

Question: What are the valuation standards for intangibles in India?

Introduction

What are the valuation standards for intangibles in India? is one entry in a series of articles about international and national valuation standards on intangibles. The aim of this series is to provide professionals with information about intangible valuation in different countries around the world. The effects of an increasingly global economy have triggered a substantial increase in cross-border transactions. In order to adapt to the changing business environment, standards must be developed and implemented to harmonize the methods used to quantify the values that are created by intangible property.

The definition of intangibles varies according to the context of the discussion, i.e. different perspectives like law, accounting or taxation. Valuations of all kinds are made on the basis of standards which have been published by professional organizations of valuers. The standards serve the purpose to make the work of professionals more transparent and relevant.

A standard¹ can be defined as:

- a written document which:
 - aims to guide users through work processes;
 - aims to provide a consistent framework to be followed;
 - assures a transparent work approach and output.

Standards can be:

- technical in nature;
- process oriented;
- or hybrids.

Separate standards are developed for different purposes of valuation. Specific standards exist also for the valuation of intangible assets, which might differ in their binding nature, i.e. providing:

- best practices;
- guidelines applicable to members;
- or a legally binding reference.

¹ <http://www.iso.org/iso/home/standards.htm>

A standard can only be binding upon members for citizens of a certain country. In the latter case the application of the standard is typically embedded in the international or national legislation. Based on the binding nature, a ranking between standards can be established, which assists users to select the one which is most appropriate to apply, given the scope and purpose of a specific valuation.

International Valuation Standards and Organizations

Several international valuation standards exist which are used by professionals for valuation of intangibles. International standards are developed by organizations that work across borders and are applied or referred to in several countries. A standard is assumed to be international if it is adopted by 10 or more countries. Depending on their binding nature, the international standards may be applied directly or by being included in local laws and/or regulations. A shared goal of international valuation standards is the alignment of different standards among various countries and the assurance of transparency. Table 1 presents the most commonly used International Valuation Standards.

Label Standard	Issuing Institute	Binding Nature of Standard (score*)	Relevant Audience
IFRS	International Accounting Standards Board ²	Legally binding (3) for member states which have adopted it E.g.: Binding in EU based on the Fourth Council Directive and Seventh Council Directive ³	Listed companies from the member states ⁴
ISO 10668	The International Organization for Standardization ⁵	Best Practices ⁶ (1): it offers prefabricated standards for easier and faster execution.	Any company which would like to have a clear-cut valuation method to be followed
IVS	International Valuation Standards Council ⁷	Guidance (2) for professional valuers in member states.	Professional valuers in member states
OECD⁸ Guidelines for	Organization for Economic Co-	Guidelines ¹⁰ (2) on transfer pricing valuation	OECD member states but often non-

² <http://www.ifrs.org/Pages/default.aspx>

³ http://ec.europa.eu/internal_market/accounting/legal_framework/index_en.htm

⁴ IFRS is used in more than 110 countries, IVS has members from approx. 45 countries while OECD has 34 member states

⁵ <http://www.iso.org/iso/home/about.htm>

⁶ <http://www.iso.org/iso/home/about/conformity-assessment.htm>

⁷ <http://www.ivsc.org/>

⁸ *Infra* n. 19, OECD Centre for Tax Policy and Administration, *Revision of the Special Considerations for Intangibles in Chapter VI of the OECD Transfer Pricing Guidelines and Related Provisions*, Discussion Draft, 6 June to 14 September 2012, para. 147: 'It is not the intention of these Guidelines to set out a comprehensive summary of the valuation techniques utilised by valuation professionals. Similarly, it is not

Multinational Enterprises	operation and Development ⁹	techniques. They do not prescribe a standard but rather refer to a few acceptable valuation techniques	OECD countries as well
----------------------------------	--	--	------------------------

*a high score represents a legally binding document. The binding nature of a document provides a basis for ranking.

