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The Institute of Chartered Accountant of India

VASAI BRANCH OF WIRC NEWSLETTER

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October 2020

CHAIRMAN'S COMMUNICATION

Dear Esteemed Members

Today, Chartered Accountants play an important role in contributing to strategic decision-making. They are the ambassadors of the country's economic system and Partners in Nation Building - interfacing between government & tax-paying companies and individuals. CAs are committed to their work and the key to their success is that they possess an ethical mindset, creativity, analytical & presentation skills, professional equanimity and collaborativeness.

Mahatma Gandhi gave us message that "wealth without work; pleasure without conscience; knowledge without character; religion without sacrifice; politics without principle; science without humanity; business without ethics, can lead us to the wrong path. Values – altruism, honesty, respect and like – keep the cycle of life smoothly going forward. Ethical values push everyone to move forward on a single path of the right, making concepts like development, progress and advancement feasible in the first place. Absence of these would push for a directionless world predominantly run on vices, where selfish greed would make living in one community impossible.

Increase in the no. of Structured CPE hours being granted in online mode

Taking cognizance of the COVID-19 pandemic situation worldwide when public gathering is still restricted/not advisable, it has been decided by Competent Authority to allow grant of 20 Structured CPE hours through online mode **till 31st December, 2020.**

Accordingly, following may be noted for information:

"Requirement of completion of 20 hours Structured CPE hours which is mandatory to be completed by Members below 60 years holding COP, in each calendar year, **can now be fulfilled** through online mode (either through Digital Learning Hub or through Virtual CPE meetings including mandatory CPE hours on "Code of ethics" and "Standard on auditing") **till 31st December, 2020.**" To clarify, if a member has earned more than 20 Structured CPE hours through Digital learning Hub and/or VCMs till 31st December, 2020, for compliance purpose, only 20 Structured CPE hours will be credited."

Assessment / Refresher Course Scheme for the students who have not taken membership or not restored their membership even after lapse for three consecutive years

The proposal for introducing an Assessment/Refresher Course Scheme for the students who have not taken membership of the Institute for more than 3 years after qualifying the Final Examination as well as for ex-members who have not applied for restoration of membership for more than three years after removal of name due to non-payment of Membership fee or any other reason. Based on the decision of the Council, the draft amendments in the Chartered Accountants Regulations, 1988 were submitted to the Central Government for its consideration and approval. While there is still time in the final changes in the regulations and their implementation, it is suggested that the members/ students who have cleared their final examination may restore/take membership of the Institute at the earliest.

Before I conclude, I wish to inform that last date for payment of Membership /COP fee for the year 2020-21 has been extended up to 30th November, 2020. I would also like to wish a happy Dushhera, Durga Puja and a prosperous Deepawali to everyone.

Ankit

CA. Ankit Rathi
Chairman
Vasai Branch of WIRC of ICAI

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Paradigm Shift in CA Practice Post COVID-19

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COVID-19 is an unprecedented pandemic for the world and has impacted every walk of life. Different individuals, Sectors, Industries, Businesses, Professions, Countries have faced varied impacts of COVID-19 across the globe. Our CA profession is also one of them.

Really speaking COVID-19 gave an opportunity for everyone to do introspection and made you realize that, where you actually stand as compared to what you thought about.

COVID-19 has forced you to accept **THE NEW NORMAL** whether you want it or not.

So let's understand what The New Normal for CA Profession post COVID-19.

In my opinion the COVID-19 has brought a paradigm shift for CA profession which is not only going to change but transform the CA Profession in days to come.

Especially the Small & Medium Practitioners (SMPs) have to gear-up themselves to accept this inevitable.

Compliances to Advisory Practice

Compliance practice has its own inherent limitations. Though it is the beginning of practice for every new entrant but for the qualitative and vertical growth of every SMPs one have to think for Advisory Practice areas and clients over a period of time. In this COVID-19 lockdown period we have seen how the compliance practice got a big impact and suddenly after unlocking SMPs really struggling to meet the deadlines and really at the mercy of the Government for extension of various due dates.

Apart from that, competition in the profession, with fellow members as well as non-members and now Fin-tech Companies is a new challenge before the SMPs for their survival.

Hence SMPs need to think over moving from compliance practice to advisory services and start growing vertically rather than horizontally.

Opportunities to Global Practice

Opportunities across the globe are made available by globalization and SMPs have to think over going globally to tap the various opportunities worldwide. ICAI has signed MRA/MOU with many such countries wherein Indian CAs are recognized. ICAI has also opened its overseas chapters in almost 50 countries. This is a new opening to SMPs to grab global opportunities and increase its spread of practice.

Virtual from Physical Practice

Social distancing and restriction on physical presence in this lockdown has challenged and created threat to the SMPs practice unimaginably. Hence one has to understand the importance of Virtual Presence in every situation. I am sure that in this lockdown virtually everyone was present and accessible to each one despite of very stringent restrictions on physical presence and movement. Even today due to lack of local train services and other public transport many SMPs are struggling to attend their offices and provide their services.

Cloud Platform, Virtual office or Cloud Server and Work From Home are going to be new routines and SMPs have to technologically upgrade themselves to these new normal.

Innovation in Tradition Practice

Innovation is the need of the hour and COVID-19 has given us an option to innovate or perish. Even the Government Departments have innovated their activities and services over a period of time and an era has come that innovation is going to be key for success. Rapid Digitalization has also increased the burden of online compliances, Faceless Assessment and Appeals, Mobile based Services, use of various advanced software's and audit tools for day to practice has made it imperative for SMPs to innovate their traditional way of practice.

