



AS 18

Related Party Disclosures

Question 1

SP hotels Limited enters into an agreement with Mr. A for running its hotel for a fixed return payable to the later every year. The contract involves the day-to-day management of the hotel, while all financial and operating policy decisions are taken by the Board of Directors of the company. Mr. A does not own any voting power in SP Hotels Limited. Would he be considered as a related party of SP Hotels Limited? Also explain the required related party disclosure requirements under AS 18?

(MTP 5 Marks April 21, Sep '23, RTP Nov 22, PYP 5 Marks July'21) (Same concepts but lesser adjustments as RTP Nov'19, May'19)

Answer 1

Mr. A will not be considered as a related party of SP Hotels Limited in view of AS 18 which states, "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". In the given case, in the absence of share ownership, Mr. A would not be considered to exercise significant influence on SP Hotels Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr. A does not have the ability to direct or instruct the board of directors does not qualify him as a key management personnel.

Related Party Disclosures: *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.*

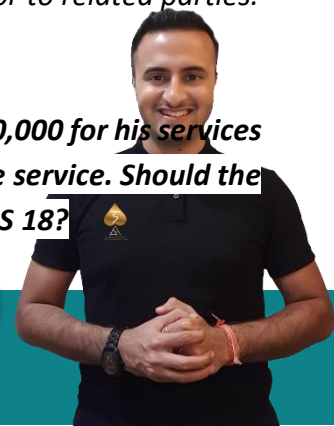
This is to enable users of financial statements to form a view about the effects of related party relationships on the enterprise.

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;*
 - Any other elements of the related party transactions necessary for an understanding of the financial statements;*
 - 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;*
 - Amounts written off or written back in the period in respect of debts due from or to related parties.*

Question 2

- (i) Mr. Raj a relative of key management personnel received remuneration of Rs. 2,50,000 for his services in the company for the period from 1.4.2020 to 30.6.2020. On 1.7.2020, he left the service. Should the relative be identified as at the closing date i.e. on 31.3.2021 for the purposes of AS 18?*



(MTP 5 Marks March 21, Oct'20, Mar'22, Old & New SM) (Same concept different figures PYP 2.5 Marks July'21, PYP 2.5 Marks, Nov '18)

- (ii) X Ltd. sold goods to its associate Company during the 1st quarter ending 30.6.2020. After that, the related party relationship ceased to exist. However, goods were supplied as were supplied to any other ordinary customer. Decide whether transactions of the entire year need disclosure as related party transaction. **(MTP 5 Marks March 21, Oct'20, Mar'22 & Oct '23, Old & New SM)**

Answer 2

- (i) According to AS 18 on 'Related Party Disclosures', 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. Hence, Mr. Raj, a relative of key management personnel should be identified as related party for disclosure in the financial statements for the year ended 31.3.2021.
- (ii) As per AS 18, transactions of X Ltd. with its associate company for the first quarter ending 30.06.2020 only are required to be disclosed as related party transactions. The transactions for the period in which related party relationship did not exist need not be reported.

Question 3

You are required to identify the related parties in the following cases as per AS 18: M Ltd. holds 61 % shares of S Ltd. S Ltd. holds 51 % shares of F Ltd. C Ltd. holds 49% shares of F Ltd. (Give your answer - Reporting Entity wise for M Ltd., S Ltd., C Ltd. and F Ltd.) **(MTP 5 Marks May 20 & Sep '22) (PYP 2.5 Marks May 18)**

Answer 3

(a) Reporting entity- M Ltd.

- S Ltd. (subsidiary) is a related party
- F Ltd.(subsidiary) is a related party

(b) Reporting entity- S Ltd.

- M Ltd. (holding company) is a related party
- F Ltd. (subsidiary) is a related party

(c) Reporting entity- F Ltd.

- M Ltd. (holding company) is a related party
- S Ltd. (holding company) is a related party
- C Ltd. (investor/ investing party) is a related party

(d) Reporting entity- C Ltd.

