increase in employee expenses and total employment in the post-resolution period, underscoring the human impact of saving a company as a going concern.

7.2 The Challenges

Despite its successes, the IBC faces critical challenges that hinder its full potential.

- The Timeline Crisis: The most significant failure is the inability to adhere to the statutory timelines. The average time to complete a CIRP has ballooned to over 650 days, with some estimates putting it over 800 days—more than double the 330-day target. These delays erode asset value, increase resolution costs, and undermine the Code's primary promise of swiftness.

8. THE ROAD AHEAD: FINE-TUNING THE ENGINE

The IBC is not a static piece of legislation; it is a dynamic framework that is continuously evolving to address the practical challenges of a complex economy. This evolution is driven by a responsive "learning-by-doing" approach, where real-world feedback from landmark cases and systemic data analysis informs a continuous cycle of reform. This process is guided by expert bodies like the Insolvency Law Committee and the Parliamentary Standing Committee on Finance, whose reports and recommendations have been instrumental in shaping the Code's trajectory.

Key reforms recently implemented or currently under discussion aim to address the Code's most pressing challenges:

- **Tackling Delays:** There is a strong consensus on the need to augment the capacity of the NCLT by increasing the number of benches and members. Alongside this, a major push is underway to digitise the entire process, from e-filings to virtual hearings, to clear backlogs and improve efficiency.
- **Streamlining the Process for Smaller Businesses:** Recognising that the entire CIRP can be cumbersome for smaller enterprises, the Government introduced the Pre-Packaged Insolvency Resolution Process (PPIRP) for Micro, Small, and Medium Enterprises (MSMEs). This provides a faster, more cost-effective, and less disruptive hybrid framework that combines informal out-of-court negotiations with the legal certainty of an NCLT-approved plan.
- **Addressing Future Frontiers:** As the Indian economy becomes more integrated and complex, the IBC must also evolve. Work is underway to develop formal frameworks for group insolvency (to handle the failure of interconnected companies within a corporate group) and cross-border insolvency (to manage cases where a company's assets or creditors are in multiple countries).

9. CONCLUSION

A strong and effective insolvency framework like the IBC creates a virtuous cycle that benefits the entire economy. By cleaning up bad loans from bank balance sheets, it makes the banking system healthier and more willing, to extend credit for everything, from large corporate investments to personal loans for vehicles and homes. By providing a predictable and transparent process for resolving distress, it boosts the confidence of both domestic and foreign investors, which in turn supports the stock market and the value of retirement funds. Most importantly, by prioritising the revival of viable businesses over their liquidation, it preserves

jobs, keeps capital productive, and fuels overall economic growth.

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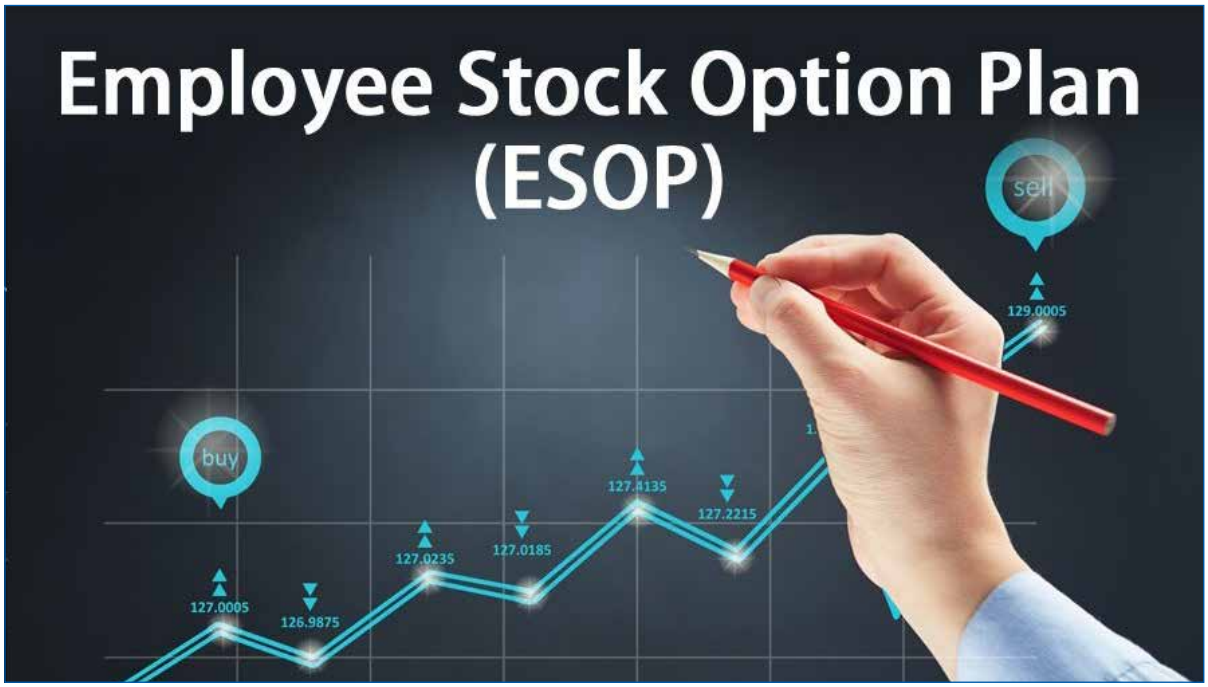
VALUATION AND ACCOUNTING FOR EMPLOYEE STOCK OPTION PLAN



