

Non-Compliance with Reporting Obligations Observed by the Financial Reporting Review Board Relating to AS 18 'Related Party Disclosures'

Financial Reporting Review Board (FRRB or “the Board”) identifies various non-compliances during its review of the general-purpose financial statements of selected enterprises and the auditors’ reports thereon. With a view to apprise the members of the Institute and others concerned about the major non-compliances, a compilation of such non-compliances is published in the Journal of the Institute. Enduring the same effort, published below are some of the common non-compliances observed by the Board during its review relating to AS 18, Related Party Disclosures, notified under the Companies (Accounting Standards) Rules, 2006:

1. Some enterprises, while giving the Related Party disclosures, simply state that there are no material individual transactions with the related parties during the year which are not in the normal course of their business or at arm’s length basis and, accordingly, do not provide any disclosures. Others provide disclosures for “significant transactions with the related parties.” It was noted that paragraph 23 of AS 18, Related Party Disclosures, notified under the Rules states as follows:

“23. If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

- (i) *the name of the transacting related party;*
- (ii) *a description of the relationship between the parties;*
- (iii) *a description of the nature of transactions;*
- (iv) *volume of the transactions either as an amount or as an appropriate proportion;*
- (v) *any other elements of the related party transactions necessary for an understanding of the financial statements*
- (vi) *the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date;”*

In the opinion of the Board, AS 18 does not prescribe for classification of transactions with related parties as significant/insignificant or material/immaterial transactions. It is also felt that all transac-

tions with related parties must be disclosed rather than just disclosing the significant transactions. Accordingly, non-disclosure of related party transactions on the pretext that no significant transactions have taken place or that only significant transactions are required to be disclosed is not in line with AS 18.

2. Under the Related Party disclosures of some enterprises, it has been noted that although the items of similar nature have been disclosed in aggregate for each type of related party, individual party disclosures have not been made though material transactions have taken place with certain individual related parties. It may be noted that as per paragraph 27 of AS18, Related Party Disclosures, items of a similar nature may be disclosed in aggregate by type of related party; however, this should not be done in such a way as to obscure the importance of significant transactions and further explanation to the paragraph states that materiality primarily depends on the facts and circumstances of each case. Ordinarily, a related party transaction the amount of which is in excess of 10% of the total related party transactions of the same type (such as purchase of goods), is considered material, unless on the basis of the facts and circumstances of the case it can be concluded that even a transaction of less than 10% is material. As regards the nature of the transaction, ordinarily the related party transactions which are not entered into in the normal course of the business of the reporting enterprise are considered material subject to the facts and circumstances of the case. Hence, it was viewed, that if any transaction with an individual party constitutes 10% of the total related party transactions of the same nature, then it shall be treated as material transaction with an individual party and, accordingly, the party-wise disclosure of the said transaction should be made in the Related Party disclosure. If such disclosure has not been made, it is felt that the disclosure requirement of AS 18 in this regard has not been strictly complied with.
3. Some enterprises have not reported under Related Party disclosures the remuneration paid to the managing director and/or the whole-time director.

It may be noted that paragraph 20 of AS 18 requires the disclosure of transactions with the directors or similar key management personnel of an enterprise because of the fiduciary nature of their relationship with the enterprise. Key Management Personnel are defined in paragraph 14 of AS 18 as "those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise." Accordingly, it is viewed that the managing director and the whole-time director are key management personnel, and therefore, remuneration paid to them should also be reported under related party disclosures in the manner specified in paragraph 23 of AS 18. It may be noted that as per explanation to paragraph 14, non executive directors are not Key Management Personnel; therefore, any remuneration paid to them cannot be considered as Related Party Transaction.

4. It has been noted from notes to accounts of the enterprises that often the accounting heads used under the Related Party disclosures are different from those used in the financial statements. For instance, in the Balance Sheet, assets have been classified as 'Tangible Assets' and 'Intangible Assets' whereas no such classification has been adopted for fixed assets under the Related Party disclosures. Further, under the Related Party disclosures 'purchases of services' has been reported to have been made from related parties whereas in the Statement of Profit and Loss, there are various services being purchased by the enterprise. Due to difference in the nature of nomenclature used under the Related Party disclosure *vis-à-vis* the financial statements, it is felt that it may be difficult for the readers of the financial statements to understand the elements of related party transactions and assess their impact on the financial statements. Accordingly, it is felt that for proper understanding of the financial statements, it is recommended that the accounting heads used for the Related Party disclosures should be in line with those used in the financial statements.
5. It may be noted that paragraph 21 of AS 18, Related Party Disclosure, requires that the name of the related party and the nature of the related party relationship where control exists should be disclosed, irrespective of whether or not there have been transactions between the related parties. Following non-compliances have been commonly noted from

review of the Related Party disclosures of various enterprises:

- In some cases, the names of related parties have been disclosed but the nature of the relationship with them has not been disclosed.
 - In other cases, the names and the nature of only those related parties have been disclosed with whom transactions have taken place during the year.
6. Under the Related Party disclosures, XYZ Co. Ltd. has been described as a fellow subsidiary of the enterprise. As per paragraph 10 of AS 18, Related Party Disclosure, "A company is considered to be a fellow subsidiary of another company if both are subsidiaries of the same holding company." Accordingly, it was observed that usage of the term 'fellow subsidiary' is a *prima facie* indicative of the fact that the company itself is a subsidiary of another company. However, name of the holding company is not disclosed under the Related Party disclosures. Accordingly, it can be concluded that either the name of the holding company has not been disclosed as required under AS 18 or the description of a party as a "fellow subsidiary" is not correct. In any case, such incomplete disclosures are not in line with the requirements of AS 18.
 7. It is often noted from the annual reports of various enterprises that while the schedules/notes to accounts/Cash Flow Statements/Corporate Governance Reports, either individually or together, contain the information about the transactions taking place with related parties, the same are not reported under Related Party disclosure. It has been viewed that if any transaction has taken place during the year with the related party, then the reporting enterprise is required to disclose the details of the transactions as required under paragraph 23 of AS 18. Non-disclosure of such details is contrary to AS 18.
 8. Although certain transactions are reported under the Related Party disclosures, some enterprises omit to provide the values of those transactions and the outstanding balance, if any, with the concerned parties. It has been felt that this is contrary to paragraphs 23 (iv) and (vi) of AS 18, Related Party Disclosures, which, requires the volume of the transactions either as an amount or as an appropriate proportion as well as the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date to be disclosed. ■