



# **Toolkit for assessing compliances pertaining to Related Party Transactions-**

## ***Identification of related party transactions***

**Foundation for Audit  
Quality**

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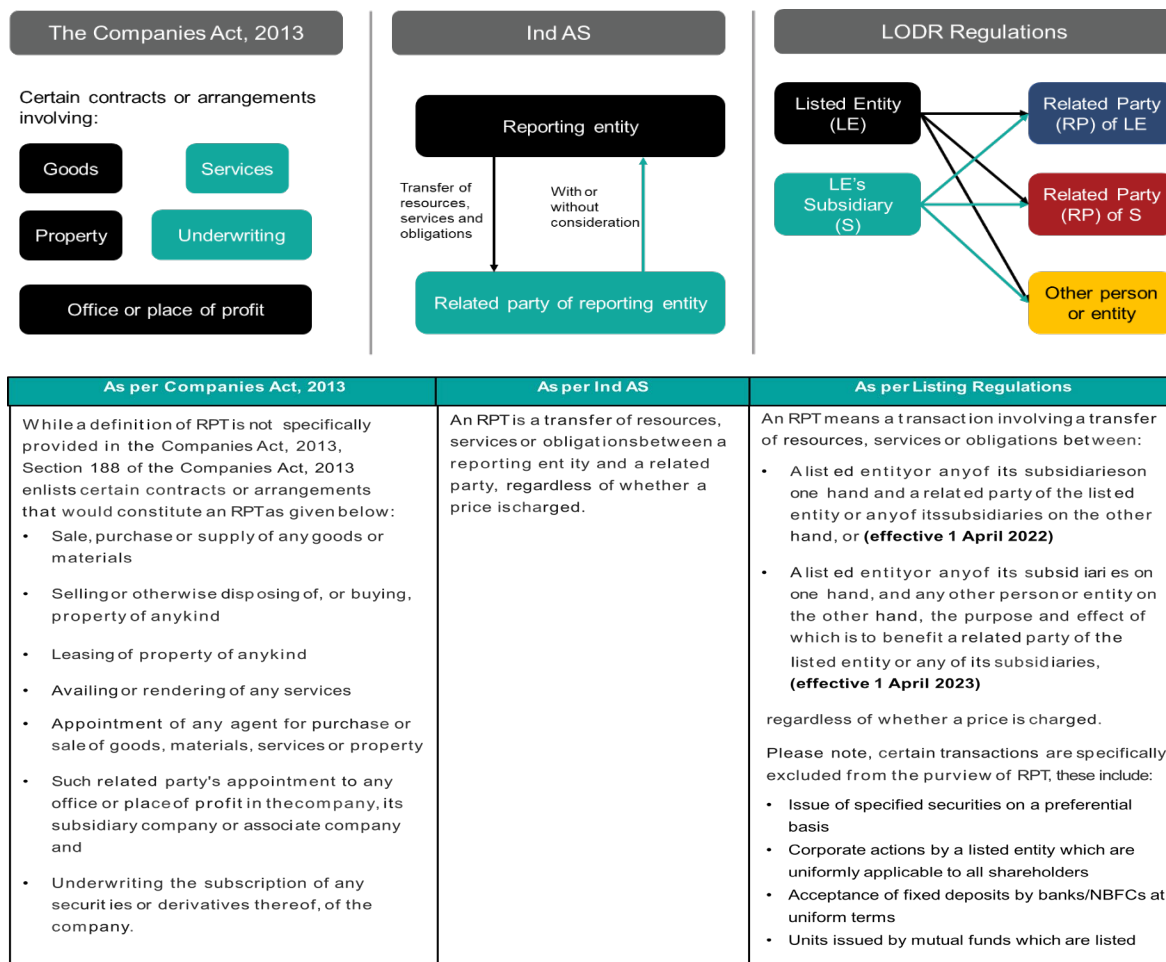
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# Checklist for compliance with Regulations pertaining to related parties

## Identifying related party transactions

When determining which transactions would be a Related Party Transaction (RPT), companies would need to refer to the three regulations- the Companies Act, 2013, Ind AS and the LODR Regulations. The definition of RPT under the three regulations is not same. The RPT definitions under the three regulations are given in the table below and depicted in figure 2.