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1. INTRODUCTION

Employee Stock Option Plans (ESOPs) are a common tool used by companies to incentivise employees. Under ESOP, an entity grants an option to its 'eligible employees' to acquire its shares at a future date but at a predetermined price, thereby giving them an ownership interest in the company.

1.1 How ESOP Benefits to Employees & Organisations?

i. ESOPs helps attract and retain top talent by offering equity-linked incentives, aligning employee interests with long-term company goals.

ii. It serves as a long-term wealth-building tool, rewarding continued service and enhancing post-retirement financial security.

iii. In private firms, employees can sell vested options to new investors during funding rounds, offering liquidity without issuing new shares—thus preserving promoter equity.

iv. ESOPs enables deferred compensation tied to performance and vesting, promoting sustained engagement and efficient cash flow management.

2. STATUTORY PROVISIONS

ESOP valuations are subject to stringent accounting and regulatory standards, depending on the jurisdiction in which the entity operates. The most relevant standard is Accounting Standards Codification (ASC) 718 (Compensation-Stock Compensation) under the Financial Accounting Standards Board (FASB) for companies in the United States. Globally, similar requirements exist under International Financial

Reporting Standards (IFRS) 2 (Share-based Payment), which outlines the accounting treatment for stock-based compensation. In the Indian context, ESOP valuations are governed by Indian Accounting Standard (Ind AS) 102 (Share-based Payment), which aligns with IFRS 2.

Additionally, the Companies Act, 2013 and regulations by the Securities and Exchange Board of India (SEBI) provide further guidance on ESOPs, particularly for listed companies. Also, the ICAI's Guidance Note on Accounting for Employee Share-based Payments permits the use of the Intrinsic Value method for ESOP valuation. Under this method, the compensation cost is calculated as the difference between the fair market value of the share and the exercise price on the grant date.

The Foreign Exchange Management Act (FEMA), 1999, governs all cross-border transactions involving foreign exchange, including the issuance of Employee Stock Option Plans (ESOPs) by foreign parent companies to Indian employees of their subsidiaries, joint ventures, or affiliates. If the issuer has a stake in the Indian entity and funds remitted abroad for the purchase of shares comply with RBI's Liberalised Remittance Scheme (LRS) limits, there is no need for prior RBI approval.

3. ESOP VALUATION

IFRS 2/Ind AS 102/ ASC 718, Share-based Payments require companies that have issued employee stock options to value them using the Fair Value Method only.

Fair value can be calculated using various option pricing models:

i. Black-Scholes Option Pricing Model

ii. Binomial-Lattice Model

iii. Monte-Carlo Simulation Model

3.1 Selection of an Appropriate Model

Comparison of Valuation Models for Share-Based Payment Awards

Criteria	Black-Scholes	Binomial-Lattice	Monte-Carlo
Type of Option	Suitable only for European-style options (can be exercised only at expiry)	Suitable for American-style options (can be exercised any time before expiry)	Applicable to both European and American-style options, especially when performance is path-dependent.
Award Complexity	Best for simple, time-based service conditions or non-market performance conditions	Also suitable for non-market conditions but offers greater flexibility for varied exercise behaviour	Preferred for complex awards, especially with market-based performance conditions or non-linear features
Assumption Dependency	Relies on relatively straightforward assumptions.	Allows modelling of changing assumptions over time	Capable of simulating multiple scenarios.
Applicability	Most widely used for and equity-settled instruments.	Suitable where flexibility in exercise is required.	Used for sophisticated or share-based payment schemes.

