Accounting Standard (AS) 18

(issued 2000)

Related Party Disclosures

Contents

The following Accounting Standards Interpretations (ASIs) relate to AS 18:

- ASI 13 - Interpretation of paragraphs 26 and 27 of AS 18
- ASI 19 - Interpretation of the term 'intermediaries'
- ASI 21 - Non-Executive Directors on the Board - whether related parties
- ASI 23 - Remuneration paid to key management personnel- whether a related party transaction

The above Interpretations are published elsewhere in this Compendium.

Accounting Standard (AS) 18*

(issued 2000)

Related Party Disclosures

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the Preface to the Statements of Accounting Standards[1].)*

Accounting Standard (AS) 18, 'Related Party Disclosures', issued by the Council of the Institute of Chartered Accountants of India, comes into effect in respect of accounting periods commencing on or after 1-4-2001. This Standard is mandatory in nature[2] in respect of accounting periods commencing on or after 1-4-2004[3] for the enterprises which fall in any one or more of the following categories, at any time during the accounting period:

(i) Enterprises whose equity or debt securities are listed whether in India or outside India.

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* A limited revision to this Standard has been made in 2003, pursuant to which paragraph 26 of this Standard has been revised and paragraph 27 has been added to this Standard (See footnote 9 to this Standard).

[1] Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

[2] Reference may be made to the section titled 'Announcements of the Council regarding status of various documents issued by the Institute of Chartered Accountants of India' appearing at the beginning of this Compendium for a detailed discussion on the implications of the mandatory status of an accounting standard.

[3] AS 18 was earlier made mandatory in respect of accounting periods commencing on or after 1-4-2001 only for the following enterprises:

(i) Enterprises whose equity or debt securities are listed on a recognised stock exchange in India, and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognised stock exchange in India as evidenced by the board of directors' resolution in this regard.

(ii) All other commercial, industrial and business reporting enterprises, whose turnover for the accounting period exceeds Rs. 50 crores.

The relevant announcement was published in 'The Chartered Accountant', April 2002, page 1242.

(ii) Enterprises which are in the process of listing their equity or debt securities as evidenced by the board of directors' resolution in this regard.

(iii) Banks including co-operative banks.

(iv) Financial institutions.

(v) Enterprises carrying on insurance business.

(vi) All commercial, industrial and business reporting enterprises, whose turnover for the immediately preceding accounting period on the basis of audited financial statements exceeds Rs. 50 crore. Turnover does not include 'other income'.

(vii) All commercial, industrial and business reporting enterprises having borrowings, including public deposits, in excess of Rs. 10 crore at any time during the accounting period.

(viii) Holding and subsidiary enterprises of any one of the above at any time during the accounting period.

The enterprises which do not fall in any of the above categories are not required to apply this Standard.

Where an enterprise has been covered in any one or more of the above categories and subsequently, ceases to be so covered, the enterprise will not qualify for exemption from application of this Standard, until the enterprise ceases to be covered in any of the above categories for two consecutive years.

Where an enterprise has previously qualified for exemption from application of this Standard (being not covered by any of the above categories) but no longer qualifies for exemption in the current accounting period, this Standard becomes applicable from the current period. However, the corresponding previous period figures need not be disclosed.

An enterprise, which, pursuant to the above provisions, does not make related party disclosures, should disclose the fact.

The following is the text of the Accounting Standard.

Objective

The objective of this Statement is to establish requirements for disclosure of:

(a) related party relationships; and

(b) transactions between a reporting enterprise and its related parties.

Scope

1. This Statement should be applied in reporting related party relationships and transactions between a reporting enterprise and its related parties. The requirements of this Statement apply to the financial statements of each reporting enterprise as also to consolidated financial statements presented by a holding company.

2. This Statement applies only to related party relationships described in paragraph 3.

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

(a) enterprises that directly, or indirectly through one or more intermediaries[4], 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[5] and relatives of such personnel; and

[4] See also Accounting Standards Interpretation (ASI) 19 published elsewhere in this Compendium.

[5] See also Accounting Standards Interpretation (ASI) 21 published elsewhere in this Compendium.

(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.

4. In the context of this Statement, 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.

5. Related party disclosure requirements as laid down in this Statement do not apply in circumstances where providing such disclosures would conflict with the reporting enterprise's duties of confidentiality as specifically required in terms of a statute or by any regulator or similar competent authority.

