Series - 12

Valuation: VCM ATQs

"Due Diligence and Valuation"

VALUATION STANDARDS BOARD
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
(Set up under an Act of Parliament)
New Delhi

Series-12

Valuation: VCM ATQs
"Due Diligence and Valuation"

Valuation Standards Board

The Institute of Chartered Accountants of India

Preamble

Valuation Standards Board of ICAI (VSB) had organised a live Virtual CPE Meeting(VCM) on the topic- "Due Diligence and Valuation" on 8th August, 2021. The details of the VCM are as under:

President ICAI: CA. Nihar N. Jambusaria

Vice President ICAI: CA. Debashis Mitra

Address by: CA. Anil Bhandari, Chairman, VSB, ICAI
CA. M. P. Vijay Kumar, Vice- Chairman, VSB, ICAI

Speaker: CA. Atul Mehta

Director: Shri Rakesh Sehgal, Director, ICAI

Secretary: CA. Sarika Singhal, Deputy Secretary, ICAI

The Webcast received an overwhelming response and was attended by more than 1000 viewers. The said webcast can be viewed again at https://live.icai.org/vsb/vcm/08082021/

There were many questions raised during the webcast. We have prepared answers to the questions (ATQs) raised during the webcast, which does not require application of valuation practices and principles. Also, repetitive questions and questions not related to the subject matter have not been answered.

We would also like to mention that the Valuation Standards Board has brought out many publications and Concept papers that may be referred for guidance and reference. All the below publications are available on the Committee link at ICAI website i.e., www.icai.org.

- ICAI Valuation Standards 2018
- Educational Material on ICAI Valuation Standard 103 - Valuation Approaches and Methods

- Educational Material on ICAI Valuation Standard 301- Business Valuation
- Valuation: Professionals' Insight- Series- I, II, III, IV, V and VI
- Answers to the Questions raised during the Live Webcast on "Valuation and Valuation Standards Compliance and other aspects under various Laws"
- Technical Guide on Valuation
- Frequently Asked Questions on Valuation
- Concept Paper on findings of Peer Review of Valuation Reports
- Concept Paper on All About Fair Value
- Sample Engagement Letter for accepting Valuation assignment
- Valuation: VCM ATQ's – Series - I, II, III, IV, V and VI

The answers have been given for reference purposes. Detailed analysis may be done, and other material may be referred.

Valuation Standards Board
New Delhi
31st August, 2021

Brief Note on Due Diligence in Valuation

1) Meaning and importance of Due Diligence in Valuation

Due diligence depicts clear and transparent business facts based on robust and reliable statements, and valuation based on such statements is very effective. To enhance the value of business, the management of company may have overvalued the assets or there may be some hidden liabilities of the business. The objective of the due diligence process is to look specifically for any such hidden liabilities or overvalued assets.

It is a very common and popular term in the corporate world in relation to corporate restructuring, merger & acquisition, joint venture, spinoffs, amalgamations, etc. Due diligence is one of the key elements in all these types of transactions because of the fact that the transactions are being done between two unrelated parties, who don't have a deep understanding about the business that they are going to take over or merge with. The purpose of due diligence exercise is to assist the purchaser or the investor in finding out all the facts and figures about the business he is going to acquire or invest prior to completion of the transaction.

From a valuation perspective, due diligence focuses on potential overvalued assets, under-recorded liabilities, quality of management, tax position and structure and its impact on the future, the robustness of the projected cash flows, and all other matters of significant interest to the acquirer which mainly are the value drivers.

2) Hidden Liabilities in financial diligence

Few examples of hidden liabilities are as follows:

- The company may not disclose show cause notice which has not matured into demands, as contingent liabilities
- Letter of comfort given to banks and financial institutions, which are not disclosed in the financial statements of the company as they are not guarantees.
- Long pending sales tax/income tax assessment
- Future lease liabilities
- Environmental problems/third party claims

- Product and/or other liability claims, warranty liabilities, liquidity damages etc.
- Huge labour claims under negotiation