3.2 Inputs in Option Pricing Model

i. **Spot Price (S):** It is the implied equity value of the company. For listed companies, it is directly observable from market price. For unlisted companies, the spot price is derived through Discounted Cash Flow, Comparable Company Analysis or Net Asset Value models conducted by a Registered Valuer as per Income Tax Rule 11UA. When the company has a complex capital structure of dilutive instruments, the Option Pricing Model Backsolve technique is used. This involves estimating enterprise value via methods like DCF or comparable and allocating it across securities. A recent funding round (typically in preferred stock) is "backsolved" to derive the implied equity value, which is then adjusted using a Discount for Lack of Marketability (DLOM) to reflect lack of marketability—ultimately serving as the FMV (spot price) of common shares.

ii. **Exercise Price (K):** The exercise price (also referred to as the strike price) represents the predetermined price at which the holder of the option can purchase the company's share, upon vesting and exercise.

iii. **Risk-Free Rate (r):** Since the option pricing model work under the risk-neutral framework, the continuously compounded risk-free rate reflects the implied yield on a zero-coupon treasury bond matching the option's expected term.

iv. **Volatility (σ):** Volatility measures how the underlying company would correlate to the overall market based on a similar set of companies in the similar industry and, ideally, with similar growth metrics and investment characteristics. It is estimated based on the historical price movements of similar companies if the company itself is unlisted. The selected volatility needs to be reflective of the estimated volatility over the time to exit (i.e. the investment horizon or holding period).

v. **Time to Maturity (t):** It reflects the expected duration until the option is exercised or expires. While standard calculations may use the average of the vesting period and contractual term, adjustments are required for specific clauses. For instance, if vesting is tied to a market-based milestone (like achieving a unicorn status) or an accelerated IPO clause, the effective time to vesting shortens, necessitating a reassessment based on expected trigger timelines or exit events.

vi. **Dividend Yield (q):** This is generally nil for venture capital backed companies and loss- making startups but does come into play for private equity investments. It will reduce the present value of the underlying stock.

3.2.1 Impact of changes in Inputs to Fair Value

Upward Changes in Assumptions	Impact on FMV
Current Spot Price	Higher
Exercise Price	Lower
Expected Volatility	Higher
Risk-Free Interest rate	Higher
Expected term	Higher
Dividend Yield	Lower

An upward change in inputs like spot price, volatility, risk-free rate, and expected term increases the fair market value (FMV) of an option, while a higher exercise price and dividend yield reduce it. This is because each factor either enhances or diminishes the potential payoff from the option.

3.3 Black-Scholes Model

Using the above-mentioned factors, the Black-Scholes formula gives the call option value per share:

The value of a call is then:

- $S\,N(d1) - K\,e^{-rt}N(d2)$
- $\mathrm{d1} = \frac{Ln\left(\frac{S}{K}\right)+\left(r+\frac{\sigma^2}{2}\right)t}{\sigma\sqrt{t}}$
- $\mathrm{d2} = d1 - \sigma\sqrt{t}$

Consider an example:

Terms of the agreement are:

Grant date	01-04-2022
Vesting Start Date	01-04-2024
Contractual expiration	01-04-2024
FMV (01-04-22)	100
Exercise Price	57

FMV as per Black-Scholes		
Exercise Price (in INR)	57	(as agreed under the contract)
Spot Price (in INR)	100	(as derived from the DCF Model)
Time to Maturity	2 years	(average of vesting and contractual term)
Risk Free Rate	6.80%	(2 year of G-sec bond yield)
Dividend Yield	0%	

Implied Volatility	40%	(historical price data of peer companies)
d1	3.034	
d2	2.468	
Call Value (in INR)	50	

3.4 Binomial Option Pricing Model

The Binomial Model uses an iterative procedure allowing for specification of nodes, or points in time, during the span between the valuation date and the option's expiration date. The model removes the possibility for arbitrage as it works under the risk-neutral approach.

Consider the following example:

Assuming that we grant an option on a 110 stock that will expire in 2 years.

Parameters	
Stock Price (in INR)	110
Strike Price (in INR)	100
Time to Maturity (t)	2 years
Risk Free Rate (r)	5 %
Volatility (σ)	20 %
Dividend Yield	0 %
Dt (t/n)	1
No. of Steps (n)	2
Option Type	Call
Up Factor $(u = e^{\sigma\sqrt{dt}})$	1.2214
Down Factor $(u = e^{\sigma\sqrt{dt}})$	0.8187
$p = \frac{(e^{r*dt} - d)}{u - d}$	0.5775
1–p	0.4225

We will calculate the future possible stock prices using the up and down factor formulas. Example: Time 2 up-up: 110 × 1.2214 × 1.2214 = 164.10, and so on.

Price MovementsTime		
Time 0	Time 1	Time 2
		164.10
	134.35	
110		110.00
	90.06	
		73.74

We will then calculate the option payoffs at Maturity. For a Call Option, payoff = MAX (Stock Price - Strike Price, 0).

Example: Time 2 Payoff: 164.10 - 100 = 64.10, and so on.

Finding Payoff		
Time 0	Time 1	Time 2
		64.10
		10.00
		0.00

Then, we will take the expected value of the Time 2 option values, weight them by the risk-neutral probabilities, and discount them back at Time 1 and Time 0 respectively to arrive at a Fair Value of the Option.

Option value=e^{-r*dt} ∗{p ∗ *Value* (*up*) + (1–p) ∗ *Value* (down)}

Example: $e^{-0.05*1}$∗{0.5775∗64.10 + 0.4225∗10}=39.23, and so on.

