

Fast Track Webinar Series

for

IBBI Valuation Exam (2024 Syllabus)

Day 3

Intangible Assets

Phase 5 of IBBI Valuation Examinations w.e.f. 1st MAY 2024

**18th
Batch**



Wednesday ♦ 31st JAN 2024 ♦ 07:30 AM to 08:30 AM ♦ www.3spro.blogspot.com

CA Dr GOPAL KRISHNA RAJU

Chartered Accountant, Insolvency Professional, Registered Valuer & Arbitrator

Visiting Faculty, Indian Institute of Management

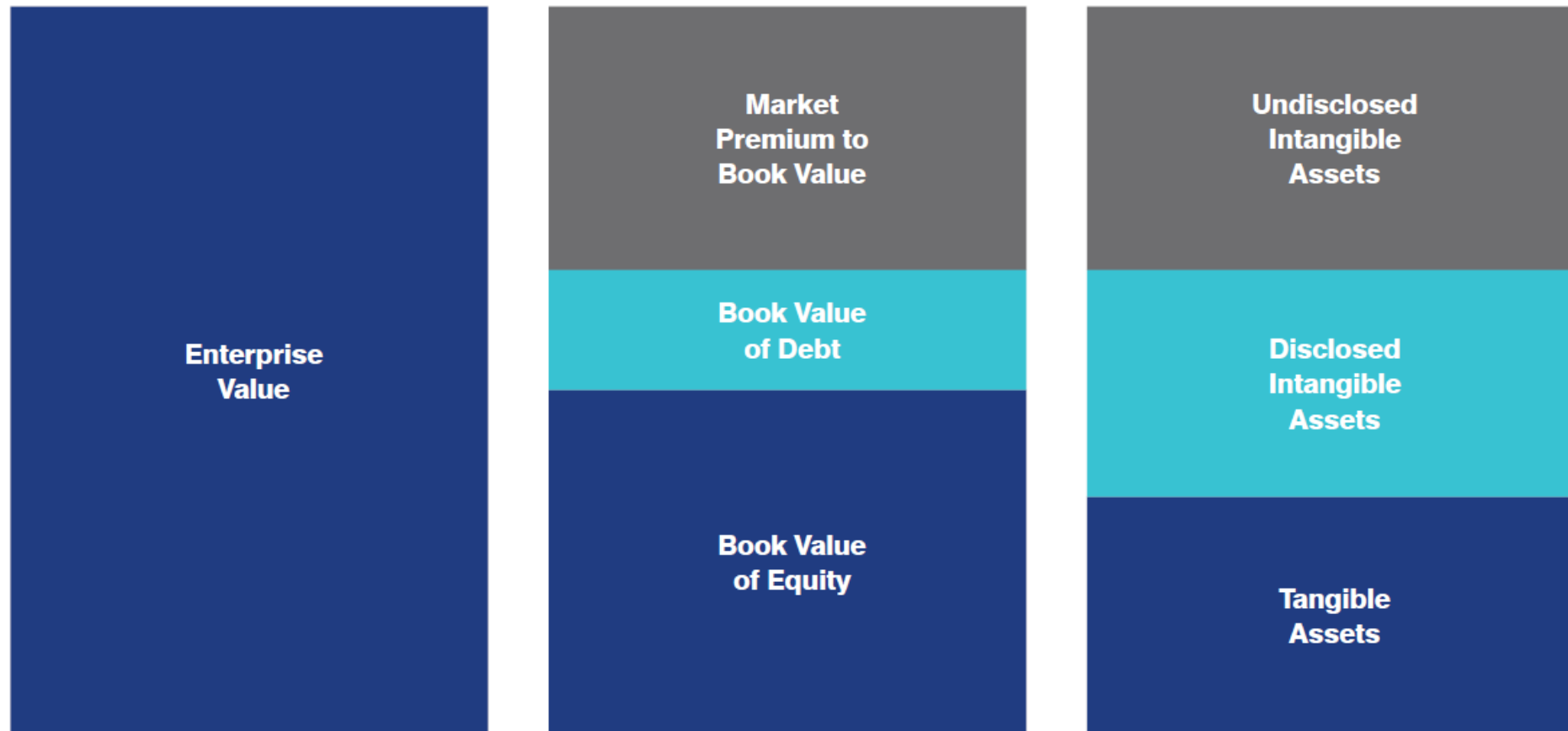
Intangible Assets – Syllabus – 5 Marks

Nature and classification of Intangibles	Nature and classification of Intangibles
Identification of nature of Intangible Assets	Life of Asset, Based on Function, Acquired or Internally generated, Generating Cash Flow Independently, Not generating cash flow Independently, Intangible Assets Under Development and Research Assets
Purpose of intangibles valuation	Financial reporting under Ind AS , Legal and tax reporting, Estate and Gift Tax, Amortization Allowance, Transfer of Standalone Intangible Assets, Transfer of Intangible Asset as part of Transaction, Collateral Lending, Franchises and Brand License Agreement, Insolvency/ Bankruptcy Purposes .
Valuation approaches	Excess earnings method, Relief-from-royalty method, Premium profit method, Greenfield method,
	Distributor method, Other valuation approaches as applicable, Rate of return and discount rate for Intangibles

Pointers for Valuation Exam (Topic: Intangible Assets)

- ✓ Minimum 5 to 8 marks
- ✓ Material to Read: [ICAIRVO_VS: 302](#) ; [IVS: 210](#) ; [IND AS 38](#)
- ✓ Technical Guide to Valuation (ICAI): Page 45 to 61
- ✓ Meaning of IA; Measurement, Recognition, Exchange of IA
- ✓ Types of IA
- ✓ Income Approach, Cost Approach, Market Approach
- ✓ Purpose of Valuation of IA
- ✓ After investing substantial amount of time and Himalayan size of Efforts, Research & Pain; this material is brought out. Your acknowledgement in the blog by few words will be an encouragement for this Hard Work

Breakdown of corporate assets, including intangibles



13 Intangible Cultural Heritage elements from India inscribed on UNESCO's List till date: Dr. Mahesh Sharma

- A total of 13 Intangible cultural heritage (ICH) elements from India have been inscribed till date on the UNESCO's Representative List of the Intangible Cultural Heritage of Humanity.
- The Ministry of Culture has appointed the Sangeet Natak Akademi, an autonomous organisation under the Ministry of Culture, as nodal office for matters relating to the intangible cultural heritage including for preparation of the nomination dossiers for the Representative List of UNESCO. The Sangeet Natak Akademi (SNA) accordingly makes necessary interaction with the stakeholders, experts/officials etc. prior to finalization of the dossier in respect of element identified for the nomination. Being the nodal office the SNA maintains a National Inventory of ICH elements and the inclusion of the identified element for UNESCO in the National Inventory/Register etc. of the applicant member state is also a pre-requisite for inclusion in the UNESCO's Representative List of ICH.

