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THE ULTIMATE

FINANCIAL DUE DILIGENCE GUIDE

— GUIDE 2026 —

Quality of Earnings • Working Capital • Net Debt • Tax, GST & FEMA • SPA Translation

A Practitioner's Guide to Quality of Earnings, Working Capital, Net Debt and Deal-Ready FDD

BY

SAGAR SHAH

CA | CS | IBBI Registered Valuer | All India Rank Holder | Ex-EY

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ABOUT THE AUTHOR

Sagar Shah

CA | CS | IBBI Registered Valuer | All India Rank Holder | Ex-EY

Founder, Elite Valuation

Sagar Shah is the Founder of Elite Valuation and leads the firm's Valuation and Advisory practice. A Chartered Accountant (All India Rank Holder), Company Secretary and IBBI Registered Valuer, he brings 15+ years of professional experience advising promoters, investors, listed companies, startups and multinational groups on complex valuation and transaction matters across India.

Before founding Elite Valuation, he spent 9 years at Ernst & Young across valuation, transaction advisory, transfer pricing and cross-border taxation. His work today spans financial reporting, M&A and restructurings, intangible assets, ESOPs, FEMA, AIFs, securities, financial modelling and other regulator-facing assignments where the valuation must stand up to scrutiny from auditors, regulators, investors and boards.

EXPERIENCE	CLIENT BASE	CREDENTIALS	BIG 4 FOUNDATION
15+ Years	500+ Client Engagements	CA | CS | IBBI RV	9 Years at EY

VALUATION & ADVISORY EXPERTISE

- Business & Company Valuation
- M&A, Merger, Swap Ratio & PPA Valuation
- Intangible Asset, Brand, Patent & IP Valuation
- ESOP, Sweat Equity & Share-Based Payment Valuation
- Ind AS / Financial Reporting Valuation
- Shares, Securities & Complex Instrument Valuation
- FEMA, FDI / ODI & Cross-Border Valuation
- Income Tax, Companies Act & SEBI Valuation
- AIF Valuation, Structuring & Compliance Support
- ESOP Structuring, Scheme Design & Implementation
- Financial Modelling, Fundraising & Transaction Support
- Due Diligence, Transfer Pricing & Cross-Border Advisory

Practice focus. Elite Valuation is built for assignments where financial judgement, regulatory interpretation and transaction context intersect. The team supports both one-time transactions and recurring reporting requirements, with an emphasis on independent analysis, clear documentation and execution that is practical for management and audit teams.

HOW WE APPROACH ENGAGEMENTS

01	02	03	04
Clarify the purpose	**Build from evidence**	**Document the judgement**	**Stay involved through review**
We start with the reporting, transaction or regulatory objective before selecting a method.	Assumptions are anchored to financials, market data, contractual terms and the economics of the business.	The report explains the why behind the number so that reviewers can follow and challenge it.	We support management through auditor, board, investor and regulator questions on the valuation.

PHONE	EMAIL	WEBSITE
+91 9879557558	sagarrvshah@elitevaluation.in	www.EliteValuation.in

WHAT WE DO

Elite Valuation supports transactions from the first question about price through diligence, valuation, structuring and the final bridge into transaction documents. Financial Due Diligence is one part of that wider practice. The same team can connect QoE findings to valuation, working capital and net debt mechanics, regulatory issues and post-diligence negotiation support.

01 Financial Due Diligence & QoE

Buy-side and sell-side diligence focused on sustainable earnings, revenue quality, cost normalisation, cash conversion and deal-critical exposures.

02 Vendor Due Diligence & Deal Readiness

Seller-side preparation, QoE bridge, data-room readiness, issue pre-emption and management support before a competitive sale or fundraising process.

03 Working Capital, Net Debt & SPA Support

NWC peg analysis, debt-like item identification, enterprise-to-equity bridge, completion-account mechanics, locked-box review and issue translation into SPA terms.

04 Tax, GST & Cross-Border Diligence

Transaction-focused screening of direct tax, GST, transfer pricing, FEMA, ECB, ODI and historical regulatory exposures, with specialist escalation where needed.

05 Business & Company Valuation

Independent enterprise and equity valuation for fundraising, strategic decisions, shareholder matters and transaction purposes.

06 M&A, Merger & Swap Ratio Valuation

Acquisition, merger, demerger, restructuring, share-exchange ratio and transaction valuation support.

07 Intangible Asset & IP Valuation

Brand, customer relationship, technology, patent, copyright, licence and other intellectual-property valuation.

08 PPA & Ind AS Valuation

Purchase price allocation, impairment, financial instruments and other fair-value measurements for financial reporting.

09 ESOP & Share-Based Payment Advisory

Pool structuring, scheme design, grant valuation, accounting support and implementation for listed and unlisted companies.

10 FEMA, SEBI & Regulatory Valuation

Valuation support for FDI, ODI, cross-border transactions, Companies Act, SEBI and other regulatory requirements.

11 AIF Valuation & Advisory

AIF portfolio valuation together with structuring, registration and compliance support for sponsors and fund managers.

12 Financial Modelling & Transaction Advisory

Investor-ready models, fundraising support, scenario analysis, transaction structuring and execution-focused advisory.

One team, multiple transaction contexts. *A QoE adjustment can change the valuation multiple, an NWC finding can change the completion price, a FEMA gap can become a specific indemnity, and an accounting issue can change the narrative presented to investors. Our work is designed to connect those consequences rather than report them in isolation.*

REPORTS	MODELS	DEAL SUPPORT	REVIEW SUPPORT
FDD / QoE / VDD	NWC / Net Debt / Scenarios	SPA / Price / Indemnities	CFO / Board / Investor

WHO WE SERVE

Our diligence and transaction advisory work is designed for decision-makers who need to understand what a target will earn, what cash and liabilities will actually transfer, and how those findings should affect price or deal protection. We work across both buyer-side and seller-side situations, from mid-market transactions to institutional processes.

CLIENTS & STAKEHOLDERS

- CFOs & Finance Directors
- Corporate Development & M&A Teams
- Private Equity & Venture Capital Funds
- Promoters & Founder-Sellers
- Family Offices & Strategic Investors
- Boards & Investment Committees
- Buy-Side Deal Teams
- Sell-Side / Vendor DD Teams
- Legal Counsel & Transaction Lawyers
- Company Secretaries & Controllers
- Lenders & Structured Finance Teams
- Portfolio Companies Preparing for Exit

WHEN CLIENTS TYPICALLY CALL US

BUY-SIDE Before signing or final pricing of an acquisition	**SELL-SIDE** Before launching a sale or fundraising process	**QOE** When reported EBITDA needs normalisation and evidence
PRICE BRIDGE When NWC, net debt or debt-like items may move equity value	**COMPLEX TARGET** Platform, cross-border, RPT-heavy or accounting-sensitive businesses	**SPA STAGE** When diligence findings need to become price, indemnity or escrow terms

SECTORS WE WORK ACROSS

Technology & SaaS	Consumer & Retail	Manufacturing	Logistics & Mobility	Financial Services & NBFCs
Healthcare & Diagnostics	Real Estate & Infrastructure	Professional Services	Food & Hospitality	Diversified Promoter Groups

WHY CLIENTS WORK WITH US

DEAL-RELEVANT We focus on numbers that affect price, risk and post-close economics.	**EVIDENCE-LED** Adjustments are tied to contracts, ledgers, cash and operational evidence.
CROSS-DISCIPLINARY Valuation, accounting, tax and FEMA consequences are considered together.	**EXECUTION SUPPORT** We stay involved through management questions and SPA / deal discussions.

START A CONVERSATION

If a transaction is already under way, send us the latest financials, management accounts, deal structure, information memorandum and the specific questions the deal team is underwriting. We can help determine whether the right scope is full FDD, a focused QoE / NWC review, vendor diligence or targeted transaction support.

PHONE	EMAIL	WEBSITE
+91 9879557558	**sagarrvshah@elitevaluation.in**	**www.EliteValuation.in**

DISCLAIMER

This guide is intended for general information and educational purposes only. It does not constitute legal, tax, accounting, investment, valuation or transaction advice. Financial Due Diligence is inherently fact-specific: scope, materiality, procedures and conclusions depend on the target, transaction structure, buyer thesis, reporting framework and legal terms. Readers should obtain transaction-specific advice before relying on any illustration or checklist in this publication.

Scope of the Guide

The guide focuses on financial due diligence from a CFO and deal-team perspective: Quality of Earnings, working capital, net debt, revenue recognition, transaction-focused tax and GST screening, related parties, cash conversion, cross-border compliance, red flags and translation of findings into transaction mechanics. It is not a statutory audit, forensic audit, legal due diligence or full-scope tax opinion, and does not replace those workstreams where separately required.

Regulatory Review - 2026

This revised edition has been checked against primary materials available as at 19 August 2026. In particular, direct-tax references are aligned to the Income-tax Act, 2025 and Income-tax Rules, 2026, which came into force on 1 April 2026; legacy periods may still require reference to the Income-tax Act, 1961. Cross-border references are framed around the current FEMA, Non-Debt Instruments, overseas investment, ECB and RBI reporting frameworks rather than older FEMA 20 / 21(R) terminology. GST and accounting positions should likewise be re-verified on the transaction date.

Illustrations and Market Practice

All worked examples are illustrative. Any references to transaction experience are anonymised and derived from the source draft supplied for this publication. Market-practice observations on EBITDA adjustments, debt-like items, indemnities, escrows and completion mechanisms are not legal rules; the final outcome is negotiated in each transaction and must be documented in the definitive agreements.

Professional Responsibility

A diligence finding should be supported by evidence and assessed for materiality, but it should not be converted into a legal conclusion beyond the scope of the engagement. Tax, GST, FEMA, forensic, legal or technical accounting matters that require specialist opinions should be escalated to the appropriate adviser and reflected in the diligence report as such.

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Written for CFOs, corporate development teams, investors, promoters and advisers who need a practical view of how reported financial information becomes transaction economics.

EXECUTIVE SUMMARY

Eight Ideas That Should Shape Every FDD Mandate

Financial Due Diligence is most valuable when it is commissioned to answer a deal thesis, not to produce a standard report. The eight points below are the practical frame for the chapters that follow.

FDD IS NOT A SECOND AUDIT Audit asks whether the financial statements are fairly presented. FDD asks what earnings, cash and liabilities a specific buyer should underwrite for a specific transaction.	**NORMALISED EBITDA DRIVES PRICE** One-off items, promoter-linked arrangements, accounting differences and run-rate effects can materially change the EBITDA to which a transaction multiple is applied.
NWC AND NET DEBT MOVE EQUITY VALUE The headline enterprise value is only the start. The working capital peg, debt-like items and cash-quality adjustments determine what is actually paid for equity.	**REVENUE QUALITY MATTERS** Principal-versus-agent, cut-off, contract assets, variable consideration, churn and customer concentration can change both the quality and the valuation narrative.
CURRENT LAW MATTERS A 2026 diligence report should not rely on obsolete Income-tax Act or FEMA numbering. Current-year and legacy-period compliance need to be separated deliberately.	**CASH CONVERSION TESTS EBITDA** A strong EBITDA story with weak operating cash flow, stretched receivables or deferred maintenance capex may not be a strong economic business.
RED FLAGS REQUIRE ESCALATION FDD is not forensic audit, but data gaps, manual journals, unusual cut-off and management resistance should trigger a defined escalation protocol.	**THE REPORT MUST REACH THE SPA** A finding has limited value unless it changes price, definitions, a specific indemnity, escrow, covenant or another enforceable transaction term.

OUR INSIGHT

The best diligence question is rarely "is this number correct?" It is usually "what would this number look like if the business were owned by us tomorrow, operated on arm's-length terms, and measured consistently with the economics we are paying for?" That question turns accounting data into a transaction decision.

PART I - THE FDD FRAMEWORK

Chapter 1: The FDD Mandate - Why Financial Due Diligence Is Not an Audit

Financial due diligence (FDD) is frequently misunderstood by first-time acquirers and even by experienced CFOs as a repeat of the statutory audit - a second set of eyes confirming that the target's financial statements are materially accurate under applicable accounting standards. This is a fundamental misconception. A statutory audit expresses an opinion on whether financial statements present a true and fair view in accordance with Ind AS or Indian GAAP, at a point in time, for a general body of stakeholders. Financial due diligence asks a different question entirely: is the earnings and cash- generating capacity reflected in these numbers the earnings and cash-generating capacity a specific buyer can rely on to justify a specific price, on a forward-looking basis?

