

ICAI Valuation Standards 2018



**Valuation Standards Board ICAI
And
ICAI Registered Valuers Organisation
The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi**

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Note: These ICAI Valuation Standards will be effective till Valuation Standards are notified by the Central Government under Rule 18 of the Companies (Registered Valuers and Valuation) Rules, 2017.

Published in : June, 2018

Committee/Department : Valuation Standards Board

E-mail : valuationstandards@icai.in

Website : www.icai.org

Price : Rs 100 /-

ISBN : 978-81-8441-935-1

Published by : The Publication Department on behalf of the Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi - 110 002.

Printed by : Sahitya Bhawan Publications, Hospital Road, Agra - 282 003.
August/2018/P2325

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Preface to the ICAI Valuation Standards

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(The Preface should be read in the context of Framework of the ICAI Valuation Standards)

The following is the text of the Preface to the ICAI Valuation Standards, issued by the Institute of Chartered Accountants of India (ICAI)

I. Formation of the Valuation Standards Board

1. The Institute of Chartered Accountants of India (ICAI), recognising the need to have the consistent, uniform and transparent valuation policies and harmonise the diverse practices in use in India, constituted the Valuation Standards Board (VSB) on 28th February, 2017.
2. The composition of the VSB is fairly broad-based and ensures participation of all interest-groups in the standard-setting process. Apart from the elected members of the Council of the ICAI nominated on the VSB, the following are represented on the VSB:
 - (i) Nominee of the Central Government representing the Ministry of Corporate Affairs on the Council of the ICAI
 - (ii) Representatives of Industry Associations
 - (iii) Representative of Central Board of Direct Taxes

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- (iv) Representative of Reserve Bank of India
- (v) Representative from Comptroller and Auditor General of India
- (vi) Representative of Insurance Regulatory and Development Authority of India
- (vii) Representative of Securities and Exchange Board of India
- (viii) Representatives of Academic Institutions
- (ix) Representative of Indian Banks Association
- (x) Eminent Professionals co-opted by the ICAI
- (xi) Representative(s) of any other body, as considered appropriate by the ICAI

II. Objectives and Functions of the Valuation Standards Board

3. The following are the objectives of the Valuation Standards Board:
 - (i) To identify and suggest areas in which Valuation Standards need to be developed.
 - (ii) To formulate Valuation Standards with a view to assisting the Council of the ICAI in evolving and establishing Valuation Standards in India.
 - (iii) To engage with ICAI Registered Valuers Organisation for adoption of Valuation Standards formulated by ICAI.
 - (iv) To examine the extent upto which, ICAI Valuation Standards are to be aligned with globally accepted valuation practices and policies.
 - (v) To review, at regular intervals, the Valuation Standards, to keep abreast of statutory, technological or other developments and , if necessary, revise the same.
 - (vi) To provide, from time to time, interpretations and guidance on Valuation Standards.
 - (vii) To proactively interact with other national and international bodies engaged in the standard-setting process, inter alia by sending comments on various consultative papers like Exposure Drafts, Discussion Papers etc., issued by them.

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(viii) To carry out such other functions relating to valuation and Valuation Standards.

4. The main function of the VSB is to formulate Valuation Standards to be recommended by ICAI to Registered Valuers Organisations in India, the Government and other regulatory bodies in India and abroad for adoption and implementation. While formulating the Valuation Standards, the VSB will take into consideration the applicable laws, customs, usages and business environment prevailing in India.
5. The VSB has also been entrusted with the responsibility of propagating the Valuation Standards and of persuading the concerned parties to adopt them in the preparation of valuation reports. The VSB will provide interpretations and guidance on issues arising from Valuation Standards. The VSB will also review the Valuation Standards at periodical intervals and, if necessary, revise the same.

III. Valuation Reports

6. While performing its function, the VSB will keep in view the purposes and limitations of valuation reports and the responsibilities of *valuer*. At the time of formulation of the Valuation Standards, the VSB will make possible efforts to explain the basic concept to which valuation principles should be oriented and state the valuation principles to which the practices and procedures should conform. The VSB will clarify the terms commonly used in valuation reports and suggest improvements in the terminology wherever necessary.
7. The responsibility for the preparation of valuation report in compliance with the Valuation Standards and for adequate disclosure of information that supports the conclusion is that of the valuer.

IV. Scope of Valuation Standards

8. The objective of issuing the Valuation Standards is to standardise the various principles, practices and procedures followed by registered valuers and other valuation professionals in valuation of assets, liabilities or a business. The Valuation Standards set out concepts, principles and procedures which are generally accepted internationally having regard to legal framework and practices prevalent in India.
9. The Standards will provide a benchmark to the professionals to ensure uniformity in approach and quality of valuation output.

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10. Efforts will be made to ensure that the Valuation Standards are in conformity with the provisions of the applicable laws, customs and usages in India. In case of deviations, the provisions of the law will prevail and the valuation report should be prepared in conformity with such law.
11. The Valuation Standards by their very nature cannot and do not override the local regulations which govern the preparation of valuation report in the country. However, the government may determine the extent of disclosure to be made in the valuation report.
12. The Valuation Standards are intended to apply only to items which are material.
13. Any limitations with regard to the applicability of a Valuation Standard and the date from which a particular Standard will come into effect will be specified in the respective Standard.
14. The Standards issued by ICAI include paragraphs in bold type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles. An individual Standard should be read in the context of the objective stated in that Standard, this Preface & Framework for the preparation of valuation report.

V. Procedure for Issuing a Valuation Standard

Broadly, the following procedure is adopted for formulating Valuation Standards:

15. The VSB determines the broad areas in which Valuation Standards need to be formulated and the priority in regard to the selection thereof.
16. In the preparation of Valuation Standards, the VSB will be assisted by Study Groups constituted to consider specific subjects. In the formation of Study Groups, provision will be made for wider participation by the members of the Institute and others. Based on the findings of the Study Group(s), Draft of the proposed Standard will be prepared.
17. The Draft of the proposed Standard will normally include the following:
 - (a) Objective of the Standard;

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- (b) Scope of the Standard including limitations with regard to its applicability;
 - (c) Significant Elements;
 - (d) Principles and important considerations;
 - (e) The date from which the Valuation Standards will become effective;
 - (f) Any other necessary aspects.
18. The VSB will consider the draft and based on findings, an Exposure Draft of the proposed Standard will be issued for comments by the members of the Institute and the public.
 19. After taking into consideration the comments received, the draft of the proposed Standard will be finalised by the VSB and submitted to the Council of the ICAI.
 20. The Council of the ICAI will consider the final draft of the proposed Standard, and approve the same with or without modifications as appropriate.
 21. The procedure followed for formulation of a new Valuation Standard, as detailed above, will also be followed for any revision thereof.

VI. Compliance with the Valuation Standards

22. The Valuation Standards will be mandatory from the respective date(s) mentioned in the Valuation Standard(s). The mandatory status of Valuation Standard implies that while preparing the valuation report, it will be the responsibility of the *valuer* to comply with the Valuation Standard.
23. Valuation Report cannot be described as complying with the Valuation Standards unless they comply with all the requirements of each relevant Valuation Standard, to the extent applicable.

VII. Effective Date

24. *Valuers* will be required to follow Valuation Standards in the preparation of valuation report issued on or after the date(s) specified in the Standard.

Framework for the Preparation of Valuation Report in accordance with the ICAI Valuation Standards

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This Framework is prepared in the context of ICAI Valuation Standards as they contain references to the Framework.

(The following is the text of the 'Framework for the Preparation of Valuation Report' under ICAI Valuation Standards.)

Introduction

Purpose and Status

1. This framework sets out the concepts that underlie the preparation of valuation reports in accordance with the ICAI Valuation Standards. The purpose of the Framework is to:
 - (a) assist in the development of future ICAI Valuation Standards and in review of ICAI Valuation Standards that are issued from time to time;
 - (b) assist in promoting harmonisation of practices, valuation standards and procedures relating to the preparation of valuation reports by providing a basis for identifying approaches and methodologies of valuation;
 - (c) assist *valuers* in applying ICAI Valuation Standards in preparation of valuation report and in dealing with topics that are yet to form the subject of an ICAI Valuation Standard;
 - (d) assist users of valuation report in understanding and comprehending the information contained in valuation reports prepared in conformity with the ICAI Valuation Standards; and
 - (e) provide those who are interested in ICAI Valuation Standards with information about approach to their formulation.
2. This Framework is not a Valuation Standard and hence does not prescribe or establish standards on valuation of any particular item for preparation of valuation report. Nothing in this Framework overrides any specific ICAI Valuation Standard.
3. This Framework does not provide procedural requirements for the preparation of valuation report. Basic principles, methods and approaches to valuation and related guidance, consistent with concepts in this Framework, for the preparation of valuation report are contained in the Valuation Standards.

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4. In a limited number of cases there may be a conflict between the Framework and an ICAI Valuation Standard. The requirements of the ICAI Valuation Standard will prevail over the Framework in case of a conflict.
5. In the absence of any definition, or lack of guidance, for a specific term or expression in the Valuation Standards, the *valuer* shall use its judgement while performing the valuation assignment in such a manner so that the information is:
 - (a) relevant to the economic decision-making needs of intended users; and
 - (b) reliable, in the valuation reports
 - (i) represent faithfully the information contained therein;
 - (ii) reflect the economic substance and not merely the legal form of an item;
 - (iii) are neutral, i.e., free from bias;
 - (iv) are prudent; and
 - (v) are complete in all material respects.
6. In making the judgement described in paragraph 5, the *valuer* shall refer to, and consider the applicability of, the following sources in descending order:
 - (a) the prescriptions laid down in Companies (Registered Valuers and Valuation) Rules, 2017, as amended from time to time;
 - (b) the requirements in this Framework;
 - (c) the requirements in the applicable accounting standards as may be notified by the Ministry of Corporate Affairs and where applicable the accounting standards issued by the Institute of Chartered Accountants of India; and
 - (d) in the absence thereof, those of the other standard-setting bodies that use a similar framework to develop valuation standards, other authoritative literature relating to valuation and accepted industry practices, to the extent that these do not conflict with any of the requirements of ICAI Valuation Standards.

Users of Valuation Report

7. The Framework is concerned with the valuation report prepared for the intended users.
8. The intended users of valuation may be present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. They require valuation report for their specific purpose and the requirements may vary depending on the intended user.

Scope

9. The Framework deals with:
 - (a) the objective of the valuation report;
 - (b) the qualitative characteristics that determine the usefulness of information in valuation report; and
 - (c) the fundamental ethical principles to be observed by the valuers.

Objective of Valuation Report

10. The objective of a valuation report is to present the result of findings of a comprehensive appraisal of and revealing a user-specific value for, one or more items.

Qualitative characteristics of valuation report

11. Qualitative characteristics are the attributes that make the information provided in valuation report useful to the intended users. The principal qualitative characteristics are understandability, relevance and reliability.

Understandability

12. An essential quality of the underlying information provided in valuation report is that it must be readily understandable by the intended users. For this purpose, it is assumed that users have a reasonable knowledge of business and economic activities and valuation approaches and methods followed in the preparation of the valuation report and ability to study the information with reasonable diligence. However, information about complex matters that should be included in the valuation report because of its relevance to the economic

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decision-making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand.

Relevance

13. To be useful, the underlying information in a valuation report must be relevant to the decision-making needs of the intended users. Information provided in the valuation report has the quality of relevance when it influences the economic and other decisions of users.

Materiality

14. The relevance of the underlying information in valuation report is affected by its nature and materiality.
15. The underlying information in valuation report is material if its omission or misstatement could influence the economic decisions taken by intended-users on the basis of the valuation report. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic, which information must have if it is to be useful.

Reliability

16. To be useful, the underlying information in a valuation report must be reliable. Information has the quality of reliability when it is free from material error and bias and can be relied upon by users to represent faithfully that which, it either purports to represent or could reasonably be expected to represent.

Faithful representation

17. To be reliable, the information presented in a valuation report must represent faithfully what it purports to represent. Faithful representation has three characteristics, namely, error-free, neutrality and completeness.
18. Sometimes the information in the valuation report is subject to some risk of being less than a faithful representation of that which it purports to portray. This is not due to bias, but may arise due to inherent difficulties either in identifying the appropriate method, approaches or techniques to be applied in valuation.

Substance over form

19. If the underlying information of valuation report represent faithfully the value, that it purports to represent, it is necessary that they are evaluated in valuation assignment in accordance with their substance and economic reality and not merely by their legal form. The substance of transactions such as acquisition or disposal of assets is not necessarily consistent with that which is apparent from their legal or contrived form. For example, an entity may dispose of an asset to another party in such a way that the documentation purports to pass legal ownership to that party; nevertheless, the entity continues to enjoy the future economic benefits embodied in the asset. In such circumstances, the reporting of a sale would not be free from error, and such a transaction may affect the result of valuation.

Neutrality

20. To be reliable, the information contained in valuation report must be neutral, that is, free from bias. The valuation reports are not considered neutral if, by the selection or presentation of information, the reports influence the making of a decision or judgement in order to achieve a predetermined result or outcome.

Prudence

21. Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty.

The preparers of the valuation report do, however, have to contend with the uncertainties that inevitably surround many events and circumstances, such as the collectability of doubtful receivables, the probable useful life of plant and equipment and the number of warranty claims that may occur. Such uncertainties are to be dealt with prudence in the preparation of the valuation report. However, the exercise of prudence does not allow the understatement of assets or income, or the overstatement of liabilities or expenses, because the valuation report would not be neutral and, therefore, not have the quality of reliability.

Completeness

22. To be reliable, the underlying information in valuation report must be

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complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

Constraints on relevant and reliable information in valuation report

Balance between benefit and cost

23. The balance between benefit and cost is a pervasive constraint rather than a qualitative characteristic. The benefits derived from information in valuation report should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a judgemental process.

Balance among qualitative characteristics

24. In practice a balancing, or trade-off, between qualitative characteristics is often necessary. Generally the aim is to achieve an appropriate balance among the characteristics in order to meet the objective of valuation report. The relative importance of the characteristics in different cases is a matter of professional judgement.

Assets and liabilities

25. The ICAI Valuation Standards are to be applied for the valuation of assets and liabilities. Any reference to the term asset also includes liability.
26. An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity and will also include a group of assets business or business ownership interests.
27. A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits and will also include a group of liabilities.

Fundamental Ethical Principles

28. The fundamental ethical principles that all *valuers* are required to observe are:

(a) Integrity and Fairness

The *valuer* should be straightforward and honest in all professional and business relationships and maintain the highest standards and integrity and fairness.

(b) Objectivity

The *valuer* should not allow bias, conflict of interest or undue influence of others to override professional or business judgments.

(c) Professional Competence and Due Care

The *valuer* should maintain professional knowledge and skill at the level required to ensure that an intended user receives competent professional service based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical standards and code of conduct.

(d) Confidentiality

The *valuer* should respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for his personal advantage or third parties.

(e) Professional Behavior

The *valuer* should comply with relevant laws and regulations and avoid any conduct that disrepute to the profession.

Valuer

29. The term *valuer* as used in this Framework means the registered valuer registered with the Registering Authority under Section 247 of the Companies Act 2013 and Rules made thereunder for carrying out valuation of assets belonging to a class or classes of assets.
30. The term *valuer* also includes a *valuer* undertaking valuation engagement under other Statutes like Income Tax, SEBI, FEMA, RBI etc.

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Intended Users/Clients

31. The intended users/clients are the person, persons or class of persons for whom the *valuer* prepares the valuation report.

Professional Judgement

32. The *valuer* plans and performs a valuation assignment in order to obtain sufficient appropriate information. The *valuer* considers materiality, risk, and the quantity and quality of available information when planning and performing the valuation assignment, in particular when determining the nature, timing and extent of evidence-gathering procedures.