Disciplined from Casual Practice

The new code of ethics is already in force from 1st July 2020 and the same has brought sea changes in the way of practice especially for SMPs. Prohibition on rendering tax services to audit clients, Non Compliances with Laws & Regulations (NOCLAR), Restriction of Advertisement and use of Social Media, 15% fees restriction from one client and many more global concepts are being introduced by new code of ethics. This is going to impact the SMPs cyclically and multiple ways. Along with that today we are witnessing the era of dynamic laws like GST as never seen before where daily one or the other change is happening either by AAR, Notification or by Twitter. Therefore it is now of utmost importance for SMPs to think on Multi-Disciplinary Partnership/ LLPs (MDP) in days to come to survive and sustain in practice. The ICAI has in-principally has given green signal to MDP and soon it will be a reality.

Thus the COVID-19 has brought a paradigm shift in the CA Practice and it's time for the CAs and especially the SMPs to accept this **NEW NORMAL** in our CA profession and to face the challenges of the post COVID-19 world.

Let's unlock our minds and give relook at the new world to do Mission Begin Again

Mediation, an Alternative that Safeguards the cordiality of relationships in disputes

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Settlement of disputes in an amicable way is the hall-mark of civilization. Mediation has been interwoven into the social fabric of society. During ancient times before the breakout of war, a mediator was sent to the enemy cap to reach amicable solutions. Our epic Mahabharata is a testimony where Lord Krishna was sent as mediator to resolve the differences between the Kaurava and Pandava kingdoms.

In modern times with changing social and economic factors, mediation has taken various new forms. From resolving disputes arising in families to disputes between giant corporate, mediation is a dispute resolution mechanism that provides complete and cost-effective means of resolving disputes. Even disputes between nations of the world are resolved by mediation. In fact, mediation is the only process of dispute resolution that promotes peace among nations.

Mediation can be applied to all sorts of disputes. One of the main benefits of mediation is that the parties can agree to take into account a broad range of aspects, especially concerning commercial and business interests. The process is flexible and can be tailored to the individual needs of parties.

Mediation is an informal, but structured settlement procedure. The main characteristics of mediation are that it provides; a voluntary, non-binding, confidential and interest-based procedure. Parties are free to terminate mediation at any time after the first meeting. No decision can be imposed on the parties involved, and they may or may not agree upon a negotiated settlement. The confidentiality principle assures that any options the parties discuss will not have consequences beyond the mediation process. As mentioned earlier Mediation is an Interest-based procedure. It means that the criteria established to reach resolution does not solely adhere to the law, instead it can include considerations concerning financial, business and personal interests as well.

The role of the mediator is to assist the parties in reaching a negotiated agreement. Unlike an arbitrator, the mediator is not a decision-maker.

The effectiveness of mediation lies in the effectiveness of the mediator and the type of mediation he chooses to resolve a particular dispute. The mediator tries to help the parties to find common ground using principles of collaboration and mutual-gains.

COMPARISON BETWEEN JUDICIAL PROCESS AND VARIOUS ADR PROCESSES JUDICIAL PROCESS ARBITRATION MEDIATION

Judicial process	Arbitration	Mediation
Judicial process is an adjudicatory process where a third party(Judge/ other party) decides the outcome	Arbitration is a quasi-judicial adjudicatory process where the arbitrators appointed by the court or by the parties decide the dispute between the parties	Mediation is a negotiation process and not an adjudicatory process. The mediator facilitates the process. The parties participate directly in there solution of their dispute and decide the terms of settlement.
Procedures and decisions are governed, controlled and restricted by the provisions of the relevant statutes	Procedures and decisions are governed, controlled and restricted by the provisions of the Arbitration and the Conciliation Act 1996	Procedure and settlement are not controlled, governed or restricted by stutatory provisions thereby allowing freedom and flexibility.
The decision is binding on the parties	The award in an arbitration is binding on the parties.	A binding settlement is reached only if parties arrive at a mutually acceptable agreement.
Adversarial in nature as focus is on past events and determination of rights and liabilities of parties	Adversarial in nature as focus is determination of rights and liabilities of parties	Collaborative in nature as focus is on the present and the future and resolution of disputes is by mutual agreement of parties irrespective of rights and liabilities.
Personal appearance or active participation of parties is not always required	Personal appearance or active participation of parties is not always required	Personal appearance or active participation of parties are always required.
A formal proceeding held in public and follows strict procedural stages.	A formal proceeding held in private following strict procedural stages.	A non-judicial and informal proceeding held in private with flexible procedural grounds.
Decision is appealable	Award is subject to challenge on specific grounds	Decree/order in terms of the settlement is final and is not appealable.
No opportunities for parties to communicate directly with each other	No opportunities for parties to communicate directly with each other	Optimal opportunities for parties to communicate directly with each other in the presence of the mediator.
Involves payment of court fees	Does not involve payment of court fees	In case of settlement, in a court annexed mediation the court fee already paid is refundable as per the rules.

Disputes where Mediation is a better alternative than other forms of dispute resolution methods

1. Family Business Disputes

Like mentioned earlier, in mediation the objective is to solve a dispute while safe guarding the cordial relationship. And what better way to solve family disputes than mediation. The disputes may arise from a major business decision in family. Sometimes there is dead lock situation in the board of directors of the family run business, where neither party is even on talking terms with each other. At such times an mediator can help resolve the dispute. Most of the family businesses face the challenge when their boards are composed of three generations. Each generation bringing with them new and different styles of leadership.