This distinction drives every methodological choice in FDD. An auditor tests whether a transaction was recorded correctly against the applicable accounting framework. A diligence provider tests whether that correctly recorded transaction represents a sustainable, recurring feature of the business, or a one-off event that will not repeat post-acquisition. A related party transaction priced correctly for accounting purposes may still require normalisation in a QoE analysis if it will not continue on the same terms after the promoter exits. A revenue recognition policy that satisfies Ind AS 115 may still mask a customer concentration or churn pattern that materially affects forward earnings quality.

1.1 The Three Questions Every FDD Engagement Answers

Regardless of sector, deal size, or buyer type, every rigorous financial due diligence engagement is structured to answer three core questions for the CFO or deal team commissioning it: What are the sustainable, normalised earnings of the business (Quality of Earnings)? What is the true net debt and net working capital position that will determine the equity value bridge from enterprise value (Net Debt and Working Capital)? And what liabilities, exposures, or contingencies exist that are not adequately reflected on the balance sheet (Tax, Legal, and Off-Balance-Sheet Risk)? Every workstream in a diligence engagement - revenue testing, cost analysis, tax review, related party mapping - ultimately feeds one of these three questions.

1.2 Buy-Side, Sell-Side, and the Growing Case for Vendor Due Diligence

Financial due diligence is traditionally commissioned by the buyer (buy-side FDD) to test the numbers underpinning an offer before it is finalised. In an increasingly competitive Indian deal market, sell-side or vendor due diligence (VDD) - diligence commissioned by the seller and shared with prospective bidders under appropriate access protocols - has become a standard tool for well-advised promoters and private equity sellers. A credible, independent VDD report accelerates the process by pre-empting the buyer's own diligence findings, reduces the risk of price chipping late in the process when a buyer's own diligence team identifies issues under time pressure, and signals to the market that the seller has nothing to hide.

1.3 Scoping the Engagement: Full Scope vs. Focused Scope

Not every transaction warrants the same depth of diligence. A CFO evaluating a bolt-on acquisition of a small, well-understood business in a familiar sector may reasonably commission a focused-scope FDD addressing only EBITDA quality and net working capital. A CFO evaluating a platform acquisition in an unfamiliar sector, with complex related party arrangements, cross-border elements, or a history of regulatory scrutiny, should commission a full-scope engagement covering earnings quality, net debt, tax, GST, related parties, and off-balance-sheet exposures in equal depth. Scoping the engagement correctly - matching the depth of work to the risk profile of the target, rather than defaulting to a standard checklist - is itself a CFO judgment call that materially affects both the cost and the value of the diligence exercise.

Diligence Type	Commissioned By	Primary Objective	Typical Timing
Buy-Side FDD	Acquirer / Investor	Validate sustainable earnings, working capital, net debt and exposures before final pricing	Post-LOI / exclusivity, pre-SPA
Vendor Due Diligence	Seller / Promoter	Pre-empt buyer findings, improve data-room readiness and reduce late price chipping	Before launch of sale process
Confirmatory Review	Acquirer	Validate narrow high-risk items after commercial agreement-in-principle	Pre-signing / pre-closing
Post-Completion Review	Acquirer / Investor	Validate completion accounts, leakage or true-up calculations	Within contractual true-up window

Types of financial due diligence

OUR INSIGHT

We are frequently engaged after a buyer has already used management-prepared EBITDA to agree a headline value, only for diligence to reveal one-off income, promoter-linked cost subsidies or non-recurring revenue. None of those findings necessarily means the audit was wrong. They mean the transaction question was different from the audit question. An unqualified audit opinion is not evidence of deal-ready earnings quality.

1.4 The FDD Information Architecture

A strong engagement starts with a data architecture, not an unstructured request list. The diligence team should map the audited financial statements to monthly management accounts, the trial balance, revenue and purchasing sub-ledgers, bank data, tax returns and operational KPIs. Every material conclusion should be traceable through that chain. Where the target cannot reconcile management reporting back to the statutory ledger, the issue is not merely administrative: it affects confidence in the QoE bridge, closing accounts and the reliability of management data used in valuation.

1.5 Materiality Is a Deal Concept

Audit materiality is designed for financial-statement assurance. FDD materiality is different because a small recurring item can have a large value effect when capitalised at a transaction multiple. A recurring Rs. 20 Lakh EBITDA adjustment at an 8x multiple is potentially a Rs. 1.6 Crore enterprise-value issue, even if it would never have been an audit qualification. The engagement should therefore define both quantitative thresholds and qualitative escalation triggers.

Illustrative Case Study - Same Financial Statements, Different Question

Assume a target reports EBITDA of Rs. 12 Crore and the audited statements are unqualified. Diligence identifies Rs. 60 Lakh of non-recurring litigation cost, but also Rs. 90 Lakh of promoter-funded central functions that the buyer will need to replace. The audit can be entirely correct. For the deal, however, sustainable EBITDA may be Rs. 11.70 Crore, not Rs. 12 Crore. At an 8x multiple, that Rs. 30 Lakh net downward adjustment changes enterprise value by Rs. 2.40 Crore. This is why FDD is a transaction analysis rather than a second opinion on the audit.

QUESTIONS TO PUT TO MANAGEMENT / THE DEAL TEAM

- What specific earnings / cash assumption is embedded in the offer price?
- Which three findings would make the buyer reduce price or change structure?
- Can monthly management accounts reconcile to the statutory ledger?
- What period must be rolled forward before signing?
- Which workstreams are owned by FDD versus tax, legal, commercial and forensic teams?
- What is the escalation path if management cannot provide transaction-level evidence?

PRO TIP

Before issuing the mandate, ask the CFO or investment committee to state the deal thesis and the three findings that would cause them to reduce price, change structure or walk away. Scope FDD backwards from those decision points, then add the standard coverage needed to ensure nothing material falls between workstreams.

PRACTITIONER CHECKLIST

- Define the buyer / seller decision objective and deal thesis
- Agree period covered: audited years, YTD and LTM
- Reconcile statutory financials to monthly management accounts
- Define FDD materiality separately from audit materiality
- Identify workstream boundaries with tax, legal, commercial and forensic teams
- Agree data-room format and transaction-level data access
- Set red-flag escalation protocol and weekly issue cadence
- Maintain a live issue register linked to valuation and SPA consequences

PART I - THE FDD FRAMEWORK

Chapter 2: Quality of Earnings - Normalising EBITDA and Testing Sustainability

Quality of Earnings (QoE) analysis is the analytical core of every financial due diligence engagement. Its objective is to convert the target's reported EBITDA - a figure produced under an accounting framework designed for a different purpose - into a normalised, sustainable EBITDA figure that reflects the earnings power an acquirer can reasonably expect the business to generate on a standalone, arm's- length, forward-looking basis. The gap between reported EBITDA and normalised EBITDA, often expressed as a bridge, is frequently the single most negotiated number in an Indian M&A transaction, because most enterprise value methodologies apply a multiple directly to this figure.

2.1 The EBITDA Bridge: Categories of Adjustment

A rigorous QoE bridge identifies and quantifies adjustments across four broad categories: non- recurring or one-off items (litigation settlements, restructuring costs, asset write-offs); related party and owner-linked items (above or below-market rent, promoter remuneration, family transactions not reflective of arm's-length terms); accounting policy and estimate differences (revenue recognition timing, provisioning policy, capitalisation versus expensing of costs); and pro-forma or run-rate adjustments (annualising a mid-year price increase, reflecting a full year of a partially-implemented cost reduction, or removing revenue from a discontinued product line). Each adjustment must be independently evidenced - a diligence team that accepts management's proposed adjustments without independent verification is not adding value beyond what management could have presented unilaterally.

2.2 Revenue Quality: Concentration, Churn, and Recurring Revenue Mix

Beyond the arithmetic of the EBITDA bridge, a rigorous QoE analysis assesses the qualitative sustainability of the revenue base itself. Customer concentration analysis identifies whether a small number of customers or driver-partners account for a disproportionate share of revenue, creating a cliff-edge risk if any single relationship terminates post-acquisition. Cohort and churn analysis, particularly relevant for platform and subscription businesses, tests whether revenue growth is being driven by genuine unit economics improvement or by an unsustainable rate of new customer acquisition masking underlying attrition. The distinction between recurring, contracted revenue and one-off or spot transaction revenue materially affects the multiple a buyer should reasonably apply.

2.3 Cost Quality and Margin Sustainability

Cost-side QoE analysis mirrors the revenue-side analysis: it tests whether reported gross and operating margins reflect sustainable input costs and cost structures, or reflect temporary conditions - a promoter absorbing costs personally, a below-market vendor arrangement expiring post-completion, or under-investment in maintenance, headcount, or compliance that will require catch-up spending after the transaction closes. Deferred capital expenditure and under-investment in working capital infrastructure are particularly easy to overlook in a QoE analysis focused narrowly on the P&L, since they manifest as inflated current-period EBITDA at the cost of understated future capital requirements.

Adjustment	Illustrative Example	Deal Direction	Evidence
One-off / non-recurring	Litigation settlement, restructuring cost, one-time launch expense	Add back only if genuinely non-recurring	Invoices, board minutes, trend analysis
Owner / related party	Promoter rent or remuneration not at arm's length	Restate to post-deal market economics	External benchmarks, agreements
Accounting / cut-off	Revenue timing, provisioning, cash-basis expense	Restate to consistent accounting basis	Contracts, ledgers, cut-off testing
Run-rate / pro forma	Price change, cost reduction, closed site	Annualise only where implemented and evidenced	Effective dates, customer/vendor data
Under-investment	Deferred maintenance, headcount or compliance spend	Reduce sustainable earnings or reflect future cash need	Asset condition, staffing, capex history

Common Quality of Earnings adjustments

OUR INSIGHT

Aggregate growth can hide deteriorating unit economics. In an anonymised restaurant diligence example from the source draft, overall EBITDA rose while same-store performance weakened as new outlets were added. The buyer needed a per-location and cohort view before underwriting the growth rate embedded in the valuation.

2.4 Evidence Hierarchy for Adjustments

Not all support carries equal weight. Executed customer contracts, invoices, bank receipts, board-approved restructurings and third-party market data generally provide stronger evidence than management explanations or budget assumptions. A defensible QoE report should show both the adjustment and the evidence level. Where evidence is incomplete, present a range or sensitivity rather than convert a management assertion into a single precise number.

2.5 Buyer-Specific Synergies Are Not Target QoE

A common mistake is to include expected buyer synergies in normalised EBITDA. QoE should ordinarily describe the target on a sustainable standalone basis. Procurement savings, headcount rationalisation or cross-selling available only because of the buyer belong in the buyer's deal model, not the target's historical QoE bridge. Keeping the two separate allows the investment committee to distinguish what it is buying from what it plans to create after closing.

Illustrative EBITDA Bridge

A target reports EBITDA of Rs. 10.00 Crore. FDD adds back Rs. 40 Lakh of a one-time factory relocation cost, removes Rs. 25 Lakh of non-recurring government incentive income, and increases recurring management cost by Rs. 30 Lakh to reflect an arm's-length standalone CFO function. Normalised EBITDA is therefore Rs. 9.85 Crore. If the agreed multiple is 9x, the Rs. 15 Lakh net reduction from reported EBITDA reduces enterprise value by Rs. 1.35 Crore. The value impact makes evidence discipline critical.

QUESTIONS TO PUT TO MANAGEMENT / THE DEAL TEAM

- Which add-backs originated with management and which were independently identified?
- Does each adjustment recur, reverse or disappear after closing?
- Are buyer-only synergies being mixed into target normalisation?
- What happens to normalised EBITDA if the three largest judgemental adjustments are rejected?
- Do revenue and margin trends reconcile to customer / product cohorts?
- What cost will the business bear on a standalone arm's-length basis after the promoter exits?

PRO TIP

Maintain the QoE bridge as a rolling LTM analysis through the diligence period. Label every adjustment as historical, recurring, one-off, run-rate or buyer-specific, and show the evidence required for it. Management-proposed add-backs should never enter normalised EBITDA merely because they appear in the information memorandum.