Professional Skepticism

33. The *valuer* plans and performs a valuation assignment with an attitude of professional skepticism recognising that circumstances may exist that cause the information used or contained in the valuation report to be materially misstated. An attitude of professional skepticism means the *valuer* makes a critical assessment, with a questioning mind, of the validity of information obtained and is alert to information that contradicts or brings into question the reliability of documents or representations by the responsible party. For example, an attitude of professional skepticism is necessary throughout the assignment process for the *valuer* to reduce the risk of overlooking suspicious circumstances, of over generalising when drawing conclusions from observations, and of using faulty assumptions in determining the nature, timing and extent of evidence-gathering procedures and evaluating the results thereof.

Valuation Report

34. The *valuer* provides a written valuation report containing the minimum requirements as per the ICAI Valuation Standards. In addition, the *valuer* considers other reporting responsibilities, including communicating with those charged with governance when it is appropriate to do so.

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Definitions

*(The ICAI Valuation Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles. (This ICAI Valuation Standard should be read in the context of Framework for the Preparation of Valuation Report in accordance with ICAI Valuation Standards)*

Objective

1. **The objective of this valuation standard is to prescribe specific definitions and principles which are applicable to the ICAI Valuation Standards, dealt specifically in other standards. The definitions enunciated in this Standard shall guide and form the basis for certain terms used in other valuation standards prescribed herein.**
2. The definitions contained in this standard define the terms used in the ICAI Valuation Standards. This Standard may not contain certain definitions which are considered to be basic from finance and accounting perspective as the professionals are expected to have basic knowledge and understanding of such terms.

Scope

3. **The terms defined in this Standard do not apply in valuation where a *valuer* is required to use a definition prescribed by any law, regulations, rules or directions of any government or regulatory authority.**
4. In case the *valuer* is required to use a definition that significantly

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depart from those contained herein, the valuer shall explain the reason for departure and disclose in the valuation report.

5. **While undertaking a valuation engagement, a valuer shall refer the terms defined in this Standard.**

Definitions

6. The following definitions provide an inclusive but not exhaustive list of terms which will be generally used during the course of a valuation engagement:
 - 6.1 **Active Market:** Active Market is a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. For listed securities, active market would refer to one where activity/transaction is ongoing and as defined in the guidelines issued by SEBI.
 - 6.2 **Asset:** The word asset would refer to the assets that need to be valued during an engagement and will also include a group of assets, a liability or a group of liabilities, business or business ownership interests. Any reference to the term asset also includes liability.
 - 6.3 **As-is-where-is Basis:** The term as-is-where-is basis will consider the existing use of the asset which may or may not be its highest and best use.
 - 6.4 **Business Valuation:** It is the act or process of determining the value of a business enterprise or ownership interest therein.
 - 6.5 **Client:** Client would mean an entity or a person for whom valuation is conducted, which/who commissions the valuation engagement and is identified as client in the valuation engagement letter entered into between such entity/person and the valuer.
 - 6.6 **Comparable Companies Multiple Method:** This method is also known as Guideline Public Company Method. It involves valuing an asset based on market multiples derived from prices of market comparables traded on active market.
 - 6.7 **Comparable Transaction Multiple Method:** This method is also known as Guideline Transaction Method. It involves valuing an asset based on transaction multiples derived from prices paid in

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transactions of assets to be valued /market comparable (comparable transactions).

- 6.8 **Control Premium:** Control Premium is an amount that a buyer is willing to pay over the current market price of a publicly-traded company to acquire a controlling interest in an asset. It is opposite of discount for lack of control to be applied in case of valuation of a non-controlling/minority interest.
- 6.9 **Cost approach:** It 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).
- 6.10 **Discount Rate:** Discount Rate is the return expected by a market participant from a particular investment and shall reflect not only the time value of money but also the risk inherent in the asset being valued as well as the risk inherent in achieving the future cash flows.
- 6.11 **Discounted Cash Flow ('DCF') Method:** The DCF method values the asset by discounting the cash flows expected to be generated by the asset for the explicit forecast period and also the perpetuity value (or terminal value) in case of assets with indefinite life.
- 6.12 **Documentation:** The term documentation includes the record of valuation procedures performed, relevant evidence obtained, and conclusions that the *valuer* has reached.
- 6.13 **Fair value:** Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the valuation date.
- 6.14 **Forced transaction:** Forced transaction is a transaction where a seller is under constraints to sell an asset without appropriate marketing period or efforts to market such asset.
- 6.15 **Going concern value:** It refers to the value of a business enterprise that is expected to continue to operate in the future.
- 6.16 **Goodwill:** The term goodwill is defined as an asset representing the future economic benefits arising from a business, business interest or a group of assets, which has not been separately recognised in other assets.
- 6.17 **Highest and best use:** The highest and best use is the use of a non-

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financial asset by market participants that would maximise the value of the asset or the group of assets (e.g., a business) within which the asset would be used.

- 6.18 **Income approach:** It is a 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.
- 6.19 **Intangible Asset:** An intangible asset is an identifiable non-monetary asset without physical substance.
- 6.20 **Integration costs:** It refers to additional one time/ recurring expenses which may need to be incurred by an acquirer, e.g., alignment of employment terms/ remuneration for employees of the target entity with the acquiring entity.
- 6.21 **Jurisdiction:** The term jurisdiction will include the regulatory and legal environment in the boundaries of which the valuation asset is located.
- 6.22 **Liquidation value:** It is the amount that will be realised on sale of an asset or a group of assets when an actual/hypothetical termination of the business is contemplated/assumed.
- 6.23 **Market approach:** 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.
- 6.24 **Market participants:** Market participants are willing buyers and willing sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:
- (a) they are independent of each other, that is, they are not related parties as defined under applicable accounting framework and set of reporting/ accounting standards therein, although the price in a related party transaction may be used as an input to a fair value measurement if the entity has evidence that the transaction was entered into at market terms;
 - (b) they are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available

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information, including information that might be obtained through due care that is usual and customary;

- (c) they are able to enter into a transaction for the asset or liability; and
- (d) they are willing to enter into a transaction for the asset or liability, i.e., they are motivated but not forced or otherwise compelled to do so.

- 6.25 **Observable inputs:** Inputs that are developed using market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the asset or liability.
- 6.26 **Orderly liquidation:** An orderly liquidation refers to the realisable value of an asset in the event of a liquidation after allowing appropriate marketing efforts and a reasonable period of time to market the asset on an as-is, where-is basis.
- 6.27 **Orderly transaction:** Orderly transaction is a transaction that assumes exposure to the market for a period before the valuation date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities and it is not a forced transaction. The length of exposure time will vary according to the type of asset and market conditions.
- 6.28 **Participant specific value:** Participant specific value is the estimated value of an asset or liability considering specific advantages or disadvantages of either of the owner or identified acquirer or identified participants.
- 6.29 **Premise of value:** Premise of value refers to the conditions and circumstances how an asset is deployed.
- 6.30 **Present value:** It 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.
- 6.31 **Purpose:** The word purpose implies the reason for which valuation is being conducted.
- 6.32 **Relief from Royalty (RFR) Method:** A method in which the value of the asset is estimated based on the present value of royalty payments

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saved by owning the asset instead of taking it on lease It is generally adopted for valuing intangible assets that are subject to licensing, such as trademarks, patents, brands, etc.

- 6.33 **Replacement Cost Method:** It is also known as 'Depreciated Replacement Cost Method' and involves valuing an asset based on the cost that a market participant shall have to incur to recreate an asset with substantially the same utility ('comparable utility') as that of the asset to be valued, adjusted for obsolescence.
- 6.34 **Reproduction Cost Method:** This method involves valuing an asset based on the cost that a market participant shall have to incur to recreate a replica of the asset to be valued, adjusted for obsolescence.
- 6.35 **Rule of Thumb or Benchmark Value:** Rule of thumb or benchmark indicator is used as a reasonable check against the values determined by the use of other valuation approaches in a valuation engagement.
- 6.36 **Scope of work:** It describes the work to be performed, responsibilities and confidentiality obligations of the Client and the *valuer* respectively, and limitation of the valuation engagement.
- 6.37 **Significant/material:** While considering any particular aspect to be significant/material from a valuation standpoint is a valuer's professional judgement, any aspect of valuation will be significant / material if its application or ignorance can significantly change or impact the overall value.
- 6.38 **Subsequent Event:** An event that occurs subsequent to the valuation date could affect the value; such an occurrence is referred to as a subsequent event.
- 6.39 **Synergies:** Synergies is a concept which indicates that the combining effect of two or more assets or group of assets and liabilities or two or more entities in terms of their value and benefits will be or is likely to be, greater than that of their individual values on a standalone basis.
- 6.40 **Terminal value:** Terminal value represents the present value at the end of explicit forecast period of all subsequent cash flows to the end of the life of the asset or into perpetuity if the asset has an indefinite life.

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- 6.41 **Transaction costs:** Transaction costs are the costs to sell an asset or transfer a liability in the principle (or most advantageous) market for the asset that are directly attributable to the disposal of the asset or transfer of liability and which meet both the following criteria:
- (a) **they result** directly from and are essential to that transaction;
 - (b) they would not have been incurred by the entity, had the decision to sell the asset or transfer the liability not been made.
- No adjustment will be made for any taxes payable by either party as a direct result of the transaction.
- 6.42 **Unobservable inputs:** Inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability.
- 6.43 **Value:** A value is an estimate of the value of a business or business ownership interests, arrived at by applying the valuation procedures appropriate for a valuation engagement and using professional judgment as to the value or range of values based on those procedures.
- 6.44 **Valuer:** A *valuer* is a professional (which can be an individual or a legally established entity) who is given the responsibility to conduct or undertake valuation. .
- 6.45 **Valuation base:** Valuation base means the indication of the type of value being used in an assignment.
- 6.46 **Valuation date:** Valuation date is the specific date at which the *valuer* estimates the value of the underlying asset.
- 6.47 **With and Without Method (WWM):** Under WWM, the value of the intangible asset to be valued is equal to the present value of the difference between the projected cash flows over the remaining useful life of the asset under the following two scenarios:
- (a) business with all assets in place *including* the intangible asset to be valued; and
 - (b) business with all assets in place *except* the intangible asset to be valued.

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6.48 **Weight/Weightage:** Weight/weightage refers to the importance given to a particular value determined using a particular valuation method/ approach.

Effective Date

7. ICAI Valuation Standard 101 *Definitions*, shall be applied for the valuation reports issued on or after 1st July, 2018.

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Valuation Bases

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*The ICAI Valuation Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles. (This ICAI Valuation Standard should be read in the*

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context of Framework for the Preparation of Valuation Report in accordance with ICAI Valuation Standards)

Objective

1. **This Standard:**
 - (a) **defines the important valuation bases;**
 - (b) **prescribes the measurement assumptions on which the value will be based; and**
 - (c) **explains the premises of values.**
2. The objective of this Standard is to define the important valuation bases which represent the fundamental principle on which professional valuations are based.
3. This Standard covers the measurement assumptions in a valuation and/or the fundamental assumption on which the value will be based.
4. **The principles enunciated in this Standard shall be applied in conjunction with the principles prescribed and contained in the *Framework for the Preparation of Valuation Report in accordance with ICAI Valuation Standards.***

Scope

5. **This Standard shall be applied in selecting the appropriate valuation bases except as specified in paragraph 6.**
6. **This Standard does not apply in cases where a *valuer* is required to adopt valuation bases that are prescribed:**
 - (a) **by a Statute, or Regulations; or**
 - (b) **in an agreement/ arrangement between the parties.**

In such cases, the prescribed bases shall apply and adequate information should be disclosed appropriately in the report, that enables users of the valuation reports to understand the valuation bases.
7. In some engagements, a *valuer* is required to adopt valuation bases prescribed by regulations or as agreed upon between the parties. In those cases, valuation bases will be applied considering the relevant

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regulations, agreement or arrangement, e.g., valuation requirements under:

- (a) Income Tax Act;
- (b) SEBI Regulations; or
- (c) The Insolvency and Bankruptcy Code.

8. In transactions of the nature of –merger or amalgamation of companies or merger or demerger of businesses, the consideration is often discharged primarily by issue of securities in the nature equity of the acquirer or transferee entity with reference to an exchange ratio or entitlement ratio, considering the relative values.

Such relative values are generally arrived at by applying an appropriate valuation approach or a combination of valuation approaches. If a combination of valuation approaches or methodologies is adopted, appropriate weightages are assigned to arrive at a single value. Relative values are usually derived by using similar valuation approaches, methodologies and weightages. Use of differing methodologies or approaches may be justified in some circumstances, e.g., merger of a listed company and an unlisted company where market price method would be relevant only for the listed company.

9. Valuation base selected by a *valuer* shall be appropriate considering the purpose of engagement and the terms of the engagement. The *valuer* shall use the relevant valuation approach and adhere to other assumptions associated with the valuation bases.

Significant Elements

10. **The key elements of a valuation exercise are:**
- (a) an actual/ possible transaction;**
 - (b) valuation date; and**
 - (c) the parties (actual or likely) to the transaction.**
11. The valuation date will determine what information can be considered in a valuation. Usually, information which is not available at the valuation date is not considered for the purpose of valuation.

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12. The valuation exercise and selection of valuation bases depend on but not limited to, the following:
 - (a) nature of the asset to be valued;
 - (b) scope and purpose of the valuation engagement;
 - (c) valuation date/ measurement date;
 - (d) intended purpose of the valuation;
 - (e) applicable standard of value;
 - (f) applicable premise of value;
 - (g) assumptions and limiting conditions; and
 - (h) applicable governmental regulations
13. A *valuer* shall gather, analyse and where appropriate adjust the relevant information in a manner that the methodology and approaches are in line with the nature or type of the engagement. For example, for valuation of business, in accordance with ICAI Valuation Standard 301 *Business Valuation*, the information shall include but not limited to the following:
 - (a) non-financial information;
 - (b) ownership details;
 - (c) financial information; and
 - (d) general information.

Valuation Bases

14. **Valuation base means the indication of the type of value being used in an engagement. Different valuation bases may lead to different conclusions of value. Therefore, it is important for the *valuer* to identify the bases of value pertinent to the engagement. This Standard defines the following valuation bases:**
 - (a) Fair value;
 - (b) Participant specific value; and
 - (c) Liquidation value
15. A *valuer* shall select an appropriate valuation base considering the terms and purpose of the valuation engagement.

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16. A *valuer* shall not select a valuation base which is not appropriate for the intended purpose of the valuation. A *valuer* is responsible for understanding the relevant regulation(s) relating to the valuation bases which are selected and used.

Fair Value

17. **Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the valuation date.**
18. Fair value is the price in an orderly transaction in the principal (or most advantageous) market at the valuation date under current market conditions (i.e. an exit price) regardless of whether that price is directly observable or estimated using another valuation technique.
19. Fair value is usually synonymous to market value except in certain circumstances where characteristics of an asset translate into a special asset value for the party(ies) involved.

Price

20. Fair value assumes that the price is negotiated in a free market (which may be domestic or international).
21. Fair value reflects characteristics of an asset which are available to market participants in general and do not consider advantages/disadvantages which are available/applicable only to particular participant(s).
22. The price in the principal (or most advantageous) market used to measure the fair value of the asset shall not be adjusted for transaction costs. To this end, a market in which the volume and level of activities is high, or one in which the realisation from an asset is maximum, is considered.

Orderly transaction

23. ***Orderly transaction* is a transaction that assumes exposure to the market for a period before the valuation date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities and it is not a forced transaction. The length of exposure time will vary according to the type of asset and market conditions.**

Market participants

24. Market participants are willing buyers and willing sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:
- (a) they are independent of each other, that is, they are not related parties as defined under applicable accounting framework and set of reporting/ accounting standards therein, although the price in a related party transaction may be used as an input to a fair value measurement if the entity has evidence that the transaction was entered into at market terms;
 - (b) they are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due care that is usual and customary;
 - (c) they are able to enter into a transaction for the asset or liability; and
 - (d) they are willing to enter into a transaction for the asset or liability, i.e., they are motivated but not forced or otherwise compelled to do so.

Valuation date

25. Valuation date is the specific date at which the *valuer* estimates the value of the underlying asset.
26. Valuation is time specific and can change with the passage of time due to changes in the condition of the asset to be valued and/ or market. Accordingly, valuation of an asset as at a particular date can be different from other date(s)
27. The valuation date is sometimes also referred to as measurement date.