Mediators will help in this situation by taking into confidence every member's perspective to create harmony at the Board.

2. In construction Sector

By very nature, the gestation period of construction companies is very long. The industry is characterised by interplay of various participants right from land owners, labour, contract labour, legal department, laisioning departments.

Delay in delivering projects is a serious concern for all the parties involved in the process. This results in unpleasantries with the concerned parties. However, they have to be working in tandem with each other till the project is completed. A mediator in such cases helps in resolve disputes and get the project going up-till completion.

Conclusion

With the rise in number of litigations and the ever-rising cost to resolving disputes in terms of cost and time required to settle a dispute, mediation seems to be a golden mean for resolving the matter. Mediation not just saves the businesses from being at loggerheads with each other but also helps in creating a friendly environment for everyone to survive. Mediation is not just a dispute resolution process but a flexible path that helps in overcoming cultural barriers, improving communications, restoring or maintaining relationships, promoting confidentiality and producing more creative, satisfactory and durable resolutions.

Listing without IPO – Innovators' Growth Platform

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Initial Public Offer (IPO) has usually been the most preferred route for getting listed on stock exchanges, however, considering the huge costs, time as well as uncertainty involved, Government of India decided to offer relaxation to selected category of SMEs and start-ups. Accordingly, SEBI made necessary provision in ICDR Regulations to allow listing on 'Institutional Trading Platform' (ITP) of stock exchanges without bringing an IPO. It was originally notified by SEBI in 2013 and detailed circular was issued, but subsequently it was modified in 2015 to facilitate listing of promising start-ups in new age sectors like bio-technology, data analytics, e-commerce, etc. In 2018, ITP was renamed as 'Innovators Growth Platform' (IGP) in order to position the product differently among the potential stakeholders.

Chapter X of SEBI (Issue of Capital & Disclosure Requirements) Regulations, 2018 specifically covers provisions related to IGP towards listing of securities only for trading on a stock exchange without IPO. Subject to meeting eligibility criteria and other conditions, a company can get itself listed on IGP on its own without hiring any intermediaries like merchant bankers, underwriters, etc.

Eligibility Criteria for IGP

Given the preferential treatment in the form of listing on IGP without IPO as well as subsequent option to access main board of stock exchange in future, SEBI has prescribed strict eligibility criteria in order to avoid any misuse.

1) Company should be intensive in the use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology to provide products, services or business platforms with substantial value addition.

2) As on the date of filing of draft information document with SEBI, twenty five per cent of the pre-issue capital of the company for at least a period of two years, should have been held by either of the following category of investors:

    1. Qualified Institutional Buyers
    2. Family Trust with net worth of ₹ 500 crores
    3. Accredited Investors for the purpose of IGP

4. Foreign Portfolio Investors
5. Pooled Investment Fund

Accredited Investors for the purpose of IGP

Accredited Investors can hold upto 10% of pre-issue paid-up capital of the company. Following category of investors can be classified as Accredited Investors by undergoing due process as per Chapter X:

1. Any individual investor with total gross income of ₹ 50 lakhs annually alongwith minimum liquid net worth of ₹ 5 crores
2. Any body corporate with net worth of ₹ 25 crores

In order to get accredition, these investors have to open a demat account with a depository and thereafter, submit an application to the stock exchange in prescribed format. Subject to eligibility, stock exchanges can grant accredition to investors upto a period of 3 years. After getting accredition, these investors can invest in any company on IGP.

Process Snapshot for Listing on IGP without IPO

SEBI has tried to keep process for listing on IGP simple and it can be completed in a span of 1 quarter if all documents are in order and the promoters successfully solve all queries by the regulators. Following is the process for listing on IGP:

1) File draft information document with SEBI alongwith necessary documents and pay fees as per Schedule III
2) Draft information documents must contain disclosures as per Part A of Schedule VI
3) Obtain in-principle approval from the stock exchange where shares will be listed
4) Complete listing process in 30 days on getting final approval from SEBI
5) Draft and final information document has to be approved by the Board of Directors of company and it should be signed by all directors as well as CEO and CFO. Each of these signatories will have to certify that all disclosures made in the information documents are true and correct.

Comparative Analysis – IGP vis-à-vis SME Exchange

Particulars	IGP	SME Exchange
Paid-up Share Capital	₹ 10 crores	Upto ₹ 10 crores – Only on SME exchange ₹ 10-25 crores – Optional
IPO	Optional	Mandatory
Minimum Trading Lot	₹ 2 Lakhs	₹ 1 Lakh
Observations Given by	SEBI	Stock Exchange
Market Making	Not required	Compulsory
Reporting	Quarterly	Half Yearly
Cooling Period for trading on Main Board	1 Year	2 Years
Minimum Lock-in of Promoters' Holding	6 Months	3 Years

Benefits of Listing on IGP

Majority of entrepreneurs aim to list their companies with an ambition to take their business to next level and use funds to tap growth opportunities. Besides earning profits, every successful listed company has a potential to create significant value for different stakeholders ~ lenders, employees, vendors, government, society and finally, its shareholders.