**Figure 1: Related party transactions under the Companies Act, 2013, LODR Regulations and Ind AS**



## 1 Identifying transactions with members of the promoter group

S. No.	Questions	Note	Response
1	<p><i>Base procedures</i></p> <p>Have companies prepared a database of related parties, and do the companies update this database on a periodical basis?</p>	1.1	
	<p>– Has the database been maintained on a technology enabled platform and integrated with other databases of the company (for example, the vendor master, customer master, etc.)</p>	1.2	
	<p>– Has the company enabled trigger-based alerts while entering into transactions to ensure that all related party transactions are identified?</p>		
2	<p><i>Management diligence procedures</i></p> <p>In order to ensure that transactions with all related parties have been identified, does the finance, legal and secretarial team perform a post-facto compliance of all transactions entered into during the year?</p>	1.3	
	<p>Has the company taken steps to rectify the errors that were identified while performing the post-facto compliance check?</p>		
3	<p><i>Monitoring procedures</i></p> <p>Has the company appointed an internal or external agency to test the following:</p> <ul style="list-style-type: none"> <li>– Validate on a sample basis that transactions entered into during the year have been assessed for involvement of a related party?</li> <li>– Whether appropriate approvals for RPTs have been obtained?</li> </ul>		

### Note 1.1

The Companies Act, 2013 requires companies to maintain a register of contracts with related parties and contracts and bodies, etc. in which directors are concerned or interested. For the purpose of compliance with the related party regulations, companies may extend the format to transactions with the promoters/promoter group.

*Note 1.2*

Companies should perform a thorough cost-benefit analysis based on the quantum of its related parties. Based on such analysis and evaluation, it should ascertain the digital platform on which it should maintain its list of related parties, and the features the database should have.

*Note 1.3*

Where the database of RPTs is maintained on a technology enabled platform, companies may link them to the database of contracts or arrangements, so that contracts or arrangements with RPTs are identified.

## 2 Transactions the purpose and effect of which is to benefit related parties (indirect transactions)

S. No.	Questions	Note	Response
4	<p><i>Base procedures</i></p> <p>Has the entity obtained periodic confirmations from the directors, promoter group, large shareholders<sup>1</sup> and other related parties that there are no transactions that have been undertaken indirectly with the listed company or its subsidiaries or its related parties?</p>		
5A	Have the board of directors prescribed any additional procedures or set out certain criteria for various classes of transactions, to ensure all transactions the purpose and effect of which is to benefit related parties have been captured?	2.1	
5B	Has the company defined the criteria to validate which transactions undertaken by a related party with the entity through an intermediary which could benefit the listed entity or its subsidiary? Has this been communicated with all related parties?		
6	Have the confirmations from directors, managers, promoters and KMP of the company and holding company, been augmented by additional processes mandated by the board of directors?		
7	Has the company updated its related party policies to include the criteria for identifying 'transactions, the purpose and effect of which is to benefit a related party'?	2.2	
8	Has the company obtained confirmations from the counterparty with whom a routine/non-routine transaction is entered into, to the extent that the transaction has not been undertaken in a manner that the purpose and effect of which is to benefit a related party?	2.3	

<sup>1</sup> Large shareholders include investors with a holding exceeding 10 per cent (these are specifically identified by SEBI as related parties)

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S. No.	Questions	Note	Response
9	<p><i>Management diligence procedures</i></p> <p>For non-routine transactions or those that aren't undertaken at market rates, has the company reviewed all transactions with third parties to determine if there are any side agreements, any built-in incentives, commissions, contra transactions, etc. which would in any manner benefit the related parties, to determine if these transactions are for the benefit of related parties?</p>		
10	<p>Have the audit committee members ensured the following:</p> <ul style="list-style-type: none"> <li>- The company has identified the connected parties</li> <li>- The company has identified which transactions have been entered into with any of the connected parties</li> <li>- Studied the details of the transaction to determine whether the transactions have benefited the company's related parties</li> <li>- If the transactions have benefited the related parties, have appropriate approvals under the Companies Act, 2013 and the LODR Regulations been obtained?</li> </ul>	2.4	
11	<p><i>Monitoring procedures</i></p> <p>Has an external or internal agency validated on a sample basis that:</p> <ul style="list-style-type: none"> <li>- Confirmations have been obtained from third parties with whom routine and non-routine transactions are entered into?</li> <li>- Confirmations have been obtained from the promoter group, large shareholders and other related parties that there are no transactions that have been undertaken indirectly with the listed company or its subsidiaries?</li> <li>- Have the board of directors prescribed any additional procedures on a basis to identify transactions by setting out certain criteria for various classes of transactions, to ensure all transactions the purpose and effect of which is to benefit related parties have been captured?</li> <li>- Reviewed whether the additional procedures as prescribed by the board of directors for identifying transactions the purpose and effect of which is to benefit related parties have been adopted by the company?</li> </ul>		

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S. No.	Questions	Note	Response
12	Has an external or internal agency performed an independent validation that transactions entered into with third parties are not for the benefit of a related party?		
13	Have the results of such a validation been considered by the company?		