The International Accounting Standards Board published the International Financial Reporting Standards for accounting professionals in order to provide them with a common financial reporting framework. The IFRS becomes legally binding in a country upon adoption by the respective governing body. Following the adoption of the national version of IFRS, local listed companies of the member states must comply with the standard. The IFRS became binding, for instance, in all EU member countries based on the Fourth Council Directive and Seventh Council Directive.

The International Organization for Standardization is an internationally oriented institute which aims to standardize work processes within a company. It offers predefined step by step recommendations for manufacturing, assembly or business procedures. The use of these standards proposes quality and transparency. The standards are available for any company which would like to acquire them. The ISO 10668 is a standard used for brand valuation. Its focus encompasses financial, behavioral and legal aspects. Therefore, it entails instructions on current and predicted market volumes, values, margins and channels. The valuation is essentially based on brand value drivers and measuring brand strength (e.g. awareness, perceptual attributes, knowledge, attitude and loyalty). Legal aspects include distinctiveness, scope of use and of registration, extent of use, extent to which brand is well-known, right of cancellation priority, dilution and the ability or willingness or both of the owner to enforce legal rights.

the intention of these Guidelines to endorse or reject one or more sets of valuation standards utilised by valuation or accounting professionals or to describe in detail one or more specific valuation techniques or methods that may be especially suitable for use in a transfer pricing analysis. However, where valuation techniques are applied in a manner that gives due regard to these Guidelines, to the specific facts of the case, to generally accepted valuation practices, and with appropriate consideration of the validity of the assumptions underlying the valuation and the consistency of those assumptions with the arm's length principle, such techniques can be useful tools in a transfer pricing analysis where reliable comparable uncontrolled transactions are not available. See, however, paragraphs 112 and 113 for a discussion of the reliability of valuation techniques based on intangible development costs.'

¹⁰<http://www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/theoecdguidelinesformultinationalenterprisesfrequentlyaskedquestions.htm>

⁹ <http://www.oecd.org/about/>

International Valuation Standards target professional valuers in a variety of areas and they are seen as professional recommendations on how to perform a valuation exercise in member states.

The OECD Guidelines for Multinational Enterprises are the most often used recommendations in transfer pricing. Their usage is strongly encouraged by the governing bodies of OECD member states. However, the OECD does not aim these Guidelines to be legally binding, rather to provide a useful framework and foundation for proper transfer pricing.

Local standards

India is planning to integrate IFRS standards in the near future. In the context of financial reporting, professionals in India refer to the Indian Accounting Standards, with the Ind AS 38 specifically focusing on Intangible Assets. Ind AS 38 was issued by The Institute of Chartered Accountants India (ICAI). The Ministry of Urban Development issued the Model National Municipal Asset Valuation Methodology Manual to facilitate Urban Local Bodies with fair and accurate financial reporting. The ICAI also issued a Business Valuation Practice standard which includes recommendations for business valuers in India.

Indian Accounting Standards, Ind AS 38

India decided to make modifications to the IFRS rather than strictly adopt it. In order to do so, the Ministry for Corporate Affairs published its Indian Accounting Standards, the Ind AS. The Ind AS is based on the IFRS by IASB. Ind AS 38, refers to intangible assets. With regard to intangible assets, the Ind AS does not significantly differ from the IFRS by IASB. In contrast to IAS 38, which allows the recognition of an intangible asset at either nominal amount plus expenditures or fair value, the Ind AS allows only fair value.

Model National Municipal Asset Valuation Methodology Manual (MNMAVMM)

The Ministry of Urban Development developed a uniform methodology for asset valuation. The Manual is addressed to Urban Local Bodies for valuation of their assets and preparation of financial statements. The Manual is particularly useful for the determination of an appropriate fair value of a municipal asset, and to increase the effectiveness of control over those assets. The goal of the Manual is the facilitation of Urban Local Bodies in determining their true and fair financial position. Even though the Manual mainly addresses fixed assets, it includes a brief section also on the valuation of intangible assets, such as softwares.

