

Related Party Disclosures under Ind AS 24: Are We Prepared?



As we look forward to the implementation of converged IFRSs, disclosure in financial statements needs to be discussed. With a requirement for transparency in Indian companies and increasing vigilance on domestic transfer-pricing transactions, the *Related Party Disclosures* standard would gain much prominence. The author endeavours to bring out a quick impact of the new standard with dependencies in the Companies Act, 1956 and various thought points that need to be addressed for the effective implementation of Ind AS 24, in comparison to the AS 18 read with its various interpretations and IAS 24, followed by an illustration to summarise the impact. Read on to know about the issues with regard to related party disclosures and our preparedness thereon...



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Introduction

Ind AS 24 along with other Ind ASs has been notified by the Ministry of Corporate Affairs (MCA) on February 25, 2011. However, the date of its implementation is yet to be notified. Ind AS 24 governs the disclosure of related party relationships, transactions and outstanding balances, including commitments, in the consolidated and separate financial statements of a parent, a venturer or an investor presented in accordance with the Indian Accounting Standard (Ind AS) 27- *Consolidated and Separate Financial Statements*. This Standard also applies to individual financial statements.

Ind AS 24 - *Related Party Disclosures* is the only standard that looks up the definition of *Relatives* under the Companies Act for defining *close members* under the standard. The new Companies Act, 2013 includes the revised definition of *Relatives*. We now have a complete framework for assessing the implications of Ind AS 24, i.e. *Related Party Disclosures* when it gets the notified date for practical application in India. The Ind AS 24 comes in with new relationships as well as additional disclosures when compared with AS 18 read with ASI 13,19,21,23. At the same time, it is not the same as International Accounting Standard (IAS) 24. Let us appreciate the nuances of this new standard in light of the principally approved regulatory framework.

Critical changes as compared to AS 18 – Related Party

Any transaction's counter party is either an individual or an entity/firm and, hence, the related parties standard also lays down the criteria to capture various ways in which these individuals and entities are covered for reporting, namely under the para 9a and b of Ind AS 24 respectively. Let us appreciate the changes in these

two broad categories.

Coverage in terms of individuals

In terms of identifying persons i.e. individuals, as related parties, Ind AS 24 brings in new requirements with respect to the following:

- I. Key managerial personnel (KMP)
- II. Close members of family

I. Key managerial personnel

The definition of KMP has been widened by including all the directors on board, whether executive or otherwise. Additionally, it includes KMP not only of the reporting entity but also of the parent entity.

This standard will override the *Accounting Standard Interpretation 21, i.e. ASI 21 to AS 18*, which concludes that the requirements of AS 18 should not be applied in respect of a nonexecutive director even if he participates in the financial and/or operating policy decision of the enterprise, unless he falls in any of the categories in paragraph 3 of AS 18. [para 9 b vii of Ind AS 24]

Thus the list of persons in the capacity of KMPs of the reporting entity has increased and consequently adding in the relatives of those identified people. For example, if a non executive independent director is paid a consulting fee by a subsidiary, the same will have to be reported by the subsidiary entity. To extend the example, if the fees are paid to spouse of such director of the holding company, the new standard requires such transaction to be part of related party disclosures of subsidiary entity.

Note: *ASI 23* clarified that remuneration paid to executive directors on board is a transaction to be reported under AS 18. This position remains unchanged under the Ind AS 24.

II. Close members of family, i.e. Relative

Ind AS 24 uses the term *close members of family* instead of *relatives of Individual* under the existing AS 18: *Close members of the family of a person are the persons specified within meaning of 'relative' under the Companies Act 1956 and that person's domestic partner, children of that person's domestic partner and dependants of that person's domestic partner* [para 9]. AS 24 definition of *relative* in relation to an individual includes spouse, son, daughter, brother, sister, father and mother, who may be expected to influence, or be influenced by, that individual. The Companies Act, 2013 defines *Relative* to include members of Hindu undivided family (HUF) and husband/wife or any other person as may be prescribed. Reading these

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definitions, we understand that there is a *potential addition to the list of individuals* under this category wherein the members of an HUF say brother's wife, i.e. sister-in-law, and their children are included if they are part of the same HUF as that of the individual. In this case, the individual is a person having control, joint control or significant influence over the reporting entity or is a KMP of the reporting entity or its parent entity. *So the coverage of related party list may increase considerably.*