Benefits for Companies

1) An opportunity to raise capital for start-ups at early stage of growth
2) Relaxed compliance norms due to optional IPO
3) Cost effective listing
4) Better visibility among peers
5) Wider investor base to reduce dependence on single investor
6) High potential to grow inorganically by using shares as a virtual currency for M&A

Benefits for Shareholders

1) Tax benefits for long term investors
2) Smooth entry and exit plans for all investors ~ more particularly for big investors like Angel Investors, VC / Private Equity Funds, etc
3) De-risking strategy due to listing on recognised stock exchange

Role of CAs

India is third largest ecosystem in the world with nearly 65000 registered start-ups. In order to promote innovation, development and improvement of key products, processes or services, Government of India has offered numerous benefits for start-ups. Several local companies have regularly started accessing global markets and even, many of them have got great support from investors. For sure, stock exchange listing can positively help them to access funds for expansion, particularly when there is an acute liquidity crunch after Covid-19 pandemic.

Chartered Accountants have been consistently rendering best quality services while getting associated with most of the business entities ever since their inception. Given the cost effective listing alternative offered by SEBI through IGP, CAs can play an active role in identifying eligible companies and create enormous value by helping them to get listed on IGP. However, it has to be always kept in mind that stock exchange listing is an important corporate activity which has to be systematically planned and carefully executed while diligently complying under different regulations over a period of time.

"Building wealth is a Marathon, not a Sprint. Discipline is the key ingredient." – Dave Ramsey

Taxation of Start-ups

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Introduction

Start-ups play a key role in the overall development of an economy. They play a leading role towards innovation, development and improvement of product, processes, and/or services. They also play a crucial role in generating large scale employments. In order to motivate these start-ups, income tax has provided several initiatives and exemptions for start-ups.

Objective

The article provides a summary of key initiatives provided by Income Tax Act,1961.

Definition of Start-ups

With reference to Notification G.S.R 127(E) dated 19th February 2019, issued by Ministry of Commerce and Industry-

An entity shall be considered as Start-Up

- ***Up to a period of 10 years from the date of incorporation/ registration.***
- ***If it is incorporated as Private Limited Co or registered as LLP or Partnership Firm in India***
- ***Turnover of any year since incorporation has not exceeded ₹ 100 crore.***
- ***Entity is working towards***
  - ***innovation, development, or improvement of products or***
  - ***processes or services, or***
  - ***if it is a scalable business model with a high potential of employment generation or wealth creation.***

However, an entity formed by splitting up or reconstruction of an existing business shall not be considered a 'Start-up'.

Further, an entity shall cease to be a Start-up on completion of 10 years from the date of its incorporation or if its turnover for any previous year exceeds ₹ 100 crore.

An Eligible entity shall be recognised as a Start-Up after its application has been approved by Department for Promotion of Industry and Internal Trade (DPIIT).

Tax Holidays for Start-ups – Exemptions under Section 80 IAC

As per provisions of Section 80 IAC, -

- A eligible start-up, being a Private Limited Company or a LLP incorporated between 1st April, 2016 and 31st March, 2021 and holding a certificate of eligible business from the notified Inter-Ministerial Board of Certification (IMBC) will be allowed 100% deduction of profits and gains derived from such business for three consecutive assessment years.
- The deduction under section 80 IAC can be claimed for any 3 consecutive assessment years out of 10 years beginning from the year in which such company or LLP is incorporated.

However, entities need to fulfil following conditions for availing exemption u/s 80 IAC

1. Total turnover of the entity does not exceed INR 100 crores in the year in which deduction is claimed.
2. Business is not formed by splitting up, or the reconstruction of a business already in existence.

   However, revival of business discontinued on account of flood, typhoon, hurricane, cyclone, earthquake or otherwise convulsion of nature, riot or civil disturbance, accidental fire or explosion, action by an enemy or action taken in combating an enemy is permissible subject to fulfilment of certain conditions.
3. Business is not formed by the transfer of previously used machinery or plant for any purpose.

Exemption from taxability of share premium u/s 56(2)(viib)- Angel Tax

A Start-up shall be eligible to be exempted from the taxation of excess share premium under section 56(2)(viib) of Income Tax Act,1961 if it fulfils the following conditions:

- it has been recognised by DPIIT; and
- aggregate amount of paid up share capital and share premium of the start-up after issue or proposed issue of share, if any, does not exceed, ₹ 25 Crore.

However, while computing the said sum of ₹ 25 crore, the amount received in respect of shares issued to following shall not be included-

- To a Venture Capital Company or Venture Capital Fund; and
- To a Specified Company.

(Specified company is defined as a company whose shares are regularly traded in a stock exchange and whose net worth on the last day of the preceding financial year exceeds ₹ 100 Crore).

Further, the start-up is also barred from investing in any of the specified assets for a period of seven years from the end of the latest financial year in which shares are issued at a premium.

In case, where an entity availing exemption u/s 80 IAC fails to comply with the conditions specified above, the consideration received for issue of shares in excess of fair market of such shares shall be deemed to be the income of the company chargeable to income-tax for the previous year in which such failure has taken place.

Carry Forward and Set Off Losses on Non-Satisfaction of conditions u/s 79(1)

An eligible start-up, shall be able to carry forward and set off loss incurred in any year prior to the previous year against the income of the previous year; if –

- All the shareholders of such company who held shares carrying voting power on the last day of the year or years in which the loss was incurred, continue to hold those shares on the last day of such previous year; and
- Such loss has been incurred during the period of seven years beginning from the year in which such company is incorporated.

Deduction for Additional Employee Cost

An assessee who is subject to tax audit under section 44AB of the Income-tax Act is eligible for deduction at the rate of 30% of additional employee cost incurred in the previous year for 3 years starting from the year in which employment is provided.