Finding Fair Value		
Time 0	Time 1	Time 2
		64.10
	39.23	
23.76		10.00
	5.49	
		0.00

3.5 Simulation Technique

The expected price for a stated Geometric Brownian Motion is calculated as:

$$S(t+1) = S(t) * \exp(r - 0.5 * v^2) * t + v\sqrt{t} * zt$$

Where,
r = risk free rate
t = time to maturity
v = volatility
zt = lognormal distribution

Based on these simulated prices and the exercise price, we shall estimate the expected payoff, which is then discounted to find out the final option price and the average of these simulations has been considered as the final option price as on the grant date. Simulation

technique is based on the assumption that the future returns are normally distributed.

4. ACCOUNTING TREATMENT OF ESOPs

Employee Stock Option Plans (ESOPs) are an essential part of compensation packages, designed to align employee interests with shareholder value. As per Ind AS 102 (Share-Based Payments) and IFRS 2, ESOP expenses must be recognised over the vesting period based on fair value.

4.1 Understanding the Measurement Approach

Under Ind AS 102, ESOPs are classified as either equity-settled or cash-settled. In equity-settled ESOPs, employees receive shares or stock options, and the expense is measured at fair value on the grant date and recognised in the Profit & Loss account over the vesting period, with a corresponding credit to equity (Share Based Payment Reserve Account). In contrast, cash-settled ESOPs involve cash payments based on share price performance. These are recognised as liabilities, remeasured at fair value at each reporting date, and any changes are reflected in the P&L.

4.2 Adjusting for Graded Vesting Method

ESOP expenses are allocated over the vesting period using either the straight-line method or the graded vesting method. Ind AS 102 recommends the graded vesting approach, which front-loads expenses in earlier years.

i. Straight-Line Method: This method recognises equal expenses each year.

ii. Graded Vesting Method: When the options have a graded vesting schedule (for example, 25% vesting each year over four years), they should be treated like multiple grants and the fair value of each grant is amortised over the respective vesting period. It recognises a higher expense in the initial years based on the number of options vested in each period.

4.3 Adjusting for Attrition

In ESOP valuations for financial reporting under Ind AS 102, attrition rate is a critical assumption influencing the expense recognised in the P&L—higher attrition implies fewer options expected to vest, thus reducing the charge, often aligning with Chief Financial Officer preferences. While Ind AS 102 does not prescribe a specific method to estimate attrition, entities may rely on historical trends (e.g., average monthly exits or full-year attrition ratios) or adopt a forward-looking approach akin to AS 15/Ind AS 19, where past data guides future expectations.

For instance, a historical attrition of 20% may be revised to 10% if a retention scheme is implemented. Planned redundancies or layoffs must also be factored in. Moreover, stratified attrition assumptions—based on employee categories (managerial/non-managerial), locations, age bands (e.g., negligible attrition in 50+ age group), or service tenure—can enhance model accuracy, reflecting varying likelihoods of option vesting and exercise.

Illustration: Consider the following example:

Employee ID	Grant Date	No. of Options
EA	01-05-2022	200
EB	01-06-2022	400
EC	06-07-2022	800
ED	19-07-2022	600

Additional info:

- Vesting Plan- 2 years (50% vesting in each year)
- FMV as per Black Scholes is 50.
- Exercise period is for 2 years.
- At the end of vesting period, 1600 vested options were exercised and 300 options were lapsed.
- Expense is recognised over the vesting period as per Graded Vesting.
- The actual attrition of 5% was in line with the historical attrition rate.

To demonstrate the ESOP Expense Recognition process, the following structured approach has been adopted:

The FMV is applied under the Graded Vesting Method to allocate the total cost over the vesting period year wise.

In this case, for options granted on 1st May 2022 with vesting on 1st May 2024, 11 months fall in FY 2022–23. Accordingly, 92 out of 100 options were deemed vested in FY 2022-23, based on time elapsed.

This methodology is consistently applied across all relevant employee IDs and granted options, and the cumulative ESOP cost is computed by aggregating the expenses recognised for each employee, based on their vesting schedule.

Thereafter the total cost is adjusted for the estimated attrition rate, reflecting the number of employees who will ultimately vest the options.

FY	Total Cost (Rs.)	Attrition	Attrition Adjusted Cost (Rs.)
2022-23	58,750	5%	55,813
2023-24	35,833	5%	34,042
2024-25	5,417	5%	5,146

Finally, based on the adjusted cost, the appropriate journal entries are recorded to recognise the expense as per the accounting standard. The attrition adjusted employee benefit expense is debited, and the share-based payment reserve is credited over the vesting period. Upon exercise, the share-based payment reserve and the cash received is debited, while the issuance of equity share capital, and securities premium is credited. In case of forfeiture, if it occurs before the vesting period ends, the cost recognised for unvested options is reversed. However, if forfeiture happens after vesting, the expense is not reversed, as per Ind AS 102.