<u>S.No.</u>	<u>ICH Element</u>	<u>Year of Inscription</u>
1.	Tradition of Vedic chanting	2008
2.	Ramlila, the traditional performance of the Ramayana	2008
3.	Kutiyattam, Sanskrit theatre	2008
4.	Ramman, religious festival and ritual theatre of the Garhwal Himalayas, India	2009
5.	Mudiyettu, ritual theatre and dance drama of Kerala	2010
6.	Kalbelia folk songs and dances of Rajasthan	2010
7.	Chhau dance	2010
8.	Buddhist chanting of Ladakh: recitation of sacred Buddhist texts in the trans-Himalayan Ladakh region, Jammu and Kashmir, India	2012
9.	Sankirtana, ritual singing, drumming and dancing of Manipur	2013
10.	Traditional brass and copper craft of utensil making among the Thatheras of Jandiala Guru, Punjab, India	2014
11.	Yoga	2016
12.	Nawrouz, Novruz, Nowrouz, Nowrouz, Nawrouz, Nauryz, Nooruz, Nowruz, Navruz, Nevruz, Nowruz, Navruz	2016
13.	Kumbh Mela gkr@icai.org www.3spro.blogspot.com	2017

Ind AS 38 – Intangible Assets

Contents	Paragraph
Objective	1
Scope	2-7
Definitions	8-17
Recognition and Measurement	18-67
Recognition of an Expense	68-71
Measurement after Recognition	72-87
Useful Life	88-96

Ind AS 38 – Intangible Assets

Contents	Paragraph
Intangible asset with finite useful lives	97-106
Intangible asset with indefinite useful lives	107-110
Recoverability of the carrying amount— impairment losses	111
Retirement and disposals	112-117
Disclosure	118-127
Other information	128

IND AS 38 – Intangible Assets

- Paras 128
- Appendix A – Intangible Assets Web-site costs
- Appendix B – Reference to matters contained in Other IND AS
- Appendix 1 – IAS 38

ICAIRVO - IVS – A Comparison

ICAIRVO		IVS	
101	Definitions		Glossary
102	Valuation Bases	104	Bases of Value
103	Valuation Approaches & Methods	105	Valuation Approaches and Methods
201	Scope of Work, Analyses & Evaluation	101	Scope of Work
202	Reporting & Documentation	103	Reporting
301	Business Valuation	200	Business and Business Interests
302	Intangible Assets	210	Intangible Assets
303	Financial Instruments	500	Financial Instruments

1. Which of the following IVS deals with Intangible assets:

- a) IVS 200**
- b) IVS 210**
- c) IVS 400**
- d) IVS 500**

IND AS 38 - Definitions

Para 8

- An intangible asset is an identifiable non-monetary asset without physical substance.

IVS_210: Para 20.1.

An intangible asset is a non-monetary asset that manifests itself by its economic properties. It does not have physical substance but grants rights and/or economic benefits to its owner.

ICAIRVO_101: Para 6.19 Intangible Asset:

An intangible asset is an identifiable non-monetary asset without physical substance.

2. What are intangible assets as per IND AS 38?

- a) An Identifiable, Non-Monetary assets with physical substance**
- b) An Identifiable, Monetary assets without physical substance**
- c) An Identifiable, Non-monetary assets without physical substance**
- d) An Identifiable, Monetary assets with physical substance**

IVS 210: Para 20.2 - Differentiation

- Specific intangible assets are defined and described by characteristics such as their ownership, function, market position and image. These characteristics differentiate intangible assets from one another.
- There are many types of intangible assets, but they are often considered to fall into one or more of the following categories (or goodwill):

CATEGORIES OF INTANGIBLE ASSETS

Customer-based intangible assets

Marketing-based intangible assets

Contract-based intangible assets

Technology-based intangible assets

Artistic-based intangible assets

IVS 210 : Para 20.3(a) – **Market Related**

- (a) **Marketing-related:** Marketing-related intangible *assets* are used primarily in the marketing or promotion of products or services.
- **Examples** include trademarks, trade names, unique trade design and internet domain names.

ICAIRVO_302 : Para 20.

- Marketing-based intangible assets are created with the **evolvment of a business** and such intangibles are also used for **further growth of the business** through marketing.

Para 21 : The examples of marketing-based intangible assets are:

- (a) trademark;
- (b) brand;
- (c) trade name;
- (d) internet domain name; or
- (e) trade design.

IVS 210 : Para 20.3(b) – Customer Related

- (b) **Customer-related:** Customer-related intangible *assets* include *customer lists, backlog, customer contracts, and contractual and non-contractual customer relationships.*

ICAIRVO_302 : Para 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.

Para 19 : The examples of customer-based intangible assets are:

- (a) customer contracts;
- (b) customer relationships;
- (c) order backlog; or
- (d) customer lists.

IVS 210 : Para 20.3(c) – Artistic Related

- (c) **Artistic-related:** Artistic-related intangible *assets* arise from the right to benefits from artistic works such as *plays, books, films and music, and from non-contractual copyright protection.*

ICAIRVO_302: Para 26

Artistic-based intangible assets are created from the **benefit arising from artistic works.**

Para 27 : The examples of artistic-based intangible assets are:

- (a) films and music;
- (b) books;
- (c) plays; or
- (d) copyright (non-contractual).

IVS 210: Para 20.3(d) – Contract Related

- (d) **Contract-related:** Contract-related intangible *assets* represent the value of rights that arise from contractual agreements.
- **Examples** include *licensing and royalty agreements, service or supply contracts, lease agreements, permits, broadcast rights, servicing contracts, employment contracts and non-competition agreements and natural resource rights*.

ICAIRVO_302: Para 22.

Contract-based intangible assets are created from **rights arising from contracts** in a business.

Para 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.

