MANAGEMENT ACCOUNTING GUIDELINES
MAG - II

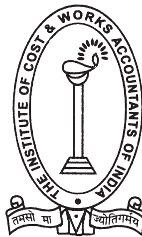
VALUATIONS MANAGEMENT
A TOOL OF MANAGEMENT ACCOUNTANT

The Institute of Cost and Works Accountants of India
(Statutory Body under an Act of Parliament)

Management Accounting Guidelines

MAG - II

VALUATIONS MANAGEMENT A TOOL OF MANAGEMENT ACCOUNTANT



Issued by
The Institute of Cost & Works Accountants of India
(Statutory Body under an Act of Parliament)
12, Sudder Street, Kolkatta-16.

ACKNOWLEDGEMENT

"This is a modification or adaptation of an earlier work entitled, "The Statement on Standards for Valuation Services No. 1 (SSVS No. 1): *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset*," Copyright 2008, by the American Institute of Certified Public Accountants, Inc. (AICPA). This modification or adaptation has been made with the permission of AICPA, which reserves all rights to its original work. AICPA has neither reviewed nor approved this modification or adaptation and, therefore, makes no representations of any kind concerning its fitness for any purpose, express, implied, statutory or otherwise. AICPA does not hereby sponsor or endorse, in any way, this modification or adaptation."on the guidelines issued by AICPA

Second Edition : Jan. 2011

© The Institute of Cost and Works Accountants of India

Price : Rs. 100/-

Published by :

The President

ICWAI

12, Sudder Street

Kolkata - 700 016

Telephone : 91- 33 - 22521031/34/35

Fax : 91 - 33 - 22527993

FOREWORD

Indian businesses are becoming global. Growth is not only organic but inorganic also. Expansion through mergers and acquisitions is the norm. For this to happen, it requires the services of professionals like valuers, who are not only competent in but could arrive at the near perfect value of a business. The valuation therefore is not only crucial but also can make or mar the project. Realising its importance, ICWAI has endeavoured to bring out the Management Accounting Guideline on "Valuations Management".

Valuation is an act to or process to determine the value of a business, business ownership interest, security or intangible asset. In addition a Valuation Analyst is a professional to estimate value that culminates in the expression of a conclusion of value or a calculated value. This provides a good scope of professional opportunities for Management Accountants.

I am happy to note ICWAI is bringing out the new printing of Management Accounting Guidelines on "Valuations Management". This may help the practitioners in the field to understand this discipline better for use in their professional assignments.

The framework proposed in these guidelines is relevant to Management Accountants, Regulators and different types of Enterprises

B M Sharma,

President

PREFACE

Valuations of businesses, business ownership interests, securities, or intangible assets (hereinafter collectively referred to in this foreword as business valuations) may be performed for a wide variety of purposes including the Transactions such as acquisitions, mergers, leveraged buyouts, initial public offerings, employee stock ownership plans and other share based plans, partner and shareholder buy-ins or buyouts, and stock redemptions.

Litigation relating to matters such as marital dissolution, bankruptcy, contractual disputes, owner disputes, dissenting shareholder and minority ownership oppression cases, and employment and intellectual property disputes.

Compliance-oriented engagements, including (a) financial reporting and (b) tax matters such as corporate reorganisations; corporation conversions; income, estate, and gift tax compliance; purchase price allocations; and charitable contributions.

Planning oriented engagements for income tax, estate tax, gift tax, mergers and acquisitions, and personal financial planning.

Valuation engagements are not necessarily external assignments or such assignments are not often outsourced. More often than not we find internal accountants engaged in determining value of business as course of business routine or as special business assignments, it is often executed alongside a cross-functional team.

The increasing number of members of the ICWAI who are involved in performing business valuation engagements or some aspect thereof, the ICWAI Professional Development Committee has written this Guidance note in order to improve the consistency and quality of practices among ICWAI members performing business valuations. ICWAI members will be required to follow

this Guidance note when they perform engagements to estimate value that culminate in the expression of a conclusion of value or a calculated value.

The Intention of this guidance note is not to be exhaustive rule based pronouncement, but to work as a explicit guide to progress in such valuation assignments. The note shall be reviewed in the context of changing business scenario, periodically, as to keep it updated in an all inclusive sphere of Valuation.

Unless the context otherwise specifically requires so, all references to the methods, process, techniques and procedures are equally applicable to Internal assignments executed by Management accountants as to the outsourced , external assignments. Where however certain assignments are to be executed by external members in public practice either individually or alongside other technical experts, specific contexts derived by the specific assignments, whether sanctified under any specific law in force or under a business obligation, shall have overriding priority and should be transparently stated in the Valuation Report.

I would like to place on record efforts put in by Mr. A. N. Raman Central Council Member of the Institute, Mr. Veer Raghavan Iyengar member of the Institute and Ms. Nalinee Jagtap student of ICWAI in bringing out these guidelines by the Institute. We are also thankful to AICPA for extending their helping hand in producing the publication.

We are grateful to Mr. Chandra Wadhwa President of ICWAI, Mr. Kunal Banerjee vice-president of ICWAI, the members of Central council and the members of the Professional Development Committee in particular who have given their valuable Guidance and support in bringing out this publication.

Brijmohan Sharma
Chairman
(Professional Development Committee)

CONTENTS

Contents	***Page***

• INTRODUCTION AND SCOPE	1
• OVERALL ENGAGEMENT CONSIDERATIONS	3
• DEVELOPMENT	8
• VALUATION APPROACHES AND METHODS	15
• THE VALUATION REPORT	25
• APPENDIX A	45
• APPENDIX B	67

VALUATIONS MANAGEMENT
A GUIDE TO MANAGEMENT ACCOUNTANT

I. Introduction and Scope

1. This Guidance note establishes Defined Path for ICWAI members (hereinafter referred to in this guidance note as members) who are engaged to, or, as part of another engagement, estimate the value of a business. **Business ownership interest, security, or intangible asset** hereinafter collectively referred to in this Guidance note as subject interest). For purposes of his guidance note, the definition of a business includes not-for-profit entities or activities and Governmental assignments.

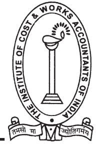
2. As described in this guidance note, the term **engagement to estimate value** refers to an engagement or any part of an engagement (for example, a tax, litigation, or acquisition related engagement) that involves estimating the value of a subject interest. An engagement to estimate value culminates in the expression of either a **conclusion of value** or a **calculated value**. A member who performs an engagement to estimate value is referred to, as **a valuation analyst.**

3. Valuation analysts should be aware of any governmental regulations and other professional standards applicable to the engagement, including the ICWAI Code of Professional Conduct, and the extent to which they apply to engagements to estimate value. Compliance is the responsibility of the valuation analyst.

4. In the process of estimating value as part of an engagement, the valuation analyst applies valuation **approaches** and **valuation methods**, as described in this Guidance note, and uses professional judgment. The use of professional judgment is an essential component of estimating value.

Jurisdictional Exception

If any part of this Guidance note differs from published pronouncement of governmental, judicial, or accounting authority, or such authority specifies valuation development procedures or valuation reporting procedures, then the valuation analyst should follow the applicable procedures published by the authority or stated procedures with respect to that part applicable to the valuation in which the member is engaged. The other parts of this guidance statement continue to guide otherwise.



OVERALL ENGAGEMENT CONSIDERATIONS

A. Professional Competence

1. Professional Competence, Professional Conduct, a member shall “undertake only those professional services that the member or the member’s firm can reasonably expect to be completed with professional competence.”

   Performing a valuation engagement with professional competence involves special knowledge and skill. A valuation analyst should possess a level of knowledge of valuation principles and theory and a level of skill in the application of such principles that will enable him or her to identify, gather, and analyze data, consider and apply appropriate valuation approaches and methods, and use professional judgment in developing the estimate of value (whether a single amount or a range). An in-depth discussion of valuation theory and principles, and how and when to apply them, is not within the scope of this Guidance Note.

2. In determining whether he or she can reasonably expect to complete the valuation engagement with professional competence, the valuation analyst should consider, at a minimum, the following:

a. Subject entity and its industry

b. Subject interest

c. Valuation date

d. Scope of the valuation engagement

i. Purpose of the valuation engagement

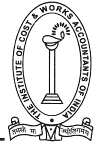
ii. Assumptions and limiting conditions expected to apply to the valuation engagement

iii. Applicable standard of value (for example, fair value or fair market value), and the applicable premise of value (for example, going concern)

iv. Type of valuation report to be issued, intended use and users of the report, and restrictions on the use of the report

e. Governmental regulations or other professional standards that apply to the subject interest or to the valuation engagement Nature and Risks of the Valuation Services and Expectations of the Client

3. In understanding the nature and risks of the valuation services to be provided, and the expectations of the client, the valuation analyst should consider the matters at a minimum, the following:



a. The proposed terms of the valuation engagement

b. The identity of the client

c. The nature of the interest and ownership rights in the business, business interest, security, or intangible asset being valued, including control characteristics and the degree of marketability of the interest

d. The procedural requirements of a valuation engagement and the extent, if any, to which procedures will be limited by either the client or circumstances beyond the client's or the valuation analyst's control

e. The use of and limitations of the report, and the conclusion or calculated value

f. Any obligation to update the valuation

B. Objectivity and Conflict of Interest

Objectivity is required in the performance of all professional services, including valuation engagements. Objectivity is a state of mind. The principle of objectivity imposes the obligation to be impartial, intellectually honest, disinterested, and free from conflicts of interest. If necessary, where a potential conflict of interest may exist, a valuation analyst should make the disclosures and obtain consent where required.

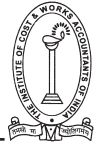
C. Independence and Valuation

If valuation services are performed for a client for which the valuation analyst or valuation analyst's firm also performs an attest engagement, the valuation analyst should meet the requirements of law so as not to impair the member's independence with respect to the client.

