Series 14

Valuation: VCM ATQs "Fair Value - Purchase Price Allocation"

VALUATION STANDARDS BOARD
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
(Set up under an Act of Parliament)
New Delhi

Series-14

Valuation: VCM ATQs
"Fair Value - Purchase Price Allocation"

Valuation Standards Board

The Institute of Chartered Accountants of India

Preamble

Valuation Standards Board of ICAI (VSB) had organised a live Virtual CPE Meeting(VCM) on the topic- "Fair Value - Purchase Price Allocation" on 29th August, 2021. The details of the VCM are as under:

President ICAI: CA. Nihar N. Jambusaria

Vice President ICAI: CA. Debashis Mitra

Address by: CA. Anil Bhandari, Chairman, VSB, ICAI
CA. M. P. Vijay Kumar, Vice- Chairman, VSB, ICAI

Speaker: CA Faisal Lakhani

Director: Shri Rakesh Sehgal, Director, ICAI

Secretary: CA. Sarika Singhal, Deputy Secretary, ICAI

The Webcast received an overwhelming response and was attended by more than 600 viewers. The said webcast can be viewed again at https://live.icai.org/vsb/vcm/29082021/.

There were many questions raised during the webcast. We have prepared answers to the questions (ATQs) raised during the webcast, which does not require application of valuation practices and principles. Also, repetitive questions and questions not related to the subject matter have not been answered.

We would also like to mention that the Valuation Standards Board has brought out many publications and Concept papers that may be referred for guidance and reference. All the below publications are available on the Committee link at the ICAI website i.e., www.icai.org.

- ICAI Valuation Standards 2018
- Educational Material on ICAI Valuation Standard 103 - Valuation Approaches and Methods

- Educational Material on ICAI Valuation Standard 301- Business Valuation
- Valuation: Professionals' Insight- Series- I, II, III, IV, V and VI
- Answers to the Questions raised during the Live Webcast on "Valuation and Valuation Standards Compliance and other aspects under various Laws"
- Technical Guide on Valuation
- Frequently Asked Questions on Valuation
- Concept Paper on findings of Peer Review of Valuation Reports
- Concept Paper on All About Fair Value
- Sample Engagement Letter for accepting Valuation assignment
- Valuation: VCM ATQ's – Series - I, II, III, IV, V, VI, VII, VII, IX and X

The answers have been given for reference purposes. Detailed analysis may be done, and other material may be referred.

Valuation Standards Board
New Delhi
31st August, 2021

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Brief Note on "Purchase Price Allocation (PPA), Valuation for Intangibles and Fair Value"

I Purchase Price Allocation (PPA)

1. Introduction

Purchase Price Allocation is the process of assigning fair values to all major assets and liabilities of an acquired enterprise following a business combination.

Under Ind AS 103 all business combinations require the acquirer to apportion the consideration paid amongst the tangible and intangible assets by applying the acquisition method. Intangibles need to be separable and identified based on their unique characteristics. The difference amount, if any, between the consideration paid and the net assets acquired is then recognised as goodwill or gain/bargain in purchase. This entire process is known as the Purchase Price Allocation process.

The underlying equation for purchase price allocation is based on the fact that the value of the assets acquired must be equal to the value of the consideration paid. Wherein the value of consideration paid includes the amount paid (in cash, notes, stock, or other consideration) for the acquisition, including the amount of debt assumed by the acquirer and the value of a contingent consideration (i.e., earn outs), if any. The value of the assets acquired include working capital (net of current liabilities), fixed assets, other tangible assets, intangible assets, and goodwill.

Purchase Price Allocation requires an extensive analysis to be performed in order to accurately identify, recognize and allocate the consideration paid to respective assets and liabilities based on their acquisition date fair values. It is a fairly complex process and requires in-depth domain knowledge, understanding of the business plan, and expertise in intrinsic valuation to ensure all aspects of the analysis have been factored-in correctly.

The accounting for intangible assets acquired in a business combination is particularly challenging for several reasons. Intangible assets are by nature less detectable than tangible ones and also most of the intangibles are not recognised in the acquiree's pre-acquisition

financial statements as considered internally generated. Determining the fair value of these intangible assets in the process of purchase price allocation requires detailed knowledge of valuation and analytical techniques.

2. Ind AS Framework around Purchase Price Allocation(PPA)

Ind AS 103 provides principles and requirements for how the acquirer shall recognise and measure identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree. It also recognises and measures the goodwill acquired in the business combination or a gain from a bargain purchase and disclosure requirements.

Ind AS 103 does not apply to the formation of a joint arrangement and the acquisition of an asset or group of assets that is not a business as defined and also in case of acquisition by an investment entity.

As per Ind AS 103 an entity shall account for each business combination by applying the acquisition method.

2.1 Identifying a business combination

An entity shall determine whether a transaction or other event is a business combination in accordance with Ind AS 103, which require that the assets acquired, and liabilities assumed constitute a business. If the assets acquired are not a business, then the same shall be accounted for as an asset acquisition.

An acquirer might obtain control of an acquiree in a variety of ways, for example by transferring cash, cash equivalents or other assets, by incurring liabilities, by issuing equity interests, by providing more than one type of consideration or without transferring consideration, including by contract alone.

As per Ind AS 103, a business consists of inputs and processes applied to those inputs that have the ability to contribute to the creation of outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business.

The three elements of a business are defined as follows:

(i) **Input:** Any economic resource that creates, or has the ability to create, outputs when one or more processes are applied to it. Examples include noncurrent assets (including intangible assets or rights to use non-current assets), intellectual property, the ability to obtain access to necessary materials or rights and employees.