Highest and best use

28. The highest and best use is the use of a non- financial asset by market participants that would maximise the value of the asset or

the group of assets (e.g., a business) within which the asset would be used.

29. Highest and best use is usually for non- financial assets. The fair value of a non-financial asset will reflect its highest and best use in accordance with paragraphs 39-44.
30. The highest and best use of a non-financial asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible.
31. Highest and best use is determined from the perspective of market participants, even if the entity intends a different use. The highest and best use of an asset may be its existing use or a different use.

Participant Specific Value

32. **Participant specific value is the estimated value of an asset or liability considering specific advantages or disadvantages of either of the owner or identified acquirer or identified participants.**
33. Participant specific value may be measured for an existing owner or for an identified acquirer or for a transaction between two identified parties and consider factors which are specific to such party(ies) and which may not be applicable to market participants in general. For example:
 - (a) participant specific value for a potential acquirer in connection with acquisition of a manufacturing facility will consider aspects such as location specific advantage or synergies which may not be available to market participants in general.
 - (b) participant specific value for transfer of 2% stake by a minority shareholder to a shareholder holding 49% stake will consider aspects such as minority discount and control premium

Liquidation Value

34. **Liquidation value is the amount that will be realised on sale of an asset or a group of assets when an actual/hypothetical termination of the business is contemplated/assumed.**
35. **Liquidation value can be carried out under the premise of an**

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orderly transaction with a typical marketing period or under the premise of forced transaction with a shortened marketing period. The *valuer* must disclose whether an orderly or forced transaction is assumed.

36. The net amount is determined after considering estimated cost of disposal.

Premise of Value

37. **Premise of Value refers to the conditions and circumstances how an asset is deployed.**
38. In a given set of circumstances, a single premise of value may be adopted while in some situations multiple *premises of value* may be adopted. Some common premises of value are as follows:
- (a) highest and best use;
 - (b) going concern value;
 - (c) as is where is value;
 - (d) orderly liquidation; or
 - (e) forced transaction.

Highest and Best Use

39. The highest and best use of a non-financial asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible. as follows:
- (a) a use that is physically possible takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (e.g., the location or size of a property);
 - (b) a use that is legally permissible takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (e.g., the zoning regulations applicable to a property);
 - (c) a use that is financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into account

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the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use.

40. Highest and best use is determined from the perspective of market participants, even if the entity intends a different use. However, an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset.
41. To protect its competitive position, or for other reasons, an entity may intend not to use an acquired non-financial asset actively or it may intend not to use the asset according to its highest and best use. Nevertheless, the *valuer* shall measure the fair value of a non-financial asset assuming its highest and best use by market participants.
42. The highest and best use of a non-financial asset establishes the valuation premise used to measure the fair value of the asset, as follows:
 - (a) the highest and best use of a non-financial asset might provide maximum value to market participants through its use in combination with other assets as a group (as installed or otherwise configured for use) or in combination with other assets and liabilities (e.g., a business).
 - (i) if the highest and best use of the asset is to use the asset in combination with other assets or with other assets and liabilities, the fair value of the asset is the price that would be received in a current transaction to sell the asset assuming that the asset would be used with other assets or with other assets and liabilities and that those assets and liabilities (i.e. its complementary assets and the associated liabilities) would be available to market participants;
 - (ii) liabilities associated with the asset and with the complementary assets include liabilities that fund working capital, but do not include liabilities used to fund assets other than those within the group of assets;

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- (iii) assumptions about the highest and best use of a non-financial asset shall be consistent for all the assets (for which highest and best use is relevant) of the group of assets or the group of assets and liabilities within which the asset would be used.
 - (b) the highest and best use of a non-financial asset might provide maximum value to market participants on a stand-alone basis. If the highest and best use of the asset is to use it on a stand-alone basis, the fair value of the asset is the price that would be received in a current transaction to sell the asset to market participants that would use the asset on a stand-alone basis.
43. Where the highest and best use is different from the existing use, costs, to be incurred, if any for conversion of an asset to its highest and best use need to be considered for determination of value based on highest and best use.
44. In certain cases, assessment of highest and best use may involve considerable subjectivity/ technical aspects and the *valuer* may base his assessment considering inter-alia relevant inputs from the client, information available in public domain, etc.

Going Concern Value

45. **Going concern value is the value of a business enterprise that is expected to continue to operate in the future.**
46. The intangible elements of Going Concern Value result from factors such as having a trained work force, an operational plant, the necessary licenses, marketing systems, and procedures in place etc.

As-is-where-is Basis

47. As-is-where-is basis will consider the existing use of the asset which may or may not be its highest and best use.

Orderly Liquidation

48. **An orderly liquidation refers to the realisable value of an asset in the event of a liquidation after allowing appropriate marketing efforts and a reasonable period of time to market the asset on an as-is, where-is basis.**
49. The reasonable period of time to market the asset would vary based on the market conditions, nature of the asset, etc.

Forced transaction

50. **Forced transaction is a transaction where a seller is under constraints to sell an asset without appropriate marketing period or effort to market such asset.**
51. Sale in the market that is not active cannot be presumed to be forced transaction without assessing the seller specific circumstances.

Other Considerations

Participant specific consideration

52. Certain examples of participant specific considerations which may be considered depending on valuation bases adopted include:
 - (a) acquirer specific considerations on account of other assets owned/ operated by such entity or ability to utilise an asset in a unique manner; and
 - (b) legal/ tax implications which are specific to a participant (e.g., implication of the Competition Act or an ability of an acquirer to utilise the available tax losses in an accelerated manner);
53. Whether certain valuation considerations are applicable only to particular participant(s) or market participants in general, it shall be analysed on a case to case basis.

Synergies

54. **Synergies is a concept which indicates that the combining effect of two or more assets or group of assets and liabilities or two or more entities in terms of their value and benefits will be or is likely to be, greater than that of their individual values on a standalone basis.**
55. Synergy is a term that is most commonly used in the context of mergers and acquisitions.
56. Synergy results from incremental benefits that accrue to the acquirer on account of economies of scale or other post-acquisition factors, such as realisation of increased discretionary cash flow (as a result of the combinations of two or more business operations over and above the aggregate discretionary cash flow of the two business viewed separately), or reduced risk in attaining same when two businesses combines.

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57. While, Fair value will consider synergies which are available to market participants in general, Participant Specific Value will consider synergies which may be specifically available only to the concerned participant(s).

Integration Costs

58. **Integration costs refer to additional one time/ recurring expenses which may need to be incurred by an acquirer, e.g., alignment of employment terms/ remuneration for employees of the target entity with the acquiring entity.**

Assumptions

59. Sometimes, a *valuer* may make assumptions to derive the value as per the chosen valuation base.
60. A *valuer* may make assumptions which are appropriate having regard to the circumstances and terms of engagement.

Transaction Costs

61. **Transaction costs are the costs to sell an asset or transfer a liability in the principle (or most advantageous) market for the asset that are directly attributable to the disposal of the asset or transfer of liability and which meet both the following criteria:**
- (a) they result directly from and are essential to that transaction;
 - (b) they would not have been incurred by the entity, had the decision to sell the asset or transfer the liability not been made.

No adjustment will be made for any taxes payable by either party as a direct result of the transaction.

62. Transaction costs are not a characteristic of an asset or a liability; rather, they are specific to a transaction and will differ on the terms of transaction.

Effective Date

63. ICAI Valuation Standard 102 *Valuation Bases*, shall be applied for the valuation reports issued on or after 1st July, 2018.

ICAI Valuation Standard-103 Valuation Approaches and Methods

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*(The ICAI Valuation Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles. (This ICAI Valuation Standard should be read in the context of Framework for the Preparation of Valuation Report in accordance with ICAI Valuation Standards)*

Objective

1. **This Standard:**
 - (a) **defines the approaches and methods for valuing an asset; and**
 - (b) **provides guidance on use of various valuation approaches and methods.**
2. The objective of this Standard is to provide guidance on different valuation approaches and methods that can be adopted to determine the value of an asset.
3. **The principles enunciated in this Standard shall be applied in conjunction with the principles prescribed and contained in the Framework for the Preparation of Valuation Report in accordance with ICAI Valuation Standards.**

Scope

4. **Subject to paragraph 7, this Standard shall be applied in selecting the appropriate valuation approaches and methodologies in determining the value of an asset, liability or a business.**
5. This Standard provides guidance on use of multiple approaches and methods.
6. This Standard does not provide an exhaustive list of all the valuation methods. For example, methods applicable for valuation of intangible assets and financial instruments have been covered briefly in this Standard and detailed guidance has been provided in the relevant Standards.

7. This Standard does not apply in cases where a *valuer* is required to adopt valuation bases that are prescribed by a statute or regulation. In such cases, the prescribed base shall apply and the valuer shall adopt specific methods or formulae as have been laid down under the statute or regulation. Adequate information should be disclosed that enables users of the valuation reports to understand the basis of the valuation report and the nature and extent of impact on the findings therein.

Valuation Approaches

8. **This Standard provides guidance for following three main valuation approaches:**
 - (a) **Market approach;**
 - (b) **Income approach; and**
 - (c) **Cost approach.**
9. A *valuer* can make use of one or more of the processes or methods available for each approach.
10. The appropriateness of a valuation approach for determining the value of an asset would depend on valuation bases and premises. In addition, some of the key factors that a *valuer* shall consider while determining the appropriateness of a specific valuation approach and method are:
 - (a) nature of asset to be valued;
 - (b) availability of adequate inputs or information and its reliability;
 - (c) strengths and weakness of each valuation approach and method; and
 - (d) valuation approach/method considered by market participants.
11. A *valuer* shall be responsible to select the appropriate valuation approach(es) and method(s) as there may not be a single approach/method that is best suited for valuation in every situation.
12. A *valuer* may consider adopting one distinct valuation approach/method or multiple valuation approaches/methods as may be appropriate to derive a reliable value. When evaluating a value

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resulting from use of multiple valuation approaches/methods, a *valuer* shall consider the reasonableness of the range of values. If the values under different approaches and/or methods significantly differ from each other, it would not be appropriate to derive the final value merely by weightages accorded to differing values. The *valuer* shall consider the factors given in paragraph 10 to determine whether the chosen approaches and methodologies are appropriate or not.

13. The valuation approaches and methods shall be selected in a manner which would maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The price information gathered from an active market is generally considered to be a strong indicator of value.

Market Approach

14. **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.**
15. The following are some of the instances where a *valuer* applies the market approach:
 - (a) where the asset to be valued or a comparable or identical asset is traded in the active market;
 - (b) there is a recent, orderly transaction in the asset to be valued; or
 - (c) there are recent comparable orderly transactions in identical or comparable asset(s) and information for the same is available and reliable.
16. In some instances, a *valuer* may consider using other valuation approaches instead of Market approach or in combination with Market approach, such as:
 - (a) where the asset has fewer identical or comparable assets (market comparable);
 - (b) the asset to be valued or its market comparables are not traded in the active market;
 - (c) sufficient information on the comparable transaction(s) is not available;

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- (d) there is no recent transaction either in the asset or in the market comparables; or
 - (e) there are material differences between the asset to be valued and the market comparables, which require significant adjustments.
17. The following valuation methods are commonly used under the market approach:
- (a) Market Price Method (see paragraphs 18 -20);
 - (b) Comparable Companies Multiple (CCM) Method (see paragraphs 21-28); and
 - (c) Comparable Transaction Multiple (CTM) Method (see paragraphs 29-48).

Market Price Method

18. A *valuer* shall consider the traded price observed over a reasonable period while valuing assets which are traded in the active market.
19. A *valuer* shall also consider the market where the trading volume of asset is the highest when such asset is traded in more than one active market.
20. A *valuer* shall use average price of the asset over a reasonable period. The *valuer* should consider using weighted average or volume weighted average to reduce the impact of volatility or any one time event in the asset.

Comparable Companies Multiple (CCM) Method

21. ***Comparable Companies Multiple Method, also known as Guideline Public Company Method, involves valuing an asset based on market multiples derived from prices of market comparables traded on active market.***
22. The following are the major steps in deriving a value using the CCM method:
- (a) identify the market comparables;
 - (b) select and calculate the market multiples of the identified market comparables;

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- (c) compare the asset to be valued with the market comparables to understand material differences; and make necessary adjustments to the market multiple to account for such differences, if any;
 - (d) apply the adjusted market multiple to the relevant parameter of the asset to be valued to arrive at the value of such asset; and
 - (e) if value of the asset is derived by using market multiples based on different metrics/parameters, the *valuer* shall consider the reasonableness of the range of values.
23. While identifying and selecting the market comparables, a *valuer* shall consider the factors such as-
- (a) industry to which the asset belongs;
 - (b) geographic area of operations;
 - (c) similar line of business, or similar economic forces that affect the asset being valued; or
 - (d) other parameters such as size (for example - revenue, assets, etc), stage of life-cycle of the asset, profitability, diversification, etc.
- This list is not an exhaustive list, there may be certain other factors which a *valuer* shall consider while identifying and selecting the market comparables.
24. The market multiples are generally computed on the basis of following inputs:
- (a) trading prices of market comparables in an active market; and
 - (b) financial metrics such as Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA), Profit After Tax (PAT), Sales, Book Value of assets, etc.
25. If market participants are using market multiple based on non-financial metrics for valuing an asset, such multiples may also be considered by the *valuer* in addition to market multiple based on the financial metrics. For example, Enterprise Value (EV) / Tower in case of tower telecom companies, EV/Tonne in case of cement industry, etc.

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26. A *valuer* shall preferably use several market comparables rather than relying on a single comparable.
27. A *valuer* shall exercise judgement while selecting the multiple in case where the market multiple computed for each comparable is significantly different from the other.
28. The following are some of the differences between the asset to be valued and market comparable that the *valuer* may consider while making adjustments to the market multiple:
 - (a) size of the asset;
 - (b) geographic location;
 - (c) profitability;
 - (d) stage of life-cycle of the asset;
 - (e) diversification;
 - (f) historical and expected growth; or
 - (g) management profile.

Comparable Transaction Multiple (CTM) Method

29. **Comparable Transaction Multiple Method, also known as 'Guideline Transaction Method' involves valuing an asset based on transaction multiples derived from prices paid in transactions of asset to be valued /market comparables (comparable transactions).**
30. The price paid in comparable transactions generally include control premium, except where transaction involves acquisition of non-controlling/minority stake.
31. The following are the major steps in deriving a value using the CTM method:
 - (a) identify comparable transaction appropriate to the asset to be valued;
 - (b) select and calculate the transaction multiples from the identified comparable transaction;
 - (c) compare the asset to be valued with the market comparables

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and make necessary adjustments to the transaction multiple to account where differences, if any existed;

- (d) apply the adjusted transaction multiple to the relevant parameter of the asset to be valued to arrive at the value of such asset; and
 - (e) if valuation of the asset is derived by using transaction multiples based on different metrics or parameters, the *valuer* shall consider the reasonableness of the range of values and exercise judgement in determining a final value.
32. While identifying and selecting the comparable transaction, a *valuer* may consider the factors such as-
- (a) transactions that have been consummated closer to the valuation date are generally more representative of the market conditions prevailing during that time;
 - (b) the selected comparable is an orderly transaction;
 - (c) availability of sufficient information on the transactions to enable the *valuer* to reasonably understand the market comparable and derive the transaction multiple; or
 - (d) availability of information on transaction from reliable sources such as regulatory filings, industry magazines, Merger & Acquisition databases, etc.
33. The transaction multiples are generally computed based on the following two inputs:
- (a) price paid in the comparable transaction; and
 - (b) financial metrics such as EBITDA, PAT, Sales, Book Value, etc of the market comparable.
- Even multiples based on non-financial metrics such as EV per room for hotels, EV/Bed for hospitals) can be considered.
34. A *valuer* shall preferably use multiple comparable transactions of recent past rather than relying on a single transaction.
35. The following are some of the differences between the asset to be valued and comparable transaction that the *valuer* may consider while making adjustments to the transaction multiple:

- (a) size of the asset;
- (b) geographic location;
- (c) profitability;
- (d) stage of life-cycle of the asset;
- (e) diversification;
- (f) historical and expected growth;
- (g) management profile such as private ownership vs. public sector undertaking; or
- (h) conditions if any governing the comparable transaction such as deferred payment of consideration contingent on achievement of certain milestones).

