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Exposure Draft
of
ICAI Valuation Standard 303
Financial Instruments



Issued by Insolvency, Bankruptcy and Valuation Standards Board

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
(Set up under an Act of Parliament)

Exposure Draft

ICAI Valuation Standard 303 *Financial Instruments*

Following is the Exposure Draft of the ICAI Valuation Standard 303 Financial Instruments issued by the Insolvency, Bankruptcy and Valuation Standards Board of the Institute of Chartered Accountants of India, for comments.

The Board invites comments on any aspect of this Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide suggestions for alternative wording.

*Comments can be submitted using one of the following methods, to be received not later than **22nd November 2026**.*

1. *Electronically: Click on **https://forms.gle/c78nuhiBHWfMrdjx9** to submit comments online. (Preferred method)*
2. *Email: Comments can be sent to **commentsvsb@icai.in***
3. *Postal: Secretary, Insolvency, Bankruptcy and Valuation Standards Board, The Institute of Chartered Accountants of India, ICAI Bhawan, A- 29, Sector- 62, Noida - 201309.*

Further clarifications on any aspect of this Exposure Draft may be sought by e-mail to ivsb@icai.in.

Draft

ICAI Valuation Standard 303
Financial Instruments

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Objective

1. **This Standard establishes principles, suggests methodology and considerations to be followed by a *valuer* in performing valuation of financial instruments.**

2. This Standard supplement the other ICAI Valuation Standards by providing specific principles and considerations in relation to financial instruments.

3. **The principles enunciated in this Standard shall be applied in conjunction with the principles prescribed and contained in the *Valuation Framework and other Valuation Standards prescribed by ICAI*.**

Scope

4. **This Standard applies to the valuation of financial instruments.**

5. For the purposes of this Standard, financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Equity instruments, derivatives, debt instruments, fixed income and structured products, compound instruments, loans, receivables, convertible instruments, warrants, options, futures, forwards, swaps, structured products and other contractual instruments having financial characteristics etc. are certain examples of

financial instruments.

6. Valuation of financial instruments is commonly carried out amongst other matters, for transactional pricing (i.e. buy or sell) and financial reporting purposes. In addition, valuation of financial instruments is also of particular importance in case of business combinations, share-based payments, off-market transactions, risk management, tax allocations, dispute resolution, purchase-price allocations, liquidation, etc.

7. Where the instrument contains an embedded feature, option, guarantee, conversion right, prepayment right, floor, cap, barrier, contingent payment or other non-linear feature, the valuer may consider whether the feature requires separate analysis or an integrated valuation**.**

8. **Considering the multiple categorisation and different usages of a financial instrument valuation, detailed consideration of purpose of valuation and the features of the instrument being valued is essential to identify the relevant information available to be perused for valuing the instrument.**

9. The Standard does not prescribe accounting recognition, classification or presentation. Such matters remain subject to the applicable accounting and legal framework.

10. The Standard does not determine whether a particular instrument is legally valid, enforceable or transferable.

11. The Standard applies to financial instruments denominated in Indian rupees or foreign currencies and to instruments whose value depends on domestic or international markets, subject to applicable regulatory requirements.

12. In accordance with the ICAI Valuation Standard 102 *Valuation Bases*, a *valuer* shall select appropriate valuation bases that are relevant in the context of the categorisation of the financial instrument. To arrive at the right valuation base, a *valuer* amongst other matters should also have an understanding of the relevant regulations governing the functioning of the instrument.

13. The selection of the appropriate approach and method in accordance with ICAI Valuation Standard 103 *Valuation Approaches and Methods*, shall be properly reasoned and shortlisted on the basis of various considerations. A *valuer* shall also give due consideration to the complexity of the instrument being valued and the available information while selecting a valuation approach and method.

Valuation Approaches

14. Financial instruments, being generally aligned to market-linked factors, the usage of market-linked methods with observable inputs is usually the preferred approach to arrive at a value. Valuation of certain financial instruments, for example, equity instruments, may in situations be based on the inherent business valuation from which the financial instrument derives value. A *valuer* should give due consideration to ICAI Valuation Standard 301 *Business Valuation* in relation to valuation of such financial instruments.