3) Overvalued Assets in financial diligence

Few examples of overvalued assets are as follows:-

- Uncollected and/ or uncollectible receivables
- Intangibles having no value
- Group company balances under reconciliation
- Litigated assets
- Investment carrying a very low rate of income
- Deferred revenue expenditures
- Obsolete, slow-moving or non-moving stock valued above net realisable value
- Obsolete or underused plant and machinery
- Capitalisation of expenditure which is in the nature of revenue

4) Types of Due Diligence

Various types of due diligence that are followed as a discipline for businesses are as follows:

a. **Commercial or Business due diligence**: It is generally performed by the concerned acquirer enterprise and involves an evaluation from a commercial, strategic or operational perspective. For example, whether the proposed merger would create operational synergies.
b. **Financial due diligence**: It commences after a price has been agreed for the business. The principal objective of financial due diligence is usually to look behind the veil of initial information provided by the company and to assess the benefits and costs of the proposed acquisition/merger by inquiring into all relevant aspects of the past, present and future of the business to be acquired/merged with.
c. **Tax due diligence:** This is conducted to ensure whether the company is adhering to the tax provisions, the tax benefits available for the target and the tax related implications of the proposed transaction or valuation on the tax positions of the target.
d. **Information system due diligence:** This is to assess the accuracy and quality of the technology infrastructure of the company.
e. **Legal due diligence:** It is to find out whether or not the company is complying with the

legal provisions. For example, whether the company is filing annual returns or not, whether necessary board resolutions are being passed or not, whether the minute's book is being maintained and updated or not.

5) Accounting Analysis by Valuer

When there are large potential distortions, accounting analysis can add considerable value. Accounting analysis is an important step in the process of business valuation and helps in removing any noise and bias introduced by the accounting rules and management decisions. Sound accounting analysis improves the reliability of conclusions from financial analysis.

The extent of analyses to be carried out by the valuer in relation to the engagement shall be based on the purpose of the valuation assignment and the terms of engagement.

There are six key aspects of accounting analysis.

- **Evaluation of accounting values** - The analyst should identify the key accounting policies and estimates that the firm uses to measure its critical success factors and risk. As a result, it influences the company's profits or asset base, if overestimated/ underestimated, it will distort the financial position.
- **Flexibility** – The analysts evaluate the degree of flexibility available to managers in selecting accounting policies and estimates related to the firm's key success factors, given the accounting rules and conventions. The relevance of accounting data for understanding a company's business is severely impacted by the degree of flexibility available to managers in choosing accounting policies and estimates and how this flexibility is exercised by managers.
- **Accounting discretion** – The analysts assess and understand whether the managers have used their accounting discretion to give a realistic view of the affairs of the company or hide its true performance.
- **Understandability of financial statements** - The adequacy and quality of a firm's disclosures about its business activities and their economic consequences are assessed. This would enable the analyst to assess the quality of accounting and use its financial statements to understand the true business economics.

- **Identifying accounting policies and transactions** - The analyst should identify questionable accounting policies/ transactions needing further investigation with considerable variations from past years' figures, unusual transactions, changes in accounting treatment etc.
- **Removal of Distortions** - The analysts remove all distortions where the accounts do not reflect a true state of affairs and restate accounting numbers. The purpose is to remove any noise and bias introduced by the accounting rules and management decisions.

6) Responsibility of a valuer as per ICAI Valuation Standard 201 towards Analyses and Evaluation of Asset to be valued.

The judgments made by the valuer during the course of an assignment, including the sufficiency of the data made available to meet the purpose of the valuation, must be adequately supported. The valuer shall carry out relevant analyses and evaluations through discussions, inspections, surveys, calculations, and such other means as may be applicable and available to that effect.

If the valuer relies on the information available in the public domain, the valuer should assess the credibility/reliability of such information taking into account, inter-alia, the purpose of valuation, and materiality vis-à-vis the valuation conclusion.

The type, availability, and significance of such information may vary with the asset to be valued. Such information shall include:
(a) non-financial information;
(b) ownership details;
(c) financial information; and
(d) general information.