6. In case a statute or a regulator or a similar competent authority governing an enterprise prohibit the enterprise to disclose certain information which is required to be disclosed as per this Statement, disclosure of such information

is not warranted. For example, banks are obliged by law to maintain confidentiality in respect of their customers' transactions and this Statement would not override the obligation to preserve the confidentiality of customers' dealings.

7. No disclosure is required in consolidated financial statements in respect of intra-group transactions.

8. Disclosure of transactions between members of a group is unnecessary in consolidated financial statements because consolidated financial statements present information about the holding and its subsidiaries as a single reporting enterprise.

9. No disclosure is required in the financial statements of state-controlled enterprises as regards related party relationships with other state-controlled enterprises and transactions with such enterprises.

Definitions

10. For the purpose of this Statement, the following terms are used with the meanings specified:

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.

Related party transaction - a transfer of resources or obligations between related parties, regardless of whether or not a price is charged[6].

Control – (a) ownership, directly or indirectly, of more than one half of the voting power of an enterprise, or

(b) control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or

(c) a substantial interest in voting power and the power to direct, by

[6] See also Accounting Standards Interpretation (ASI) 23 published elsewhere in this Compendium.

statute or agreement, the financial and/or operating policies of the enterprise.

***Significant influence** - participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies.*

***An Associate** - an enterprise in which an investing reporting party has significant influence and which is neither a subsidiary nor a joint venture of that party.*

***A Joint venture** - a contractual arrangement whereby two or more parties undertake an economic activity which is subject to joint control.*

***Joint control** - the contractually agreed sharing of power to govern the financial and operating policies of an economic activity so as to obtain benefits from it.*

***Key management personnel** - those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise.*

***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.*

***Holding company** - a company having one or more subsidiaries.*

***Subsidiary** - a company:*

(a) in which another company (the holding company) holds, either by itself and/or through one or more subsidiaries, more than one-half in nominal value of its equity share capital; or

(b) of which another company (the holding company) controls, either by itself and/or through one or more subsidiaries, the composition of its board of directors.

***Fellow subsidiary** - a company is considered to be a fellow subsidiary of another company if both are subsidiaries of the same holding company.*

***State-controlled enterprise* - an enterprise which is under the control of the Central Government and/or any State Government(s).**

11. For the purpose of this Statement, an enterprise is considered to control the composition of

(i) the board of directors of a company, if it has the power, without the consent or concurrence of any other person, to appoint or remove all or a majority of directors of that company. An enterprise is deemed to have the power to appoint a director if any of the following conditions is satisfied:

(a) a person cannot be appointed as director without the exercise in his favour by that enterprise of such a power as aforesaid; or

(b) a person's appointment as director follows necessarily from his appointment to a position held by him in that enterprise; or

(c) the director is nominated by that enterprise; in case that enterprise is a company, the director is nominated by that company/subsidiary thereof.

(ii) the governing body of an enterprise that is not a company, if it has the power, without the consent or the concurrence of any other person, to appoint or remove all or a majority of members of the governing body of that other enterprise. An enterprise is deemed to have the power to appoint a member if any of the following conditions is satisfied:

(a) a person cannot be appointed as member of the governing body without the exercise in his favour by that other enterprise of such a power as aforesaid; or

(b) a person's appointment as member of the governing body follows necessarily from his appointment to a position held by him in that other enterprise; or

(c) the member of the governing body is nominated by that other enterprise.

12. An enterprise is considered to have a substantial interest in another enterprise if that enterprise owns, directly or indirectly, 20 per cent or more interest in the voting power of the other enterprise. Similarly, an individual is considered to have a substantial interest in an enterprise, if that individual owns, directly or indirectly, 20 per cent or more interest in the voting power of the enterprise.

13. Significant influence may be exercised in several ways, for example, by representation on the board of directors, participation in the policy making process, material inter-company transactions, interchange of managerial personnel, or dependence on technical information. Significant influence may be gained by share ownership, statute or agreement. As regards share ownership, if an investing party holds, directly or indirectly through intermediaries[7], 20 per cent or more of the voting power of the enterprise, it is presumed that the investing party does have significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investing party holds, directly or indirectly through intermediaries[7], less than 20 per cent of the voting power of the enterprise, it is presumed that the investing party does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investing party does not necessarily preclude an investing party from having significant influence.

14. Key management personnel are 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.[8]

The Related Party Issue

15. Related party relationships are a normal feature of commerce and business. For example, enterprises frequently carry on separate parts of their activities through subsidiaries or associates and acquire interests in other enterprises - for investment purposes or for trading reasons - that are

[7] See also Accounting Standards Interpretation (ASI) 19 published elsewhere in this Compendium.

