



CS Gaurav Pingle,
Assistant Editor, LawStreetIndia
gaurav.pingle@lawstreetindia.com

Absurdities in RPT disclosures in Board's Report

The article analyses of the disclosure requirements relating to the related party transactions ('RPTs') in Directors Report.

Section 188(2) of the Companies Act, 2013 ('the Act') states that every contract or arrangement entered into under sub-section (1) of Section 188 of the Act shall be referred to in the Board's Report to the shareholders along with the justification for entering into such contract or arrangement. Section 134 of the Act relates to 'Financial Statement, Board's Report, etc.' Pursuant to clause (h) of sub-section (3) of Section 134 of the Act, the company shall attach a report by its Board of Directors to the financial statements to be laid down in general meeting, which shall include particulars of contracts or arrangements with related parties referred to in sub-section (1) of Section 188 in the prescribed form.

However, if the transaction is entered in the ordinary course of business and at arms' length, then the company is not required to obtain the consent of the board of directors and the shareholders i.e. the company is exempt from the compliance of the provisions of Section 188(1). Therefore, by reading and interpreting sub-section (1) and (2) of Section 188 of Companies Act, 2013, the company not required to report such transactions in the Board's Report with any justification. However, if the company has entered into any contract / arrangement with the related parties and such contract / arrangement is not in the ordinary course of business or not at arms' length basis or both, then the company is required to comply with the provisions of Section 188(1) of the Companies Act, 2013. In such case, the company is required to refer the contract / arrangement in the Board's Report along with the justification.

Disclosure pursuant to Companies (Accounts) Rules, 2014:

Rule 8(2) of the Companies (Accounts) Rules, 2014 states that the Report of the Board shall contain particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the **Form AOC-2**.

The disclosures prescribed in the Form AOC – 2 pursuant to Rule 8(2) of the Companies (Accounts) Rules, 2014 are different than the disclosures prescribed in Section 188(2), 134(3)(h) of the Companies Act, 2013. Form AOC – 2 relates to the disclosure of particulars of contracts/arrangements entered into by the company with related parties referred to in sub-section (1) of section 188 of the Companies Act, 2013 including certain transactions at arms' length pursuant to under third proviso of sub-section (1) of section 188. Form AOC – 2 as prescribed in Companies (Accounts) Rules, 2014 is divided in two parts, namely:

- (1) Details of contracts or arrangements or transactions not at arm's length basis,
- (2) Details of material contracts or arrangement or transactions at arm's length basis.

Following are the disclosures that the company is required to make, under the head "details of contracts or arrangements or transactions not at arm's length basis" in Form AOC – 2:

- (a) Name(s) of the related party and nature of relationship,
- (b) Nature of contracts/arrangements/transactions,
- (c) Duration of the contracts / arrangements/transactions,
- (d) Salient terms of the contracts or arrangements or transactions including the value, if any,
- (e) Justification for entering into such contracts or arrangements or transactions,
- (f) Date(s) of approval by the Board,
- (g) Amount paid as advances, if any.

Following are the disclosures that the company is required to make, under the head “details of material contracts or arrangement or transactions at arm’s length basis” in Form AOC – 2:

- (a) Name(s) of the related party and nature of relationship
- (b) Nature of contracts/arrangements/transactions
- (c) Duration of the contracts / arrangements/transactions
- (d) Salient terms of the contracts or arrangements or transactions including the value, if any:
- (e) Date(s) of approval by the Board, if any:
- (f) Amount paid as advances, if any.

Absurdities in the provisions relating to disclosures in Directors’ Report:

- (1) The provisions in Companies Act, 2013 and Rules made there under, contemplate that the transactions which not in the ordinary course of business and / or not at arms’ length, ought to be disclosed in the Directors Report. However, the Form AOC – 2 contemplate that disclosure of contracts / arrangements / transactions not at arm’s length basis and material contracts / arrangements / transactions at arm’s length basis;
- (2) The disclosure made by the company in Form AOC – 2 overrides the provisions in the Companies Act and the Rules made there under. Therefore, the significance of the provisions – Section 188(2), 134(3)(h) of the Companies Act, 2013 and Rule 8(2) of the Companies (Accounts) Rules, 2014 – is completely lost due to the different disclosure requirements in Form AOC – 2.
- (3) In Form AOC – 2, the company is required to disclose the details of ‘material’ contracts or arrangement or transactions. In the Companies Act, 2013 there is no reference or meaning of the term ‘material’ transaction. Such reference is there in the ‘Related Party Transactions’ under Clause 49 of the Listing Agreement (discussed in the later Chapters). Such reference of the term ‘material’ in Companies Act, 2013 – which is applicable to all companies – is completely misplaced.
- (4) Where a contract or arrangement or transaction is not at arm’s length basis, the Directors’ Report is required to provide justification for entering into such contracts / arrangements / transactions. There is no guideline for making such justification, the Board of directors are required to disclosure in the same in the Boards’ Report. Such justification will depend on company to company and transaction to transaction.
- (5) In Form AOC – 2, there is no reference of disclosure of a contract / arrangement / transaction in the ordinary course of business, which ought to have been made, in accordance with provisions of Section 188(2), 134(3)(h) of the Companies Act, 2013.

Conclusion:

There is a pressing need to ensure that the disclosures in the Board’s Report are streamlined. It is necessary that the provisions of the Act, Rules and contents of the prescribed Form are in alignment, which will ensure uniform reporting by companies throughout India. These disclosure requirements relating to related party transactions are applicable to all companies, with no exemption and modification, wherein every company ought to make the above-mentioned disclosures.