7) Information's to be Analysed and Evaluated in valuation

i) Non-Financial Information

A valuer shall obtain sufficient non-financial information to enable him to understand the underlying business, such as:

(a) nature, background, and history of the business;
(b) facilities;
(c) organizational structure;
(d) management team (which may include officers, directors, and key employees);
(e) classes of equity ownership interests and rights attached thereto;
(f) products or services, or both;
(g) capital markets providing relevant information; e.g., relevant public stock market information and relevant merger and acquisition information;
(h) prior transactions involving the subject business, or involving interests in, the securities of, or intangible assets in the subject business;
(i) economic environment;
(j) geographical markets;
(k) industry markets;
(l) key customers and suppliers;
(m) competition;
(n) business risks;
(o) future outlook for the business;
(p) strategy and future plans;
(q) governmental or regulatory environment;
(r) legal status of the asset being valued.

ii) Ownership Information

A valuer shall obtain ownership information regarding the asset to be valued to enable him to:
(a) determine the type of ownership interest being valued and ascertain whether that interest exhibits control characteristics;
(b) analyse the different ownership interests of other owners and assess the potential effect on the value of the asset;
(c) understand the classes of equity ownership interests and rights attached thereto;
(d) understand other matters that may affect the value of the subject interest, such as:
    (i) for a business, business ownership interest: shareholder agreements, partnership agreements, operating agreements, voting trust agreements, buy-sell agreements,

loan covenants, restrictions, and other contractual obligations or restrictions affecting the owners and the asset to be valued;

(ii) for an intangible asset: legal rights, licensing agreements, sublicense agreements, nondisclosure agreements, development rights, commercialization or exploitation rights, and other contractual obligations.

iii) Financial Information

A valuer shall obtain, where applicable and available, financial information on the underlying business such as:

(a) historical financial information (including annual and interim financial statements and key financial statement ratios and statistics) for an appropriate number of years;

(b) prospective financial information (for example, budgets, forecasts, and projections)- in the absence of which the valuer could consider information on future developments or course of the business;

(c) comparative summaries of financial statements or information covering a relevant time period;

(d) comparative common size financial statements for the subject entity for an appropriate number of years;

(e) comparative common size industry financial information for a relevant time period;

(f) income tax returns for an appropriate number of years;

(g) information on compensation for owners including benefits and personal expenses;

(h) details of and management's response to the inquiry regarding:

   (i) advantageous or disadvantageous contracts;

   (ii) contingent or off-balance-sheet assets or liabilities;

   (iii) surplus/ non-operating assets.

A valuer shall read and evaluate the information to determine that it is reasonable for the purposes of the engagement.

iv) General Information

A valuer shall gather and analyse the relevant general information which may affect the business directly or indirectly and/or which are deemed relevant by the valuer.

Answers to the Questions (ATQs) raised during the Virtual CPE Meeting Series "Sundays with Valuation Experts" on the topic "Due Diligence and Valuation?" held on 8th August, 2021

S. No	Question	Answer
1.	How are valuation and due diligence connected?	Valuation and diligence are well connected and integrated. Due diligence depicts clear and transparent business facts based on robust and reliable statements, and valuation based on such statements is more effective. A proper valuation is one that uses the information based on due diligence. In a normal scenario, the inputs received post diligence is factored into a financial model based on which valuation is done. Various other factors that are considered in valuation like socio-economic factors, legal implications, competition analysis, prospective tax liabilities, future growth potential etc. are also ascertained vide various due diligence like business diligence, tax diligence, legal diligence etc. Further, Para 26 to 35 of ICAI Valuation Standard 201 provide detailed guidance on Analyses and Evaluation of assets to be valued. This is nothing else but Due-Diligence to be exercised in Valuation. Many International valuation standards like the IVS 102 uses terms Investigation instead of due diligence. The term Investigation, in Indian context, is associated with fraud investigation

S. No	Question	Answer
		whereas the work of a valuer is focused on analysing the information, evaluating the same to form judgements and make reasonable assumptions for the purpose of valuation.
2.	What are the different types of due diligence?	Over the last few years, the entire gamut of due diligence has increased significantly, and now it includes several new areas. Some of them are as under: - i) **Business Diligence** – It looks into the first area every prospective investor wants comfort in i.e., with respect to the growth potential of the company, the pricing potential & the future market. ii) **Financial Diligence** – It takes care of the next important area which is the analysis of the Books of Accounts and the overall finances. iii) **Legal Diligence** – It involves looking at compliances, disputes arising out of contracts, titles, implications of change in control etc. iv) **Tax Diligence** – It involves investigating the pending and probable tax liabilities and continuing and discontinuing tax benefits in future. v) **Human Resource Diligence** - It involves analyzing the contractual regulations, compliances, benefits offered to employees, compensation policy, and ascertaining if the overall organizational structure is in-line with the future growth and projected market demand post the merger. vi) **Technology Diligence** – This has been

