INDAS – 24
RELATED PARTY DISCLOSURES

(TOTAL NO. OF QUESTIONS – 8)

INDEX

RTPs QUESTIONS

Q1 (RTP May 18 & MTP May 20)

Mr. Atul is an independent director of a company X Ltd. He plays a vital role in the Management of X Ltd. and contributes in the major decision-making process of the organisation. X Ltd. pays a sitting fee of Rs 2,00,000 to him for every Board of Directors' (BOD) meeting he attends. Throughout the year, X Ltd. had 5 such meetings which were attended by Mr. Atul.

Similarly, a non-executive director, Mr. Naveen also attended 5 BOD meetings and charged Rs 1,50,000 per meeting. The Accountant of X Ltd. believes that they being not the employees of the organisation, their fee should not be disclosed as per related party transaction in accordance with Ind AS 24.

Examine whether the sitting fee paid to independent director and non-executive director is required to be disclosed in the financial statements prepared as per Ind AS?

SOLUTION

As per Ind AS 24, Related Party Disclosures, "Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity."

Accordingly, key management personnel (KMP) includes any director of the entity who has authority and responsibility for planning, directing and controlling the activities of the entity. Hence, independent director Mr. Atul and non-executive director Mr. Naveen are covered under the definition of KMP in accordance with Ind AS.

Also as per Ind AS 19, 'Employee Benefits', an employee may provide services to an entity on a full-time, part-time, permanent, casual or temporary basis. For the purpose of the Standard, Employees include directors and other management personnel.

Therefore, contention of the Accountant is wrong that they are not employees of X Ltd.

The Ind AS requires disclosure about employee benefits for key management personnel. Therefore, an entity

shall disclose key management personnel compensation in total i.e. disclosure of directors' fee of (Rs10,00,000 + Rs7,50,000) Rs17,50,000 is to be made as employees benefits (under various categories).
Since short-term employee benefits are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services, the sitting fee paid to directors will fall under it (as per Ind AS 19) and is required to be disclosed in accordance with Ind AS 24.

Q2 (November 18, October 20 MTP – 5 Marks)

ABC Ltd. is a long-standing customer of XYZ Ltd. Mrs. P whose husband is a director in XYZ Ltd. purchased a controlling interest in entity ABC Ltd. on 1st June, 2017. Sales of products from XYZ Ltd. to ABC Ltd. in the two-month period from 1st April 2017 to 31st May 2017 totaled Rs8,00,000. Following the shares purchased by Mrs. P, XYZ Ltd. began to supply the products at a discount of 20% to their normal selling price and allowed ABC Ltd. three months' credit (previously ABC Ltd. was only allowed one month's credit, XYZ Ltd. 's normal credit policy). Sales of products from XYZ Ltd. to ABC Ltd. in the ten-month period from 1st June 2017 to 31st March 2017 totaled Rs 60,00,000. On 31st March 2018, the trade receivables of XYZ Ltd. included Rs18,00,000 in respect of amounts owing by ABC Ltd.
Analyse and show how the above event would be reported in the financial statements of XYZ Ltd. for the year ended 31 March 2018 and mention the disclosure requirements also as per Ind AS.

SOLUTION

XYZ Ltd. would include the total revenue of Rs 68,00,000 (Rs 60,00,000 + Rs8,00,000) from ABC Ltd. received / receivable in the year ended 31st March 2018 within its revenue and show Rs 18,00,000 within trade receivables at 31st March 2018.
Mrs. P would be regarded as a related party of XYZ Ltd. because she is a close family member of one of the key management personnel of XYZ Ltd. From 1st June 2017, ABC Ltd. would also be regarded as a related party of XYZ Ltd. because from that date ABC Ltd. is an entity controlled by another related party.
Because ABC Ltd. is a related party with whom XYZ Ltd. has transactions, then XYZ Ltd. should disclose:

- The nature of the related party relationship.
- The revenue of Rs 60,00,000 from ABC Ltd. since 1st June 2017.
- The outstanding balance of Rs 18,00,000at 31st March 2018.

  In the current circumstances it may well be necessary for XYZ Ltd. to also disclose the favourable terms under which the transactions are carried out.

