



Compliance for Related Party Transactions under the Companies Act, 2013 and SEBI Equity Listing Agreement

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Increased compliance and transparency



Background

- The Companies Act, 2013 (2013 Act) seeks to replace the Companies Act, 1956 (1956 Act).
- The 2013 Act puts significant emphasis on:
 - Self-regulation with disclosures/transparency instead of ‘Government Approval’ based regime
 - e-Governance and Corporate Governance measures
 - Accounting and reporting considerations
 - Stricter enforcement to investigate, adjudicate and penalize
- Securities and Exchange Board of India (SEBI) has amended Equity Listing Agreement w.e.f. 01 October 2014 and expanded the scope of Related Party Transactions

Objectives

- More responsibility and accountability for the Board of Directors, Key Management Personnel (KMPs) to revamp and / or put systems and processes in place for compliance on a continuous basis.
- Consent of Board/Audit Committee/ Shareholders, in specific cases, for Related Party Transactions.

High Impact Areas of 2013 Act - A Quick Snapshot



Directors and Governance

- Mandatory woman director.
- Stringent eligibility criteria for independent directors.
- Directors committees – new / change in roles and responsibilities.
- KMPs Related parties.



Accounts, Audit and Auditors

- Board Report on Financial Statements to state adequacy and operating effectiveness of controls.
 - Internal financial controls (IFC) for listed companies.
 - Compliance with all applicable laws.
 - Board Report to include manner of formal annual evaluation of its own performance, committees and individual directors.
- Consolidated Financial Statements mandated under 2013 Act.
- Corporate Social Responsibility at 2% of average net profits of past three years.
- Increased responsibility on Auditors.
- Mandatory rotation of Auditors.
- New Regulator – National Financial Reporting Authority (NFRA) for oversight on auditors and audit quality.
- Fraud and reporting requirements relating thereto.

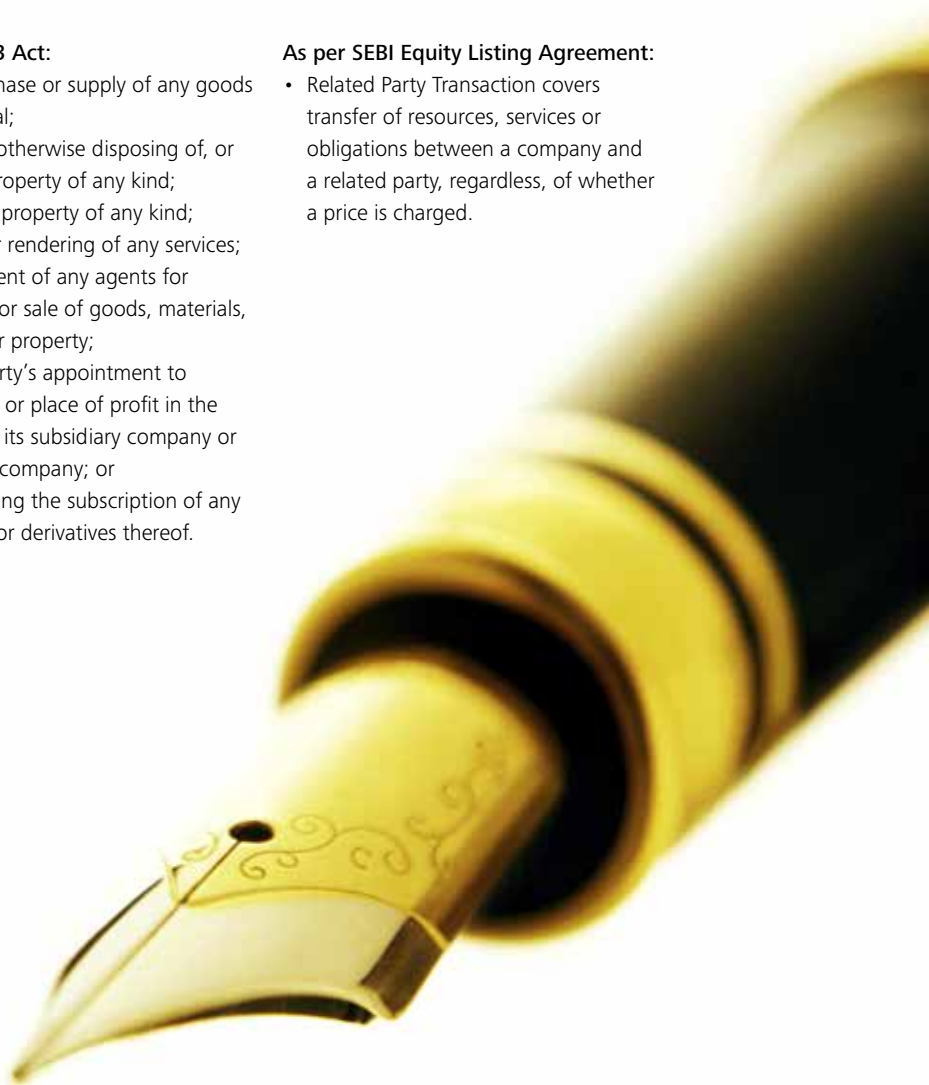
What are Related Party Transactions under 2013 Act and SEBI Equity Listing Agreement?