(ii) **Process:** Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs. Examples include strategic management processes, operational processes and resource management processes.

(iii) **Output:** The result of inputs and processes applied to those inputs that provide or have the ability to provide a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

A business need not include all of the inputs or processes that the seller used in operating that business if market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes.

2.2 Acquisition Method

Business combinations are accounted for by using the acquisition method which require following steps:

(i) identifying the acquirer (the acquirer is the entity that obtains control of another entity);

(ii) determining the acquisition date (the date on which the acquirer obtains control);

(iii) ascertain the purchase consideration

(iv) recognise and measure the identifiable assets acquired and the liabilities assumed and any non-controlling interest; and

(v) recognise and measure any goodwill or bargain purchase.

2.3 Major differences between Ind AS 103, Business Combinations and AS 14, Accounting for Amalgamations

(i) Ind AS 103 defines a business combination which has a wider scope whereas AS 14 deals with amalgamation and mergers.

(ii) Under AS 14, there are two methods of accounting for amalgamation: the pooling of interest method and the purchase method. Ind AS 103 prescribes only the acquisition method for every business combination. (Paragraph 7 of AS 14)

(iii) Under AS 14, the acquired assets and liabilities are recognised at their existing book values or at fair values under the purchase method. Ind AS 103 requires the acquired identifiable assets liabilities and non-controlling interest to be recognised at fair value under acquisition method. (Paragraph 12 of AS 14 and paragraphs 18-19 of Ind AS 103)

(iv) Ind AS 103 requires that for each business combination, the acquirer shall measure any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. On the other hand, AS 14 states that the minority interest is the amount of equity attributable to minorities at the date on which investment in a subsidiary is made and it is shown outside shareholders' equity. (Paragraph 13(e) of AS 21 and paragraph 19 of Ind AS 103)

(v) Under Ind AS 103, the goodwill is not amortised but tested for impairment on annual basis in accordance with Ind AS 36. AS 14 requires that the goodwill arising on amalgamation is in the nature of purchase and shall be amortised over a period not exceeding five years.

(vi) Ind AS 103 deals with reverse acquisitions, whereas AS 14 does not deal with the same.

(vii) Ind AS 103 deals with the contingent consideration in case of business combination, i.e., an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met. AS 14 does not provide specific guidance on this aspect.

(viii) Ind AS 103 requires bargain purchase gain arising on business combination to be recognised in other comprehensive income and accumulated in equity as capital reserve, unless there is no clear evidence for the underlying reason for classification of the business combination as a bargain purchase, in which case, it shall be recognised directly in equity as capital reserve. Under AS 14, the excess amount is treated as capital reserve. (Paragraph 34 of Ind AS 103 and paragraph 17 of AS 14)

(ix) Appendix C of Ind AS 103 deals with accounting for common control transactions, which prescribes a method of accounting different from Ind AS 103. AS 14 does not prescribe accounting for such transactions different from other amalgamations.

II Intangible Assets

1. Introduction

Ind-AS 38 and ICAI Valuation Standard 302 define Intangible Asset as an identifiable non-monetary asset without physical substance.

For an item to be recognised as an intangible asset it must meet the definition of an intangible asset i.e.,

- identifiability,
- control over a resource and
- existence of future economic benefits

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.

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.

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.

If an item does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in a business combination, it forms part of the goodwill recognised at the acquisition date provided it cannot be recognised as an intangible asset.

2. Categories of Intangible Assets

Based on their function Intangible assets can be categorized as follows:

(i) **Contract-based intangible assets** represent the value of rights that arise from contractual agreements, such as non-competition agreements, licenses, permits, royalty agreements etc.

(ii) **Customer-based intangible assets** normally include customer related intangibles, such as customer relationships (both contractual and non-contractual), backlogs, customer lists etc.

(iii) **Marketing-based intangible assets** are normally used in marketing or promotion of products or services, such as trademarks or trade names, service marks, copyrights, internet domain names etc.

(iv) **Technology related intangible assets** are generated from contractual or non-contractual rights to use patented or unpatented technology, software, databases (including title plants), trade secrets, technical know-how, technical designs etc. among others.

(v) **Artistic-related intangible assets** arise from the right to benefits from artistic works, such as royalties from pictures, photographs, videos, plays, books, magazines, newspapers, films and music etc.

3. Approaches and Methods used in Intangible Valuation

The three primary approaches viz. Income, Market and Cost approaches or a combination of these approaches are typically used to value intangible assets. For some assets, various methods are usually attempted to ascertain value, for other assets, one method is usually employed. For example, franchise agreements, licenses, software licenses, etc. are valued by using different approaches whereas customer lists and engineering are generally valued by using Income and Cost approaches respectively.

3.1 Income Approach

As per ICAI Valuation Standard 302, the income approach should be used as the primary basis of value for intangible assets only if the following criteria are met:

(i) the primary economic benefit associated with the subject intangible asset is its ability to generate income, or reduced costs, and
(ii) the future economic benefits can be reasonably forecasted.

The Income Approach utilizes projected cash flows based on what a prudent investor would expect the subject asset to generate, taking care to reasonably exclude the cash flow contributions of other tangible and intangible assets. The estimated annual cash flows are then converted to present value by applying a rate of return appropriate to the risk of the asset. The present values of such yearly cash flows are summed to estimate the value.

The discount rate to be employed for valuing an intangible asset depends upon the risk and liquidity of the type of asset being acquired. For example, patents, in process research and development ("IPR&D") etc. are riskier and/or less liquid as compared to trade name, trademarks, non-competition agreements, etc. It is generally appropriate to address this issue by assigning reasonable premiums or discounts to the overall company discount rate when valuing specific assets.