PRACTITIONER CHECKLIST

- Build reported-to-normalised EBITDA bridge by month / LTM
- Evidence every add-back and downward adjustment
- Separate target QoE from buyer-only synergies
- Test customer concentration, churn and recurring revenue mix
- Normalise promoter / related-party economics to standalone terms
- Review cut-off, provisioning and capitalisation policies
- Identify deferred maintenance / compliance / headcount spend
- Quantify valuation sensitivity to each material EBITDA adjustment

Deal Team Takeaway

Normalised EBITDA should be presented as a range of evidence-backed conclusions, not a contest to maximise add-backs. The investment committee should be able to see which adjustments are hard facts, which are judgemental and which depend on buyer-specific assumptions. That transparency makes the valuation sensitivity more useful: management may reasonably disagree with an adjustment, but the buyer can still price the uncertainty rather than hide it inside a single EBITDA number.

PART II - THE EQUITY VALUE BRIDGE

Chapter 3: Net Working Capital - The Peg, Normalisation & Completion Mechanics

Net working capital (NWC) analysis is the second pillar of the enterprise-to-equity value bridge, alongside net debt. Its purpose is to establish a normalised, sustainable level of working capital required to operate the business - the NWC peg - against which the actual working capital delivered at completion is measured, with any shortfall reducing the purchase price and any surplus increasing it (or vice versa, depending on the direction of the mechanism agreed in the SPA). An improperly set NWC peg is one of the most common sources of post-completion dispute in Indian M&A transactions, precisely because it is negotiated well before completion, based on historical trends that may not hold.

3.1 Defining Working Capital for Deal Purposes

The definition of net working capital for SPA purposes rarely mirrors the balance sheet definition used in statutory reporting. Deal-specific NWC definitions typically include trade receivables, inventory, and trade payables, but explicitly exclude cash and cash equivalents (which are addressed separately in the net debt bridge), short and long-term debt (also addressed in net debt), and any items agreed to be treated as debt-like (discussed in Chapter 4). Getting this definition precisely right, and having it explicitly scheduled in the SPA with a worked numerical example, is essential - a NWC definition that is ambiguous in its treatment of even a single balance sheet line item can produce a materially different completion adjustment than intended by either party.

3.2 Setting the Peg: Historical Average vs. Seasonally Adjusted

The NWC peg is typically derived from an analysis of the target's historical working capital levels over a trailing period - commonly twelve to twenty-four months - adjusted for known seasonality, one-off events, and any structural changes expected to affect working capital requirements going forward (a new customer contract with different payment terms, a planned change in inventory policy, or a shift in the payables cycle negotiated with a key vendor). For businesses with pronounced seasonality - a common feature of Indian consumer, retail, and agri-processing businesses - a peg based on a single month-end balance sheet date can produce a materially unrepresentative figure; a monthly trend analysis across a full seasonal cycle is the appropriate approach.

3.3 Locked-Box vs. Completion Accounts Mechanisms

Indian transactions increasingly use both locked-box and completion accounts structures, and the diligence approach differs meaningfully between them. Under a locked-box mechanism, the purchase price is fixed by reference to a balance sheet as of a date prior to signing, with the seller indemnifying the buyer for any leakage (value extracted from the business) between that date and completion; diligence must therefore focus heavily on defining and monitoring leakage protections. Under a completion accounts mechanism, the purchase price is adjusted after completion based on actual net debt and working capital determined as of the completion date itself, requiring the diligence team to establish robust, unambiguous accounting policies and dispute resolution mechanics that will govern the post-completion true-up process.

Component	Typical Deal Treatment	Key Diligence Focus
Trade receivables	Included	Ageing, collectability, cut-off, related-party balances
Inventory	Included	Obsolescence, slow-moving stock, costing consistency
Trade payables	Included	Normal payment cycle, pre-close stretching, vendor concentration
Cash / equivalents	Excluded from NWC; addressed in net debt	Restricted or trapped cash, outstanding cheques
Borrowings	Excluded from NWC; addressed in net debt	Classification, accrued interest, debt-like items
Statutory / employee dues	SPA-specific	Ageing, recurring accrual versus overdue exposure

Deal working-capital classification

OUR INSIGHT

Working-capital gaming is usually visible in the weeks before closing: collections accelerate, supplier payments stretch or inventory replenishment is deferred. The answer is not to distrust every movement; it is to compare the closing pattern with normal historical behaviour and define the SPA mechanism so short-term balance-sheet optimisation does not transfer value unfairly.

3.4 Ageing Quality Matters as Much as the Peg

Two businesses can report identical NWC but have very different working-capital quality. Rs. 5 Crore of receivables that are current is not economically equivalent to Rs. 5 Crore that includes a large overdue balance from a disputed customer. The NWC schedule should therefore carry ageing, provisions and agreed exclusions. If an amount is economically unlikely to convert into cash, the deal team should decide whether it belongs in NWC at all or should be treated separately.

3.5 Avoid Double Counting Between NWC and Net Debt

Statutory dues, accrued bonuses, customer advances, capex creditors and overdue trade payables are frequent classification disputes. The principle is simple: every item should appear once in the price bridge. If a liability is included in normal NWC, do not deduct it again as debt-like unless the SPA definition deliberately isolates an abnormal or overdue component. A classification matrix agreed before signing is one of the best protections against post-close double counting.

Illustrative Completion Adjustment

Assume the agreed NWC peg is Rs. 8.00 Crore. At completion, the target has Rs. 9.20 Crore under the SPA definition, but Rs. 50 Lakh of receivables are excluded because they relate to a pre-close disputed customer balance. Adjusted closing NWC is Rs. 8.70 Crore, producing a Rs. 70 Lakh surplus. If the SPA is drafted so a surplus increases price, the seller receives Rs. 70 Lakh more - not Rs. 1.20 Crore. The definition and exclusions matter as much as the arithmetic.

QUESTIONS TO PUT TO MANAGEMENT / THE DEAL TEAM

- Which balance-sheet accounts are explicitly inside the SPA NWC definition?
- Does the proposed peg cover a full seasonal cycle?
- Are overdue or disputed balances being included at face value?
- Has the seller changed collection, inventory or payment behaviour near closing?
- Which statutory / employee balances belong in NWC and which are debt-like?
- Can both parties calculate the same adjustment from a worked example?

PRO TIP

Put a worked numerical NWC example into the SPA schedule using an actual historical balance sheet. If the accounting and deal teams cannot arrive at the same adjustment from the example, the definition is not ready for signing.

PRACTITIONER CHECKLIST

- Define included and excluded NWC line items
- Analyse at least one full seasonal cycle where relevant
- Review ageing and quality, not only balance amount
- Adjust for one-offs and structural changes in terms
- Separate normal NWC from overdue / debt-like balances
- Test pre-close collection, payment and inventory behaviour
- Agree locked-box versus completion-account implications
- Insert a worked NWC example into SPA schedules

Deal Team Takeaway

The NWC peg should answer a practical operating question: how much working capital must remain in the business at closing for the buyer to continue normal operations without immediately injecting cash. A statistical average is only the starting point. The final peg should reflect seasonality, business growth, structural term changes, overdue balances, provisioning and the exact items included in the SPA definition. Where the historical monthly range is wide, show the range and explain why the selected peg is appropriate rather than creating false precision.

Challenge the Peg Before It Becomes an SPA Number

A proposed peg should be challenged against the monthly data, not accepted because it is described as a twelve-month average. Rebuild the trend with consistent account classifications, identify months affected by one-off collections or payment delays, and compare the selected peg with the most recent run-rate. If the business has grown materially, an unadjusted historical average can understate the operating capital needed at closing; if management has deliberately reduced inventory or accelerated collections ahead of sale, the latest month can be equally misleading.

Document the Negotiation Range

Where the evidence supports more than one reasonable peg, show the range and the purchase-price sensitivity. A Rs. 2 Crore difference in the agreed peg is economically the same as a Rs. 2 Crore price difference at completion. Presenting the sensitivity explicitly helps the CFO negotiate the assumption consciously and gives legal counsel a clear basis for the worked example and accounting policies in the SPA.

PART II - THE EQUITY VALUE BRIDGE

Chapter 4: Net Debt and Debt-Like Items - Uncovering Hidden Value Leakage

The bridge from enterprise value to equity value in an Indian M&A transaction is built on two pillars: the net working capital adjustment addressed in Chapter 3, and the net debt position of the target as of completion. While conventional financial debt - term loans, working capital facilities, and non- convertible debentures - is readily identifiable from the target's financial statements, a disciplined FDD engagement identifies a much broader category of 'debt-like items': balance sheet obligations that are economically equivalent to debt but are not classified as borrowings in the statutory financial statements, and which, if overlooked, transfer value from the buyer to the seller at completion.

4.1 Categories of Debt-Like Items

Debt-like items commonly identified in Indian FDD engagements include: unfunded or underfunded employee benefit obligations (gratuity, leave encashment) not adequately provided for on the balance sheet; deferred and contingent consideration from prior acquisitions; declared but unpaid dividends; overdue statutory liabilities including GST, TDS, and provident fund dues, particularly where they carry associated interest and penalty exposure; litigation settlements and legal claims assessed as probable; capital expenditure commitments contracted for but not yet paid; and lease, hire-purchase or similar financing obligations that may be presented outside conventional borrowings but are economically relevant to the deal. For Ind AS reporters, Ind AS 116 generally brings lessee lease liabilities onto the balance sheet; the diligence question is therefore whether the SPA definition of net debt captures the relevant lease and lease-like obligations, not whether the statutory accounts call them borrowings.

4.2 Cash Quality: Restricted, Trapped, and Non-Repatriable Cash

Not all cash reported on the balance sheet is available to reduce the purchase price on a rupee-for-rupee basis. Cash held in escrow, cash pledged as security for bank guarantees or letters of credit, cash held in subsidiaries with FEMA-related repatriation restrictions, and cash held in jurisdictions with capital controls should be identified separately and, depending on the deal structure, either excluded from the net debt calculation or given a discounted value that reflects the buyer's actual ability to access it post- completion.

Item	Why It May Be Debt-Like	Diligence Test
Unfunded employee benefits	Future cash obligation attributable to pre-close service	Actuarial basis, provision adequacy, SPA treatment
Overdue statutory dues	Pre-close liability plus possible interest / penalty	Ageing, return reconciliation, legal status
Deferred / contingent consideration	Future cash payment from an earlier transaction	Underlying acquisition agreement and earn-out status
Lease / hire-purchase obligations	Financing-like commitment may sit outside conventional borrowings	Ind AS 116 / contractual liability and SPA definition

Item	Why It May Be Debt-Like	Diligence Test
Declared unpaid dividend	Obligation to existing shareholders reduces cash available to buyer	Board/shareholder approvals and payment status
Capex / supplier commitments	Contracted pre-close outflow may be unavoidable after closing	POs, contracts, delivery status, cancellation rights

Debt-like item framework

OUR INSIGHT

The phrase debt-like is a transaction concept, not an accounting line item. A liability can be properly classified under the accounting standards and still belong in the enterprise-to-equity bridge if the parties agree that it represents pre-close financing or a seller-period cash obligation. Conversely, not every balance-sheet liability should be called debt-like. The SPA definition must follow the agreed economics.

4.3 Cash Is Not Automatically Cash-Like

Cash presented on the balance sheet should be tested for availability. Margin money, lien-marked deposits, escrow balances, restricted bank accounts, uncleared receipts and cash needed to settle pre-close obligations may not reduce net debt rupee-for-rupee. Conversely, a deposit with a short maturity can be cash-like if it is freely accessible. The deal team should define cash with the same precision used for debt.

4.4 Ind AS 116 and Deal Definitions

For an Ind AS lessee, many leases create a right-of-use asset and lease liability. Whether that lease liability is treated as net debt in a transaction depends on valuation convention and the SPA definition. If enterprise value was derived from an EBITDA metric before lease costs or from a multiple convention that already capitalises leases, an additional deduction can double count the same economics. FDD should therefore reconcile the accounting treatment, valuation metric and price bridge.

Illustrative Enterprise-to-Equity Bridge

Assume enterprise value is Rs. 120 Crore. Conventional borrowings are Rs. 18 Crore, debt-like items are Rs. 3 Crore and qualifying cash is Rs. 5 Crore. Net debt is therefore Rs. 16 Crore. If closing NWC is Rs. 1 Crore below the peg, equity value becomes Rs. 103 Crore before any other negotiated adjustments. A single overlooked Rs. 2 Crore debt-like obligation would transfer that amount of value directly from buyer to seller.