As per 2013 Act:

- sale, purchase or supply of any goods or material;
- selling or otherwise disposing of, or buying, property of any kind;
- leasing of property of any kind;
- availing or rendering of any services;
- appointment of any agents for purchase or sale of goods, materials, services or property;
- related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; or
- underwriting the subscription of any shares in or derivatives thereof.

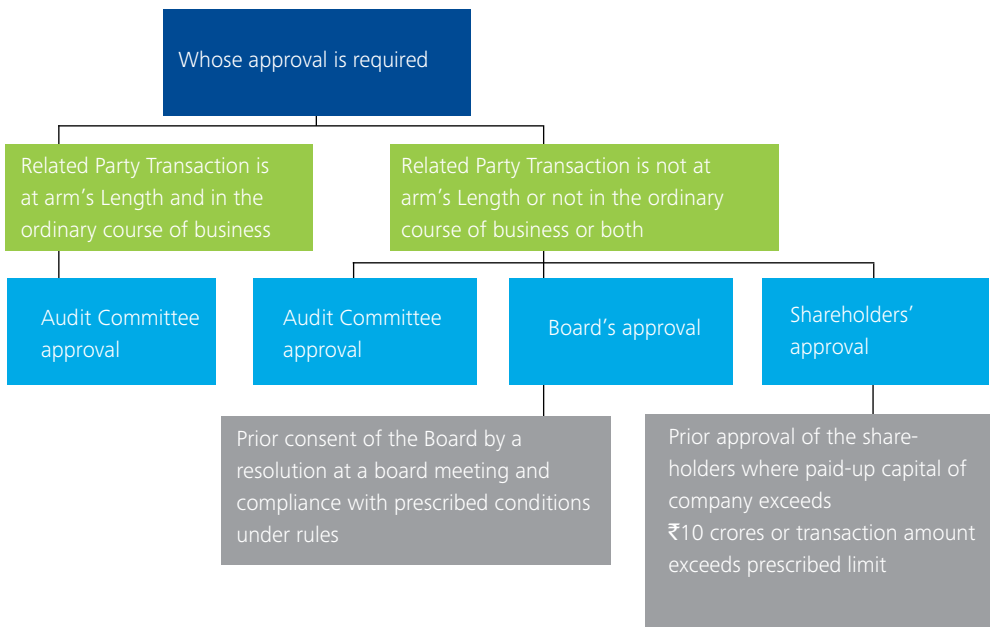
As per SEBI Equity Listing Agreement:

- Related Party Transaction covers transfer of resources, services or obligations between a company and a related party, regardless, of whether a price is charged.



Approval of Related Party Transactions under 2013 Act

'Arm's length transaction' means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

