Non-Disclosure of Related Parties of a Company

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Introduction

ABC (Pvt) Ltd. is a private limited liability company incorporated and domiciled in Sri Lanka, the main business operation of the company is manufacturing, distributing, selling and marketing of cosmetics, toiletries, and beauty treatment products.

ABC (Pvt) Ltd, is owned by one director, with 100% of ownership. One share is worth, Rs 10.00 as at 31st March 2017.

Discussion of the Issue

ABC (Pvt) Ltd has not identified the following companies as related parties and accordingly, has not disclosed related party transactions.

TD (Pvt) Ltd

Triad (Pvt) Ltd was incorporated in 1993 with its primary focus on advertising industry.

TD (Pvt) Ltd has transferred Rs. 196,699,608 of funds including 9,000,000 during the year to ABC (Pvt) Ltd since 2011, but has not been repaid yet. There were no repayments or interest charged for above mentioned transactions amounts from TD (Pvt) Ltd to ABC (Pvt) Ltd.

On the other hand, TD (Pvt) Ltd is the indemnifier of the factoring loan obtained by ABC (Pvt) Ltd and also ABC (Pvt) Ltd has done some TV commercials with TD (Pvt) Ltd. The TD (Pvt) Ltd has invoiced ABC (Pvt) Ltd for a low price compared to current market prices. ABC (Pvt) Ltd has paid only, VAT and NBT amount on the total invoice value and not paid the subsequent settlements as well.

PW (Pvt) Ltd

PW (Pvt) Ltd is a Company engaged in entertainment and broadcasting activities and has transferred Rs. 56,500,000 of funds to ABC (Pvt) Ltd as of the reporting date. Out of such funds Rs.37, 000,000 were transferred during the year
concerned. There were no repayments or interest charged for above mentioned transactions.

Furthermore, both companies have one common director from 01st April 2017.

**GS & Company Ltd**

GS & Company Ltd is a holding company of GSL (Pvt) Ltd. GS & Company has many subsidiaries, which operates in many diversified industries. Further, both companies have one common director from 01st April 2017. On 9th June 2017, the ABC (Pvt) Ltd has transferred the total shareholding to GS & Company Ltd.

**GSL (Pvt) Ltd**

GSL (Pvt) Ltd is a Subsidiary of GS & Company Ltd. During the period Company has sublet the premises for GS & Company Ltd for an amount of Rs.2,469,170 and amounts due from such party has amounted for Rs.7,334,178 as at the reporting date.

When considering the directorship, four companies have two common directors after 07th June 2017.

**DE (Pvt) Ltd**

DE (Pvt) Ltd is the parent Company of GS & Company Ltd. This Company has provided Rs.8,000,100 of funds to ABC (Pvt) Ltd. There were no repayments or interest charged for above mentioned transactions.

**Implication**

The purpose of the disclosure of related party transaction is to bring the attention of the users, to the likelihood that the financial performance of the entity may be influenced because of the related party relationships and by transactions, outstanding balances, and any contractual or non-contractual commitments with such parties.

Accordingly, this company has only share capital of Rs 10.00. ABC (Pvt) Ltd is totally depending on the loans they receive from above mentioned parties. Although the company has been incorporated since 2011, it’s unable to make profit till 2017. The total accumulated loss up to the end of March 2017 is Rs 214,060,033.
Each year the company write off those payable balances as other income of the company. For the current financial period, Rs 27 million has been written off from above mentioned payable balances. Due to that, ABC (Pvt) Ltd has been able to lessen their Rs.40 Million loss to Rs.13 Million. Therefore, it definitely made an impact on the firm’s financial performance. On one hand, there is no interest charged on loans obtained, that has a significant impact on profit or loss of the company and the loan payable written off as other income in each year minimizes the real loss of the company during the financial year.

**Conclusion and Recommendation**

The director of the ABC (Pvt) Ltd is also a director of following companies,

- TD (Pvt) Ltd
- GSL (Pvt) Ltd
- GS & Company (Pvt) Ltd

Transfer of shareholding of the ABC (Pvt) Ltd to the GS & Company during the financial year, makes ABC (Pvt) Ltd as a fellow subsidiary of the DE (Pvt) Ltd. which is the ultimate parent of the GSL (Pvt) Ltd & GS & Company (Pvt) Ltd.

According to the SLFRS for SMEs section 33.2 (b) (i), an entity is related to a reporting entity if the following condition applies,

“Two or more entities of the same group, that means that each parent, subsidiary and fellow subsidiary are related to the others.”

Therefore, ABC (Pvt) Ltd becomes a related party to GSL (Pvt) Ltd & GS & Company (Pvt) Ltd. All the transactions and relationships in relation to these parties need to be disclosed such as,

- Subletting factory and office premises to GSL (Pvt) Ltd by ABC (Pvt) Ltd. Since ABC (Pvt) Ltd is a fellow subsidiary of the ultimate parent of DE (Pvt) Ltd.
- Loans received from the DE (Pvt) Ltd. Since ABC (Pvt) Ltd is a fellow subsidiary of the ultimate parent of DE (Pvt) Ltd.
- GS & Company (Pvt) Ltd as their parent company.

According to the SLFRS for SMEs section 33.4, **following are not necessarily related parties:**

“Two entities having a director or key management personnel in common or because a member of key management personnel of one entity have significant influence over the other entity.”
According to the above-mentioned clause TD (Pvt) Ltd & PW (Pvt) Ltd are not related parties. Therefore, the company does not need to disclose above mentioned parties as related parties and related party transactions made with them.