The Income Approach is used to value a wide range of intangible assets including developed technology, non-competition agreements, trade names/trademarks/domain names, and customer related intangibles.

Some of the common methods under the Income Approach that are used to value intangible assets are as under:-
(i) Relief from Royalty Method
(ii) With and without Method
(iii) Multi-Period Excess Earning Method
(iv) Distributor Method and
(v) Greenfield Method

3.2 Market Approach

The Market Approach values the intangible assets on the basis of market-based metrics, such as price paid in actual transactions. This approach should be used as the primary basis for valuing intangible assets only if the following criteria are met:

(i) The transaction is based on arm's length assumption and information is available on identical or similar intangible assets on or near the valuation date; and
(ii) Sufficient information on the transaction is available that helps the valuer to adjust for all the significant differences between the subject intangible asset and those involved in the transactions.

Where market information on either prices or valuation parameters is available, it is often necessary to make adjustments to these to reflect differences between the subject asset and those involved in the transactions, as it is rarely possible to find market evidence of transactions involving identical assets. These adjustments are required to reflect the differentiating characteristics of the subject intangible asset and the assets involved in the transactions. These adjustments may be qualitative in nature, rather than quantitative factors. However, the need for significant qualitative adjustments may indicate that another approach would be appropriate for the valuation.

The Market Approach is often inapplicable to the valuation of intangible assets. Intangible assets are often purchased "bundled" with other assets, so the price paid for an individual intangible asset is not observable with certainty. Without knowing the amount paid for an asset in a transaction, the Market Approach would not serve as a useful valuation measure for an individual intangible asset. The common methodologies for the market approach are Price/Valuation multiples/Capitalisation rates and Guideline pricing method.

3.3 Cost Approach

The Cost Approach values intangible assets by examining costs that would currently be required to replace the asset. The premise of this approach is that an investor would pay no more for an asset than what would be required to replace it. The Cost Approach also considers the reproduction cost as the value of the intangible asset.

However, as intangible assets do not have the physical form that can be reproduced (even intangible assets like technology are reproduced based on their functionality and not exact codes), the Replacement Cost Method is widely used under the Cost Approach.

III Fair Value

1. Definition of Fair Value as per Ind AS- 113

Typically, Fair Value is the most commonly utilized basis of value. Ind AS 113 – Fair Value Measurement defines Fair Value as:

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 measurement date.

2. Key aspects of Fair Value as per Ind AS 113

Key aspects of Fair Value as per Ind AS 113 include:

- Fair Value is based on the exit price i.e., the price that would be received to sell an asset or paid to transfer a liability, not the transaction price or entry price or the price that was actually paid for the asset or that was received to assume the liability. Generally, entry and exit prices are different. The idea of exit price is based on expectations about the sale or transfer price from the perspective of market participants as of the valuation date.

- Fair Value emphasizes the concepts of a "principal market" and the "most advantageous market" with respect to the business/asset being valued. The principal market is defined as the market with the greatest volume and level of activity for the subject asset or liability. Ind AS 113, specifies that in the absence of a principal market, the most advantageous market should be considered. The most advantageous market is the market that maximizes the amount that would be received to sell a given asset or minimizes the amount that would be paid to transfer the liability, taking into account transaction costs and transportation costs.

- Fair Value measurements should reflect market participant assumptions in pricing an asset or liability. Market participants are assumed to be buyers and sellers in the principal (or most advantageous) market that are knowledgeable independent, unrelated parties willing and able to transact for the asset or liability being Fair Valued without compulsion.

- The highest and best use ("HABU") of a nonfinancial asset or group of nonfinancial assets and nonfinancial liabilities is the use by market participants that maximises the value of the nonfinancial assets/liabilities. This Fair Value concept considers (i) the different ways of utilizing the individual asset/liability, i.e., the highest and best use, and (ii) the valuation premise, whether the maximum value is on a standalone basis or in combination with other assets.

- Fair Value measurements should consider characteristics of the assets/liabilities being valued such as the condition, location, restrictions associated with the sale or use of an asset as applicable. Liability fair valuations should reflect non-performance risk.

3. Fair Value may not be equal to Transaction Price

- When transaction is between related parties
- Where transaction occurs under duress or force
- Unit of account represented by the transaction is different from that of the asset or liability
- Market in which the transaction occurs is different from the principal or most advantageous market

4. Fair value for Financial Reporting vs. Fair Market Value (FMV)

- Fair value has a hierarchy of inputs for Valuation, but FMV does not have it
- Fair Value uses HABU for non – financial assets Valuation resulting in maximising value against consensus value under FMV
- DLOM adjustments may be required in certain cases under Fair Value but DLOC is doubtful
- Fair value disregards blockage discount (decline in value due to size)

Fair value is usually synonymous to fair market value except in certain circumstances where characteristics of an asset translate into a special asset value for the party(ies) involved.

5. Highest and best use for a non-financial asset

A fair value measurement of a non-financial asset takes into account a market participant's

ability to generate economic benefits by using the asset in its highest and best use. The highest and best use of a non-financial asset takes into account the use of the asset that is.

a. Physically Possible
b. Legally Permissible
c. Financially feasible

Highest or best use is usually (but not always) the current use – if for competitive reasons an entity does not intend to use the asset at its highest and best use, the fair value of asset still reflects its highest and best use by market participants (defensive value).

