



Toolkit for assessing compliances pertaining to Related Party Transactions-

Identification of related parties

**Foundation for Audit
Quality**

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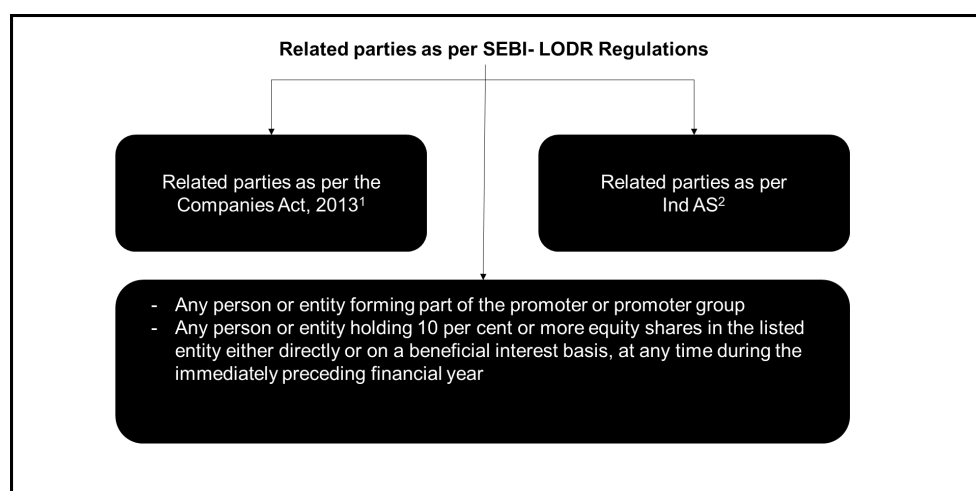
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Checklist for compliance with Regulations pertaining to related parties

Identifying related parties

Related parties are defined under the Companies Act, 2013, the accounting standards and under the SEBI regulations. While identifying related parties for the purpose of obtaining requisite approvals and making disclosures to stakeholders, entities would need to comply with all three regulations¹.

Figure 1: Related parties under the Companies Act, 2013, LODR Regulations and Ind AS



¹ If a company is governed by any other regulation, for example, the RBI or IRDAI regulations, then it should take such regulations into account while planning compliance procedures for related parties and RPTs.

² Related parties as per Section 2(76) of the Companies Act, 2013 include the following:

- Director or his relative
- Key managerial personnel or his relative;
- A firm, in which a director, manager or his relative is a partner;
- A private company in which a director or manager or his relative is a member or director;
- A public company in which a director or manager is a director or holds along with his relatives, more than two per cent. of its paid-up share capital;
- Any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;
- Any person on whose advice, directions or instructions a director or manager is accustomed to act;
- Any company which is—
 - (A) a holding, subsidiary or an associate company of such company; or
 - (B) a subsidiary of a holding company to which it is also a subsidiary;
 - (C) an investing company or the venturer of the company;";
 Explanation.—For the purpose of this clause, "the investing company or the venturer of a company" means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate.
- Such other person as may be prescribed;



1 Declaration of related entities by directors, managers and key managerial personnel

S. No.	Questions	Note	Response
1	<p><i>Base procedures</i></p> <p>Has the company obtained periodical confirmations from the directors, managers and Key Managerial Personnel of the company and its holding company (together termed as KMP) at the beginning of each financial year to identify their relatives³, related entities and their interests?</p> <p>Have the directors, managers and KMP notified to companies whenever there is a change in interest in the related entities?</p>	1.1	
2	<p><i>Management diligence procedures</i></p> <p>Has the company performed procedures to validate the information declared by directors, for example, the company could identify if directors have other directorships, evaluate their investments, by accessing certain websites, such as the MCA website, etc.?</p>	1.2	
3	<p><i>Monitoring procedures</i></p> <ul style="list-style-type: none"> Has this information been subject to validation by an internal or an external agency? Have the results of the validation been considered by the company? 		