IVS 210: Para 20.3(e) – Technology Related

- (e) **Technology-based:** Technology-related intangible *assets* arise from *contractual or non-contractual rights to use patented technology, unpatented technology, databases, formulae, designs, software, processes or recipes.*

ICAIRVO_302 : Para 24

Technology-based intangibles are those intangible assets that **create propriety knowledge.**

Para 25 : The examples of Technology-based intangible assets are:

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

3. Which type of Intangible Assets are created with an entity establishing relationships with its customers in the due course of its business:

- a) Marketing-based**
- b) Customer-based**
- c) Artistic-based**
- d) Technology-based**

ICAIRVO_302 : Para 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.**

4. Customer-based intangibles may be:

- a) Contractual
- b) Non-contractual
- c) Either (a) or (b)
- d) Both (a) and (b)
- e) NOTA

ICAIRVO_302 :

Para 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.

5. Which type of Intangible Assets include customer lists, backlog, contracts, and contractual and non-contractual customer relationships:

- a) Marketing-based**
- b) Customer-based**
- c) Artistic-based**
- d) Technology-based**

ICAIRVO_302 :

Para 19.

The examples of customer-based intangible assets are:

- (a) customer contracts;
- (b) customer relationships;
- (c) order backlog; or
- (d) customer lists.

6. Which of the following is **not a example of customer based intangible assets?**

- a) Backlog**
- b) Customer relationship**
- c) Customer contracts**
- d) Trademark**

**7. Which type of Intangible assets are created with the
evolvment of a business and such intangible are also
used for further growth of the business through
marketing:**

- a) Marketing-based**
- b) Customer-based**
- c) Artistic-based**
- d) Technology-based**

ICAIRVO_302 : Para 20.

Marketing-based intangible assets are created with the **evolvment of a business** and such intangibles are also used for **further growth of the business** through marketing.

Relative Value

- Relative valuation models constitute the second broad type of going-concern valuation models.
- **Relative valuation models** estimate an asset's value relative to that of another asset.
- The idea underlying relative valuation is that similar assets should sell at similar prices, and relative valuation is typically implemented using price multiples (ratios of stock price to a fundamental such as cash flow per share) or enterprise value multiples (ratios of the total value of common stock and debt net of cash and short-term investments to a fundamental such as operating earnings).

8. Which of the following method, under Market Approach, would you consider **appropriate while valuing the intangible assets?**

- a) Multiple**
- b) Relative**
- c) Consistent**
- d) Exclusive**

9. Which of the following is **not an example of Market-related intangible assets:**

- a) Trademark**
- b) Brand**
- c) Internet domain name**
- d) Lease agreement**

ICAIRVO_VS 302: Para 21 : The examples of marketing-based intangible assets are:

- (a) trademark;
- (b) brand;
- (c) trade name;
- (d) internet domain name; or
- (e) trade design.

10. Which intangible assets arise from the **right to benefits** from artistic works:

- a) Marketing-based
- b) Customer-based
- c) Artistic-based
- d) Technology-based

ICAIRVO_302: Para 26

Artistic-based intangible assets are created from the **benefit arising from artistic works.**

Para 27 : The examples of artistic-based intangible assets are:

- (a) films and music;
- (b) books;
- (c) plays; or
- (d) copyright (non-contractual).

11. Which intangible assets include plays, books, films and music, and from non-contractual copyright protection etc:

- a) Marketing-based**
- b) Customer-based**
- c) Artistic-based**
- d) Technology-based**

Ind AS 38 - Recognition and measurement

Para 44: Acquisition by way of a government grant

- In some cases, an intangible asset may be acquired free of charge, or for nominal consideration, by way of a government grant. This may happen when a government transfers or allocates to an entity intangible assets such as airport landing rights, licences to operate radio or television stations, import licences or quotas or rights to access other restricted resources.
- In accordance with Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance, an entity recognises both the intangible asset and the grant initially at fair value.

12. An intangible asset acquired free of charge, or for nominal consideration, such as *airport landing rights, licences to operate radio or television stations, import licences or quotas or rights to access other restricted resources*, by way of a government grant; then an entity may choose to recognise both the intangible asset and the grant initially at

- a) Fair value**
- b) Cost price**
- c) Market Value**
- d) Nominal Cost**

13. Under which method are those intangible assets that create propriety knowledge:

- a) Technology-based
- b) Customer-based
- c) Artistic-based
- d) Contract-based

ICAIRVO_302 : Para 24

Technology-based intangibles are those intangible assets that create propriety knowledge.

Para 25 : The examples of Technology-based intangible assets are:

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

14. Which Intangible Assets include patented technology, unpatented technology, databases, formulae, designs, software, processes or recipes:

- a) Marketing-related**
- b) Customer-related**
- c) Artistic-based**
- d) Technology-related**

IVS_210 : Para 40.1 : Valuation Approaches and methods

- **The three principal valuation approaches described in IVS 105 Valuation Approaches can all be applied to the valuation of intangible assets.**

ICAIRVO_302: Para 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.**

15. Which of the following approach(es) is/are used for valuation of intangible assets?

- a) Income approach**
- b) Cost approach**
- c) Market approach**
- d) All of the above**
- e) Any of the above**

IVS_210 : Para 70.3

Consistent with these criteria, the cost approach is commonly used for intangible assets such as the following:

- **(a) acquired third-party software,**
- **(b) internally-developed and internally-used, non-marketable software, and**
- **(c) assembled workforce.**

16. The cost approach is commonly used for intangible assets such as the following:

- a) Acquired third-party software**
- b) Internally-developed and Internally-used, Non-marketable software**
- c) Assembled workforce**
- d) All of the above**

ICAIRVO_302 : Para 42 to 84

VALUATION APPROACHES AND METHODS

Market Approach

Price /Valuation multiples/Capitalisation rates

Guideline pricing method

Income Approach

Relief from Royalty (RFR) Method

Multi-Period Excess Earnings Method (MEEM)

With and Without Method (WWM)

Greenfield Method

Distributor Method

Cost Approach

Reproduction Cost Method

Replacement Cost Method

17. Which of the following is **not a method under the **income approach** to valuation of intangible assets?**

- a) Greenfield method**
- b) Comparable transaction method**
- c) With-or-without method**
- d) Relief from royalty method**

IND AS – 38 Recognition and measurement

Para 48 : Internally generated goodwill

- Internally generated goodwill shall not be recognised as an asset

Para 49 : Why

- In some cases, expenditure is incurred to generate future economic benefits, but it does not result in the creation of an intangible asset that meets the recognition criteria in this Standard.
- Such expenditure is often described as contributing to internally generated goodwill.
- Internally generated goodwill is not recognised as an asset because it is not an identifiable resource (*i.e. it is not separable nor does it arise from contractual or other legal rights*) controlled by the entity that can be measured reliably at cost.