Answers to the Questions (ATQs) raised during the Virtual CPE Meeting Series "Sundays with Valuation Experts" on the topic "Fair Value - Purchase Price Allocation" held on 29th August, 2021

S. No	Question	Answer
1.	What do you mean by Purchase Price Allocation? Is the term defined by the accounting standards?	Purchase price allocation (PPA) as a term has not been defined in any Accounting Standards but in practice it refers to the exercise of allocating the price paid for the purchase of the acquisition amongst various buckets of tangible and intangible assets acquired through the transaction. While PPA is more associated in context of IFRS and Ind AS but also under the Accounting Standards Framework, which has been in use for long, AS-14 explains purchase method which is quite similar to purchase price allocation. Major differences between the two are discussed above in the brief note. Under PPA the purchase consideration needs to be allocated to the net tangible assets first based on their acquisition date fair value and then the intangible assets are to be identified and purchase price shall be allocated to them based on their acquisition date fair value. The balance is then recognised as goodwill or gain/bargain in purchase depending upon the amount left. E.g.: Company A acquires company D for a cash consideration of 100 Mn dollars and the debt liability of the target is worth 120 Mn dollars. From a purchase consideration definition standpoint, the total purchase

S. No	Question	Answer
		consideration for the transaction will be 120 Mn dollars. These 120 Mn dollars is then allocated to the three major buckets based on their acquisition date fair value. First one being the net working capital, second is Property Plant and Equipment i.e., tangible fixed assets and the third bucket is intangible assets. Let us suppose 80 Mn dollars gets allocated to these three buckets based on their fair value, then the remaining 40 Mn dollars is allocated to goodwill.
2.	Which accounting standards provide guidance on purchase price allocation?	There are two Ind AS that provide guidance in respect of purchase price allocation. The primary standard is Ind AS 103 – Business Combination, which provides guidance for how the acquirer recognises and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree and how to recognise and measures the goodwill acquired in the business combination or a gain from a bargain purchase. The other is Ind AS 113 – Fair Value Measurement, which provides for the definition of fair value and guidance for measurement of fair value with respect to tangible and intangible assets.
3.	What constitutes a business as per Ind AS 103? When will a group of assets acquired in a transaction be accounted for as a business	Ind AS 103 provides that an entity shall account for each business combination by applying the acquisition method. An entity shall determine whether a transaction or

S. No	Question	Answer
	combination vs asset acquisition?	other event is a business combination by applying the definition in Ind AS- 103, which requires that the assets acquired, and liabilities assumed shall constitute a business. If the assets acquired are not a business combination, the reporting entity shall account for the transaction or other event as an asset acquisition. As per Ind AS a business consists of inputs and processes applied to those inputs that have the ability to contribute to the creation of outputs. The three elements of a business are Input, Process and Output. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business. Hence the two inevitable elements are input and process. Further, an input shall also not necessarily be creating output today but shall have the ability to contribute to the ability to create output. E.g. : - Company X is a pharma company conducting in-house R&D activities using its skilled work force. It has obtained IPR in the form of a patent for a certain drug. While it has a production plan ready with approvals, but it has not yet commenced commercial production. Another company Y acquires Company X, does this acquisition satisfy the definition of a business under Ind AS 103. Yes, it will constitute as a business since there is skilled workforce, IPR and production facility in place

S. No	Question	Answer
		and hence the two elements that are input and process are available, and hence they have the ability to create output though there is no commercial production as of date. It is because of this many startups and early-stage companies that are not generating income today but has all these elements that have the ability to create output, can be defined as business under Ind AS 103. One of the significant amendments introduced in Ind AS 103 is with respect to the optional concentration test. Concentration test is a very simple method which assesses whether the fair value of gross assets acquired is substantially concentrated to individual asset or group of similar assets out of set of activities and assets acquired. If the test is satisfied then the transaction is classified as an asset acquisition and not a business combination. The concentration test is an optional test, and an entity may or may not opt for it. All businesses that fail a concentration test and satisfy all the conditions of a business will be accounted for as a business combination and the rest shall be accounted for as an asset acquisition.
4.	You mentioned about the acquisition method of accounting. Can you describe what are the general steps applied in the	As already discussed Ind AS 103 provides for application of acquisition method of accounting for all transactions that qualify as a business combination. The steps that one need to follow in adopting the

S. No	Question	Answer
	acquisition method of accounting?	acquisition method of accounting are as under:- i. First and foremost, one needs to identify who the accounting acquirer is. Though this appears to be pretty straight forward, it gets complicated with respect to the complex transactions like in case of a reverse merger transaction and SPAC's transactions. SPACs though not applicable currently in India but in future may become relevant. ii. The next step is to determine the acquisition date. Acquisition date is the date of change of control from the acquiree to an acquirer. Though this again is pretty straight forward but can become complicated if the agreement identifies the effective date of change of control and the same is different from the date on which the transaction is being signed. iii. The next step is to measure the purchase consideration. Consideration can come in many forms like cash, equity or any other type of assets being transferred from acquirer to acquiree. The consideration transferred in a business combination is the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer. iv. The next step is to recognise and measure all the identifiable tangible and intangible assets and the liabilities assumed. The acquirer shall measure the

S. No	Question	Answer
		identifiable assets acquired and the liabilities assumed at their acquisition-date fair values. v. The last step is recognising and measuring goodwill or a gain from a bargain purchase for the balancing figure.
5.	What is purchase consideration and what are the various components of purchase consideration?	Purchase consideration is the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer. As per Ind AS we need to value each component of the consideration as per their acquisition date fair values. A purchase consideration can primarily be categorized under the following buckets:- i. The first bucket includes anything that is transferred from the acquirer to the former owners of the acquiree in their capacity as the shareholders. Hence it includes cash, equity shares or any other assets transferred by the acquirer to the former owners of the target. ii. The next bucket is that of the earnouts or contingent considerations. These are deferred future payments that are triggered by happening of a future event like an achievement of a future milestone. E.g.:- R&D milestones, or revenue or EBIDTA targets that needs to be achieved etc. iii. The third bucket is that of the non-controlling interest left in the business, especially in case of acquisitions that is for less than 100% stake.