Discounts and Control Premium

36. A *valuer* shall evaluate and make adjustments for differences between the asset to be valued and market comparables/comparable transactions. The most common adjustment under CCM method and CTM method pertain to 'Discounts' and 'Control Premium'.
37. 'Discounts' include Discount for Lack of Marketability (DLOM) and Discount for Lack of Control (DLOC).

Discount for Lack of Marketability (DLOM)

38. **DLOM is based on the premise that an asset which is readily marketable (such as frequently traded securities) commands a higher value than an asset which requires longer marketing period to be sold (such as securities of an unlisted entity) or an asset having restriction on its ability to sell (such as securities under lock-in-period or regulatory restrictions).**
39. Generally, restrictions on marketability that are only inherent in the asset to be valued shall be considered while valuing the asset. Marketability restrictions that are specific to a particular owner of the asset are not generally considered for discount adjustment.
40. Determining an appropriate level of DLOM can be a complex and subjective process. Accordingly, the specific nature and characteristics of the asset and the facts and circumstances surrounding the valuation should be considered.

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41. A *valuer* shall use his professional judgement while applying DLOM and consider the relevant factors including but not limited to-
- (a) size and nature;
 - (b) time and costs associated with marketing or for making a public offer;
 - (c) restrictions on transferability;
 - (d) history of past transactions;
 - (e) exit rights; or
 - (f) lack of or limitation to access to information.

Control Premium and Discount for Lack of Control (DLOC)

42. ***Control Premium generally represents the amount paid by acquirer for the benefits it would derive by controlling the acquiree's assets and cash flows.***
43. **Control Premium is an amount that a buyer is willing to pay over the current market price of a publicly-traded company to acquire a controlling interest in an asset. It is opposite of discount for lack of control to be applied in case of valuation of a non-controlling/minority interest.**
44. Generally, on acquisition an acquirer can derive benefits from the following:
- (a) potential synergies as a result of merger/combination; and
 - (b) ability to influence acquiree's operating, financial, or corporate governance policies relating to appointment of board members, declaration of dividends, etc.
45. Under the CCM method, the value of the asset is on a minority interest/non-controlling interest as the market multiples of market comparables are derived from their respective traded price in the active market. The traded price of such comparables may not include the benefit derived from controlling the market comparable's assets and cash flows. Therefore, while applying the CCM method to value the asset having controlling interest, a control premium may be considered.

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46. Under the CTM method, the transaction price generally includes price paid for control premium. Therefore, while valuing the asset for a non-controlling/minority interest, DLOC may be considered.
47. Determining an appropriate level of Control Premium and DLOC can be a complex and subjective process. Accordingly, the specific nature and characteristics of the asset and the facts and circumstances surrounding the valuation should be considered.
48. A *valuer* shall use his professional judgement while applying control premiums and DLOC, considering the factors such as amount/ extent of control in the asset to be valued, distribution of control of the remaining interest in the subject entity, statutory provision relating to protection of minority shareholders; the shareholder protection restrictions contained in the articles of incorporation, the bye-laws and/or the shareholders' agreement, blockage discount, etc.

Income Approach

49. **Income approach is a 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.**
50. This approach involves discounting future amounts (cash flows/income/cost savings) to a single present value.
51. The following are some of the instances where a *valuer* may apply the income approach:
 - (a) where the asset does not have any market comparable or comparable transaction;
 - (b) where the asset has fewer relevant market comparables; or
 - (c) where the asset is an income producing asset for which the future cash flows are available and can reasonably be projected.
52. In some instances, a *valuer* may consider using other valuation approaches instead of income approach or in combination with income approach, such as, where –
 - (a) the asset has not yet started generating income or cash flows, e.g., projects under development;

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- (b) there is significant uncertainty on the amount and timing of income/future cash flows, e.g., start-up companies; or
 - (c) the client does not have access to the information relating to the asset being valued, e.g., minority shareholder may not have access to projections/budgets or growth expectations specific to the business.
53. Some of the common valuation methods under income approach are as follows:
- (a) Discounted Cash Flow (DCF) Method (see paragraphs 54- 83);
 - (b) Relief from Royalty (RFR) Method (see paragraphs 84-86);
 - (c) Multi-Period Excess Earnings Method (MEEM) (see paragraphs 87-89);
 - (d) With and Without Method (WWM) (see paragraphs 90-91); and
 - (e) Option pricing models such as Black-Scholes-Merton formula or binomial (lattice) model (see paragraphs 92-94).

Discounted Cash Flow ('DCF') Method

54. **The DCF method values the asset by discounting the cash flows expected to be generated by the asset for the explicit forecast period and also the perpetuity value (or terminal value) in case of assets with indefinite life.**
55. The DCF method is one of the most common methods for valuing various assets such as shares, businesses, real estate projects, debt instruments, etc.
56. This method involves discounting of future cash flows expected to be generated by an asset over its life using an appropriate discount rate to arrive at the present value.
57. The following are the major steps in deriving a value using the DCF method:
- (a) Consider the projections to determine the future cash flows expected to be generated by the asset;
 - (b) analyse the projections and its underlying assumptions to assess the reasonableness of the cash flows;
 - (c) choose the most appropriate type of cash flows for the asset,

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- viz.*, pre-tax or post-tax cash flows, free cash flows to equity or free cash flows to firm;
- (d) determine the discount rate and growth rate beyond explicit forecast period; and
 - (e) apply the discount rate to arrive at the present value of the explicit period cash flows and for arriving at the terminal value.
58. While using the DCF method, it may also be necessary to make adjustments to the valuation to reflect matters that are not captured in either the cash flow forecasts or the discount rate adopted.
59. In case of the DCF method, projected cash flows reflect the benefits of control and accordingly the value of asset arrived under this method is not to be grossed up for control premium.
60. A *valuer* shall use his professional judgement while applying the DLOM / DLOC. It may include adjustments for discount for the marketability of the interest being valued or whether the interest being valued is non-controlling interest in the business.
61. The following are important inputs for the DCF method:
- (a) Cash flows;
 - (b) Discount rate; and
 - (c) Terminal value

Cash Flows

62. In most cases, the projections shall comprise the statement of profit & loss, balance sheet, cash flow statement, along with the underlying key assumptions. However, in certain cases, if balance sheet and cash flow statement are not available, details of future capital expenditure and working capital requirements may also suffice.
63. The projections reflect the accrual based accounting income and expenses. For arriving at the cash flows, non-cash expenses, such as depreciation and amortisation, shall be added back. Further, cash outflows relating to capital expenditure and incremental working capital requirements, if any shall be deducted.
64. Generally, historical financial statements are used as the base for preparation of projections. If in future, changes in circumstances are

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anticipated the assumptions underlying the projections shall reflect differences on account of such differences *vis-à-vis* the historical financial statements.

65. A *valuer* shall by employing procedures such as ratio analysis, trend analysis to determine historical trends, gather necessary information to assess risks inherent in the achievability of the projections.
66. The fact that the *valuer* considers the projections in estimating the value of the asset shall not be construed as the *valuer* being associated with or being a party to such projections.
67. The length of the period of projections (explicit forecast period) shall be determined based on the following factors:
 - (a) *Nature of the asset*- where the business is of cyclical nature, explicit forecast period should ordinarily consider one entire cycle (for example cement business).
 - (b) *Life of the asset*- In case of asset with definite life, explicit period should be for the entire life of the asset (for example, debt instruments, Build Operate Transfer (BOT) road projects).
 - (c) *Sufficient period*- The forecast period should have a length of time that is sufficient for the asset to achieve stable levels of operating performance.
 - (d) *Reliable data*- The data that are used for projecting the cash flows, should be reliable.
68. The following are the cash flows which are used for the projections:
 - (a) *Free Cash Flows to Firm (FCFF)*: FCFF refers to cash flows that are available to all the providers of capital, i.e. equity shareholders, preference shareholders and lenders. Therefore, cash flows required to service lenders and preference shareholders such as interest, dividend, repayment of principal amount and even additional fund raising are not considered in the calculation of FCFF.
 - (b) *Free Cash Flows to Equity (FCFE)*: FCFE refers to cash flows available to equity shareholders and therefore, cash flows after interest, dividend to preference shareholders, principal repayment and additional funds raised from lenders / preference shareholders are considered.

Asset value is independent of the manner of finance, hence, FCFF is most commonly used to arrive at an asset value. However, the value of an asset is independent of the manner in which it is financed.

Discount Rate

69. **Discount Rate** is the return expected by a market participant from a particular investment and shall reflect not only the time value of money but also the risk inherent in the asset being valued as well as the risk inherent in achieving the future cash flows.
70. The following discount rates are most commonly used depending upon the type of the asset:
- (a) cost of equity;
 - (b) weighted average cost of capital;
 - (c) Internal Rate of Return ('IRR');
 - (d) cost of debt; or
 - (e) yield.
71. Different methods are used for determining the discount rate. The most commonly used methods are as follows:
- (a) Capital Asset Pricing Model (CAPM) for determining the cost of equity.
 - (b) Weighted Average Cost of Capital (WACC) is the combination of cost of equity and cost of debt weighted for their relative funding in the asset.
 - (c) Build-up method (generally used only in absence of market inputs).
72. A *valuer* may consider the following factors while determining the discount rate:
- (a) type of asset being valued such as example debt, preference shares, business, real estate, intangibles, etc.;
 - (b) life of the asset such as the risk-free rate used for determining the cost of equity in the CAPM model differs for an asset with a one-year life vs an indefinite life;

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- (c) geographic location of the asset;
 - (d) currency in which the projections have been prepared;
 - (e) type of cash flows;
 - (f) risk in achieving the projected cash flows;
 - (g) cash flows used for the projections as FCFE needs to be discounted by Cost of Equity whereas FCFF to be discounted using WACC;
 - (h) discount the cash flows in the functional currency using a discount rate appropriate for that functional currency; and
 - (i) pre-tax cash flows need to be discounted by pre-tax discount rate and post-tax cash flows to be discounted by post-tax discount rate;
73. A *valuer* shall include where appropriate risk adjustments that a market participant shall expect as compensation for uncertainty inherent in the cash flows.

Terminal Value

74. ***Terminal value* represents the present value at the end of explicit forecast period of all subsequent cash flows to the end of the life of the asset or into perpetuity if the asset has an indefinite life.**
75. In case of assets having indefinite or very long useful life, it is not practical to project the cash flows for such indefinite or long periods. Therefore, the *valuer* needs to determine the terminal value to capture the value of the asset at the end of explicit forecast period.
76. There are different methods for estimating the terminal value. The commonly used methods are :
- (a) Gordon (Constant) Growth Model;
 - (b) Variable Growth Model;
 - (c) Exit Multiple; and
 - (d) Salvage / Liquidation value

Gordon (Constant) Growth Model

77. The terminal value under this method is computed by dividing the

perpetuity maintainable cash flows with the discount rate as reduced by the stable growth rate.

78. The estimation of stable growth rate is of great significance because even a minor change in stable growth rate can have an impact on the terminal value and the value of the asset too.

Variable Growth Model

79. The Constant Growth Model assumes that the asset grows (or declines) at a constant rate beyond the explicit forecast period whereas the Variable Growth Model assumes that the asset grows (or declines) at variable rate beyond the explicit forecast period.

Exit Multiple

80. The estimation of terminal value under this method involves application of a market-evidence based capitalisation factor or a market multiple (for example, Enterprise Value (EV) / Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA), EV / Sales) to the perpetuity earnings / income.
81. The multiple needs to be estimated based on multiples of comparable assets and hence, the principles laid down under the market approach section of this standard should be complied with.

Salvage or Liquidation value

82. In some cases, such as mine or oil fields, the terminal value has limited or no relationship with the cash flows projected for the explicit forecast period. For such assets, the terminal value is calculated as the salvage or realisable value less costs to be incurred for disposing of such asset.

Terminal growth rate

83. Some of the factors that a *valuer* may consider while determining the terminal growth rate:
- (a) whether the level of operations beyond explicit forecast period are expected to be significantly different from the level projected in the last year of the explicit forecast period or only a normal growth is expected;
 - (b) capacity utilisation at the end of explicit forecast period;

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- (c) functional currency in which the projections have been prepared;
- (d) market share;
- (e) product life cycle;
- (f) geographic location of the asset;
- (g) type of cash flows;
- (h) residual life of the asset at the end of the explicit forecast period;
- (i) capital investment required to support the assumed growth rate;
- (j) whether there is future growth potential for the asset beyond the explicit forecast period, or whether the asset is deteriorating in nature; and
- (k) for cyclical assets, the terminal value should consider the cyclical nature of the asset.

Relief from Royalty (RFR) Method

84. ***RFR Method* is a method in which the value of the asset is estimated based on the present value of royalty payments saved by owning the asset instead of taking it on lease. It is generally adopted for valuing intangible assets that are subject to licensing, such as trademarks, patents, brands, etc.**
85. The fundamental assumption underlying this method is that if the intangible asset to be valued had to be licensed from a third-party owner there shall be a royalty charge for use of such asset. By owning the said intangible asset, royalty outgo is avoided. The value under this method is equal to the present value of the licence fees / royalty avoided by owning the asset over its remaining useful life.
86. The following are the major steps in deriving a value using the RFR method:
- (a) obtain the projected income statement associated with the intangible asset to be valued over the remaining useful life of the said asset from the client or the target;
 - (b) analyse the projected income statement and its underlying assumptions to assess the reasonableness;
 - (c) select the appropriate royalty rate based on market-based

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royalty rates for similar intangible assets or using the profit split method;

- (d) deduct costs associated with maintaining licencing arrangements for the intangible asset from the resultant royalty savings;
- (e) apply the selected royalty rate to the future income attributable to the said asset;
- (f) use the appropriate marginal tax rate or such other appropriate tax rate to arrive at an after-tax royalty savings;
- (g) discount the after-tax royalty savings to arrive at the present value using an appropriate discount rate; and
- (h) Tax amortisation benefit, if appropriate, should be added to the overall value of the asset.

Multi-Period Excess Earnings Method (MEEM)

- 87. **MEEM is generally used for valuing intangible asset that is leading or the most significant intangible asset out of group of intangible assets being valued.**
- 88. The fundamental concept underlying this method is to segregate the earnings attributable to the intangible asset being valued. Intangible assets which have a finite life can only be used to value using MEEM. The value under this method is equal to the present value of the incremental after-tax cash flows ('excess earnings') attributable to the intangible asset to be valued over its remaining useful life.
- 89. The following are the major steps in deriving a value using the MEEM
 - (a) obtain the projections for the entity or the combined asset group over the remaining useful life of the said intangible asset to be valued from the client or the target to determine the future after-tax cash flows expected to be generated;
 - (b) analyse the projections and its underlying assumptions to assess the reasonableness of the cash flows;
 - (c) Contributory Asset Charges (CAC) or economic rents to be reduced from the total net after-tax cash flows projected for the entity/combined asset group to obtain the incremental after-tax cash flows attributable to the intangible asset to be valued;

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- (d) the CAC represent the charges for the use of an asset or group of assets (e.g., working capital, fixed assets, assembled workforce, other intangibles) based on their respective fair values and should be considered for all assets, excluding goodwill, that contribute to the realisation of cash flows for the intangible asset to be valued;
- (e) discount the incremental after-tax cash flows attributable to the intangible asset to be valued to arrive at the present value using an appropriate discount rate; and
- (f) Tax amortisation benefit, if appropriate.

