



# Related Party Relationships

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# The Related Party Issue

- RPT – Common globally
- Approach change – Nothing wrong with RPT
  - Quality reasons
  - Propriety technology
  - Many cases transactions **SHOULD BE at OTHER THAN FAIR VALUE**
- Share information – no issues
- Information **held back raises** discomfort

# Related Party Disclosures

## FUNDAMENTALS – Why Group Ops??

1. Enterprises operate as Groups ; not as single entity for all business
2. Group includes
  - Subsidiary
  - Associates
  - Joint Ventures
3. Reasons
  - Fiscal incentives –Direct and Indirect
  - Optimal allocation of resources
  - Core competence - Technology
  - Difference in Management skills, Board personnel
  - Differing degree of control need and “dominance factor”
  - Succession planning
  - Regulatory framework

# AS 18 - Brief Overview



- **Applicability**
- **The Related Party Issue**
  
- **Meaning of Related Party Relationships**
  
- **Certain other Definitions**
  
- **Disclosure Requirements**
  - **Control, Significant influence**
  
- **Companies Act 2013**

# AS 21 – Related Party Disclosures

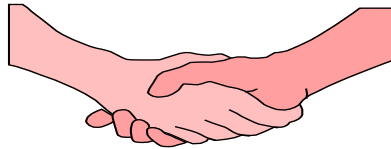
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# AS 18 - Related Party Disclosures -- Objectives

## Disclosure Requirements

Related Party Relationships.



Related Party Transactions

Related Party Relations arise from:

- ..ability to control or
- ..exercise significant influence in financial and/or operating decisions.

Related Party transactions..

.. is transfer of resources or obligations between related parties

.. regardless of price being charged or not

# Two simple rules

- If control exists, during the period, disclose relationship whether or not transactions
- If significant influence exists, disclose
  - a) nature of relationship,
  - b) also details of transaction

# Exceptions to disclosure

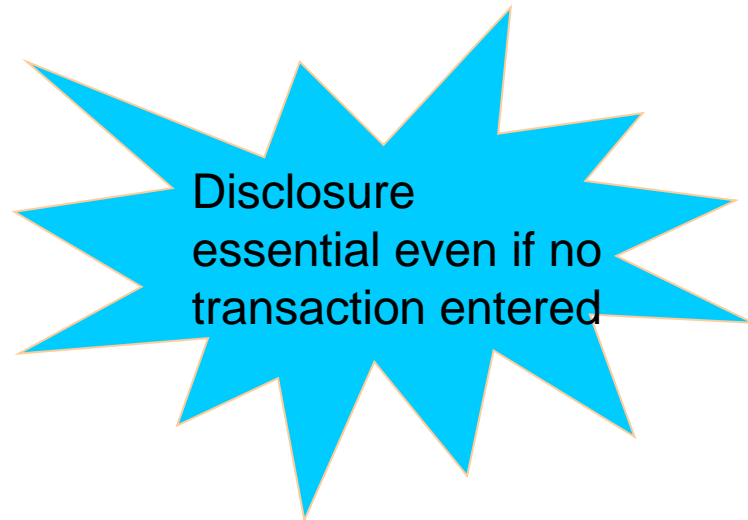
- Even if control or significant influence exists no need for any disclosure - where
  - a) RE's duties of confidentiality (Bank)
  - b) Intra group transactions in CFS (rationale, they already stand eliminated)
  - c) All kinds of PSUs - their transactions with other PSUs (Volume, and meaninglessness)