S. No	Question	Answer
		gaining significant importance in the last decade and checks how safe and prepared is the technology at the entity in terms of any potential cyberattack, ransomware and other infringements.
3.	In terms of timing, whether valuation is done prior to or post diligence?	Let us understand this with a practical example. In case of a buyout/investment deal, the company to be sold or raising money will first of all share its various financial and non-financial information with the prospective buyer/investor. At this stage, the investor undertakes initial analysis and valuation of the company based on market, legal environment, future growth prospects and broad-level review of information shared. Based on this analysis the initial term sheet or letter of intent is signed. These are non-binding documents and generally lays down the condition that valuation and terms are subject to detailed diligence, like tax diligence, financial diligence, legal diligence, market diligence etc. Subsequent to the diligence the buyer or the investor decides if they need to revise the valuation and the terms to be included. Once the entire due diligence process is completed then the agreement becomes binding in nature and the valuation and terms therein also become binding.

S. No	Question	Answer
		Hence, there is limited diligence and evaluation that is done at the first stage before finalizing the term sheet and then the same is subjected to detailed diligence which provides the final valuation and the terms for the transaction.
4.	Which are the types of transactions where due diligence will be undertaken?	Due Diligence is a very common and popular term in the corporate world in relation to corporate restructuring, merger & acquisition, joint venture, spinoffs, amalgamations, etc. Due diligence is one of the key elements in all these types of transactions because of the fact that the transactions are being done between two unrelated parties, who don't have a deep understanding about the business that they are going to take over or merge with. The purpose of due diligence exercise is to assist the purchaser or the investor in finding out all the facts and figures about the business he is going to acquire or invest prior to completion of the transaction.
5.	How does due diligence impact the projections?	From a valuation perspective, due diligence focuses on potential overvalued assets, under-recorded liabilities, overestimated revenue growth, incorrect synergy impact, tax position, quality of management, and structure and its impact on the robustness of the projected cash flows. The information received based on due diligence forms the inputs based on which the future profitability and cash flows are projected in valuation. Due diligence depicts clear and

S. No	Question	Answer
		transparent business facts based on robust and reliable statements, and valuation based on such statements is very effective.
6.	How does due diligence impact the multiple on earnings?	Financial Due diligence from an earnings and revenue perspective has three important considerations: 1) Adherence to Accounting Policy i.e., identify the key accounting policies and standards that the firm use and also identify questionable policies needing further investigations. 2) Commercial aspects i.e.. ascertain how much of the profits is sustainable in future. 3) Skeptical perspective i.e.. to identify if there are any leakage in revenue or are revenue over-stated.
7.	Does the due diligence impact enterprise value or equity value?	Yes, it impacts both enterprise value and equity value.
8.	Is working capital important for valuation. What due diligence is generally done on working capital?	Yes, working capital is important for ascertaining the estimated future cash flows for the company. The Discounted Cash Flow method involves the estimation of post-tax cash flows for the projected period, after taking into account the business's requirement of reinvestment in terms of capital expenditure and incremental working capital. A working capital analysis is one of the key areas in financial due diligence and same is required to ascertain the quality of current assets and adequacy of current liabilities. It also tests if the estimated cash/financing requirements for operations post the transaction are adequate or