Q3 (November 18)

Mr. X, is the financial controller of ABC Ltd., a listed entity which prepares consolidated financial statements in accordance with Ind AS. Mr. X has recently produced the final draft of the financial statements of ABC Ltd. for the year ended 31st March, 2018 to the managing director for approval. Mr. Y, who is not an accountant, had raised following queries from Mr. X after going through the draft financial statements:
One of the notes to the financial statements gives details of purchases made by ABC Ltd. from PQR Ltd. during the period. Mr. Y own 100% of the shares in PQR Ltd. However, he feels that there is no requirement for any disclosure to be made in ABC Ltd.'s financial statements since the transaction is carried out on normal commercial terms and is totally insignificant to ABC Ltd., as it represents less than 1% of ABC Ltd.'s purchases.

SOLUTION

Ongoing through the queries raised by the Managing Director Mr. Y, the financial controller Mr. X explained the notes and reasons for their disclosures as follows:

Related parties are generally characterised by the presence of control or influence between the two parties. Ind AS 24 'Related Party Disclosures' identifies related parties as, inter alia, key management personnel and companies controlled by key management personnel. On this basis, PQR Ltd. is a related party of ABC Ltd.

The transaction is required to be disclosed in the financial statements of ABC Ltd. since Mr. Y is Key Management personnel of ABC Ltd. Also at the same time, it owns 100% shares of PQR Ltd. i.e. he controls PQR Ltd. This implies that PQR Ltd. is a related party of ABC Ltd.

Where transactions occur with related parties, Ind AS 24 requires that details of the transactions are disclosed in a note to the financial statements. This is required even if the transactions are carried out on an arm's length basis.

Transactions with related parties are material by their nature, so the fact that the transaction may be numerically insignificant to ABC Ltd. does not affect the need for disclosure.

Q4 (Nov 19)

Uttar Pradesh State Government holds 60% shares in PQR Limited and 55% shares in ABC Limited. PQR Limited has two subsidiaries namely P Limited and Q Limited. ABC Limited has two subsidiaries namely A Limited and B Limited. Mr. KM is one of the Key management personnel in PQR Limited.

(a) *Determine the entity to whom exemption from disclosure of related party transactions is to be given. Also examine the transactions and with whom such exemption applies.*

(b) *What are the disclosure requirements for the entity which has availed the exemption?*

SOLUTION

(a) As per Ind AS 24, 'Related Party Disclosures', if an entity had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements.

However, as per the standard a reporting entity is exempt from the disclosure requirements in relation to related party transactions and outstanding balances, including commitments, with:

(i) *a government that has control or joint control of, or significant influence over, the reporting entity; and*

(ii) *another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.*

According to the above paras, for Entity P's financial statements, the exemption in paragraph 25 applies to:

(i) *transactions with Government Uttar Pradesh State Government; and*

(ii) *transactions with Entities PQR and ABC and Entities Q, A and B.*

Similar exemptions are available to Entities PQR, ABC, Q, A and B, with the transactions with the UP State Government and other entities controlled directly or indirectly by the UP State Government. However, that exemption does not apply to transactions with Mr. KM. Hence, the transactions with Mr. KM need to be disclosed under related party transactions.

(b) *It shall disclose the following about the transactions and related outstanding balances:*

(a) *the name of the government and the nature of its relationship with the reporting entity (ie control, joint control or significant influence);*

(b) *the following information in sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:*

(i) *the nature and amount of each individually significant transaction; and*

(ii) *for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.*

Q5 (Nov. 20)

Mr. X owns 95% of entity A and is its director. He is also the beneficiary of a trust that owns 100% of entity B, of which he is a director.

Whether entities A and B are related parties?

Would the situation be different if:

(a) *Mr. X resigned as a director of entity A, but retained his 95% holding?*

(b) *Mr. X resigned as a director of entities A and B and transferred the 95% holding in entity A to the trust?*

SOLUTION

Entities A and B are related parties, because the director (Mr. X) controls entity A and is a member of the key management personnel of entity B.

Answers to different given situations would be as under:

(a) Mr. X resigned as a director of entity A, but retained his 95% holding

Mr. X continues to control entity A through his 95% holding even though he is not (nominally) a director of the entity. Entities A and B are related if Mr. X controls the trust. Mr. X controls entity A and also, through the trust, controls entity B. Entities A and B are controlled by the same person, and so they are related parties.

