

CHAPTER 2

Related party provisions and disclosures

This article aims to:

Elucidate the provisions pertaining to related party transactions and disclosures, that are applicable to NBFCs.



Background

Related Party Transactions (RPTs) have been an area of focus for regulators, auditors and shareholders. Thus, the Companies Act, 2013 (the 2013 Act), and the Securities and Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirement) Regulations, 2015 (Listing Regulations) lay a lot of emphasis on RPTs.

Entities are required to obtain prescribed approvals under the 2013 Act and the Listing Regulations for certain RPTs entered into by them. Additionally, the accounting standards (both Ind AS and the accounting standards¹) and Listing Regulations require entities to disclose RPTs in the annual financial statements and to the stock exchange, respectively. While the current guidelines of RBI require NBFCs to disclose RPTs in the financial statements, it neither prescribes the transactions that need to be covered, nor does it provide a format, thus no separate disclosures are being provided by NBFCs apart from what was disclosed as part of the accounting standards.

The RBI vide the SBR framework and a circular issued in April 2022² has now specified the format for disclosure of RPTs in the annual financial statements. This disclosure will be applicable for financial statements for the year ending 31 March 2023 for NBFCs in all layers of the SBR.

In this article, we aim to provide an overview of the provisions of the 2013 Act, the Listing Regulations, RBI guidelines and accounting standards applicable to RPTs entered into by NBFCs and disclosures of such RPTs.



1. Accounting Standards prescribed under the Companies (Accounting Standards) Rules, 2021.

2. Circular dated 19 April 2022 on 'Disclosures in Financial Statements- Notes to Accounts of NBFCs'.


3. The RBI does not define 'related parties' or 'related party transactions', hence NBFCs need to consider the applicable provisions under the 2013 Act, accounting standards and the Listing Regulations (for listed NBFCs) while complying with RPT requirements.

Determining related parties and RPTs

The definition of related parties, is provided in Section 2(76) of the 2013 Act, AS 18, *Related Party Disclosures*, Ind AS 24, *Related Party Disclosures* and the Listing Regulations. However, this definition is not fully aligned, as can be seen in table 1 below:

Table 1: Definition of related parties under various provisions³

The 2013 Act (Section 2(76))	Ind AS 24	AS 18	Listing Regulations
<ul style="list-style-type: none"> i. A director or his/her relative; ii. A KMP or his/her relative; iii. A firm, in which a director, manager or his/her relative is a partner; iv. A private company in which a director or manager or his/her relative is a member or director; v. A public company in which director or manager is a director and holds along with his/her relatives, more than two per cent. of its paid-up share capital; vi. Any body corporate whose Board of Directors (BoD), managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager; 	<ul style="list-style-type: none"> a. A person or a close member of that person's family is related to a reporting entity if that person: <ul style="list-style-type: none"> 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 KMP 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: <ul style="list-style-type: none"> 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). 	<ul style="list-style-type: none"> 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; 	<ul style="list-style-type: none"> • A related party as defined under the 2013 Act • A related party as defined under the applicable accounting standards • Any person or entity forming a part of the promoter or promoter group of the listed entity; or • Any person or any entity, holding equity shares in the listed entity either directly or on a beneficial interest basis as provided under Section 89 of the 2013 Act at any time, during the immediate preceding financial year: <ul style="list-style-type: none"> i. Of 20 per cent or more; or ii. Of 10 per cent or more, with effect from April 1, 2023;

The 2013 Act (Section 2(76))	Ind AS 24	AS 18	Listing Regulations
<p>vii. Any person on whose advice, directions or instructions a director or manager is accustomed to act:</p> <p>viii. Any company which is:</p> <p>A. A holding, subsidiary or an associate company of such company; or</p> <p>B. A subsidiary of a holding company to which it is also a subsidiary;</p> <p>C. An investing company or the venturer of the company</p> <p>ix. Such other person as may be prescribed;</p>	<p>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).</p> <p>iii. Both entities are joint ventures of the same third party.</p> <p>iv. One entity is a joint venture of a third entity and the other entity is an associate of the third entity.</p> <p>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.</p> <p>vi. The entity is controlled or jointly controlled by a person identified in (a).</p> <p>vii. A person identified in (a)(i) has significant influence over the entity or is a member of the KMP of the entity (or of a parent of the entity).</p> <p>viii. The entity, or any member of a group of which it is a part, provides KMP services to the reporting entity or to the parent of the reporting entity.</p>	<p>d. KMP and relatives of such personnel; and</p> <p>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.</p>	

(Source: KPMG in India's analysis, 2022)

Likewise, the definition of RPT under the 2013 Act, Ind AS, AS and the Listing Regulations is not fully aligned as given in table 2 below.