D. Establishing an Understanding with the Client

1. The valuation analyst should establish an understanding with the client, preferably in writing, regarding the engagement to be performed. If the understanding is oral, the valuation analyst should document that understanding by appropriate memoranda or notations in the working papers. (If the engagement is being performed for an attest client, Regardless of whether the understanding is written or oral, the valuation analyst should modify the understanding if he or she encounters circumstances during the engagement that make it appropriate to modify that understanding.

2. The understanding with the client reduces the possibility that either the valuation analyst or the client may misinterpret the needs or expectations of the other party. The understanding should include, at a minimum, the nature, purpose, and objective of the valuation engagement, the client's responsibilities, the valuation analyst's responsibilities, the applicable assumptions and



limiting conditions, the type of report to be issued, and the standard of value to be used.

E. Assumptions and Limiting Conditions

Assumptions and limiting conditions are common to valuation engagements. The assumptions and limiting conditions should be disclosed in the valuation report.

F. Scope Restrictions or Limitations

A restriction or limitation on the scope of the valuation analyst's work, or the data available for analysis, may be present and known to the valuation analyst at the outset of the valuation engagement or may arise during the course of a valuation engagement. Such a restriction or limitation should be disclosed in the valuation report.

G. Using the Work of Specialists in the Engagement to Estimate Value

In performing an engagement to estimate value, the valuation analyst may rely on the work of a third party specialist (for example, a real estate or equipment appraiser). The valuation analyst should note in the assumptions and limiting conditions the level of responsibility, if any, being assumed by the valuation analyst for the work of the third party specialist. At the option of the valuation analyst, the written report of the third party specialist may be included in the valuation analyst's report.

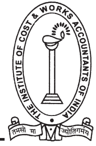
DEVELOPMENT

A. Types of Engagement

1. There are two types of engagements to estimate value - **a valuation engagement** and a **calculation engagement.** The valuation engagement requires more procedures than does the calculation engagement. The valuation engagement results in a conclusion of value. The calculation engagement results in a calculated value. The type of engagement is established in the understanding with the client:

a. Valuation engagement - A valuation analyst performs a valuation engagement when (1) the engagement calls for the valuation analyst to estimate the value of a subject interest and (2) the valuation analyst estimates the value and is free to apply the valuation approaches and methods he or she deems appropriate in the circumstances. The valuation analyst expresses the results of the valuation as a conclusion of value; the conclusion may be either a single amount or a range.

b. Calculation engagement - A valuation analyst performs a calculation engagement when (1) the valuation analyst and the client agree on the valuation approaches and methods the valuation analyst will use and the extent of procedures the valuation analyst will perform in the process of calculating the value of a subject interest (these procedures will be



more limited than those of a valuation engagement) and (2) the valuation analyst calculates the value in compliance with the agreement. The valuation analyst expresses the results of these procedures as a calculated value. The calculated value is expressed as a range or as a single amount. A calculation engagement does not include all of the procedures required for a valuation engagement.

B. Hypothetical Conditions

Hypothetical conditions affecting the subject interest may be required in some circumstances. When a valuation analyst uses hypothetical conditions during a valuation or calculation engagement, he or she should indicate the purpose for including the hypothetical conditions and disclose these conditions in the valuation or calculation report.

C. Valuation engagement

In performing a valuation engagement, the valuation analyst should:

- Analyze the subject interest.
- Consider and apply appropriate valuation approaches and methods.
- Prepare and maintain appropriate documentation.

Valuations involve an ongoing process of gathering, updating, and analysing information. Accordingly, the sequence of the requirements and guidance in this Note may be

implemented differently at the option of the valuation analyst.

D. Analysis of the Subject Interest

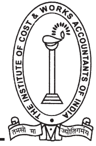
The analysis of the subject interest will assist the valuation analyst in considering, evaluating, and applying the various valuation approaches and methods to the subject interest. The nature and extent of the information needed to perform the analysis will depend on, at a minimum, the following:

- Nature of the subject interest
- Scope of the valuation engagement
- Valuation date
- Intended use of the valuation
- Applicable standard of value
- Applicable premise of value
- Assumptions and limiting conditions
- Applicable governmental regulations or other professional standards

In analyzing the subject interest, the valuation analyst should consider financial and non-financial information. The type, availability, and significance of such information vary with the subject interest.

E. Nonfinancial information

The valuation analyst should, as available and applicable



to the valuation engagement, obtain sufficient non-financial information to enable him or her to understand the subject entity, including it's:

- Nature, background, and history
- Facilities
- Organizational structure
- Management team (which may include officers, directors, and key employees)
- Classes of equity ownership interests and rights attached thereto
- Products or services, or both
- Comparative common size financial statements for the subject
- Economic environment
- Geographical markets
- Industry markets
- Key customers and suppliers
- Competition
- Business risks
- Strategy and future plans
- Governmental or regulatory environment

F. Ownership Information

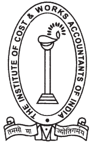
The valuation analyst should obtain, where applicable and available, ownership information regarding the subject interest to enable him or her to:

- Determine the type of ownership interest being valued and ascertain whether that interest exhibits control characteristics
- Analyze the different ownership interests of other owners and assess the potential effect on the value of the subject interest
- Understand the classes of equity ownership interests and rights attached thereto
- Understand the rights included in, or excluded from, each intangible asset
- Understand other matters that may affect the value of the subject interest, such as:
    - For a business, business ownership interest, or security: shareholder agreements, partnership agreements, operating agreements, voting trust agreements, buy-sell agreements, loan covenants, restrictions, and other contractual obligations or restrictions affecting the owners and the subject interest
    - For an intangible asset: legal rights, licensing agreements, sublicense agreements, nondisclosure agreements, development rights, commercialization or exploitation rights, and other contractual obligations

G. Financial Information

The valuation analyst should obtain, where applicable and available, financial information on the subject entity such as:

- Historical financial information (including annual and interim financial statements and key financial statement ratios and statistics) for an appropriate number of years
- Prospective financial information (for example, budgets, forecasts, and projections)
- Comparative summaries of financial statements or information covering a relevant time period
- Comparative common size financial statements for the subject entity for an appropriate number of years
- Comparative common size industry financial information for a relevant time period
- Income tax returns for an appropriate number of years
- Information on compensation for owners including benefits and personal expenses
- Information on key man or officers' life insurance
- Management's response to inquiry regarding:
    - Advantageous or disadvantageous contracts



- Contingent or off-balance-sheet assets or liabilities
- Information on prior sales of company stock

The valuation analyst should read and evaluate the information to determine that it is reasonable for the purposes of the engagement.

VALUATION APPROACHES AND METHODS

In developing the valuation, the valuation analyst should consider the three most common valuation approaches:

Income (Income-based) approach

Asset (Asset-based) approach (used for businesses, business ownership interests, and securities) or cost approach (used for intangible assets)

Market (Market-based) approach :

The valuation analyst should use the valuation approaches and methods that are appropriate for the valuation engagement. General guidance on the use of approaches and methods are enumerated below, but detailed guidance on specific valuation approaches and methods and their applicability is outside the scope of this Guidance note.

A. Income Approach

Two frequently used valuation methods under the income approach include the capitalization of benefits method (for example, earnings or cash flows) and the discounted future benefits method (for example, earnings or cash flows).

When applying these methods, the valuation analyst should consider a variety of factors, including but not limited to, the following:

i. Capitalization of benefits (for example, earnings or cash flows) method. The valuation analyst should consider the following:

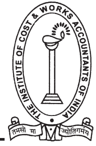
- Normalization adjustments
- Nonrecurring revenue and expense items
- Taxes
- Capital structure and financing costs
- Appropriate capital investments
- Non-cash items
- Qualitative judgments for risks used to compute discount and capitalization rates
- Expected changes (growth or decline) in future benefits (for example, earnings or cash flows)

ii. Discounted future benefits method (for example, earnings or cash flows). In addition to the items in item a above, the valuation analyst should consider:

- Forecast/projection assumptions
- Forecast/projected earnings or cash flows
- Terminal value

iii. For an intangible asset, the valuation analyst should also consider, when relevant:

- Remaining useful life
- Current and anticipated future use of the intangible asset



- Rights attributable to the intangible asset
- Position of intangible asset in its life cycle
- Appropriate discount rate for the intangible asset
- Appropriate capital or contributory asset charge, if any
- Research and development or marketing expense needed to support the intangible asset in its existing state
- Allocation of income (for example, incremental income, residual income, or profit split income) to intangible asset
- Whether any tax amortization benefit would be included in the analysis
- Discounted multi-year excess earnings
- Market royalties
- Relief from royalty

B. Asset Approach and Cost Approach

A frequently used method under the asset approach is the adjusted net asset method. When using the adjusted net asset method in valuing a business, business ownership interest, or security, the valuation analyst should consider, as appropriate, the following information related to the premise of value:

- Identification of the assets and liabilities
- Value of the assets and liabilities (individually or in the aggregate)
- Liquidation costs (if applicable)

When using methods under the cost approach to value intangible assets, the valuation analyst should consider the type of cost to be used (for example, reproduction cost or replacement cost), and, where applicable, the appropriate forms of depreciation and obsolescence and the remaining useful life of the intangible asset.

C. Market Approach

Three frequently used valuation methods under the market approach for valuing a business, business ownership interest, or security are:

- Guideline public company method
- Guideline company transactions method
- Guideline sales of interests in the subject entity, such as business ownership interests or securities

Three frequently used market approach valuation methods for intangible assets are:

- Comparable uncontrolled transactions method (which is based on arm's-length sales or licenses of guideline intangible assets)

- Comparable profit margin method (which is based on comparison of the profit margin earned by the subject entity that owns or operates the intangible asset to profit margins earned by guideline companies)
- Relief from royalty method (which is based on the royalty rate, often expressed as a percentage of revenue that the subject entity that owns or operates the intangible asset would be obligated to pay to a hypothetical third-party licensor for the use of that intangible asset)

For the methods involving guideline intangible assets (for example, the comparable profit margin method), the valuation analyst should consider the subject intangible asset's remaining useful life relative to the remaining useful life of the guideline intangible assets, if available.

