



**IDENTIFICATION OF
FUNCTIONS, ASSETS
AND RISK FROM
DOCUMENTATION**

BACKGROUND



NEED FOR FAR

- ALP to be determined with reference to comparable uncontrolled transaction.
- Comparability to be judged with reference to various factors, including functions performed, assets employed and risks assumed.
- Material effect of differences, if any, to be eliminated through reasonably accurate adjustments.
- Description of the FAR to be documented.

IDENTIFICATION OF FAR

- FAR of Assessee and its AEs –
 - Interview
 - Books of accounts
 - Agreements, communications
- FAR of uncontrolled comparables
 - Annual Reports
 - Other publicly available information – regulatory filings, news reports, website.

FAR OF MANUFACTURERS



TYPICAL FAR OF MANUFACTURERS

FAR	Types of Manufacturers			
	Full risk	Licensed	Contract	Toll
FUNCTIONS				
Research & Development	Y	N	N	N
Inventory management	Y	Y	Y	N
Manufacturing	Y	Y	Y	Y
Marketing	Y	Y	N	N
Sales & Distribution	Y	Y	N	N
ASSETS				
Intellectual Property	Y	N	N	N
Inventory	Y	Y	Y	N
Routine Tangible Property	Y	Y	Y	Y

TYPICAL FAR OF MANUFACTURERS

FAR	Types of Manufacturers			
	Full risk	Licensed	Contract	Toll
RISKS				
Technology Obsolescence Risk	Y	N	N	N
Inventory Risk	Y	Y	Y	N
Capacity Risk	Y	Y	Limited	N
Market Risk	Y	Y	N	N
Price Risk	Y	Y	N	N
Product Liability Risk	Y	Y	N	N
Warranty Risk	Y	Y	Limited	Limited

CHARACTERISATION OF ASSESSEE

- Purchasing & inventory function –
 - Responsibility of purchase and negotiations
 - Scheduling and inventory monitoring including obsolescence
 - Vendor selection and quality
 - Storage of inventory
- Production –
 - Responsibility of scheduling
 - Quality control process and costs
 - Risk of product failure
 - Provision of production technology
 - Ownership of technical know-how developed during production
 - Packaging and labelling

CHARACTERISATION OF ASSESSEE

- Sales and Marketing –
 - Responsibility of marketing strategies, advertisement and promotion policies
 - Estimation and monitoring of market demand
 - Cost of advertisement and promotion

INDICATORS TO EVALUATE FAR OF COMPARABLES

Filters and Ratios	Types of Manufacturers			
	Full risk	Licensed	Contract	Toll
Manufacturing Sales to Sales %	Y	Y	Y	N (Toll manufacturing may be recorded as a service)
R&D / Sales	Y	N	N	N
Inventory / Sales	Y	Y	Y	N
Intangible Assets / Total Assets	Y	N	N	N
Plant and Machinery / Total Assets	Y	Y	Y	Y
Royalty / Sales	N	Y	N	N
Raw Material / Total Cost	Y	Y	Y	N
Advertising - Marketing Expenses / Sales	Y	Y	N	N

FAR OF DISTRIBUTORS



TYPICAL FAR OF DISTRIBUTORS

FAR	Types of Distributors		
	Marketer	Normal	Limited Risk
FUNCTIONS			
Inventory management	Y	Y	Nominal
Warehousing and logistics	Y	Y	Y
Marketing	Y (Extensive)	Y (As per industry norms)	Minimal
After Sales Service	Y	Y	Y
ASSETS			
Customer Lists	Y	Y	Y
Other Marketing Intangibles	Y	N	N
Inventory	Y	Y	Nominal
Warehouse / other Tangible Assets	Y	Y	Y

TYPICAL FAR OF DISTRIBUTORS

FAR	Types of Distributors		
	Marketer	Normal	Limited Risk
RISKS			
Inventory Risk	Y	Y	Nominal
Market Risk	Y	Y	Nominal
Price Risk	Y	Y	N
Product Liability Risk	Y	N	N
Credit Risk	Y	Y	N
Warranty Risk	Y	N	N

CHARACTERISATION OF ASSESSEE

- Inventory function –
 - Distribution scheduling and inventory monitoring
 - Ownership of inventory
- Sales and Marketing –
 - Ownership of marketing intangible
 - Estimation and monitoring of market demand
 - Distribution network
 - Responsibility of advertising and promotion policy and cost of the same
 - Product pricing
 - Responsibility of Bad debts

CHARACTERISATION OF ASSESSEE

- Post Sales –
 - Risk of product failure
 - Responsibility of installation and after sales service
 - Warranty policies and cost of warranty

INDICATORS TO EVALUATE FAR OF COMPARABLES

Filters and Ratios	Types of Distributors		
	Marketer	Normal	Limited Risk
Trading Sales to Sales %	Y	Y	Y
Plant and Machinery / Total Assets	N	N	N
Inventory / Sales	Y	Y	Nominal
Advertising - Marketing Expenses / Sales	High	Moderate	Low
Value Added Expenses / Sales	High	Moderate	Low

FAR OF SERVICE PROVIDERS



TYPICAL FAR OF SERVICE PROVIDERS

FAR	Types of Service Providers		
	Entrepreneur	Low Risk	Captive
FUNCTIONS			
Research and Development	Y	N	N
Quality	Y	Limited	Limited
Human Resource / Significant People Functions	Y	N	N
Marketing	Y	Y	N
ASSETS			
Human Resource Intangibles	Y	N	N
Intellectual Property	Y	N	N
Other Tangible Assets	Y	Y	Y

TYPICAL FAR OF SERVICE PROVIDERS

FAR	Types of Service Providers		
	Entrepreneur	Low Risk	Captive
RISKS			
Human Resource attrition	Y	Y	Y
Service Liability	Y	Limited	N
Capacity Utilisation	Y	N	N
Regulatory	Y	Y	Y
Credit Risk	Y	N	N

CHARACTERISATION OF ASSESSEE

- Personnel function –
 - Risk of employee attrition
 - Quality of personnel
 - Deputation and secondment
- Intellectual Property –
 - Strategic framework for provision of services
 - Monitoring and control of services
 - Development of IP in the course of providing services
- Responsibility of Service Quality

INDICATORS TO EVALUATE FAR OF COMPARABLES

Filters and Ratios	Types of Service Providers		
	Entrepreneur	Low Risk	Captive
Operating Income to Sales %	Y	Y	Y
Employee Cost / Sales	High	High	High
Intangible Assets / Total Assets	Y	Moderate	N
R&D Expenses / Sales	Y	N	N

THANK YOU



CA. Namrata Dedhia