With and Without Method (WWM)

90. **Under WWM, the value of the intangible asset to be valued is equal to the present value of the difference between the projected cash flows over the remaining useful life of the asset under the following two scenarios:**
- (a) **business with all assets in place *including* the intangible asset to be valued; and**
 - (b) **business with all assets in place *except* the intangible asset to be valued.**
91. The following are the major steps in deriving a value using the WWM :
- (a) obtain cash flow projections for the business over the remaining useful life of the said asset to be valued under the following two scenarios:
 - (i) business with all assets in place including the intangible asset to be valued; and
 - (ii) business with all assets in place except the intangible asset to be valued.
 - (b) analyse the projections and its underlying assumptions to assess the reasonableness of the cash flows;
 - (c) discount the difference between the projected cash flows under two scenarios to arrive at the present value using an appropriate discount rate; and
 - (d) Tax amortisation benefit, if appropriate.

Option Pricing Models

92. There are several methods to value options, of which the Black-Scholes-Merton Model and Binomial Model are widely used. The important inputs required in these models are as under:
- (a) current price of asset to be valued;
 - (b) exercise price;
 - (c) life of the option;
 - (d) expected volatility in the price of the asset;
 - (e) expected dividend yield; and
 - (f) risk free interest rate.
93. These models value options by creating replicating portfolios composed of asset to be valued and riskless lending or borrowing.
94. MEEM, Relief from Royalty method, With and Without method are used only for valuation of intangible assets and Option Pricing Models are used in case of valuation of options. Specific guidance on the aforesaid valuation methods is provided in other relevant ICAI Valuation Standards.

Cost Approach

95. **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).**
96. In certain situations, historical cost of the asset may be considered by the *valuer* where it has been prescribed by the applicable regulations/law/guidelines or is appropriate considering the nature of the asset.
97. Examples of situations where a *valuer* applies the cost approach are:
- (a) an asset can be quickly recreated with substantially the same utility as the asset to be valued;
 - (b) in case where liquidation value is to be determined; or
 - (c) income approach and/or market approach cannot be used.
98. In some instances, the *valuer* may consider using other valuation approaches in combination with cost approach, such as:

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- (a) the asset has not yet started generating income / cash flows (directly or indirectly);
 - (b) an asset of substantially the same utility as the asset to be valued can be created but there are regulatory or legal restrictions and involves significant time for recreation; or
 - (c) the asset was recently created.
99. The following are the two most commonly used valuation methods under the Cost approach:
- (a) Replacement Cost Method (see paragraph 100-102); and
 - (b) Reproduction Cost Method (see paragraph 103-107).

Replacement Cost Method

100. ***Replacement Cost Method, also known as 'Depreciated Replacement Cost Method' involves valuing an asset based on the cost that a market participant shall have to incur to recreate an asset with substantially the same utility (comparable utility) as that of the asset to be valued, adjusted for obsolescence.***
101. The physical properties of the new asset may or may not be similar to the one under valuation, but the former asset should bear comparable utility. Obsolescence includes physical deterioration, functional (technological) and economic obsolescence. The term obsolescence connotes a wider meaning than the term depreciation adopted for financial reporting or tax purposes.
102. The following are the major steps in deriving a value using the Replacement Cost method:
- (a) estimate the costs that will be incurred by a market participant for creating an asset with comparable utility as that of the asset to be valued;
 - (b) assess whether there is any loss on account of physical, functional or economic obsolescence in the asset to be valued; and
 - (c) adjust the obsolescence value, if any as determined under (b) above from the total costs estimated under (a) above, to arrive at the value of the asset to be valued.

Reproduction Cost Method

103. **Reproduction Cost Method** involves valuing an asset based on the cost that a market participant shall have to incur to recreate a replica of the asset to be valued, adjusted for obsolescence.
104. The following are the major steps in deriving a value using the Reproduction Cost method:
- (a) estimate the costs that will be incurred by a market participant for creating a replica of the asset to be valued;
 - (b) assess whether there is any loss of value on account of physical, functional or economic obsolescence in the asset to be valued; and
 - (c) adjust the obsolescence value, if any as determined under (b) above from the total costs estimated under (a) above, to arrive at the value of the asset to be valued.

Obsolescence

105. **Under the Replacement Cost Method or the Reproduction Cost Method, the estimated cost of creating an asset is required to be adjusted for depreciation on account of obsolescence in the asset to be valued.**
106. The following are common types of obsolescence
- (a) *Physical obsolescence* represents the loss in value on account of decreased usefulness of the asset as the useful life expires.
 - (b) *Functional (technological) obsolescence* represents the loss in value on account of new technological developments; whereby the asset to be valued becomes inefficient due to availability of more efficient replacement assets.
 - (c) *Economic (external) obsolescence* represents the loss in value on account of decreased usefulness of the asset caused by external economic factors such as change in environmental or other regulations, excess supply, high interest rates, etc.
107. Cost approach is generally used in case of valuation of property, plant and equipment and certain intangible assets. ICAI Valuation Standards dealing with valuation of these assets provides specific

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guidance on the aforesaid valuation methods under the Cost approach.

Effective Date

108. ICAI Valuation Standard 103 *Valuation Approaches and Methods*, shall be applied for the valuation reports issued on or after 1st July, 2018.

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Scope of Work, Analyses and Evaluation

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*This ICAI Valuation Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in **bold** type indicate the main principles. (This ICAI Valuation Standard should be read in the context of Framework for the Preparation of Valuation Report in accordance with ICAI Valuation Standards)*

Objective

1. This Standard prescribes the basis for:
 - (a) determining and documenting the scope/terms of a valuation engagement, responsibilities of the *valuer* and the client;

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- (b) **the extent of analyses and evaluations to be carried out by the *valuer*; and**
 - (c) **responsibilities of the *valuer* while relying on the work of other experts.**
2. The objective of this Standard is to prescribe the minimum requirements in respect of terms of the engagement of valuation.
 3. This Standard provides guidance to the *valuer* in relation to his responsibility for a valuation assignment.
 4. **The principles enunciated in this Standard shall be applied in conjunction with the principles prescribed and contained in the *Framework for the Preparation of Valuation Report in accordance with ICAI Valuation Standards*.**

Scope

5. **A *valuer* shall follow the requirement of this Standard while accepting an engagement of valuation. The *valuer* and the client should agree on the terms of engagement before commencement of the engagement.**
6. The agreed terms shall be recorded in the engagement letter including where necessary, an addendum, thereto.
7. This Standard is applicable to all valuation assignments performed giving reference to any of the ICAI Valuation Standards.
8. The valuation engagement covers:
 - (a) arriving at an estimate of / providing an opinion of value;
 - (b) fairness opinion which involves opining on the fairness of the price at which a transaction has taken place or on the fairness of the value conclusion of another *valuer*;
 - (c) valuation review, where the work of another *valuer* is reviewed. As part of a valuation review, the reviewer may perform certain valuation procedures and/or providing an opinion of value.
9. A *valuer* shall carry out the assignment in accordance with the principles laid in the ICAI Valuation Standards, as applicable to the purpose and terms of engagement.

Significant Elements

10. **Scope of work describes the work to be performed, responsibilities and confidentiality obligations of the client and the *valuer* respectively, and limitation of the valuation engagement.**
11. The terms of engagement shall be mutually agreed between the *valuer* and the client. The *valuer* shall ensure that the terms of the engagement provide a reasonable framework to perform the valuation in accordance with the ICAI Valuation Standards.
12. The terms shall be reviewed by the *valuer* and the client and modified suitably, if required, to meet the changed circumstances.
13. A *valuer* shall be responsible for the methods and assumptions used by him.
14. The valuation shall not be constituted as an audit or review in accordance with the auditing standards applicable in India, accounting/financial/commercial/legal/tax/environmental due diligence or forensic/investigation services, and shall not include verification or validation work.
15. The client should keep the *valuer* informed of any material development relating to the business or operations which may have a bearing on the engagement.

Scope of Work/Terms of Engagement

16. **The following are the key elements of the engagement:**
 - (a) **scope;**
 - (b) **responsibility;**
 - (c) **authority;**
 - (d) **confidentiality;**
 - (e) **limitations;**
 - (f) **reporting; and**
 - (g) **compliance with ICAI Valuation Standards.**

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17. There should be clarity of terms of the valuation engagement between the *valuer* and the client to avoid misunderstanding as to any aspect of the engagement.
18. The terms of the valuation assignment shall be documented in writing in an engagement letter.
19. The engagement letter shall at the minimum include:
 - (a) details of the client;
 - (b) details of any other user/s of the valuation report apart from the client, if any;
 - (c) details of the *valuer*;
 - (d) purpose of the valuation;
 - (e) identification of the subject matter of valuation;
 - (f) valuation date;
 - (g) basis and premise of valuation;
 - (h) responsibilities of the client and the *valuer*;
 - (i) confidentiality obligations of the client and the *valuer*;
 - (j) scope/ limitations;
 - (k) fees ;
 - (l) details of third party expert, if any, and their scope of work, scope limitations, and responsibilities.
20. Any changes to the agreed upon terms of the engagement shall be documented in writing.
21. The client shall be responsible for providing timely and accurate data, information, records, clarifications, personnel etc.
22. The terms of engagement shall clearly specify that the ownership of the working papers rests with the *valuer*. It should also be made clear that the *valuer* may provide copies of non-proprietary working papers, upon a written request of the client.
23. The terms of engagement shall specify clearly the limitations on scope, coverage and reporting requirement, if any.

24. In case the *valuer* is unable to agree to any change in the terms of engagement and/or is not permitted to continue as per the original terms, he should withdraw from the engagement and should consider whether there is an obligation, contractual or otherwise, to report the circumstances necessitating the withdrawal to the client.

Confidentiality of the Report

25. The engagement letter shall contain a condition that the valuation report should not be used, reproduced, distributed or circulated whether in whole or part, other than for the purpose agreed in the scope of work/terms of engagement, without the prior written consent of the client or *valuer* as the case may be unless there is a statutory or a regulatory requirement to do so.

Analyses and Evaluation

26. **The extent of analyses to be carried out by the *valuer* in relation to the engagement shall be based on the purpose of the valuation assignment and the terms of engagement.**
27. The judgments made by the *valuer* during the course of assignment, including the sufficiency of the data made available to meet the purpose of the valuation, must be adequately supported.
28. The *valuer* shall carry out relevant analyses and evaluations through discussions, inspections, survey, calculations and such other means as may be applicable and available to that effect.

Analysis of Asset to be Valued

29. If the *valuer* relies on the information available in public domain, the *valuer* should assess the credibility/reliability of such information taking into account, *inter-alia*, the purpose of valuation, and materiality *vis-à-vis* the valuation conclusion,.
30. The type, availability, and significance of such information may vary with the asset to be valued. Such information shall include:
- (a) non-financial information;
 - (b) ownership details;
 - (c) financial information; and
 - (d) general information.

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Non-Financial Information

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

Ownership Information

32. A *valuer* shall obtain ownership information regarding the asset to be valued to enable him to:

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- (a) determine the type of ownership interest being valued and ascertain whether that interest exhibits control characteristics;
- (b) analyse the different ownership interests of other owners and assess the potential effect on the value of the asset;
- (c) understand the classes of equity ownership interests and rights attached thereto;
- (d) understand other matters that may affect the value of the subject interest, such as:
 - (i) for a business, business ownership interest: shareholder agreements, partnership agreements, operating agreements, voting trust agreements, buy-sell agreements, loan covenants, restrictions, and other contractual obligations or restrictions affecting the owners and the asset to be valued;
 - (ii) for an intangible asset: legal rights, licensing agreements, sublicense agreements, nondisclosure agreements, development rights, commercialization or exploitation rights, and other contractual obligations.

Financial Information

33. A *valuer* shall obtain, where applicable and available, financial information on the underlying business such as:
- (a) historical financial information (including annual and interim financial statements and key financial statement ratios and statistics) for an appropriate number of years;
 - (b) prospective financial information (for example, budgets, forecasts, and projections)- in the absence of which the *valuer* could consider information on future developments or course of the business;
 - (c) comparative summaries of financial statements or information covering a relevant time period;
 - (d) comparative common size financial statements for the subject entity for an appropriate number of years;
 - (e) comparative common size industry financial information for a relevant time period;

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- (f) income tax returns for an appropriate number of years;
 - (g) information on compensation for owners including benefits and personal expenses;
 - (h) details of and management's response to the inquiry regarding:
 - (i) advantageous or disadvantageous contracts;
 - (ii) contingent or off-balance-sheet assets or liabilities;
 - (iii) surplus/ non-operating assets.
34. A *valuer* shall read and evaluate the information to determine that it is reasonable for the purposes of the engagement.

General Information

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

Subsequent Events

36. The valuation date is the specific date at which a *valuer* estimates the value of the asset.
37. **An event that occurs subsequent to the valuation date could affect the value; such an occurrence is referred to as a *subsequent event*.**
38. Subsequent events are indicative of the conditions that were not known or knowable at the valuation date, including conditions that arose subsequent to the valuation date.
39. Generally, a *valuer* would consider only circumstances existing at the valuation date and events occurring up to the valuation date. However, events and circumstances occurring subsequent to the valuation date, may be relevant to the valuation depending upon, inter alia, the basis, premise and purpose of valuation. Hence the valuer should apply its professional judgement, to consider any of such circumstances / events which are relevant for the valuation. Such circumstances / events could be relating to, but not limited to, the asset being valued, comparables and valuation parameters used. In the event such circumstances / events are considered by the valuer the same should be explicitly disclosed in the valuation report.

Reliance on the work of other Experts

40. **A *valuer* shall evaluate the skills, qualification, and experience of the other expert in relation to the subject matter of his valuation.**
41. A *valuer* must determine that the expert has sufficient resources to perform the work in a specified time frame and also explore the relationship which shall not give rise to the conflict of interest.
42. If the work of any third party expert is to be relied upon in the valuation assignment, the description of such services to be provided by the third party expert and the extent of reliance placed by the *valuer* on the expert's work shall be documented in the engagement letter. The engagement letter should document that the third party expert is solely responsible for their scope of work, assumptions and conclusions.
43. A *valuer* shall specifically disclose the nature of work done and give sufficient disclosure about reliance placed by him on the work of the third party expert in the valuation report.

Information and Analyses

44. **A *valuer* shall obtain sufficient appropriate data, information, explanations and perform appropriate analyses based on his professional judgment to enable him to draw reasonable conclusions on which to base his opinions or findings.**
45. The factors affecting the professional judgement include the possible errors and their materiality and the risk of occurrence of such errors.

Effective Date

46. ICAI Valuation Standard 201 *Scope of Work, Analyses and Evaluation*, shall be applied for the valuation reports issued on or after 1st July, 2018

ICAI Valuation Standard 202 Valuation Report and Documentation

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*The ICAI Valuation Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles. (This ICAI Valuation Standard should be read in the context of Framework for the Preparation of Valuation Report in accordance with the ICAI Valuation Standards)*

Objective

1. **This Standard provides the:**
 - (a) **minimum content of the valuation report;**
 - (b) **basis for preparation of the valuation report; and**
 - (c) **basis for maintaining sufficient and appropriate documentation.**
2. The objective of this Standard is to prescribe the minimum contents of the valuation report depending upon the nature of the engagement and specify the responsibility of a *valuer* in preparing the relevant documentation for arriving at a value.
3. **The principles enunciated in this Standard shall be applied in conjunction with the principles prescribed and contained in the Framework for the Preparation of Valuation Report in accordance with the ICAI Valuation Standards.**

Scope

4. **A *valuer* shall follow all requirements of this Standard in preparation of the valuation report.**
5. This Standard provides guidance on the documentation to be maintained for the preparation of a valuation report. Relevant valuation documentation that meets the requirements of this Standard provides evidence of the *valuer's* basis for arriving at the value and that the valuation was planned and performed in accordance with the relevant ICAI Valuation Standards.
6. The contents of the valuation report specified in this Standard are not applicable to the extent a *valuer* is required to follow the requirements prescribed by any law, regulations, rules or directions of any Government or regulatory authority, or Court order. Sometimes, a *valuer*, as required by law or otherwise, may review a valuation undertaken by another valuer. Such review may be called by any other term such as opinion, valuation review engagement, etc. This valuation standard shall apply to the reports of such reviews undertaken.