Note 1.1

As per Section 2(76) of the Companies Act, 2013, related entities of directors include partnership firms in which a director, manager or his/her relative is a partner, a private company

³ A person or close family member is related to a reporting entity if that individual:

- Has control or joint control over the reporting entity.
 - Has significant influence over the reporting entity.
 - Is a member of the key personnel of the reporting entity or of the parent of the reporting entity.
- An entity is related to a reporting entity if the following conditions are met:
- Both the reporting entity and the entity belong to the same group.
 - An associate or joint venture of the other entity or of the same third party.
 - The entity is a post-employment benefit plan for the reporting entity or any entity related to the reporting entity.
 - The entity is controlled or jointly controlled by the person mentioned above or the person mentioned has significant influence over the entity.

- The entity or any member of the group provides key management personnel service to the reporting entity or parent of reporting entity.

Ind AS specifically excludes certain entities from being recognised as related parties- these include:

- Entities that have a common director or KMP or because KMP of one entity has significant influence on the other
- Two joint venturers simply because they share joint control of a joint venture
- Providers of finance, trade unions, public utilities and departments and agencies of the government that do not control or have significant influence on the entity
- A customer, supplier, franchisor, distributor or general agent with whom the entity has significant volume of transactions, simply by virtue of the resulting economic dependence



in which a director or manager or his/her relative is a member or director, a public company in which a director or manager is a director or a member (with a holding exceeding two per cent on an individual or joint basis, with relatives), bodies corporate which are accustomed to act in accordance with the advice of the directors or managers, or any person on whose advice, direction or instruction the directors or managers are accustomed to act.

Note 1.2

As per the Companies Act, 2013, the interest of the directors needs to be mentioned in the register of contracts in form MBP-1. One of the validation checks that may be adopted by the company is comparing the declaration of directors of the company with form MBP-1 filed with other companies in which the director/KMP/manager is a director.



2 Identifying and keeping track of group companies

S. No.	Questions	Note	Response
4	<p><i>Base procedures</i></p> <p>Has the company obtained a legal structure of the entire group - which at the minimum includes:</p> <ol style="list-style-type: none"> The holding company, the ultimate holding company and their investments (subsidiaries, associates and Joint Ventures (JVs)) Investors in the company Fellow subsidiaries and their investments Subsidiaries and their investments Associates and JVs and their investments Other companies forming part of the promoter's group (apart from a-e above and their investments)? 	2.1	
5	Does the company keep track of all changes that are taking place at a group level (this includes investments, disinvestments, mergers, acquisitions, demergers, etc.) and update the group structure on a periodic basis?		
6	<p><i>Management diligence procedures</i></p> <p>Has it been ensured that appropriate internal control processes have been established to verify the group structure (for any changes therein) on a periodic basis?</p>		
7	<p><i>Monitoring procedures</i></p> <ul style="list-style-type: none"> Has this information been subject to validation by an internal or an external agency? Have the results of the validation been considered by the company? 		

Note 2.1

The group structure should include all relationships of the company that are covered in the related party definition prescribed in the Companies Act, 2023 and in the accounting standards. This includes relationships where control exists without shareholding.



3 Determining control

S. No.	Questions	Note	Response
8	<p><i>Base procedures</i></p> <p>When determining whether an entity or an individual has control over the company, or vice versa, have all regulations which explain the concept of control been considered?</p>	3.1	
9	<p><i>Management diligence procedures</i></p> <p>Have companies reviewed all shareholders' agreements and relevant contracts to identify entities that it has control on?</p>		
	<p>Have companies reviewed all shareholders' agreements and relevant contracts to identify entities that control the entity?</p>		
10	<p><i>Monitoring procedures</i></p> <ul style="list-style-type: none"> - Has this information been subject to validation by an internal or an external agency? - Have the results of the validation been considered by the company? 		