- F Ltd. (associate) is a related party

Question 4

(i) On the basis of provisions of AS 18 'Related Party Disclosures': Identify the related parties in the following cases:

X Limited holds 60% shares of Y Limited Y Limited holds 55% shares of W Limited Z Limited holds 35% shares of W Limited





(ii) Himalaya Limited sold goods for ₹ 40 Lakhs to Aravalli Limited during financial year ended on March 31, 2022. The Managing Director of Himalaya Limited owns 80% shares of Aravalli Limited. The sales were made to Aravalli Limited at normal selling prices followed by Himalaya Limited. The chief accountant of Himalaya Limited contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per AS 18. You are required to comment on this. (MTP 5 Marks March '23, RTP Nov '20) (Same concept different figures RTP May'20, RTP Nov'18, Old & New SM)

Answer 4

- (i) X Ltd., Y Ltd. & W Ltd. are related to each other. Z Ltd. & W Ltd. are related to each other by virtue of associate relationship. However, neither X Ltd. nor Y Ltd. is related to Z Ltd. and vice versa since neither control nor significant influence exists between them.
- (ii) Himalaya Ltd. and Aravalli Ltd are related parties since key management personnel of Himalaya Ltd. i.e. its managing director holds 80% in Aravalli Ltd. and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price. Hence the contention of Chief Accountant of Himalaya Ltd that these sales require no disclosure under related party Transactions, is wrong.

Question 5

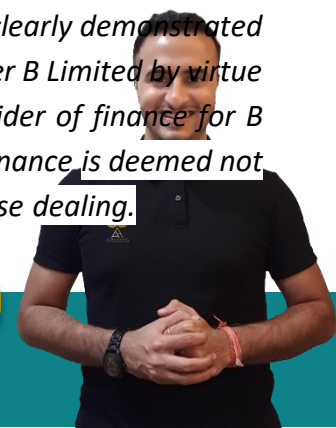
- (a) Omega Bank Limited holds 25 per cent of the voting power of B Limited. Omega Bank Limited also provides finance by way of a loan to B Limited at market rates of interest, on account of which, Omega Bank Limited would have the power to nominate one person to the board of directors of B Limited. Any major transactions proposed to be entered into by B Limited would need the consent of Omega Bank Limited. Would Omega Bank Limited be considered as related party for B Ltd. (reporting enterprise)?
- (b) A Limited has two Associates, B Limited and C Limited, and owns 25 per cent of the voting power of B Limited and 30 per cent of the voting power of C Limited. Would B Limited be considered a related party for the purpose of financial statements of C Limited? **(RTP Nov '21)**

Answer 5

(a) Omega Bank Limited would be a related party of B Limited. As per AS 18 "associates and joint ventures of the reporting enterprise and the investing party of venture in respect of which the reporting enterprise is an associate or a joint venture" are related party relationship.

Further, an associate has been defined as "an enterprise in which an investing reporting party has significant influence and which is neither a subsidiary nor a joint venture of the party". Significant influence has been defined to be "participation in the financial and /or operating policy decisions of an enterprise, but not control of those policies".

Further, it is given in the standard that significant influence may be gained by share ownership, agreement or statute. As regards share ownership, there is a presumption that ownership of 20 per cent or more of the voting power enables the enterprise to exercise significant influence, unless it could be clearly demonstrated otherwise. In the given example, Omega Bank Limited exercises significant influence over B Limited by virtue of ownership of 25 per cent of the voting power. Omega Bank Limited is also a provider of finance for B Limited (as it has provided a loan to B Limited), and as per the standard, a provider of finance is deemed not to be a related party during its normal dealings with the enterprise by virtue only of those dealing.





However, in this case, the exemption would not be available to Omega Bank Limited as the exercise of significant influence of Omega Bank Limited over B Limited has been demonstrated on account of ownership of more than 20 per cent of voting power. Accordingly, Omega Bank Limited would be construed to be a related party in the financial statements of B Limited and consequently, the latter would be required to disclose the transactions with Omega Bank Limited in its financial statements.