#### Note 2.1

The board of directors should develop certain guidelines or attributes on the basis of which management identifies and analyses transactions in detail. In addition to this, the board of directors should also prescribe materiality thresholds for certain transactions, such as one-off transactions, non-routine transactions, and similar transactions which may not be in the normal course of business, which may require specific attention of the audit committee.

Given below are certain categories of transactions that may be considered by the board of directors for setting policies/guidelines, with a focus on when entities are essentially acting as intermediaries, and the purpose and effect of the transaction is to ultimately benefit a related party:

- Sale of goods or materials or assets (movable or immovable)
- Purchase or supply of goods or materials or assets (movable or immovable)
- Leasing of property of any kind
- Availing or rendering of services
- Appointment of any agent for:
  - Purchase of goods, services, materials or property
  - Sale of goods, services, materials or property
- Appointment of the relative, employee or officer of a related party to any place of profit
- Underwriting the subscription of any securities or derivatives
- Investments made in a third party, with the intent of passing funds to a related party
- Guarantees or security provided to a third party, with the intent of benefiting related parties
- Loans or advances in the nature of loans granted to a third party, with the intent of benefiting the related parties
- Where funds have been advanced, loaned, or invested (either from borrowed funds or share premium or any other sources or kind of funds) to any person, including foreign entities, with the understanding that the intermediary would directly or indirectly lend or invest in other persons or entities identified in any manner (ultimate beneficiary) or provide any guarantee, security or the like on behalf of the ultimate beneficiary

- Where funds have been received by an entity from any person or entity (including foreign entities) (funding parties) with the understanding that the company should directly or indirectly invest, lend in other persons or entities identified by or on behalf of the funding parties (ultimate beneficiary) or provide any guarantee or security or the like on behalf of the ultimate beneficiary
- Funds taken to meet obligations of subsidiaries, associates or joint ventures
- Any other transactions involving transfer of goods, services, or resources between parties, irrespective of whether a price is charged or not.

*Note 2.2*

The revised RPT policies of a company should be placed on the website of the company.

*Note 2.3*

Standard wordings of the confirmation are given hereunder. Also, a link to the list of related parties of the company may be provided by the company to the counterparty.

***Illustrative format of confirmation for routine transactions***

For routine purchases and sales, a legal clause may be included in the purchase or sales order issued by a company (say Z Ltd.), stating that the transactions entered into by the third parties with Z Ltd. are not undertaken for the purpose of or have the effect of benefiting the related parties of Z Ltd. An example of a clause that may be included in the purchase or sales order is given hereunder:

Illustrative clause included in a purchase order

By accepting this purchase order, I/we hereby confirm that this transaction has not been undertaken for the purpose of or have the effect of benefiting any related party of the purchasing company or related parties of its subsidiaries. For the list of related parties, please refer [the latest RPT filing of the purchasing company with the stock exchanges or please click here]. We further confirm that any change in the declaration provided above shall be notified to the company immediately.

***Illustrative format of confirmation for non-routine transactions***

For one-off transactions, for example, where there is sale of an asset, a specific confirmation can be obtained from the third party as part of the sale contract.

Illustrative text of the confirmation obtained

I/we hereby confirm that I/we have purchased the asset from Z Ltd. (i.e. the listed company) for my/our own use, and that I/we am/are not acting as an intermediary, and the transaction is not being undertaken for the purpose or does not have the effect of ultimately benefiting any other party, being a related party of Z Ltd. or its subsidiaries as on [insert date of contract]. Accordingly, the asset or its related benefits are not intended to be transferred onward ultimately to a related party of Z Ltd. or a related party of its subsidiaries.



*Note 2.4*

Members of the audit committee may use the connected parties checklist prepared by the Foundation for Audit Quality which includes a comprehensive list of individuals and entities that may be considered as 'connected parties'?

