

A Discussion on Related Parties

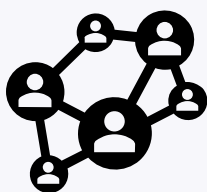
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Introduction



Related party transactions are common as they make a lot of business sense – they are easier, more flexible and more beneficial compared to transactions with other parties. However, since there is a chance that they may not take place at arm's length and hence may pose risks to investors, laws of the land require that corporates make certain minimum levels of disclosure on related parties and transactions with related parties in their annual reports and seek necessary

approvals from shareholders.

The following is a topical discussion on the definition of “Related Parties” as per section 2(76) of the Companies Act, 2013 and as per the Accounting Standards – AS 18 and Ind AS 24. The purpose of the discussion is to throw light on the differences in the scope of the term and to serve as a ready reckoner for the purpose of compliance relating to related party transactions. This note does not cover the procedure or approval process for related party transactions, which shall be dealt with in a later note.

The definition under section 2(76) of the Companies Act, 2013 is necessary for compliance under section 177 and section 188, which, inter alia, deal with audit committee approval, board approval and shareholders' approval for certain related party transactions. While section 177 mandates audit committee approval for all transactions with related parties for those companies where constitution of an audit committee is necessary.

Section 188 mandates approval of board of directors for specified related party transactions and shareholders' approval in case the transactions cross prescribed thresholds. However, the compliance under section 188 shall not be necessary where the transactions are in the ordinary course of business and are on arm's length basis.

Regulation 23 read with Schedule V of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("Listing Regulations") also contain certain requirements relating to related party transactions.

The first step towards related party compliance is identification of the related parties. In respect of unlisted companies, study of the definition under section 2(76) would suffice. However, in case of listed companies, the term not only includes the parties included under the Companies Act, 2013 but also those included under AS-18 or Ind AS 24, as the case may be. Further, disclosures required under AS 18 and Ind AS 24, as the case may be, need to form part of the notes accompanying the financial statements for both listed as well as unlisted companies.

Hence, we shall undertake a study of the term as used in these three legal requirements. We shall first see the definitions given in these three provisions and then attempt compare and contrast the differences in the definitions.

Definitions

Definition under the Companies Act, 2013

As given in section 2(76) and 2(77) of the Companies Act, 2013:

2(76) "related party", with reference to a company, means—

- (i) a director or his relative;
- (ii) a key managerial personnel or his relative;
- (iii) a firm, in which a director, manager or his relative is a partner;
- (iv) a private company in which a director or manager or his relative is a member or director;
- (v) a public company in which a director or manager is a director and holds along with his relatives, more than two per cent of its paid-up share capital;
- (vi) any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;
- (vii) any person on whose advice, directions or instructions a director or manager is accustomed to act:

Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;

(viii) any body corporate which is—

- (A) a holding, subsidiary or an associate company of such company;
- (B) a subsidiary of a holding company to which it is also a subsidiary; or

(C) an investing company or the venturer of the company;"

Explanation.—For the purpose of this clause, “the investing company or the venturer of a company” means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate.

(ix) such other person [as may be prescribed](#);

For the purposes of sub-clause (ix) of clause (76) of section 2 of the Act, a director other than an independent director or key managerial personnel of the holding company or his relative with reference to a company, shall be deemed to be a related party.

(77) "relative", with reference to any person, means any one who is related to another, if—

(i) they are members of a Hindu Undivided Family;

(ii) they are husband and wife; or

(iii) one person is related to the other in such manner [as may be prescribed](#);

Definition under AS-18

Related party - parties are considered to be related if at any time during 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.

This Standard deals only with related party relationships described in (a) to (e) below:

(a) enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries);

(b) associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture;

(c) individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual;

(d) key management personnel and relatives of such personnel; and

(e) enterprises over which any person described in (c) or (d) is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.

In the context of this Standard, the following are deemed not to be related parties:

(a) two companies simply because they have a director in common, notwithstanding paragraph 3(d) or (e) above (unless the director is able to affect the policies of both companies in their mutual dealings);

(b) a single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence; and

(c) the parties listed below, in the course of their normal dealings with an enterprise by virtue only of those dealings (although they may circumscribe the freedom of action of the enterprise or participate in its decision-making process): (i) providers of finance; (ii) trade unions; (iii) public utilities; (iv) government departments and government agencies including government sponsored bodies.

In the context of AS-18, Key management personnel refers to those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. For example, in the case of a company, the managing director(s), whole time director(s), manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel. Explanation: A non-executive director of a company is not considered as a key management person under this Standard by virtue of merely his being a director unless he has the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. The requirements of this Standard are not applied in respect of a non-executive director even enterprise, unless he falls in any of the categories in paragraph 3 of this Standard.

Relative – in relation to an individual, means the spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or be influenced by, that individual in his/her dealings with the reporting enterprise.

Definition under Ind-AS-24

A related party is a person or entity that is related to the entity that is preparing its financial statements (in this Standard referred to as the 'reporting entity').

(a) A person or a close member of that person's family is related to a reporting entity if that person:

(i) has control or joint control of the reporting entity;

(ii) has significant influence over the reporting entity; or

(iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

(b) An entity is related to a reporting entity if any of the following conditions applies:

(i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

(ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

- (iii) Both entities are joint ventures of the same third party.
- (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
- (v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
- (vi) The entity is controlled or jointly controlled by a person identified in (a).
- (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).
- (viii) The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity including: (a) that person's children, spouse or domestic partner, brother, sister, father and mother; (b) children of that person's spouse or domestic partner; and (c) dependants of that person or that person's spouse or domestic partner.

Key management personnel are those persons having 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.

