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ACCOUNTING STANDARD – 18

RELATED PARTY DISCLOSURES

Why AS 18?

It is quite probable that a related party relationship **may have an effect on the profit or loss and financial position of an entity**. Therefore, the users of the financial statements of any entity should have the knowledge of:

- Related party relationships of an entity.
- Entity's transactions, outstanding balances, commitments etc. with such related parties.

1. DEFINITIONS

The following definitions are relevant for understanding the Standard:

1. A **related party** can be
 - a person or
 - entity that is related to the reporting entity.
2. **Relatives in relation to any person** includes: children, spouse, brother, sister, father and mother
3. **Key management personnel** are those people who have authority and responsibility for **planning, directing and controlling** the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

Note:

The definition **includes executive as well as non-executive directors** who have responsibility for the management and direction of a significant part of the business. It is not necessary that these people should have the 'director' designation. The term also includes members of the management committee(s), if those committee(s) has the authority for planning, directing and controlling the entity's activities.

Types of Related Party Relationships:

Type 1: Reporting Entity and a Person

Type 2: Reporting Entity and Another Entity

2. TYPE 1 – RELATIONSHIP WITH A PERSON

A **person** or **his relative is related to a reporting entity** if that person:

- (a) Has **control** or joint control over the reporting entity.
- (b) Has **significant influence** over the reporting entity; or
- (c) Is a member of the **key management personnel (KMP)** of the reporting entity

Examples 1:

1. Mr. A holds 51% of the equity share capital of A Limited. A Limited has no other form of share capital. Since Mr. A control A Limited, he is a related party.
2. Mrs. A is wife of Mr. A. Mr. A hold 51% of equity shares of A Limited. A Limited has no other form of share capital. Mr. A controls A Limited. Since Mr. A is a related party, Mrs. A is also a related party of A Limited.
3. Mr. D is a director of A Limited. Being a member of key management personnel of A Limited, he is related to A Limited.

3. TYPE 2 –RELATIONSHIP WITH ANOTHER ENTITY

Following are the related party relationships:

(a) Parent Company and all subsidiary companies of that Parent are related to each other.

Note: Fellow subsidiary companies are also related to each other.

Example 2:

SA Limited and SB Limited are subsidiaries of H Limited. SA Limited, SB Limited and H Limited are related to each other.

(b) Associate or JV of Parent company or any of its subsidiary companies are related to the parent and all subsidiary companies.

Note:

- i. Subsidiary companies of the above Associate or JV are also related to Parent and all its subsidiaries.
- ii. But Associate/JV of above Associate or JV is not Related Party of the Parent and all its subsidiaries.

Example 3:

AS Limited is an associate of S Limited. S Limited is a subsidiary of H Limited. SH Limited is another subsidiary of H Limited. AS Limited and SH Limited are related parties.

Example 4:

Parent Ltd. has a joint venture in J Ltd. with co-venturer X Ltd. and Parent Ltd. has 35% investment (significant influence) in A Ltd.

Here, Parent Ltd. and J Ltd. are related to each other.

Parent Ltd. and A Ltd. are related to each other.

But Parent Ltd. and X Ltd. (Co-Venturers) are not related to each other.

Example 5:

X Ltd. has Subsidiaries Y Ltd., Z Ltd., A Ltd. & B Ltd.

Also, B Ltd. has an Associate co. C Ltd. and A Ltd. has an associate co. D Ltd.

Here, Group consist of X, Y, Z, A & B only. Entire group is related party of each other.

C Ltd. is related party of all members of group i.e. X, Y, Z, A & B.

D Ltd. is related party of all members of group i.e. X, Y, Z, A & B.

But C Ltd. and D Ltd. are co-associate and are not related party to each other.

Example 6:

R Limited has an associate B Limited. B Limited has a subsidiary S Limited, a joint venture J Limited and an associate A Limited. R Limited is the reporting entity. It identifies B Limited and S Limited as its related parties. J Limited and A Limited are not related parties of R Limited.

- (c) If a Person (including his relative) or an Entity is having Control/Significant Influence/KMP over one entity and Control or Significant influence or is a KMP of another entity then both entities are related to each other.