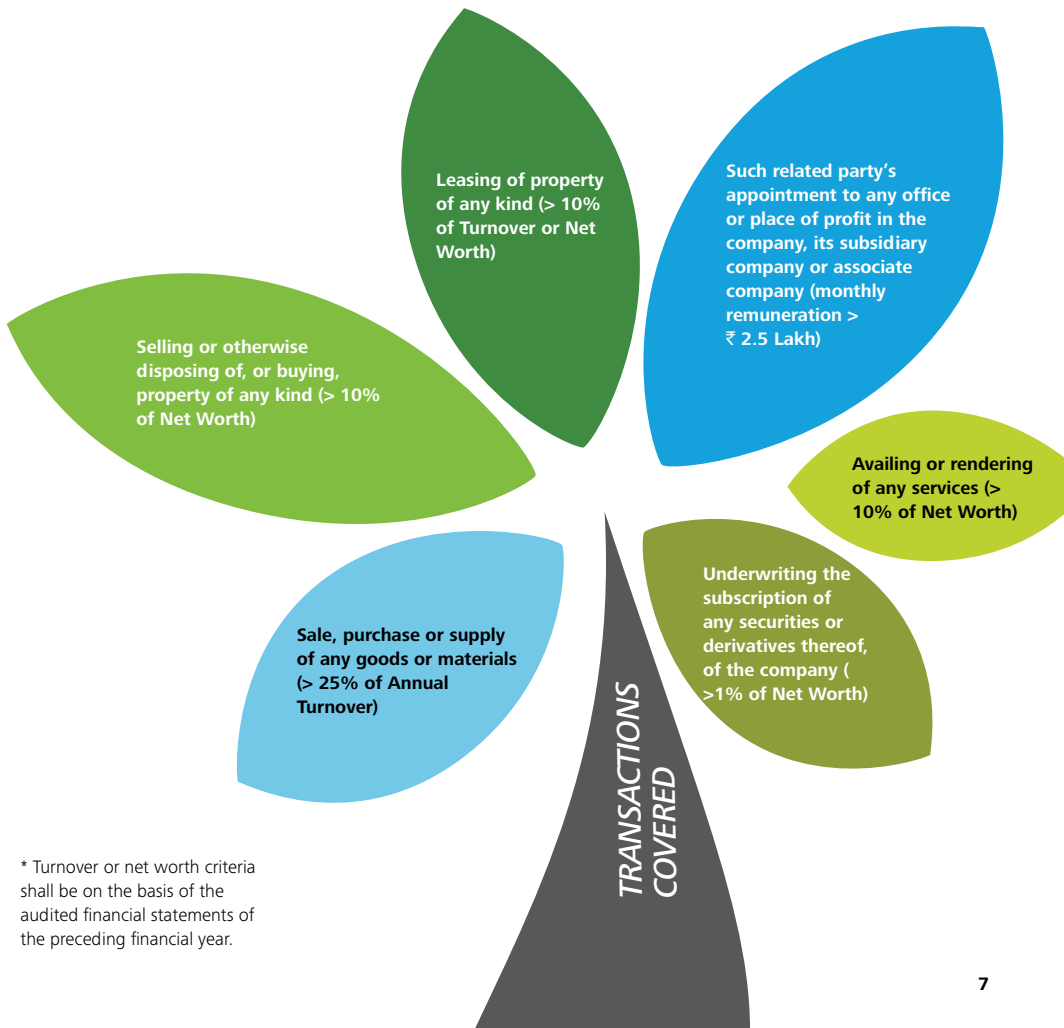


Disclosure:

Details of contracts/arrangements/transactions not on arm's length basis and material contracts/arrangements/transactions shall be disclosed in the Board's report.

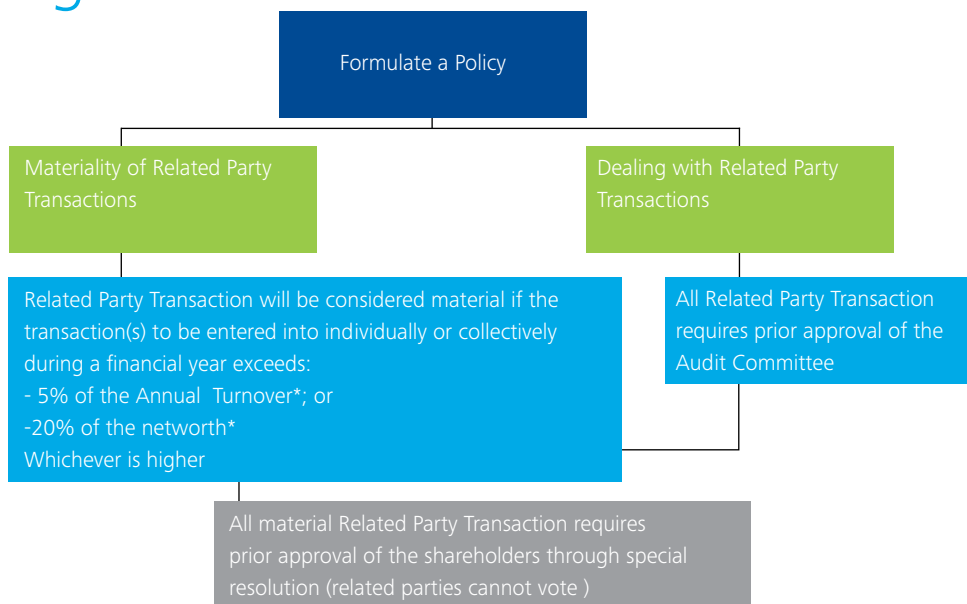
Types of Related Party Transactions that need Approval under 2013 Act

Related Party Transactions by a company having paid-up capital of ₹10 crores or exceeding value of transaction as mentioned below will require prior approval of the shareholders by special resolution.



* Turnover or net worth criteria shall be on the basis of the audited financial statements of the preceding financial year.