# Related Party Relationships of Control

What should be disclosed -

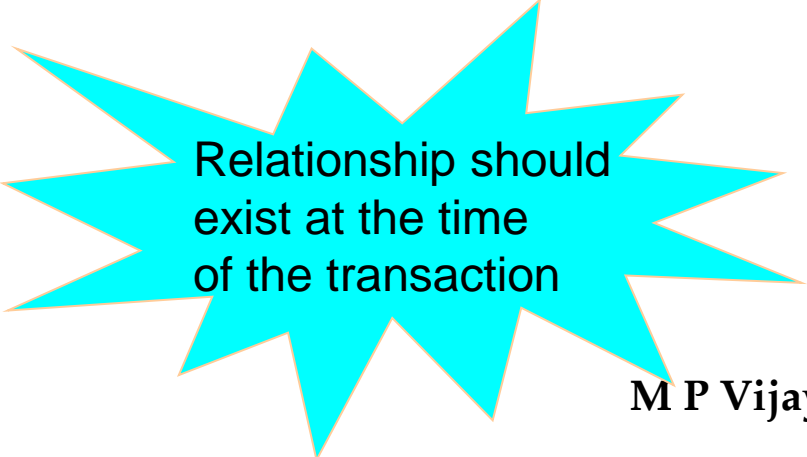
- a) Name of the related party
- b) Nature of the related party relationship where control exists.



# Related Party Transactions – C+SI

Disclose - all details

- \* Name of the transacting party
- \* Description of the relationship
- \* Description of the nature of transactions including volume and any other elements considered necessary for understanding
- \* Amounts outstanding
- \* Provisions for doubtful debts due from such parties at that date; and
- \* Amounts written off or written back in the period



Relationship should exist at the time of the transaction

# Meaning of RP & RPT

- Basically, one who has the “ability” to control, or exercise significant influence over another
- RP T - where there is a transfer of economic resource, with or without consideration
- Can be many situations - leading to Related party relationships
- Standard provides five specific situations

# Reporting Entity

- The relationships revolve round the Reporting Entity
- If there is no link with Reporting Entity, we can stop there
- See what is the link with “RE”

# What constitutes RPR

- (a) HC, Sub, Fellow Subsidiaries
- (b) Associates and JVs
- (c) Individuals having VP + Relatives
- (d) K M P + Relatives
- (e) Enterprises in which such Individuals or KMP have significant influence  
(but this includes enterprises owned by Directors or major shareholders)

# Five Relationships

1. HC, Sub, Fellow Sub - closely in alignment with Companies Act - no elaboration
2. Associate - where investing reporting entity has significant influence (sans Sub, JV) + JV: common economic activity of two or more parties, under contractual arrangement (vice versa)
3. Individuals - control or significant influence +Rel
4. KMP - “Authority and Responsibility” - planning, directing and controlling activity + Rel
5. Enterprises involving Individuals or KMP

# Individuals.. .. + relatives!

- Own (direct/indirect) voting power
  - Control, or
  - Substantial interest
  - substantial interest -- drawn from IT Act
- 20% or more Voting Power
- Rebuttable presumption
- His/her relative

# Key Management Personnel + relative

- KMP in the case of a company
  - Managing Director
  - Whole time Director
  - Manager
  - Part time or ED, VPs, etc not a part of KMP
  - TEST - Board accustomed to act