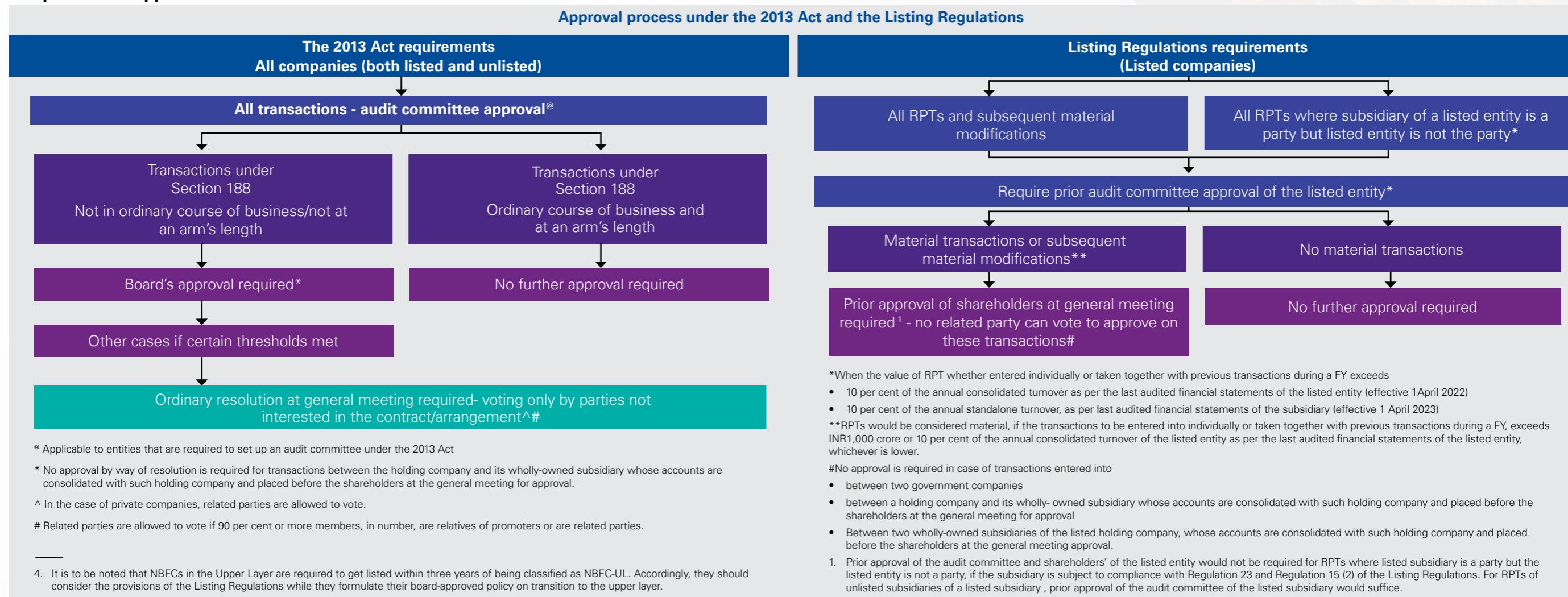
Table 2: Definition of RPTs under various provisions

The 2013 Act	Ind AS 24	AS 18	Listing Regulations
<p>A definition of RPT is not specifically provided in the 2013 Act, Section 188 of the 2013 Act prescribes specific approval mechanism for specific RPTs, which are given below:</p> <ul style="list-style-type: none"> • Sale, purchase or supply of any goods or materials • Selling or otherwise disposing of, or buying, property of any kind • Leasing of property of any kind • Availing or rendering of any services • Appointment to any office or place of profit in the company, subsidiary company or associate Company • Underwriting the subscription of any securities or derivatives of the company 	<p>A RPT is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.</p>	<p>RPT - a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.</p>	<p>RPT means a transaction involving a transfer of resources, services or obligations between:</p> <ol style="list-style-type: none"> A listed entity or any of its subsidiaries on one hand and a related party of the listed entity or any of its subsidiaries on the other hand; or A listed entity or any of its subsidiaries on one hand, and any other person or entity on the other hand, the purpose and effect of which is to benefit a related party of the listed entity or any of its subsidiaries, with effect from April 1, 2023. <p>Regardless of whether a price is charged and a 'transaction' with a related party shall be construed to include a single transaction or a group of transactions in a contract.</p> <p>Additionally, certain transactions are specifically excluded from the purview of RPT.</p>

(Source: KPMG in India's analysis, 2022)

Thus, while entering into a transaction with a person or an entity, NBFCs would need to evaluate whether the person or entity is a related party as per the above provisions and whether the transaction would be considered as an RPT. Accordingly, approvals would be required under the 2013 Act and Listing Regulations (where the NBFC is listed)⁴. An overview of the approval process under both the 2013 Act and the Listing Regulations is given in figure 1 below:

The process for approvals of RPTs has been summarised in the flow chart below:



(Source: KPMG in India's analysis, 2022)

Disclosures of RPT

Transactions with related parties may impact the financial position and performance of a company- this is because entities having control, joint control or significant influence over the investee have the ability to affect its operating and financial policies.

In this view, it is imperative that users of financial statements have knowledge of an entity's transactions, outstanding balances, including commitments, and relationships with related parties. This information could have an impact on the assessment of an entity's operations, including assessment of risks and opportunities facing the entity.