Significant Elements

7. **The form and content of the valuation report depends on the-**
 - (a) **nature of the engagement; and**
 - (b) **purpose of the valuation.**
8. A *valuer* shall document matters which are important in providing evidence that the valuation assignment was carried out in accordance with the ICAI Valuation Standards and support his assessment or the valuation report submitted by him.
9. A *valuer* shall prepare the valuation report with due professional care.

Contents of the Valuation Report

10. **The contents of the valuation report are selected by the *valuer*, based on the specifics of the engagement, in particular, the nature of the engagement, and the purpose of valuation.**
11. **A *valuer* shall at a minimum include the following in the valuation report:**

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- (a) background information of the asset being valued;
 - (b) purpose of the valuation and appointing authority;
 - (c) the identity of the *valuer* and any other experts involved in the valuation;
 - (d) disclosure of the *valuer's* interest or conflict, if any;
 - (e) date of appointment, valuation date and date of the valuation report;
 - (f) inspections and/or investigations undertaken;
 - (g) nature and sources of the information used or relied upon;
 - (h) procedures adopted in carrying out valuation and valuation standards followed;
 - (i) valuation methodology used;
 - (j) restrictions on use of the valuation report, if any;
 - (k) major factors that were taken into account during the valuation;
 - (l) conclusion; and
 - (m) caveats, limitation and disclaimers to the extent they explain or elucidate the limitations faced by *valuer*, which shall not be for the purpose of limiting his responsibility for the valuation report.
12. Where a *valuer* uses the work of an expert during the process of valuation, he shall disclose the identity of such expert and the reliance placed on the valuation report of such expert.
13. A *valuer* may decide to include the valuation report issued by such expert as an annexure to his valuation report.
14. It is normally presumed by the users of the valuation report that the *valuer* is independent of the asset to be valued and the client for whom the valuation is being done. Where the valuation is being undertaken for a client and is to be used for the purpose of any transaction or otherwise by another identified specific party at the time of engagement, the *valuer* shall evaluate independence with reference to the other specific party also.

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15. A *valuer* shall appropriately disclose his interest/conflict of interest, if any, in the assets to be valued in the valuation report.
16. In case where the relevant law prohibits the acceptance of an assignment by a *valuer* due to the existence of any interest in the asset valued, or any conflict of interest, the *valuer* shall not accept the valuation engagement.
17. A *valuer* shall determine the valuation bases for undertaking the valuation of any asset category. These valuation bases describe the fundamental premises on which the value will be based.
18. A *valuer* shall disclose the valuation bases which are considered in accordance with ICAI Valuation Standard 102 *Valuation Bases* while arriving at the value in the valuation report. The following are examples of the valuation bases which are explained in detail in ICAI Valuation Standard 102:
 - (a) Fair value;
 - (b) Participants specific value; and
 - (c) Liquidation value
19. A *valuer* shall use appropriate valuation approach/ approaches for arriving at the value. Certain valuation approaches which are explained in detail in ICAI Valuation Standard 103, *Valuation Approaches and Methods* are as follows:
 - (a) Market approach;
 - (b) Income approach; and
 - (c) Cost approach.
20. The examples of various methods within these approaches are:
 - (a) market price method;
 - (b) comparable companies multiple method;
 - (c) comparable transaction multiple method;
 - (d) discounted cash flow method;
 - (e) relief from royalty method;
 - (f) multi-period excess earnings method;

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- (g) with and without method;
 - (h) option pricing method;
 - (i) replacement cost method; and
 - (j) reproduction cost method.
21. A *valuer* may use a combination of methods and approaches to arrive at the value.
 22. A *valuer* shall disclose the approaches and methods which are considered in accordance with ICAI Valuation Standard 103 used in arriving at the value.
 23. The valuation assignment concludes with the *valuer* providing an estimate of value. Such an estimate of value may be an exact number or a range of values.
 24. A *valuer* shall clearly describe the conclusion of value, either as a single amount or a range.
 25. In certain cases, the law or regulatory orders may require the *valuer* to report a specific amount, which may be a number or some other specific unit. In such cases, the *valuer* shall clearly describe the specific exchange or swap ratio based on the value arrived at.
 26. The identity of the *valuer* shall be clearly mentioned in the valuation report.
 27. The valuation report shall include the signature of *valuer* along with the name of entity (in case an entity is appointed) appointed for the valuation assignment.
 28. The signature shall (to the extent applicable) contain the name of the *valuer* vested with signing authority, entity name, individual and entity's registration number along with the date and place where the valuation report is signed.
 29. A *valuer* considers various factors while undertaking the valuation. These include assumptions in respect of information received, information not available, as well as information which are not capable of being independently verified.
 30. A *valuer* shall disclose the major factors considered by him in the valuation report to assist the readers to have a complete understanding of the valuation.

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31. Valuation analysis and results are specific to the purpose of valuation, the client requirements and the valuation date. The caveats, limitations or disclaimers which are considered while arriving at the value shall be clearly disclosed in the valuation report.
32. A *valuer* shall exercise reasonable restraint in using caveats while writing the valuation report.
33. ICAI Valuation Standards pertaining to certain classes of assets may prescribe additional information to be reported. In such cases, the valuation report shall include such additional information as specified in the relevant ICAI Valuation Standard pertaining to such class of assets.
34. A *valuer* shall indicate in the valuation report the restrictions on the use of the report by or on the users of the report, as the case may be.
35. In addition to the minimum contents as given above, if the *valuer* believes that certain additional information will be useful to the user for a better understanding of the valuation, the *valuer* may include such additional information in the valuation report.

Management Representations

36. A *valuer* may obtain written representations from the management/client regarding information for performing the valuation assignment. The decision to obtain a representation letter is a matter of judgment by the *valuer*. A written representation obtained from the management or those charged with governance becomes part of the evidence obtained by the *valuer* which forms a basis for his valuation report.
37. Wherever a *valuer* obtains written representations from the management/client regarding information which is the base for the valuation assignment, the *valuer* shall mention the fact of such representation and the reliance placed on the same.
38. The existence of a management representation letter shall not preclude the *valuer* from exercising reasonable skill and care with respect to the information obtained regarding the valuation. The *valuer* shall carry required procedures in the performance of his valuation assignment in respect of the information included in the management representation letter.

Documentation

39. **Documentation includes the record of valuation procedures performed, relevant evidence obtained and conclusions that the valuer has reached.**
40. A *valuer* shall maintain documentation which provides:
- (a) sufficient and appropriate record of the basis of the valuation report; and
 - (b) evidence that the valuation assignment was planned and performed in accordance with the ICAI Valuation Standards and applicable legal and regulatory requirements, as the case may be.
41. A *valuer* shall obtain sufficient and appropriate evidence in arriving at conclusions which form the basis of his valuation report.
42. A *valuer* shall document the valuation evidence obtained on a timely basis. Documentation shall be prepared at the time the valuation assignment is performed. The extent of documentation is a matter of professional judgement.
43. A *valuer* shall retain the information obtained, as well as his analyses, assumptions, and workings to arrive at the valuation for a period of time sufficient to meet the needs of applicable legal, regulatory or other professional requirements for records retention. This retention period for valuation documentation is ordinarily not shorter than eight years from the date of the valuation report. The *valuer* may maintain documentation in either physical or electronic format.
44. A *valuer* shall ensure that the documentation is maintained in a form that is sufficient to enable another professional having no connection with the engagement or a reviewer appointed by any relevant professional body, to review the valuation process and conclusions.
45. The information received and relied upon, as well as analyses thereon differ for every valuation engagement, However, the following documents/information/analyses shall, at the minimum, be documented:
- (a) engagement or appointment letter which appoints the *valuer* to undertake the valuation;

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- (b) tabulation of data obtained during the course of valuation;
 - (c) workings undertaken to arrive at the value;
 - (d) copies of relevant circulars, extracts of legal provisions;
 - (e) the base/s, approach/es, and method/s, or a combination thereof, used to arrive at the value;
 - (f) assumptions, a change in which, may materially affect the value;
 - (g) a copy of the signed valuation report issued; and
 - (h) management/client representation letter or such communication received, if any.
46. The valuation documentation is not limited to records prepared by the *valuer* but may include appropriate records such as minutes of meetings, reports issued by other experts, and other independent industry/sector or other such data provided to the *valuer* by the client, if any.
47. Unless otherwise specified by law or regulation, valuation documentation is the property of the *valuer*.
48. A *valuer* or his organisation shall establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of the documentation.

Effective Date

49. ICAI Valuation Standard 202 *Valuation Report and Documentation*, shall be applied for the valuation reports issued on or after 1st July, 2018.

ICAI Valuation Standard- 301 Business Valuation

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*(The ICAI Valuation Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles. (This ICAI Valuation Standard should be read in the context of Framework for the Preparation of Valuation Report in accordance with ICAI Valuation Standards)*

Objective

1. This Standard provides guidance for business *valuers* who are performing business valuation or business ownership interests valuation engagements.

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2. The objective of this Standard is to establish uniform concepts, principles, practices and procedures for *valuers* performing valuation services.
3. Valuations of businesses, business ownership interests may be performed for a wide variety of purposes including the following:
 - (a) valuation of financial transactions such as acquisitions, mergers, leveraged buyouts, initial public offerings, employee stock ownership plans and other share-based plans, partner and shareholder buy-ins or buy-outs, and stock redemptions;
 - (b) valuation for dispute resolution and/ or litigation/pending litigation relating to matters such as marital dissolution, bankruptcy, contractual disputes, owner disputes, dissenting shareholder and minority ownership oppression cases, employment disputes, etc;
 - (c) valuation for compliance oriented engagements, for example:
 - (i) financial reporting; and
 - (ii) tax matters such as corporate reorganisations, ; purchase price allocations etc.
 - (d) valuation for other purposes like the valuation for planning, internal use by the owners etc;
 - (e) valuation under Insolvency and Bankruptcy Code.
4. This Standard provides a broad framework of generally accepted principles, theories and procedures.
5. **The principles enunciated in this Standard shall be applied in conjunction with the principles prescribed and contained in the *Framework for the Preparation of Valuation Report in accordance with ICAI Valuation Standards*.**

Scope

6. A *valuer* shall follow all applicable requirements of this Standard in the valuation of a business.
7. This Standard describes the basic principles which govern the *valuer's* professional responsibilities and which shall be complied with whenever an engagement to estimate value is carried out.

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8. A *valuer* shall not apply this Standard, where any requirement of this Standard is inconsistent with
- (a) the requirements prescribed under; or
 - (b) valuation procedures specified by
any law, regulations, rules or directions of any government or regulatory authority, or Court order.

In such cases, the *valuer* shall follow the requirements prescribed by any law, regulations, rules or directions of any government or regulatory authority, or Court order.

Significant Elements

9. **Business Valuation is the act or process of determining the value of a business enterprise or ownership interest therein.**
10. A *valuer* shall apply valuation approaches and valuation methods, as described in ICAI Valuation Standard 103 *Valuation Approaches and Methods*, and also use his professional judgment which is an essential component of estimating value.
11. When valuing a business or business ownership interest, a *valuer* may express either an exact number or a range of values. There could be different benchmarks at which the estimate of value of an entity could be expressed by the *Valuer*. For example:
- (a) Enterprise Value: Enterprise Value is the value attributable to the equity shareholders plus the value of debt and debt like items, minority interest, preference share less the amount of non-operating cash and cash equivalents.
 - (b) Business Value: Business value is the value of the business attributable to all its shareholders
 - (c) Equity Value: Equity Value is the value of the business attributable to equity shareholders

Valuation Methodology

12. In performing a valuation assignment, a *valuer* shall:
- (a) define the premise of the value;

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- (b) analyse the asset to be valued and collect the necessary information;
- (c) identify the adjustments to the financial and non-financial information for the valuation;
- (d) consider and apply appropriate valuation approaches and methods;
- (e) arrive at a value or a range of values; and
- (f) identify the subsequent events, if any

Premise of the value

- 13. **Premise of the value refers to the conditions and circumstances how an asset is deployed.**
- 14. The premise shall always reflect the facts and circumstances underlying each valuation engagement.
- 15. Determining the business value depends upon the situation in which the business is valued, i.e, the events likely to happen to the business as contemplated at the valuation date.
- 16. Premises of value are explained in detail in ICAI Valuation Standard 102 *Valuation Bases*.

Analysis of asset to be valued

- 17. The analysis of the asset to be valued shall assist the *valuer* in considering, evaluating, and applying the various valuation approaches and methods to the valuation engagement.
- 18. The nature and extent of the information required to perform the analysis shall depend on the following:
 - (a) nature of the asset to be valued;
 - (b) scope and purpose of the valuation engagement;
 - (c) the valuation date;
 - (d) the intended use of the valuation;
 - (e) the applicable ICAI Valuation Standard;
 - (f) the applicable premise of value;

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- (g) assumptions and limiting conditions; and
 - (h) applicable governmental regulations or regulations prescribed by other regulators or other professional standards;
19. In analysing the asset to be valued, the *valuer* shall gather, analyse and adjust the relevant information necessary to perform a valuation, appropriate to the nature or type of the engagement. Such information shall include:
- (a) non-financial information;
 - (b) ownership details;
 - (c) financial information; and
 - (d) general information.
- The detailed guidance in this respect is laid down in ICAI Valuation Standard 201 *Scope of Work, Analyses and Evaluation*.
20. A *valuer* shall read and evaluate the information to determine the reasonableness of information.
21. Even though the above mentioned procedure is presented in a manner that suggests a sequential valuation process, valuations involve an ongoing process of gathering, updating, and analysing information. Accordingly, the sequence of the requirements and guidance in this Standard may be implemented differently at the option of the *valuer*.
22. If the historical financial statements of the business to be valued are not considered to be reflective of its future business performance, the *valuer* should understand the rationale for the same and document the same.
23. The conditions, rights and obligations of ownership right are usually mentioned in the legal document such as articles of association, bye-laws, shareholders agreement, partnership agreements, etc of the asset to be valued. These documents may consider certain restrictions or give certain benefits for ownership rights for certain groups of stakeholders. A *valuer* shall consider and incorporate the same in the valuation of the ownership interest of the business.
24. The type, availability, and significance of such information may vary with the asset to be valued.

Adjustment to information from financial statements

25. Adjustment shall be made to information available from the historical financial statements, if appropriate, to reflect the appropriate asset value, income, cash flows and/or benefit stream, as applicable, to be consistent with the valuation method(s) selected by the *valuer*.
26. Financial information adjusted to be analysed include those of the underlying company and any entities used as comparable entities to the extent available in public domain.
27. Adjustments to financial information are modifications to reported financial information which is relevant and significant to the valuation process. Adjustments may be appropriate for the following reasons, amongst others:
 - (a) to present financial data of the underlying and comparable companies on a consistent basis;
 - (b) to adjust revenues and expenses to levels that are reasonably representative of continuing operations;
 - (c) to adjust for non-operating/non-recurring assets and liabilities, and any revenues and expenses related to the non-operating items.
28. Adjustments to the financial information are made for the sole purpose of assisting the *valuer* in reaching a value.

Valuation Approaches and Methods

29. Generally, the following three main valuation approaches are adopted to perform the business valuation in correlation with the valuation approaches and methodologies prescribed under ICAI Valuation Standard 103 *Valuation Approaches and Methods* :
 - (a) Market approach;
 - (b) Income approach; and
 - (c) Cost approach.
30. A *valuer* shall select and apply appropriate valuation approaches, methods and procedures to the extent relevant for the engagement.
31. The requirements of this Standard shall be followed consistently in addition to the requirements as contained in ICAI Valuation Standard 103 while selecting and applying the valuation approach.

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Market approach

32. **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**
33. The following are the common methodologies for the market approach:
 - (a) Market Price Method;
 - (b) Comparable Companies Multiple Method; and
 - (c) Comparable Transaction Multiple Method.

Income approach

34. **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.**
35. The most commonly used income approach is Discounted Cash Flow (DCF) Method.

Cost approach

36. **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).**
37. The following are the commonly used valuation methods under the cost approach:
 - (a) Replacement Cost Method; and
 - (b) Reproduction Cost Method.