IND AS – 38 Recognition and measurement

Para 50 : What is Internally generated Goodwill

- Differences between the market value of an entity and the carrying amount of its identifiable net assets at any time may capture a range of factors that affect the value of the entity.
- However, such differences do not represent the cost of intangible assets controlled by the entity.

18. An per IND AS 38, internally generated goodwill

- a) Shall be recognized as an asset**
- b) Shall not be recognized as an asset**
- c) Shall be recognized as non-current asset**
- d) Shall not be recognized as a current asset**

19. In IND AS 38; The residual value of an intangible asset with a finite useful life shall be assumed to be

- a) Carrying Cost**
- b) Zero**
- c) Cost to Disposal**
- d) Value in Use**

IND AS – 38 Recognition and measurement

Para 21

An intangible asset shall be recognised if, and only if:

- (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and
- (b) the cost of the asset can be measured reliably.

20. An intangible asset shall be recognized if :

- a) It can be recognized as and when expenditure incurred**
- b) The cost is uncertain**
- c) It is probable that expected future economic benefit that are attributable to the assets will flow to the entity and the cost of assets can be measured reliably**
- d) There is remote possibility of future economic benefit**

IND AS – 38 Recognition and measurement

Para 22

- An entity shall assess the probability of expected future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.

IND AS – 38 Recognition and measurement

Para 23

- **An entity uses judgement to assess the degree of certainty attached to the flow of future economic benefits that are attributable to the use of the asset on the basis of the evidence available at the time of initial recognition, giving greater weight to external evidence.**

21. An entity shall assess the probability of expected future economic benefit using reasonable and supportable assumption that represent of the set of economic conditions that will exist over the useful life of the asset

- a) Market's best estimate**
- b) Registered Valuer's best estimate**
- c) Management's best estimate**
- d) Auditor's best estimate**

IND AS – 38

Review of amortisation period and amortisation method

Para 104

- The amortisation period and the amortisation method for an intangible asset with a finite useful life shall be reviewed at least at each financial year-end.
- If the expected useful life of the asset is different from previous estimates, the amortisation period shall be changed accordingly.
- If there has been a change in the expected pattern of consumption of the future economic benefits embodied in the asset, the amortisation method shall be changed to reflect the changed pattern.
- Such changes shall be accounted for as changes in accounting estimates in accordance with Ind AS 8.

22. How often should the useful life of intangible asset with a finite useful life be reviewed:

- a) Every year**
- b) Every Three years**
- c) Every Five years**
- d) Every Ten years**

Recognition and measurement

Para 45 : Exchanges of assets

- One or more intangible assets may be acquired **in exchange for a non-monetary asset or assets, or a combination of monetary and nonmonetary assets.**
- The following discussion refers simply to an exchange of **one non-monetary asset for another**, but it also applies to all exchanges described in the preceding sentence.

Para 45 : Fair Value...

The **cost of such an intangible asset is measured at fair value unless**

- (a) the exchange transaction lacks commercial substance or
- (a) the fair value of **neither** the asset received **nor** the asset given up is reliably measurable. The acquired asset is measured in this way even if an entity cannot immediately derecognise the asset given up. **If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.**

Para 46 : What is Commercial Substance

An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

- (a) the configuration (i.e. risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or
- (b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and
- (c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

Para 46 : Exchange

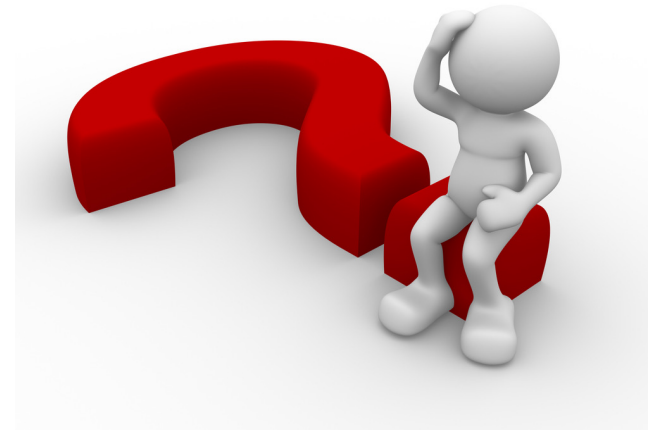
- For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post-tax cash flows.
- The result of these analyses may be clear without an entity having to perform detailed calculations.

Ind AS 38: Para 8

Entity-specific value is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.

23. If an intangible asset is **exchanged for another, the cost of intangible assets are measured at:**

- a) Fair value**
- b) Cost price**
- c) Market price**
- d) Acquisition price**



Para 60.5 : Income Approach Methods

There are many income approach methods. The following methods are discussed in this standard in more detail:

- (a) excess earnings method,**
- (b) relief-from-royalty method,**
- (c) premium profit method or with-and-without method,**
- (d) greenfield method, and**
- (e) distributor method.**

Income Approach



Important

Type	Intangible Assets
✓ MEEM	Primary IA (Technology)
✓ RFR	Licensing vs. Owning IA (Brand, Know-how)
✓ WWM	Non-Compete Agreements
✓ Greenfield	Franchise Agreements
✓ Distributor	Secondary IA (Customer Relationships/List)

24. Which of the following is/are income approach methods?

- a) Excess earnings method**
- b) Relief-from-royalty method**
- c) Premium profit method or with-and-without method**
- d) AOTA**

ICAIRVO_302: Intangible Assets

Para 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.

Para 69.

- This method is commonly used for valuation of **non-compete agreements**.

IVS_210 : Para 60.25.

The with-and-without method is frequently used in the valuation of **non-competition agreements** but may be appropriate in the valuation of other intangible assets in certain circumstances.