Note 3.1

On a combined reading of the Companies Act, 2013 and Ind AS 110, *Consolidated Financial Statements*, control over an entity is established when:

- An entity has the right to appoint majority of the directors (Section 2(27) of the Companies Act, 2013)
- An entity can control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders' agreements or voting agreements (Section 2(27) of the Companies Act, 2013)
- An entity has power over the other entity (Ind AS 110)
- An entity has exposure or rights to variable returns from its involvement with the investee (Ind AS 110)
- An entity has the ability to use its power over the investee to affect the amount of the investor's returns (Ind AS 110)



4 Identification of the promoter group

S. No.	Questions	Note	Response
11	<p><i>Base procedures</i></p> <p>Have companies obtained periodical confirmations from the promoters at the beginning of each financial year to identify their related entities?</p> <p>Have the promoters notified to companies whenever there is a change in interest in the related parties?</p> <p>(Note: These related entities would be considered as members of the promoter group)</p>	4.1	
12	Has the company evaluated whether a promoter related trust or any other trust holds shares in a company or in its group companies?	4.2	
13	Has the company evaluated whether such trusts would be considered as part of related parties?		
14	<p><i>Management diligence procedures</i></p> <p>Have companies performed additional procedures to validate the information, for example, the company could identify if promoters have other directorships, evaluate their investments, by accessing certain websites, such as the MCA website?</p>	4.3	
	<i>Procedures when promoters have applied for reclassification as public shareholders</i>		
	Where a promoter, being an individual or an entity, has applied for reclassification of the promoter to a public shareholder, has the management performed the following procedures:	4.4	
	<ul style="list-style-type: none"> Checked the status of the reclassification application of the promoter as on date a shareholders' approval for RPTs is sought 		
	<ul style="list-style-type: none"> Ensured that the promoter does not cast a vote as public shareholder on a related party transaction till the time the approval for reclassification of the promoter to a public shareholder has been obtained? 		
15	<p><i>Monitoring procedures</i></p> <ul style="list-style-type: none"> Has this information been subject to validation by 		

	an internal or an external agency? – Have the results of the validation been considered by the company?	4.5	
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Note 4.1

The declarations provided by the promoters (be it an individual or an entity) would be similar to the annual disclosures of interest which is presently provided by directors (in form MBP-1), and should include details of their relationships and interest with the related entities. Additionally, the PAN, Company Registration Number (CRN), or any other identifier should be provided for easy tracking of such entities/individuals.

The format and periodicity of such disclosures should be determined by the board of directors, in such a manner that it captures changes in interest of the promoters in the related parties on a continuous basis (and not at a point in time).

The declarations should include direct and indirect holdings (indirect holdings include holdings through layers of subsidiaries) of the promoters - this is because it is important to identify the ultimate beneficial owner of an entity, i.e. there is no shell company involved.

Note 4.2

Any other trust could include trusts that are controlled by a promoter of the company or a trust where the promoter of the company or his/her relatives are the beneficiary.

Note 4.3

As part of the Standard Operating Procedures (SOP) of a company for determining related parties and RPTs and validating the same, the company should include certain procedures that should be adopted by the company, including the information it should seek from directors, promoters, etc. The SOP should also include additional procedures that would be adopted by the company, such as procedures to independently validate the information declared by directors or promoters, etc.

Note 4.4

Regulation 31A of the LODR Regulations empowers the stock exchanges to permit the reclassification of the status of any person as a promoter to a public shareholder subject to the compliance of certain prescribed conditions.

Note 4.5

The internal auditors of the company or a third-party entity may be appointed to validate the information submitted by the promoters, by performing a thorough review of directorships, relationships, etc. for a sample of selected promoters.