Additionally, there is a new requirement to include a person's domestic partner, his/her parents and children. *Point to note is, there is no definition of 'domestic partner' in the Accounting Standard nor in the Companies Act 1956.*

Coverage in terms of entities

- (I) Entities/members of the *Same Group*, which will include each parent, subsidiary and fellow subsidiary companies [para 9b i]. It would be fairly simple to test this criterion if it is a holding structure with a clear corporate operating entity at the apex level. However, when it is held ultimately by a Trust, the application becomes a little difficult. Similarly, it is possible that the ultimate holding company is an Investment or a Private Equity fund. The Fund will consider the investments as held for trading and will not consolidate them in its balance sheet as per latest amendments in the IFRS 10, which governs consolidation requirements.

For example, a private equity fund may acquire more than 50% stake in a startup entity and it may also hold similar interests in other entities. In this case, whether the start up entity will consider other investments of its private equity investor as fellow subsidiaries is a question to be addressed based on its substance. Again, if the ultimate holding of an entity is a discretionary trust whose beneficiaries include promoter group members along with charitable institutions, it will be again a matter of assessment whether such trust should be considered as an ultimate controlling

ASI 13 requires that for the purpose of applying the test of materiality as per paragraph 27 of AS 18 for non aggregate disclosure, 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 facts and circumstances of the case, it can be concluded that even a transaction of less than 10% is material.

body and consequentially whether the group definition will include all the entities controlled or significantly influenced by such trust or restrict only to the subsidiaries and associates of the last holding entity that is not a discretionary trust or private equity fund. *A lot of judgment will have to be applied in considering the entities within the same group in these scenarios.* Companies will have to look up to Ind AS 27 and Ind AS 110 for assessment of control via substantive or protective rights in areas of significant judgment. It is to note that ASI 19 provides interpretation for the term *intermediaries* in the context of control and significant influence. It clarified that the intermediaries mean subsidiaries of the group and should not be extended to include associates. However, this term of intermediaries is not present in the Ind AS 24, but the substantive view may continue to prevail in assessing the relationship in a wider group. For example, the subsidiary of an entity's associate may not be a related party but associate of a subsidiary will be one. There may be a view that in the former case, the subsidiary of associate could be argued as an entity on which the reporting entity can exercise significant influence, however it becomes challenging is the associate has a number of subsidiaries. Thus, considering subsidiaries of associate may be farfetched for consideration of disclosure under the standard.

- (II) An associate or joint venture of any member of the same group in which the reporting entity is consolidated as a subsidiary. *In comparison to AS 18, the relationship point has now been enlarged to cover not only the reporting entity but all group entities.* Again, the assessment of the group will have to be done as stated in the point above [para 9 b ii]. In the definition of a related party, it is pertinent to note that 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 and thus the coverage of *same group* gets wider. [para 12]

- (III) Under Ind AS 24 there is extended coverage in case of joint ventures. Two entities are related to each other in both their financial statements, if they are either co-venturers or one is a venturer and the other is an associate [para 9 b iii & iv]. Whereas as per existing AS 18, co-venturers are not related to each other. However, as a breather, *one may note that two associates with a common investor are not considered to be related parties for their respective standalone entity disclosures under Ind AS 24.*
- (IV) Post-employment benefit trusts are now newly covered under the Ind AS 24 [para 9b v].
- (V) Entities controlled, jointly-controlled or significantly-influenced by individuals covered in the above section. Significant influence is also by being a KMP of that entity or the parent of that entity [para 9b vi]. There requirement is similar to that under existing AS 18.

Disclosure aspects

- (I) Name of the related disclosure under the Ind AS 24 is to be done only for entities where control exists. Name disclosure for all other related party transactions is not part of the minimum disclosure requirement as laid down in the para 18 of Ind AS 24.
- (II) Ind AS 24 requires an additional disclosure with respect to the name of its parent and if different, the ultimate controlling party. If neither of them produces consolidated financial statements for public use, then the name of the next most senior parent is to be disclosed, whereas the existing AS 18 has no such requirement. [para 13]
- (III) ASI 13 requires that for the purpose of applying the test of materiality as per paragraph 27 of AS 18 for non aggregate disclosure, 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 facts and circumstances of the case, it can be concluded that even a transaction of less than 10% is material. *It is to note that the same para 27 is incorporated as para 24A in Ind AS 24.* Since the ASIs will be no longer part of the Ind AS framework, one may look forward for its substantive application in practice.