15. The methods used for the valuation of financial instruments are based on the market, income and cost approaches as described in ICAI Valuation Standard 103.

16. The following are some of the factors that a *valuer* shall consider while determining the appropriateness of the method (or a combination of methods) that should be used for the valuation:

    (a) the valuation base and terms and conditions of the instrument being valued;

    (b) the purpose of valuation; and

    (c) other considerations including the control framework of the entity and input data sets.

17. Valuation of certain financial instruments involves significant uncertainty with regard to the method used or market aberrations. In such situations, a *valuer* shall document the nature of the uncertainty. A valuer shall also document the inherent nature of the complexity in detail to enable the user to understand the assumptions that impact the value of the instrument.

Market Approach

18. **Market approach is a valuation approach that uses prices and other relevant information generated by market transactions involving identical or comparable (i.e., similar) assets, liabilities or a group of assets and liabilities, such as a business.**

19. In market approach, the value of the financial instrument is determined by considering traded prices of such instrument in an active market; or prices and other relevant information generated by market transactions involving identical or comparable (similar) assets. A *valuer* shall follow the detailed guidance provided in ICAI Valuation Standard 103 for application of the market approach.

20. An example of the market approach is the price obtained from active trading of financial instrument on an exchange as it is normally the preferred indication of the market value of an identical instrument. In absence of an active market benchmark price, comparable pricing or private transaction pricing may also be considered.

21. Further, valuation methods consistent with the market approach often use market benchmarks derived from a set of comparable financial instrument operating in a similar framework. Benchmarks might be in a range with a different pricing benchmark for each comparable. The selection of the appropriate comparable and its pricing benchmark within the range requires close evaluation of comparability, consideration of qualitative and quantitative factors specific to the measurement of the financial instrument and judgement.

22. In case, the financial instrument being valued is characterised by certain different terms than the identical quoted instrument, the *valuer* shall adjust the comparable price to reflect the different terms and characteristics.

Income Approach

23. **Income approach is the valuation approach that converts maintainable or future amounts (e.g., cash flows or income and expenses) to a single current (i.e., discounted or capitalised) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.**

24. In income approach, value of a financial instrument is determined based on the expected economic benefits generated by such financial instrument and level of risk associated with such financial instrument. It generally involves discounting future amounts to a single present value after adjusting inherent risks.

25. The use of income approach, especially the discounted cash flow model, requires usage of present-value methods that are deployed to ascertain the present value of future cash flows basis of certain assumptions. Paragraphs 33-35 of this Standard further elaborate on the considerations involving present value methods.

26. Black-Scholes-Merton formula or a binomial model and similar other pricing models are examples of income approach, that incorporate present value methods and reflect both the time value and the intrinsic value of an option.

27. Apart from the cash flows that the entity expects to realise the cash flow, the terms of a financial instrument, amongst other matters, also typically cover:

    (a) the timing when the entity expects to realise the cash flows related to the instrument;

(b) the basis of calculation of the cash flows, e.g., the interest rate, coupon rate, underlying index or indices, etc; and

(c) the terms and timing for any special terms/restrictions in the contract, e.g., put or call, lock-in, prepayment, extension, conversion options, residuary right.

Cost Approach

28. **Cost approach is a valuation approach that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).**

29. From the perspective of a market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquire a substitute asset of comparable utility.

30. The usage of cost approach is of more predominance in valuation of non-financial assets. A *valuer* shall follow the detailed guidance provided in ICAI Valuation Standard 103 for application of the cost approach.

Valuation Methods

31. **A *valuer* shall use valuation methods that are appropriate in the circumstances and for which sufficient data is available to measure the value, the use of relevant observable inputs.**

32. A *valuer* shall use valuation methods that enable him to form an opinion to estimate the price at which an orderly transaction to sell the financial instrument would take place between market participants at the valuation date under the market conditions existing on that valuation date.