Value under liquidation

38. **Liquidation value is the amount that will be realised on sale of an asset or a group of assets when an actual/hypothetical termination of the business is contemplated/assumed.**

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39. The value under liquidation would be relevant in case the basis of valuation is liquidation value
40. In the event of valuation of ownership interest under the premise of liquidation, it may be relevant to consider the realisable values of assets of the entity after considering transaction costs.
41. Liabilities could be considered at their settlement values.

Rule of Thumb or Benchmark Value

42. **Rule of thumb or benchmark indicator is used as a reasonable check against the values determined by the use of other valuation approaches in a valuation engagement.**
43. Rule of thumb may provide insight into the value of a business or business ownership interest. Some of the examples of rule of thumb or benchmark valuation would be value based on transaction multiples for capacity or turnover.
44. It shall not be used as the only method to determine the value of the asset to be valued.
45. Value indications derived from the use of rules of thumb method shall not be given substantial weight unless they are supported by other valuation methods and it can be established that knowledgeable buyers and sellers place substantial reliance on them.
46. A *valuer* shall set forth in the report the rationale and support for the valuation methods used.

Treatment of non-operating assets and inter-company investments

47. Apart from operating assets, entities hold non-operating assets. Such assets should be valued based on their realisable values net of costs and outgoes and added to the value arrived under the various approaches to derive the value for ownership interest.
48. Inter-company adjustments or substantial cross holdings between companies in the business valuations should be considered at fair value.

Consideration of Capital Structure of the business

49. A business is usually financed by a combination of investments such

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as equity interests, debt (including redeemable preference shares) and quasi equity instruments. Certain engagements may require the valuer to allocate the enterprise value of the business into (a) value allocable to equity and (b) value allocable to debt. In deriving the above allocation, the valuer should give due consideration to the capital structure of the business including the terms of instruments used to finance the business. The value allocable to equity interests is usually the residuary value after reducing the debt from enterprise value.

Value

50. **Value is an estimate of a business or business ownership interest, arrived at by applying the valuation procedures appropriate for a valuation engagement and using professional judgment as to the value or range of values based on those procedures.**
51. The value shall be based upon the applicable bases of value, the purpose and intended use of the valuation, and all relevant information available as of the valuation date in carrying out the value for the valuation engagement and on value indications resulting from one or more valuation methods performed under the valuation process.
52. In arriving at the value, the *valuer* shall:
 - (a) assess the reliability of the results under the different approaches and assign weights to value indications reached on the basis of various methods;
 - (b) the selection of and reliance on appropriate methods and procedures depends on the judgment of the *valuer* and not on any prescribed formula. One or more approaches may not be relevant to a particular situation, and more than one method under an approach may be relevant;
 - (c) the *valuer* must use informed judgment when determining the relative weight to be accorded to indications of value reached on the basis of various methods, or whether an indication of value from a single method shall be conclusive. In any case, the *valuer* shall provide the rationale for the selection or weighting of the method or methods relied on in reaching the conclusion;

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- (d) in assessing the relative importance of indications of the value determined under each method, or whether an indication of value from a single method shall be the value, the *valuer* shall consider factors such as:
 - (i) the applicable premise of value;
 - (ii) the purpose and intended use of the valuation;
 - (iii) whether the underlying business is an operating company, a real estate or investment holding company, or a company with substantial non-operating or excess assets;
 - (iv) the quality and reliability of data underlying the value;
 - (v) such other factors that in the opinion of the *valuer*, are appropriate for consideration.

Effective Date

53. ICAI Valuation Standard 301 *Business Valuation*, shall be applied for the valuation reports issued on or after 1st July, 2018.

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Intangible Assets

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*The ICAI Valuation Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles. (This ICAI Valuation Standard should be read in the context of Framework for the preparation of Valuation Report in accordance with ICAI Valuation Standards)*

Objective

1. **The objective of this Standard is to prescribe specific guidelines and principles which are applicable to the valuation of intangible assets that are not dealt specifically in another Standard.**
2. The importance of valuing intangible assets arises from the fact that the reported net worth of businesses may not be reflecting its true value, which most likely is in the form of intangible assets. Certain areas where intangible assets are required to be valued are as follows:
 - (a) purchase price allocation for accounting and financial reporting under Ind AS 103 *Business Combination*;
 - (b) impairment testing under Ind AS 36 *Impairment of Assets*;
 - (c) transfer pricing when an intangible asset is being transferred/licensed in/out between geographies/companies;
 - (d) taxation by way of a purchase price allocation for claiming tax deductions when a business is transferred by a slump sale;
 - (e) transaction (merger & acquisition) when the subject is the intangible itself, such as a brand/telecom license or for carrying out a pre-deal purchase price allocation to assess the impact of the deal on financials;
 - (f) financing, when an intangible is used as a collateral;
 - (g) litigation, when there has been a breach of contract/right and the compensation has to be determined;
 - (h) bankruptcy / restructuring, etc;
 - (i) insurance, such as determining the personal worth of a celebrity/football franchise/cricket franchise; or

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- (j) issuance of sweat equity shares which are generally issued against technical knowhow/ technical expertise/intellectual property.
- 3. **The principles enunciated in this Standard shall be applied in conjunction with the principles prescribed and contained in the *Framework for the Preparation of Valuation Report in accordance with ICAI Valuation Standards.***

Scope

- 4. **This Standard shall be applied for valuation of identified intangible assets for the given purpose of valuation.**
- 5. Some intangible assets may be contained in or on a physical substance such as a compact disc (in the case of computer software), legal documentation (in the case of a licence or patent) or film. In determining whether an asset that incorporates both intangible and tangible elements should be treated as a tangible asset, or as an intangible asset under this Standard, the *valuer* uses judgement to assess which element is more significant. For example, computer software for a computer-controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as tangible asset. The same applies to the operating system of a computer. When the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

Valuation Bases

- 6. A *valuer* must consider the relevant valuation bases for valuation of an intangible asset in accordance with ICAI Valuation Standard 102 *Valuation Bases*. However, a *valuer* should follow the bases prescribed by a prescribed law or regulation, if it is applicable.

Intangible assets

- 7. **An intangible asset is an identifiable non-monetary asset without physical substance.**
- 8. An intangible asset is a non-monetary asset without physical substance, whereas a monetary asset is one where assets to be

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received are in fixed or determinable amounts of money. An intangible asset grants economic rights or benefits to its owner and can be identified and differentiated primarily on the basis of its ownership and utility. Intangible assets lack physical properties and represent legal rights developed or acquired by an owner.

9. Intangible assets shall be able to generate quantifiable economic benefits for its owner and can be either directly owned through own business (internally developed) or purchased by paying royalty or licence fee. Common examples of items of intangible assets are computer software, patents, copyrights, trademark, brands, motion picture films, customer lists/contracts, mortgage servicing rights, franchises, marketing rights, non-competition agreements, internet domain names, distribution network, literary works/musical works, telecom licenses, gaming platforms, trade design, licensing arrangements, royalty agreements, employment contracts, trade secrets, processes, designs, formulae, etc. Intangible assets may be transferable, i.e. intangible assets can be bought, sold, rented, etc.
10. An intangible asset is identifiable if it either:
 - (a) is separable, i.e. is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or
 - (b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Goodwill

11. **The definition of an intangible asset requires an intangible asset to be identifiable to distinguish it from goodwill.**
12. **Goodwill is defined as an asset representing the future economic benefits arising from a business, business interest or a group of assets, which has not been separately recognised in another asset.**
13. Goodwill is the difference between the cost of the business combination and the acquirer's interest in the net fair value of the

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identifiable assets, liabilities and provisions for contingent liabilities. In other words, goodwill is the residual amount after ascribing values to identified intangible assets, other assets and liabilities. Goodwill can be transferable or non-transferable.

14. The goodwill subsumes the value of an acquired intangible asset that is not identifiable as of the acquisition date. Goodwill includes elements of company and business-related synergies. Goodwill could certain times include elements of assembled workforce, going concern value, new customers, future technologies, etc.
15. Amount of goodwill could vary depending on the purpose of valuation as the value of goodwill is dependent on the value of tangible and other intangible assets.

Categories of Intangible Assets

16. Intangible assets can generally be classified under the following broad categories (not intended to be exhaustive):
 - (a) Customer-based intangible assets;
 - (b) Marketing-based intangible assets;
 - (c) Contract-based intangible assets;
 - (d) Technology-based intangible assets; or
 - (e) Artistic-based intangible assets.
17. Intangible assets within the same category have certain similarities as well as differences based on characteristics such as their ownership, market position, function, and image. Additionally, certain intangible assets, such as brands, may belong to more than one category. Similarly, the value assigned to intangible assets belonging to the same category could differ depending on the valuation subject and purpose of valuation. For example, the intangible assets under customer-based category like customer contracts could fetch a different value than customer lists.

Customer-based intangible assets

18. **Customer-based intangible assets are created with an entity establishing relationships with its customers in the due course of its business. Such intangibles may be contractual or non-contractual.**

19. The examples of customer-based intangible assets are:
- (a) customer contracts;
 - (b) customer relationships;
 - (c) order backlog; or
 - (d) customer lists.

Marketing-based intangible assets

20. **Marketing-based intangible assets are created with the involvement of a business and such intangibles are also used for further growth of the business through marketing.**
21. The examples of marketing-based intangible assets are:
- (a) trademark;
 - (b) brand;
 - (c) trade name;
 - (d) internet domain name; or
 - (e) trade design.

Contract-based intangible assets

22. **Contract-based intangible assets are created from rights arising from contracts in a business.**
23. The examples of contract-based intangible assets are:
- (a) lease agreements;
 - (b) non-compete agreements;
 - (c) licensing agreements;
 - (d) royalty agreements; or
 - (e) employment contracts.

Technology-based intangible assets

24. **Technology-based intangibles are those intangible assets that create propriety knowledge.**
25. The examples of contract-based intangible assets are:

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- (a) patents;
- (b) know-how;
- (c) trade secrets;
- (d) copyrights;
- (e) processes;
- (f) software;
- (g) designs; or
- (h) formulae.

Artistic-based intangible assets

26. **Artistic-based intangible assets are created from the benefit arising from artistic works.**
27. The examples of contract-based intangible assets are:
- (a) films and music;
 - (b) books;
 - (c) plays; or
 - (d) copyright (non-contractual).

Significant Considerations

28. The following other significant considerations shall be made for the valuation of intangible assets:
- (a) to determine the purpose and objective of the overall valuation assignment;
 - (b) to consider the legal rights of the intangible asset to be valued, for example, a registered trademark may have a higher value as compared to an unregistered trademark. However, an unpatented technology (as not in public domain) may have a higher value than a patented technology;
 - (c) to evaluate the highest and best use considerations;
 - (d) to assess the history and development of the intangible asset; or
 - (e) to consider any specific laws or regulations guiding the intangible

asset valuation in the country, for example, royalty payments in India are regulated.

Economic Useful Life

29. Intangible assets could have a finite or indefinite life where finite life will usually be established by law or a contract, technology, function or economic factors along with the pattern of replacement of the intangible asset to be valued. Economic life of an intangible asset is not the same as the remaining useful life for tax or accounting purpose.
30. The economic and legal factors shall be considered together as well as individually while determining the useful life of an intangible asset. Economic factors determine the period over which future economic benefits will be received by the entity. Legal factors may restrict the period over which the entity controls access to these benefits. The useful life is the shorter of the periods determined by these factors.
31. Economic life of customer-based intangible assets is to an extent dependent on the attrition. Attrition refers to the possible expected loss of customers which is based on the historical behavior of customers. Historical attrition can be based on the following:
 - (a) *Variable loss rate*: dependent on the age of customer relationship;
 - (b) *Constant loss rate*: calculated as a percentage of previous year's parameters.

Discount Rates

32. ***Discount Rate* is the return expected by a market participant from a particular investment and shall reflect not only the time value of money but also the risk inherent in the asset being valued as well as the risk inherent in achieving the future cash flows.**
33. Discount rate shall be indicative of the risk associated with the cash flows arising from the intangible asset to be valued. Some of the factors which should be considered for determining the discount rate are :
 - (a) generally intangible assets have relatively more risk associated than tangible assets, a group of assets or business as a whole;

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- (b) intangible assets having a higher economic life have more risk associated than intangible assets having a lower economic life, other things remaining the same; and
 - (c) intangible assets with definite and determinable cash flows have relatively less risk associated as compared to intangible assets not having determinable cash flows.
34. The following discount rates are most commonly used:
- (a) weighted average cost of capital (WACC) of the company or market participants;
 - (b) cost of equity for the company using the intangible assets or the participants;
 - (c) cost of debt having maturity similar to the economic life of the intangible asset to be valued;
 - (d) risk-free interest rates which have a maturity similar to the economic life of the intangible asset to be valued; or
 - (e) internal rate of return of the transaction for the particular intangible asset.
35. The discount rate is commonly considered with necessary premiums or discounts to arrive at the appropriate discount rate for the intangible asset to be valued.
36. In case of a business valuation or valuation of all assets, a *valuer* shall determine the Weighted Average Return on Assets (WARA) to confirm the reasonableness of the discount rate / WACC so considered for valuation of the intangible asset. WARA is the expected rate of return on a particular asset and can be determined based on the riskiness involved for a particular asset.
37. The discount rates are discussed in detail in ICAI Valuation Standard 103 *Valuation Approaches and Methods*.

Tax Amortisation Benefits

38. **Tax Amortisation Benefit (TAB) is a hypothetical benefit available to a market participant by way of amortisation of the acquired intangible assets, thereby reducing the tax burden.**
39. Tax amortisation benefits (TAB) can be computed and added to the

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overall value of the intangible asset based on nature of the asset and purpose of valuation, if appropriate. Intangible assets can be amortised based on tax jurisdictions and valuation methodology used.

40. Intangible assets can be amortised based on tax jurisdictions and valuation methodology used. TAB generally needs to be computed and added under the income approach as the value of TAB is understood to be embedded in the value of the intangible asset under the market or cost approach.
41. The discount rate to be used for determining the present value of tax saving can be:
 - (a) weighted average cost of capital;
 - (b) discount rate used for valuation of the intangible asset to be valued.

Valuation Approaches and Methods

42. Generally, the following three main valuation approaches are adopted to measure value of intangible assets in correlation with the valuation approaches and methodologies prescribed under ICAI Valuation Standard 103 *Valuation Approaches and Methods*.
 - (a) Market approach;
 - (b) Income approach; and
 - (c) Cost approach.
43. The requirements of this Standard shall be followed consistently in addition to the requirements as contained in ICAI Valuation Standard 103, while selecting and applying the valuation approach.
44. A particular intangible asset can be valued using more than one approach or methodology as this provides the *valuer* multiple value indications thus setting a range of value for the intangible asset to be valued. A *valuer* shall consider some factors like availability of data, quality of data available, consideration of actual transaction in the industry, characteristics of the intangible, etc.
45. Intangible assets are generally entity specific and price information is rarely available.

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Market Approach

46. **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.**
47. Valuation of an intangible asset using the market approach is based on a certain market transaction or activity.
48. In accordance with the requirements contained in ICAI Valuation Standard 103, the market approach shall be adopted only if adequate information is available about the comparable intangible asset from a recent transaction and there are instances of orderly transactions that can be compared with the intangible asset to be valued. A comparable intangible asset is an intangible asset which is of the same nature, age, function and is at same stage of its life cycle.
49. Valuation will be based on a transaction of a comparable intangible asset which can be considered to obtain pricing multiples. The rate obtained can be applied to arrive at the value of the intangible asset.
50. The following are the common methodologies for the market approach:
 - (a) Price/Valuation multiples/Capitalisation rates;
 - (b) Guideline pricing method.

Price/Valuation multiples/Capitalisation rates

51. This method considers certain multiples/ capitalisation rates to arrive at the valuation of a comparable intangible asset. The multiples shall be adjusted appropriately to factor in any differences between the intangible asset to be valued and comparable intangible asset.