In applying the methods listed in or other methods to determine valuation pricing multiples or metrics, the valuation analyst should consider:

- Qualitative and quantitative comparisons
- Arm's-length transactions and prices
- The dates and, consequently, the relevance of the market data

The valuation analyst should set forth in the report the rationale and support for the valuation methods used.

Rules of Thumb. Although technically not a valuation method, some valuation analysts use rules of thumb or industry benchmark indicators (hereinafter, collectively referred to as rules of thumb) in a valuation engagement. A rule of thumb is typically a reasonableness check against other methods used and should generally not be used as the only method to estimate the value of the subject interest.

D. Valuation Adjustments

During the course of a valuation engagement, the valuation analyst should consider whether valuation adjustments (discounts or premiums) should be made to a pre-adjustment value. Examples of valuation adjustments for valuation of a business, business ownership interest, or security include a discount for lack of marketability or liquidity and a discount for lack of control. An example of a valuation adjustment for valuation of an intangible asset is obsolescence.

When valuing a controlling ownership interest under the income approach, the value of any non-operating assets, non-operating liabilities, or excess or deficient operating assets should be excluded from the computation of the value based on the operating assets and should be added to or deleted from the value of the operating entity. When valuing a non-controlling ownership interest under the income approach, the value of any non-operating assets, non-operating liabilities, or excess or deficient operating assets may or may not be used to adjust the value of the operating entity depending on the valuation analyst's assessment of the influence exercisable

by the non-controlling interest. In the asset-based or cost approach, it may not be necessary to separately consider non-operating assets, non-operating liabilities, or excess or deficient operating assets.

E. Conclusion of Value

In arriving at a conclusion of value, the valuation analyst should:

a. Correlate and reconcile the results obtained under the different approaches and methods used.

b. Assess the reliability of the results under the different approaches and methods using the information gathered during the valuation engagement.

c. Determine, based on items a and b, whether the conclusion of value should reflect (1) the results of one valuation approach and method or (2) a combination of the results of more than one valuation approach and method.

F. Subsequent Events

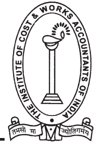
The valuation date is the specific date at which the valuation analyst estimates the value of the subject interest and concludes on his or her estimation of value. Generally, the valuation analyst should consider only circumstances existing at the valuation date and events occurring up to the valuation date. An event that could affect the value may occur subsequent to the valuation date; such an occurrence is referred to as a

subsequent event. Subsequent events are indicative of conditions that were not known or knowable at the valuation date, including conditions that arose subsequent to the valuation date. The valuation would not be updated to reflect those events or conditions. Moreover, the valuation report would typically not include a discussion of those events or conditions because a valuation is performed as of a point in time - the valuation date - and the events described in this subparagraph, occurring subsequent to that date, are not relevant to the value determined as of that date. In situations in which a valuation is meaningful to the intended user beyond the valuation date, the events may be of such nature and significance as to warrant disclosure (at the option of the valuation analyst) in a separate section of the report in order to keep users informed. Such disclosure should clearly indicate that information regarding the events is provided for informational purposes only and does not affect the determination of value as of the specified valuation date.

G. Documentation

Documentation is the principal record of information obtained and analyzed, procedures performed, valuation approaches and methods considered and used, and the conclusion of value. The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment. Documentation may include:

- Information gathered and analyzed to obtain an understanding of matters that may affect the value of the subject interest.



- Assumptions and limiting conditions.
- Any restriction or limitation on the scope of the valuation analyst's work or the data available for analysis.
- Basis for using any valuation assumption during the valuation engagement
- Valuation approaches and methods considered
- Valuation approaches and methods used including the rationale and support for their use
- If applicable, information relating to subsequent events considered by the valuation analyst.
- For any rule of thumb used in the valuation, source(s) of data used, and how the rule of thumb was applied.
- Other documentation considered relevant to the engagement by the valuation analyst

The valuation analyst should retain the documentation for a period of time sufficient to meet the needs of applicable legal, regulatory, or other professional requirements for records retention.

H. Calculation engagement

In performing a calculation engagement, the valuation analyst should consider, at a minimum, the following:

a. Identity of the client

b. Identity of the subject interest

c. Whether or not a business interest has ownership control characteristics and its degree of marketability

d. Purpose and intended use of the calculated value

e. Intended users of the report and the limitations on its use

f. Valuation date

g. Applicable premise of value

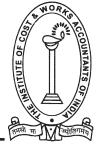
h. Applicable standard of value

i. Sources of information used in the calculation engagement

j. Valuation approaches or valuation methods agreed upon with the client

k. Subsequent events, if applicable.

The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment.



THE VALUATION REPORT

A valuation report is a written or oral communication to the client containing the conclusion of value or the calculated value of the subject interest. The three types of written reports that a valuation analyst may use to communicate the results of an engagement to estimate value are: for a valuation engagement, a detailed report or a summary report; and for a calculation engagement, a calculation report.

a. **Detailed Report:** This report may be used only to communicate the results of a valuation engagement (conclusion of value); it should not be used to communicate the results of a calculation engagement (calculated value).

b. **Summary Report:** This report may be used only to communicate the results of a valuation engagement (conclusion of value); it should not be used to communicate the results of a calculation engagement (calculated value).

For a valuation engagement, the determination of whether to prepare a detailed report or a summary report is based on the level of reporting detail agreed to by the valuation analyst and the client.

B. For a Calculation Engagement

Calculation Report: This type of report should be used only to communicate the results of a calculation engagement (calculated value); it should not be used to communicate

the results of a valuation engagement (conclusion of value).

The valuation analyst should indicate in the valuation report the restrictions on the use of the report (which may include restrictions on the users of the report, the uses of the report by such users, or both).

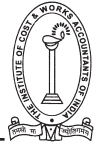
C. Reporting Exemption for Certain Controversy Proceedings

A valuation performed for a matter before a court, an arbitrator, a mediator or other facilitator, or a matter in a governmental or administrative proceeding, is exempt from the reporting provisions of this Statement. The reporting exemption applies whether the matter proceeds to trial or settles. The exemption applies only to the reporting provisions of this Statement. The developmental provisions of the Statement still apply whenever the valuation analyst expresses a conclusion of value or a calculated value.

D. Detailed Report

The detailed report is structured to provide sufficient information to permit intended users to understand the data, reasoning, and analyses underlying the valuation analyst's conclusion of value. A Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset detailed report should include, as applicable, the following sections titled using wording similar in content to that shown:

- Letter of transmittal
- Table of contents



- Introduction
- Sources of information
- Analysis of the subject entity and related non-financial information
- Financial statement/information analysis
- Valuation approaches and methods considered
- Valuation approaches and methods used
- Valuation adjustments
- Non-operating assets, non-operating liabilities, and excess or deficient operating assets (if any)
- Representation of the valuation analyst
- Reconciliation of estimates and conclusion of value
- Qualifications of the valuation analyst
- Appendices and exhibits

The above listed report sections and the detailed information within the sections described in the following paragraphs may be positioned in the body of the report or elsewhere in the report at the discretion of the valuation analyst.

1. Introduction

This section should provide an overall description of the valuation engagement. The information in the section should be sufficient to enable the intended user of the report to

understand the nature and scope of the valuation engagement, as well as the work performed. The introduction section may include, among other things, the following information:

a. Identity of the client

b. Purpose and intended use of the valuation

c. Intended users of the valuation

d. Identity of the subject entity

e. Description of the subject interest

f. Whether the business interest has ownership control characteristics and its degree of marketability

g. Valuation date

h. Report date

i. Type of report issued (namely, a detailed report) (paragraph 51)

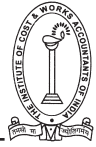
j. Applicable premise of value

k. Applicable standard of value

l. Assumptions and limiting conditions (alternatively, these often appear in an appendix)

m. Any restrictions or limitations in the scope of work or data available for analysis

n. Any hypothetical conditions used in the valuation engagement, including the basis for their use



o. If the work of a specialist was used in the valuation engagement, a description of how the specialist's work was relied upon

p. Disclosure of subsequent events in certain circumstances

q. Any application of the jurisdictional exception

r. Any additional information the valuation analyst deems useful to enable the user(s) of the report to understand the work performed If the above items are not included in the introduction, they should be included elsewhere in the valuation report.

2. Sources of Information

This section of the report should identify the relevant sources of information used in performing the valuation engagement. It may include, among other things, the following:

a. For valuation of a business, business ownership interest, or security, whether and to what extent the subject entity's facilities were visited

b. For valuation of an intangible asset, whether the legal registration, contractual documentation, or other tangible evidence of the asset was inspected

c. Names, positions, and titles of persons interviewed and their relationships to the subject interest

d. Financial information

e. Tax information

f. Industry data

g. Market data

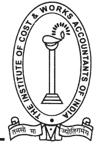
h. Economic data

i. Other empirical information

j. Relevant documents and other sources of information provided by or related to the entity

If the financial information includes financial statements that were reported on by the valuation analyst's firm, the valuation report should disclose this fact and the type of report issued. If the valuation analyst or the valuation analyst's firm did not audit, review, compile, or attest the financial information, the valuation analyst should so state and should also state that the valuation analyst assumes no responsibility for the financial information.

The financial information may be derived from or may include information derived from tax returns. With regard to such derived information and other tax information, the valuation analyst should identify the tax returns used and any existing relationship between the valuation analyst and the tax preparer. If the valuation analyst or the valuation analyst's firm did not audit, review, compile, or attest any financial information derived from tax returns that is used during the valuation engagement, the valuation analyst should so state and should also state that the valuation analyst assumes no responsibility for that derived information.