S. No	Question	Answer
		iv. The fourth item are the liabilities that are incurred by an acquirer to the former owners of the acquiree.
6.	How is the fair value of earnouts/contingent consideration determined?	Contingent Considerations are deferred future payments tied to certain event, condition or performance milestone. It is defined as an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met. There are two methods that are widely used in practice for valuation of contingent consideration. The first one is the scenario-based method and the second is the option pricing technique. The scenario-based method involves developing discrete scenarios especially in cases where the trigger for payment is based on certain events like IPO, R&D milestone etc. It determines fair value by building up various scenarios and assigning them appropriate weights based on their probability and then discounting their respective estimated cash flows to determine the fair value. The next method is the option pricing method, it is similar to scenario-based method as the basic concept is common, but it uses an option pricing framework to determine the fair value. It deals in risk neutral pricing hence it eliminates the need to ascertain the discount rate and uses the risk-free rate. It also replaces the need to develop multiple scenarios with

S. No	Question	Answer
		a volatility assumption. It is most relevant when the payment trigger is linked to the market for e.g.: - achievement of an EBIDTA or revenue target.
7.	What is conceptually the fair value per Ind AS?	Ind AS -113 defines fair value as 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 measurement date. Key aspects of Fair Value as per Ind AS 113 are: i. Fair Value is based on the exit price i.e., the price that would be received to sell an asset or paid to transfer a liability, not the transaction price or entry price or the price that was actually paid for the asset or that was received to assume the liability. ii. Fair Value emphasizes the concepts of a "principal market" and the "most advantageous market" with respect to the business/asset being valued. iii. Fair Value measurements should reflect market participant assumptions in pricing an asset or liability. iv. This Fair Value concept considers (i) the different ways of utilizing the individual asset/liability, i.e., the highest and best use, and (ii) the valuation premise, whether the maximum value is on a standalone basis or in combination with other assets. v. Fair Value measurements should consider characteristics of the assets/liabilities being valued such as the condition, location, restrictions associated with the sale or use of an asset as applicable.

S. No	Question	Answer
8.	What are market participants as described under IndAS?	Market participants are assumed to be buyers and sellers in the principal (or most advantageous) market that are knowledgeable independent, unrelated parties willing and able to transact for the asset or liability being Fair Valued without compulsion. Market Participants can be of two types:- i. Strategic Buyers – It generally includes peer sets, competitors. ii. Financial Buyers – It generally includes Individual investors, Private equity players, Venture Capital funds and also financial institutions at times.
9.	Elaborate on the concept of Highest and Best use under IndAS?	The highest and best use ("HABU") of a non-financial asset or group of non-financial assets and non-financial liabilities is the use by market participants that maximise the value of the non-financial assets/liabilities. A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use. The highest and best use of a non-financial asset takes into account the use of the asset that is. a. Physically Possible b. Legally Permissible c. Financially feasible Highest or best use is usually (but not always) the current use – if for competitive reasons an entity does not intend to use the asset at its highest and best use,

S. No	Question	Answer
		the fair value of asset still reflects its highest and best use by market participants (defensive value).
10.	What is Business Enterprise Value (BEV) and the related IRR analysis?	Typically, the initial step in measuring the fair value of assets and liabilities assumed is to perform a business enterprise valuation analysis and related internal rate of return (IRR) analysis using market participant assumptions and the consideration transferred. The business enterprise valuation analysis is a key tool, which is the key support for many of the valuation assumptions (discount rate, projected cash flows, synergies, etc.) used in measuring the fair value of the identified assets and liabilities of the entity. Generally, the BEV is performed using one or both of the following methods: (iii) The income approach (e.g., discounted cash flow method) (iv) The guideline public company or the guideline transaction methods of the market approach There are 2 key items in the income approach analysis, the cash flows and the discount rate. The source of free cash flows is the Prospective Financial Information (PFI). The PFI is a critical input in the valuation process and hence it is important to understand the underlying assumptions behind it. The PFI should only include those synergies that would be available to other market participants also and is not entity-specific synergies. Once done with the PFI, the next step is to compute the IRR, which is the implied rate of return. It is

S. No	Question	Answer
		derived by equating the PFI ascertained with the consideration transferred. Conceptually, when the PFI reflects only market participant synergies and the consideration transferred is adjusted for any entity-specific synergies that were paid for, then the IRR should be consistent with the industry-weighted average cost of capital (WACC), which is the industry-weighted average rate of return on debt and equity as required by market participants (i.e., investors).
11.	Explain the importance of reconciliation of IRR and WACC in a Purchase Price Allocation analysis.	To obtain an indication of the overall entity's return, a valuer would look to the IRR implied by the acquisition. It is a helpful diagnostic and conceptually, the IRR should be consistent with the WACC i.e., the discount rate built for the business enterprise valuation analysis. They both should tie up and if they are different, it can very well provide good cues about various aspects. There can only be 3 scenarios: IRR = WACC - Indicates that the PFI reflects market participant synergies and the consideration transferred equals the fair value of the acquiree. IRR > WACC - Indicates that the PFI may include entity-specific synergies, the PFI may include an optimistic bias, or the consideration transferred is lower than the fair value of the acquiree (potential bargain purchase).

