

POST-IMPLEMENTATION REVIEW OF GRAP 109 ON ACCOUNTING BY PRINCIPALS AND AGENTS (ED 200)

This Executive Summary provides an overview of the Invitation to Participate in the Post-implementation Review of the Standard of GRAP on *Accounting by Principals and Agents* (ED 200)

Overview

The Accounting Standards Board (the Board) undertakes post-implementation reviews (PIR) with the objectives to:

- assess if a Standard of GRAP achieved its intended outcome; and
- identify difficulties experienced in applying the Standard across all spheres of government.

The Board approved the Invitation to Participate in the Post-implementation Review of the Standard of GRAP on *Accounting by Principals and Agents* (GRAP 109) at its November 2022 meeting.

Project objectives

The objectives of the GRAP 109 PIR is to obtain input from stakeholders to:

Users	<ul style="list-style-type: none"> • determine if GRAP 109 provides relevant information that enables users to make decisions and hold entities accountable; and • identify other information that users may need on principal-agent arrangements.
Preparers	understand the challenges that preparers experience with the implementation of GRAP 109, and the extent to which these challenges impact the consistent application of GRAP 109.
Auditors	understand the audit issues raised on accounting by principals and agents.

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EXPOSURE DRAFT – POST-IMPLEMENTATION REVIEW OF GRAP 109 ON <i>ACCOUNTING BY PRINCIPALS AND AGENTS</i> (ED 200)		
<p>This Executive Summary provides an overview of the Invitation to Participate in the Post-implementation Review of the Standard of GRAP on <i>Accounting by Principals and Agents</i> (ED 200)</p>	<p>Consultation process</p>	<p>The Invitation to Participate in the Post-implementation Review of GRAP 109 has been published for comment as ED 200.</p> <p>The comment deadline is 15 September 2023.</p>
	<p>Next steps</p>	<p>Based on the results of the review, the Board will decide whether amendments are required to GRAP 109, and whether any other action should be taken. This is the next phase of the project.</p>

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Background to the project	
Phases of the project	<p>The PIR consists of two phases:</p> <ol style="list-style-type: none"> 1) an initial phase to obtain preliminary information on issues in the environment, through a desktop review and targeted stakeholder engagement; and 2) feedback from stakeholders, through questionnaires and direct consultations.
Phase 1: preliminary understanding of the issues	<p>This phase of the project is complete. It included a review of various sources (such as the Auditor-General of South Africa General Reports and financial statements of entities that apply Standards of GRAP), and targeted stakeholder engagement. The objective of the initial phase was to understand how entities apply the principles of GRAP 109, what information on principal-agent arrangements they disclose in their financial statements, and what difficulties they experience to apply GRAP 109.</p> <p><i>Key observations from phase 1</i></p> <p>Some of the key observations were:</p> <ol style="list-style-type: none"> (a) Accounting policies were found to be generic and included the exact wording from GRAP 109 rather than explaining how the principles were applied to the entity's circumstances. (b) The area where entities struggle most to apply GRAP 109 is the identification of principal-agent arrangements. Entities have difficulty distinguishing principal-agent arrangements from other arrangements, and are unsure of the Standards to apply when an arrangement is not a principal-agent arrangement. Economic substance over legal form is not applied, and entities incorrectly interpret various aspects of the definition of principal-agent arrangements, including the role of third parties, and the types of transactions with third parties that could be principal-agent arrangements. (c) Entities are unsure whether materiality should be applied to principal-agent arrangements, and if so, how to apply it. (d) Agents are unsure when it is appropriate to recognise assets and liabilities from the principal's transactions with third parties, and question the value of the information to users in the agent's financial statements. Other stakeholders view the information as important to hold the agent accountable for resources of the principal that are in the agent's custody.