If the financial information used was derived from financial statements prepared by management that were not the subject of an audit, review, compilation, or attest engagement, the valuation report should:

- Identify the financial statements
- State that, as part of the valuation engagement, the valuation analyst did not audit, review, compile, or attest the financial information and assumes no responsibility for that information

3. Analysis of the Subject Entity and Related Non-financial Information

The valuation analyst should include a description of the relevant non-financial information.

4. Financial Statement / Information Analysis

This section should include a description of the relevant information as may include:

a. The rationale underlying any normalization or control adjustments to financial information

b. Comparison of current performance with historical performance

c. Comparison of performance with industry trends and norms, where available

5. Valuation Approaches and Methods Considered

This section should state that the valuation analyst has

considered the valuation approaches in this guidance note.

6. Valuation Approaches and Methods Used

In this section, the valuation analyst should identify the valuation methods used under each valuation approach and the rationale for their use. This section should also identify the following for each of the three approaches (if used):

a. Income approach:

- Composition of the representative benefit stream
- Method(s) used, and a summary of the most relevant risk factors considered in selecting the appropriate discount rate, the capitalization rate, or both
- Other factors as discussed in

b. Asset-based approach or cost approach:

- Asset-based approach: Any adjustments made by the valuation analyst to the relevant balance sheet data
- Cost approach: The type of cost used, how this cost was estimated, and, if applicable, the forms of and costs associated with depreciation and obsolescence used under the approach and how those costs were estimated

c. Market approach:

- For the guideline public company method:
  - The selected guideline companies and the process used in their selection
  - The pricing multiples used, how they were used, and the rationale for their selection. If the pricing multiples were adjusted, the rationale for such adjustments
- For the guideline company transactions method, the sales transactions and pricing multiples used, how they were used, and the rationale for their selection. If the pricing multiples were adjusted, the rationale for such adjustments
- For the guideline sales of interests in the subject entity method, the sales transactions used, how they were used, and the rationale for determining that these sales are representative of arm's length transactions.

When a rule of thumb is used in combination with other methods, the valuation report.This section should state that the valuation analyst has considered the valuation approaches in this guidance note.

7. Valuation Adjustments

This section should (a) identify each valuation adjustment

considered and determined to be applicable, for example, discount for lack of marketability, (b) describe the rationale for using the adjustment and the factors considered in selecting the amount or percentage used, and (c) describe the pre-adjustment value to which the adjustment was applied.

8. Nonoperating Assets and Excess Operating Assets

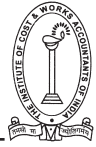
When the subject interest is a business, business ownership interest, or security, the valuation report should identify any related non-operating assets, non-operating liabilities, or excess or deficient operating assets and their effect on the valuation.

9. Representation of the Valuation Analyst

Each written report should contain the representation of the valuation analyst. The representation is the section of the report wherein the valuation analyst summarizes the factors that guided his or her work during the engagement. Examples of these factors include the following:

a. The analyses, opinions, and conclusion of value included in the valuation report are subject to the specified assumptions and limiting conditions, and they are the personal analyses, opinions, and conclusion of value of the valuation analyst.

b. The economic and industry data included in the valuation report have been obtained from various printed or electronic reference sources that the valuation analyst believes to be reliable (any



exceptions should be noted). The valuation analyst has not performed any corroborating procedures to substantiate that data.

c. The valuation engagement was performed in accordance with the guidance note of the ICWAI.

d. The parties for which the information and use of the valuation report is restricted are identified; the valuation report is not intended to be and should not be used by anyone other than such parties.

e. The analyst's compensation is fee-based or is contingent on the outcome of the valuation

f. The valuation analyst used the work of one or more outside specialists to assist during the valuation engagement. (An outside specialist is a specialist other than those employed in the valuation analyst's firm.) If the work of such a specialist was used, the specialist should be identified. The valuation report should include a statement identifying the level of responsibility, if any, the valuation analyst is assuming for the specialist's work.

g. The valuation analyst has no obligation to update the report or the opinion of value for information that comes to his or her attention after the date of the report.

h. The valuation analyst and the person(s) assuming responsibility for the valuation should sign the

representation in their own name(s). The names of those providing significant professional assistance should be identified.

10. Representations Regarding Information Provided to the Valuation Analyst

It may be appropriate for the valuation analyst to obtain written representations regarding information that the subject entity's management provides to the valuation analyst for purposes of his or her performing the valuation engagement. The decision whether to obtain a representation letter is a matter of judgment for the valuation analyst.

11. Qualifications of the Valuation Analyst

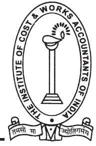
The report should contain information regarding the qualifications of the valuation analyst.

12. Conclusion of Value

This section should present a reconciliation of the valuation analyst's estimate or various estimates of the value of the subject interest. In addition to a discussion of the rationale underlying the conclusion of value, this section should include the following or similar statements:

a. A valuation engagement was performed, including the subject interest and the valuation date.

b. The analysis was performed solely for the purpose described in this report, and the resulting estimate



of value should not be used for any other purpose.

c. The valuation engagement was conducted in accordance with the Guidance note issued by the ICWAI.

d. A statement that the estimate of value resulting from a valuation engagement is expressed as a conclusion of value.

e. The scope of work or data available for analysis is explained, including any restrictions or limitations (paragraph 19).

f. A statement describing the conclusion of value, either a single amount or a range.

g. The conclusion of value is subject to the assumptions and limiting conditions and to the valuation analyst's representation.

h. The report is signed in the name of the valuation analyst or the valuation analyst's firm.

i. The date of the valuation report is included.

j. The valuation analyst has no obligation to update the report or the conclusion of value for information that comes to his or her attention after the date of the report.

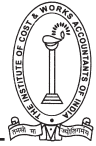
The following is an example of report language that could be used, but is not required, when reporting the results of a valuation engagement:

We have performed a calculation engagement, as defined in the guidance note issued by the ICWAI. We performed certain calculation procedures on [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [calculation date]. The specific calculation procedures are detailed in paragraphs [reference to paragraph numbers] of our calculation report. The calculation procedures were performed solely to assist in the matter of [purpose of valuation procedures], and the resulting calculation of value should not be used for any other purpose or by any other party for any purpose. This calculation engagement was conducted in accordance with the SSVS. The estimate of value that results from a calculation engagement is expressed as a calculated value.

In a calculation engagement, the valuation analyst and the client agree on the specific valuation approaches and valuation methods the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform to estimate the value of the subject interest. A calculation engagement does not include all of the procedures required in a valuation engagement, Had a valuation engagement been performed, the results might have been different.

A Sample Report:

Based on our calculations, as described in this report,



which are based solely on the procedures agreed upon as referred to above, the resulting calculated value of [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [valuation date] was [calculated value, either a single amount or a range]. This calculated value is subject to the Statement of Assumptions and Limiting Conditions found in [reference to applicable section of valuation report] and to the Valuation Analyst's Representation found in [reference to applicable section of valuation report]. We have no obligation to update this report or our calculation of value for information that comes to our attention after the date of this report.

[Signature]

[Date]

Oral Report

An oral report may be used in a valuation engagement or a calculation engagement. An oral report should include all information the valuation analyst believes necessary to relate the scope, assumptions, limitations, and the results of the engagement so as to limit any misunderstandings between the analyst and the recipient of the oral report. The member should document in the working papers the substance of the oral report communicated to the client.

This Guidance Note shall be effective and apply to engagements to estimate value accepted on or after...........

13. Appendices and Exhibits the following:

Appendices or exhibits may be used for required information or information that supplements the detailed report. Often, the assumptions and limiting conditions and the valuation analyst's representation are provided in appendices to the detailed report.

14. Summary Report

A summary report is structured to provide an abridged version of the information that would be provided in a detailed report, and therefore, need not contain the same level of detail as a detailed report. However, a summary report should, at a minimum, include the following:

a. Identity of the client

b. Purpose and intended use of the valuation

c. Intended users of the valuation

d. Identity of the subject entity

e. Description of the subject interest

f. The business interest's ownership control characteristics, if any, and its degree of marketability

g. Valuation date

h. Valuation report date

i. Type of report issued (namely, a summary report)

j. Applicable premise of value

k. Applicable standard of value

l. Sources of information used in the valuation engagement

m. Assumptions and limiting conditions of the valuation engagement

n. The scope of work or data available for analysis including any restrictions or limitations

o. Any hypothetical conditions used in the valuation engagement, including the basis for their use

p. If the work of a specialist was used in the valuation, a description of how the specialist's work was used, and the level of responsibility, if any, the valuation analyst is assuming for the specialist's work

q. The valuation approaches and methods used

r. Disclosure of subsequent events in certain circumstances

s. Any application of the jurisdictional exception

t. Representation of the valuation analyst

u. The report is signed in the name of the valuation analyst or the valuation analyst's firm

v. A section summarizing the reconciliation of the estimates and the conclusion of value.

w. A statement that the valuation analyst has no obligation to update the report or the calculation of

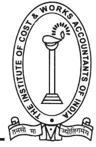
value for information that comes to his or her attention after the date of the valuation report

Appendices or exhibits may be used for required information or information that supplements the summary report. Often, the assumptions, limiting conditions, and the valuation analyst's representation are provided in appendices to the summary report.

15. Calculation Report

A calculation report is the only report that should be used to report the results of a calculation engagement. The report should state that it is a calculation report. The calculation report should include the representation of the valuation analyst similar to that in, but adapted for a calculation engagement.

A calculation report is the only report that should be used to report the results of a calculation engagement. The report should state that it is a calculation report. The calculation report should include the representation of the valuation analyst similar to that in, but adapted for a calculation engagement. The calculation report should identify any hypothetical conditions used in the calculation engagement, including the basis for their use, any application of the jurisdictional exception, and any assumptions and limiting conditions applicable to the engagement. If the valuation analyst used the work of a specialist, the valuation analyst should describe in the calculation report how the specialist's work was used and the level of responsibility, if any, the valuation analyst is assuming for the specialist's work. The



calculation report may also include a disclosure of subsequent events in certain circumstances.