Date	Particulars	Debit (Rs.)	Credit (Rs.)
Year 1 31-03-2023	Employee Benefit Expense a/c	55,813	
	To Share Based Payment Reserve a/c		55,813
Year 2 31-03-2024	Employee Benefit Expense a/c	34,042	
	To Share Based Payment Reserve a/c		34,042
Year 3 19-07-2024	Employee Benefit Expense a/c	5,146	
	To Share Based Payment Reserve a/c		5,146
19-07-2024 (1700 options Exercised)	Bank a/c (1600*57)	96,900	
	Share Based Payment Reserve a/c (1700*50)	80,000	
	To Equity Share Capital (1700*10)		16,000
	To Share Premium (Balancing)		1,60,900
19-07-2024 (300 options lapsed)	Share Based Payment Reserve a/c (300*50)	15,000	
	To Employee Benefit Expense a/c		15,000

5. IMPORTANCE OF ACCURATELY CAPTURING ESOP EXPENSES

Accurately capturing the cost of employee stock option (ESOP) expense is crucial for ensuring transparent and fair financial reporting.

- ❖ Proper recognition ensures compliance with accounting standards (such as Ind AS 102 or IFRS 2).
- ❖ If ESOP expenses are under-reported, a company may overstate profits, misleading investors—for instance, recognising only Rs. 2 lakhs instead of the actual Rs. 10 lakhs can inflate net income by Rs. 8 lakhs. Conversely, overstating the expense can understate profits, affecting valuation and stakeholder trust.
- ❖ It also aids internal decision-making by revealing the real cost of talent acquisition and retention.

6. TAXATION OF ESOPS

Under the Income Tax Act, 1961 ESOPs are taxed at two stages. At the time of exercise, the difference between the fair market value (FMV) and the exercise price is treated as a perquisite and taxed as part of salary income. Upon subsequent sale of shares, the gain—i.e., the difference between the sale price and the FMV on exercise date—is taxed as capital gains.

However, since employees do not receive immediate liquidity upon exercise, taxing the perquisite upfront can be financially burdensome. To address this, an amendment allows deferment of perquisite taxation and TDS obligations specifically for eligible startups as defined under Section 80-IAC of the Income Tax Act, 1961. As per Section 192(1C) of the Income Tax Act, 1961, such startups can defer TDS on ESOPs to within 14 days of the following specified events:

i. expiry of 48 months from the end of the relevant assessment year,

ii. cessation of employment, or

iii. sale of the ESOP shares; whichever is earlier.

7. CONCLUSION

In conclusion, the valuation and accounting of ESOP expenses demand a confluence of financial rigor, statutory awareness, and valuation acumen. We have dissected valuation frameworks such as the Black-Scholes and Binomial Models, and illuminated the impact of key inputs including volatility, risk-free rate, and expected life — all of which materially affect fair value estimation. Moreover, the application of graded vesting adjustments and iterative computations underlines the complexity in real-world scenarios.

The nuanced treatment of ESOPs is not merely an exercise in compliance but a cornerstone of transparent and meaningful financial reporting. As organisations increasingly deploy ESOPs as strategic instruments for talent retention and performance alignment, it becomes imperative to recognise and measure the associated compensation cost with precision and consistency.

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THE GENERATIVE AI CO-PILOT: A NEW FRONTIER FOR PROFESSIONAL EXCELLENCE

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1. INTRODUCTION

The digital age has consistently reshaped the professional landscape, and for finance professionals, this evolution has been particularly profound. From the advent of enterprise resource planning (ERP) systems in the 1990s to the adoption of sophisticated data analytics platforms in the 2010s, our profession has always adapted and thrived by leveraging technology. Today, we stand at the precipice of another paradigm shift with the rise of Generative AI. Tools like Gemini and ChatGPT are no longer futuristic concepts; they are powerful co-pilots ready to redefine our daily workflows.

This article explores how a leading professional services firm is strategically integrating Generative AI across its practice, transforming routine tasks into opportunities for deeper analysis. We will outline a practical framework for its responsible use, demonstrating through a real-world case study as to how these tools can accelerate our work, from initial data analysis to a boardroom-ready presentation. The overarching message is clear: AI is not a replacement for a finance professional's expertise, but a force multiplier that empowers us to focus on the strategic, high-value advisory work that truly defines our profession.

2. THE TRANSFORMATIVE POTENTIAL OF GENERATIVE AI

At its core, Generative AI is a sophisticated form of artificial intelligence trained on vast datasets, enabling it to understand context, generate human-like text, and even summarise complex information with remarkable speed and accuracy. Its primary value for a professional firm lies in its ability to:

- **Automate Routine Tasks:** This is perhaps the most immediate benefit. Instead of spending hours drafting a standard memo or a routine client email, a professional can provide a few key inputs and let the AI generate a high-quality draft. For example, a professional could provide bullet points from a meeting and ask the AI to draft a detailed memo to the audit committee, complete with an executive summary, key findings, and recommendations. This frees up valuable time for more complex, non-routine work.