25. The with-and-without method is frequently used in the valuation of:

- a) Non-competition agreements**
- b) Technology**
- c) Customer-related intangibles (e.g., backlog, contracts, relationships),**
- d) Trade names/trademarks/brands**

IVS 210 : Para 60.33 : Distributor Method

- The distributor method, sometimes referred to as the disaggregated method, is a variation of the multi-period excess earnings method sometimes used to value customer-related intangible assets.
- The underlying theory of the distributor method is that businesses that are comprised of various functions are expected to generate profits associated with each function.
- As distributors generally only perform functions related to distribution of products to customers rather than development of intellectual property or manufacturing, information on profit margins earned by distributors is used to estimate the excess earnings attributable to customer-related intangible assets.

IVS 210: Para 60.34

- The distributor method is appropriate to value customer-related intangible assets when another intangible asset (for example, technology or a brand) is deemed to be the primary or most significant intangible asset and is valued under a multi-period excess earnings method (MEEM)

26. The distributor method is appropriate to value WHICH Intangible Assets when another intangible asset (for example, technology or a brand) is deemed to be the primary or most significant intangible asset and is valued under a multi-period excess earnings method:

- a) Customer-related**
- b) Marketing-related**
- c) Artistic-related**
- d) Contract-related**

IVS_210 : Para 60.29 : Greenfield Method

- Under the greenfield method, the value of the subject intangible is determined using cash flow projections that assume the only asset of the business at the valuation date is the subject intangible.
- All other tangible and intangible assets must be bought, built or rented.

Para 60.30

- The greenfield method is conceptually similar to the excess earnings method. However, instead of subtracting contributory asset charges from the cash flow to reflect the contribution of contributory assets, the greenfield method assumes that the owner of the subject asset would have to build, buy or rent the contributory assets. When building or buying the contributory assets, the cost of a replacement asset of equivalent utility is used rather than a reproduction cost.

Para 60.31

- The greenfield method is often used to estimate the value of "enabling" intangible assets such as franchise agreements and broadcast spectrum.

27. The green field method is often used to estimate the value of “enabling” intangible assets such as:

- a) Franchise agreements**
- b) Broadcast spectrum**
- c) Both a and b**
- d) None of the above**

IVS_201 : Para 50.6

Examples of intangible assets for which the market approach is sometimes used include:

- ✓ (a) broadcast spectrum,
- ✓ (b) internet domain names, and
- ✓ (c) taxi medallions.

28. Which is/are an example of intangible assets for which the market approach is sometimes used?

- a) Broadcast spectrum**
- b) Internet domain names**
- c) Taxi medallions**
- d) All of the above**

IVS 210 – Intangible Assets

Contents	Paragraph
Overview	10
Introduction	20
Bases of Value	30
Valuation Approaches & Methods	40
Market Approach	50
Income Approach	60

Contents	Paragraph
Cost Approach	70
Special Considerations for Intangible Assets	80
Discount Rate / Rates of Return for Intangible Assets	90
Intangible Asset Economic Life	100
Tax Amortization Benefit	110

Para 20.5

- Particularly in valuing an intangible asset, valuers **must** understand specifically what needs to be valued and the purpose of the valuation.
- *For example, customer data (names, addresses, etc) typically has a very different value from customer contracts (those contracts in place on the valuation date) and customer relationships (the value of the ongoing customer relationship including existing and future contracts).*
- What intangible assets need to be valued and how those intangible assets are defined may differ depending on the purpose of the valuation, and the differences in how intangible assets are defined can lead to significant differences in value.

Para 20.6 : **Goodwill**

- Generally, goodwill is any future economic benefit arising from a business, an interest in a business or from the use of a group of assets which has not been separately recognised in another asset.
- The value of **goodwill is typically measured as the residual amount remaining after the values of all identifiable tangible, intangible and monetary assets, adjusted for actual or potential liabilities, have been deducted from the value of a business.**

Para 20.6 : Excess Paid

- It is often represented as the excess of the price paid in a real or hypothetical acquisition of a company over the value of the company's other identified assets and liabilities.
- For some purposes, goodwill may need to be further divided into transferable goodwill (that which can be transferred to third parties) and non-transferable or "personal" goodwill.

Para 20.10 : Purpose

- ✓ **Intangible asset valuations are performed for a variety of purposes.** It is the valuer's responsibility to understand the purpose of a valuation and whether intangible assets should be valued, whether separately or grouped with other assets.
- ✓ A **non-exhaustive** list of examples of circumstances that commonly include an intangible asset valuation component is provided below:
 - (a) For **financial reporting** purposes, valuations of intangible assets are often required in connection with accounting for business combinations, asset acquisitions and sales, and impairment analysis.

- (b) For **tax reporting** purposes, intangible asset valuations are frequently needed for transfer pricing analyses, estate and gift tax planning and reporting, and ad valorem taxation analyses.
- (c) Intangible assets may be the **subject of litigation**, requiring valuation analysis in circumstances such as shareholder disputes, damage calculations and marital dissolutions (divorce).
- d) Other **statutory** or **legal** events may require the valuation of intangible assets such as compulsory purchases/eminent domain proceedings.
- (e) Valuers are often asked to value intangible assets as part of **general consulting**, **collateral lending** and **transactional support** engagements.

29. Intangible asset valuations are performed for a variety of purposes includes:

- a) Statutory or legal events**
- b) General consulting**
- c) Subject of litigation**
- d) AOTA**

ICAIRVO_302: Intangible Assets : Para 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;

Para 2...

- (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
- (j) issuance of sweat equity shares which are generally issued against technical knowhow/ technical expertise/intellectual property.

30. Which of the following areas where intangible assets is required to be valued; except

- a) Bankruptcy / Restructuring**
- b) Non-Financial Liabilities**
- c) Insurance, such as determining the personal worth of a celebrity / football franchise / cricket franchise**
- d) Transaction (mergers & acquisition) when the subject is the intangible itself, such as a brand / telecom license**



Multi-Period Excess Earnings Method (MEEM)

- The MEEM is a variation of discounted cash-flow analysis. Rather than focusing on the whole entity, the MEEM isolates the cash flows that can be associated with a single intangible asset and measures fair value by discounting them to present value.
- The MEEM tends to be applied when one asset is the primary driver of a firm's value and the related cash flows can be isolated from the firm's overall cash flows.
- **Early stage enterprises and technology firms are prime candidates for this approach.**
- Computer software and customer relationships are among the sorts of assets that frequently generate such cash flows and could be assessed with fair value measurement using the MEEM.