Appendices or exhibits may be used for required information or information that supplements the calculation report. Often, the assumptions and limiting conditions and the valuation analyst's representation are provided in appendices to the calculation report.

The calculation report should include a section summarizing the calculated value. This section should include the following (or similar) statements:

a. Certain calculation procedures were performed; include the identity of the subject interest and the calculation date.

b. Describe the calculation procedures and the scope of work performed or reference the section(s) of the calculation report in which the calculation procedures and scope of work are described.

c. Describe the purpose of the calculation procedures, including that the calculation procedures were performed solely for that purpose and that the resulting calculated value should not be used for any other purpose or by any other party for any purpose.

d. The calculation engagement was conducted in accordance with the Guidance note on Valuation Services of the MAG of ICWAI.

e. A description of the business interest's

characteristics, including whether the subject interest exhibits control characteristics, and a statement about the marketability of the subject interest.

f. The estimate of value resulting from a calculation engagement is expressed as a calculated value.

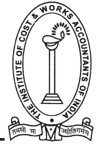
g. A general description of a calculation engagement is given, including that (1) a calculation engagement does not include all of the procedures required for a valuation engagement and (2) had a valuation engagement been performed, the results may have been different.

h. The calculated value, either a single amount or a range, is described.

i. The report is signed in the name of the valuation analyst or the valuation analyst's firm.

j. The date of the valuation report is given.

k. The valuation analyst has no obligation to update the report or the calculation of value for information that comes to his or her attention after the date of the report. ■



APPENDIX A

International Glossary of Business Valuation Terms*

To enhance and sustain the quality of business valuations for the benefit of the profession and its clientele, the below identified societies and organizations have adopted the definitions for the terms included in this glossary.

The performance of business valuation services requires a high degree of skill and imposes upon the valuation professional a duty to communicate the valuation process and conclusion in a manner that is clear and not misleading. This duty is advanced through the use of terms whose meanings are clearly established and consistently applied throughout the profession.

If, in the opinion of the business valuation professional, one or more of these terms needs to be used in a manner which materially departs from the enclosed definitions, it is recommended that the term be defined as used within that valuation engagement.

This glossary has been developed to provide guidance to business valuation practitioners by further memorializing the body of knowledge that constitutes the competent and careful determination of value and, more particularly, the communication of how that value was determined.

Departure from this glossary is not intended to provide

a basis for civil liability and should not be presumed to create evidence that any duty has been breached.

American Institute of Certified Public Accountants

American Society of Appraisers

Canadian Institute of Chartered Business Valuators

National Association of Certified Valuation Analysts

The Institute of Business Appraisers

* Reproduced verbatim from the International Glossary of Business Valuation

Adjusted Book Value Method - a method within the asset approach whereby all assets and liabilities (including off-balance sheet, intangible, and contingent) are adjusted to their fair market values.

{**NOTE:** In Canada on a going concern basis}

Adjusted Net Asset Method - see Adjusted Book Value Method.

Appraisal - see Valuation.

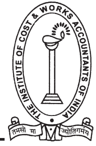
Appraisal Approach - see Valuation Approach.

Appraisal Date - see Valuation Date.

Appraisal Method - see Valuation Method.

Appraisal Procedure - see Valuation Procedure.

Arbitrage Pricing Theory - a multivariate model for estimating the cost of equity capital, which incorporates several systematic risk factors.



Asset (Asset-Based) Approach - a general way of determining a value indication of a business, business ownership interest, or security using one or more methods based on the value of the assets net of liabilities.

Beta - a measure of systematic risk of a stock; the tendency of a stock's price to correlate with changes in a specific index.

Blockage Discount - an amount or percentage deducted from the current market price of a publicly traded stock to reflect the decrease in the per share value of a block of stock that is of a size that could not be sold in a reasonable period of time given normal trading volume.

Book Value - see Net Book Value.

Business - see Business Enterprise.

Business Enterprise - a commercial, industrial, service, or investment entity (or a combination thereof) pursuing an economic activity.

Business Risk - the degree of uncertainty of realizing expected future returns of the business resulting from factors other than financial leverage. See **Financial Risk.**

Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset 41

Business Valuation - the act or process of determining the value of a business enterprise or ownership interest therein.

Capital Asset Pricing Model (CAPM) - a model in which the cost of capital for any stock or portfolio of stocks equals a risk-free rate plus a risk premium that is proportionate to the systematic risk of the stock or portfolio.

Capitalisation - a conversion of a single period of economic benefits into value.

Capitalisation Factor - any multiple or divisor used to convert anticipated economic benefits of a single period into value.

Capitalisation of Earnings Method - a method within the income approach whereby economic benefits for a representative single period are converted to value through division by a capitalization rate.

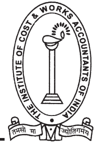
Capitalisation Rate - any divisor (usually expressed as a percentage) used to convert anticipated economic benefits of a single period into value.

Capital Structure - the composition of the invested capital of a business enterprise; the mix of debt and equity financing.

Cash Flow - cash that is generated over a period of time by an asset, group of assets, or business enterprise. It may be used in a general sense to encompass various levels of specifically defined cash flows. When the term is used, it should be supplemented by a qualifier (for example, “discretionary” or “operating”) and a specific definition in the given valuation context.

Common Size Statements - financial statements in which each line is expressed as a percentage of the total. On the balance sheet, each line item is shown as a percentage of total assets, and on the income statement, each item is expressed as a percentage of sales.

Control - the power to direct the management and policies of a business enterprise.



Control Premium - an amount or a percentage by which the pro - rata value of a controlling interest exceeds the pro rata value of a non - controlling interest in a business enterprise to reflect the power of control.

42 Statement on Standards for Valuation Services No. 1

Cost Approach - a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset.

Cost of Capital - the expected rate of return that the market requires in order to attract funds to a particular investment.

Debt-Free - we discourage the use of this term. See Invested Capital.

Discount for Lack of Control - an amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control.

Discount for Lack of Marketability - an amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.

Discount for Lack of Voting Rights - an amount or percentage deducted from the per share value of a minority interest voting share to reflect the absence of voting rights.

Discount Rate - a rate of return used to convert a future monetary sum into present value.

Discounted Cash Flow Method - a method within the income approach whereby the present value of future expected net cash flows is calculated using a discount rate.

Discounted Future Earnings Method - a method within the income approach whereby the present value of future expected economic benefits is calculated using a discount rate.

Economic Benefits - inflows such as revenues, net income, net cash flows, etc.

Economic Life - the period of time over which property may generate economic benefits.

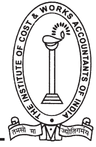
Effective Date - *see* **Valuation Date.**

Enterprise - *see* **Business Enterprise.**

Equity - the owner's interest in property after deduction of all liabilities. Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset 43

Equity Net Cash Flows - those cash flows available to pay out to equity holders (in the form of dividends) after funding operations of the business enterprise, making necessary capital investments, and increasing or decreasing debt financing.

Equity Risk Premium - a rate of return added to a risk-free rate to reflect the additional risk of equity instruments over risk free instruments (a component of the cost of equity capital or equity discount rate).



Excess Earnings - that amount of anticipated economic benefits that exceeds an appropriate rate of return on the value of a selected asset base (often net tangible assets) used to generate those anticipated economic benefits.

Excess Earnings Method - a specific way of determining a value indication of a business, business ownership interest, or security determined as the sum of a) the value of the assets derived by capitalizing excess earnings and b) the value of the selected asset base. Also frequently used to value intangible assets. See **Excess Earnings.**

Fair Market Value - the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts. {NOTE: In Canada, the term “price” should be replaced with the term “highest price”.}

Fairness Opinion - an opinion as to whether or not the consideration in a transaction is fair from a financial point of view.

Financial Risk - the degree of uncertainty of realizing expected future returns of the business resulting from financial leverage. See Business Risk.

Forced Liquidation Value - liquidation value, at which the asset or assets are sold as quickly as possible, such as at an auction.

Free Cash Flow - we discourage the use of this term. See Net Cash Flow.

Going Concern - an ongoing operating business enterprise.

44 Statement on Standards for Valuation Services No. 1

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

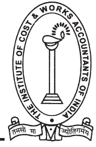
Goodwill - that intangible asset arising as a result of name, reputation, customer loyalty, location, products, and similar factors not separately identified.

Goodwill Value - the value attributable to goodwill.

Guideline Public Company Method - a method within the market approach whereby market multiples are derived from market prices of stocks of companies that are engaged in the same or similar lines of business and that are actively traded on a free and open market.

Income (Income-Based) Approach - a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that convert anticipated economic benefits into a present single amount.

Intangible Assets - nonphysical assets such as franchises, trademarks, patents, copyrights, goodwill, equities, mineral



rights, securities, and contracts (as distinguished from physical assets) that grant rights and privileges and have value for the owner.

Internal Rate of Return - a discount rate at which the present value of the future cash flows of the investment equals the cost of the investment.

Intrinsic Value - the value that an investor considers, on the basis of an evaluation or available facts, to be the "true" or "real" value that will become the market value when other investors reach the same conclusion. When the term applies to options, it is the difference between the exercise price and strike price of an option and the market value of the underlying security.

Invested Capital - the sum of equity and debt in a business enterprise. Debt is typically (a) all interest-bearing debt or (b) long-term, interest-bearing debt. When the term is used, it should be supplemented by a specific definition in the given valuation context. Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset 45

Invested Capital Net Cash Flows - those cash flows available to pay out to equity holders (in the form of dividends) and debt investors (in the form of principal and interest) after funding operations of the business enterprise and making necessary capital investments.

Investment Risk - the degree of uncertainty as to the realization of expected returns.