- **Enhance Analytical Capabilities:** Generative AI's ability to process and synthesise information is unparalleled. It can quickly summarise lengthy financial documents, legal circulars, and industry reports, allowing professionals to glean critical insights in minutes rather than hours. A professional can upload a 200-page annual report and ask for a summary of key financial risks and management's outlook, providing an instant head start on analysis.

- **Improve Document Drafting:** The tool acts as a creative partner, generating structured outlines, content, and even code for custom solutions. For example, a professional writing an opinion on a new regulatory change can use AI to generate an outline of the key sections, a draft of the introduction, and a list of key compliance actions. This ensures structural integrity from the outset and significantly reduces the time to first draft.

- **Streamline Research:** AI provides instant answers to queries on complex regulatory or accounting standards, citing relevant sections for verification. Instead of navigating dozens of web pages or PDFs, a professional can ask a direct question like, "What are the key requirements of Ind AS 36 for recognising an impairment loss?" and receive a concise, referenced answer that can be used as a starting point for their analysis.

3. HIGH-IMPACT AI APPLICATIONS IN DIVERSE DOMAINS

The versatility of Generative AI means it can be applied to virtually every facet of a professional's practice, from the most technical compliance tasks to strategic advisory roles. Here are some detailed examples of its use in key domains:

i) Audit & Assurance

The audit process is ripe for AI integration, from planning to reporting. AI can instantly summarise a complex new standard or draft a checklist of compliance points. It can also assist in audit planning by summarising a client's business model and identifying inherent risks. For instance, in a client's internal controls walkthrough, the professional can input the flowcharts and narratives into the AI and ask it to identify potential control deficiencies or gaps in the control design. This shifts the auditor's focus from a mechanical review to a strategic, risk-based analysis. During substantive testing, an auditor can provide a large data set of accounts payable transactions and ask the AI to identify anomalies or potential duplicate payments, significantly enhancing the efficiency and quality of the audit.

ii) Valuation

AI can quickly summarise and explain valuation standards and help compare them with international frameworks. It can also assist with market and industry research by aggregating vast amounts of data to identify trends and benchmarks. For example, a valuer can use AI to search for recent M&A transactions in a specific industry, extract the valuation multiples (e.g., Enterprise Value/EBITDA), and present them in a structured table, saving days of manual research. For report writing, AI can draft sections such as the executive summary or methodology description based on the valuer's data and findings.

iii) Corporate Laws & Compliance

Compliance is a time-sensitive and document-heavy domain where AI can be a powerful asset. AI can digest lengthy legal documents and provide a concise summary of key compliance requirements or changes. For example, when a new regulation is released, a professional can feed the full text into the AI and ask it to "create a compliance checklist for our firm, detailing the key action items, responsible parties, and deadlines." The AI can then draft a ready-to-use

checklist, saving significant time and reducing the risk of non-compliance. Similarly, it can draft a template for a board resolution or a filing with a regulatory body, ensuring all the required legal language is included.

iv) Taxation (Direct & Indirect)

AI can significantly streamline tax practice, where both law and procedure are constantly changing. It can draft a structured reply to a tax notice or summarise a set of complex case laws to support a legal argument. A professional can input a tax notice and the relevant financial data, and the AI can generate a preliminary draft of the response, citing the relevant sections of the Income Tax Act and presenting the taxpayer's position in a clear, professional manner. This allows the tax professional to focus on the strategic arguments and unique nuances of the case rather than the tedious drafting process.

4. THE ITERATIVE COLLABORATION: A PRACTICAL CASE STUDY

This case study demonstrates how a professional can leverage an AI model to perform a comprehensive impairment analysis under Ind AS 36 / IAS 36. The process begins with the professional providing specific, real-world queries and iteratively refining the AI's output to reach a final, well-supported conclusion.

Step 1: Foundational Query and Initial AI Response

The process starts with a clear, concise query from the professional. The professional is performing an impairment analysis and needs to clarify the correct treatment of specific financial items.

Professional's Initial Query: "In determining the Value in Use (VIU), what should be the treatment for a) Other income and tax thereon; b) net deferred tax assets; c) current tax liabilities?"

AI's Initial Response: The AI model responds by applying the core principles of Ind AS 36. It correctly identifies that a VIU calculation is based on the cash flows generated by the core operations of the asset.

