

Related Party Transactions: A Governance Deep Dive

Related Party Transactions (RPTs) are central to Corporate Governance and regulatory compliance in India, impacting Transparency, Risk Management, and Stakeholder Confidence. This article offers a comprehensive overview of the legal and regulatory framework for RPTs. The article addresses governance best practices to manage risks from complex ownership structures, emphasizing the need for continuous updated registers and proactive board oversight. It advocates adopting advanced technologies and underscores the grave consequences of non-compliance, including penalties, reputational damage, and director disqualifications, positioning effective RPT governance as both a legal necessity and a strategic advantage aligned with evolving ESG expectations.



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INTRODUCTION

Related Party Transactions (RPTs) have long been a subject of close regulatory scrutiny due to their potential to obscure the transparency of financial reporting and compromise governance standards. While such transactions are often a normal part of doing business, particularly in corporate groups, they become challenging when conducted without due process or transparency, risking conflicts of interest and shareholder value erosion. In an era of increasing investor activism and stakeholder accountability, RPTs are no longer merely a compliance checklist item but a vital component of corporate governance. The evolution of laws in India and globally, reflects the growing emphasis on ethical business conduct, disclosure, and board-level oversight.

In India, the regulatory focus on RPTs has intensified with a series of amendments in the Companies Act, 2013, SEBI (LODR) Regulations, and adoption of Ind AS 24. These frameworks aim to ensure that RPTs are disclosed, reviewed, and approved appropriately. Yet, implementation challenges persist, which range from identification to disclosure, often requiring significant effort from compliance professionals, particularly Company Secretaries.

SPECTRUM OF LEGAL AND REGULATORY PROVISIONS

India's legal framework around RPTs is multi-layered and integrates regulatory requirements of corporate, securities, accounting and tax laws. The primary regulatory sources include:

Companies Act, 2013

- **Section 2(76):** Defines 'related party' comprehensively to include directors, KMPs, their relatives, and entities over which they exercise significant influence.
- **Section 188:** Governs transactions with related parties and mandates board and, in certain cases, shareholder approval, especially if the transaction exceeds prescribed thresholds.
- **Rule 15 of Companies (Meetings of Board and its Powers) Rules, 2014:** Specifies thresholds for prior approvals and procedural nuances.

SEBI (LODR) Regulations, 2015

- **Regulation 23:** Applies to listed companies. It mandates prior approval of the Audit Committee, disclosure of material RPTs to stock exchanges, and shareholder approval for significant transactions. Audit Committees must grant omnibus approval where needed, with disclosures recorded in the minutes and periodic reviews ensured.

Income-Tax Act, 1961

- Transfer pricing provisions under **Sections 92–92F** apply to international and specified domestic RPTs. The arm's length principle governs pricing and disclosure to ensure tax neutrality.

These interlinked laws aim to ensure fairness, transparency, and accountability in RPTs.

GLOBAL PERSPECTIVE

Globally, corporate regulators recognize RPTs as a source of potential abuse if left unchecked. Hence, most jurisdictions have robust laws governing disclosure and approval processes:

- **United States:** SEC mandates disclosure of material RPTs in financial statements (e.g., in Form 10-K). The Sarbanes-Oxley Act restricts certain types of insider transactions, such as personal loans to executives. Independent Directors play a key role in approval and oversight.
- **United Kingdom:** Under the UK Listing Rules, shareholder approval is mandatory for significant RPTs. The UK Corporate Governance Code emphasizes Board independence and oversight of RPTs.
- **OECD Guidelines:** Encourage disclosure and fairness in RPTs, especially in state-owned enterprises. Recommend that all material RPTs be approved by the board and, where applicable, shareholders.
- **IFRS (IAS 24):** Like Ind AS 24, it mandates disclosure of relationships, nature of transactions, amounts involved, and outstanding balances.
- **Financial statement disclosures:** If the company is compliant with Indian Accounting Standards (Ind AS), disclosures for RPTs must be included under Ind AS 24 in the financial statements.
- **Transparency expectations:** Private companies, particularly those engaged in transactions with institutional investors or involved in mergers and acquisitions, are expected to uphold transparency like public companies despite a nominally lighter compliance burden.