However, the deduction will not be allowed, if:

- Business is formed by splitting up, or the reconstruction of a business already in existence.

  However, revival of business discontinued on account of flood, typhoon, hurricane, cyclone, earthquake or otherwise convulsion of nature, riot or civil disturbance, accidental fire or explosion, action by an enemy or action taken in combating an enemy is permissible subject to fulfilment of certain conditions.
- Business is acquired by the assessee by way of transfer from any other person or a result of business re-organisation.
- Failure to submit Accountant's report as may be prescribed.

Conclusion

We understand that Income Tax Department has launched several initiatives, however the same are subject to several conditions and restrictions. Overall, the initiatives shall help the start-up to cruise ahead in initial years.

Valuation of Debt Securities

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Thomas Jefferson once quoted "Never spend your money before you have it". In Corporate Finance, a well-known postulation under Pecking Order Theory proposes that the cost of financing increases with asymmetric information. Companies usually prioritise their funding options in the order of Internal Accruals, Debt and then Equity. Theoretically speaking, debt is always a cheaper option as compared to equity which lands us in the plight when it comes to the valuation of Debt Securities.

Introduction

Debt Market is a financial market where investors enter into buying and selling of debt securities. Such debt securities mostly involve Bonds, Debentures, T-Bills, Commercial Papers and Certificate of Deposits.

Indian Debt Market has been witnessing growth over past 2 decades as more and more investors are dazzled with the peculiar characteristics of the debt securities. Indian Debt Market is broadly classified in two categories viz. G-Sec Market and Bond Market. G-Sec Market refers to the securities issued by Central and State Governments.

Type of Debt Instruments

Debt Instruments can be classified as:

- Money Market Instruments
- Government Securities
- Corporate Bonds / Debentures

Money Market Instruments

Typical Money Market Instruments have a maturity of less than 1 year. Some of the important money market instruments in India are Treasury Bills, Certificate of Deposits and Commercial Papers.

The treasury bills are the securities issued by the Government with varied maturities like 91 days, 182 days and 364 days. T-Bills are virtually risk-free. Investors feel T-Bills attractive because these are actively traded in the secondary market and these can be readily transacted being in bearer form.

A Certificate of Deposit is a negotiable receipt of funds deposited with a bank. Bearer form of CD is more popular due to its acceptance in the secondary market. Similar to the T-Bills, CDs are usually issued at a discount and redeemed at par.

Commercial Papers are issued by financially sound and highly rated companies with a maturity period of minimum 7 days and maximum 365 days. Similar to the T-Bills and CDs, CPs are usually issued at discount and redeemed at par. Therefore, the implicit rate is the function of the size of the discount and maturity period involved. However, CPs being issued by private firms, are considered to be riskier as compared to T-Bills and CDs.

Government Securities

The Central Government sells Government Securities which are essentially medium to long-term bonds issued by the Reserve Bank of India on behalf of the Central Government. State Governments also sell similar bonds to the investors. Apart from the Government, many Public Sector Undertakings issue similar securities with varying coupon rates and periodicities.

Corporate Bonds / Debentures

Bonds and Debentures are regularly issued by PSUs, Banks and Public Companies and Private Companies. Such bonds / debentures are of different nature and characterised by different terms and conditions attached to such bonds / debentures. Debentures are often coupled with convertibility features either compulsorily or optionally by embedding put / call option.

Valuation of Debt Securities

Provisions of the ICAI Valuation Standards

ICAI Valuation Standard 303 – Financial Instruments speaks about valuation approaches, methods and techniques for valuation of financial instruments. The standard defines financial instrument as any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Equity instruments, derivatives, debt instruments, fixed income and structured products, compound instruments, etc. are certain examples of financial instruments.

When it comes to valuation of a Debt Instrument, important considerations are use of the debt instrument, purpose of valuation, characteristics of the instrument and availability of information. As per the provisions of ICAI Valuation Standard 102 – Valuation Bases, valuers need to select appropriate valuation bases relevant in the context of the instrument being valued. Furthermore, appropriate approaches and methods need to be applied as per the provisions of ICAI Valuation Standard 103 – Valuation Approaches and Methods.

In most of the circumstances, Present Value method under the Income Approach is the most appropriate. While applying the Present Value method, one needs to consider the following factors:

- Contractual Cash Flows arising out of the Debt Instrument
- The timing when the entity expects realisation of the cash flows
- The basis of calculation of cash flows viz. interest / coupon rate, underlying index etc.
- Contractual restrictions like lock-in period, put / call option, extension, conversion etc.

In the case of a debt instrument having embedded call / put option, one needs to bifurcate the instrument into debt and equity and calculate the value of the option by applying Black-Scholes-Merton model. For the sake of simplicity, we shall consider pure-debt instruments without having any embedded options for the purpose of understanding valuation of debt instrument in this article.

Valuation of Debt Instrument using Present Value technique

Valuing a debt instrument using Present Value method includes consideration of following points from the perspective of the market participants as on the valuation date:

- Estimation of the cash flows arising out of such Debt Instrument viz. periodic interest / coupon and redemption proceeds and premium if any
- Estimation of timing and possible variations including inherent uncertainty in realisation of the cash flows
- Estimation of the Discount Rate on the basis of Risk-Free Rate and Appropriate Risk Premium
- Calculation of Present Value of the Estimated Cash Flows

Estimation of cash flows usually depends upon the terms of the agreement of the debt security being valued. One needs to ascertain the possibility of variations and accordingly map the periodical cash flows in the DCF model.