(b) Both B Limited and C Limited are 'associates' of A Limited. Follow-associates cannot be regarded as a related parties only by virtue of the relationship. AS 18 states that "enterprise that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise" are related parties. Further, it is given that "associates and joint ventures of the reporting enterprise and the investing party or venture in respect of which the reporting enterprise is an associate or a joint venture" are also related parties. As B Limited is not an associate of C Limited, nor is it being controlled, directly or indirectly, by C Limited or is not so controlling C Limited, it is not a related party of C Limited.

Question 6

R Ltd. has 60% voting right in S Ltd. S Ltd. has 15% voting right in T Ltd. R Ltd. directly enjoys voting right of 10% in T Ltd. T Ltd. is a listed company and regularly supplies goods to R Ltd. The management of T Ltd. has not disclosed its relationship with R Ltd. You are required to assess the situation from the view point of AS 18 on Related Party Disclosures. (RTP May 21)

Answer 6

AS 18 'Related Party Disclosures', defines related party as one that has at any time during the reporting period, the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Definition for Control

Here, control is defined as ownership directly or indirectly of more than one-half of the voting power of an enterprise; and Significant Influence is defined as participation in the financial and/or operating policy decisions of an enterprise but not control of those policies.

Nature of Relationship

R Ltd. has direct economic interest in T Ltd. to the extent of 10%, and through S Ltd. in which it is the majority shareholders, it has further control of 9% in T Ltd. (60% of S Ltd.'s 15%). These two taken together (10% + 9%) make the total control of 19%.

Conclusion

In the present case, control of R Ltd. in T Ltd. directly and through S Ltd., is only 19%. Significant influence may also not be exercised as an investing party (R Ltd.) holds, directly or indirectly through intermediaries only 19% of the voting power of the T Ltd. Accordingly, R Ltd. and T Ltd. are not related parties. Hence related party disclosure, as per AS 18, is not required.



Question 7

Is remuneration paid to Board of Directors a related party transaction? Explain.

(RTP May 18)

Answer 7

In case of a Company, the Managing Director, whole time director, 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 Managerial Personnel (KMP). Persons who do not have the authority and responsibility for planning, directing and controlling the activities of the enterprise would not be KMP. Conversely, persons without any formal titles may be considered to be KMP, if they plan, direct and control the activities of the enterprise.

Further, as per Sec 2(76) of Companies Act, 2013, a related party includes a director or his relative. Sec 2(34) defines a director as a director appointed to the Board of a Company. Hence, remuneration paid to Board of Directors will be considered as related party transaction.

Question 8

(a) In respect of a key supplier who is dependent on the company for its existence and the company enjoys influence over the prices of this supplier (which may not be formally demonstrable), can the supplier and the company be considered as related parties?

(b) Define “Key management personnel” in the context of AS 18.

(RTP May 22)

Answer 8

The supplier and the company cannot be considered to be related parties merely because the latter is able to influence the transaction price between the parties. Paragraph 3 of AS 18 states that “enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise” are considered to be related party relationships. However, the conditions which define the existence of control, as follows, are not satisfied in the given example.

- ‘Ownership, directly or indirectly, of more than one-half of the voting power of an enterprise, or
- 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
- a substantial interest in voting power and the power to direct, by statue or agreement, the financial and/or operating policies of the enterprise”.

Paragraph 10 of the standard defines significant influence as “participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies”. In the given example, although the supplier and the company have entered into a commercial transaction, the terms of which are influenced by the latter because of its better bargaining power in the specific market for such goods, it cannot be concluded that there is participation in the financial and/or operating policy decisions.

Therefore, as the conditions specified by the Standard for being classified as a related party are not satisfied in the given example, the company cannot be said to be related to the supplier. This view is supported by paragraph 4 (b) of the Standard which states that “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” would not be deemed to be related parties.



(b) In context of AS 18, “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.

Question 9

Identify the related parties in the following cases as per AS-18

Maya Ltd. holds 61 % shares of Sheetal Ltd. Sheetal Ltd. holds 51 % shares of Fair Ltd. Care Ltd. holds 49% shares of Fair Ltd. (Give your answer - Reporting Entity wise for Maya Ltd., Sheetal Ltd., Care Ltd. and Fair Ltd.)