- **Other Income:** Excluded, as it is non-operational. For example, interest income from bank deposits or a one-time gain from the sale of a surplus asset would not be included in the VIU cash flow projections because these are not generated from the CGU's primary business activities.
- **Net Deferred Tax Assets & Liabilities:** Excluded, as the VIU model uses pre-tax cash flows and a pre-tax discount rate. This is to avoid the complexity of valuing the tax effects on both the cash flows and the discount rate, which would effectively double-count the tax impact. The recoverable amount is compared against the CGU's carrying amount, which also excludes deferred tax balances.
- **Current Tax Liabilities:** Also excluded. As the model is pre-tax, current taxes are not part of the cash flows from operations.

This initial interaction saves the professional from manually searching through standards and provides a structured, principle-based foundation for the analysis. It establishes the AI's role as a reliable reference guide.

Step 2: Assessing Company-Specific Risk

The professional presents a specific company profile and asks for guidance on whether a Company-Specific Risk Premium (CSRP) and a Discount for Lack of Marketability (DLOM) should be applied.

Professional's Second Query: "An Indian company is a 100% subsidiary of a large well-established overseas listed multinational. Its revenues are closely tied to services exported to the parent. Please provide guidance on whether a) any Company-specific discounting is required; b) a DLOM should be considered."

AI's Final Refinement: The AI integrates the detailed reasoning from the supplied file to provide a clear, justified conclusion.

- **Company-Specific Risk Premium (CSRP):** The AI justifies a NIL CSRP. The reasons are a direct application of the guidance provided in the document:
  - ❖ **Ownership and Support:** Full ownership by a creditworthy parent significantly reduces idiosyncratic risks. The parent acts as a backstop, providing financial and operational stability.

- **Stable Revenue:** Predictable, intra-group revenue minimises market exposure and execution risk, as the company is not subject to the volatility of an open market.
- **ICAI Guidance:** The AI references the ICAI Concept Paper on Discount Rates, which states that CSRP is only applied when the company's risk profile deviates significantly from systematic risk. The strong parent relationship here suggests that the company's risk is more aligned with the market.
- **Discount for Lack of Marketability (DLOM):** The AI confirms that a low DLOM (5-10%) or even NIL can be defensible, based on the following reasons from the document:
- **Intra-group Transfers:** The valuation is for internal purposes, not an external market transaction, making marketability academic.
- **ICAI Guidance:** The AI confirms that ICAI guidance suggests DLOM is applied for illiquid minority interests, which is not the case here. The asset being valued is the entire CGU, which would be sold as a whole, not a small, unmarketable stake.

Step 3: Addressing Conceptual Pitfalls

As the analysis progresses, the professional encounters a common conceptual challenge: whether to apply a liquidity discount to the valuation.

Professional's Third Query: "A valuer is performing an impairment analysis of a 100% unlisted subsidiary. They have applied a 5% liquidity discount. Is this appropriate?"

AI's Refined Response: The AI's response is not a simple "yes" or "no." It delves into the underlying valuation principles to provide a definitive and educational clarification.

- **Fair Value Less Cost of Disposal (FVLCD) vs. VIU:** The AI explains that while a liquidity discount is relevant in certain contexts (e.g., valuing a minority stake), it is not appropriate for an impairment test.
- **Orderly Transaction:** It cites Ind AS 113, which defines Fair Value as the price in an orderly transaction. By definition, an orderly transaction allows for a sufficient marketing period, negating the need for a liquidity discount.
- **Misapplication of Principles:** The AI correctly identifies the proposed approach as a misapplication of a Discount for Lack of Marketability (DLOM), which is used for valuing minority interests, not the entire CGU. A DLOM is used to account for the risk of not being able to sell an asset quickly without a price concession. In an impairment analysis, the FVLCD is a hypothetical sale of the entire CGU as a going concern to a market participant, a transaction that is, by definition, orderly.

This step demonstrates the AI's ability to act as a technical guardrail, preventing the professional from making a critical error and reinforcing fundamental valuation principles.

Step 4: Calculating Pre-tax Value and Discount Rates

The professional seeks to confirm the correct methodology for computing the pre-tax VIU and the associated discount rate, especially in scenarios with or without debt.

Professional's Fourth Query: "Is it necessary to compute the pre-tax Value as per the ICAI standards? How do you handle the pre-tax discount rate when there is no debt?"

AI's Refined Response: The AI provides a detailed, step-by-step breakdown of the pre-tax VIU calculation, referencing specific paragraphs from Ind AS 36. It confirms that using pre-tax cash flows and a pre-tax discount rate is mandatory under the standard.

- **Pre-tax Rate with No Debt:** The AI confirms the professional's understanding

that if a company has no debt, its Cost of Equity is the only discount rate. Since the Cost of Equity is inherently a pre-tax rate, no further adjustment is needed.