QUESTIONS TO PUT TO MANAGEMENT / THE DEAL TEAM

- What liabilities will require cash after closing even though they are not conventional borrowings?
- Which reported cash balances are pledged, restricted or operationally trapped?
- How are leases treated in the valuation metric and in the SPA net-debt definition?
- Are accrued interest and financing fees completely captured?
- Could any debt-like item already be included in NWC or another price adjustment?
- What would equity value be under a conservative debt-like / cash sensitivity?

PRO TIP

Create a target-specific debt-like checklist before reviewing the balance sheet. A SaaS company, restaurant chain, NBFC and fleet operator will have different hidden obligations. Use the sector and legal structure to decide what to search for, then reconcile each candidate item to the SPA definition to avoid double counting.

PRACTITIONER CHECKLIST

- Reconcile borrowings to bank confirmations and agreements
- Build sector-specific debt-like item population
- Test employee benefit, tax, capex and contingent obligations
- Assess Ind AS 116 / lease treatment against valuation convention
- Identify restricted, pledged or otherwise unavailable cash
- Check accrued interest and unrecorded financing costs
- Prevent double counting with NWC or purchase-price adjustments
- Prepare enterprise-to-equity bridge with sensitivities

Deal Team Takeaway

Debt-like classification should be governed by the transaction economics and the valuation convention. Start with the agreed enterprise value metric, then ask which pre-close obligations the seller would otherwise leave for the buyer to fund without compensation. Reconcile every candidate item to the NWC definition, cash definition and other purchase-price adjustments. The strongest net-debt schedule contains a classification rationale for each disputed line item, the underlying evidence and a column showing exactly where the SPA will capture it. That discipline is more valuable than a long generic list of possible debt-like items.

Build a Classification Schedule, Not Just a List

For every proposed debt-like item, the diligence schedule should state the balance, why it is seller-period in nature, whether it is already captured in reported debt or NWC, the supporting evidence, and the proposed SPA treatment. This is especially important for leases, employee obligations, deferred consideration and overdue statutory balances, where different buyers may adopt different conventions. A classification schedule turns a generic debate about what is debt-like into a line-by-line economic analysis.

Make Cash Quality Symmetrical with Debt Quality

The same discipline applied to debt should be applied to cash. Bank balances should be reconciled to confirmations and tested for pledges, escrow restrictions, minimum balance requirements, uncleared receipts and amounts needed to discharge pre-close liabilities. A buyer should not pay rupee-for-rupee for cash it cannot access, just as it should not ignore obligations that do not happen to sit in the borrowings note.

PART III - ACCOUNTING & COMPLIANCE

Chapter 5: Revenue Recognition - Ind AS 115 Issues in Platform and Marketplace Models

Revenue recognition analysis has become one of the most technically demanding areas of financial due diligence in India, driven by the proliferation of platform, marketplace, and subscription-based business models where the appropriate accounting treatment under Ind AS 115 - Revenue from Contracts with Customers is genuinely contestable, and where the choice of treatment can materially affect reported revenue, margin, and the trajectory of growth presented to a prospective buyer.

5.1 Principal vs. Agent: The Core Marketplace Question

For any platform or marketplace business - ride-hailing platforms, driver-fleet aggregators, e- commerce marketplaces, and food or grocery delivery platforms - the single most consequential Ind AS 115 judgment is whether the platform operator is acting as principal (recognising the full transaction value as revenue, with the amount paid to the underlying service provider as a cost) or as agent (recognising only its commission or margin as revenue). The core Ind AS 115 question is whether the entity controls the specified good or service before it is transferred to the customer. Fulfilment responsibility, inventory or service risk and pricing discretion are indicators that support that control assessment; they are not a mechanical checklist that overrides the contract and the substance of the promise to the customer. A target that has adopted principal-basis revenue recognition when the substance of the arrangement is closer to an agency relationship will present materially inflated revenue - even though gross margin percentage would appear correspondingly lower - creating a distorted picture for a buyer valuing the business on a revenue multiple rather than a gross profit basis.

5.2 Timing of Revenue Recognition: Performance Obligations and

Contract Modifications Beyond the principal-versus-agent question, FDD revenue testing examines whether revenue is recognised at the point each distinct performance obligation is satisfied, consistent with Ind AS 115's five-step model, or whether the target's policy front-loads or defers recognition relative to the underlying pattern of service delivery. Subscription businesses that recognise annual contract value upfront rather than ratably over the service period, businesses that fail to separately identify and defer set-up or onboarding fees as distinct performance obligations, and businesses with variable consideration (volume discounts, rebates, penalty clauses) that is not appropriately constrained and

estimated, are all common sources of overstated in-period revenue that a rigorous diligence review will identify and normalise.

5.3 Deferred Revenue and Customer Prepayments

For subscription and prepaid-wallet business models, the deferred revenue balance on the balance sheet represents a real future service obligation to customers, and diligence must confirm that the target is appropriately releasing this balance to revenue as the underlying performance obligation is satisfied, rather than releasing it prematurely to inflate current-period revenue. A deferred revenue balance that is declining as a percentage of billings, without a corresponding explanation in customer acquisition or renewal trends, is a common red flag warranting further investigation.

Indicator	Evidence Supporting Principal	Evidence Supporting Agent
Control before transfer	Entity controls the specified good/service before customer transfer	Entity arranges for another party to provide the specified good/service
Primary responsibility	Entity is responsible to customer for fulfilment / acceptability	Underlying supplier remains primarily responsible
Inventory / service risk	Entity bears meaningful risk before or after transfer	Risk substantially remains with underlying supplier
Pricing discretion	Entity can establish price for specified good/service	Economics are a fixed commission / take-rate with limited discretion
Revenue presentation	Gross presentation follows a principal conclusion	Net fee / commission follows an agent conclusion

Ind AS 115 - principal versus agent

OUR INSIGHT

A principal-versus-agent conclusion can dramatically change reported revenue without changing EBITDA or cash. That matters when valuation is anchored to a revenue multiple, growth rate or market share. FDD therefore needs to separate an accounting presentation issue from an economic performance issue - and explain both to the deal team.

5.4 Variable Consideration, Refunds and Incentives

Marketplace and subscription businesses often have refunds, credits, rebates, penalties, promotional incentives and service-level adjustments. Ind AS 115 requires variable consideration to be estimated subject to the constraint that a significant reversal should not be highly probable when uncertainty resolves. FDD should test whether the target's historical assumptions match actual subsequent credit notes and customer claims, because an optimistic estimate can front-load revenue into the diligence period.

5.5 Contract Assets, Deferred Revenue and Billings

Revenue, billings and cash collection are different metrics. A growing contract-asset balance can indicate revenue recognised ahead of billing, while a contract liability or deferred revenue balance can represent cash collected before performance. Neither is inherently negative. The diligence task is to reconcile movements to contracts and service delivery, test whether they are consistent with the business model, and ensure the valuation narrative does not treat billing growth as revenue growth without adjustment.

Illustrative Platform Recast

A platform records gross customer billings of Rs. 100 Crore as revenue and Rs. 82 Crore payable to service providers as cost, producing Rs. 18 Crore gross profit. If contract analysis concludes the platform is an agent, reported revenue may be Rs. 18 Crore rather than Rs. 100 Crore while EBITDA and cash economics are broadly unchanged. A buyer applying a revenue multiple must recast the valuation basis; a buyer using EBITDA may care more about take-rate durability and customer / supplier economics.

QUESTIONS TO PUT TO MANAGEMENT / THE DEAL TEAM

- What is the specified good or service promised to the customer in each major revenue stream?
- Who controls that good or service before transfer?
- How do refunds, credits, incentives and variable consideration behave after period end?
- Do billings, revenue, contract assets, deferred revenue and cash reconcile?
- Would a principal-to-agent recast change the valuation metric being used?
- Are customer concentration and churn consistent with the growth rate management is presenting?

PRO TIP

Test the largest customer contracts and a sample of unusual transaction types rather than relying only on the accounting-policy memo. For a platform, map the promised service, control point, payment flow, refunds, incentives and supplier obligations for each major revenue stream before concluding principal or agent.

PRACTITIONER CHECKLIST

- Map material revenue streams to contract types
- Identify each promised good / service and performance obligation
- Assess principal / agent from control before transfer
- Test cut-off and subsequent credit notes / refunds
- Review variable consideration and constraint assumptions
- Reconcile billings, contract assets, deferred revenue and cash
- Analyse customer concentration / churn alongside accounting
- Recast deal metrics if revenue presentation changes

PART III - ACCOUNTING & COMPLIANCE

Chapter 6: Direct Tax Areas Covered in Financial Due Diligence

Financial Due Diligence is not a substitute for a dedicated tax due diligence or legal tax opinion. Its role is to identify tax matters that can change price, cash flow, net debt or transaction protection, and to give the deal team a sufficiently structured issue register to know where specialist review is required. For a 2026 transaction, the first discipline is to separate current compliance under the Income-tax Act, 2025 from legacy periods governed by the earlier Act.

Area	Current 2026 Reference	FDD Focus
Open matters & litigation	Income-tax Act, 2025 / legacy 1961 Act for earlier periods	Demand, appeal stage, provisioning, cash / indemnity exposure
TDS / withholding	Section 393 tables and related provisions	Major payment categories, rates, thresholds, deposits and return consistency
Cash expenditure	Section 36(4)-(7)	Payments above Rs. 10,000 per person per day outside specified banking / online modes, subject to exceptions
Large cash receipts	Section 186	Receipts of Rs. 2,00,000 or more within the statutory transaction / event tests, subject to exceptions
Transfer pricing	Sections 172-173; Form 48 under Rule 85	International / specified domestic transactions, accountant report and benchmarking consistency
Legacy positions	Income-tax Act, 1961	Old-section references remain relevant for pre-1 April 2026 periods and proceedings

2026 direct-tax diligence map

OUR INSIGHT

The 2026 change in direct-tax legislation creates a practical diligence trap: many historical years, notices and reconciliations still use section references from the Income-tax Act, 1961, while current tax-year compliance is governed by the Income-tax Act, 2025. A clean FDD schedule should carry both the period and the governing law so old and new references are not mixed.

6.1 Separate Current-Year Law from Legacy Years

The Income-tax Act, 2025 came into force on 1 April 2026. A 2026 diligence should therefore map each matter to the law applicable to that tax period. Current compliance schedules, withholding and cash-transaction rules should use the new Act and Rules; older assessments, historical TDS positions and appeals may still carry references under the 1961 Act. Mixing the two creates avoidable reporting errors and can make a technically correct historical observation look obsolete.

6.2 TDS / Withholding Review Under Section 393

The current Act consolidates many withholding categories into section 393 tables. FDD should not merely search the ledger for old labels such as section 194C, 194J or 194O. Instead, map major payment streams - contracts, professional or technical fees, rent, commission, e-commerce participants and other relevant categories - to the current withholding provision, test thresholds and rates, reconcile deposits and returns, and separately retain the old section references for legacy periods where they remain relevant.

6.3 Cash Expenditure and Receipt Controls

Under section 36(4), expenditure can be disallowed where a payment or aggregate of payments made in a day to a person exceeds Rs. 10,000 and is not through specified banking or online modes, subject to the statutory exceptions; separate rules apply to goods-carriage payments and certain asset-cost situations. Section 186 restricts receipt of Rs. 2,00,000 or more within its person / transaction / event tests, again subject to exceptions. FDD should identify the exposure population and then refer detailed interpretation to the tax specialist.

6.4 Transfer Pricing Reporting - Form 48

For the 2026 Rules, the accountant's report for international and specified domestic transactions is Form 48 under section 172 and Rule 85 - the successor to Form 3CEB under the earlier regime. Diligence should reconcile the transaction population in the report to intercompany ledgers, agreements and transfer-pricing studies, then flag any unreported stream, material year-on-year change or pricing inconsistent with the documentation.