Accordingly, the accounting standards⁵ have prescribed the related party relationships and transactions that need to be reported. Additionally, Schedule V of the Listing Regulations prescribes certain related party disclosures (which should be in compliance with the accounting standards) to be made in the annual report of entities that have listed their non-convertible securities⁶.

With a view to provide greater transparency in this area, the SBR has prescribed a disclosure format for RPTs (as given in Figure 2 below). Disclosures are required in the annual financial statements of NBFCs within all the levels of the SBR.

Figure 2: Format of RPT disclosures prescribed in the SBR

Related Party Items	Parent (as per ownership or control)		Subsidiaries		Associates/ Joint ventures		KMP@		Relatives of KMP		Others*		Total	
	Current year	Previous year	Current year	Previous year	Current year	Previous year	Current year	Previous year	Current year	Previous year	Current year	Previous year	Current year	Previous year
Borrowings#														
Deposits#														
Placement of deposits#														
Advances#														
Investments#														
Purchase of fixed/other assets														
Sale of fixed/other assets														
Interest paid														
Interest received														
Others*														

(Source: RBI circular on Disclosures in Financial Statements – Notes to Accounts of NBFCs, dated 19 April 2022)

5. As per Ind AS 24, entities are required to disclose all RPT where control exists (i.e. parent company, ultimate controlling party and where required, next most senior parent that prepares CFS, irrespective of whether there is a transaction entered into with such entities. Compensation paid to KMP also needs to be disclosed. With regard to RPTs, entities are required to disclose the amount of transaction, outstanding balances (including commitments and guarantees) and terms and conditions of these balances- i.e. whether they are secured and nature of consideration to be provided on settlement. Provision for doubtful debts and expense recognised in respect of bad or doubtful debts due from related parties. These disclosures are required to be made separately for the parent, entities with joint control or significant influence over the entity, subsidiaries, associates, joint ventures in which the entity is a joint venturer, KMP of the entity or its parent and other related parties. Similar disclosures are required as per AS 18.

6. Regulation 23(9) of the Listing Regulations also requires entities that have listed their specified securities and HVDLEs to submit related party disclosures in a prescribed format to the stock exchange within the prescribed time period.

Notes

Related party, in the context of the aforementioned disclosure, would include all related parties as per the applicable accounting standards, and certain related parties as defined in the 2013 Act.

@ Disclosures for directors and relatives⁷ of directors should be made separately in separate columns from other KMPs⁸ and relatives of other KMPs.

The outstanding amount at the year end and the maximum amount during the year are to be disclosed

* Specify item if total for the item is more than 5 per cent of total RPTs. Related parties would include trusts and other bodies in which the NBFC can directly or indirectly (through its related parties) exert control or significant influence.

In view of the overlapping disclosure requirements in the regulations and accounting standards pertaining to related parties, NBFCs may consider disclosing a single consolidated note on related parties in the annual financial statements. Listed NBFCs, will also have to comply with the applicable Listing Regulations⁹.

7. Relative is defined under Section 2(77) of the 2013 Act, read with Rule 4 of the Companies (Specification of definitions details) Rules, 2014, which includes member of a Hindu Undivided Family, spouse, father, mother, son, son's wife, daughter, daughter's husband, brother, sister

8. KMP includes the persons defined under Section 2(51) of the 2013 Act, which includes CEO or the managing director or the manager, the company secretary, the whole-time director, CFO, such other officer, not more than one level below the director, who is in whole-time employment, designated as KMP by the BoD, and such other officer as may be prescribed.

9. SEBI vide circular SEBI/HO/CFD/CMD1/CIR/P/2021/662 dated 22 November 2021 has provided a format for reporting of RPTs identified basis the Listing Regulations. These disclosures are required to be made on a six-monthly basis to stock exchanges by entities that have listed their specified securities (i.e. equity instruments and convertible securities) and by High-Value Debt Listed Entities (HVDLE).

Next Steps

Some of the incremental provisions that are applicable to NBFCs, on account of the SBR framework are:

- NBFCs should note that separate disclosures are required to be provided for transactions with directors and relatives of directors and other KMPs and relatives of other KMPs, further, other transactions that are more than 5 per cent of the total RPT need to be disclosed separately.
- The SBR has broadened the related party definition as is currently defined in the 2013 Act, by specifically calling out, the trusts and other bodies where NBFCs (itself or through its related parties) may exert control or significant influence. This is in line with the requirements of Ind AS which requires reporting entities to evaluate whether a trust needs to be consolidated in the first instance.
- Currently, disclosure of maximum amount outstanding during the year for loans, advances in the nature of loans and investments is required under the Listing Regulations for entities that have listed their non-convertible securities on a recognised stock exchange. The SBR framework, has now brought into the ambit all the NBFCs (listed and unlisted) and widened the transactions for which maximum amount is required to be disclosed to borrowings, deposits, placement of deposits, advances and investments.