(RTP Nov '23)

Mr. Subhash Kumar is Managing Director of a Ltd. and also holds 72% capital of B Ltd.

(PYP 5 Marks May '19)

Answer 9

a) Reporting entity-Maya Ltd.

- Sheetal Ltd. (subsidiary) is a related party
- Fair Ltd.(subsidiary) is a related party

(b) Reporting entity- Sheetal Ltd.

- Maya Ltd. (holding company) is a related party
- Fair Ltd. (subsidiary) is a related party

(c) Reporting entity- FairLtd.

- Maya Ltd. (holding company) is a related party
- Sheetal Ltd. (holding company) is a related party
- Care Ltd. (investor/ investing party) is a related party

(d) Reporting entity- Care Ltd.

- Fair Ltd. (associate) is a related party

Mr. Subhash Kumar is Key management personnel as he has the authority for planning, directing and controlling the activities of A Ltd. He also holds substantial interest in B Ltd. as he holds 72% capital of B Ltd. Thus, Mr. Subhash is related party for both A Ltd. and B Ltd. Moreover, as per the definition of related party relationship described in para 3 of AS 18, enterprises over which Subhash is able to exercise significant influence are also related parties. Thus, A Ltd. and B Ltd. will also be construed as related to each other.

Question 10

Following transactions are disclosed as on 31st March, 2018:

Goods sold amounting to Rs. 50 lakhs to associate company during the 1st quarter ended on 30th June, 2017. After that related party relationship ceased to exist. However, goods were supplied as was supplied to any other ordinary customer. Decide whether transactions of the entire year have to be disclosed as related party transaction.

(PYP 2.5 Marks, Nov '18)

Answer 10

As per provision of AS 18, the transactions only for the period in which related party relationships exist need to be reported.



Hence, transactions of the entity with its associate company for the first quarter ending 30.06.2017 only are required to be disclosed as related party transactions. Transactions of the entire year need not be disclosed as related party transactions and transactions for the period (after 1st July) in which related party relationship did not exist need not be reported.

Hence transaction of sale of goods with the associate company for first quarter ending 30th June, 2017 for Rs. 50 Lakhs only are required to be disclosed as related party transaction on 31.3.18.

Question 11

Answer the following with respect to AS-18:

- i) ABC Ltd. sold goods of ` 2,00,000 to its associate company for the 1st quarter ending 30.06.2022. After that the related party relationship ceased to exist. However, goods were supplied to any other ordinary customer. Decide whether transactions of the entire year have to be disclosed as related party transaction.**
- ii) If the majority of directors of Arjun Ltd. constitute the majority of the Board of another Company Bheem Ltd. in their individual capacity as professionals (and not by virtue of their being Directors in Arjun Ltd.). Are both the companies related?**
- iii) Asha Ltd. sells all the manufactured furniture of ` 1,00,00,000 to Sasha Ltd, as per agreement. Sasha Ltd. is the only customer to Asha Ltd. In the financial statements, Asha Ltd. wants to present Sasha company as a related party. Comment on the disclosure requirement. **(PYP 5 Marks May '23)****

Answer 11:

- i) As per AS 18, parties are considered to be related if any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party. Transactions of ABC Ltd. with its associate company for the first quarter ending 30.06.2022 only are required to be disclosed as related party transactions as the company has the ability to exercise significant influence only till 30.6.2022.**

The transactions for the period in which related party relationship did not exist need not be reported.

- ii) In the given case, Arjun Ltd. cannot be said to control the composition of board of directors of Bheem Ltd. as the directors have been appointed in their individual capacity as professionals and not by virtue of their being directors in Arjun Ltd.**

Hence, it cannot be concluded that the companies are related merely because the majority of the directors of one company became the majority of the directors of the second in their individual capacity as professionals.

- iii) In the context of AS 18, a single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business cannot be construed as Related Party Relationship merely by virtue of the resulting economic dependence. There is an economic dependence between the companies but no one controls or exercise significant influence on the other.**

In the given case, Asha Ltd. need not report Sasha Company as its related party in its financial statements.