Illustrative Tax Issue Register

A target has an open demand of Rs. 60 Lakh under appeal, a potential withholding shortfall of Rs. 18 Lakh plus interest, and Rs. 12 Lakh of cash expenditure requiring a section 36(4) exception analysis. FDD should not collapse these into a single Rs. 90 Lakh liability. The first is a contested assessment, the second may be a more quantifiable compliance exposure, and the third is a tax-deductibility question. Each needs its own probability, cash timing and SPA remedy.

QUESTIONS TO PUT TO MANAGEMENT / THE DEAL TEAM

- Which tax years are governed by the 2025 Act and which matters remain under the legacy Act?
- What is the status, cash amount and probability range for each open demand / appeal?
- Are current withholding categories mapped to Section 393 rather than only old section labels?
- Are cash-payment / receipt exceptions documented where thresholds are breached?
- Does Form 48 reconcile to the full intercompany transaction population?
- Which matters need a tax specialist opinion before the deal team can quantify the exposure?

PRO TIP

Treat FDD tax work as screening plus deal quantification. Where a point requires legal interpretation, transfer-pricing benchmarking or a merits opinion on litigation, escalate it to the tax specialist. The FDD report should then connect the specialist conclusion back to price, net debt, indemnity or cash-flow impact.

PRACTITIONER CHECKLIST

- Map each tax period to the governing 2025 or legacy 1961 Act
- List open demands, notices, appeals and assessment status
- Map current withholding categories to Section 393 tables
- Reconcile withholding deposits / returns to ledgers at a risk-based level
- Screen cash expenditures under Section 36 and cash receipts under Section 186
- Reconcile international / specified domestic transactions to Form 48
- Separate quantified exposure from matters requiring specialist opinion
- Map material findings to price, net debt or specific indemnity

Deal Team Takeaway

For tax diligence, separate three dimensions that are often mixed together: the gross amount in a notice or transaction population, the technically sustainable exposure after specialist review, and the cash / timing consequence for the buyer. A Rs. 5 Crore assessment demand under appeal is not automatically a Rs. 5 Crore purchase-price issue; a smaller withholding default with a clear statutory consequence may be more certain. The report should therefore show governing period, law, status, management position, adviser view, exposure range, interest / penalty mechanics and proposed transaction protection. This also makes transition between the old and new Income-tax Acts easier to follow.

Use a Tax Issue Register Designed for the Deal

A deal-ready tax schedule should not stop at section references. For each material matter, capture the tax period, authority, status, gross demand or transaction population, management position, available legal or tax advice, estimated exposure range, interest or penalty mechanics, expected cash timing and the proposed deal remedy. This allows the investment committee to distinguish a high-quantum but remote appeal from a smaller, highly certain withholding or cash-payment exposure.

Keep Legacy and Current-Law References Separate

Transactions and assessments relating to periods before 1 April 2026 may still need to be analysed under the Income-tax Act, 1961, while current-year compliance is governed by the Income-tax Act, 2025. The report should therefore state the governing law alongside each finding rather than translating every historical matter into new section numbers. This avoids legal ambiguity and makes the diligence report usable by tax counsel, finance teams and SPA drafters reviewing different periods.

PART III - ACCOUNTING & COMPLIANCE

Chapter 7: GST Areas Covered in Financial Due Diligence

GST compliance forms the second standard tax-related component of an FDD scope, alongside the direct tax checks described in Chapter 6. As with direct tax, the objective at the FDD stage is to flag likely areas of exposure for the buyer's attention, not to conduct an exhaustive GST audit or to independently relitigate the target's return positions.

7.1 Input Tax Credit Reconciliation

FDD includes a summary-level reconciliation of the input tax credit claimed by the target against the credit reflected in its GST returns. Mismatches - most often caused by a supplier's own non-compliance rather than any error by the target - can still result in credit reversal and interest exposure for the target, so this check is a standard part of the FDD scope even where the target's own filings appear consistent.

7.2 E-Commerce and Marketplace GST Liability

For platform or marketplace businesses, FDD checks whether GST liability on the categories of services where liability shifts to the e-commerce operator under Section 9(5) of the CGST Act is being correctly discharged by the platform itself, rather than assumed to sit with the underlying service provider or left unaddressed for revenue streams that fall outside the platform's collection mechanism.

7.3 Reverse Charge and Basic Documentation Compliance

FDD also includes a sample-level check of reverse charge compliance on the categories of inward supply where it commonly applies, and of basic documentation such as e-way bills for goods-intensive operations. Both are easy to overlook relative to output-side GST compliance, but are a common source of penalty exposure in practice.

Area	What FDD Should Test	Typical Deal Consequence
ITC eligibility / reconciliation	Books, GSTR-2B / GSTR-3B, Section 16 conditions, reversals and blocked credits	Cash tax leakage, provision or indemnity
Revenue-to-return bridge	Books / billing versus GSTR-1 / GSTR-3B and credit notes	Unreported liability or cut-off issue
Section 9(5) platform liability	Whether notified supplies through an e-commerce operator are discharged by the correct person	Operator-level historical exposure
Reverse charge	Notified inward supplies and payment / ITC treatment	Tax, interest and cash-flow exposure
Documentation	E-invoice / e-way bill and invoice controls where applicable	Penalty, credit and process risk
Open notices / audits	Orders, SCNs, appeals, refunds and reconciliations	Specific indemnity / escrow / price issue

GST diligence workstreams

OUR INSIGHT

A GST reconciliation should connect three layers: the commercial ledger, the tax-return population and the cash / credit ledger consequence. A return can be filed on time and still contain an economic problem if ITC is ineligible, revenue is mapped incorrectly, a Section 9(5) liability sits with the wrong party or old credit notes have not flowed through the books.

7.4 Output Tax and Revenue Reconciliation

A strong GST workstream reconciles turnover across the trial balance, billing system, GSTR-1 and GSTR-3B, then explains legitimate differences such as exports, exempt supplies, advances, credit notes or timing. Material unexplained differences can indicate either a tax exposure or an accounting cut-off issue, so the GST and QoE teams should share the same reconciliation rather than work from separate populations.

7.5 Input Tax Credit Is an Eligibility Question, Not Only a Match

GSTR-2B matching is important, but the buyer also needs to understand whether credit was legally eligible, whether blocked-credit categories were respected, whether reversals were made where required, and whether old unmatched balances are realistically recoverable. An ITC balance can be an asset in the accounts while still being economically impaired for deal purposes.

7.6 Platform Businesses Need a Supply-by-Supply Map

Section 9(5) does not shift liability for every transaction that passes through an e-commerce operator. It applies to notified categories. For a multi-service platform, diligence should map each revenue stream to the underlying supply, supplier, place of supply, liable person and tax collection / settlement flow. That map also helps reconcile accounting principal-versus-agent conclusions to GST treatment without assuming the two frameworks always produce the same answer.

Illustrative GST Exposure Bridge

Suppose a target carries Rs. 75 Lakh of unmatched or potentially ineligible ITC, but management can support Rs. 40 Lakh through subsequent-period matching and documentation. The diligence exposure is not automatically Rs. 75 Lakh or Rs. 35 Lakh; it should distinguish supported credit, uncertain credit, interest implications and any cash already reversed. The SPA remedy can then be calibrated to the residual risk rather than an undifferentiated gross number.

QUESTIONS TO PUT TO MANAGEMENT / THE DEAL TEAM

- Can turnover by GSTIN reconcile from books to GSTR-1 and GSTR-3B?
- What portion of unmatched ITC is actually eligible and recoverable?
- Which revenue streams fall within notified Section 9(5) categories?
- Are reverse-charge liabilities and related ITC treated consistently?
- Are there registration-specific notices, audits or refunds that group totals hide?
- What is the cash, interest and transaction-protection consequence of each material GST issue?

PRO TIP

For GST, reconcile by GSTIN and by revenue stream. Group-level totals can hide a registration-specific shortfall, an inactive unit with legacy exposure or an e-commerce stream with different liability mechanics. Build the exposure schedule so it can be used directly by transaction counsel if protection is required.

PRACTITIONER CHECKLIST

- Reconcile revenue by GSTIN from books to GSTR-1 and GSTR-3B
- Reconcile eligible ITC to GSTR-2B and reversal schedules
- Review Section 16 eligibility and blocked / reversed credits
- Map Section 9(5) exposure by notified supply category
- Test reverse-charge categories relevant to the target
- Review e-invoice / e-way bill controls where applicable
- List open notices, audits, refunds and disputed positions
- Quantify cash, interest and SPA consequence by registration

Deal Team Takeaway

GST findings become decision-useful only when they are quantified by registration and by type of consequence. Separate tax already paid, credit that may be reversible, interest that continues to accrue, penalties that depend on the nature of the default and amounts that are still supportable with documentation. For e-commerce and multi-state businesses, include the legal entity, GSTIN and revenue stream in the issue register. That structure prevents one registration's historical issue from contaminating the apparent risk profile of the whole group and gives transaction counsel a clean basis for a targeted indemnity rather than a blanket tax protection.

Analyse GST Registration by Registration

A consolidated group total can hide the location of the real exposure. Build the GST issue register by legal entity and GSTIN, then reconcile turnover, ITC, reverse charge, notices, refunds and Section 9(5) positions at that level. This matters because a clean registration should not be burdened by an issue isolated to another state, while a material problem in one GSTIN may require a targeted pre-closing cure or indemnity rather than a group-wide adjustment.

Quantify What Is Actually at Risk

An ITC mismatch is not automatically equal to cash loss. Separate credits that are ineligible, credits that are merely unmatched but supportable, amounts already reversed, interest continuing to accrue and matters under notice or appeal. The diligence conclusion should present the residual exposure after available evidence, together with the timing and recoverability of any cash payment. That is the number the deal team can use in pricing and transaction protection.

PART III - ACCOUNTING & COMPLIANCE

Chapter 8: Related Party Transactions & Off-Balance-Sheet Arrangements

Related party transactions (RPTs) and off-balance-sheet arrangements are among the most consequential areas of financial due diligence in Indian promoter-controlled and family-owned businesses, where the boundary between the company's economics and the promoter family's personal economics is frequently blurred. A diligence engagement that treats RPT review as a disclosure- checking exercise - confirming that related party transactions are disclosed in the notes to accounts as required under Ind AS 24 - materially understates the value of this workstream. The core diligence objective is to determine whether related party transactions are priced at arm's length, and if not, to normalise reported earnings and net debt for the difference, since a buyer will not have access to the same non-arm's-length terms after the promoter's involvement ends.

8.1 Common Categories of RPT Requiring Normalisation

The most frequently encountered related party normalisation items in Indian FDD engagements include: promoter or family-owned premises leased to the company at below or above market rent; promoter remuneration or family salaries not reflective of the market rate for the role performed; loans to or from promoters and group companies, often interest-free or at below-market rates; procurement or sales transactions with group companies at non-arm's-length prices; and shared corporate overheads (finance, HR, legal functions) allocated across group entities on a basis that may not reflect the actual cost of service to the target on a standalone basis.

8.2 Off-Balance-Sheet Arrangements and Guarantees

Beyond related party transactions in the ordinary course, diligence must specifically identify off-balance-sheet arrangements including corporate guarantees issued by the target in favour of group companies or promoter entities, letters of comfort, and undocumented informal support arrangements (working capital support extended to group vendors or customers) that may not appear on the balance sheet but represent real economic exposure that a buyer would inherit. A target that has issued a corporate guarantee to secure a group company's debt facility carries a contingent liability that must be

identified, quantified where possible, and addressed in the transaction structure - typically through a requirement that the guarantee be released prior to or at completion.

RPT Category	Potential Distortion	Normalisation Approach
Promoter-owned premises	Rent above or below market	Benchmark comparable independent lease terms
Promoter / family payroll	Compensation does not reflect market role	Replace with market cost of required post-deal role
Intercompany loans	Interest-free / below-market financing or settlement balances	Assess net debt, finance cost and collectability; do not force an EBITDA adjustment

RPT Category	Potential Distortion	Normalisation Approach
Intercompany purchases / sales	Non-arm's-length operating pricing	Benchmark third-party economics and restate sustainable margin
Shared services	Finance / HR / legal costs subsidised by group	Build standalone cost-to-serve for buyer ownership
Guarantees / support	Contingent obligation for group debt or parties	Quantify, seek release at closing or protect contractually

Related party normalisation framework

OUR INSIGHT

Related-party normalisation is ultimately a standalone-cost exercise. The question is not simply whether a related-party transaction was disclosed under Ind AS 24; it is what the business will earn and cost once the buyer no longer benefits from the promoter group's rent, staff, procurement, financing or informal support arrangements.