S. No	Question	Answer
		not.
9.	What is the difference between financial due diligence and audit?	Audit and financial due diligence are not one and the same. While audit is an opinion on the historical financial statements of a company, due diligence has a wider scope and looks not just into the historical financial statements but also involves review of estimated future profitability and reports on this in terms of relevancy for the proposed transaction. The main aim of audit is to report on a true and fair view of the financials of the company but for financial due diligence, the main aim is to look at the sustainability of revenue and cash flows in future. E.g.,- One time cost in audit will be expensed off while for due diligence for normalizing the earnings same might be excluded as it is not recurring.
10.	What is business/ commercial due diligence? How does this impact valuation?	While valuing a company, a valuer is required to project the future profitability of the company which in turn would require estimating the future growth potential, market size and pricing for the product/business. From a valuation perspective, a Business Diligence focuses on estimating the future growth potential of a business and while estimating the same it requires one to investigates each individual business of the entity, study various geographies the entity is based, analyse the pricing of its

S. No	Question	Answer
		product, and understand the current and future expected demand and penetration of the business. Business Diligence involves looking into the entire market outlook. In addition to this, business diligence also seeks how well the individual company is placed against competition and does the company has the required uniqueness and resources to grow faster than the competitors.
11.	Accounting due diligence is connected with the historic financials. What is the impact on valuation?	Financial/Accounting due diligence is connected with both the historical financial and also future projections. It involves a review/investigation of the historical financial trends and report on this in terms of relevancy for the proposed transaction. For financial due diligence, the main aim is to look at the sustainability of revenue and cash flows based on the operational results observed over a specified time period. From a valuation perspective, financial due diligence focuses on potential overvalued assets, under-recorded liabilities and their impact on the future, the robustness of the projected cash flows both for revenue and cost.
12.	What has been the impact of Covid on the financials of companies? How do we adjust the financial statements for the impact of Covid?	While assessing the impact of COVID-19 on the financials, an entity's ability to continue as going concern shall be the first test to be undertaken. Economic distress like COVID causes financial distress in entities wherein they are unable to meet off their financial obligations to their creditors typically due to high fixed costs, illiquid assets or

S. No	Question	Answer
		revenues that are sensitive to economic downturns. It is also important to ascertain the industry-wise impact because some industry may be immensely impacted while other might have benefited/less immensely impacted during this period. Even the recovery period will vary from industry to industry and needs to be ascertained cautiously. You can also refer Valuation Professionals' Insight Series IV, which has multiple articles on this topic and is available at:- https://resource.cdn.icai.org/63123vsb51074.pdf
13.	What is the impact of tax due diligence on valuation?	Tax outflow also impacts the value of a business. Valuation should incorporate all tax benefits like tax holiday, accumulated losses etc. or probable tax exposures that might impact the future estimated post-tax cash flow for the company. Tax Due Diligence is carried out to understand the tax status of a company and also to identify and quantify any material tax exposure that is already existing or might arise as a result of the concerned transaction. Any potential tax benefit that is not being claimed or can arise post the deal are also identified and quantified. Hence, a Tax due diligence helps in validating all the tax related assumptions made by a valuer while ascertaining the valuation of a target

S. No	Question	Answer
		company.
14.	What is the impact of legal due diligence on valuation?	A legal due diligence is a process of assessing and ascertaining the legal risk associated with an entity. During the process one reviews all the documents pertaining to the entity and interviews people associated. The objective of the legal diligence is to understand all the potential legal issues that can arise in future post the concerned transaction.
15.	What is the impact of human resource due diligence on valuation?	Human resource diligence involves analysing the contractual regulations and compliances, benefits offered to employees and existing compensation policy. The overall organizational structure is also evaluated, and it is ascertained whether the same is in line with the expected future growth and market size of the new entity. In valuation, human resource diligence has both quantitative and qualitative impacts. Examples of quantitative impacts are personnel cost and future productivity, while qualitative impacts are creativity and know-how for the company.
16.	What is the impact of technology due diligence on valuation?	In today's scenario huge amounts are being spent on technology by entities and hence acquirers in M&A transactions do vet them by conducting technology due diligence. Generally, the buyer/investor of software or technology companies has knowledge about the product and how it will fit into their business, but they need a deeper insight into the tools, processes, architecture of the software, intellectual property