33. **Valuation Methods:**

a) Discounted cash flow and present value methods may be used for fixed or variable contractual cash flows, subject to appropriate treatment of credit and other risks.

b) Yield-based methods may be used where observable yields or spreads provide relevant evidence for comparable instruments.

c) Option pricing methods may be used for instruments containing options or option-like features where the assumptions and model inputs can be supported.

d) Lattice and tree-based models may be used where exercise decisions depend on changes in market variables over time.

e) Simulation methods may be used for instruments with path dependency, multiple correlated risk factors or complex contingent cash flows.

f) Credit-based methods may be used for instruments where expected loss, default probability, recovery and exposure characteristics materially determine value.

The choice of model should consider the economic features that materially affect value.

The model shall be tested for internal consistency, mathematical accuracy and reasonable behaviour under relevant changes in inputs.

Where material model limitations exist, the valuer shall consider an adjustment, alternative model, sensitivity analysis or disclosure as appropriate.

34. A *valuer* may choose basis of either a single valuation method or a combination of multiple valuation methods to perform the valuation. If multiple valuation methods are used to measure the value, the results shall be evaluated considering the reasonableness of the range of values indicated by those results. Appropriate weightage can be provided to the outcome derived from the deployment of

multiple valuation methods. For further guidance, refer Paragraph 9 of Valuation Standard 103.

35. Once the valuation method has been shortlisted and deployed, such valuation method used for valuation shall be applied consistently. However, in certain circumstances a change in a valuation method or its application is appropriate if the change results in a measurement that is equally or more representative of value in the circumstances. Examples of instances when a change in valuation method may be necessitated are:

    (a) change in terms or regulations governing the instrument;

    (b) new markets development;

    (c) new information becomes available;

    (d) information previously used is no longer available; or

    (e) market conditions change.

36. Usage of unobservable inputs carries a reasonable degree of judgment and assumptions, and hence may be considered as a choice of input in circumstances where observable inputs are unavailable. Therefore, unobservable inputs shall also reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

37. A valuation method based on unobservable inputs values a probability of outcome using certain assumptions (or range of assumptions). A *valuer* would be expected to factor a risk element that may be inherent to the probability or the assumptions. Accordingly, assumptions about risk include the risk inherent in a particular valuation method used to measure value or the risk inherent in the inputs to the valuation method. It would be incorrect not to consider appropriate levels of risks inherent in valuation of financial instruments.

38. In using unobservable inputs, the *valuer* would evaluate whether the unobservable inputs have been developed using the adequate information available at the time of valuation. The unobservable input shall also factor in the information about market participant assumptions which is reasonably available.

Major Considerations

Determination of Present Value

39. **Present value is an integral tool used in the income approach to link future amounts (e.g., cash flows or values) to a present amount using a discount rate.**

40. The valuation of a financial instrument using a present value technique captures all the following elements from the perspective of market participants at the valuation date:

    (a) an estimate of future cash flows for the asset or liability being measured;

    (b) expectations about possible variations in the amount and timing of the cash flows representing the uncertainty inherent in the cash flows;

    (c) the time value of money, represented by the rate on risk-free security that have maturity dates or durations that is appropriate considering the period covered by the cash flows / tenor of the instrument and pose neither uncertainty in timing nor risk of default to the holder (i.e. a risk-free interest rate);

    (d) the price for bearing the uncertainty inherent in the cash flows (i.e., a risk premium); and

    (e) other factors that market participants would take into account in the circumstances.

Adjustments for Credit Risk

41. One of the important characteristic of valuing a financial instrument is to understand the risk associated with the following:

    (a) instrument; and

    (b) the issuer including the respective credit risk

42. The following are some of the factors that need to be considered in measuring credit risk:

    (a) *Counterparty risk:* The credit-risk measurement is influenced by the financial strength of the issuer or any guarantors and will involve the following major considerations:

        (i) present and projected financial performance of the parties; and

        (ii) performance and prospects for the macro industry sector in which the entity/business operates.

        The due consideration shall also be given to the credit exposure of any counterparties to the asset or liability being valued.