IVS 210: Section 60

Para 60.6 : Excess Earning Method

- The excess earnings method estimates the value of an intangible asset as the present value of the cash flows attributable to the subject intangible asset after excluding the proportion of the cash flows that are attributable to other assets required to generate the cash flows (“contributory assets”). It is often used for valuations where there is a requirement for the acquirer to allocate the overall price paid for a business between tangible assets, identifiable intangible assets and goodwill.

31. WHICH method estimates the value of an intangible asset as the present value of the cash flows attributable to the subject intangible asset after excluding the proportion of the cash flows that are attributable to other assets required to generate the cash flows (contributory assets)

- a) Excess Earnings Method**
- b) Relief for Royalty Method**
- c) Greenfield Method**
- d) With-or-Without Method**

The MEEM usually involves the following steps:

1. Projecting financial information (PFI) — cash flows, revenue, expenses, etc. — for the entity.
2. Subtracting the cash flows attributable to all other assets through a contributory asset charge (CAC). The CAC is a form of economic rent for the use of all other assets in generating total cash flows that is composed of the required rate of return on all other assets and an amount necessary to replace the fair value of certain contributory intangible assets.
3. Calculating the cash flows attributable to the intangible asset subject to valuation and discount them to present value.

32. The distinguishing characteristic of a contributory asset (in valuation of Intangible Asset using excess-earnings method) is

- a) It is the Subject Income-Generating Asset**
- b) It supports Income-Generating Asset**
- c) It is irrelevant**
- d) NOTA**

- The distinguishing characteristic of a contributory asset is that it is **not** the subject income-generating asset itself; rather it is an asset that is required to support the subject income-generating asset.
- The CAC represents the charge that is required to compensate for an investment in a contributory asset, giving consideration to rates of return required by market participants investing in such assets.

Contributory Assets

- Contributory assets are defined as assets that are used in conjunction with the subject intangible asset in the realization of prospective cash flows associated with the subject intangible asset.
- Assets that do not contribute to the prospective cash flows associated with the subject intangible asset are not contributory assets.
- ✓ For example, a certain amount of real property (land and buildings) may be necessary to support the cash flow attributable to a subject intangible asset.
- X Alternatively, land held by an entity for investment (a non-operating asset) would not be appropriate to include as a contributory asset if the land is not necessary for, or expected to contribute to, the generation of the prospective cash flows of the subject intangible asset.

		2011	2012	2013	2014	2015	Residual	
Revenues	1	71	99	104	109	115	121	
COGS	2							
Operations		7	9	10	10	10	10	
Development		12	12	13	13	13	14	
S&M	3	33.3% 4	3	4	4	5	5	
G&A		2	2	2	2	3	3	
EBIT		47	71	75	80	84	89	
Taxes		16	25	26	28	30	31	
Brand		2.3%	2	2	2	3	3	
Content		27.3%	19	27	30	31	33	
License	6	0.8%	1	1	1	1	1	
Workforce		0.3%	0	0	0	0	0	
PP&E		0.0%	-	-	-	-	-	
Working Capital		0.7%	0	1	1	1	1	
Cashflow		8	15	16	17	19	20	
Long-term Growth	2.5%							
Residual							145	
Discount Periods		0.5	1.5	2.5	3.5	4.5	4.5	
Discount Factor	7	16.5%	0.93	0.80	0.68	0.59	0.50	
Present Value		8	12	11	10	9	73	
							Total	123
							TAB	18
							Fair Value	141

Contributory Assets

- The types of asset categories required to support the cash flows associated with a subject intangible asset are based on the facts and circumstances of the entity and the subject intangible asset.
- The asset categories and examples of their components that might be considered as contributory assets are illustrated in the following table:

Asset Category	Illustrative Components
Working Capital ²	Cash, Receivables, Inventory, Payables, Accruals
Fixed (Tangible) Assets	Real Property, Machinery and Equipment, Furniture and Fixtures
Intangible Assets	Trademarks and Trade Names, Technology, Software, Customer Relationships, Non-Compete Agreements, Assembled Workforce ³

Pointers.....

What is a bottom-up beta?

Answer - De-levering & Re-levering

- A bottom-up beta is estimated by starting with the businesses that a firm is in, estimating the fundamental risk or beta of each of these businesses and taking a weighted average of these risks.
- A **bottom-up beta** is estimated from the **betas** of firms in a specified business, thereby addressing problems associated with computing the cost of capital. First, by eliminating the need for historical stock prices to estimate the firm's **beta**, the standard error, created by regression **betas**, is reduced.

1. **Beta unleveraged** = **Beta levered** / $(1 + (1 - \text{tax rate}) * (D/E \text{ of comparable}))$

2. **Beta firm** = **Beta unleveraged** * $(1 + (1 - \text{tax rate}) * (D/E \text{ of firm}))$

This is called as levered bottom-up Beta

Pointers.....

What are the steps involved in estimating bottom-up betas?

There are four steps:

- **Step 1:** Break down your company into the businesses that it operates in. *{A firm A Ltd operates in 26 businesses but B Ltd is a single business company. Do not define your business too narrowly or you will run into trouble in step 2}*
- **Step 2:** Estimate the risk (beta) of being in each business. This beta is called an asset beta or an unlevered beta.
- **Step 3:** Take a weighted average of the unlevered betas of the businesses you are in, weighted by how much value you get from each business.
- **Step 4:** Adjust the beta for your company's financial leverage (Debt to equity ratio)

Bottom-up Beta

33. Company X is a non-listed private company. Here are some details available

✓ Total Debt	<i>20 Lakhs</i>
✓ Total Equity	<i>50 Lakhs</i>
✓ Debt to Equity ratio	<i>40%</i>
✓ Tax rate	<i>30%</i>

The comparable company is publicly listed and its beta are calculated. You found that **Company A** is very similar in nature with Company X.

Company A is operating in the same industry and it has the same product line and risk profile as **Company X**.