8.3 Build Standalone Economics

In a carve-out or promoter-group business, historical profitability may rely on shared people, systems, premises, purchasing power or financing that will not transfer. FDD should build a standalone cost schedule: what the buyer will need to pay for finance, HR, IT, insurance, rent, procurement and management once the target is outside the group. This schedule often matters more than whether each historical related-party invoice was technically arm's length.

8.4 Guarantees, Comfort Letters and Informal Support

A formal corporate guarantee is easy to identify if the legal register is complete. Informal support is harder: group vendors paid centrally, customer advances settled through affiliates, promoter assets pledged for target facilities, or group companies funding payroll temporarily. These arrangements may disappear at closing and can create both financing needs and contingent exposure. Review bank sanctions, security documents, board minutes and intercompany settlement patterns.

Illustrative Standalone Normalisation

A target reports EBITDA of Rs. 14 Crore but uses group-level finance, HR and IT resources for a nominal Rs. 10 Lakh annual recharge. Market evidence indicates standalone services would cost about Rs. 80 Lakh. The Rs. 70 Lakh incremental cost is a potential normalisation if the functions are required after closing. At an 8x multiple, that one shared-services adjustment can reduce enterprise value by Rs. 5.6 Crore before considering any one-time separation costs.

QUESTIONS TO PUT TO MANAGEMENT / THE DEAL TEAM

- Which services or assets are supplied by the promoter group below or above market terms?
- What corporate functions must the target build or buy after separation?
- Are intercompany receivables genuinely collectible before or after closing?
- What guarantees, pledges or letters of comfort must be released at completion?
- Do vendor / customer master data reveal related parties not obvious from the audited note?
- How much would sustainable EBITDA change on a fully standalone cost base?

PRO TIP

Do not start with the audited related-party note alone. Build the population from shareholder / director records, group structure, vendor and customer masters, bank narrations, employee records and management interviews, then compare that wider population to the accounting disclosure.

PRACTITIONER CHECKLIST

- Build related-party universe beyond the audited note
- Reconcile transactions to vendor/customer masters and bank data
- Benchmark promoter rent and remuneration
- Build standalone shared-services cost base
- Review intercompany balances and settlement history
- Identify guarantees, pledges and letters of comfort
- Assess collectability of related-party receivables
- Link normalisation and release conditions to SPA terms

Deal Team Takeaway

For a promoter-controlled target, prepare a post-close standalone P&L alongside the historical QoE bridge. List every group-provided resource, related-party price and informal support arrangement that will change when control transfers. Some items will be replaced by a transition services agreement; others will need permanent standalone capability. The diligence adjustment should reflect the sustainable post-transition cost, while one-time separation expenditure belongs in the deal model or purchase-price discussion. Keeping recurring standalone cost separate from one-time separation cost avoids understating either the EBITDA impact or the cash required after closing.

Separate Recurring Standalone Cost from One-Time Separation Cost

When the target relies on group finance, HR, procurement, premises, technology or management support, FDD should model two different consequences. The first is the recurring standalone cost that affects sustainable EBITDA and therefore valuation. The second is the one-time cost of separation, migration or replacement, which belongs in the post-close cash plan or transaction negotiation. Combining the two can distort both the EBITDA bridge and the buyer's funding model.

Translate RPT Findings into Closing Actions

Not every related-party finding is solved through an EBITDA normalisation. Intercompany receivables may need to be settled before closing; guarantees may need release letters; shared-service arrangements may need a transition services agreement; promoter-owned premises may need a new lease; and undocumented support may need to be formalised or replaced. The final FDD report should therefore pair each material RPT finding with a specific closing or post-closing action.

PART IV - CASH, RISK & TRANSACTION EXECUTION

Chapter 9: Cash Flow Quality - From EBITDA to Cash Conversion

A normalised EBITDA figure, however carefully constructed, tells a buyer only part of the story if the business does not reliably convert that EBITDA into cash. Cash flow quality analysis - examining the historical relationship between reported EBITDA and operating cash flow - is an essential complement to the QoE workstream described in Chapter 2, and is frequently the analysis that reveals working capital or capital expenditure dynamics that the EBITDA bridge alone does not capture.

9.1 The EBITDA-to-Cash Conversion Ratio

A useful summary metric in cash flow quality analysis is the EBITDA-to-cash conversion ratio - operating cash flow before tax and interest, divided by EBITDA, calculated on a trailing basis across multiple periods. A business with a consistently high conversion ratio (typically above 80-90% for asset- light businesses with stable working capital) demonstrates that reported profitability translates reliably into distributable or reinvestable cash. A declining or volatile conversion ratio warrants further investigation into whether the decline is driven by structural working capital deterioration, aggressive revenue recognition timing (discussed in Chapter 5), or capital expenditure requirements not adequately reflected in the EBITDA figure.

9.2 Capital Expenditure Quality: Maintenance vs. Growth

Cash flow quality analysis must also decompose reported capital expenditure into maintenance capex (spending required simply to sustain the current level of operations - vehicle replacement in a fleet business, equipment refurbishment in a manufacturing business) and growth capex (spending intended to expand capacity or enter new markets). A target that has deferred necessary maintenance capex in the periods leading up to a sale process will present an artificially favourable free cash flow picture, at the cost of a capital expenditure catch-up burden the buyer will bear immediately post-completion. Diligence should benchmark the target's asset base against its age, condition, and expected remaining useful life to assess whether reported maintenance capex is adequate relative to the asset base being acquired.

Metric	What It Reveals	Diligence Follow-Up
EBITDA to operating cash flow	Whether earnings become cash before financing	Bridge working capital, taxes, provisions and non-cash items
DSO / receivable ageing	Collection quality and revenue conversion	Customer-level collections, disputes, cut-off
Inventory days	Cash tied in stock and obsolescence risk	SKU ageing, provisioning, purchase commitments
DPO / payable ageing	Vendor financing and pre-close payment behaviour	Normal terms, stretched creditors, overdue liabilities
Maintenance capex / EBITDA	Whether current earnings depend on under-investment	Asset age, replacement cycle, deferred spend
Free cash flow trend	Capacity to fund debt service, dividends and growth	Normalise capex and working-capital seasonality

Cash conversion diagnostic

OUR INSIGHT

EBITDA can improve while cash economics deteriorate. The combination to watch is rising EBITDA, weakening collection, stretched payables and deferred maintenance capex. Each metric in isolation can have an innocent explanation; together they can signal that the business is using the balance sheet or asset base to preserve the P&L before a transaction.

9.3 Working Capital Is the Main Bridge from EBITDA to Cash

For many asset-light businesses, the largest difference between EBITDA and operating cash flow is not capex but the movement in receivables, inventory and payables. Track DSO, DIO and DPO by month and by customer / product class. A growth business can legitimately consume working capital, but the buyer needs to know whether that cash requirement is structural and should be funded in the valuation model.

9.4 Separate Maintenance from Expansion Capex

Growth capex is a choice to expand; maintenance capex is the cost of sustaining the existing earnings base. Management often has more discretion over the timing of maintenance than the buyer would like. FDD should compare asset age, historical replacement, repair expense, breakdown history and management forecasts. If maintenance has been deferred, the deal model should reflect the catch-up even if accounting depreciation appears adequate.

Illustrative Cash Conversion Walkthrough

A target reports normalised EBITDA of Rs. 10 Crore. Before tax and interest, operating cash flow is Rs. 7.2 Crore because receivables consumed Rs. 1.8 Crore and inventory consumed Rs. 1 Crore. On the surface the conversion ratio is 72%. If the business is growing rapidly and customer terms explain the working-capital use, that may be acceptable; if sales are flat and receivable ageing is deteriorating, the same 72% tells a very different diligence story.

Cash Conversion Ratio = Operating Cash Flow (pre-tax, pre-interest) / Normalised EBITDA

QUESTIONS TO PUT TO MANAGEMENT / THE DEAL TEAM

- What explains the multi-year gap between EBITDA and operating cash flow?
- Are receivable days deteriorating because of growth, mix or collectability?
- Has inventory growth outpaced sales without a clear operational reason?
- Are payables funding the business beyond normal vendor terms?
- What level of capex is needed merely to sustain current earnings?
- Does the deal model fund the structural working-capital and maintenance requirements identified by FDD?

PRO TIP

For asset-intensive businesses, build a three-to-five-year asset replacement schedule and compare it with historical capex. A maintenance-capex catch-up is often more deal-relevant than a small EBITDA add-back because it consumes cash immediately after the buyer takes control.

PRACTITIONER CHECKLIST

- Bridge EBITDA to operating cash flow by period
- Track DSO, DIO and DPO monthly
- Test subsequent collections for material receivables
- Separate maintenance from growth capex
- Review age / condition / replacement cycle of key assets
- Identify deferred capex and one-time cash catches
- Compare cash conversion across growth and mature periods
- Reflect structural cash needs in valuation / financing model

Deal Team Takeaway

Cash conversion should be analysed in the context of the investment thesis. A fast-growing business may legitimately consume working capital while creating value, whereas a mature business with the same cash-conversion ratio may be deteriorating. Build a bridge from normalised EBITDA to operating cash flow and then to pre-financing free cash flow, identify which components scale with growth and which represent catch-up, and compare that bridge with management's forecast. The output should tell the buyer not merely that cash conversion was weak, but what level of cash generation is sustainable after the deal and what funding the operating plan will require.

Bridge Cash Conversion to the Deal Model

The historical cash-conversion bridge should feed directly into the buyer's financing and integration model. If receivable days are structurally rising, inventory must increase with growth, or maintenance capex has been deferred, the post-close model should include those cash requirements rather than assuming EBITDA converts at a headline percentage. The most useful FDD conclusion identifies the normal cash investment required to support the forecast level of earnings.

Stress the Cash Drivers, Not Only the Ratio

A single cash-conversion ratio can conceal very different risks. Stress DSO, inventory days, payable normalisation and maintenance capex separately, and show the cash effect of each assumption. This makes it possible to distinguish a temporary growth-related working-capital build from weak collections, vendor stretching or under-investment. It also gives the investment committee a more actionable downside case than a generic statement that conversion has been below target.

PART IV - CASH, RISK & TRANSACTION EXECUTION

Chapter 10: Cross-Border FDD - FEMA, ECB & ODI Considerations

A target with foreign shareholders, overseas subsidiaries, external commercial borrowings or historic cross-border transactions needs a dedicated FEMA workstream because the financial statements rarely reveal whether the underlying pricing, reporting and remittance trail is complete. The 2026 diligence framework should use the current Non-Debt Instruments, Overseas Investment, ECB and RBI reporting architecture, while mapping older transactions to the rules that applied when they occurred.

Area	Current Framework / Filing	Diligence Focus
Foreign investment into India	FEMA + Non-Debt Instruments Rules, 2019; RBI reporting framework	Sectoral conditions, pricing, issue / transfer reporting, downstream implications
Foreign liabilities / assets	RBI FLA reporting where applicable	Annual reporting completeness and balance consistency
External Commercial Borrowing	Current ECB framework; LRN / ECB reporting through AD bank	Borrower/lender eligibility, terms, end-use, maturity, all-in-cost and periodic reporting
Overseas investment	Overseas Investment Rules / Regulations / Directions, 2022; Form FC and APR	Financial commitment, reporting, evidence, APR and disinvestment history
Delayed / missed reporting	Late Submission Fee / regularisation route where available; compounding where required	Determine correct remediation instead of assuming every filing delay requires compounding
Transaction restructuring	Current FEMA and AD-bank process	Conditions precedent, pricing / reporting and pre-close remediation plan

Current cross-border FDD framework

OUR INSIGHT

Cross-border compliance cannot be inferred from the consolidated financial statements. A foreign subsidiary may be correctly consolidated while the underlying ODI, APR or remittance reporting is incomplete. Likewise, a foreign investment can be correctly recorded in equity while the issue or transfer reporting trail is deficient. The diligence evidence sits in RBI / AD-bank records, not only in the accounts.

10.1 Use the Current Foreign-Investment Architecture

The source draft referred to FEMA 21(R), an older regulatory architecture. For a 2026 transaction, inward foreign investment should be reviewed under FEMA, the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, the applicable RBI regulations / directions and the current reporting framework. Diligence should trace historical issues and transfers to the rules that applied when they occurred, but the report should not present superseded FEMA numbering as the current law.