PUBLIC LIMITED COMPANIES

Public and listed companies are subject to a far more rigorous and comprehensive governance structure for related party transactions, aimed at safeguarding minority shareholders and maintaining investor confidence.

Despite differences in thresholds and procedures, the common global theme is: transparency, independence, and accountability.

REPORTING REQUIREMENTS

a. Private Limited Companies:

Private limited companies in India are required to adhere to specific statutory reporting and governance requirements for related party transactions (RPTs). While the compliance regime is somewhat less burdensome compared to public companies, it still prioritizes transparency and regulatory discipline.

b. Key compliance obligations

- **Section 188 compliance:** Transactions with related parties that exceed prescribed thresholds under Section 188 of the Companies Act, 2013, mandate board approval. In some cases, shareholder approval may be exempt if specific conditions outlined in the Act are satisfied.
- **Board approvals:** Approval from the Board of Directors is mandatory for RPTs beyond certain monetary limits, ensuring oversight and accountability.
- **Shareholder approval:** While relaxed for private companies, shareholder approval might be required unless they meet exemption criteria based on the nature of the transaction and the parties involved.
- **Registers and disclosures:** Maintenance of Register MBP-4 is compulsory for recording contracts or arrangements in which Directors are interested. Directors must make disclosures in Form MBP-1 regarding their interests in any company, body corporate, or association of individuals.

Effective board oversight and transparent stakeholder communication are essential to managing risks associated with Related Party Transactions (RPTs). These risks pose a governance challenge that extends well beyond regulatory compliance, especially in closely-held or promoter-driven companies where conflicts of interest are more likely.

a. Mandatory approvals and controls

- **Audit committee approvals:** All RPTs require approval by the audit committee before execution, ensuring independent scrutiny.
- **Board approvals:** Certain related party transactions necessitate formal Board approval in addition to audit committee clearance.
- **Shareholder approvals for material transactions:** If a related party transaction qualifies as 'material' under Regulation 23 of SEBI Listing Obligations and Disclosure Requirements (LODR), shareholder approval by way of an ordinary resolution is mandatory.

b. Disclosure and reporting requirements

- **Half-yearly RPT disclosure:** Listed companies must make half-yearly disclosure of RPTs to stock exchanges, increasing periodic transparency.
- **Annual confirmation under regulation 23(9):** Companies must submit an annual confirmation of RPTs to stock exchanges, certifying compliance with LODR norms.
- **Mandatory inclusions in statutory reports**
 - **Board's Report:** Summary of related party transactions to be included.
 - **Notes to financial statements:** Detailed disclosures in the annual financial statements as per Ind AS 24.
 - **Annual Return (Form MGT-7):** RPTs must be reported in the annual return submitted to the Registrar of Companies.

CONSEQUENCES OF NON-COMPLIANCE

Failure to comply with RPT reporting and approval requirements can attract significant repercussions:

- **Penalties:** Monetary penalties may be imposed on the company and officers in default.
- **Reputational damage:** Non-compliance can lead to adverse publicity and erosion of stakeholder trust.
- **Disqualification of Directors:** In grave cases, Directors may face disqualification under the Companies Act, 2013 impacting their professional standing and eligibility to serve on boards.