You have collected the following data about the comparable company:

- **Total Debt** *40 Lakhs*
- **Total Equity** *80 Lakhs*
- **Debt to Equity ratio** *50%*
- **Tax rate** *35%*
- **Calculated β** *1.2 (Levered)*

33A. Unlevered Beta Formula:

a) $\beta_u = \beta_l * [1 + (1 + \text{tax rate}) / (D / E)]$

b) $\beta_u = \beta_l / [1 + (1 - \text{tax rate}) x (D / E)]$

c) $\beta_u = \beta_l * [1 + (1 - \text{tax rate}) x (D / E)]$

d) $\beta_u = \beta_l * [1 + (1 + \text{tax rate}) x (D / E)]$

33B. Unlevered Beta of Company A:

a) 0.81

b) 0.91

c) 1.01

d) 1.11

33C. Levered Beta of Company X:

a) 1.10

b) 1.53

c) 1.05

d) 1.17

34. ABC Company has a debt-to-equity ratio of 25% and a marginal tax rate of 25%. The average unlevered β of comparable companies is 1.1. The levered β of the company should be:

- A. 0.8928**
- B. 1.1652**
- C. 1.2743**
- D. 1.3063**

Statement Showing Summary of Intangible Assets

Valuation Approach

Asset	Primary	Secondary	Tertiary
Patents	Income	Market	Cost
Technology	Income	Market	Cost
Copyrights	Income	Market	Cost
Assembled Workforce	Cost	Income	Market
Internally Developed Software	Cost	Market	Income
Brand Name	Income	Market	Cost
Customer Relationships	Income	Cost	Market

35. An intangible asset shall be measured initially at ...

- a) Fair Value**
- b) Market Value**
- c) Going Concern Value**
- d) Cost**

36. To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classify/ies the generation of the asset into:

- a) A Research Phase**
- b) A Development Phase**
- c) Either (a) or (b)**
- d) Both (a) and (b)**

37. An entity shall choose as its accounting policy for Intangible Assets

- a) Cost Model**
- b) Revaluation Model**
- c) Either (a) or (b)**
- d) Both (a) and (b)**

38. An intangible asset shall be regarded by the entity as having an useful life when, based on an analysis of all of the relevant factors, there is **no foreseeable limit** to the period over which the asset is expected to generate net cash inflows for the entity.

- a) Infinite
- b) Indefinite
- c) Indeterminate
- d) Unlimited

IVS 210 : Section 60

Para 60.18 : Relief-from-Royalty Method

- Under the relief-from-royalty method, the value of an intangible asset is determined by reference to the value of the hypothetical royalty payments that would be saved through owning the asset, as compared with licensing the intangible asset from a third party.
- Conceptually, the method may also be viewed as a discounted cash flow method applied to the cash flow that the owner of the intangible asset could receive through licensing the intangible asset to third parties.

39. Under WHICH method, the value of an intangible asset is determined by reference to the value of the hypothetical fee payments that would be saved through owning the asset, as compared with licensing the intangible asset from a third party.

- a) Excess Earnings Method**
- b) Relief for Royalty Method**
- c) Greenfield Method**
- d) With-or-Without Method**

IVS 210: Section 100

IA Economic Lives

Para 100.1 – EL vs. RUL

- An important consideration in the valuation of an intangible asset, particularly under the income approach, is the economic life of the asset.
- This **may** be a finite period limited by legal, technological, functional or economic factors; other assets may have an indefinite life.
- *The **economic life** of an intangible asset is a different concept than the **remaining useful life** for accounting or tax purposes.*

40. An important consideration in the valuation of an intangible asset, particularly under the income approach, is the of the asset.

- a) Remaining Useful Life**
- b) Economic Life**
- c) Amortization Period**
- d) Higher of (a) or (b)**

41. The weighted average return on assets, or WARA, is the collective rates of return on the various types of tangible and intangible assets of a company. Therefore....

- a) $WARA > WACC$**
- b) $WARA = WACC$**
- c) $WARA < WACC$**
- d) WARA and WACC are not comparable**

42. Income Approach valuation techniques includes, the following, except:

- a) present value techniques**
- b) option pricing models, such as the Black-Scholes-Merton formula or a binomial model (i.e. a lattice model), that incorporate present value techniques and reflect both the time value and the intrinsic value of an option**
- c) the multi-period excess earnings method, which is used to measure the fair value of some intangible assets**
- d) Sum of the Parts technique**

43. While identifying the contributory assets that are needed to achieve the forecasted revenue and expenses; contributory assets often include the following; except

- a) Working Capital**
- b) Fixed Assets**
- c) Assembled Workforce**
- d) Subject Intangible Asset**

44. Under WHICH method, it is viewed as a discounted cash flow method applied to the cash flow that the owner of the intangible asset could receive through **licensing the intangible asset to third parties.**

- a) Excess Earnings Method**
- b) Relief for Royalty Method**
- c) Greenfield Method**
- d) With-or-Without Method**

45. In the, Tax Amortisation Benefit needs to be explicitly calculated and included, if appropriate.

- a) Cost Approach**
- b) Income Approach**
- c) Market Approach**
- d) Asset Approach**

46. In Valuation engagements, involving valuation of all assets of a business, the valuer should perform a analysis to confirm reasonableness of selected discount rates.

- a) Weighted Average Cost of Capital (WACC)**
- b) Weighted Average Return on Assets (WARA)**
- c) Internal Rate of Return (IRR)**
- d) Any of the Above (AOTA)**