Approval of Related Party Transactions – Additional requirements for Listed Companies under the SEBI Equity Listing Agreement



Disclosure:

- Details of all material Related Party Transaction to be disclosed quarterly along with the compliance report on corporate governance
- Policy on dealing with Related Party Transaction to be disclosed on the Company's website and Annual Report

* Turnover or net worth criteria shall be on the basis of the audited financial statements of the preceding financial year.

Alignment with 2013 Act

Related Party Transactions which are not at arm's length or is not in ordinary course of business will need to obtain Board's approval or shareholders' approval, as the case may be.

Penalties for Non-compliance

- Company may proceed against a director / employee, who had entered into contract or arrangement in contravention of the provisions, for recovery of any loss sustained by it as a result of such contract or arrangement.
- Such a director shall be disqualified for a period of 5 years.
- In case of a listed company, such director / employee may be punishable with imprisonment for a term up to 1 year and/or with fine of ₹25,000 – ₹5,00,000.
- In case of any other company, such director / employee may be punishable with fine of ₹25,000 – ₹5,00,000.

Have you thought about these challenges?

Identifying Related Parties

Updating/ maintaining the database of such persons / entities



Identifying the ordinary course of business in relation to the company and such person / entity



Identifying Related Party Transactions



Obtaining internal clearance before entering into any transaction with such persons / entities



Documenting the Arm's Length pricing of transaction



Deloitte approach

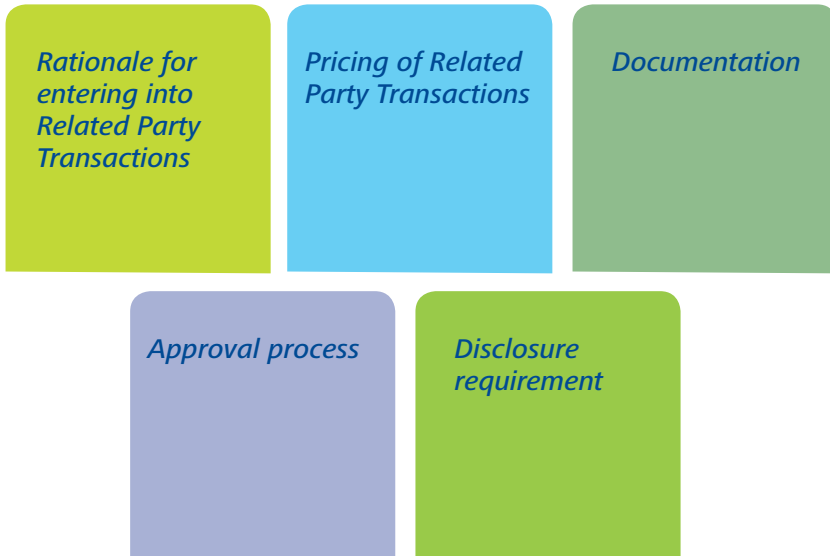
Deloitte's Regulatory and Transfer Pricing team can assist you in addressing the current challenges by analysing the impact of and complying with 2013 Act and Equity Listing Agreement, in respect of the Related Party Transactions, along with advice on structural aspects.

How can Deloitte help



Formulate policy

Assist in formulating policies and procedures for Related Party Transactions covering



How can Deloitte help



Implementation

Identification

- Develop an understanding of the organization structure and operations.
- Review the current processes for identification of related parties and transactions.
- Identify additional related parties and transactions.
- Set procedures and guidelines to identify a related party.

Analysis of Related Party Transaction pricing

- Understand the current method of determining ordinary course of business and pricing of transactions.
- Evaluation of existing contracts and identify the risk areas, if any, and assist in taking corrective measures for transactions not in line with arm's length policy.
- Set procedures for determination of arm's length pricing for new contracts.
- Evaluation of arm's length pricing for new contracts on real-time basis.

Documentation

- Define minimum required supporting documents required to evaluate Related Party Transaction.
- Develop a checklist for documenting Related Party Transactions.
- Set an effective control system for verification of supporting documents.

Approval Process

- Identification and evaluation of former contracts which need to undergo approval process.
- Assist in setting up review and approval mechanism

Disclosure requirements

- Assist in developing a framework to capture all the Related Party Transactions to ensure its correctness, completeness, etc.

How can Deloitte help



Review of controls

Review the existing IT systems and controls to understand how related party identification and Related Party Transaction identification is carried out.



Review controls (preventive and detective) in the processing of related party approvals and Related Party Transaction processing.



Analyse data pertaining to current financial year on Related Party Transactions.



Provide recommendations on modifications to IT systems and controls i.e.

- Changes to IT process and controls to tag related parties.
- Prevent processing of Related Party Transactions without appropriate approvals.
- Design reports to meet the disclosure requirements.



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