The Manual has been developed based on the Accounting Principles Framework provided by the Model National Municipal Accounting Manual (NMAM) released by the Government of India and Accounting Standards issued by the ICAI. It aims to complement the NMAM by providing specific guidance in the area of fixed asset valuation, treatment, and reporting. It specifically focuses on valuation of assets for the purpose of opening balance sheet, and the determination of depreciation rates for annual depreciation. It represents a policy level guidance which can be adapted by states to suit their needs.

Business Valuation Practice standard from ICAI

The Business Valuation Practice standard is a standard published by The Institute of Chartered Accountants India (ICAI) and is meant for business valuers operating in India. Even though compliance with the standard is merely recommended, the ICAI is planning to institute mandatory compliance with the established standards. The standard aims to provide a broad framework of generally accepted principles, theories and procedures rather than an in-depth discussion of valuation theory and principles.

Hierarchy of the standards

Which standard to use and whether one standard dominates the other is unique in each case and there is no easy rule of thumb. The most important aspect to be considered is the scope and purpose of the valuation at hand. Valuation standards exist for multiple purposes, therefore, a strong match between the field of the standard and the purpose of the valuation should be aimed for. Furthermore, legally binding standards might receive priority over other standards. Some standards are complementary to legally required standards.

When establishing a hierarchy between the standards the following steps are to be considered:

- Define the scope and purpose of the valuation;
- Find a standard which fits the purpose of the valuation;
- Define ranking between international and national standards;
- Apply the most appropriate standard based on the variables as outlined in Appendix A.

Ind AS is the new financial reporting standard applied in India. It aims to replace the Indian GAAP and serves as a new way for a harmonized global financial reporting. Reference to MNMAVMN is recommended for professionals who explicitly focus on the valuation of

fixed assets. The manual is rather limited in intangible asset valuation and it mainly relies on the accounting standards to attach a value to an intangible asset. Compliance with the Business Valuation Practice is not yet mandatory, and it includes a detailed description of the methods used for the valuation of intangible assets, these including but not limited to income, market and cost approaches.

Similarities and Differences

The above described manuals are based on the fair value principle. Both the MNAV MN and the Business Valuation Practice manual originates from Indian accounting standards. Furthermore, the Business Valuation Practice manual and the Ind AS accept the market-, income-, and cost approaches for intangible valuation.

The manuals differ in purpose:

- Ind AS is used for financial reporting;
- MNAV MN focuses on municipal assets;
- Business Valuation Practice is aimed at business valuers;

Appendix A – Valuation Factors as common denominator

The international valuation standards offer guidance on the assessment of the value of the intangibles. They determine unique features which represent the key value drivers of intangible assets and assess value based on the comparability of the intangibles. The recommendations might differ based on the various purposes the standards endure. However, these international standards agree on the following steps:

1. Define the scope and purpose of the valuation.
2. Determine the period or date when the transaction takes place.
3. Determine the definition and type of intangible assets, in other words, the object to be transferred.
4. Distinguish between identifiable and non-identifiable intangible assets.
5. Evaluate the asset's stage of development.
6. Define the intangible asset's expected remaining economic (useful) and/or legal life.
7. Assess the extent and duration of legal protection involving the intangible asset.
8. Determine the expected future economic benefits, direct or indirect, that the intangible asset is expected to provide to its owner during the asset's life.
9. Assess the risks associated with the intangible.
10. Assess the rights to enhancement, revisions and updates the asset carries.
11. Determine the asset's geographic scope.
12. Assess the history (the past), the business context and market conditions (the present) of the intangible asset.
13. Assess the feasibility and character of potential commercial exploitation (the future) of the intangible asset.
14. Assess the substitutes and exclusivity of the intangible asset.
15. Determine the buyer's and seller's perspective.
16. Select and execute valuation techniques.

The commonly used valuation techniques imply three methods. These are the income, the market and the cost approach.