Guideline pricing method

52. This method determines the value of an intangible asset by considering the price paid in an orderly transaction for a comparable intangible asset (called as the guideline intangible asset which is similar to the intangible asset to be valued).
53. However, in most instances, it may be difficult to obtain reliable data in the form of a public transaction, valuation multiple or a guideline intangible asset.

Income Approach

54. **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.**
55. Valuation of an intangible asset using the income approach is based on the expectation of economic benefits from the intangible asset to be valued. In other words, the value of an intangible asset is the present value of the income expected or costs saved by the owner of the intangible asset either through owned operations or licensing of the intangible asset. The income so determined is adjusted with any related expenses pertaining to the maintenance or enhancement of the intangible asset. The projected net cash flows are then discounted to present value using a risk-adjusted discount rate.
56. Income approach is commonly used for the valuation of intangible assets like customer relationships and contracts, technology, non-competition agreements, leasehold rights, trademark, brand, etc. The income approach shall be applied in accordance with the requirements contained in ICAI Valuation Standard 103 *Valuation Approaches and Methods*.
57. Some of the common valuation methods under the income approach are as follows:
- (a) Relief-from-royalty-method;
 - (b) Multi-period Excess Earnings Method (MEEM);
 - (c) With-and-Without method or premium profit method;
 - (d) Greenfield method; and
 - (e) Distributor method

Relief-from-royalty-method

58. Under *relief-from-royalty-method*, the value of an intangible asset is determined by estimating the value of total costs saved that would have otherwise been paid by the user as royalty payments, if had

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been taken on lease from another party. Alternatively, it could also indicate the value of an intangible asset that could have fetched cash flows in the form of royalty payments, had it been leased to a third party. Any associated costs expected to be incurred by the licensee needs to be adjusted from the forecasted revenues.

59. The following are the major steps in the RFR method:
- (a) *obtain the projected income statement associated with the intangible asset to be valued over the remaining useful life of the said asset.* The value of the intangible asset to be valued is determined by first considering projections (of royalty income adjusted with associated expenses like maintenance or marketing) relevant to the intangible asset to be valued for its estimated useful life. Forecasted revenue is royalty computed as a percentage of revenue using an appropriate royalty rate.
 - (b) *analyse the projected income statement and its underlying assumptions to assess the reasonableness.*
 - (c) *select the appropriate royalty rate based on market-based royalty rates for similar intangible assets:* An appropriate royalty rate (which can be based on royalty rates of similar transactions or can be determined using the profit-split method).
 - (d) *apply the selected royalty rate to the future income attributable to the said asset:* The selected royalty rate is then applied to the cash flows so determined. Royalty rate should consider the features of the intangible asset to be valued relevant to the profit attributable to the intangible asset to be valued or the observed transactions to determine the royalty rate. Other factors that should be considered to determine the royalty rate are the significance of the intangible asset to be valued to its owner and the expected economic life of the intangible asset with any risks relating to obsolescence.
 - (e) *use the appropriate marginal tax rate or such other appropriate tax rate to arrive at an after-tax royalty savings.*
 - (f) *discount the after-tax royalty savings to arrive at the present value using an appropriate discount rate:* The value of the intangible asset to be valued is the present value of the after-tax

cash flows so computed by using an appropriate risk-adjusted discount rate.

- (g) Tax amortization benefit (TAB), if appropriate considering nature of the asset and purpose of the engagement, should be added to the overall value of the intangible asset.

Multi-period Excess Earnings Method (MEEM)

- 60. The MEEM is used to value an intangible asset which is the primary intangible asset of the business. For example, for valuation of two intangible assets, say customer contracts and intellectual property rights, MEEM should be considered for valuation of one of the intangible asset while the other intangible asset should be valued using another method, unless both intangible assets are significant for the business.
- 61. Under this method, the value of an intangible asset is equal to the present value of the incremental after-tax cash flows ('excess earnings') attributable to the intangible asset to be valued over its remaining useful life. In other words, it is the present value of the excess cash flows attributable to the intangible asset to be valued (based on attrition rate of customers) as adjusted by the associated expenses required for the generation of the cash flows and cash flows pertaining to contributory assets (assets that contribute to the cash flows relating to the intangible asset to be valued).
- 62. The following are the major steps in deriving a value using the MEEM:
 - (a) obtain the projections for the entity or the combined asset group over the remaining useful life of the said intangible asset to be valued from the client or the target to determine the future after-tax cash flows expected to be generated;
 - (b) analyse the projections and its underlying assumptions to assess the reasonableness of the cash flows;
 - (c) Contributory Asset Charges (CAC) or economic rents to be reduced from the total net after-tax cash flows projected for the entity/combined asset group to obtain the incremental after-tax cash flows attributable to the intangible asset to be valued;
 - (d) the CAC represent the charges for the use of an asset or group

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of assets (e.g., working capital, fixed assets, assembled workforce, other intangibles) based on their respective fair values and should be considered for all assets, excluding goodwill, that contribute to the realization of cash flows for the intangible asset to be valued;

- (e) discount the incremental after-tax cash flows attributable to the intangible asset to be valued to arrive at the present value using an appropriate discount rate; and
- (f) Tax amortisation benefit (TAB) can be appropriately built and added to the overall value of the intangible asset.

63. Contributory assets are assets that assist/support the intangible asset to be valued to generate cash flows and are used in combination with the intangible asset to be valued. Contributory asset charge (CAC) is widely used by the *valuers* and refers to the return on assets supporting the cash flow generation of the intangible asset to be valued. Contributory assets could be in the form of working capital, fixed assets, assembled workforce and any other intangible asset so considered and valued. An appropriate rate of return on each asset needs to be determined and shall be applied to the revenues to arrive at the CAC. The rate of return will depend on the nature of asset and is considered on post-tax basis.
64. For customer-based intangible assets, a *valuer* needs to consider attrition, which refers to the possible expected loss of customers which is based on the historical behavior of customers. Attrition can either be calculated using the mid-point convention (average of beginning and end of the year) or by considering the year-on-year customer count or change in revenue.

With-and-Without method

65. The value of an intangible asset using the With and Without Method (WWM) is computed by comparing the below-mentioned scenarios in which the business:
- (a) utilises the intangible asset to be valued ('With' scenario); and
 - (b) does not utilise the intangible asset to be valued ('Without' scenario).

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It should be noted that all other factors relating to valuation should remain constant.

66. **Under this method, the value of the intangible asset to be valued is equal to the present value of the difference between the projected cash flows over the remaining useful life of the asset under the following two scenarios :**
- (a) **business with all assets in place *including* the intangible asset to be valued; and**
 - (b) **business with all assets in place *except* the intangible asset to be valued.**
67. The following are the major steps in deriving a value using the WWM :
- (a) obtain the projections comprising revenue, expenses, working capital and capital expenditure under the following two scenarios:
 - (i) with scenario; and
 - (ii) without scenario.
 - (b) discounted the projections obtained under two scenarios to present value using an appropriate discount rate;
 - (c) difference between present value of cash flows under two scenarios is considered to be the value of the intangible asset. The difference so computed can also be probability-weighted depending on the likelihood of competition expected to affect the cash flows; and
 - (d) Tax amortisation benefit (TAB) can be appropriately built and added to the overall value of the intangible asset.
68. The value of the intangible asset can also be computed by determining the difference in the value of the business under 'with' and 'without' scenarios. The value of the intangible asset under both approaches, i.e. using difference in cash flows or business values, should be similar. Further, the discount rate used in both approaches shall be same.
69. This method is commonly used for valuation of non-compete agreements.

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Greenfield Method

70. The basic assumption for valuation using the greenfield method is that the intangible asset to be valued is the only asset with all other tangible or intangible assets being created, leased or acquired. Instead of the contributory asset charge generally deducted from the cash flows, a *valuer* is required to subtract replacement cost of the asset that is required to be built or bought.
71. The greenfield method is usually used to value franchise agreements and certain licenses.
72. The following are the major steps in deriving a value using the greenfield method:
 - (a) prepare cash flow projections with the premise that the intangible is the only asset in the business;
 - (b) project the related revenues, expenses, working capital and capital;
 - (c) project the amount and timing of expenditure relating to acquisition, creation or rentals of other assets required by the intangible asset to be valued;
 - (d) compute the present value of the net cash flows using an appropriate discount rate; and
 - (e) Tax amortisation benefit (TAB) can be appropriately built and added to the overall value of the intangible asset.

Distributor Method

73. This is a variation of MEEM and is adopted for valuation of customer-based intangible assets when MEEM is applied to value another intangible asset (considered to be more significant). The fundamental assumption used in this method is that cash flows of each segment of a particular business are expected to generate profits.
74. The following are the major steps in deriving a value using the distributor method:
 - (a) prepare revenue and expenses projections of existing customers relationships along with relevant attrition;

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- (b) determine profit margins of distributors who are comparable to the subject business and apply the same to the cash flows projected;
 - (c) determine the support of distributor contributory assets like working capital, fixed assets, workforce, etc;
 - (d) determine excess earnings after considering the contributory asset charges;
 - (e) compute the present value of cash flows using an appropriate discount rate; and
 - (f) calculate tax amortisation benefit, if appropriate and applicable, and add it to the value of the intangible asset to be valued.
75. Other than the methods explained above, there can be other methods that can be adopted to value intangibles, like Profit Premium method and Differential Cash Flows method.

Cost Approach

76. **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).**
77. Valuation of an intangible asset using the cost approach is based on the principle rule of substitution, i.e. the amount that will be required to create a new similar intangible asset as adjusted for any depreciation becomes the value of the intangible asset to be valued. This approach may not hold good when the intangible asset to be valued is not replaceable and is unique, e.g., patents, which is a unique intellectual property and cannot be perfectly recreated.
78. Cost method is commonly used to value acquired or internally generated intangible assets like software, technology, assembled workforce, etc. Also, cost approach is generally adopted when market and income approach cannot be applied. The cost approach should be used with discretion and generally for intangible assets that are not the primary business drivers and for which a market participant may not be willing to pay a significant premium.
79. The following are the commonly used valuation methods under the income approach:
- (a) Reproduction Cost Method;

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- (b) Replacement Cost Method.

Reproduction Cost Method

80. ***Reproduction Cost Method*** involves valuing an asset based on the cost that a market participant shall have to incur to recreate a replica of the asset to be valued, adjusted for obsolescence.
81. Under this method, the value of an intangible asset is the total cost (based on current prices) to produce an exact replica of the intangible asset to be valued. Nevertheless, since intangible assets are generally not developed (other than certain assets like software), any intangible asset that can be hypothetically developed using the same function and utility, can provide a value base for the intangible asset to be valued.
82. Costs to reproduce could include data-sets like direct costs, indirect costs, developer's profit for the intangible asset, etc. The cost obtained under this method shall be adjusted for any physical, functional or economical obsolescence.

Replacement Cost Method

83. ***Replacement Cost Method*** involves valuing an asset based on the cost that a market participant shall have to incur to recreate an asset with substantially the same utility (comparable utility) as that of the asset to be valued, adjusted for obsolescence.
84. Under this method, the value of an intangible asset is the total cost (based on current prices) to produce an asset similar to the intangible asset to be valued. Nevertheless, since intangible assets are generally not developed (other than certain assets like software), any intangible asset that can be hypothetically developed using the same function and utility, can provide a value base for the intangible asset to be valued. Costs to replace could include datasets like direct costs, indirect costs, developer's profit for the intangible asset, etc. The cost obtained under this method shall be adjusted for any physical, functional or economical obsolescence.

Effective Date

85. ICAI Valuation Standard 302 *Intangible Assets*, shall be applied for the valuation reports issued on or after 1st July, 2018.

ICAI Valuation Standard 303

Financial Instruments

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*The of the ICAI Valuation Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles. (This ICAI Valuation Standard should be read in the context of Framework for the Preparation of Valuation Report in accordance with ICAI Valuation Standards)*

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 supplements 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 Framework for the Preparation of Valuation Report in accordance with ICAI Valuation Standards.**

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Scope

4. **A valuer shall follow the requirement of this standard in 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, 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. **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.**
8. The principles contained in the other ICAI Valuation Standards also apply to valuation of financial instruments. This Standard provides additional guidance for the valuation of financial instruments.
9. 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.
10. 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 Methods

11. 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.
12. **In selection of the approach and method, a *valuer* shall also give due consideration to the control environment under which the entity and the instrument operates. The control environment consist the entity's internal governance and control objectives, procedures and their operating effectiveness with the objective of enhancing the reliance on the valuation process and outcome thereof. A *valuer*, if relying on valuation inputs provided by the entity, shall form independent opinion on the valuation control environment and factor outcome on the valuation method, approach, outcome and reporting thereof.**
13. 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.
14. 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.
15. 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

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detail to enable the user to understand the assumptions that impact the value of the instrument.

Market Approach

16. **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.**
17. 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.
18. 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.
19. Further, valuation techniques 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.
20. 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

21. **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.

22. In income approach, value of a financial instrument is determined based on the expected economic benefits by way of income, cash flows or cost savings 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.
23. The use of income approach especially the discounted cash flow model requires usage of present-value techniques that are deployed to ascertain the present value of future cash flows basis of certain assumptions. Paragraphs 37-39 of this Standard further elaborates on the considerations involving present value techniques.
24. Black-Scholes-Merton formula or a binomial model and similar other pricing models are examples of income approach, that incorporate present value techniques and reflect both the time value and the intrinsic value of an option.
25. In situations where a financial instrument does not give rise to committed contractual cash flows, an estimation of future cash flow basis of various available estimates would aid the income approach. A *valuer* shall follow detailed guidelines provided in ICAI Valuation Standard 103 for use of discounted cash flow model.
26. 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.

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Cost Approach

27. **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).**
28. 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 or construct a substitute asset of comparable utility.
29. The usage of cost method 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 Techniques and Inputs

30. **A *valuer* shall use valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure the value, maximising the use of relevant observable inputs and accordingly minimising the use of unobservable inputs.**
31. A *valuer* shall use valuation techniques 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. Valuation techniques differ in their application based on the three approaches mentioned in paragraphs 16-29 or sometimes even a combination thereof.
32. A *valuer* may choose basis of either a single valuation technique or a combination of multiple valuation techniques to perform the valuation. If multiple valuation techniques 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 techniques. A valuation of financial instrument measurement is the point within that range that is most representative of value in the circumstances.

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33. Once the valuation technique has been shortlisted and deployed, such valuation technique used for valuation shall be applied consistently. However, in certain circumstances a change in a valuation technique 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 technique 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;
 - (e) valuation techniques improvement; or
 - (f) market conditions change.
34. 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. In addition to that a *valuer* shall place a higher degree of emphasis on the entity control framework and integrity of data used in deriving the unobservable input.
35. A valuation technique 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 technique used to measure value or the risk inherent in the inputs to the valuation technique. It would be incorrect not to consider appropriate levels of risks inherent in valuation of financial instruments.
36. 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

37. **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.**
38. Paragraphs 21-26 of this Standard refers to income approach as a valuation approach/method.
39. 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 coincide with the period covered by the cash flows 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

40. One of an 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
41. 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

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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.

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- (f) *Offsetting*: If derivative instrument and underlying asset are held by counterparty, credit risk will reduce by offsetting it with counterparty.
42. Typically, valuation is carried on a controlling and marketable basis. The *valuer* shall make appropriate adjustments for minority and non-marketable instruments, while performing the valuation of an instrument. Higher the liquidity and control, lower would be the discount on valuation of the instrument.

Control Environment

43. The consideration for control environment in valuation of financial instruments gains enhanced importance in the event the valuation is based on unobservable inputs. Unobservable inputs and calculation models are usually prepared by the entity that owns or issues the financial instrument.
44. The control environment of an entity consists of the governance and control procedures that are set in place by an entity with the objective of increasing the reliance on the valuation process and conclusion.
45. A *valuer* placing reliance upon an internally performed valuation, shall consider the reliance on the control environment, its adequacy and independence.

Effective Date

46. ICAI Valuation Standard 303 *Financial Instruments*, shall be applied for the valuation reports issued on or after 1st July, 2018.