Overview of compliances

| Criterion | Private Limited Companies | Public Limited Companies |
|------------------------------|--|--|
| Required Approvals | Board approval (above threshold); shareholders in exceptional cases. | Audit Committee, Board, and shareholders for material RPTs. |
| Registers/ Disclosures | MBP-4, MBP-1, Ind AS 24 (if applicable). | Ind AS 24, Board's Report, Notes, Annual Return, Exchange filings. |
| Periodic Reporting | None mandated except statutory reports. | Half-yearly and annual stock exchange disclosures. |
| Stringency | Moderate, with certain exemptions. | Highly stringent, minimal exemptions. |
| Penalties for Non-Compliance | Monetary, reputational. | Monetary, reputational, director disqualification. |

OVERSEEING COMPLIANCE FOR RELATED PARTY TRANSACTIONS

A robust compliance framework for Related Party Transactions (RPTs) is essential to maintain transparency, legal soundness, and stakeholder trust. Below is a practical and professional overview of the key points in effectively overseeing compliance, humanized to reflect both the legal rigor and the realities companies face.

Identification: Accurate identification is the first critical step. Properly determining who qualifies as a related party prevents inadvertent non-compliance and ensures that all transactions receive the necessary scrutiny.

- **Comprehensive declarations:** Use statutory forms such as MBP-1 to collect disclosures from Directors and Key Managerial Personnels (KMPs) about their interests in other entities.
- **Registers and documentation:** Maintain and routinely update a register of contracts in which Directors are interested. Utilize group structure charts to visualize subsidiaries, associates, and joint ventures.
- **Beneficial ownership disclosures:** Look beyond formal shareholding, to identify those who exert actual, possibly indirect, influence over the company.
- **Cross-verification:** Regularly check internal declarations and lists against official shareholding records and data from the Registrar of Companies (ROC) for completeness and accuracy.
- **Update:** The dynamic nature of business requires that related party lists and registers reflect current reality.
- **Periodic declarations:** Set up a schedule like quarterly or biannual, for directors and KMPs to update their disclosures.
- **Automated triggers:** Employ workflow tools to prompt register updates following events like new appointments, resignations, or significant changes in ownership.
- **Ongoing review:** Ensure that updates aren't left to annual cycles; make the process continuous and responsive to changes.
- **Tracking:** Consistent tracking allows companies to catch potential compliance issues early.
- **ERP tagging:** Classify vendors, customers, and intercompany accounts as "related" within ERP and accounting systems, so RPTs are flagged as soon as they're initiated.
- **System integration:** Link finance, procurement, legal, and secretarial platforms to eliminate informational silos, a transaction entered in one department should be visible and alert the compliance team everywhere.
- **Audit trails and reconciliations:** Schedule regular audits comparing contractual documents, invoices, and payment trails to ERP records to verify nothing falls through the cracks.
- **Approval and reporting:** Approvals provide the formal green light and increase accountability.
- **Routing of transactions:** Direct all RPTs to the audit committee (for listed/public companies) or Board of Directors (for private companies) for review and sign-off.
- **Documentation repository:** Retain supporting documents like pricing justifications, comparable, legal and fairness opinions, to support decisions in case of future reviews.
- **Timely approvals:** Use workflow calendaring to adhere to regulatory deadlines for committee/board reviews and shareholder meetings, critical for omnibus approvals.
- **Disclosures:** Transparent disclosure is both a statutory mandate and a best governance practice.
- **Notes to financial statements:** Report all RPTs in the notes to accounts as per AS 18 or Ind AS 24, detailing nature, scope, and amounts.
- **Statutory filings:** Include RPT details in Board reports, Annual Returns (MGT-7), and ROC filings, keeping regulators and stakeholders informed.
- **Stock Exchange filings:** For listed companies, comply with SEBI LODR norms by submitting half-yearly and annual RPT disclosure filings, making key information available to the public and investors.
- **Internal dashboards:** Use MIS dashboards to provide ongoing, real-time summaries of RPTs for the leadership team, enabling active oversight and early action if trends warrant.