Mr. X might still be a member of 'key management personnel' even though he is not (nominally) a director of entity A. Key management personnel includes, but is not restricted to, directors, which include those who are executive 'or otherwise' provided they had authority and responsibility for planning, directing and controlling the activities of the entity. There could be two reasons why entities A and B would continue to be related parties: Mr. X being a member of 'Key management personnel' of entity A and Mr. X controlling entity A.

(b) Mr. X resigned as a director of entities A and B and transferred the 95% holding in entity A to the trust.

If Mr. X controls the trust, he controls entities A and B through the trust, so they will be related parties (see reason in (a) above)

Mr. X is a member of 'key management personnel' of the two entities (see (a) above) if, as seems likely, he continues to direct their operating and financial policies. The substance of the relationship and not merely the legal form should be considered. If Mr X is regarded as a member of the key management personnel of, say, entity A, entity B is a related party, because he exercises control or significant influence over entity B by virtue of his control over the trust.

MTPs QUESTIONS

Q6 (March 18)

An Indian company has a parent company outside India parent company negotiates software licenses with end vendor and based on number of licenses, parent company gets its reimbursement from Indian company. Say, license cost of Rs. 12 lac is charged for calendar year of 2018. Parent company generates it's invoice in February 2018. Indian company account full invoice in February 18 and then for Indian financial year accounts reimbursement expense of Rs. 3.00 lac during FY17-18 (for to licensing cost relating to. January 18 to March 18) and prepaid expenses of Rs. 9 lacs for licensing cost reimbursement relating to April 18 to December 18. Prepaid expense is subsequently burst and expense of Rs. 9 Lac is accounted for in financial year 18-19. What amount should be disclosed at related party transaction?

SOLUTION

Paragraph 9 of Ind as 24 related party disclosure defines related party transactions as under :

"A Related party transaction is a transfer of resources, service or obligations between a reporting entity and the related party, regardless of whether a price is charged."

Paragraph 6 of ind as 24 stated as under:

"A related parties relationships would have an effect on the profit or loss and financial position of an entity"
In the given case, there is a transfer of resources to the extent of Rs. 12 Lac from the company to the parent towards software license. Of this transfer of resources the company has consumed the benefit relating to Rs. 3 lacs of software license cost which is recognise in profit or loss. The benefit relating to Rs. 9 lacs of software license cost will be consumed in the next reporting period and therefore is recognized in the balance sheet as prepaid expenses.

Paragraph 18 of Ind as 24 started as under:

"If an entity has had related party transaction during the period covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments necessary for users to understand the potential effect of the relationship of the financial statements. At a minimum, disclosures shall be include

a. The amount of the transactions;

b. Tournament of outstanding balances including commitments, and:

i. Terms and conditions, including whether they are secured, and the nature of the consideration to be provided in statement, and;

ii. Details of any guarantees given or received;

c. Provision for doubtful debts related to the amount of outstanding balances, and

d. The expense recognized during the period in respect of bad and doubtful deaths due from related parties"

Therefore the company has to disclose:

1. *The amount of transaction with the parent of Rs. 12 lac toward software license;*

2. *Outstanding balance of Rs. 9 lac presented as prepaid expense along with the terms and conditions and state that the same will be settled in the next reporting period by receipt of software licensing services*

3. *The amount of Rs. 3 lac recognized as software license expense in profit or loss for the benefit consumed during the period to make it understandable to users.*

Paragraph 113 off Ind as 1 presentation of financial statements stated as under:

"An entity shall present notes in a systematic manner. An entity shall cross-reference each line items in the balance sheet and in the statement of profit and loss, and in the statement of changes in equity and of cash flow to any related information in the notes."

Therefore, the company shall cross-reference the software licensing expenses recognized in profit or loss and prepared expenses recognized in the balance sheet to the notes disclosing related party transactions.

Q7 (August 18 – 4 Marks)

Mr. X has a 100% investment in A Ltd. He is also a member of the key management personnel (KMP) of B Ltd. B Ltd has a 100% investment in C Ltd.

Examine related party relationships of A Ltd., as per Ind AS 24, in the financial statements of C Ltd.