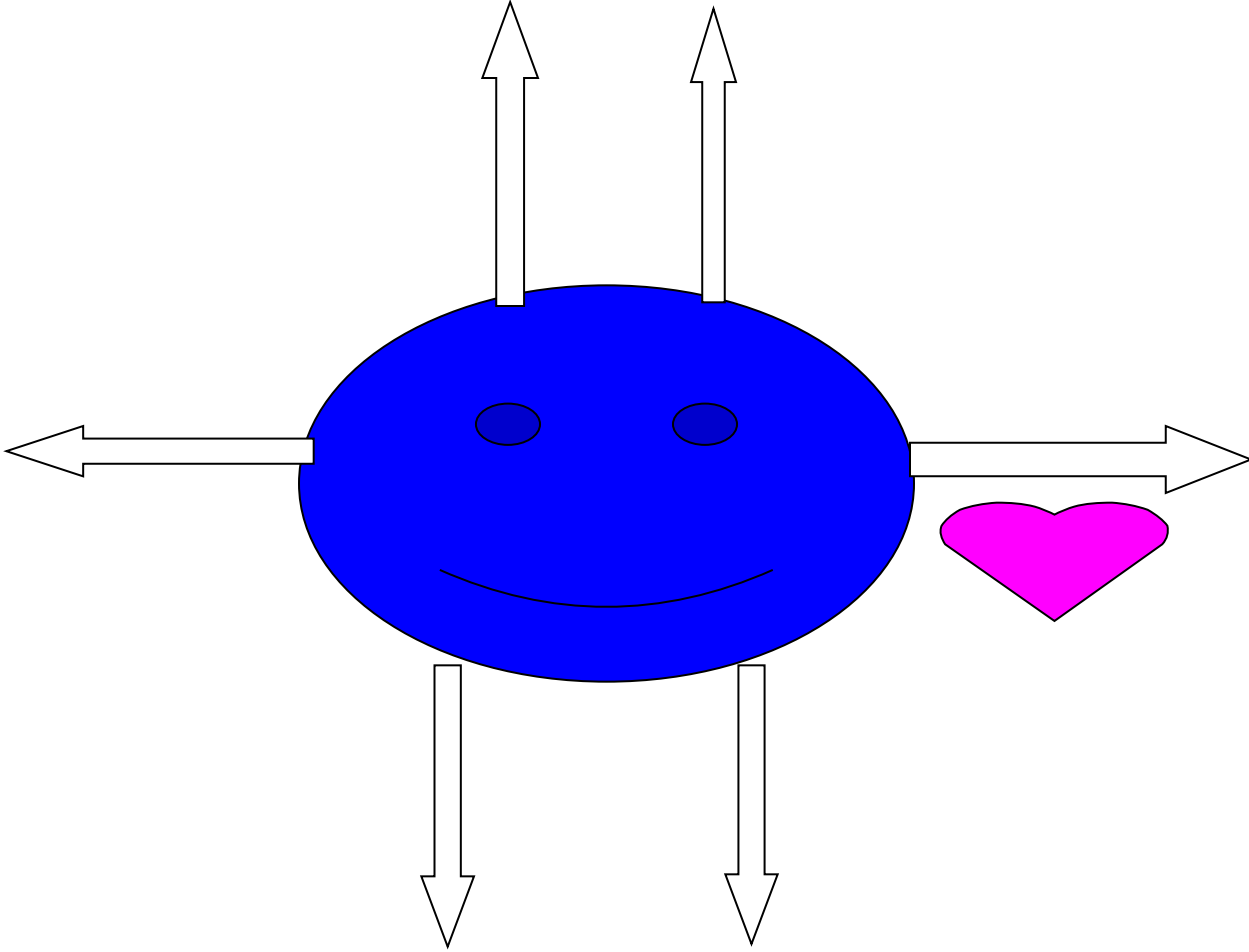
# Enterprises - - - KMP

- There are KMP (or their relatives)
- There are also certain enterprises (say X)
- If a KMP or his relative can exercise significant influence over X, then that enterprise is a related party

# Relative??

- Compared to Companies Act comprehending this term is easy
- A relative for AS 18 is

PARENTS



BROTHERS  
SISTER

SPOUSE

CHILDREN

# Disclosures -- Control vs. Significant Influence

## Control

- a) - ownership of more than 50% voting power, or
- b) - control of the composition of the BoD
- c) - substantial interest in voting power **and power to direct** financial and/or operating policies.

## Significant influence Examples include

- a) - Representation on the Board
- b) - Participation in the policy making process,
- c) - Interchange of managerial personnel, or
- d) - Dependence on technical information.

# What is not “R P R”

- Only because there is common directorship in two companies - NO RPR, unless “control, or significant influence”
- Single customer - franchisee, distributor etc
- Finance Providers, Trade Unions, Public utilities, GOI departments/agencies etc

# Exceptions to disclosure

- Even if control or significant influence exists no need for any disclosure - where
  - a) RE's duties of confidentiality (Bank)
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# A small point

- Related Party relationship
- Not at the BS date, but
- If it exists, at any time during the period
- Disclosure requirements are attracted

# AS 18 - Related Party Disclosures -- Disclosure requirements - (GC 9/2002)

	Holding Company	Subsidiaries	Fellow Subsidiaries	Associates	KMP	Relatives of KMP	Total
Purchases of goods							
Sale of goods							
Purchase of fixed assets							
Sale of fixed assets							
Rendering of services							
Receiving of services							
Agency arrangements							
Leasing or HP arrangements							
Transfer of R&D							
Licence agreements							
Finance (including loans and equity contributions in cash/kind)							