CHALLENGES IN MANAGING RELATED PARTY TRANSACTIONS: A PROFESSIONAL PERSPECTIVE

Managing compliance around Related Party Transactions is inherently complex and fraught with obstacles that require vigilance, robust processes, and a culture of transparency. Below are some of the key challenges companies encounter and practical reflections on each.

a. Completeness of related party identification

- **Uncovering indirect, layered relationships remains a significant challenge:** Companies often operate within intricate ownership and control networks that include subsidiaries, associates, joint ventures, trusts, or family-owned entities. These layers can obscure the true nature of relationships, making it difficult to comprehensively identify related parties. Basic registers or direct shareholding information often do not reveal such indirect connections, risking inadvertent non compliance.
- **Beneficial ownership can be concealed, intentionally or unintentionally:** There are cases where ultimate beneficial owners use nominee shareholders, cross-holdings, or offshore entities to mask control. Even when not designed to evade compliance, limited access to up-to-date ownership data and insufficient due diligence frequently leaves beneficial ownership hidden. Without leveraging legal disclosures, third-party data providers, and enhanced due diligence measures, related party lists risk being incomplete and unreliable.

b. Tracking mechanisms and systems

- **Manual registers and spreadsheets are error-prone and lack scalability:** Many organizations still rely on traditional, manual methods such as Excel spreadsheets or paper registers. These systems are vulnerable to data entry mistakes, inconsistencies, outdated information, and may fail to scale as businesses grow. These issues not only impede compliance rigor but can undermine stakeholder confidence during audits or regulatory scrutiny.
- **Decentralization of data across departments weakens oversight:** RPT-related information often resides in silos like procurement, finance, legal, and secretarial functions may possess fragmented data with limited cross-communication. Without integrated approaches, this decentralization can lead to missed transactions, duplicated effort, and inconsistent compliance application.
- **ERP systems require customization to effectively capture all related party transactions:** While Enterprise Resource Planning systems offer structured transaction processing, most out-of-the-box configurations do not actively flag related party relationships, especially indirect or complex ones. Companies must invest in configuring or customizing their ERP workflows so that related party transactions are automatically identified, routed for approval, and reported in a timely fashion.

c. Approvals and authorization

- **Backdated or informal transactions outside established board processes still occur:** Despite regulatory mandates, some related party transactions bypass required prior approvals. These may be retroactively ‘approved’ or negotiated informally to avoid scrutiny. Such practices pose significant risks, including regulatory penalties, reputational damage, and loss of trust among minority shareholders and investors.
- **Audit Committees may lack full documentation when reviewing transactions:** Effective oversight depends on comprehensive information. However, audit committees sometimes receive incomplete files lacking detailed pricing rationales, market comparable, or independent legal opinions. This compromises their ability to challenge proposals effectively, potentially resulting in approvals despite gaps, thereby elevating compliance and fairness risks.

d. Defining “Ordinary Course of Business”

- **Absence of a clear legal definition creates ambiguity:** The term “ordinary course of business” is not explicitly defined under company law or related regulations, leading to subjective interpretations by management, auditors, and regulators. What qualifies as “ordinary” varies not only by industry but also by company-specific context, complicating uniform compliance.
- **Internal frameworks and benchmark policies are essential:** To mitigate uncertainty, organizations must develop well-documented internal policies defining what constitutes ordinary business transactions in their own context. This includes clear pricing guidelines, benchmarking against prior comparable transactions, and detailed justifications for each classification decision.
- **Auditors and regulators frequently scrutinize these determinations critically:** Even with internal policies, external reviewers often challenge assertions around “ordinary course” status, especially concerning high-value or unusual transactions. Without robust supporting evidence, companies risk objections, delayed approvals, or penalties. Preparing thorough documentation and engaging in transparent dialogues with stakeholders are critical defensive measures.

ROLE OF COMPANY SECRETARIES IN RELATED PARTY TRANSACTION (RPT) COMPLIANCE

The Company Secretary (CS) plays a significant role in establishing and maintaining a rigorous framework for governance around Related Party Transactions (RPTs). To embed strong compliance and ethical practices, the following prescriptive measures should be implemented:

a. Establish robust compliance systems

- **Develop clear SOPs:** Companies should have comprehensive Standard Operating Procedures for identifying, approving, and disclosing RPTs. These SOPs must foster consistent application of governance standards at every level.