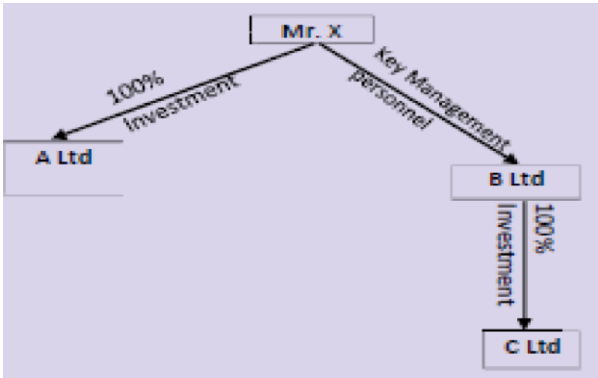
SOLUTION

Ind AS 24 defines the term "key management personnel" as persons having authority and responsibility for planning, directing and controlling the activities of the entity directly or indirectly, including any director (whether executive or not). Further, significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

Therefore, a key management personnel (KMP) has significant influence over the entity. Accordingly, Mr. X has significant influence over B Ltd. since he is a key management personnel of B Ltd.

Now, the standard states that an entity is related to a reporting entity if the person identified (here KMP ie. Mr. X) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity)"

Therefore, if C Ltd. is a reporting entity, A Ltd. is related to C Ltd. because a key management personnel of parent B Limited has control over A Limited. Therefore, the relationship of C Ltd. and A Ltd. will be "Entities controlled by key management personnel of the Parent Entity".



Q8 (March 19 – 4 Marks)

An Indian company has a parent company outside India. Parent company negotiates software licenses with end vendor and based on number of licences, parent company get its reimbursement from Indian company. Say, license cost of Rs. 12 Lac is charged for calendar year of 2018. Parent company generates is invoice in February 18. Indian company accounts full invoice on February 18 and then for Indian financial year, accounts Reimbursement expense of Rs. 3. 00 Lac during FY 1718 (for licensing cost relating to period January 18 to

March'18) and Prepaid expenses of Rs. 9 Lac for licensing cost reimbursement relating to April'18 to December'18. Prepaid expense is subsequently reversed and expense of Rs. 9 Lac is accounted for in FY 18-19. What amount should be disclosed at Related party transactions?

SOLUTION

Ind AS 24 Related Party Disclosures defines Related Party Transactions as under:

"A related party transaction is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged."

Ind AS 24 states as under:

"A related party relationship could have an effect on the profit or loss and financial position of an entity…"

In the given case, there is a transfer of resources to the extent of Rs.12 lac from the company to the parent towards software license. Of this transfer of resources, the company has consumed the benefits relating to Rs. 3 lac of software license cost which is recognised in profit or loss. The benefits relating to Rs.9 lac of software license cost will be consumed in the next reporting period and therefore is recognised in the balance sheet as prepaid expenses.

Ind AS 24 states as under:

"If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments necessary for users to understand the potential effect of the relationship of the financial statements. At a minimum, disclosures shall include:

a. *The amount of the transactions;*

b. *The amount of outstanding balances, including commitments, and;*

(i) *Their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and*

(ii) *Details of any guarantees given or received;*

c. *Provisions for doubtful debts related to the amount of outstanding balances; and*

d. *The expense recognised during the period in respect of bad and doubtful debts due from related parties."*

Therefore, the company has to disclose:

1. *The amount of transaction with the parent of Rs.12 lac towards software license;*
2. *Outstanding balance of Rs.9 lac presented as prepaid expense along with the terms and conditions and state that the same will be settled in the next reporting period by receipt of software licensing services.*
3. *The amount of Rs.3 lac recognised as software license expense in profit or loss for the benefits consumed during the period to make it understandable to users.*

Ind AS 1 Presentation of Financial Statements states as under:

"An entity shall present notes in a systematic manner. An entity shall cross-reference each line item in the balance sheet and in the statement of profit and loss, and in the statement of changes in equity and of cash flows to any related information in the notes."

Therefore, the company shall cross-reference the software license expense recognised in profit or loss and prepaid expenses recognised in the balance sheet to the notes disclosing related party transactions.