S. No	Question	Answer
		etc. Hence, a technology due diligence is required to perform a range of inquires in all the above angles. A technology due diligence also checks how safe and prepared is the technology at the entity in terms of any potential Cyberattack, ransomware and other infringements.
17.	How do contingent liabilities impact valuation?	In due diligence, one needs to look into all the liabilities including contingent liabilities. With respect to Contingent Liabilities, normally a PPR test is done, i.e.. probable, possible and remote. Remote contingent liabilities are those that can be excluded from valuation as the probability of them being incurred is remote. Probable events are those that necessarily have to be provisioned for and hence shall be considered in valuation. It is the possible category wherein the judgement of the valuer comes into play, and he needs to decide whether the liability is to be provisioned and considered in valuation or shall be excluded.
18.	How does related party transactions impacts valuation?	The impact of related party transactions on the sustainable operations of the business are to be assessed as part of the due diligence. For example, the promoter/CEO may be drawing lower compensation than market benchmarks for similar business and the additional compensation in future will need to be factored in the earnings.

S. No	Question	Answer
		Another example is, there may be borrowings or investments in related parties which may not be on arms-length basis or not related to the business operations and hence needs to be adjusted.
19.	What is the impact of due diligence on valuation of start-ups companies?	Apart from other due diligence, business/ commercial due diligence is important while reviewing start-ups.
20.	How does diligence impact brand valuation?	Due diligence has far-reaching impact on brand valuation too. It can impact the amount of existing sales reported and can also impact the forecasted sales which are used as the base for brand valuation.
21.	How is due diligence used in the transaction agreements?	Apart from the valuation, observations of due diligence process can also impact the protections related terms of transaction documents like representations, warranties, indemnities, material adverse clauses, etc.
22.	How does diligence impact earnouts/contingent consideration?	Earn-out or contingent consideration is generally applicable where the seller wants to be compensated for the future growth of the business. The pre-acquisition/investment due diligence helps in defining the parameters for calculating the earnings which will be eligible for earn-out.
23.	One of the key outcomes of a Due Diligence report is normalised earnings view. Is it fair to equate it to Proforma EBIDTA and add back future oriented synergies/cost savings calling such actual costs to be non-	Let us understand this with the help of an example. Consider an acquisition, wherein both the acquirer and seller have offices in a common area and post-acquisition one of the offices can be surrendered. The acquirer will consider cash savings on account of same and will also take it in the proforma

S. No	Question	Answer
	recurring? Especially when such savings/synergies will come through acquiror only? Should the seller get a price multiple based on such inflated Proforma EBIDTA?	earnings. Now whether the benefit is being considered in valuation while finalizing the deal will depend upon the buyer's contract negotiation skill. While he might consider this savings as part of his working but not necessarily disclose it to the seller. From a valuer's perspective this will vary depending upon from whose side the valuer is undertaking the valuation. As a valuer one should always ascertain the probable synergies arising out of the transactions and drive back that value and report same in his report as same can be useful for both buyer and seller in negotiating and deciding the final price.
24.	What are techniques available for valuation?	Please refer Educational Material on ICAI Valuation Standard 103 – Valuation Approaches and Methods as issued by Valuation Standards Board of ICAI and ICAI RVO and available at: https://resource.cdn.icai.org/63029vsb51000.pdf
25.	How to value a startup that is loss-making, can we rely on management projection since it never made any profits? How will DCF work under such a situation?	The companies with no revenue or losses cannot use the multiple of profit or EBITDA method as it will lead to a negative valuation. Hence, these companies are valued on the basis of estimated future cash flows being discounted to present value. The break-even point is to be estimated, and the valuer needs to ascertain how the negative margins will turn zero and thereafter positive and ultimately when will it become sustainable with a low growth rate. Accordingly, the explicit period

S. No	Question	Answer
		shall be considered, and estimations shall be developed appropriately. The explicit period for such cases is normally not restricted to 5 years and can go up beyond it to say 10 years too. Further, majority of the value in these cases comes from the perpetuity value and not from the foreseeable future. Hence, to compensate for this risk a higher discounting rate is used to reflect the higher probability of failure, or the higher uncertainty associated with the same or by the use of certainty factor or both. Also, the Growth rate plays an important role in the valuation of perpetuity(terminal) value and shall be determined appropriately. Stress testing and scenario-based modelling could also be performed along with sensitivity analysis to check the confidence level of the fair value identified.
26.	Can we record any goodwill on acquisition of a startup? Since it's in losses hence impairment may be triggered immediately after recognition?	Goodwill may be recorded on acquisition of a start-up which will be subject to impairment testing on reporting of the Acquirer's financial statements.
27.	How to do valuation for a target Co.?	Kindly refer to Educational Material on ICAI Valuation Standard 301- Business Valuation as issued by Valuation Standards Board of ICAI and ICAI RVO and available at: https://resource.cdn.icai.org/63123vsb51074.pdf The Educational Material gives detailed guideline

