

We will be discussing accounting standard 18, disclosure requirements, need for disclosure, meaning of related party and related party transactions and items to be disclosed.

At the end of this unit, you will be able to understand the concept of accounting standard 18 and the related aspects. Now what does accounting standard 18 related party disclosure deal with? There are two aspects that we need to understand here related party and related party transactions.

When there are related parties or there are related party transactions happening in an organization that has to be disclosed in the financial statements, what does this mean? Or why this has to be done? When there are two related parties in an organization, it is said that one party may have an influence over the other party on the financial decision making and the operating results of the organization. Hence, it is necessary to disclose the related party relationships as well as related party transactions in the financial statements. This standard establishes requirements for the disclosure of related party relationships and transactions between a reporting enterprise and its related parties. So we are going to learn what are related parties and the transactions taking place between the reporting enterprise and the related parties.

Now, why do we require this disclosure? As already discussed earlier, there is some influence when two parties are related.

So firstly, it is the requirement of statutes. Since there can be some influence of one party over the other and that might have an impact on the financial operations or the operating results of the company, it is mandatory that such a relationship if it exists has to be disclosed in the financial statements.

Next, to reflect that transaction may not be at arm's length price. Now what do you mean by this arm's length price? If disclosures are not made, it is presumed that when transactions occur between the two parties, the two parties are not related or there is no related party relationship existing in the organization.

Next, effect on financial position and operating results. Now you need to know that even if there are no related party transactions happening in the organization, yet merely having a related party in the organization can have an effect on the financial position as well as the operating results of the reporting enterprise.

Next, recording of all possible transactions. These disclosures are required sometimes because the transactions would not have taken place if the related party relationship did not exist. So these are some of the requirements, or these were some of the reasons for disclosing the related party relationships and transactions in the financial statements.

Now what do you mean by the related party?

Related party means at any time during the year one party has an ability to control the other party or exercise significant influence over the other party in making financial and or operating decisions. So when control and significant influence are present, that is, one can influence the other. In that situation you have Related parties.

Now what does this term control mean?

Control means ownership, whether direct or indirect, of more than 50% of the voting power of an enterprise. So when a person owns more than 50% of voting right in an enterprise control over composition of the Board of Directors that means more number of members are present in the Board of Directors who are related.

A substantial interest in voting power and power to direct the financial and or operating policies of the enterprise, so there is substantial interest as well.

Next significant influence, now significant influence can be gained by share ownership, statute or agreement, but under this also there is some sort of power to direct the financial position of the enterprise or operating policies of the enterprise or financial as well as operating policies of the enterprise.

Now what are related party transactions? If you have two related parties and there is some sort of transaction between the two for a price or maybe free of cost, in that case, that transaction is known as related party transaction. So the simple meaning is transfer of resources or obligations between related parties, regardless of whether or not a price is charged. So you transfer maybe goods, could be an asset, so these transfers between two parties may be for a cost, or it may be free of cost. So coming some examples.

These are some examples of related party transactions, purchases or sales of goods. So when goods are purchased from one party to the other, so maybe from the reporting enterprise from its holding company or its subsidiary company, Purchases or sales of fixed assets, Rendering or receiving of Services Agency arrangements, Leasing or hire purchase arrangements.

Now when we say parties, when we see related parties, what parties are we talking about?

We are talking about the holding companies, subsidiaries, and fellow subsidiaries. It could be associates and joint ventures of the reporting enterprise. It could also be investors, investors in respect of which reporting enterprises associate or a joint venture. It could be individuals, now which individuals, those who have direct or indirect interest in the voting power of the reporting enterprise.

Key management personnel: Key management personnel is a person who works in the key position in the organization and who has power to plan, coordinate and direct the people in the organisation. The example of this could be the Managing Director and his relatives. Now relatives here of the key management personnel means his spouse, parents and children. And enterprises of which any person who is a KMP or has direct and indirect interest in voting power can exercise significant influence. So any person who is a KMP or has direct or indirect interest in the voting power can also exercise this significant influence, can have an influence on the financial and operating decisions of the company.

Now, what exactly needs to be disclosed under accounting Standard 18? So the following needs to be disclosed: the name of the transacting related party, so the parties names have to be correctly disclosed.

A description of the relationship between the parties, whether it's a holding company, subsidiary company, and so on. A description of the nature of transactions, what transaction has taken place? Is it a sale of goods? Is it a purchase of good? the volume of transactions- either an amount or a part of the transaction has been for a price? Any elements of related party transactions which is necessary for an understanding of the financial statements. So apart from this, any other element that improves the financial statements and understanding of the financial statements. Outstanding amount from related parties at the balance sheet date, so any amount that's outstanding has to be mentioned in the balance sheet date. Provisions for doubtful debts due from related parties at the balance sheet dates, also need to be disclosed. Amounts written off or written back of debts due from or to related parties.

So we have dealt with accounting standard 18 related party disclosures. For more you can refer to these these websites.

Thank you.