

**Deloitte.**

## Drafting of Audit Report / Study Report J. B. NAGAR CPE STUDY CIRCLE

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### Agenda for discussion

- Form 3CEB
  - Disclosure Norms
- Documentation
  - The concept
  - Industry Analysis
  - Company Analysis
  - International Transactions
  - Functional Analysis
  - Economic Analysis
  - Penalty
  - Conclusion
  - Takeaways

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## Form 3CEB



### Introduction - Accountant's Report on International Transactions

#### Section 92E

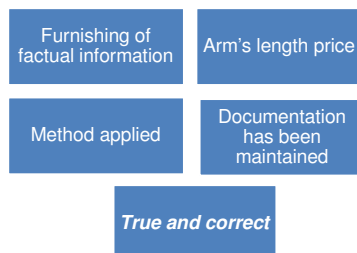
- "Every **person** who has entered into an **international transaction** during a **previous year** shall obtain a report from an accountant and furnish such report **on or before the specified date** in the prescribed form **duly signed and verified** in the prescribed manner by such accountant and setting forth such particulars as may be prescribed."

#### Rule 10E

- "The report from an accountant required to be furnished under section 92E by every person who has entered into an international transaction during a previous year shall be in Form 3CEB and be verified in the manner indicated therein."

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### Introduction – Requirement of Accountant's Report on International Transactions



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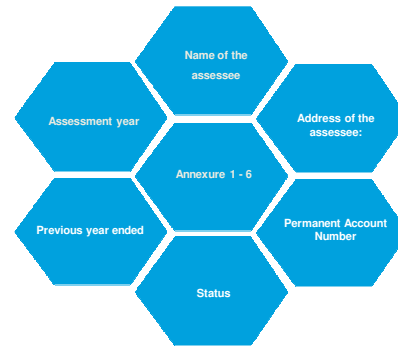
### Form 3CEB – Summary Points

<b>Applicability</b>	Every person who has entered into an "international transaction" during the previous year
<b>Issued by</b>	Chartered Accountant, or any person who is appointed as an auditor of Companies
<b>Due date</b>	Furnished on or before the due date applicable to such person or filing its return of income for the relevant assessment year
<b>Penalty</b>	Failure to furnish this report, will attract a penalty, a sum of Rs. 1 Lakh; and Failure to report any international transaction which is required to be reported – 2% of the value of international transactions

## Disclosure Norms



## Disclosure Norms – Annexure 1- 6



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## Annexure 7 - List Of Associated Enterprises

- The relevant sub clause of section 92A (2) under which such relationship is covered should also be provided; and
- In case of international transactions between deemed AE, the following language can be used in Clause 7 of the Annexure to Form 3CEB:

"Party A and Party B do not qualify as associated enterprises under section 92A(2), however in view of the deeming provisions defined in section 92B(2), the two enterprises are deemed to be associated enterprises and hence the transaction between Party A and Party B has been disclosed as an international transaction."

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## Annexure 8A & 8B



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## Annexure 8C – Purchase & Sale Of Tangible Property Or Lease Of Such Property...Checklist

Obtain quantity and value details of purchase / sale of assets from Associated Enterprises

Review the asset purchase agreement for the purchase of asset

Check the mode of payment for purchase of asset in the asset purchase agreement and addendums if any

Obtain the copy of the valuation certificate issued to the company by an independent valuation expert ( if any)

Obtain a copy of share purchase agreement in case of purchase / sale of shares

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## Annexure 9 – Intangible Property

The types of transactions generally covered under this category are transactions relating to purchase / sale / use of intangible property such as know-how, patents, copyrights, licenses, royalty etc.

### For royalty

- Comparable Uncontrolled Price ("CUP") is the preferred method (where we find comparable agreements using Royalty Stat, Lexis Nexis etc.).
- IF CUP is not undertaken, Transaction Net Margin Method ("TNMM") could be used as the most appropriate method to test the arm's length nature of royalty payment (assuming aggregation of transactions is possible).
- If the tested party is not profitable (under TNMM), we cannot use TNMM.

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**Annexure 10 – Services such as financial, administrative, technical, commercial services, etc.**

The types of transactions generally covered under this category are transactions relating to services rendered, cost allocations with mark up, guarantee transactions (including performance guarantee).

- All the amounts disclosed under this clause should be inclusive of any applicable service tax; and
- Check for CUP, if such services are offered to unrelated parties.