# AS 18 - Related Party Disclosures -- Disclosure requirements - (GC 9/2002) - (Contd...)

	Holding Company	Subsidiaries	Fellow Subsidiaries	Associates	KMP	Relatives of KMP	Total
Guarantees and collaterals							
Management contracts including for deputation of employees							

<b>Note: Names of related parties and description of relationship:</b>		
1	Holding Company	A Ltd.
2	Subsidiaries	B Ltd. and C (P) Ltd.
3	Fellow Subsidiaries	D Ltd. and Q Ltd.
4	Associates	X Ltd., Y Ltd. and Z (P) Ltd.
5	KMP	Mr. Y and Mr. Z
6	Relatives of KMP	Mrs. Y (wife of Mr. Y), Mr. F (father of Mr. Z)

# Legislation in India – Comp. Act

- 297** - Board's sanction for "contracts" in which D are interested
- 299** - Disclosure of D's Interest
- 300** - Interested D not to participate
- 301** - Register of Contracts; also companies where D interested
- 303** - Register of Directors (other companies, offices held by D)

# Legislation in India – Comp. Act

- **134 (3) (h) – Directors' Report shall specify RPTs**
- **217-2A - Employee remuneration;**  
**but sub clause (b)(i) also provides disclosure of “relationship” with D, if any**
- **Sch VI - Loans to D, Investment in companies in D interested etc. separate disclosure**
- **227 4A CARO : Also, in our general 227 report comments - Personal expenses**

# Legislation in India - I T, Competition Act, Excise

- **IT 1973** - Charitable Institutions 12A(b), listing in terms of 13(1(3) Manager, Trustee etc
- **IT : 40(A)(2)(b)** - disallowance for “excessive” payments
- **IT : 80-I, 80-IA** - disallowance if, transaction is in excess of fair market price
- **Competition Act** - Dominant or Group Undertakings
- **Excise Law** - Related party sale, drawn MRTP Act now (valuation rules)
- Likely many others exist

# CLAUSE 49

## Role of Audit Committee

- Reviewing with Management, the Annual Financial Statements before submission to BoD w.r.t **“Disclosure of related party transactions”**
- RPT has same meaning as in AS 18

# CLAUSE 49

## Review of Information by Audit Committee

- Mandatorily review “ **Statement of significant RPT ( as defined by audit committee), submitted by management**”
- Review what?
  1. Whether all transactions are reported
  2. Adequacy of disclosures
  3. Bonafides of the transaction – propriety and need

# CLAUSE 49

## Disclosure – Basis of RPT

1. Periodically placed before A.C.
  - Statement in summary form of transactions with RP **in the ORDINARY course of business**
2. Placed before A.C.
  - Details of material transactions with RP which are **not in NORMAL course of business**
3. Placed before A.C. with Management Justification
  - Details of **MATERIAL** individual transactions with related parties or **OTHERS** which are **not** on arms length basis

# Companies Act, 2013

## Related Party Transactions (RPT)

- **Sec 188 of the Companies Act, 2013\***
- **Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014**
- **Applicable to all Companies**
- \*as per Companies (Amendment) Act, 2015



# Related Party - Definition

1. Director , KMP or relative of such person – of the Company and Holding Company
2. **Firm** in which a director, manager or relative is a partner
3. **Private company** in which a director or manager *or his relative* is a member/director
4. **A Public Co.** in which a director or manager is a director *along with relatives* holds more than 2% paid up capital
5. **Any body corporate** whose Board, MD or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager *(except in Professional capacity)*

# Related Party – Definition – Contd..

6. **Any person (except in Professional capacity)** on whose advice, directions or instructions a director or manager is accustomed to act
  
7. **Any Company** which is:
  - a holding, subsidiary or an associated company of such company
  - a fellow subsidiary
  
8. (Central Govt can add.....)

