

Accounting Standards Interpretation (ASI) 21¹
**Non-Executive Directors on the Board –
whether related parties**

**Accounting Standard (AS) 18, Related Party
Disclosures**

[Pursuant to the issuance of this Accounting Standards Interpretation, General Clarification (GC) – 13/2002, issued in October 2002, stands withdrawn.]

ISSUES

1. The issue is as to whether a non-executive director on the Board of Directors of a company is a key management person.
2. Another related issue is as to whether a non-executive director is covered by AS 18 in case he participates in the financial and/or operating policy decisions of an enterprise.

CONSENSUS

3. A non-executive director of a company should not be considered as a key management person under AS 18 by virtue of merely his being a director unless he has the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise.
4. The requirements of AS 18 should not be applied in respect of a non-executive director even if he participates in the financial and/or operating policy decision of the enterprise, unless he falls in any of the categories in paragraph 3 of AS 18.

¹ Published in 'The Chartered Accountant', March 2004, pp. 964-965. The authority of this ASI is the same as that of the Accounting Standard to which it relates. The contents of this ASI are intended for the limited purpose of the Accounting Standard to which it relates. ASI is intended to apply only to material items.

BASIS FOR CONCLUSIONS

5. AS 18 defines “key management personnel” as under:

“Key management personnel - those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise.”

Paragraph 14 of AS 18 explains as under:

“14. Key management personnel are those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. For example, in the case of a company, the managing director(s), whole time director(s), manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel.”

AS 18 considers only such persons as key management personnel who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. Therefore, merely being a director of a company is not sufficient for becoming key management person within the meaning of AS 18, unless that director has the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise.

6. AS 18 defines ‘related party’ and ‘significant influence’ as below:

“Related party - parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.”

“Significant influence - participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies.”

A non-executive director, who participates in the financial and/or operating policy decisions of the enterprise, may qualify as a ‘related party’. However, paragraphs 2 and 3 of AS 18 dealing with the scope of AS 18 provide as below:

“2. This Statement applies only to related party relationships described in paragraph 3.

3. This Statement deals only with related party relationships described in (a) to (e) below:

- (a) enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries);
- (b) associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture;
- (c) individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual;
- (d) key management personnel and relatives of such personnel; and
- (e) enterprises over which any person described in (c) or (d) is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.”

In view of the above, a non-executive director, merely by virtue of his being a director and thereby participating in the financial and/or operating policy decisions of the enterprise, is not covered under any one of the above. Accordingly, AS 18 is not applicable to such a non-executive director. However, a non-executive director is covered by a related party relationship in case other requirements of the Standard are met. For instance, he is considered as a key management person as per paragraph 3 of this Interpretation or he is in a position to exercise control or significant influence by virtue of owning an interest in the voting power as per paragraph 3 (c) of AS 18.