**Annexure 11 – Lending Or Borrowing Money**

The types of transactions generally covered under this category are transactions relating to :

- Interest payments for loans borrowed
- Interest paid on debentures
- Interest receipts for loans/ guarantees given.
- Interest free loans/ borrowings

**Annexure 12 – Mutual Agreements Or Arrangements**

- The types of transactions generally covered under this category are transactions relating to:
  - Cost allocations agreements
  - Cost Sharing Agreements
- Obtain a copy of the agreements
  - Check allocation drivers/ allocation basis
  - Benefits received in context of overall business and payments made

**Annexure 13 – Any Other Transactions**

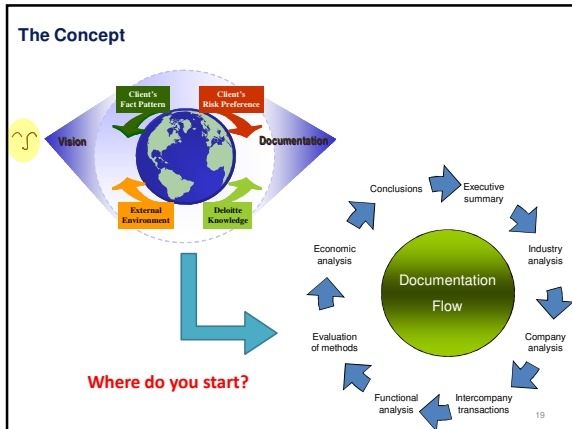
<ul style="list-style-type: none"> <li>• Reimbursement of expenses;</li> <li>• Recovery of expenses (only those on which no mark-up have been charged)</li> </ul> <p><b>Reimbursement</b></p>	<ul style="list-style-type: none"> <li>• Receipt of corporate guarantee;</li> <li>• Use of trademark without any royalty;</li> <li>• Receipt of capital assets without any payment</li> </ul> <p><b>Free of cost</b></p>	<ul style="list-style-type: none"> <li>• Buyback of shares;</li> <li>• Sale of shares;</li> <li>• In case the company is listed on a stock exchange the price on the stock exchange is CUP.</li> </ul> <p><b>Shares</b></p>
<ul style="list-style-type: none"> <li>• Initial infusion of capital, payment or receipt</li> </ul> <p><b>Initial capital</b></p>	<ul style="list-style-type: none"> <li>• Interest free trade advances received during the year, which was adjusted against fees/ commission charged to name of the AE for the year</li> </ul> <p><b>Trade Advances</b></p>	

**Documentation**



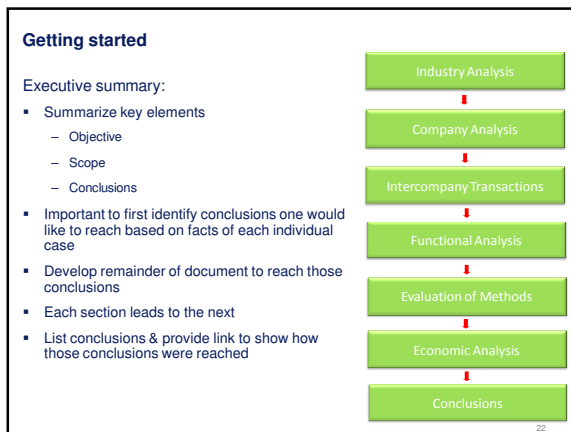
**Rules – India**

- Every person who has entered into an international transaction shall keep and maintain:
  - description of the ownership structure
  - profile of the multinational group
  - broad description of the business
  - nature and terms (incl. prices) of international transactions
  - description of the functions performed, risks assumed and assets employed
  - record of economic and market analyses, forecasts, budgets etc.
  - record of uncontrolled transactions
  - description of the methods considered
  - details of adjustments
  - supportive documents under 10D (2).



- ### Planning a TP documentation
- Understand the objectives of the study
  - Scoping the study
    - Is the scope limited to TP? Are other specialty advisors required?
    - When the “rules of the game” are changing, do you need a crystal ball?
    - What TP risks must be addressed and for what period?
    - What is the end deliverable?
    - Who will prepare the documentation?
    - Time sensitivities

- ### Sources
- Corporate TP policy
  - Intercompany agreements
  - Company Information
    - Corporate entity structure charts
    - Ownership
    - Organization
    - Management responsibility
  - Industry research
    - Competitive environment
    - Market research
  - Functional analysis
    - Interviews
  - Potentially comparable uncontrolled transactions
  - Identify potentially comparable companies
    - Benchmarking Exercise
  - Financial data
    - Legal entity
    - Local & HO
    - Transaction segment and / or
    - Product line as necessary for main intercompany transactions
- It's important to connect all these and build a story!**



- ### Industry analysis – what's this?
- Provides reader with description of industry in which company is operating
    - Focus on those industry factors which have the greatest effect on client's profitability
    - Listen to company's viewpoint as to which factors it considers most important, & review your research, highlighting areas which are most supportive or demonstrative of your case
    - Make sure focus is on competitive conditions faced by client

- ### Company analysis – what's this?
- Provides reader with a background of the company in which the transactions are placed
  - Prepared to understand legal & business structure/ operations of the client
  - Objective is to describe the group's:
    - Competitive & corporate strategy
    - Financial performance
    - Strengths & weaknesses (SWOT Analysis?)
    - Supply chain & legal structure
    - Assets owned & deployed and risks faced
    - Management & control
  - Make use of major points identified in industry analysis

### Company analysis – contents

Overview →

- Background
  - History,
  - Business Overview,
  - Legal & organizational structure.
- Focus on those stages that will be most important to later analysis
- Corporate strategy – Describe in relation to the **value chain steps** providing rationale
- Financial performance – Describe over time

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### Company analysis – contents (contd.)