The most important part is to ascertain the discount rate. When it comes to valuation of listed debt securities, the price reflected on the stock exchange is assumed to be the fair value. Accordingly, yield to maturity (YTM) is calculated using the formula:

$$Approximate\ YTM = \frac{C + \frac{F-P}{n}}{\frac{F+P}{2}}$$

Where,

YTM = Yield To Maturity

C = Annual Coupon

F = Face Value of the Bond

P = Price of the Bond

Under normal circumstances, YTM is assumed to be the discount rate. As such, while valuing an unlisted debt instrument, it become important to identify similar bonds / debentures being traded in the open market and calculation of YTM of such bonds. By making suitable adjustment on account of risks associated with the company whose bonds / debentures are being valued, suitable discount rate can be arrived at.

Another approach is to add appropriate risk premium to the risk-free rate and arrive at suitable discount rate. Doing so, one needs to understand major risks associated with the company / the instrument being valued. Some typical risks associated could be:

Credit Default Risk

Credit Default Risk refers to the risk that the company may not pay interest and / or principal on time.

It is normally measured by way of credit rating assigned to the debt instrument by an independent credit rating agency like CRISIL, ICRA, CARE etc. Other things kept constant, bonds / debentures carrying a higher credit default risk would trade at a higher yield to maturity. Based on the Credit Rating, appropriate mark-up can be added to the risk-free rate. While assessing the credit risk, rating agencies take into account factors like counterparty risk, capital leveraging, hierarchy of the security, collateral available, history of default etc.

Liquidity Risk

All debt instruments may not be as liquid as government securities. Unless the instrument is listed on any stock exchange, there is a lack of marketability which adds to the liquidity risk associated with the instrument. There is a standard practice of adding a lump-sum percentage to the discount rate on account of liquidity risk. The more scientific practice could be understanding the effect of similar debt instruments and having observable inputs from the secondary market.

Interest Rate Risk

Another risk associated with the debt securities is Interest Rate Risk. As we know, bond prices and yields are inversely related. As such, in a perfect market, securities are priced in such a fashion that fair expected returns are offered to the investor. For example, a bond with 10% return and 10% YTM would trade at par. If the Market Rate of Return increases, the YTM would eventually increase, bringing down the effective price of the bond. Similarly, reduction in Market Rate of Return would result into lowering of YTM and increase in the effective price of the bond.

Valuation of Debt Securities of Private Firms

A peculiar challenge may arise while valuing debt securities of private firm / small companies where instrument specific credit rating is not available. Under such circumstances, valuer may need to create a Synthetic Rating Model by assessing the Credit Default Risk associated.

In simple words, valuer may need to step into the shoes of a credit rating agency and consider the impact of counterparty risk, capital leveraging, hierarchy of the security, collateral available, history of default etc. on the financial position of the company. Valuer also needs to ascertain the risk associated with the company based on the interest coverage ratio and / or debt service coverage ratio in order to assign weightage in the synthetic rating model.

Conclusion

Valuation of debt securities is a complex exercise. Especially where availability of information is a big challenge, valuation may become a complicated assignment. When such debt instruments are issued by a company; such issue is mostly done under controlled environment. In the absence of observable inputs, valuer may often need to rely on the information and financial models provided by the company. As such, it is pertinent to analyse such control environment, its adequacy and independence. Furthermore, having an in-depth analysis of market trends, movements in the debt market and identification of similar bonds also becomes important in order to calculate effective discount rate.

Fintech – innovation which will define Banking 2021

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Financial technology in India is following the model of many successful start-ups in service area. The world of financial services IT start-ups is currently so vibrant that it has been given its own name Fintech.

Financial institutions are not the only players assessing this trend. Paytm and Google wallet are clear example that fintech products and services are not the exclusive domain of banks or major financial institutions. The Competition between banks and digital service providers to develop the next best Fintech products or service will also help identify the best of breed in Fintech companies with which they will attempt to cooperate.

We are currently in the early phase of exponential shift. As more and more Fintech companies emerge, more products and services will become available. As more traditional model decline, the new Fintech model offering might become the majority rather than the exception of nothing is done to integrate them in a new, revised, disintermediated financial services industry economy. Financial institutions and their CIOs have to start preparing for this change right now. Moreover, banks have to start assessing the likelihood that their customers will accept adoption of these technologies. There is a clear demand from the customer side to improve the current service offering of banks, however, customers do not give directions, but rather assess what is offered and decide to engage with it or not.

When the Fintech companies start doing IPOs and mergers with large public organizations, the field will gain even more attention and clear leaders will emerge. This will give more direction to the industry and filter out companies that are either too small or not innovative enough to survive on their own.

Robotic Process Automation (RPA) software will be widely used in 75% of financial services institutions by the end of 2021.

Why fintech is in demand.

Financial institutions have been operating in a challenging environment over the past few years. Consumers and regulators keep putting pressure on the business model of large players while giving an edge to small organization that benefit from more flexibility. Customer expect more from their interaction with financial institutions, particularly in terms of interaction on digital platforms.

Why are financial services firms making venture capital investments with Fintech start-ups?

There has been a structure shift in Banking IT. IT solutions no longer need to be built in-house. Third party suppliers are considered as viable for even the most core IT systems. But the biggest changes are driven by the digital revolution. Core system maintenance and challenge of meeting ever-tightening and changing regulations are very costly.

How there are venture capital investments with Fintech start-ups?