5 Determining and monitoring shareholding of investors with a prescribed shareholding

S. No.	Questions	Note	Response
16A	<i>Base procedures</i>		
	Is the investors' shareholding provided by share transfer agents reviewed by the company on a periodical basis?	5.1	
	Have investors whose shareholding (direct and indirect with their connected entities) exceeds a certain percentage (say, 9 per cent) been placed on an 'alert list' so as to actively track when their shareholding may cross the threshold of 10 per cent (threshold for qualifying as a related party)?	5.2	
	Have the investors whose shareholding has crossed the 10 per cent threshold been added to the 'related parties' digital database maintained by the company?	5.3	
	Does the company track all transactions entered into with entities that are included in its 'alert list'?	5.4	
16B	While disclosing their related party transactions to investors and regulators, have companies categorised the list of related party transactions into a logical grouping such as, routine, non-routine transactions and transactions at off-market rates so as to enable a more effective review/use of the information? To illustrate, routine transactions could include transactions with institutional investors, which are in the normal course of business (such as opening of a bank account, obtaining an insurance policy, etc.) and are at market rates or based on an arm's length pricing	5.5	
17	<i>Management diligence procedures</i> Does the company cross check the investor information obtained from share transfer agents/registrars with other information, such as tracking of shareholding by the investor relations department or declarations on beneficial ownership, etc.?	5.6	
18	<i>Monitoring procedures</i> – Has the information pertaining to shareholding of investors been validated on a sample basis by internal or external agencies (such as secretarial auditors) with reports		

	obtained from share transfer agents? <ul style="list-style-type: none">- Has the internal or external agency also tested management's independent validation of transactions entered into with entities in the alert list?- Has the result of the validation been considered by the company?		
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Note 5.1

As per Regulation 31 of the LODR Regulations, a listed entity should, inter alia disclose a statement showing holding of securities and shareholding pattern separately for each class of securities in a prescribed format.

Note 5.2

Companies should monitor shareholding of investors on a regular basis and classify the shareholders with a shareholding exceeding a certain percentage (e.g. nine per cent) in an 'alert list' as it will help track if any such investor would fall in the related party definition and may require application of these regulations.

Note 5.3

The digital database should be accessible to auditors and regulators. The database should also be technology enabled, and linked to relevant systems, so as to generate an alert for audit committees' approvals for all RPTs and shareholders' approvals when the transaction with a related party crosses a particular threshold which is lower than the regulatory threshold for obtaining shareholders' approvals (say for example, INR900 crore or eight per cent of the annual consolidated turnover of the company). With regard to the transactions of the company's subsidiaries, similar alerts should be enabled for transactions with related parties- which is below the threshold for obtaining the listed company's audit committee approval (say, for example, if the transaction crosses eight per cent of the annual standalone turnover of the subsidiary (for transactions post 1 April 2023).)

Investors that cross the 10 per cent threshold shareholding should immediately be added to the related parties database to facilitate pre-approval of previous year's transactions.

Note 5.4

Alert list should include shareholders with the same beneficial owner where the aggregate shareholding exceeds nine per cent. Management's procedures to review transactions with entities in the alert list should be included as a part of the SOP for RPTs. Appropriate documentation should be maintained by management with regard to their validation of transactions with entities in the alert list.

Note 5.5

While an institutional investor as a major shareholder may not be a related party in the traditional sense, companies would need to ensure compliance with SEBI regulations for

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transactions, after taking into consideration the pricing, the nature of transaction and other criteria for obtaining omnibus approval is met.

Note 5.6

In order to comply with the enhanced requirements on RPTs, the information on shareholding should be sought to cover holdings throughout the period, rather than at a point in time.



6 Identifying related parties while entering into schemes of arrangement/strategic transactions including mergers and acquisitions

S. No.	Questions	Note	Response
19	<p><i>Base procedures</i></p> <p>While entering into schemes of arrangement (such as mergers, acquisitions, strategic investments, strategic partnerships, etc.) have the investor and investee companies exchanged a list of their related parties and identified RPTs?</p>		
	<p>Has the list of related parties received as per the above question been updated in the 'related parties' (digital) database maintained by the company?</p>		
20	<p><i>Management diligence procedures</i></p> <p>Have companies performed additional procedures to validate the information obtained, for example, the company could identify the directorships of the promoters of the investor or investee company, as the case may be, evaluate their investments, by accessing certain websites, such as MCA website.</p>		
21	<p><i>Monitoring procedures</i></p> <ul style="list-style-type: none"> - Has the information submitted by the investor or investee company, as the case may be, been subject to validation on a sample basis by internal or external agencies? 		
	<ul style="list-style-type: none"> - Have the results of the validation been considered by the company? 		

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