S. No	Question	Answer
		IRR < WACC - Indicates that the PFI may exclude market participant synergies, the PFI may include a conservative bias, the consideration transferred may be greater than the fair value of the acquiree, or the consideration transferred may include payment for entity specific synergies.
12.	What are the recognition criteria for the intangible assets identified in a business combination?	As per Ind AS 103 the identifiable assets acquired and liabilities assumed must meet the following conditions to qualify for recognition as part of applying the acquisition method:- 1) it must meet the definitions of assets and liabilities in the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards. 2) it must be part of what the acquirer and the acquiree (or its former owners) exchanged in the business combination transaction rather than the result of separate transactions. With respect to Intangibles, the acquirer's application of the recognition principle and conditions may result in recognising some assets that the acquiree had not previously recognised as assets in its financial statements. For example, the acquirer recognises the acquired identifiable intangible assets, such as a brand name, a patent or a customer relationship, that the acquiree did not recognise as assets in its financial statements because it developed them internally and charged the related costs to expense.

S. No	Question	Answer
		Further Ind AS 38 also specifically provides that if an item does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in a business combination, it forms part of the goodwill recognised at the acquisition date provided it cannot be recognised as an intangible asset.
13.	What are the common categories of intangible assets identified in a business combination?	The following categories of intangible assets must be considered in the search for identifiable intangible assets during the allocation of the purchase price: - Marketing-related intangible assets - trademarks, trade names, non-compete agreements, and internet domain names. - Customer-related intangible assets - customer lists and existing customer relationships, whether or not they are contractual in nature - Artistic-related intangible assets – copyrights, works of art and literature - Contract-based intangible assets - permits, franchise agreements, licensing and royalty agreements, supply agreements - Technology-based intangible assets – patented technology, databases, trade secrets
14.	What are the general approaches and methods to value intangible assets?	Kindly refer to ICAI Valuation Standard 301-Intangible Assets to understand various approaches and methods that can be used to value Intangible Assets. This has also been discussed above in the brief notes forming part of this booklet.

S. No	Question	Answer
15.	What is WARA analysis and how it is utilized?	The stratification of the discount rate to the various classes of assets is a challenging process because there are few, if any, observable active markets for intangible assets. Nonetheless, reporting entities should assess the overall reasonableness of the discount rate assigned to each asset by reconciling the discount rates assigned to the individual assets, on a fair-value-weighted basis, to the WACC of the acquiree (or the IRR of the transaction if the PFI does not represent market participant assumptions). This reconciliation is often referred to as a "weighted average return analysis" (WARA). The WARA is a tool used to assess the reasonableness of the selected discount rates. The rate of return assigned to each asset should be consistent with the type of cash flows associated with the underlying asset; that is, the expected cash flows or conditional cash flows, as the rate of return may be different for each. Assets valued using expected cash flows would have a lower required rate of return than the same assets valued using conditional cash flows because the latter cash flows do not include all the possible downside scenarios. The discount rates used in the WARA should be appropriate for expected cash flows. Using discount rates appropriate to conditional cash flows will distort the WARA analysis as the discount rate for the overall

S. No	Question	Answer
		company will generally be on an expected cash flows basis. The value of the assets used in the WARA should be adjusted to the extent the assets' value is not amortizable for tax purposes. Some transactions (for example, share acquisitions in some jurisdictions) do not result in a change in the tax basis of acquired assets or liabilities assumed. Determining the implied rate of return on goodwill, is necessary to assess the reasonableness of the selected rates of return on the individual assets acquired and is the reconciling rate between the WACC and total of individual asset rates in the WARA. Although goodwill is not explicitly valued by discounting residual cash flows, its implied discount rate should be reasonable, considering the facts and circumstances surrounding the transaction and the risks normally associated with realizing earnings high enough to justify investment in goodwill.
16.	Discuss adjustment of tax amortization benefit in fair value of intangible assets.	Tax Amortization Benefit (TAB) refers to the expected benefit in income tax expense resulting from the amortization of the Intangible Assets. The acquirer of an intangible asset is allowed to amortise the price of an asset as an expense for the purpose of income tax computation. Hence the value of the intangible assets is enhanced by ascertaining the present value of the projected future tax savings on such amortisation.

S. No	Question	Answer
		Again, adjustment for TAB will be dependent upon the valuation approach and methodology used to ascertain the fair value. In case of Income Approach, TAB will be adjusted in the future expected cash flows but in case of a Market Approach it will not be adjusted because the multiples are expected to account for the benefit on account of TAB. Under Cost Approach, there is two schools of thought for inclusion of TAB and various proponents exist for both sides.
17.	Is a purchase price allocation required in case of a slump sale?	Yes, purchase price allocation is applicable in case of a slump sale. Slump Sale refers to a sale of an undertaking for a lumpsum consideration without the value actually being assigned to the individual assets and liabilities. From an acquirer's perspective, since the acquiring entity has a variety of assets and liabilities and if the transaction satisfies the condition of business combination as discussed above then Purchase Price Allocation will be applicable for recognising the assets and liabilities.
18.	During deflation which one shall be considered - fair value or purchase price?	As per definition, fair value represents the best price based on the current economic and market environment. Hence a fair value will appropriately reflect the deflationary price pressure on the value of the asset. Thus, even in case of deflation fair value shall be used.