Comparison with IAS 24, Related Party Disclosures

In terms of practical applications, there are two potential differences that can make the disclosure under IFRS and Ind AS. They are:

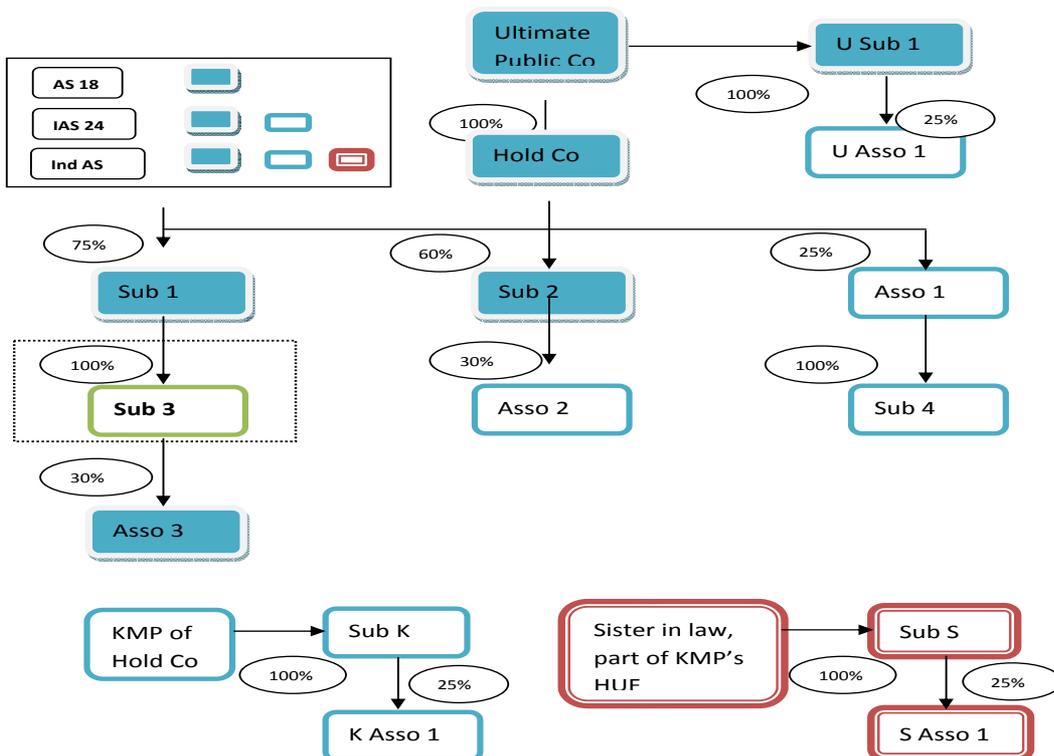
- (I) Considering the definition of Close family members from the Companies Act 1956, which is different from IFRS.
- (II) Substantive application of the para 24A which is brought in from existing AS 18.

Thought points

- Inclusion of HUF members as close family members for reporting
- No definition of a domestic partner—dependents of domestic partner included
- Dependents of wife are not included unless part of an HUF
- Father and mother are not default related parties, unless dependent or part of an HUF
- Non-executive director will be considered as a KMP

- Maintain a comprehensive list of relatives for individuals having control, significant influence or KMPs, including KMPs of the holding company
- Application of significant judgement in considering the same group in certain holding structures
- Subsidiaries of associates and joint ventures are also related parties and are to be disclosed in the category of associates/joint ventures as the case may be
- Increased the coverage of individuals as well as entities
- For disclosure, considering the same para 27 of AS 18 being included as para 24A under the Ind AS 24 on aggregate disclosures, the substantive application of ASI 13 would be something to look forward.
- Minimum disclosure requirements exclude name of related parties with whom transactions are made, except for those entities wherein control exist irrespective of transactions during the period.

Illustration: Applying Related Party Disclosures in Sub 3 under AS 18, IAS 24 and Ind AS 24



Analysis

1. Under the AS 18, associates of the reporting entity are only considered, whereas under the Ind AS 24, associates of the Group are considered as related parties.
2. Subsidiary of associate (Sub4) is also a related party as read with the para 12 of Ind AS 24.
3. KMPs of the holding company along with entities in which they and their close family members are related to the Sub 3 under Ind AS 24.
4. Under the Ind AS 24, as the definition of close family members looks up into Companies Act, 1956, members of HUF also become related and hence entities controlled and influenced are part of disclosures. ■