S. No	Question	Answer
		with practical examples on Business Valuation.
28.	Please share detailed process for due diligence from finalizing the investors to receiving the fund.	As discussed above, there are various types of due diligence to be done pre and post execution of the Term Sheet. Generally, business due diligence is the main focus pre-term sheet stage and all the other detailed due diligences including financial, legal, tax, technology, environment is to be undertaken post the term sheet execution and before the transaction documents are executed.
29.	Please discuss DCF method of Valuation?	Please refer to Educational Material on ÏCAI Valuation Standard 103 – Valuation Approaches and Methods as issued by Valuation Standards Board of ICAI and ICAI RVO available at https://resource.cdn.icai.org/63029vsb51000.pdfp
30.	The main aim of an Investor is predominantly to identify any un-recorded liabilities; thus, Due Diligence becomes an Investigation exercise, how does one balance between Investigation and Diligence?	The balance between the Investigation and Diligence depends on the kind of company that is being dealt with. If one suspect large potential financial distortion by looking at the company itself and believes that there are hidden liabilities in the company then the focus of the diligence shall be ungraving them first and accordingly the investigation in that area shall be more intensive as compared to others.
31.	How to do a system audit for valuation purposes?	System Audit as part of technology diligence is a part of the entire Due Diligence activity.
32.	Can the Valuation be negotiated for Promoter and brand value? What is the best method to do so?	A valuer shall never conclude an assignment basis the negotiations between the valuer and seller as that will be considered as professional negligence.

S. No	Question	Answer
		ICAI Valuation Standard 201- clearly spells out "The judgments made by the valuer during the course of assignment, including the sufficiency of the data made available to meet the purpose of the valuation, must be adequately supported." "The valuer shall carry out relevant analyses and evaluations through discussions, inspections, survey, calculations and such other means as may be applicable and available to that effect."
33.	How can we value off-balance sheet assets like customer loyalty which is completely undermining the traditional valuation methods? Can we use an imaginary cash flow contribution margin attributable to customer royalty and discount it with the cost of capital to arrive at the asset value and blend it with Net asset value to arrive at the enterprise value?	Non-financial factors like customer loyalty and participation are used by a valuer in analysing and evaluating the adequacy of the estimated cash flow of a company and revenue sustainability. It is one of the critical inputs for competition analysis and future threats and opportunities available to the company. A valuer cannot use an imaginary cash-flow based on just one factor. ICAI Valuation Standard 201- clearly spells out *"The judgments made by the valuer during the course of assignment, including the sufficiency of the data made available to meet the purpose of the valuation, must be adequately supported."* *"The valuer shall carry out relevant analyses and evaluations through discussions, inspections, survey, calculations and such other means as may be applicable and available to that effect."*

S. No	Question	Answer
		ICAI Valuation Standards 2018 also provide that a valuer is expected to exercise Professional Skepticism in all his Valuation Assignments.
34.	How to improve the quality of the valuation reports?	Kindly look into the Concept Paper issued by ICAI RVO on Learnings from the Observations of Peer Review of Valuation Reports in 2020 and in 2021. The paper is available at the below link:- https://icairvo.in/concept-papers.aspx The Concept paper guides about the common mistakes valuers does in drafting a valuation report and also gives suggestions and recommendations on how to improve quality of the valuation reports. Kindly also refer to our webinar on the topic "Valuation Reports- Do's & Don'ts-To what extent are they followed" held on 20th Jun, 2021. The webcast can be viewed on the below link:- https://live.icai.org/vsb/vcm/20062021/
35.	Where can we revisit these recordings of VCM again?	All the links to previous sessions can be accessed from the Valuation Standards Board webpage at the ICAI website. Link is as under:- http://icai.org/post/valuation-standards-board
36.	Zomato being a loss-making company over the years, do you think it is over-valued for the IPO?	Value of Zomato is mainly based on the future expected cash flows of the company and not on the fact that Zomato is a loss-making company. Valuations are mainly done based on the prospects and on the basis of TTM (Trailing Twelve Months). The speed at which the Indian economy is growing is fast thus, leading to a sharp rise in the