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	<p>(e) Disclosure of information required by GRAP 109 is incomplete in the financial statements of principals and agents. For example information on the terms and conditions of a principal-agent arrangement, whether any changes occurred during the period, an explanation of the purpose and significant risks and benefits of the relationship, and for entities that are the principal, the resource or cost implications if the arrangement is terminated.</p>
<p>Phase 2 feedback from stakeholders</p>	<p>In this phase of the project, the Secretariat intends to obtain feedback from stakeholders through the completion of questionnaires, and direct consultations.</p> <p>The questionnaires are included with ED 200 on the ASB’s website at: https://www.asb.co.za/ed-200/.</p>
<h2>Overview of ED 200</h2>	
<h3>Focus areas of the review</h3>	
<p>Objective of reporting on principal-agent arrangements</p>	<p>Entities operating in the public sector have the primary objective of providing services that enhance or maintain the well-being of their citizens, and they may work together to achieve this objective. “Working together” often leads to an entity having certain activities executed by another entity, or undertaking activities on behalf of other entities. Binding arrangements giving effect to such collaborative relationships may give rise to principal-agent arrangements.</p> <p>In discharging its accountability, an entity needs to provide information to users to enable them to make decisions on whether principal-agent arrangements effectively meet the purpose of the arrangement in delivering services. To meet users’ needs, information is included in the financial statements on the following aspects of principal-agent arrangements, among others.</p> <ul style="list-style-type: none"> • All principal-agent arrangements: information on the nature and risks of the arrangements. • Agents: information that assists a user to assess the accountability of the agent in relation to the transactions with third parties. • Principals: information on the resource implications of the arrangement, including on termination.

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Identifying principal-agent arrangements

Binding arrangements

A principal-agent arrangement arises from a binding arrangement between the parties to the arrangement. A binding arrangement may be in the form of a contract, legislation or similar means, common law, or a combination of these.

A single binding arrangement could include multiple arrangements, which may be a combination of a principal-agent arrangements and other type of arrangements such as service provider arrangements. Where arrangements include the fulfilment of multiple rights and obligations, the role of the parties should be analysed for these different rights and obligations. For example, a single binding arrangement may require an entity to represent another party in its interactions with suppliers, as well as the recipients of the goods or services developed by the suppliers, i.e. the beneficiaries. The role of either party should be analysed in the context of the supplier and beneficiary relationships respectively.

The review requests input from stakeholders on the challenges they experience to identify whether an arrangement is a binding arrangement, and identify all the rights and obligations that may exist within an arrangement.

Distinguishing principal-agent arrangements from other arrangements

Principal-agent arrangements have the characteristic that third parties are involved, and the transactions with third parties are undertaken on behalf of and for the benefit of the principal.

This distinguishes principal-agent arrangements from other types of arrangements. In the absence of transactions with third parties, the arrangement is not a principal-agent arrangement. On the other hand, a common misconception is that any transaction with more than two parties is a principal-agent arrangement. This is not the case. In a principal-agent arrangement, the agent represents the principal and administers the transactions between the principal and the third parties, and it does so according to the specific direction given by the principal.

The review seeks to identify the challenges that stakeholders experience to identify whether an arrangement includes transactions with third parties, and the transactions with third parties are undertaken by the agent on behalf of and for the benefit of the principal.

The nature of the transactions with third parties is linked to the type of activities carried out by the agent in accordance with the binding arrangement. Based on these activities, “transactions with third parties” includes the execution of a specific financial

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	<p>transaction with a third party, e.g. a sale or purchase transaction, but it also includes interactions with third parties where the agent represents the interest of the principal, e.g. when an agent is able to negotiate with third parties on the principal’s behalf.</p> <p>The Board seeks to obtain information through the review about the type of transactions undertaken with third parties in a principal-agent arrangement.</p> <p>The financial statements are prepared by applying <u>economic substance over legal form</u>. The terms “principal” and “agent” are described in law. As such, binding arrangements might stipulate that “this arrangement is (or is not) a principal-agent arrangement”, or “entity X is (or is not) the agent” and “entity Y is (or is not) the principal”, or that an entity “acts on behalf of XXX”. Entities should apply the definition of a principal-agent arrangement in GRAP 109 and assess the economic substance of the arrangement, irrespective of the legal form based on terminology used in the binding arrangement or the legal interpretation thereof.</p> <p>The review seeks to identify the challenges stakeholders experience to apply economic substance over legal form when assessing the type of arrangement.</p> <p><i>Definition of a principal-agent arrangement in GRAP 109</i></p> <p>The review seeks feedback from preparers on their experiences with applying the definition of a principal-agent arrangement in GRAP 109, and from users on whether the definition results in information in the financial statements that is useful.</p>
<p>Identifying roles of parties to a principal-agent arrangement</p>	<p>Only if an entity concludes that an arrangement is a principal-agent arrangement, does the entity proceed to determine whether it is acting as the principal, or as the agent in a principal-agent arrangement.</p> <p>The terms and conditions of the binding arrangement are assessed to determine the roles, responsibilities and authority of parties in relation to the activities and resulting transactions undertaken in terms of the arrangement.</p> <p>An entity applies the criteria in GRAP 109.25 to assess if it is an agent. If the criteria are not met, the entity is the principal. If a party to the arrangement has regulatory powers, it may be able to determine the significant terms and conditions of the transaction even though it is an agent. Economic substance over legal form is again applied to assess whether an entity is a principal or an agent, irrespective of the terminology that may be used in an arrangement.</p>