Large financial institutions that invest in fintech obviously want to support the best start-up, in other words start-ups that have the highest potential for disruption. Herein lies the central paradox for big financial institutions pushing into Silicon Valley.

Scenarios of evolution

Fintech start-ups are increasingly concentrated in geographic clusters. Places like Silicon Valley or London hold opportunities for the most successful ideas. Large companies are offering incubators and accelerators to increase the chances of cooperating with future leaders in the field.

Conclusion

There is no guide to Fintech start-ups and this will not change until someone revolutionizes the industry. The Fintech world is likely to be hit with the changes that are difficult to replicate and will therefore give a competitive advantage to those who engaged with the change early. These reforms of innovation will only increase in 2021, as global financial and tech giants revolutionize the financial service arena.

"Balancing of Professional & Personal Life" – Real Key of Happiness!

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Chartered Accountants have been known for ethics, dignity, respect & responsibility. Every Chartered Accountant is always trying the best for achievement of these four aspects in the life. People, situation & destiny gives us various lessons & experiences in the life. Recently we have seen Covid-19 pandemic has proved that life is very uncertain, which resulted in drastic & unexpected changes on every part of the world resulting in loss of over a millian human lives and collapse of numerous business enterprises. However there are many people and corporates who has conquered this unprecedented corona disease with strong mental & physical fitness.

Healthy life, proper time management, acceptance level, right approach towards the life and more importantly **Poper Balance between Professional & Personal Life can certainly** give the real happiness & satisfaction to every professional in the world.

If we have to talk specifically about professional life, being CA it is very important to understand following changes in our profession which has occurred recently and which every one of us should try to adopt them quickly –

- Understanding that digital is no more critical.
- Transparent work environment is necessary.
- Dividing Authority & understanding the power of joint efforts.
- Being more confident in leadership skills.
- Prepare for Worst & have plan B always with you.

If we have to talk specifically about personal life, being CA it is very important to understand that as we are accountable to others in the society same way we are accountable to ourselves to achieve something extraordinary in the life as human being and for that following are the few things where each one should pay an attention -

- Healthy life style is very important.
- Learn to appreciate the nature.
- Utilisation of time & resources effectively.
- Ethical Norms & Moral Values should be the Personal Quality.
- Practicising empathy in day to day life.

Now a days we have seen so many CA friends/ collegues who are unhappy in the life, who have stressed out due to too much work pressure, who have frustrated about the life, and even few professionals finished their life on their own too. Why this is happening??? –

Real reason is lack of patience & imbalancing of personal & professional life. Our Attitude is a matter of outlook & definitely matter of choice with us, we should always remember that Circle of Influence is to be given more importance than Circle of Concerns. It is recommended for every human being who is dreaming to go longer in his /her career should always balance work & family well through following ways –

1. Identify your support system.
2. Realastically evaluate your employment decision.
3. Set priorities for the family.
4. Plan ahead for the next day/month/year.
5. Prioritise the success in initial phase of professional life.
6. Redefine leadership.
7. Play it forward – Never loose the ray of hope.
8. Try to be independent always.
9. Reward yourself when you are not in good mood.
10. Keep role models & role modeling at every phase of the life.

Conclusion

Being healthy is more important than being wealthy, Being good executor is more important than being good planner,Being satisfied is more important than being greedy, Being knowledgeble is more important than being educated.

Government has extended various due dates under different regulations and there will be great workload in November and December while helping clients to do their compliances, however it does not mean that workload should affect our celebrations for Diwali, the biggest Indian festival with our near and dear ones. Diwali is known for light which is important for human existence and let us celebrate it with full enthusiasm by spreading light in our professional and personal lives while removing darkness caused due to Covid-19.

If we can successfully balance the Personal Life & Professional Life in desired manner then no one can stop us to complete all goals, aims & aspirations of the precious life. "Let's promise ourselves to do it and it can be the best gift for Diwali".

Series on Valuation Methods

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There are various methods of valuations prescribed by the ICAI Valuation Standards, 2018. The various Valuation Approaches and Methods are part of ICAI Valuation Standard – 103 Valuation Approaches and Methods We would be writing about these methods in this series of the articles over period. In this article we would have a look at Discounted Cash Flow Method of Valuation under Income Approach.

Discounted Cash Flow

Discounted Cash Flow (DCF) analysis gained wide popularity following the Great Stock Market Crash of 1929. Though DCF calculation has been used in some form or other since ancient times, it was formally expressed in modern economic terms for the first time by Mr Irving Fisher in his book “The Theory of Interest” in 1930. It is one of the most complex methods of stock valuation.

ICAI Valuation Standard – 101 defines Discounted Cash Flow (DCF) Method as follows:

The DCF method values the asset by discounting the cash flows expected to be generated by the asset for the explicit forecast period and also the perpetuity value (or terminal value) in case of assets with indefinite life.

Discounted Cash Flow method is generally used to estimate the attractiveness of an investment opportunity. The DCF is usually used in the following scenario

(a) where the asset / company does not have any market comparable or comparable transaction;

(b) where the asset / company has fewer relevant market comparables; or

(c) where the asset / company is an income producing asset for which the future cash flows are available and can reasonably be projected.