# Relative - Definition

- **Members of HUF**
- **Spouse**
- **As may be prescribed**
  - **Mom/Dad including Step....**
  - **Son including step-son.**
  - **Daughter**
  - **Daughter in law/ Son in law**
  - **Brother/Sister including Step- bro/sis**

# Other - Definitions

- **Arms Length Transaction**
  - **A TXN between related parties, as if they are between unrelated parties and there is no conflict of interest**
- **Office or Place of profit**
  - **Director- anything above remuneration**
  - **Others (individual not a director, firm, pvt co or body corporate) – anything above remuneration**  
(some ambiguity for other than individuals- to wait and watch)

# Related party transactions

## RPT – Contract / arrangement with respect to

1. Sale, Purchase or supply of any goods or materials;
2. Selling or otherwise disposing of, or buying, property of any kind;
3. Leasing of property of any kind;
4. Availing or rendering of any services;
5. Appointment of any agent for purchase or sale of goods, materials, services or property;
6. Such related party's appointment to any Office or Place of Profit in the Company, its Subsidiary Company or Associate Company and
7. Underwriting the subscription of any securities or derivatives thereof

# RPT: Approvals

Contracts / arrangements (transactions)

1. **Prior approval of Board and Shareholders** by Ordinary\* resolution:

- RPT that exceed the limits prescribed in the next slide
- ~~Contract or Arrangement: If Paid up capital is Rs. 10 crore or more. (Dispensed w.e.f August 14, 2014)~~

2. **Prior Board approval** enough for the transactions within above limits

3. **No approval** is required if any transaction is in the **Ordinary** course of business and at **arms length**.

***W.E.F. 26.05.2015 NO APPROVAL is required for the RPT between Holding Company and its Wholly Owned Subsidiary***

# RPT- limits

Nature of Transaction	Limit
Sale, purchase or supply of any goods or materials directly or through appointment of agents*	>10% of the TO or Rs.100 crore whichever is lower
Selling or otherwise disposing of, or buying, property directly or through appointment of agents*	>10%. of NW or Rs.100 crore whichever is lower
Leasing of property*	>10% of the NW or exceeding 10%. of TO or Rs.100 crore whichever is lower
Availing or rendering of any services directly or through appointment of agents*	>10% of TO or Rs. 50 crore whichever is lower
Appointment to any office or place of profit in the Company, its subsidiary company or associate company	At a monthly remuneration exceeding ₹ 2,50,000/-
Remuneration for underwriting the subscription of any securities or derivatives thereof of the company	> 1% of the NW

\* The limits specified for transaction or transactions to be entered into either individually or taken together with the previous transactions during the year. Net worth/Turnover is based on audited financial statement of preceding FY

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# Board Approval

Agenda to contain:

- Name of RP and nature of relationship
- Nature, duration, particulars, material terms of contract
- Advance paid/received if any
- Manner of determining pricing/other commercial terms – included in contract **as well as not included**
- Whether all factors relevant to contract have been considered ; **if not what factors are not considered and reasons for non considering**
- **Any other info, relevant/important for Board to take a decision on proposed TXN**



# Shareholders Approval

**Explanatory statement – to include**

- **Name of RP and nature of relationship**
- **Name of Director/KMP who is related, if any**
- **Nature, material terms, monetary value and particulars of contract**
- **Any other info, relevant/important for members to take a decision**

# RPT Reporting and compliance

- **RPT– Board report, with justification**
  - Circulate all details in notice to board meeting
  - Interested Director not to be present in meeting
- **RPT - If prior approval missed; ratify within 3 months; else**
  - Director/other employee is interested – voidable at option of Board
  - Related Party to any Director or authorised by any other director, the Director concerned has to compensate company for loss
- Interested party not to vote at GM

# Compliance

- Conviction of Director- disqualified for 5 years.
- Section 177(4) of Companies Act, 2013 amended on 26.05.2015 to **empower Audit Committee** to give omnibus approvals for related party transactions on annual basis.
- Sec 188 not applicable to scheme of amalgamation/compromise/restructuring
- Contracts signed up before 1<sup>st</sup> April 14- continue to be valid. Board/Shareholders approvals- required only when terms change or old contract period expires

# Punishment

- Any **director or any other employee** of a company, who had entered into or authorized the contract or arrangement in violation of the provisions of this section shall in case of:
  - Listed Company : 1 year or Rs 25,000 to Rs 5 lacs or both
  - Other Companies : Rs25,000 to Rs.5 lacs





# What's new

- The MCA had asked Sebi to align its provisions regarding RPTs with the Companies Act 2013 - to benefit Vedanta and Suzuki!!