Investment Value - the value to a particular investor based on individual investment requirements and expectations. {NOTE: in Canada, the term used is “Value to the Owner”.}

Key Person Discount - an amount or percentage deducted from the value of an ownership interest to reflect the reduction in value resulting from the actual or potential loss of a key person in a business enterprise.

Levered Beta - the beta reflecting a capital structure that includes debt.

Limited Appraisal - the act or process of determining the value of a business, business ownership interest, security, or intangible asset with limitations in analyses, procedures, or scope.

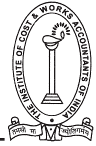
Liquidity - the ability to quickly convert property to cash or pay a liability.

Liquidation Value - the net amount that would be realized if the business is terminated and the assets are sold piecemeal. Liquidation can be either “orderly” or “forced”.

Majority Control - the degree of control provided by a majority position.

Majority Interest - an ownership interest greater than 50% of the voting interest in a business enterprise.

Market (Market-Based) Approach - a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one



or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.

Market Capitalization of Equity - the share price of a publicly traded stock multiplied by the number of shares outstanding.

Market Capitalization of Invested Capital - the market capitalization of equity plus the market value of the debt component of invested capital.

Market Multiple - the market value of a company's stock or invested capital divided by a company measure (such as economic benefits, number of customers).

Marketability - the ability to quickly convert property to cash at minimal cost.

Marketability Discount - see Discount for Lack of Marketability.

Merger and Acquisition Method - a method within the market approach whereby pricing multiples are derived from transactions of significant interests in companies engaged in the same or similar lines of business.

Mid-Year Discounting - a convention used in the Discounted Future Earnings Method that reflects economic benefits being generated at midyear, approximating the effect of economic benefits being generated evenly throughout the year.

Minority Discount - a discount for lack of control applicable to a minority interest.

Minority Interest - an ownership interest less than 50% of the voting interest in a business enterprise.

Multiple - the inverse of the capitalization rate.

Net Book Value - with respect to a business enterprise, the difference between total assets (net of accumulated depreciation, depletion, and amortization) and total liabilities as they appear on the balance sheet (synonymous with Shareholder's Equity). With respect to a specific asset, the capitalized cost less accumulated amortization or depreciation as it appears on the books of account of the business enterprise.

Net Cash Flows - when the term is used, it should be supplemented by a qualifier. See **Equity Net Cash Flows and Invested Capital**

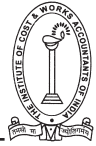
Net Present Value - the value, as of a specified date, of future cash inflows less all cash outflows (including the cost of investment) calculated using an appropriate discount rate.

Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset 47

Net Tangible Asset Value - the value of the business enterprise's tangible assets (excluding excess assets and non-operating assets) minus the value of its liabilities.

Non-operating Assets - assets not necessary to ongoing operations of the business enterprise. {NOTE: in Canada, the term used is "Redundant Assets".}

Normalised Earnings - economic benefits adjusted for



nonrecurring, non-economic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

Normalised Financial Statements - financial statements adjusted for non-operating assets and liabilities and/or for nonrecurring,

Non-economic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

Orderly Liquidation Value - liquidation value at which the asset or assets are sold over a reasonable period of time to maximize proceeds received.

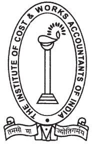
Premise of Value - an assumption regarding the most likely set of transactional circumstances that may be applicable to the subject valuation; for example, going concern, liquidation.

Present Value - the value, as of a specified date, of future economic benefits and/or proceeds from sale, calculated using an appropriate discount rate.

Portfolio Discount - an amount or percentage deducted from the value of a business enterprise to reflect the fact that it owns dissimilar operations or assets that do not fit well together.

Price/Earnings Multiple - the price of a share of stock divided by its earnings per share.

Rate of Return - an amount of income (loss) and/or change in value realized or anticipated on an investment, expressed as a percentage of that investment.



Redundant Assets - see Non-operating Assets.

Report Date - the date conclusions are transmitted to the client.

Replacement Cost New - the current cost of a similar new property having the nearest equivalent utility to the property being valued. 48 Statement on Standards for Valuation Services No. 1

Reproduction Cost New - the current cost of an identical new property.

Required Rate of Return - the minimum rate of return acceptable by investors before they will commit money to an investment at a given level of risk.

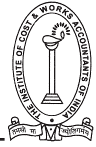
Residual Value - the value as of the end of the discrete projection period in a discounted future earnings model.

Return on Equity - the amount, expressed as a percentage, earned on a company's common equity for a given period.

Return on Investment - see Return on Invested Capital and Return on Equity.

Return on Invested Capital - the amount, expressed as a percentage, earned on a company's total capital for a given period.

Risk-Free Rate - the rate of return available in the market on an investment free of default risk.



Risk Premium - a rate of return added to a risk-free rate to reflect risk.

Rule of Thumb - a mathematical formula developed from the relationship between price and certain variables based on experience, observation, hearsay, or a combination of these; usually industry specific.

Special Interest Purchasers - acquirers who believe they can enjoy post-acquisition economies of scale, synergies, or strategic advantages by combining the acquired business interest with their own.

Standard of Value - the identification of the type of value being utilized in a specific engagement; for example, fair market value, fair value, investment value.

Sustaining Capital Reinvestment - the periodic capital outlay required to maintain operations at existing levels, net of the tax shield available from such outlays.

Systematic Risk - the risk that is common to all risky securities and cannot be eliminated through diversification. The measure of systematic risk in stocks is the beta coefficient.

Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset 49

Tangible Assets - physical assets (such as cash, accounts receivable, inventory, property, plant and equipment, etc.).

Terminal Value - see Residual Value.

Transaction Method - see Merger and Acquisition Method.

Unlevered Beta - the beta reflecting a capital structure without debt.

Unsystematic Risk - the risk specific to an individual security that can be avoided through diversification.

Valuation - the act or process of determining the value of a business, business ownership interest, security, or intangible asset.

Valuation Approach - a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more valuation methods.

Valuation Date - the specific point in time as of which the valuator's opinion of value applies (also referred to as "Effective Date" or "Appraisal Date").

Valuation Method - within approaches, a specific way to determine value.

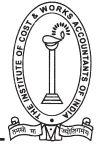
Valuation Procedure - the act, manner, and technique of performing the steps of an appraisal method.

Valuation Ratio - a fraction in which a value or price serves as the numerator and financial, operating, or physical data serve as the denominator.

Value to the Owner - see Investment Value.

Voting Control - de jure control of a business enterprise.

Weighted Average Cost of Capital (WACC) - the cost of capital (discount rate) determined by the weighted average,



at market value, of the cost of all financing sources in the business enterprise's capital structure.

Assumptions and Limiting Conditions - parameters and boundaries under which a valuation is performed, as agreed upon by the valuation analyst and the client or as acknowledged or understood by the valuation analyst and the client as being due to existing circumstances. An example is the acceptance, without further verification, by the valuation analyst from the client of the client's financial statements and related information.

Business Ownership Interest - a designated share in the ownership of a business (business enterprise).

Calculated Value - an estimate as to the value of a business, business ownership interest, security, or intangible asset, arrived at by applying valuation procedures agreed upon with the client and using professional judgment as to the value or range of values base those procedures.

Calculation Engagement - an engagement to estimate value wherein the valuation analyst and the client agree on the specific valuation approaches and valuation methods that the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform to estimate the value of a subject interest. A calculation engagement generally does not include all of the valuation procedures required for a valuation engagement. If a valuation engagement had been performed, the results might have been different. The valuation analyst

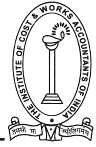
expresses the results of the calculation engagement as a calculated value, which may be either a single amount or a range.

Capital or Contributory Asset Charge - a fair return on an entity's contributory assets, which are tangible and intangible assets used in the production of income or cash flow associated with an intangible asset being valued. In this context, income or cash flow refers to an applicable measure of income or cash flow, such as net income, or operating cash flow before taxes and capital expenditures. A capital charge may be expressed as a percentage return on an economic rent associated with, or a profit split related to, the contributory assets.

Capitalization of Benefits Method - a method within the income approach whereby expected future benefits (for example, earnings or Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset cash flow) for a representative single period are converted to value through division by a capitalization rate.

Comparable Profits Method - a method of determining the value of intangible assets by comparing the profits of the subject entity with those of similar uncontrolled companies that have the same or similar complement of intangible assets as the subject company.

Comparable Uncontrolled Transaction Method - a method of determining the value of intangible assets by comparing the subject transaction to similar transactions in the market



place made between independent (uncontrolled) parties.

Conclusion of Value - an estimate of the value of a business, business ownership interest, security, or intangible asset, arrived at by applying the valuation procedures appropriate for a valuation engagement and using professional judgment as to the value or rang of values based on those procedures.

Control Adjustment - a valuation adjustment to financial statements to reflect the effect of a controlling interest in a business. An example would be an adjustment to owners' compensation that is in excess of market compensation.

Engagement to Estimate Value - an engagement, or any part of an engagement (for example, a tax, litigation, or acquisition-related engagement), that involves determining the value of a business, business ownership interest, security, or intangible asset. Also known as valuation service.

Excess Operating Assets - operating assets in excess of those needed for the normal operation of a business. Fair Value. In valuation applications, there are two commonly used definitions for fair value:

(1) For financial reporting purposes only, 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. Fair Value Measurements, as used in the context of IFRS.

(2) For state legal matters only, some states have laws that use the term fair value in shareholder and partner

matters. For state legal matters only, therefore, the term may be defined by statute or case law in the particular jurisdiction.

Guideline Company Transactions Method - a method within the market approach whereby market multiples are derived from the sales of entire companies engaged in the same or similar lines of business.

Hypothetical Condition - that which is or may be contrary to what exists, but is supposed for the purpose of analysis.