Income approach

The income approach is a future cash flow oriented method because it relies on the assumption that the value of the intangible originates from its ability to generate future cash

flows. The value of an intangible is defined by the present value of the income. The discount of forecasted cash flows is achieved through the use of the relief from royalty method, the premium profits method or the excess earnings method.

Market approach

The aim of this approach is to find a comparable market value via transactions in an existing market. However, due to the fact that each and every intangible asset is unique and that they are not developed to be sold, it is extremely difficult to find a comparable market transaction. Therefore, the use of this approach is inherently limited. As a solution professionals use supposed comparable market transactions instead.

Cost approach

The cost approach is applied for internally generated intangibles. It relies on the assumption that a relationship exists between the costs of the asset and its value. These costs may be development or replacement costs. Development costs entail the costs incurred given that an intangible with identical economic features would be reproduced. Replacement costs entail the costs incurred during a transaction which replaces the asset at hand by another identically economically feasible one. Several drawbacks exist for this method. First of all, it does not take any future benefits that may originate from the intangible in question into account. Second, according to chapter 6 of the OECD guidelines, valuations based on development costs of intangibles should be avoided since they cannot be reasonably measured.

Appendix B

IFRS

The International Financial Reporting Standards Foundation (IFRSs) represents a non-profit organization whose aims target the harmonization and realization of financial reporting standards. These standards are of supreme quality, designed to have a globally enforceable structure, taking into consideration the financial reporting needs of various market actors, including small and medium-sized entities. The IFRSs are developed and published through the standard-setting body of the Foundation, the International Accounting Standards Board (IASB). The IASB is also responsible for the promotion and facilitation of the IFRSs, a duty that it accomplishes not only through the issuance of standards and interpretations of the IFRSs, but also through acting in strong cognizance with the national accounting entities and standards. The IASB's work comprises of discussion papers and publication of consultative documents, while acting in strong co-operation with numerous stakeholders, such as investors, business leaders and regulators around the globe. The IASB conducts its work in an open and transparent manner, according elevated attention to public contributions. The IFRS replaces and therefore includes the previous IAS standards. Two standards are to be mentioned when valuing intangibles, the IFRS 3 about Business Combinations and the IAS 38 – Intangible assets. A third useful standard is the IAS 36 which deals with the impairment of assets¹¹.

ISO

The International Organization for Standardization (ISO)¹² is one of the largest developers of international standards. The goal of the ISO is to provide specifications for products, services and good practices, in order to assist and contribute to a more efficient market. Since its foundation in 1947, the ISO developed over 19,000 international standards covering a wide net of market sectors. The Geneva-based institution operates through national standards bodies of 164 countries that represent the ISO in their respective States. The international standards of the ISO are developed by experts from around the globe who operate on a consensus basis. These international standards are then applied by the national standards bodies that perform the conformity assessment, a process that ensures that the tested product, service or system abides by the requirements of the ISO standards. The conformity assessment had various forms, the most well-known being the certification of the products, services or systems.

¹¹ <http://www.intangiblebusiness.com/Reports/Accounting-under-IFRS~369.html>

¹² http://www.iso.org/iso/home/about/about_governance.htm

IVSC

The International Valuation Standards Council (IVSC) ¹³ functions as an independent, non-profit organization whose central aim targets the global strengthening of the profession of valuation. Its functions comprise of developing and disseminating international standards as well as facilitating co-operation among its members and other international organizations. Founded in 1981, the IVSC is incorporated in the USA but operates in London, the UK. The members of the IVSC encompass valuation professional bodies ¹⁴, educators and regulators of valuation services from over fifty States. While the strategic direction of the IVSC is vested upon the main body of the organization, the Board of Trustees; developing, monitoring and revising international valuation standards is entrusted to the Standards Board. The third body of the organization, the Professional Board, operates with the goal of developing a worldwide valuation profession through promoting benchmarks and issuing guidance that assist the profession.