Example 7:

Mr. A controls A Limited (the reporting entity). He also controls B Limited. A Limited and B Limited are related to each other.

Example 8:

Mr. A controls A Limited (the reporting entity). He is a non-executive director of B Limited. A Limited and B Limited are related parties.

Example 9:

Mr. A is Director of A Limited (the reporting entity). He is a non-executive director of B Limited also. A Limited and B Limited are related parties.

4. NO RELATED PARTY RELASHIOSHIPS

- (a) Co-venturers of the same Joint Venture are not related to each other.
- (b) Major Customers, Finance Providers, Trade unions, Govt. Departments or agencies, Major Supplier, Franchisor, distributor, Agent etc only because of their business dealings with entity.

Example 10:

A Bank and B Bank have provided finance to XY Limited. By virtue of the loan agreement, they occupy a non-executive observer seat on the Board of Directors of XY Limited. A Bank and B Bank are not related parties of XY Limited.

5. RELATED PARTY DISCLOSURES

The disclosure requirements can be broadly classified into two categories.

- (a) **Category 1:** Relationship between Parent & Subsidiary, following disclosures are required **even when there are not transactions between them** during the year:
 - 1) Name of Parent or Subsidiary companies.
 - 2) Name of Ultimate Parent Company (if immediate parent is also a subsidiary)
- (b) **Category 2:** Any other Relationship between Entity and a Person or Another entity requires disclosures of relationships and items **only when there are related party transactions** during the year:
 - 1) Nature of Related Party Relationship
 - 2) Nature and Amount of Transaction during relationship period
 - 3) Outstanding Balance due from or due to as on balance sheet date
 - 4) Expenses recognised in respect of bad-debts due from related parties
 - 5) Provisions created on outstanding balances from related parties

Note: Remuneration paid to key management personnel should be **considered as a related party transaction** requiring disclosures. In case non-executive directors on the Board of Directors are not related parties, remuneration paid to them should not be considered a related party transaction.

6. OTHER IMPORTANT POINTS

- 1) A related party transaction can be **transfer of resources, services or obligations** between reporting entity and related entities, such as:
 - purchases or sales of goods (finished or unfinished);
 - purchases or sales of property and other assets;
 - rendering or receiving of services;
 - leases;
 - transfers of research and development;
 - transfers under licence agreements;
 - transfers under finance arrangements (including loans and equity contributions in cash or in kind);
 - provision of guarantees or collateral;
- 2) A reporting entity is also **exempt from the disclosure** requirements in relation to (i) related party transactions (ii) outstanding balances and (iii) commitments with **a government or state controlled entity** that has control, joint control or significant influence over the reporting entity;

7. (MCQ's from ICAI Material)

1. According to AS-18 Related Party Disclosures, which ONE of the following is not a related party of Skyline Limited?
- (a) A shareholder of Skyline Limited owning 30% of the ordinary share capital
 - (b) An entity providing banking facilities to Skyline Limited in the normal course of business
 - (c) An associate of Skyline Limited
 - (d) Key management personnel of Skyline Limited

2. Are the following statements in relation to related parties true or false, according to AS-18 Related Party Disclosures?

(A) A party is related to another entity that it is jointly controlled by. (B) A party is related to another entity that it controls.

Statement (A)	Statement (B)
(a) False	False
(b) False	True
(c) True	False
(d) True	True

3. Which of the following is not a related party as envisaged by AS-18 Related Party Disclosures?
- (a) A director of the entity
 - (b) The parent company of the entity
 - (c) A shareholder of the entity that holds 1% stake in the entity
 - (d) The spouse of the managing director of the entity
4. According to AS-18 Related Party Disclosures, related party transaction is a transfer of resources or obligations between related parties - provided a price is charged for such transfer.
- (a) True
 - (b) False
5. According to AS-18 Related Party Disclosures, parties are considered to be related, if and only if at the end of the reporting period - one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.
- (a) True
 - (b) False

ANSWERS	1	2	3	4	5
	b	d	c	b	b