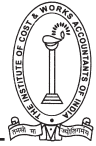
Incremental Income - additional income or cash flow attributable to an entity's ownership or operation of an intangible asset being valued, as determined by a comparison of the entity's income or cash flow with the intangible asset to the entity's income or cash flow without the intangible asset. In this context, income or cash flow refers to an applicable measure of income or cash flow, such as license royalty income or operating cash flow before taxes and capital expenditures.

Normalization. see Normalized Earnings

"International Glossary of Business Valuation Terms."

Pre-adjustment Value - the value arrived at prior to the application, if appropriate, of valuation discounts or premiums.

Profit Split Income - with respect to the valuation of an intangible asset of an entity, a percentage allocation of the entity's income or cash flow whereby (1) a split (or percentage)



is allocated to the subject intangible and (2) the remainder is allocated to all of the entity's tangible and other intangible assets. In this context, income or cash flow refers to an applicable measure of income or cash flow, such as net income or operating cash flow before taxes and capital expenditures.

Relief from Royalty Method - a valuation method used to value certain intangible assets (for example, trademarks and trade names) based on the premise that the only value that a purchaser of the assets receives is the exemption from paying a royalty for its use. Application of this method usually involves estimating the fair market value of an intangible asset by quantifying the present value of Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset the stream of market-derived royalty payments that the owner of the intangible asset is exempted from or "relieved" from paying.

Residual Income - for an entity that owns or operates an intangible asset being valued, the portion of the entity's income or cash flow remaining after subtracting a capital charge on all of the entity's tangible and other intangible assets. Income or cash flows can refer to any appropriate measure of income or cash flow, such as net income or operating cash flow before taxes and capital expenditures.

Security - a certificate evidencing ownership or the rights to ownership in a business enterprise that (1) is represented by an instrument or by a book record or contractual agreement, (2) is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly

recognized in any area in which it is issued or dealt in as a medium for investment, and (3) either one of a class or series or, by its terms, is divisible into a class or series of shares, participations, interests, rights, or interest-bearing obligations.

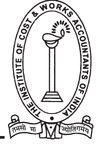
Subject Interest - a business, business ownership interest, security, or intangible asset that is the subject of a valuation engagement.

Subsequent Event - an event that occurs subsequent to the valuation date.

Valuation Analyst - for purposes of this Statement, ICWAI members (holding COP) who performs an engagement to estimate value that culminates in the expression of a conclusion of value or a calculated value.

Valuation Assumptions - statements or inputs utilized in the performance of an engagement to estimate value that serve as a basis for the application of particular valuation methods.

Valuation Engagement - an engagement to estimate value in which a valuation analyst determines an estimate of the value of a subject interest by performing appropriate valuation procedures, and is free to apply the valuation approaches and methods he or she deems appropriate in the circumstances. The valuation analyst expresses the results of the valuation engagement as a conclusion of value, which may be either a single amount or a range. ■



APPENDIX B:

Telecom Regulatory Authority of India

New Delhi the 23rd February, 2004

Notification

No.414/7/99-FA.- In exercise of the powers conferred upon it under section 36 read with clause (i) of sub-section 1(b) of Section 11 of the Telecom Regulatory Authority of India Act, 1997 as amended by Telecom Regulatory Authority of India (Amendment) Act, 2000, the Telecom Regulatory Authority of India, Service Providers (Maintenance of Books of Accounts and Other Documents) Rules, 2002 and the order/ notification issued there under, the Telecom Regulatory Authority of India hereby makes the following Regulation:

The Reporting System on Accounting Separation Regulation, 2004 (4 of 2004)

Section I

1. Short title, extent and commencement: -

(1) This Regulation shall be called "The Reporting System on Accounting Separation Regulation, 2004".

(2) This Regulation shall apply to every service provider, which is engaged in any one or more of the following telecommunication activities, namely: -

i. Basic Telephone Service;

ii. National Long Distance Service;

iii. International Long Distance Service;

iv. Cellular Mobile Telephone Service;

v. Very Small Aperture Terminal Service (VSAT);

vi. Radio Paging Service;

vii. Public Mobile Radio Trunk Service;

viii. Global Mobile Personal Communication Service; and

ix. Internet Service.

(3) The Regulation shall come into force on the date of its publication in the Official Gazette.

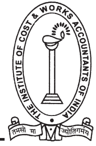
Section II

2. Definitions: - In this Regulation, unless the context otherwise requires

(a) “Act” means the Telecom Regulatory Authority of India Act, 1997 as amended by the Telecom Regulatory Authority of India (Amendment) Act, 2000;

(b) “Authority” means the Telecom Regulatory Authority of India established under sub-section (1) of section 3 of the Act;

(c) “Cost centre” means the support function or department of a company or a network element for which costs are incurred;



(d) “Historical Cost Accounting” means a system of accounting where assets, liabilities, costs and revenues are recorded at the value when the transactions were incurred and where assets are valued and depreciated according to their cost at the time of purchase;

(e) “Holding gain or loss” means gain or loss when the replacement cost of an asset changes while the asset is still being held at the Historical Cost.

Mathematically,

Holding Gain or Loss = NBV_{t-1} x (GRC_t /HCA) - NBV_{t-1} x (GRC_{t-1} /HCA)

Where,

NBV_{t-1} = Written down value of an asset at historical cost at the beginning of year **t**,

GRC_t = Gross replacement cost of an asset at the end of year **t**,

HCA = Cost of an asset at the time of its purchase;

(f) “Financial capital maintenance” is a methodology of recognising profit after taking account of holding gain or loss arising as a result of replacement cost accounting;

(g) “Geographical area” is service area, which is to be treated as separate segment for purpose of preparing Reports under regulation 4.

Geographical areas are mentioned in the column (3) of Schedule - I for services mentioned in column (2) of that Schedule;

(h) "Intra circle call" means long distance call within boundaries of one telecom circle;

(i) "Intra-circle network" means network to carry long distance traffic within boundaries of one Telecom Circle;

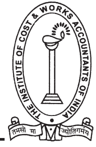
(j) "Local call" means calls originating and terminating within the same local area and charged at local call rates;

(k) "Long distance call" means a call terminating in a local area other than in which it is originated;

(l) "Modern equivalent asset" means value of currently available asset with the same level of capacity and functionality as that of original asset;

(m) "Product" means a sub-service within a service which is treated as separate accounting segment and profit and loss statement is to be prepared for each of the product mentioned in the column (4) of the Schedule I for services mentioned in column (2) of that schedule;

(n) "Profit Centre" means a service or a product offered by a service provider to which revenues and cost can be traced so that profits can be ascribed to that activity;



(o) “Related party” means parties who are considered to be related if at any time during the reporting period one party has the ability to control the other part or exercise significant influence over the other party in making financial and /or operating decisions;

(p) “Related party transaction” means a transfer of resources or obligations between related parties whether or not a price is charged;

(q) “Regulation” means The Reporting System on Accounting Separation Regulation, 2004;

(r) “Replacement cost accounting” means assets are carried in the financial statement at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset were acquired currently;

(s) “Reports” mean Accounting Separation statement, both financial and non-financial, prepared by service providers under the provision laid down in regulation 4;

(t) “Rules” mean the Telecom Regulatory Authority of India, Service Provider (Maintenance of Books of Accounts and Other Documents) Rules, 2002;

(u) “Service Provider” has the meaning assigned to it in clause (j) of Section 2 of the Act;

(v) “Supplementary depreciation” means depreciation for an asset under replacement cost accounting less its depreciation under historical cost accounting;

(w) "Toll Quality Service" or "Below Toll Quality Service" have the same meaning as laid down in the Regulation on Quality of Service for VOIP based International Long Distance Services, 2002;

(x) "Wholesale" means product for which revenue is received from other service providers for terminating calls; and

(y) Words and expressions used in this Regulation and not defined but defined in the Act and/or the Rules and regulations made there under shall have the same meanings respectively assigned to them in the act and/or the rules and regulations made there under.

3. Manual –

(1) In order to execute and implement the accounting and reporting practices prescribed in the Rules and/ or the Regulation, service providers shall prepare a manual containing comprehensive and complete documentation of policies, principles, methodologies and procedures for accounting and cost allocation.

(2) In particular, and without prejudice to the generality of the regulation 3(1), such manual may provide for following details, namely: -

  (a) An overview of the service provider's organisational structure;

(b) A list of the entities in the telecom sector with in the group. Relationship of the Service Provider with other group companies/ related parties in terms of interconnection, common resources etc.;

(c) An overview of the financial accounting system which may include policies relating to capitalisation, depreciation, advance receipts of revenue, security deposits, provision for bad and doubtful debts etc.;

(d) Description of the treatment of related party transactions, allocation of shared services and allocation of jointly used assets;

(e) Products, Services, Network Elements and Geographical Areas which shall be treated as separate segments for preparing Accounting Separation Statements;

(f) Description of Accounting policies for allocation and apportionment of revenue, cost, assets and liabilities;

(g) Accounting System followed for recording and generation of the accounting separation information and reports which may include list of cost and profit centres, linkages of financial heads to cost and profit centres;

(h) Description of studies, surveys and model

employed in cost apportionment and allocation process;

(i) Definition of terms used in the manual; and

(j) Procedure for maintenance and updating manual.

(3) The copy of the manual shall be filed with the Authority within three months from the date of publication of this regulation.

(4) All subsequent changes in the manual, together with the reasons thereof shall be submitted to Authority.