OECD

The Organisation for Economic Co-operation and Development (OECD) ¹⁵ is another important policy promoter. The OECD was established in 1961 with the aim of improving the economic and social well-being of people throughout the world. The Paris based institution provides with a discussion table for its 34 member States, where common policies are being assessed on the basis of shared experiences and solutions to common issues. The OECD conducts a wide range of activities: it measures and analyzes numerous aspects of the economic, social and environmental sectors, putting forward international standards and future trends in a vast sphere of economic areas. The OECD's work, most of which is conducted in specialized committees such as the Business and Industry Advisory Committee, goes deep into the State's complex systems, analyzing aspects directly connected to the lives of the citizens, such as the tax, education, and pension systems. These analyses will result in policy recommendations being issued by the OECD in order to offset any potential problems in the relevant sectors. The OECD has issued the OECD Guidelines for Multinational Enterprises which is strongly recommended by governments and its chapter 6 is used by transfer pricing professionals for identifying intangibles for transfer pricing purposes and which of the group entities of an MNE can claim the intangible related return ("IRR"). ¹⁶

¹³ <http://www.ivsc.org/~ivscorg/about>

¹⁴ A list of professional bodies and institutes is to be found in Appendix C

¹⁵ <http://www.oecd.org/about/>

¹⁶ OECD Centre for Tax Policy and Administration, *Revision of the Special Considerations for Intangibles in Chapter VI of the OECD Transfer Pricing Guidelines and Related Provisions*, Discussion Draft, 6 June to 14 September 2012, para. 147: 'It is not the intention of these Guidelines to set out a comprehensive summary of the valuation techniques utilised by valuation professionals.'

Appendix C

Financial and business valuers aim together to bring a harmonized internationally valid valuation standard to life. Table 2 presents a list of bodies and institutes aiming for the development of international standards. These institutes provide the basis of professional knowledge from which valuation expertise can be drawn. They differ in their competencies, as shown also in Table 2, for instance, most of them offer valuation standards but not all of them are able to offer trainings. Consensus is not yet found and these institutes focus either on creating a new standard or on adopting existing ones.

Table 1 International Institutes aiming for International Standards

	IVSC	IASB	FASB	CICBV	ASA	AICPA
Members	67 organizations	NA	NA	1500 CBVs	2200 BV members	3100 ABVs (CPAs accredited in business valuation)
Valuation Standards	✓	✓	✓	✓	✓	✓
Valuation Accreditation	✓	✗	✗	✓	✓	✓
Training	✗	✗	✗	✓	✓	✓
Definition of Value	✓	✓	✓	✓	✓	✓

IVSC - International Valuation Standard Council; IASB – International Accounting Standards Board; FASB – Financial Accounting Standards Board; CICBV – Canadian Institute of Chartered Business Valuators; ASA – American Society of Appraisers; AICPA – American Institute of Certified Public Accountants

About IPR Plaza: IPR Plaza is a web-based portal that bridges multiple disciplines by providing free-of-charge qualitative and quantitative information on intangibles. IPR Plaza is empowered by different leading IP advisory firms. IPR Plaza is headquartered in the Netherlands with representation in other major countries.

| www.iprplaza.com | info@iprplaza.com | IPR Plaza is an initiative of Transfer Pricing Technologies B.V. |

Similarly, it is not the intention of these Guidelines to endorse or reject one or more sets of valuation standards utilised by valuation or accounting professionals or to describe in detail one or more specific valuation techniques or methods that may be especially suitable for use in a transfer pricing analysis. However, where valuation techniques are applied in a manner that gives due regard to these Guidelines, to the specific facts of the case, to generally accepted valuation practices, and with appropriate consideration of the validity of the assumptions underlying the valuation and the consistency of those assumptions with the arm's length principle, such techniques can be useful tools in a transfer pricing analysis where reliable comparable uncontrolled transactions are not available. See, however, paragraphs 112 and 113 for a discussion of the reliability of valuation techniques based on intangible development costs.'