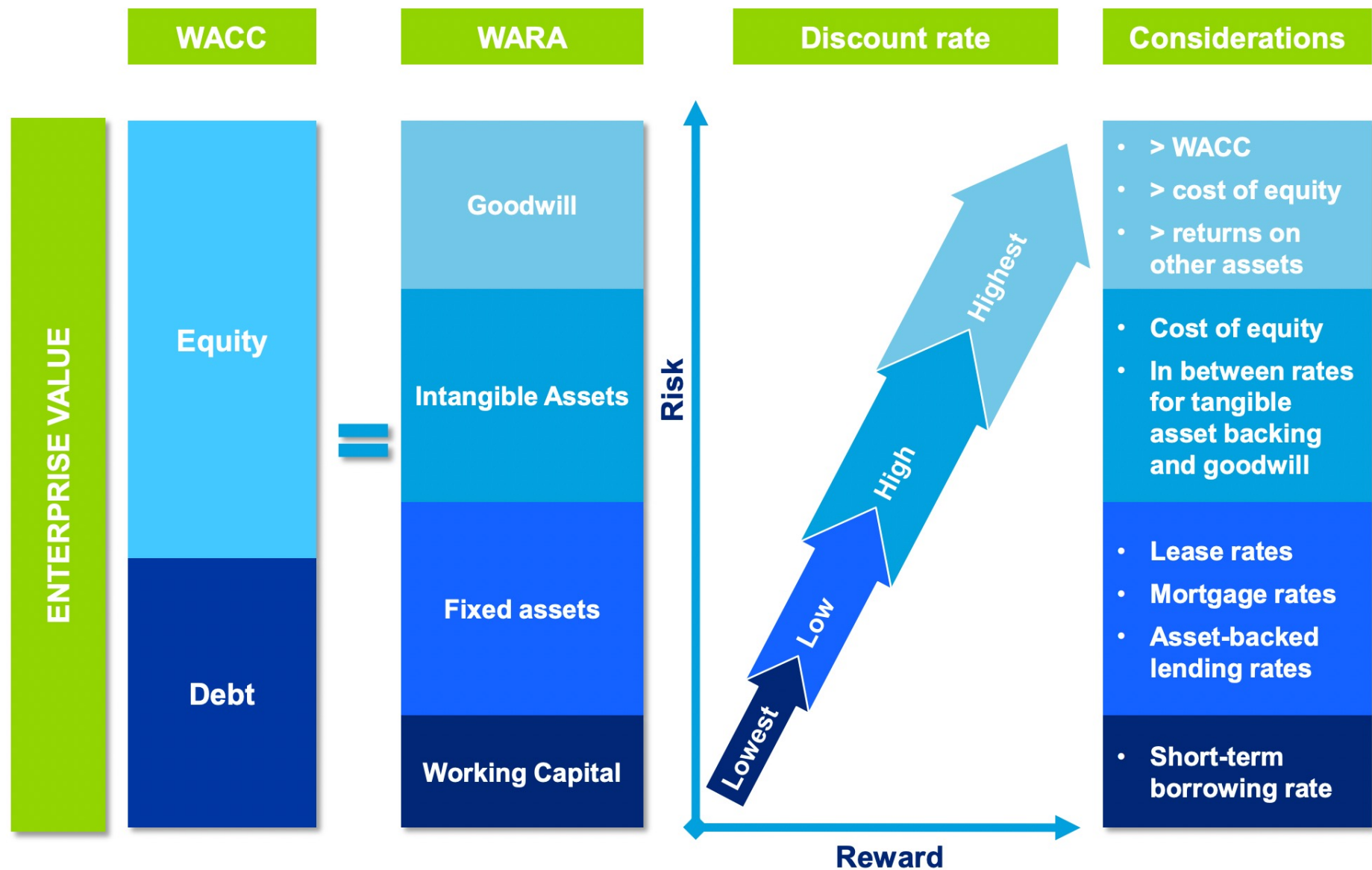
47. The method is appropriate to value **customer-related intangible assets when another intangible asset (for example, technology or a brand) is deemed to be the primary or most significant intangible asset and is valued under a multi-period excess earnings method.**

- a) Relief for Royalty Method**
- b) Greenfield Method**
- c) With-or-Without Method**
- d) Distributor Method**

48. Which Intangible Asset having different valuation as per IVS 210?

- a) Goodwill**
- b) Royalty**
- c) Trade Mark**
- d) Copyright**

Discount rate considerations



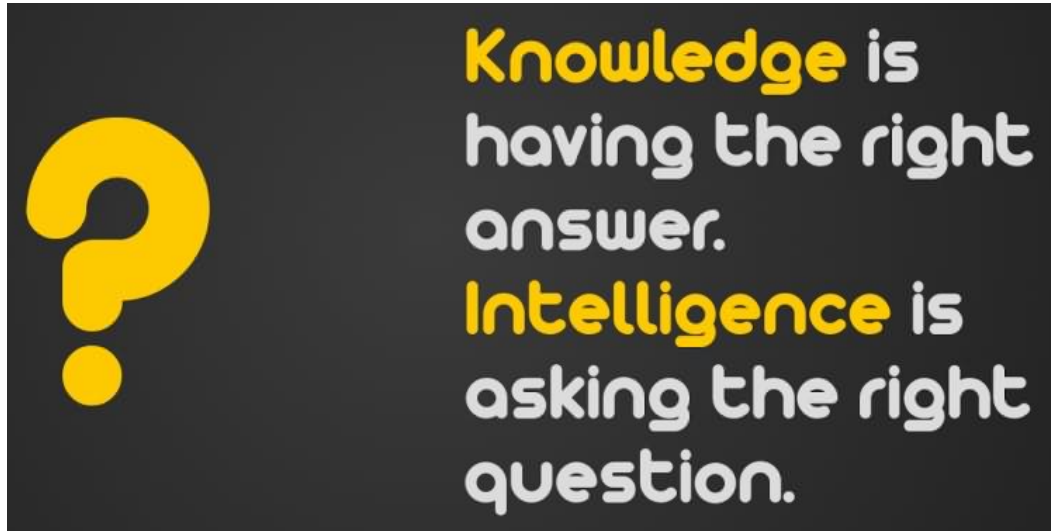
WARA vs WACC

- The **weighted average return on assets**, or **WARA**, is the collective rates of return on the various types of tangible and intangible assets of a company.
- In theory, the WARA should generate the same cost of capital as the Weighted average cost of capital, or WACC.
- The theory holds true because the operating entity is considered fundamentally equivalent to the combined assets of the company. Therefore, the measure of risks across each are equivalent.

Managers and investors must understand that accounting numbers are the beginning, not the end, of business valuation

1	b	11	c	21	c	31	a	33B	b
2	c	12	a	22	a	32	b	33C	d
3	b	13	a	23	a	33A	b	41	b
4	c	14	d	24	d	34	d	42	d
5	b	15	d	25	a	35	d	43	d
6	d	16	d	26	a	36	d	44	b
7	a	17	b	27	c	37	c	45	b
8	b	18	b	28	d	38	b	46	b
9	d	19	b	29	d	39	b	47	d
10	c	20	c	30	b	40	b	48	a





CA Dr GOPAL KRISHNA RAJU

Chartered Accountant, Insolvency Professional & Registered Valuer

Partner : K GOPAL RAO & CO | Chartered Accountants

Mumbai, Chennai, Bengaluru, Coimbatore, Hyderabad, Trichy, Madurai & Tiruvallur

Email: gkr@icai.org; gkr@kgrca.in **Blog:** www.3spro.blogspot.com

Mobile: 98400 63269 | 98401 63269