[8] See also Accounting Standards Interpretation (ASI) 21 published elsewhere in this Compendium.

of sufficient proportions for the investing enterprise to be able to control or exercise significant influence on the financial and/or operating decisions of its investee.

16. Without related party disclosures, there is a general presumption that transactions reflected in financial statements are consummated on an arm's-length basis between independent parties. However, that presumption may not be valid when related party relationships exist because related parties may enter into transactions which unrelated parties would not enter into. Also, transactions between related parties may not be effected at the same terms and conditions as between unrelated parties. Sometimes, no price is charged in related party transactions, for example, free provision of management services and the extension of free credit on a debt. In view of the aforesaid, the resulting accounting measures may not represent what they usually would be expected to represent. Thus, a related party relationship could have an effect on the financial position and operating results of the reporting enterprise.

17. The operating results and financial position of an enterprise may be affected by a related party relationship even if related party transactions do not occur. The mere existence of the relationship may be sufficient to affect the transactions of the reporting enterprise with other parties. For example, a subsidiary may terminate relations with a trading partner on acquisition by the holding company of a fellow subsidiary engaged in the same trade as the former partner. Alternatively, one party may refrain from acting because of the control or significant influence of another - for example, a subsidiary may be instructed by its holding company not to engage in research and development.

18. Because there is an inherent difficulty for management to determine the effect of influences which do not lead to transactions, disclosure of such effects is not required by this Statement.

19. Sometimes, transactions would not have taken place if the related party relationship had not existed. For example, a company that sold a large proportion of its production to its holding company at cost might not have found an alternative customer if the holding company had not purchased the goods.

Disclosure

20. The statutes governing an enterprise often require disclosure in financial

statements of transactions with certain categories of related parties. In particular, attention is focussed on transactions with the directors or similar key management personnel of an enterprise, especially their remuneration and borrowings, because of the fiduciary nature of their relationship with the enterprise.

21. Name of the related party and 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.

22. Where the reporting enterprise controls, or is controlled by, another party, this information is relevant to the users of financial statements irrespective of whether or not transactions have taken place with that party. This is because the existence of control relationship may prevent the reporting enterprise from being independent in making its financial and/or operating decisions. The disclosure of the name of the related party and the nature of the related party relationship where control exists may sometimes be at least as relevant in appraising an enterprise's prospects as are the operating results and the financial position presented in its financial statements. Such a related party may establish the enterprise's credit standing, determine the source and price of its raw materials, and determine to whom and at what price the product is sold.

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; and

(vii) amounts written off or written back in the period in respect of debts due from or to related parties.

24. The following are examples of the related party transactions in respect of which disclosures may be made by a reporting enterprise:

- purchases or sales of goods (finished or unfinished);
- purchases or sales of fixed assets;
- rendering or receiving of services;
- agency arrangements;
- leasing or hire purchase arrangements;
- transfer of research and development;
- licence agreements;
- finance (including loans and equity contributions in cash or in kind);
- guarantees and collaterals; and
- management contracts including for deputation of employees.

25. Paragraph 23 (v) requires disclosure of 'any other elements of the related party transactions necessary for an understanding of the financial statements'. An example of such a disclosure would be an indication that the transfer of a major asset had taken place at an amount materially different from that obtainable on normal commercial terms.

26.[9] Items of a similar nature may be disclosed in aggregate by type

[9] The Council of the Institute decided to make limited revision to AS 18 in 2003, pursuant to which paragraph 26 has been revised and an explanatory paragraph 27 has been added (see 'The Chartered Accountant', March 2003, pp. 963). The revisions have come into effect in respect of accounting periods commencing on or after 1-4-2003. The erstwhile paragraph 26 was as under:

> ***"26. Items of a similar nature may be disclosed in aggregate by type of related party."***

of related party except when seperate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the reporting enterprise.[10]

27.[11] Disclosure of details of particular transactions with individual related parties would frequently be too voluminous to be easily understood. Accordingly, items of a similar nature may be disclosed in aggregate by type of related party. However, this is not done in such a way as to obscure the importance of significant transactions. Hence, purchases or sales of goods are not aggregated with purchases or sales of fixed assets. Nor a material related party transaction with an individual party is clubbed in an aggregated disclosure.[12]

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[10] See also Accounting Standards Interpretation (ASI) 13 published elsewhere in this Compendium.

[11] See footnote 9.

[12] See footnote 10.