**3 Management diligence procedures on identifying indirect transactions**

S. No.	Questions	Note	Response
14	<i>Base procedures</i> <b>Routine transactions</b> Has the entity performed background verification and due diligence on counterparties as part of the onboarding process (customer onboarding, vendor onboarding, etc.), covering the following procedures:		
	- Is this a connected party (see connected party checklist)? If so, is there any evidence of this being a related party transaction (indirect transaction)?		
	- Confirm there are no side agreements or arrangements for back-to-back transactions with the company's related parties		
	- For any connected parties and a selected sample of other parties, has the entity performed a more detailed assessment covering the following:		
	a. Does this party have commercial substance (i.e. it is not a shell company, etc.)		
	b. Does the party have other reasonable sized counterparties (i.e. customers, suppliers, service providers, providers of capital, etc.) or is the entity and the entity's group companies its dominant counterparties	3.1	
	c. If the party under question has other counterparties, are the transactions with such counterparties substantive or in the nature of 'high seas trading' or pass-through transactions		
	d. Does the party appear to be predominantly a 'captive unit' of the entity		
	e. Does this transaction appear to be a routine transaction in the context of both the Company's and the counterparty's business?	3.2	
15	<b>Non-routine transactions</b> Has the entity performed background verification and due diligence on counterparties as part of onboarding process (customer onboarding, vendor onboarding, etc.), covering the following procedures:		

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S. No.	Questions	Note	Response
	- Is this a connected party (see connected party checklist)? If so, is there any evidence of this being a related party transaction (indirect transaction)?		
	- Does this counterparty have commercial substance (i.e. it is not a shell company, etc.)		
	- Does the party have other reasonable sized counterparties (i.e. customers, suppliers, service providers, providers of capital, etc.) or is the entity and the entity's group companies its dominant counterparties	3.1	
	- If the party under question has other counterparties, are the transactions with such counterparties substantive or in the nature of 'high seas trading' or pass-through transactions		
	- Does the party appear to be predominantly a 'captive unit' of the entity		
	- Does this transaction appear to be a routine transaction in the context of both the Company's and the counter party's business?	3.2	
	- Confirm there are no side agreements or arrangements for back-to-back transactions with the company's related parties		
16	<b>Unusual patterns in transactions</b> Has the entity identified any unusual patterns in transactions with related or other parties, for instance:		
	- Has the entity identified related parties where there is:		
	a. A drop in the level of transactions		
	b. Stagnation in the level of transactions		
	c. Increase in the level of transactions which is not in line with the growth in business/expectations		
	- Identified any corresponding increase in transactions with any other parties/new parties		
	- For such other parties/new parties identified, has the entity performed the following procedures:		

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S. No.	Questions	Note	Response
	a. Is this a connected party (see connected party checklist)		
	b. Does this counterparty have commercial substance (i.e. it is not a shell company, etc.)		
	c. Does the party have other reasonable sized counterparties (i.e. customers, suppliers, service providers, providers of capital, etc.) or is the entity and the entity's group companies its dominant counterparties	3.1	
	d. If the party under question has other counterparties, are the transactions with such counterparties substantive or in the nature of 'high seas trading' or pass-through transactions		
	e. Does the party appear to be predominantly a 'captive unit' of the entity		
	f. Does this transaction appear to be a routine transaction in the context of both the Company's and the counter party's business	3.2	
	g. Confirm there are no side agreements or arrangements for back to back transactions with the company's related parties?		
17	<b><i>Transactions exceeding a certain threshold</i></b> Has the entity identified parties (other than related parties) with whom transactions exceed a certain threshold (e.g., exceeding 20% of SEBI prescribed threshold), and determined if transactions with that party are an indirect transaction by performing the following procedures:		
	- Is this a connected party (see connected party checklist)? If so, is there any evidence of this being a related party transaction (indirect transaction)?		
	- Does this counterparty have commercial substance (i.e. it is not a shell company etc.)		
	- Does the party have other reasonable sized counterparties (i.e. customers, suppliers, service providers, providers of capital, etc.) or is the entity and the entity's group companies its dominant counterparties	3.1	
	- If the party under question has other counterparties, are the transactions with such counterparties substantive or in the nature of 'high seas trading' or pass-through transactions		
	- Does the party appear to be predominantly a 'captive unit' of the entity		

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S. No.	Questions	Note	Response
	- Does this transaction appear to be a routine transaction in the context of both the Company's and the counter party's business	3.2	
	- Confirm there are no side agreements or arrangements for back-to-back transactions with the company's related parties?		

#### *Note 3.1*

Where the entity and its group are the dominant counterparties of the party under question, then its an indicator of high concentration of business and hence dependence on such dominant counterparties. This may require further evaluation as a related party/related party transaction.

#### *Note 3.2*

This can be determined by:

- Examining whether the transaction is relevant to the line of business and nature of operations
- Whether the transaction size is commensurate with the counterparty's level of operations (i.e. revenues, net worth, etc)

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