Key Risks & Assets →

- Tie back to points discussed in industry analysis
- Client may be facing specific risks at a greater level than some others – draw out & explain
- List **assets created or utilized**

Core Competencies →

- Few skills that the client possesses to a greater extent than most others (may be identified in relation to industry **critical success factors**)

Key Conclusions for Transfer Pricing →

- Discuss company's **strengths & weaknesses** relative to immediate competitors
- Draw out company's activities compared to strategic group – link to the international transactions

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### Intercompany transactions

- Provides a description of intercompany transactions under review
- Depending on circumstances can focus on the following:
  - Separability of transactions
  - Company transfer pricing policy (document, agreements etc.)

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### Intercompany transactions – contents

List transactions →

- Provides clarity on which transactions have been analyzed

Separability of transactions →

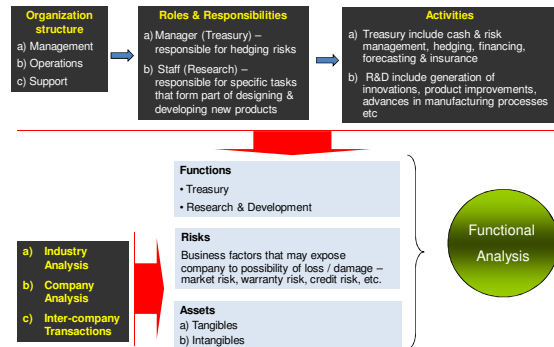
- Discuss whether appropriate to consider transactions one by one or on a grouped basis (whole entity?)
- Consider factors like economic / commercial linkages, available data etc.

TP Policy →

- Describe the company's TP policy document (if any) and/or
- Terms & conditions that apply to transactions
- Intercompany agreements / contracts.

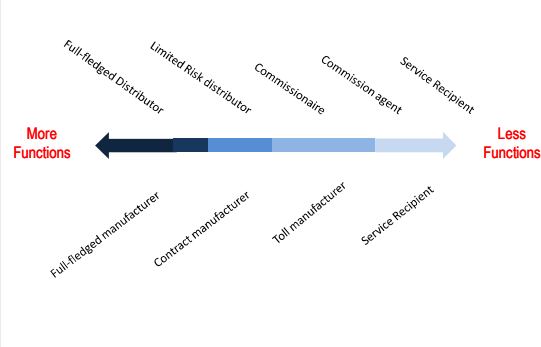
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### Functional analysis – process flow



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### Characterization & Contribution



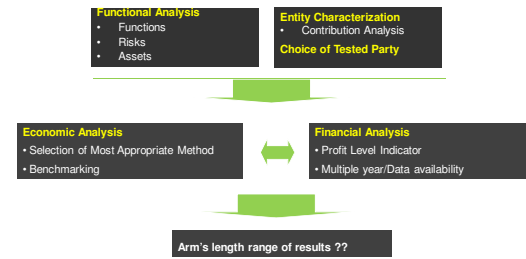
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### Economic analysis – what's this?

- Summarises evaluation of TP accepted methodology, comparable search process & results of benchmarking analysis
  - Choice of most appropriate methodology is based on functions assets & risks
  - Choice of tested party based on summary of contributions
  - Methodology provides indication of which profit level indicator ("PLI") should be applied
  - Core benchmarking consists of searches performed on databases to arrive at a list of comparable independent companies
  - PLI is applied to comparable companies' financials
  - Economic adjustments may need to be performed to enhance comparability

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### Economic analysis – process flow



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### Penalty

- As per the amended provision introduced in the Finance Act 2012, an additional penalty at the rate of **2 percent of the value of international transactions** will be levied in the following cases:
  - Failure to report any international transaction which is required to be reported; and
  - Maintaining or furnishing incorrect information
- Existing penalties provision will be continued, provided as under:

Type of default	Penalty
Concealed income penalty	100% to 300% of tax
Failure to maintain documentation or to submit documentation/information penalty	2% of the value of transaction
Failure to furnish accountant's report	Rs. 100,000/-

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### Conclusions

- Provides the findings of each section of the report
- Analyzes how these conclusions were reached
- Comment on whether the objectives of the report have been met

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### Takeaways

- Build a TP story
- Understand the issues
- Connect the dots / Make the complex understandable
- Speak your client's language
- Seek a fresh perspective



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Thank You