10.2 Share Issues and Transfers - Reconcile the Evidence Chain

For historical foreign investment, reconcile board approvals, share allotment records, consideration receipts, pricing support, FC-GPR / FC-TRS or other applicable reporting acknowledgements and the share register. Do not rely on a spreadsheet stating that reporting was completed. Where a delay exists, identify whether the current framework permits regularisation through a Late Submission Fee or another administrative route, or whether compounding / separate action is required.

10.3 ECB - Review the Actual 2026 Terms

The ECB framework has changed over time, including in 2026. Avoid repeating broad historic statements that working capital or general corporate purposes are always prohibited. Instead, review the borrower and recognised lender, currency, amount, minimum average maturity, permitted end-use, all-in-cost, hedging where applicable, LRN, drawdown and periodic ECB reporting against the rules that governed the borrowing. A covenant breach and a reporting delay are different risks and should be reported separately.

10.4 ODI and Overseas Entities

For overseas investment, review the current 2022 Overseas Investment framework, the Form FC / UIN trail, evidence of investment, financial commitment and Annual Performance Reports where applicable. Reconcile these records to the consolidated group structure and intercompany balances. A foreign entity appearing correctly in consolidated accounts is not evidence that the underlying overseas-investment reporting is complete.

Illustrative Cross-Border Issue Register

Assume a target has one delayed share-issue filing, one overseas subsidiary with an overdue APR and one ECB reporting lapse. FDD should not estimate a generic compounding fee across all three. First identify the governing rule and remediation route for each contravention or delay, obtain the AD bank's status, and distinguish administrative late-filing costs from matters that may require compounding or substantive regularisation. That distinction changes both quantum and SPA protection.

QUESTIONS TO PUT TO MANAGEMENT / THE DEAL TEAM

- Can every material cross-border transaction be tied to an RBI / AD-bank evidence trail?
- Which historical issues are substantive pricing / end-use breaches versus delayed reporting?
- Is FLA reporting complete for the relevant foreign asset / liability population?
- Do ECB terms and periodic reporting match the current framework applicable to the borrowing?
- Are Form FC / UIN / APR records complete for each overseas entity?
- What remediation can be completed before closing and what needs transaction protection?

PRO TIP

Request RBI / AD-bank evidence as a transaction schedule, not a folder dump: date, transaction, amount, governing route, filing / UIN / LRN reference, due date, actual filing date, delay and remediation status. That schedule turns cross-border compliance into a diligence workpaper the deal team can actually price.

PRACTITIONER CHECKLIST

- Map foreign ownership and overseas entities to RBI / AD-bank records
- Reconcile historical issue / transfer reporting to corporate records
- Review FLA reporting where applicable
- Review ECB eligibility, terms, LRN and periodic reporting
- Review ODI / Form FC / UIN / APR trail for overseas entities
- Distinguish pricing breach, reporting delay and end-use breach
- Identify LSF / regularisation / compounding route for each gap
- Convert unresolved matters into CP / indemnity / escrow as appropriate

Deal Team Takeaway

A cross-border issue register should distinguish transaction validity, pricing, filing, remittance and ongoing compliance. For each item, record the date, parties, amount, instrument, governing framework, required filing or approval, evidence available, delay, current remediation route and whether the matter blocks closing. Do not use a single generic "FEMA non-compliance" label. A delayed report that can be regularised administratively, an ODI matter that restricts further remittance and an ECB end-use breach have different risk profiles. The buyer needs to know what can be cured before completion, what requires the authorised dealer or RBI process, and what should remain protected through the SPA.

Build the Cross-Border Evidence Pack Before Signing

For each material foreign-investment, borrowing or overseas-investment event, the evidence pack should link the corporate approval, agreement, valuation or pricing support, bank remittance evidence, RBI or AD-bank filing acknowledgement, identification number where applicable, and any subsequent annual or periodic compliance. The objective is not merely to confirm that a form name appears in a tracker; it is to prove that the underlying transaction and the regulatory record reconcile to one another.

Use a Remediation Hierarchy

Classify each gap by the route available today: documentary clean-up, late submission fee or administrative regularisation where permitted, authorised-dealer clarification, RBI approval or compounding where required. The diligence report should avoid assuming that every delayed filing has the same legal consequence. It should also identify whether remediation can be completed before closing, whether it is a condition precedent, and whether residual exposure needs a specific indemnity or escrow.

Separate Historical Breach from Future Operating Constraint

Some cross-border issues matter not because of the historical penalty but because they restrict what the buyer can do next. An unresolved ODI reporting issue may affect future remittances; an ECB end-use or reporting problem may complicate refinancing; a foreign-ownership position may affect downstream investment conditions. The report should therefore state both the backward-looking exposure and the forward-looking operating consequence so that transaction structure is designed around the real risk.

PART IV - CASH, RISK & TRANSACTION EXECUTION

Chapter 11: Red Flags & Fraud Indicators in Financial Due Diligence

While financial due diligence is not a forensic audit and is not designed to detect fraud with certainty, a well-trained diligence team should be alert throughout every workstream to indicators that warrant escalation to a more targeted, forensic-level review. Recognising these red flags early in the diligence timeline - rather than after a deal has closed - allows the buyer to either walk away, renegotiate price, or insist on specific warranties and indemnities addressing the identified risk.

11.1 Revenue and Receivables Red Flags

Common indicators of revenue-related risk include: revenue growth substantially outpacing comparable companies in the same sector without a clear underlying driver; a disproportionate share of revenue recognised in the final days or weeks of a reporting period (a classic channel-stuffing or premature recognition pattern); receivables ageing that is deteriorating while revenue continues to grow, suggesting revenue is being recognised without corresponding cash collection; and a pattern of large, unusual, or round-number journal entries posted directly to revenue accounts outside the normal invoicing cycle.

11.2 When to Escalate to Forensic Specialists

Financial due diligence teams should have a clear, pre-agreed threshold for escalating specific findings to a dedicated forensic accounting specialist, rather than attempting to resolve suspected fraud indicators within the standard FDD scope and timeline. Escalation is warranted where the indicator suggests possible intentional misstatement (as opposed to an aggressive but good-faith accounting judgment), where management's response to direct questioning is evasive or inconsistent, or where the potential quantum of the issue is large enough to affect the fundamental investment thesis. Escalating promptly, even at the cost of extending the diligence timeline, is invariably less costly than discovering the same issue after completion.

Red Flag	Specific Indicator	Recommended Response
Revenue manipulation	Unusual period-end spike or manual revenue journals	Cut-off testing; contract / delivery evidence; journal analytics
Receivable quality	Ageing worsens while revenue grows	Subsequent collections; customer confirmations; dispute analysis
Related-party leakage	New vendors / customers connected to management	Master-data / bank / director linkage review
Journal anomalies	Round-number or senior-management entries outside normal flows	Data-driven journal entry testing and override assessment
Documentation gaps	Material entries lack credible support	Expand sample, obtain third-party evidence, consider forensic escalation
Management behaviour	Repeated delay or refusal of granular data	Treat behaviour as a risk indicator and escalate scope / governance

Red flags and escalation response

OUR INSIGHT

Persistent difficulty in obtaining transaction-level data is itself a diligence finding. The source draft describes an engagement where management initially supplied only summaries for a revenue stream; the underlying data later showed revenue recognised before service performance. The broader lesson is that data-access behaviour should be assessed alongside the accounting result.

11.3 Use Data Analytics to Narrow the Human Review

Journal-entry testing is most effective when risk filters identify the small population worth reading: entries posted near period end, manual journals to revenue, users with elevated rights, round-number postings, reversals immediately after close and entries that bypass normal sub-ledgers. Data analytics does not prove fraud; it directs experienced review toward transactions that need explanation and supporting evidence.

11.4 Separate Aggressive Judgement from Intentional Misstatement

A revenue estimate, provision or capitalisation judgement can be aggressive without being fraudulent. The escalation decision should consider the accounting basis, evidence available when management made the estimate, consistency over time, management's response when challenged and whether the treatment appears designed to achieve a reporting target. FDD should avoid alleging fraud without evidence while still making the investment committee aware of manipulation risk.

Illustrative Escalation Decision

A target has Rs. 1.5 Crore of quarter-end manual revenue entries. If contracts and delivery evidence support them and the pattern reflects a seasonal billing cycle, the issue may close as a control weakness. If support is missing, the entries reverse after period end and management resists system access, the same population warrants forensic escalation. The number alone does not determine the response; the evidence pattern does.

QUESTIONS TO PUT TO MANAGEMENT / THE DEAL TEAM

- Which red flags are explained by process weakness and which suggest intentional override?
- Do suspicious period-end entries reverse shortly after the reporting date?
- Can management explanations be corroborated by independent system or third-party evidence?
- Has the team preserved a clear audit trail of requests, responses and contradictory evidence?
- What threshold triggers forensic escalation, pause of diligence or legal involvement?
- Could the issue be large enough to invalidate the investment thesis rather than merely change price?

PRO TIP

Agree the escalation protocol before the first red flag appears: who is notified, when FDD pauses, when legal counsel is involved, when forensic specialists are engaged and what information can be shared with the seller. Decisions made under live deal pressure are otherwise too easy to rationalise away.

PRACTITIONER CHECKLIST

- Run journal-entry risk filters and period-end cut-off testing
- Analyse receivable ageing and subsequent collections
- Investigate unexplained related-party / master-data links
- Treat data-access resistance as a separate risk indicator
- Document management explanations and contradictory evidence
- Agree forensic escalation threshold before issues arise
- Preserve evidence and coordinate with legal counsel where needed
- Avoid definitive fraud conclusions outside the evidence / scope

Deal Team Takeaway

When red flags surface, the diligence report should preserve the distinction between observation, evidence and conclusion. For example: "manual revenue journals of Rs. 1.5 Crore were posted in the final three days of the quarter" is an observation; "supporting delivery evidence was unavailable for 40% of the sample and several entries reversed in the following month" is evidence; "the pattern creates a risk of premature revenue recognition and warrants forensic escalation" is the diligence conclusion. Writing findings this way protects the quality of the analysis and prevents the deal team from overstating what has actually been proven. It also creates a clear hand-off to forensic specialists, who can design procedures around the exact population rather than restarting the review from first principles.

The decision to escalate should consider more than quantum. Management override, fabricated documentation, undisclosed related parties, diversion of cash, repeated contradictions in explanations and deliberate restriction of data access can be investment-thesis issues even when the amount initially identified is not material. Conversely, a large accounting error caused by a consistently applied but incorrect policy may require a price adjustment without implying misconduct. The purpose of the red-flag chapter is therefore not to label a target as fraudulent; it is to ensure that signs of intentional misstatement are recognised early enough for the buyer to obtain the evidence needed before control changes hands.

Treat Management Behaviour as Evidence

Data-access delays, repeated changes in explanation, selective production of documents and resistance to independent confirmations are not proof of fraud, but they are relevant evidence about control environment and management override risk. Record those behaviours objectively in the issue log and assess whether they justify scope expansion. A clean explanation supported by system data should close the matter; a pattern of unsupported explanations should increase the level of professional scepticism.

Preserve the Handoff to Forensics and Legal

Where escalation is required, preserve the exact transaction population, source files, journal-entry extracts, interview notes and chronology that led to the concern. Avoid altering source data or over-writing the original request trail. A disciplined handoff allows forensic specialists and legal counsel to build on the FDD work efficiently and reduces the risk that a potentially serious issue is weakened by poor evidence preservation or imprecise language in the initial report.

PART IV - CASH, RISK & TRANSACTION EXECUTION

Chapter 12: From FDD to SPA - Purchase Price Adjustments, Indemnities & Escrow

The value of a financial due diligence engagement is ultimately realised not in the report itself, but in how effectively its findings are translated into the commercial and legal terms of the Share Purchase Agreement (SPA). A CFO who treats FDD as a standalone deliverable, disconnected from the deal team negotiating the SPA, forfeits much of the protective value the diligence exercise was intended to create. This final chapter addresses how FDD findings should flow directly into purchase price mechanics, indemnity provisions, and escrow structuring.