S. No	Question	Answer
19.	What is the Income Tax impact on acquisitions under Ind AS 103?	The Deferred Tax Assets or Deferred Tax Liability will get created for the difference between the book value and the fair value of the assets and liabilities assumed on acquisition under Ind AS 103. Additionally, as per the amendment in the Income Tax Act, amortization will no longer be allowed on goodwill recorded on acquisition.
20.	Is there any Guidance Note issued by ICAI on Purchase Price Allocation?	No
21.	Can we use PPA allocation principle as per Ind AS 103 in respect of acquisitions in the joint venture /associates.	Accounting for Joint Venture is one of the exceptions to the scope of Ind AS 103.
22.	Business combinations is applicable only to manufacturing firms or is it also applicable to service firms?	It is applicable to service firms as well.
23.	How to work out the Fair Market Value accounting where the acquirer is purchasing the whole business of 3 product lines, but intends to continue with only one product line? The price paid for the two discontinued units will be Goodwill or it is to be	Fair value is a market-based measurement and not an entity's own specific measurement. Hence while determining the economic fair value the entity's own intended future use will not be considered. Thus, the fair value for the purpose of PPA will consider all three product lines. In the given situation, one shall consider the fair value as for a normal market participant who would have continued with all the three products and accordingly goodwill will be booked on day 1. If the company is

S. No	Question	Answer
	adjusted with capital or other Reserve?	discontinuing the two product lines then the fair value attributable to both has to be written off the next day itself.
24.	What are SPACs in the context of the acquisition method?	A special purpose acquisition company (SPAC) is a company with no commercial operations that is formed strictly to raise capital through an initial public offering (IPO) for the purpose of acquiring an existing company. SPACs are entities that get listed with only cash in their financials and raise fund from the public which they then use to acquire a right target and merge into them. The remaining entity post-merger is the entity that has been acquired. From an accounting perspective, the acquirer is actually the acquired entity and hence the responsibility of reporting lies with the acquired entity.
25.	Why SPAC's transactions are not applicable in India?	It is under consideration and SEBI is expected to release regulations soon.
26.	What is bargain purchase?	Bargain Purchase is the other side of the coin for which one side is goodwill. A bargain purchase gain arises if value of the net assets acquired by an acquirer is more than what has been paid as purchase consideration. Bargain purchase occurs in extremely rare circumstances. For example, a bargain purchase might happen in a business combination that is a forced sale in which the seller is acting under compulsion.

S. No	Question	Answer
		As per Ind AS, the acquirer shall recognise the bargain purchase gain in other comprehensive income on the acquisition date and accumulate the same in equity as capital reserve. The gain shall be attributed to the acquirer. Before recognising a gain on a bargain purchase, the acquirer shall determine whether there exists clear evidence of the underlying reasons for classifying the business combination as a bargain purchase.
27.	How can we value customer relationship?	Customer Relationships are valued like any other intangible asset. Since it is cash generating and income generating hence, Income Approach is the most optimal approach for valuing the same. Discounted Cash Flow Method and Excess Earnings Method can be used under the Income Approach. In case one has a comparable market reference with respect to the market price paid for acquiring the customer list or customer contract in a similar business then the Market Approach can be used.
28.	Kindly explain accounting and reporting requirements if Purchase Price is less than total individual value of acquired assets.	It is to be reported as bargain purchase gain. Kindly refer answer to question no. 26 above.
29.	What is the definition of Self-generated goodwill? Does it mean brands, trademarks, patents etc. are self-generated goodwill?	Self-generated goodwill is organically generated while running a business and will not be accounted for in the balance sheet as per Ind AS – 38, but under Ind AS 103 it will be added to the fair value of the entity.

S. No	Question	Answer
		Brand Names and Trademarks are internally developed technology/assets and they are recognised if they meet the recognition criteria as per Ind AS 38. As per Ind AS 38, to assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into (a) research phase and (b) development phase No intangible asset arising from research (or on the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an entity can demonstrate all of the following:- (a) the technical feasibility of completing the intangible asset so that it will be available for use or sale. (b) its intention to complete the intangible asset and use or sell it. (c) its ability to use or sell the intangible asset. (d) how the intangible asset will generate probable future economic benefits. (e) the availability of adequate technical\financial and other resources to complete the

S. No	Question	Answer
		development and to use or sell the intangible asset. (f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.
30.	How do companies derive/decide fair consideration amount as PPA valuation which actually shows the true value of business is done post business transfer agreement execution?	As the transaction is happening between unrelated parties and the buyer and seller are the best judge for valuation, hence the transaction price is considered to be at fair value. The base premise under purchase price allocation is that the transaction price is fair and based on the future earning capability and represents the true value of all assets and liabilities, unless one has reasons to believe that there was a distress sale, and the transaction price will not reflect the fair value.
31.	Brands, patents, trademarks are not self-generated goodwill as per Ind AS 103 then how do they meet Ind AS 38 requirements?	Kindly refer answer to question no 29 above.
32.	Intellectual Property Right (IPR) related to some inventions and research associated with specific employee have the intangible value which cannot be measured by keeping the employees under Bond. How to deal with such a situation?	In such case, one will normally enter into a non-compete agreement with the concerned personnel and the value of intangible shall be determined not on the basis of the technology invented or the harm that personnel can do to the business but on the basis of the opportunity cost saved by entering into the non-compete agreement and not internally cannibalizing the business.

