

Related Party Recognition

H.W.M.A. Herath & C.R.Thilakarathna

Anusha911230@gmail.com & chamindat@kln.ac.lk

Introduction

ABC Limited is a limited liability Company incorporated in Sri Lanka under the companies Act No 17 of 1982 and also ABC Limited is licensed by the Monetary Board of the Central Bank of Sri Lanka under the Finance companies Act No 78 of 1988 and re-registered under the Companies Act No. 07 of 2007. The company provides vast range of financial service which includes accepting deposits, leasing, gold loans, hire purchase, pawn brokering and other financial services. The company has accepted deposits from director's relatives, and they have not recognized those transaction as related party transaction according to central bank direction as well LKAS 24.

Discussion of the Issue

ABC Limited accepts fixed deposit and savings from the customers and also they have accepted deposits from its directors, subsidiaries and director's relatives. According to Central Bank direction No 3 of 2010 Finance companies insurance of Deposits Liabilities, All registered finance companies shall insure their deposit liabilities in the deposit insurance scheme operated by the Monetary Broad in terms of Sri Lanka deposit insurance scheme regulation No 01 of 2010 issued under sections 32 A to 32 E of Monetary law Act with effect from 01st October 2010. According to that they have prepared deposits insurance premium at the end of each month and made the payment. According to the **paragraph No 5.2 (iii) of Sri Lanka Insurance Scheme Regulations** when calculating the premium, related party deposits should be excluded. Here they have excluded directors' and subsidiary's deposits **except** deposits of directors' relatives. At the same time they **have not** disclosed transactions of directors' relatives on their financial statements.

Implication of the Issue

As a finance company ABC Limited has to comply with regulations which are monitored by regulatory bodies and should prepare financial statements in accordance with Sri Lanka accounting standards. If company does not comply with those requirements, it will be highly impacted on company's survival. Company has identified following implications.

- Main issue is non-compliance with Central Bank directions. Due to that they will have pay a penalty which will be imposed by Central Bank of Sri Lanka.
- Non-compliance with LKAS 24, financial statements are misleading.
- Decisions made by stakeholders referring to the financial statements will be ineffective.

Conclusion and Recommendations

This issue can be addressed by Sri Lanka Accounting standards, issued by the Institute of Chartered Accountants of Sri Lanka as well as Central Bank Directions, which are issued by Central Bank of Sri Lanka.

-According to **LKAS 24- “Related Party Disclosures”**, under **paragraph No 09**, it states,

“A related party is a person or entity that is related to the entity that is preparing its financial statements”

(a) A person or a close member of that person’s family is related to a reporting entity if that person:

- I. Has control or joint control of the reporting entity;*
- II. Has significant influence over the reporting entity; or*
- III. Is a member of the key management personnel of the reporting entity or of a parent of the reporting entity”*

Further, **paragraph No 9 of LKAS 24** states that, *“close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity and include:*

- a) That person’s children and spouse or domestic partner;*
- b) Children of that person’s spouse or domestic partner; or*
- c) Dependents of that person or that person’s spouse or domestic partner.”*

According to **Central Bank’s Finance Companies (Corporate Governance) Direction No 03 of 2008, section No 09 – Related party transaction, sub No 02 – (e)** stated that,

“A relative of a director or a key management personnel of the finance company” is a related party of that finance company.

According to **paragraph no 73 of Finance Business Act No 42 of 2011** relatives are defined as *“a relative in relation to any individual means the spouse, the children, or the parent of such individuals”*

Here, our recommendation is that, ABC Company has to exclude the directors’ relatives’ deposits when they are preparing deposits insurance premium. And they have to disclosure those deposits’ details under accounting notes in financial statements in accordance with disclosure requirements of LKAS 24.