- **Iterative Computation with Debt:** For companies with debt, the AI explains the iterative approach required by IAS 36, Appendix A. A simple grossing up of the post-tax WACC is incorrect. The professional must find the pre-tax rate that, when applied to pre-tax cash flows, yields the same net present value as the post-tax cash flows discounted by the post-tax WACC. This is often done using a goal-seek function in a spreadsheet.

This step shows the AI's capacity to handle both simple and complex valuation scenarios, providing a clear model for a correct, standards-compliant calculation.

5. THE PROFESSIONAL'S EVOLVING ROLE IN AN AI-DRIVEN WORLD

The introduction of AI does not diminish the professional's role; it elevates it. By offloading the mechanical and repetitive tasks to an AI co-pilot, the professional is freed to focus on the uniquely human skills that AI cannot replicate:

- **Professional Judgement:** The ability to apply years of experience, a healthy dose of professional skepticism, and intuition to complex scenarios. AI provides data, but a human professional provides the wisdom to interpret it. For example, an AI might flag a transaction as an anomaly based on a statistical model, but only a human professional can apply their judgement to determine if that anomaly represents a genuine risk, a clerical error, or a legitimate business decision that falls outside the norm.
- **Ethical Reasoning:** Making decisions based on professional codes of conduct, integrity, and a commitment to the public interest is a uniquely human responsibility. When faced with a situation that presents a conflict of interest or an ethical dilemma, the professional's moral compass is the ultimate guide. AI has no such compass; it can only process data based on its training.
- **Client Relationship Management:** Building trust, understanding a client's business deeply, and providing empathetic, tailored advice is at the heart of our profession. The trust between a client and their professional advisor is built on consistent, reliable, and personal interaction. This human connection cannot be automated.
- **Critical Thinking & Nuance:** AI is a powerful pattern matcher, but it can struggle with nuance, context, and situations that defy established patterns. The professional's role is to question AI's assumptions and identify the subtle complexities in a business scenario. For instance, an AI might misinterpret a company's financial performance because it doesn't account for a recent strategic shift or a one-time market event that the professional is aware of. The professional's ability to inject this context is what transforms raw data into meaningful insight. The evolution of technology presents an opportunity for professionals to become even more incisive. Beyond generating summaries, AI can be trained to identify anomalous patterns in vast datasets of transactions, flagging potential risks or fraud that a human professional might overlook. This shifts the focus from simply verifying a sample to using technology to analyse the entire population of data, a massive leap in audit quality and effectiveness.

6. MITIGATING RISKS AND ENSURING ETHICAL COMPLIANCE

As we embrace Generative AI, we must do so with a clear understanding of its risks and our ethical obligations.

Do's	Don'ts
Verify Everything: Treat AI output as a draft that requires human verification against primary sources.	Don't Assume Accuracy: Never present AI-generated content as final without a thorough, independent review.
Protect Confidentiality: Use secure, enterprise-level AI solutions or ensure that no sensitive data is ever uploaded to public models.	Don't Use Public Models for Sensitive Data: Never input client names, financial figures, or confidential business information into public AI interfaces.
Apply Professional Judgement: Use AI to enhance your work but always rely on your own expertise to make final decisions and interpret results.	Don't Cede Control: Do not let AI make critical decisions or form professional opinions on your behalf.
Train Staff Thoroughly: Educate your team on effective prompting techniques and the ethical guidelines for AI usage.	Don't Allow Unsupervised Use: Implement clear firm-wide policies on AI tools to prevent misuse or non-compliance.
Use for Research & Drafting: Leverage AI for summarising standards, drafting reports, and performing background research efficiently.	Don't Use as a Sole Source: Do not rely on AI as the only source of truth. Always cross-reference with established standards and legal texts.

7. CONCLUSION: A FUTURE OF ENHANCED EXCELLENCE

Generative AI is not a fleeting trend but a fundamental shift in how we work. By viewing it not as a competitor but as a collaborative tool, we can enhance our efficiency, elevate our analytical capabilities, and improve the quality of our deliverables. This transition requires us to be deliberate and disciplined, always prioritising professional judgement, ethical conduct, and data security. The future of the finance profession is not in fearing this technology, but in mastering it, ensuring that we continue to stand at the forefront of business excellence.

Invitation to *Write Articles*

Valuation Professionals and other subject experts, with academic passion and flair for writing, are invited to share their expertise through the ICAI RVO Journal – ***"The Valuation Perspective"***. The article should cover topic relevant to the valuation profession and Registered Valuers. While submitting articles, please keep following aspects in mind:

- The length of the article should be 2500-3000 words.
- The article should be original, i.e., not published/ broadcasted/hosted elsewhere including on any website.
- An executive summary of about 100 words should accompany the article.
- The article should be technically correct and sound.
- The article should help in development of the profession of Registered Valuers and promote continuous professional development of Valuation Professionals.

For submission: Please send article in editable soft copy format along with your passport size photograph and declaration of originality and assignment of copyright in the prescribed format to icairvo.journal@icai.in.

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