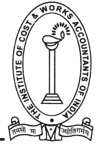
4. Reports –

(1) Based on the information available in the books of accounts and other documents specified in the Rules and the order/notification issued there under, service provider shall prepare geographical area-wise following financial and non-financial reports: -

Financial Reports

Profit and Loss Statements

(i) Profit and loss statement of the products mentioned in column (4) against services rendered by the service providers specified in column (2) of the Schedule I. The statement shall be prepared in the Proforma “A” of Schedule III;



(ii) Separate Profit and Loss statement for each of the service rendered by the service provider and specified in regulation 1(2). The statement shall be prepared in the Proforma "B" of Schedule III;

Product Cost Statement

(iii) Product wise Cost Sheet in the Proforma "C" of Schedule III;

Network Element Cost Statements

(iv) Network Element wise Cost Sheet shall be prepared which clearly indicates cost and its allocation to various products. An indicative list of Network elements of services for which these cost sheets shall be prepared is at Schedule II. However, the list of network elements shall depend on network architecture used by the service provider. The Network Element Cost Statements shall be prepared in the Proforma "D" of Schedule III;

(v) A summary sheet showing network element wise total cost, cost driver and cost per unit of usage. The statement shall be prepared in Proforma "E" of Schedule III;

(vi) A summary sheet indicating network element wise cost allocated to various products. The statement shall be prepared in Proforma "F" of Schedule III;

Capital Employed Statements

(vii) Capital Employed Statement for each of the service rendered by the service provider and specified in regulation 1(2). The statement shall be prepared in Proforma “G” of Schedule III;

(viii) A statement showing allocation of capital employed for a service to the network elements. The statement shall be prepared in Proforma “H” of Schedule III;

Fixed Asset Statement

(ix) Statement showing category wise fixed assets and depreciation in the Proforma “I” of Schedule III’; and

Non-Financial Reports

(x) A statement of operational data relating to network architecture, network usage, network capacity, product, services volumes, tariffs, etc. Reports for services mentioned in Regulation 1(2) shall be prepared in Proformae “L” to “T” of Schedule III.

(2) The service providers shall prepare Reports mentioned in Regulation 4 (1) every year on the basis of historical cost accounting and every second year on the basis of replacement cost accounting:

Provided that if less than three years have elapsed since issue of the license to provide a particular

service, the financial statements based on Replacement Cost Accounting may not be prepared for that service.

(3) The profit and loss statement and capital employed statement mentioned under Regulation 4(1) of this regulation prepared on the basis of the Historical cost Accounting shall be reconciled with the Annual Financial Statement of the service provider prepared under Section 211 of the Companies Act, 1956. The reconciliation statements shall be prepared in Proformae J and K of Schedule III.

(4) The service providers shall prepare financial reports mentioned in regulation 4(1) on the basis of replacement cost accounting, by-

- i following financial capital maintenance methodology;
- ii limiting cost adjustment to the fixed assets;
- iii ignoring replacement cost adjustment for assets having life of less than 3 years;
- iv taking cost of modern equivalent asset when existing asset is not available due to change in technology. Whenever, old asset is replaced by modern equivalent asset, change in operational expenditure as a result of such replacement shall also be accounted for; and

- v clearly indicating holding gain or loss, supplementary depreciation and change in the operational cost due to replacement of old asset by modern equivalent asset.

5. Periodicity of submission of report –

(1) The service providers shall submit audited reports based on the historical cost accounting every year within six months of the end of accounting year to the Authority.

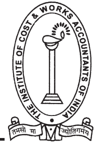
(2) The service provider shall also submit reports based on the replacement cost accounting every second year within six months of the end of accounting year to the Authority.

(3) The reporting period shall be same as followed by the company for preparation of the annual financial accounts under sub section (4) of section 210 of the Companies Act, 1956.

Provided that, if reporting period exceeds fifteen calendar months, the accounting separation statements shall be divided into 12 months and the balance period.

6. Audit –

(1) Every service provider, to which these regulations apply, shall appoint an auditor who is qualified for appointment as an auditor under section 224 or 233-B of The Companies Act, 1956.



(2) The auditor shall audit the reports so prepared.

(3) The auditor in his report shall express an opinion as to whether the reports have been properly drawn in accordance with the regulation and he has received all information and explanation necessary for the purpose of audit.

7. Confidentiality –

The Authority shall ensure the confidentiality of the financial information submitted under various provisions of the Regulation. Provided that, where the Authority is of the opinion that it is necessary or expedient to disclose the information in public interest, it may, for reasons to be recorded in writing, do so.

Provided further that no information shall be disclosed by the Authority, except after giving the company an opportunity of making such representation in writing, as it may wish to make in that behalf and taking such representation into consideration.

8. Interpretation –

Where any doubt arises as to the interpretation of the provisions of these regulations, the matter shall be referred to the Authority whose decision thereon shall be final.

Section III

Explanatory Memorandum

1. An essential ingredient of effective regulatory

framework is the arrangement, which enables the system to generate accounting statements for analysing costs, revenues and capital employed in major areas of an operator's business.The financial reporting at the corporate/entity level presents aggregate information, which does not provide details for regulatory purpose such as:

(i) Measuring financial performance of products;

(ii) Monitor return on products and services regulated with price ceilings;

(iii) Identify cross subsidising, Investigating predatory pricing, discrimination and other anti-competitive conduct;

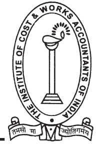
(iv) Understanding the inter-operator arrangements in terms of price and cost, and

(v) Monitoring adequacy of access deficit etc.

2. This Regulation will facilitate the availability of more detailed and disaggregated information on revenues and costs on regular basis.

(i) Measuring financial performance of products;

(ii) Monitor return on products and services regulated with price ceilings;



(iii) Identify cross subsidising, Investigating predatory pricing, discrimination and other anti-competitive conduct;

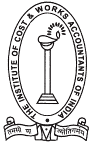
(iv) Understanding the inter-operator arrangements in terms of price and cost, and

(v) Monitoring adequacy of access deficit etc.

3. The central government published Notification No. GSR 782(E) dated 27.11.2002 to specify books of accounts and other documents, which are to be maintained and notification/order no 7-4/2001-tariff dated 21st October 2003 in the Gazette of India dated 8.11.2003 to specify the manner in which books of Accounts and Other documents are to be maintained. These books of accounts and other documents form the underlying records for preparation of the reports prescribed in the Regulation.

4. The Reporting System on Accounting Separation can be broadly classified into the following segments:

4.1 Service-wise Reporting - For every geographical area, separate profit and loss statements are to be prepared for each of the services mentioned in clause (2) of regulation 1. The geographical area wise profit and loss statements for a particular service when aggregated at the company



level will provide information on overall profitability of a that service. The authority requires profit and loss report for services to understand the profitability of each service and whether it is influenced by cross-subsidisation;

4.2 Product-wise Reporting - Geographical area wise profit and loss statements are to be prepared for each of the sub-service or product mentioned against services rendered by the service provider in Schedule I. The profit and loss statements of all products of a service when aggregated for a geographical area shall provide profit and loss statement for service in that geographical area.

4.3 Statements on Capital Employed and Cost Sheets of Network Elements - The cost sheet provide information about costs incurred on network elements. The Capital Employed statements provide input for cost sheets on Return on Capital Employed (RoCE) and Depreciation that is to be allocated to a particular Network Element/ product. Cost Sheets of Network Elements are required to decide network element based pricing of products or interconnection usage charges; and

4.4 Non-financial statements- These statements will provide information on operational data relating to network architecture, network usage, network capacity, product and services volumes and other measures of activities. These reports help to understand the methodology adopted by service providers to apportion and allocate joint cost and for meaningful analysis of financial results.

Framework for generation of Profit and Loss Statements and Network cost sheets.

5. The generation of financial reports on Accounting Separation assume a methodology and the Authority expects service providers to follow the same methodology for preparation of reports mentioned in the Regulation. Details of this methodology are available in the "Guidelines on System on Accounting Separation" prepared by the Authority and can be accessed from TRAI's web site. The conceptual framework of this methodology can be understood using following flow diagram:

Revenue and Costs captured from GL

Step 1

- Capture revenue and cost from the books of account that is from general ledger and

allocate them to Products, Network elements and Support NFunctions/ Department.

Step 2

- Attribute the cost of support functions/ departments to profit centres (i.e products) and other cost centres (i.e. network elements). These costs would have to be attributed using appropriate cost drivers.

- The cost of support functions would have to be allocated to the profit centres or other cost centres depending upon whether such costs are:

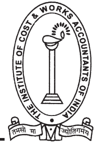
  - Directly attributable

  - Indirectly attributable

  - Un-attributable

Step 3

- After undertaking the above two steps, the cost for each network element would be available. The cost for each network element would include direct cost incurred for operation and maintenance of the respective network elements and also the allocated cost of support function.



- The next step is to apportion the network element cost to various products, which should also include the return on capital employed.
- The cost of each network element is to be attributed to products based on a causation effect i.e. cost is directly allocated to the products for which the network element is used, for example international gateway will be allocated directly to ILD calls, similarly SMS server cost is directly allocable to SMS charges. In case the network element is used for more than one service then the cost of network element is to be attributed to various products based on an appropriate cost driver, which primarily will be usage based such as usage in minutes, number of connections, number of circuits or bandwidth, etc.

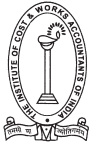
Step 4

- This step involves aggregating costs of various services / products for preparation of profit and loss statements.

Indu Liberhan

Principal Advisor (FA &IFA)

F. No.: 414-7/99-FA


THE INSTITUTE OF COST & WORKS ACCOUNTANTS OF INDIA

Central Council

B. M. Sharma
President

M. Gopalakrishnan
Vice President

Central Council Members

Shri. Sanjiban Bandyopadhyaya
Shri. Kunal Banerjee
Shri. Chandra Wadhwa
Shri. Balwinder Singh
Shri. S. R. Bhargave
Shri. V. C. Kothari
Shri. H. K. Goel
Shri. Somnath Mukherjee
Shri. A. G. Dalwadi
Shri. G. N. Venkataraman
Shri. S. C. Mohanty
Shri. A. S. Durga Prasad
Shri. A. N. Raman

Government Nominees

Shri. A.K. Srivastava
Shri. Munesh Kumar
Shri. D.S. Chakrabarti
Ms. Nandana Munshi
Shri. P.K. Jena