    (b) *Capital leveraging*: The amount of borrowing deployed to operationalise the assets from which an instrument's return is derived, or the overall capital leveraging profile of the issuer can affect the volatility of returns to the issuer and also the credit risk of the instrument.

    (c) *Security hierarchy*: Establishing the security hierarchy of an instrument is important in assessing the credit risk. Lower hierarchy in security charge would usually result in a higher credit risk profile.

    (d) *Collateral and default protection*: For the purposes of measuring credit risk, it is relevant that the estimate of expected cash shortfalls reflect the cash flows expected from collateral and other credit enhancements that are part of the contractual terms. The estimate of expected cash shortfalls on a collateralised financial instrument reflects the amount and timing of cash flows that are expected from foreclosure on the collateral less the costs of obtaining and selling the collateral, irrespective of whether foreclosure is probable. A *valuer* needs to understand whether there is recourse to all the assets or only to specified assets. The greater the value and liquidity of the assets to which an entity has recourse in the event of default, the lower the credit risk of the instrument. Protection might take the form of a guarantee by another party or a credit default swap. Credit risk is reduced if subordinated instruments take the first losses on the underlying assets and therefore reduce the risk to more senior instruments.

    (e) *History of default*: Default occurred in the recent past in payment obligations on borrowings, payables, etc. is relevant in evaluating the financial stress and resulting credit risk therefrom.

    (f) *Offsetting:* If derivative instrument and underlying asset are held by counterparty, credit risk will reduce by offsetting it with counter party.

Liquidity, Marketability and other Adjustments

43. For liquidity and marketability considerations refer to paragraphs [54-58] of Valuation Standard 103.

Debt Instruments and Loans

44. Debt instruments shall be valued based on contractual cash flows, credit risk, market yields, security, seniority, maturity, optionality and other material characteristics.

45. For actively traded debt, quoted prices, traded yields and comparable market evidence shall receive appropriate consideration.

46. For privately negotiated loans, present value methods may be used with appropriate assumptions regarding benchmark rates, credit spreads, security, seniority, repayment and prepayment etc.

47. Floating-rate instruments shall be valued using the relevant reference rate, spread and reset conventions.

48. Accrued interest shall be treated consistently with the purpose and basis of value and shall be clearly distinguished from clean and dirty pricing where relevant.

49. Where the issuer has an option to redeem or the holder has a put option, such option feature shall be appropriately considered for the valuation of the debt instrument / loan.

50. Restructured, overdue or defaulted loans and debt instruments may require assessment of expected cash flows and recovery (including recovery from underlying collaterals) rather than reliance solely on contractual terms.

51. Transaction costs shall be treated in accordance with the applicable basis of value. The valuer shall distinguish the value of the instrument from transaction costs and from any net proceeds' receivable or net payments required and shall state the treatment adopted in the report.

Redeemable Preference Shares

52. Redeemable Preference Shares (RPS) shall be valued based on dividend, redemption, credit risk, market yields, seniority / liquidation rights, participation rights and other material characteristics.

53. Cumulative and non-cumulative dividend features shall be reflected in expected cash flows where relevant.

54. In cases where there is uncertainty in receiving cash flows as per contractual terms, valuation of RPS may require assessment of expected cash flows in terms of timing and amounts.

55. Where the issuer has an option to redeem or the holder has a put option, such option feature shall be appropriately considered for the valuation of the RPS.

Valuation of Portfolios and Groups of Instruments

56. Portfolio valuation shall consider whether instruments are valued individually or on a portfolio basis and whether portfolio-level characteristics affect value.

57. Diversification, correlation, netting, offsetting, collateral and concentration may affect portfolio value where relevant.

58. The valuer shall avoid double counting when the same risk or benefit is captured at both instrument and portfolio levels.

59. Where a portfolio is expected to be sold or transferred as a group, the basis of value shall determine whether portfolio-level adjustments are appropriate.

60. Material concentration and liquidity effects shall be disclosed.

Calibration

61. Reference is invited to Valuation Standard 103.

Effective Date

62. ICAI Valuation Standard 303 Financial Instruments, shall be applied for the valuation reports issued on or after []