12.1 Purchase Price Adjustment Mechanics

The QoE, net working capital, and net debt findings developed across Chapters 2 through 4 feed directly into the purchase price mechanism in the SPA. Normalised EBITDA informs the valuation multiple applied to arrive at enterprise value; the net working capital peg and completion mechanism (locked- box or completion accounts, as discussed in Chapter 3) determine the working capital true-up; and the net debt bridge, inclusive of all debt-like items identified in Chapter 4, determines the deduction from enterprise value to arrive at equity value payable at completion. Each of these figures should be explicitly cross-referenced in the SPA definitions section to the diligence report's findings, rather than restated independently by legal counsel, to avoid an inadvertent disconnect between the economic analysis and the legal documentation.

12.2 Indemnities: Specific vs. General

Findings from the tax, GST, and legal diligence workstreams that identify specific, quantifiable exposures - an open tax assessment, an identified GST liability, a pending litigation matter - should generally be addressed through specific indemnities in the SPA, with the seller bearing the identified exposure directly, rather than being folded into the general representations and warranties framework subject to standard limitation periods, materiality thresholds, and caps. Specific indemnities are often negotiated with different caps, time limits or materiality mechanics from general warranty claims because they address a known risk. Those terms are commercial outcomes, not automatic legal consequences, and should be settled with transaction counsel on the facts.

12.3 Escrow Structuring and Holdback Mechanics

Where a specific indemnity addresses an exposure whose ultimate quantum is uncertain at the time of completion - a pending litigation matter or an open tax assessment awaiting a final order - an escrow or holdback mechanism, under which a portion of the purchase price is retained for a defined period pending resolution of the specific matter, is frequently the most commercially workable solution. The escrow quantum should be sized by reference to the diligence team's assessed range of potential outcomes for the specific matter, not by an arbitrary percentage of total consideration, and the release mechanics and dispute resolution process for any disagreement about the escrow release should be explicitly defined in the SPA rather than left to a general dispute resolution clause.

FDD Finding	Potential Deal Mechanism	Objective
Normalised EBITDA	Headline price / valuation multiple negotiation	Price the business on sustainable earnings
NWC peg / definition	Completion accounts or locked-box mechanism	Deliver the agreed normal working-capital level
Net debt / debt-like items	Enterprise-to-equity bridge / closing adjustment	Prevent buyer from inheriting seller-period obligations without price effect
Known tax / GST / FEMA exposure	Specific indemnity, covenant, condition precedent or escrow	Allocate an identified risk to the agreed party
Unknown general risk	Representations and warranties subject to negotiated limits	Allocate unquantified residual business risk
Unresolved operational issue	Holdback, closing condition, remediation covenant	Ensure action is completed or economically secured

Translating diligence findings into transaction terms

OUR INSIGHT

A quantified finding that never reaches the SPA can become commercially irrelevant. The diligence team should maintain a live issue-to-remedy register showing, for each material item, whether it affects headline price, NWC, net debt, a condition precedent, a specific indemnity, escrow, covenant or only disclosure. That register is the bridge between analysis and enforceable risk allocation.

12.3 Build an Issue-to-Remedy Matrix

For every material diligence finding, record five fields: description, quantified exposure or range, evidence status, transaction consequence and owner of the remediation. The consequence column should choose among headline price, NWC, net debt, condition precedent, covenant, specific indemnity, escrow / holdback, general warranty or disclosure only. This prevents the same issue from being adjusted twice and prevents important findings from disappearing between the diligence report and SPA drafting.

12.4 Locked-Box Leakage and Completion Accounts Need Different Protections

In a locked-box, the economic focus is leakage between the locked-box date and completion, so due diligence should define permitted leakage and test potential value extraction. Under completion accounts, the focus is the accounting definition and closing measurement of cash, debt and NWC. The same target can justify different diligence procedures depending on which price mechanism the parties choose.

12.5 Escrow Is Security, Not a Substitute for Drafting

Escrow or holdback can provide recovery security for a known exposure, but it does not solve an ambiguous indemnity. Define the covered matter, claim process, evidence standard, release milestones, interest on escrow, dispute mechanism and any interaction with general liability caps. The diligence team supplies the risk quantification; transaction counsel converts it into enforceable drafting.

Illustrative Deal Translation

FDD identifies: Rs. 1 Crore of excess NWC at closing, Rs. 1.5 Crore of debt-like liabilities, a Rs. 40 Lakh probable GST exposure and a disputed tax appeal with a Rs. 2 Crore gross demand but a lower assessed risk. A clean SPA solution might increase price by the NWC surplus, deduct debt-like items in the equity bridge, protect the GST exposure through a specific indemnity / escrow, and address the disputed tax matter through a separately negotiated indemnity rather than treating all four items as a single price reduction.

QUESTIONS TO PUT TO MANAGEMENT / THE DEAL TEAM

- Has every material FDD issue been assigned exactly one primary deal remedy?
- Do SPA definitions match the diligence schedules word-for-word where economics depend on them?
- Are known exposures separated from general warranties?
- Is the proposed escrow linked to a specific quantified risk and release condition?
- Could any issue be double counted across price, net debt, NWC and indemnity?
- Who owns each open remediation item between signing and completion?

PRO TIP

Have the diligence lead join the SPA sessions dealing with purchase-price definitions and material identified exposures. Legal drafting should reflect the economic finding precisely; summaries passed between teams are where debt-like items get omitted, NWC definitions drift and indemnities lose the protection the buyer intended.

PRACTITIONER CHECKLIST

- Maintain live issue-to-remedy matrix through signing
- Cross-reference QoE, NWC and net debt definitions to SPA schedules
- Prevent double counting across price adjustments and indemnities
- Separate known quantified risks from general warranty risk
- Define escrow / holdback quantum from evidence, not arbitrary percentages
- Set leakage / completion-account policies consistently
- Involve diligence team in relevant SPA negotiation sessions
- Track open remediation items through conditions precedent and closing

Deal Team Takeaway

The final transaction model, FDD schedules and SPA should be capable of being read together without reconciliation surprises. The EBITDA used for valuation should reconcile to the QoE bridge; cash, debt and NWC should use the same classifications as the closing model; and each material identified exposure should appear once in the agreed remedy matrix. A final cross-functional review before signing is often the cheapest way to prevent an otherwise well-run diligence process from losing value in documentation.

CONCLUSION

From Findings to Decision - The CFO's FDD Playbook

Financial Due Diligence is valuable because it compresses uncertainty before a transaction becomes irreversible. A good report does not attempt to replace the audit, legal review, tax opinion or commercial diligence. It connects the financial evidence those workstreams generate to the buyer's or seller's central questions: what is sustainable EBITDA, what working capital and debt will transfer, what cash is genuinely available, what exposures remain, and how should those findings change price or protection?

The Five Outputs a CFO Should Demand

A publication-ready FDD report can take many forms, but the CFO should be able to extract five deal-ready outputs from it: a reported-to-normalised EBITDA bridge; a normal working-capital analysis and clear peg logic; a net debt and debt-like schedule; a prioritised risk / exposure register; and an issue-to-remedy matrix showing how each material finding is expected to reach valuation, price mechanics or the SPA. If one of those outputs is missing, the deal team should ask why.

01	02	03	04	05
Normalised Earnings	**Working Capital**	**Net Debt**	**Risk Register**	**Deal Translation**
Reported EBITDA to sustainable earnings, with evidence and valuation sensitivity	Historical trend, seasonality, quality and a defendable closing peg	Conventional debt, debt-like obligations and only genuinely available cash	Tax, GST, FEMA, accounting, RPT, cash-flow and red-flag findings by severity	Price, completion adjustment, CP, indemnity, escrow, covenant or disclosure consequence

What Changes for the Seller

For a seller, the same discipline can reduce deal friction. Vendor diligence and pre-sale readiness allow management to explain accounting judgements, isolate one-offs, reconcile NWC and net debt and address historic compliance gaps before multiple bidders discover them separately. The objective is not to make the business look artificially clean; it is to make the economics consistent, supported and easier to underwrite.

What Changes for the Buyer

For a buyer, disciplined FDD changes the negotiating position. A material adjustment supported by contract, ledger and cash evidence is harder to dismiss than a generic concern. A working-capital peg built from monthly seasonality is harder to game than a single balance-sheet number. A debt-like schedule tied to SPA definitions is harder to lose during drafting. The quality of the evidence often determines how much of the analytical finding becomes actual purchase-price protection.

OUR INSIGHT

The measure of a good diligence engagement is not how many issues it reports. It is how many transaction decisions become clearer because the team can distinguish sustainable economics from accounting presentation, ordinary operating risk from seller-period exposure, and a matter that needs a specialist opinion from one that can be quantified immediately.

Before Signing - Ten-Point CFO Gate

01 QoE reconciles to books	**02** LTM is rolled to current month	**03** NWC definition has worked example	**04** Net debt captures agreed debt-like items	**05** Cash is tested for availability
06 Tax / GST / FEMA issues have owners	**07** Red flags are closed or escalated	**08** No finding is double counted	**09** Issue-to-remedy matrix matches SPA	**10** Closing model reconciles to documents

The Final CFO Test

Before the SPA is signed, ask five questions: Can we reconcile the EBITDA we are paying for to the books? Can both parties compute the NWC and net debt adjustment from the same definitions? Do we know which cash is actually available? Have all material tax, GST, FEMA and related-party findings been assigned a deal remedy? And does the closing model reconcile exactly to the transaction documents? If the answer to any one is no, diligence is not finished simply because the report has been issued.

What a Deal-Ready FDD Deliverable Looks Like

A useful report is concise at the front and deep in the workpapers. The executive summary should state the sustainable EBITDA range, NWC and net-debt implications, the five to ten issues that can change the transaction and the recommended deal response. Detailed sections should then show the evidence, reconciliations and sensitivities supporting those conclusions. The output should be usable by the CFO, investment committee and transaction counsel without each team creating a separate interpretation of the same finding. That is the standard this guide is designed to encourage: diligence that is rigorous enough to withstand challenge and practical enough to change the deal while there is still time to act.

ONE LAST THING BEFORE YOU CLOSE THIS GUIDE

If the price depends on EBITDA, make sure the EBITDA can survive diligence.

The most expensive diligence finding is rarely the one discovered early. It is the one discovered after the headline value is agreed, the exclusivity clock is running, the financing has been sized or the SPA is nearly final. At that point, a Rs. 50 Lakh recurring EBITDA issue can become a multi-crore valuation argument, and an undefined NWC or debt-like item can become a post-completion dispute.

You do not need to know whether you need full FDD, QoE-only, vendor diligence or a focused red-flag review before calling us. Tell us the transaction, the target, the decision timeline and the numbers the deal team is relying on. We can help define the smallest scope that still answers the investment question properly.

CALL US WHEN YOU ARE DEALING WITH

- A buy-side acquisition where reported EBITDA drives valuation
- A sell-side / fundraising process that needs investor-grade vendor diligence
- A disputed QoE bridge or management add-backs that require independent evidence
- An NWC peg, net debt or debt-like item definition that can change closing price
- A platform / marketplace business with complex Ind AS 115 or GST mechanics
- Historical tax, GST, FEMA, ECB or ODI issues that need deal quantification
- An SPA where diligence findings must become adjustments, indemnities or escrow
- A wider M&A, valuation, modelling or transaction issue elsewhere in the group

EXPERIENCE	CLIENT ENGAGEMENTS	CREDENTIALS	BIG-4 FOUNDATION
15+ Years	500+	CA | CS | IBBI RV	9 Years at EY

WHAT HAPPENS IN THE FIRST CONVERSATION

01	02	03
Tell us the deal	**We map the risk**	**You get a practical scope**
Transaction stage, target, valuation basis, timeline and the numbers already being relied on.	QoE, NWC, net debt, tax / GST / FEMA, accounting, data and SPA workstreams.	Information list, proposed procedures, timeline, deliverables and the issues that need specialist support.

BOOK A 15-MINUTE INTRODUCTORY CALL

Speak to us before a material number becomes a late-stage negotiation. Early diligence is easier to scope, easier to evidence and much easier to translate into price protection than a finding discovered after the transaction documents have hardened.

CALL	EMAIL	VISIT
+91 9879557558	**sagarrvshah@elitevaluation.in**	**www.EliteValuation.in**

A deal is easiest to reprice, restructure or protect before it is signed.

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