In considering each possible related party relationship, attention is directed to the substance of the relationship and not merely the legal form.

In the context of this Standard, the following are not related parties:

- (a) two entities simply because they have a director or other member of key management personnel in common or because a member of key management personnel of one entity has significant influence over the other entity.
- (b) two joint venturers simply because they share joint control of a joint venture.
- (c) (i) providers of finance, (ii) trade unions, (iii) public utilities, and (iv) departments and agencies of a government that does not control, jointly control or significantly influence the reporting entity, simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision making process).
- (d) a customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, simply by virtue of the resulting economic dependence.

In the definition of a related party, an associate includes subsidiaries of the associate and a joint venture includes subsidiaries of the joint venture. Therefore, for example, an associate's subsidiary and the investor that has significant influence over the associate are related to each other.

Comparison of Related Parties under the Companies Act, 2013 and the Accounting Standards

From the above definitions, let us attempt to create a table that would highlight the differences:

Party	Companies Act, 2013	AS-18	Ind AS-24
Director and Relatives	Yes	If they can be classified as KMP	All directors as KMP definition specifically includes NEDs
KMP and relatives	Yes	Yes	Yes
Definition of KMP	2(51) "key managerial personnel", in relation to a company, means— (i) the Chief Executive Officer or the managing director or the manager; (ii) the company secretary; (iii) the whole-time director; (iv) the Chief Financial Officer; (v) such other officer, not more than one level below the directors who is in whole-time employment, designated as key managerial personnel by the Board; and (vi) such other officer as may be prescribed NEDs are not included.	In the context of AS-18, Key management personnel refers to those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. For example, in the case of a company, the managing director(s), whole time director(s), manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel. NEDs are not included.	Key management personnel are those persons having 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. NEDs are included.
Director of holding company and relatives	Yes except independent director	No	Yes
KMP of holding company and relatives	Yes	No	Yes
Definition of relative	Members of HUF; Spouse; Father including step-father; Mother	spouse, son, daughter, brother, sister, father and mother who may be expected to influence,	Close members of the family of a person are those family members who may be expected to

	<p>including step-mother; Son including step-son; Son's wife; Daughter; Daughter's husband; Brother including step-brother; Sister including step-sister.</p> <p>Other dependents, domestic partners are not included. Members of HUF are included only under the Act not under accounting standards unless they fall under other categories.</p>	<p>or be influenced by, that individual in his/her dealings with the reporting enterprise.</p> <p>This is a narrow definition in comparison with the other two.</p>	<p>influence, or be influenced by, that person in their dealings with the entity including: (a) that person's children, spouse or domestic partner, brother, sister, father and mother; (b) children of that person's spouse or domestic partner; and (c) dependents of that person or that person's spouse or domestic partner. Son-in-law, daughter-in-law, step-mother, step-father, etc. are not included unless they are dependents. Further, domestic partner and his/her dependents are also included.</p>
Entities related to aforesaid directors and KMP and their relatives	<p>A firm, in which a director, manager or his relative is a partner; a private company in which a director or manager or his relative is a member or director; a public company in which a director or manager is a director and holds along with his relatives, more than two per cent of its paid-up share capital; any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or</p>	<p>Enterprises over which KMP or relative is able to exercise significant influence. This includes enterprises owned by directors (executive) and enterprises that have a member of key management in common with the reporting enterprise.</p>	<p>Entities controlled or jointly controlled by KMPs of the reporting entity and their relatives and the KMPs of the parent of the reporting entity and their relatives.</p> <p>Concept of control or joint control by the KMP or relative needs to be seen.</p>

	instructions of a director or manager; This is a specific list of entities.		
Person on whose advice, directions or instructions a director or manager is accustomed to act	Yes	Yes as included in KMP	Yes
Individuals having control or significant influence and relatives and not falling under above categories – Eg.: Major individual shareholders who are neither directors nor KMP or their relative	No	Yes	Yes
Entities related to individuals having control or significant influence and relatives and not falling under above categories	No	Enterprises over which the individual is able to exercise significant influence. This includes enterprises owned by major shareholders of the reporting enterprise.	Yes; entities controlled or jointly controlled or significantly influenced by them; In case of individuals having only significant influence over the reporting entity and their relatives, entities controlled or jointly controlled by such individuals (and not merely significant influence over the other entity)
Mere common directorship	Yes in case the other party is a private company	No	No
Mere common KMP	No	Yes as specifically provided in example in the Standard.	No.
Mere common shareholding	No	No	No
Holding entity (companies as well as)	Yes (not if reporting entity is a private company)	Yes	Yes

other bodies corporate)			
Subsidiaries (companies as well as other bodies corporate) (directly or indirectly through other subsidiaries)	Yes (not if reporting entity is a private company)	Yes	Yes
Fellow subsidiaries (companies and other bodies corporate)	Only if company (not if reporting entity is a private company)	Yes	Yes
Associates	Only if company (not if reporting entity is a private company)	Yes	Yes and includes associates' subsidiaries
Investing party	Yes (investing company is defined to mean a body corporate and not merely a company)	Yes	Yes
JV	Only if company (not if reporting entity is a private company)	Yes	Yes and includes JV's subsidiaries
Venturer	Yes	Yes	Yes
Subsidiary's associate/JV	No	No	Yes
Holding company's associate/JV	No	No	Yes
Fellow subsidiary's associate/JV	No	No	Yes
*Venturer's associate	No	No	Yes
*Investing party's JV	No	No	Yes
*Associate's subsidiary	No	No	Yes
*JV's subsidiary	No	No	Yes
*Associate's associate	No	No	No
*JV's venturer	No	No	No

*For the sake of clarity: these are from the point of view of reporting enterprise.

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