- **Implement real-time monitoring Tools:** Deploy compliance management platforms equipped with dashboards to monitor adherence continuously and promptly flag anomalies or risks, enabling proactive management.
 - **Create risk matrices:** Risk assessment frameworks must prioritize transactions based on value and complexity, ensuring heightened oversight for high-risk or high-value RPTs.
- b. Maintain dynamic and accurate documentation**
- **Keep statutory registers updated:** Registers such as MBP-4 should be diligently maintained and periodically reviewed to reflect current director interests and related party relationships, ensuring transparency and regulatory readiness.
 - **Automate documentation workflows:** Automation of the collection, archival, and retrieval of RPT-related documentation will reduce human errors and support timely access during audits and investigations.
- c. Ensure effective reporting to the Board**
- **Provide periodic compliance reports:** Detailed compliance reports supplemented by visual analytics should be presented regularly, enabling the board to understand the RPT landscape clearly.
 - **Highlight compliance gaps and exceptions:** Boards must be promptly informed about any delays, exceptions, or recurring compliance challenges to enable timely mitigations.
 - **Document Board deliberations meticulously:** Drafting clear board resolutions, explanatory notes, and minutes ensures all compliance decisions are transparent and enforceable.
- d. Oversee comprehensive disclosure practices**
- **Align with accounting and regulatory standards:** Disclosures of RPTs in financial statements and statutory filings must fully comply with Ind AS 24 and applicable legal requirements.
 - **Adhere to filing timelines:** Regulatory submissions to bodies like SEBI and the Ministry of Corporate Affairs require strict adherence to deadlines.
 - **Integrate Governance with ESG and investor relations:** Disclosure practices should support broader governance goals, including transparency benchmarks relevant to ESG commitments and investor expectations.
- e. Build organizational capability**
- **Conduct training programs:** Regular training sessions should be held to increase awareness across business units on RPT identification, risks, and reporting obligations.
 - **Orient new directors thoroughly:** Onboarding processes must include detailed education on RPT regulations and the company's governance policies.
 - **Act as a communication bridge:** The CS should facilitate effective, cross-functional communication to embed compliance culture within day-to-day business operations.

f. Leverage AI and technology

- **Implement AI-enabled relationship mapping:** AI tools should be used to automatically identify and analyze complex and indirect related party relationships, enhancing accuracy and scope beyond manual methods.
- **Use machine learning for risk alerts:** Deploy ML algorithms to continuously monitor transactions, detect unusual patterns, and provide early-warning signals for possible non-compliant or suspicious RPTs.
- **Integrate AI with existing systems:** Compliance technology stacks must be integrated across finance, legal, procurement, and secretarial functions to optimize tracking, approvals, and reporting.

CONCLUSION

Related Party Transactions (RPTs) pose a governance challenge that extends well beyond regulatory compliance, especially in closely-held or promoter-driven companies where conflicts of interest are more likely. Effective board oversight and transparent stakeholder communication are essential to managing these risks. As businesses grow more complex, RPT management requires a blend of legal expertise, ethical judgment, and process automation. The role of the Company Secretary in designing and overseeing these frameworks has become vital, shifting from a routine compliance task to a strategic leadership function.

Emerging technologies such as AI-powered ERP systems, blockchain for contract management, and advanced data analytics are transforming how companies approach RPT compliance enabling real-time detection, tracking, and predictive governance. Moreover, global investors and rating agencies increasingly consider RPT governance a key factor in ESG and risk assessments. A transparent, system-driven, and board-supported RPT regime not only satisfies legal mandates but also serves as a strategic advantage, turning a potential compliance burden into a hallmark of strong governance and sustainable growth.

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