S. No	Question	Answer
		discretionary spending power of the consumers in India which gives companies like Zomato a huge advantage. However, in the opinion of several valuers and market experts, Zomato is currently overvalued due to the excess demand for its shares in the market and hence it may see a correction once the demand stabilizes, and the company is valued on the basis of business fundamentals and not demand and supply in the market.
37.	What should be the key focus area in Due Diligence on behalf of a PE on target and Due Diligence on behalf of an existing Company that wants to grow through acquisitions?	For an existing company, since they are already in similar line of business hence, they understand the sector very well and thus from the business diligence perspective not much is to be done. However, financial diligence around Synergies will play a critical role and the focus will be on non-compliance issues, tax and legal issues. For a Private Equity player focus is a lot more on the business and financial diligence. Legal diligence is also critical as the Private Equity players would like to know the legal implications that they can face at the time of exit from the investment.
38.	Is there any model with questionnaire on valuation of a unit for takeover and merger?	There are no standard models or questionnaires. However, the three pillars for due diligence under any merger or take-over deals are as under :- 1) Valuation 2) Anything taken in transaction documents in terms of Representations warranties

S. No	Question	Answer
		indemnities etc. 3) Post-merger Integration and Synergy
39.	What is the difference between Due Diligence, Audit, and Investigation? To what extent do you deep dive in case of diligence?	The main aim of an audit is to give a true and fair view of the financials of the company. In the case of Financial due diligence, the aim is to look at the sustainability of revenue and future cash flows. One-time cost in audit will be expensed off while for due diligence for normalizing the earnings same might be excluded as it is not recurring. Investigation means deep diving into all the aspects and can also involve forensic audit if required.
40.	Can Due Diligence be a part of Forensic Audit?	A Forensic Audit is largely meant to gather information to be presented in the court of law. Due diligence is all about validating the sustainability of revenue and future cash flows, and hence both shall not be interconnected.
41.	Can we put this in a sense that the savings expected as a result of the transaction can be further validated by due diligence?	Yes that's correct.
42.	Does Due Diligence help in determining what is the right valuation method to be applied to a given opportunity?	As discussed above, information obtained from a due diligence process forms critical inputs required for valuation. Based on the study of these inputs a valuer can decide the valuation methodology to be applied. The valuation approaches and methods shall be

S. No	Question	Answer
		selected in a manner that would maximise the use of relevant observable inputs and minimise the use of unobservable inputs.
43.	How is the scope of due diligence determined in different scenarios, does time limitation impact the whole scope of due diligence?	Yes, the time limitation impacts the whole scope of due diligence for sure.
44.	Have you seen differences of opinion out of Due Diligence outcomes? What is the approach taken to address these conflicts?	Difference of opinions does happen in due diligence, e.g.: one may say that a particular event is a one-time impact while other can consider it to be of recurring nature. In most cases the buyer or investor will take a balanced decision and ultimately its the experience that helps in addressing these conflicts.
45.	For bank loan can we chartered accountants give due diligence reports?	Yes
46.	What kind of timelines comes to play in the start and end of due diligence and valuation of a company in a takeover or merger process?	There is no standard benchmark and can vary on case-to-case basis depending upon the nature and size of the transaction. However, the expected timelines shall be adequately captured in the engagement letter.
47.	Can you suggest any book on business valuation?	Kindly refer to Educational Material on ICAI Valuation Standard 301- Business Valuation as issued by Valuation Standards Board of ICAI and ICAI RVO and available at:- https://resource.cdn.icai.org/63123vsb51074.pdf
48.	If a new Chartered Accountant wants to start a career in Due Diligence and Valuation, where	Process for becoming a registered valuer may be referred from the FAQs available at ICAI RVO's Website

S. No	Question	Answer
	should he start? As there are very few CA firms practicing in due diligence and valuation.	https://icairvo.in/

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