S. No	Question	Answer
33.	How is purchase consideration determined? Can it be any random number decided by the entity? Please throw some light on it.	Purchase consideration is the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer. As per Ind AS, we need to value each component of the consideration as per their acquisition date fair values. A purchase consideration can primarily be categorized under the following buckets:- i. The first bucket includes anything that is transferred from the acquirer to the former owners of the acquiree in their capacity as the shareholders. Hence it includes cash, equity shares or any other assets transferred by the acquirer to the former owners of the target. ii. The next bucket is that of the earnouts or contingent considerations. These are deferred future payments that are triggered by happening of a future event like an achievement of a future milestone. E.g.:- R&D milestones, or revenue or EBIDTA targets that needs to be achieved etc. iii. The third bucket is that of the non-controlling interest left in the business, especially in case of acquisitions that is for less than 100% stake. iv. The fourth item are the liabilities that are incurred by an acquirer to the former owners of the acquiree.

S. No	Question	Answer
34.	Is Purchase price allocation required if a holding company transfers its business to a wholly-owned subsidiary? How will the differential figure be accounted - goodwill/capital reserve	There are specific caveats with respect to common control transactions in Ind AS 103. If the given transactions fall under common control transactions then it is out of the scope of Ind AS 103 and purchase price allocation will not be applicable. Kindly refer to Appendix C under Ind AS 103 - Business combinations of entities under common control. It deals with accounting for business combinations of entities or businesses under common control and also talks about the book value method of valuation for such transactions. Internationally also there is a discussion paper available on this topic.
35.	In case of acquisition of a listed company, how minority interest is to be valued? At the price on the stock exchange as on the date of acquisition or % of net asset acquired.	Kindly refer to the VCM on the topic "Minority holding valuation often unsatisfactory" held on 13th June, 2021 by the Valuation Standards Board. The VCM can be viewed at the following link. https://live.icai.org/vsb/vcm/13062021/ You can also refer to booklet "Valuation: VCM ATQs - Minority Holding Valuation: Often Unsatisfactory?". The booklet provides answer to the Questions raised during the VCM on Minority holding valuation often unsatisfactory. The ATQ is available at:- https://resource.cdn.icai.org/65388vsb52704s4.pdf
36.	In the case study of 3 product lines and one to be continued, if the company is intending to carry only one line of service, won't the company buy just that specific line of service? If the	Yes

S. No	Question	Answer
	company is paying for all 3 lines of services, then it can mean that the 3 lines of services are not separable and then accordingly the company would impair the remaining two line of services that are to be discontinued. Didn't a similar situation arise when HLL acquired TOMCO?	
37.	Kindly clarify if a purchase price allocation is required in case of a slump sale?	Yes, Purchase Price Allocation (PPA) is applicable in case of a slump sale. Slump Sale refers to a sale of an undertaking for a lumpsum consideration without the value actually being assigned to the individual assets and liabilities. From an acquirer's perspective, since the acquiring entity has a variety of assets and liabilities and if the transaction satisfies the condition of business combination as discussed above then Purchase Price Allocation will be applicable for recognising the assets and liabilities.
38.	How do we value human resources?	An assembled workforce is defined as an existing collection of employees that permits an acquirer to continue to operate from the date of the acquisition. An assembled workforce is not an identifiable

S. No	Question	Answer
		intangible asset as it does not meet the contractual and separability criteria and, as such, any value attributable to the assembled workforce is subsumed in goodwill. However, it may affect the value of an identified intangible asset. When an excess earnings method is used to place value on the primary intangible asset the cash flow from it is often reduced by a contributory asset charge by a value of assembled workforce. Generally, replacement cost method is used to value the assembled workforce for each entity.
39.	How the company acquired under NCLT will be accounted for under IND AS 103?	It will be recognised as any other acquisition and there will be no difference provided it satisfies the definition of business combination as per Ind AS 103.
40.	What is the Excess Earning method of intangible assets?	Multi-Period Excess Earnings Method (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. The Multi-Period Excess Earnings Method is commonly used when a reliable direct measurement of future economic benefits generated by an intangible asset is not possible. However, revenue and earnings to other assets can be readily determined. The method adopts a 'residual approach' for estimating the income that an intangible is expected to generate.

S. No	Question	Answer
		The excess earnings method examines the economic returns contributed by all assets utilized in generating earnings and then isolates the excess return that is attributed to the specific asset being valued. Kindly refer para 60-64 of ICAI Valuation Standard 302- Intangible Assets for further details.
41.	The acquirer has acquired a part of the target company which was earlier supplying goods to other entities of the target company. As part of the deal, the target company agrees to purchase goods from the acquirer for say next five years. Will any value be assigned to it in the acquirer's books?	Yes, the value will be assigned, as any preexisting relationship between the acquirer and the acquiree will be allocated value.
42.	While allocating purchase price to the tangible and intangible asset etc., are liabilities reduced from the purchase price and then allocated on assets or is the purchase price presumed to have taken into consideration all the liabilities?	Purchase price includes the liability, as it is added to the purchase consideration.
43.	In customer valuation can we use terminal value if the company is of the assumption that atleast x%	Such assumption is non-justifiable and hence should be avoided.

S. No	Question	Answer
	of customers will continue for a long-term?	
44.	How do we deal with a situation where the HABU of an asset is not in line with the prime objectives and purpose of the company? Does this situation arise practically?	In practice, such situation arises quite a lot of time where the intended use is different from the highest and the best use. Fair economic value in a such situation will be determined as per HABU but the treatment in the books of accounts will be done as per the intended use of the asset.
45.	What is the status of TAB in change scenario where depreciation will not be allowed on goodwill?	The treatment for TAB on the identified intangible assets remains the same. However, the amortization of goodwill (as considered in IRR analysis) as allowed earlier will no longer continue to be allowed.
46.	What will be the impact of depreciation on other intangibles i.e., customer relationship, customer contract, non-compete fee etc. under the changed scenario in the Income Tax Act?	None.

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