Main components / information required for this are

Analysts usually discount projected free cash flows at Weighted Average Cost of Capital (WACC) to determine the Net Present Value (NPV) of a particular project, using the following formula:

$$NPV = \frac{CF_1}{(1+r)^1} + \frac{CF_2}{(1+r)^2} + \ldots\ldots + \frac{CF_n}{(1+r)^n}$$

where

CF = Annual Cash Flow

r = Discount Rate (WACC)

Estimated cashflows include all types of inflows and outflows related to the project considered for valuation. Generally, it is assumed that the enterprise will run till infinity and hence, cashflows also need to be projected accordingly. However, instead of projecting the cash flows till infinity, a terminal value approach can be used. A simple annuity can be used to estimate the terminal value after certain years usual period taken for discreet cash flow is about 5 years. In case of cyclical business usually full cycle of the business is covered or multiple of such cycles are considered.

WACC is the overall required return on the company as a whole and usually, calculated as per Capital Asset Pricing Model (CAPM). It is the average of the costs of company’s sources of financing viz. capital and debt, each of which is weighted by its proportionate use in the given situation.

As a thumb rule, if the net present value calculated using DCF analysis is higher than the current cost of the investment, it is believed to be a good opportunity and vice-versa. Given the fact that the Management is well-verse with the business, their guidance about future performance carries substantial weightage while arriving at the enterprise valuation / NPV of the project. DCF is considered to be one of the most scientific and reliable methods of valuations as DCF relies upon management projections to calculate the enterprise value / NPV of the project.

DCF is regularly used in corporate finance management, real estate development, investment finance and evaluation of the project returns wherein future projections are likely to be somewhat more certain. DCF is one of the most commonly used methods for valuing shares, businesses, debt instruments etc.

However, we must understand that there are many complexities. Any variations while projecting future cashflows as well as determining WACC will have impact on the outcome. As the time lapses, it is even more difficult to have a more realistic estimate of the future cashflows. Sometimes, DCF can be merely a mechanical tool which may not be suitably applied for real-life situation. One need to be extremely cautious while using this tool because small changes in input can make huge difference in valuation of the enterprise / asset.

Illustration

XYZ Limited - Discounted Cash Flow						
						INR in Lakhs
		Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
	FY 2020	**FY 2021**	**FY2022**	**FY 2023**	**FY 2024**	**FY 2025**
	Actuals	**Estimates**	**Estimates**	**Estimates**	**Estimates**	**Estimates**
Net Sales	**1,547.72**	**2,202.72**	**2,786.84**	**3,372.36**	**3,795.35**	**4,124.67**
YoY Increase		42.32%	26.52%	21.01%	12.54%	8.68%
EBIDTA	**226.90**	**424.23**	**593.78**	**794.85**	**916.73**	**1,030.29**
EBIDTA Margins	*14.66%*	*19.26%*	*21.31%*	*23.57%*	*24.15%*	*24.98%*
Less: Depreciation	63.10	102.64	147.23	194.74	253.89	296.49
Less: Interest	23.67	45.30	63.92	82.47	104.92	143.45
EBT	**140.13**	**276.29**	**382.63**	**517.64**	**557.92**	**590.35**
Taxes	35.27	69.54	96.31	130.29	140.43	148.59
EAT	**104.86**	**206.75**	**286.32**	**387.35**	**417.49**	**441.76**

Cash Flow Statement					
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
EAT	**206.75**	**286.32**	**387.35**	**417.49**	**441.76**
Add: Depreciation	102.64	147.23	194.74	253.89	296.49
Add: Interest	45.30	63.92	82.47	104.92	143.45
Changes in Working Capital	(186.00)	(299.00)	(388.00)	(376.35)	(245.28)
Capital Expenditure	(50.00)	(100.00)	(100.00)	(100.00)	(50.00)
Free Cash Flow (A)	**118.69**	**98.47**	**176.56**	**299.95**	**586.42**
Discounted FCF (B)	**100.30**	**83.22**	**149.21**	**253.48**	**495.57**
Terminal Value (C)					4,618.68
NPV of Terminal Value (D)					**1,990.75**
Enterprise Value (EV) (E=∑B+D)					**3,072.53**
Less: Net Debt					478.72
PV of Equity					**2,593.81**

Particulars	Connotation	Value	Remarks
Risk Free Rate of Return	R_f	7.07%	Closely approximates to the return on Zero Coupon Government of India Bond for residual period of 10 years
Market Return	R_m	14.87%	Compounded annualised return on BSE Sensex
Beta	B	2.00	Average Beta of Identical Industries / comparable companies
Market Risk Premium	$R_m – R_f$	7.80%	Excess Return on Market Portfolio over and above Risk-Free Rate of Return
Cost of Equity	K_e	22.66%	Calculated using CAPM, adjusted for company specific risk
Cost of Debt	K_d	11.00%	Weighted Interest Cost of all o/s borrowings of the company
Tax Rate	T	25.17%	Effective Normal Tax Rate
Debt to Equity Ratio	D/E	30.00%	Ratio of targeted debt and equity
Weighted Average Cost of Capital	WACC	18.33%	Weighted Average Cost calculated on the basis of Debt – Equity structure of the company and making adjustment for illiquidity and lack of control
Terminal Growth Rate	G	5.00%	Growth rate in perpetuity after explicit period of projections

31st Virtual CPE Meeting on Issues in Tax Audit Report held on 3rd October, 2020

Speaker- CA. Manoj Fadnis (Past President, ICAI), Welcome note - CA. Sunil Patodia (Past Chairman, WIRC of ICAI), Coordinators – CA. Abhishek Tiwari (Vice Chairman – Vasai Branch), CA. Vijendra Jain (Secretary – Vasai Branch) & CA. Amit Agarwal (Committee Member – Vasai Branch)

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