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	<p>The review requests input from stakeholders on the challenges they experience to assess whether the entity is a principal or an agent in a principal-agent arrangement, and whether the criteria and guidance in GRAP 109 to identify the party that is the agent is helpful.</p>
<p>Applying materiality to principal-agent arrangements</p>	<p>The Standard of GRAP on <i>Presentation of Financial Statements</i> requires that each material class of similar items be presented separately in the financial statements, and that specific disclosure requirements in the Standards of GRAP be applied if the information is material.</p> <p>The Guideline on <i>The Application of Materiality to Financial Statements</i> explains the phases during a reporting period when materiality is considered - determining accounting policies, the treatment of transactions during a reporting period, and the presentation and disclosure of information in financial statements at the end of the reporting period. The Guideline also provides considerations to assist entities to determine qualitatively and quantitatively materiality.</p> <p>Materiality should be applied when making accounting and reporting decisions about principal-agent arrangements, and should consider both qualitative and quantitative aspects of each arrangement.</p> <p>The review aims to understand preparers' experience with applying materiality to principal-agent arrangements and if it was not applied, why not.</p>
<p>Applying GRAP 109 with other Standards of GRAP</p>	<p>GRAP 109 is applied before considering the other Standards of GRAP. When an entity concludes that an arrangement is a principal-agent arrangement, GRAP 109 is applied to identify which transactions in the arrangement each party includes in its financial statements. The principal recognises transactions with third parties, while the agent recognises the revenue and expenses associated with performing the agency service. In certain circumstances, an agent may account for assets and liabilities from the arrangement. The other Standards of GRAP prescribe the recognition, measurement, presentation and disclosure requirements for the items related to those transactions. In addition, the disclosure requirements of GRAP 109 are applied.</p> <p>The review seeks feedback from preparers on the challenges they experience to apply the requirements of GRAP 109 with the requirements of other Standards of GRAP.</p>
<p>Recognising assets and liabilities as an agent</p>	<p>Whether an entity is a principal or an agent, the entity applies the principles in the <i>Framework for Preparation and Presentation of Financial Statements</i> and the applicable Standards of GRAP to recognise assets and liabilities arising from a principal-agent arrangement.</p>

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	<p>GRAP 109 provides guidance on the circumstances when it would be appropriate for an agent to recognise assets and liabilities from the arrangement and includes indicators to help an agent with the assessment.</p> <p>The review seeks feedback from preparers on their experiences to apply GRAP 109 to recognise rights and obligations from principal-agent arrangements as assets and liabilities under certain circumstances.</p>
<p>Disclosing information about principal-agent arrangements in the financial statements</p>	<p>An entity needs to provide information in financial statements to enable users to make decisions about whether principal-agent arrangements effectively meet the purpose of the arrangements in delivering services, and to hold the entity accountable. For the information to be useful, it should be specific to the entity’s principal-agent arrangements, and all the relevant information should be provided as required by GRAP 109.</p> <p>Information required by GRAP 109 includes:</p> <ul style="list-style-type: none"> • <u>General information</u> about an entity’s principal-agent arrangements, including a description of the arrangement and the transactions undertaken, whether the entity is the principal or agent and any significant judgement applied in making this assessment, significant terms and conditions of the arrangements, whether any changes occurred during the reporting period, an explanation of the purpose of the principal-agent relationship, and any significant risks and benefits associated with the relationship. • <u>An entity that is the agent</u> discloses information about the resources that are held on behalf of a principal and recognised in the agent’s financial statements, risks that may be transferred from the principal to the agent, the aggregate amount of revenue recognised as compensation for the agency service, and a description of any liabilities incurred on behalf of a principal that have been recognised by the agent, together with any corresponding rights of reimbursement that have been recognised as assets. Under certain circumstances, the agent also discloses information about the revenue and expenses that relate to transactions with third parties, and a reconciliation of the carrying amounts at the beginning and end of the period of any receivables or payables the agent recognises. • <u>An entity that is the principal</u> discloses the resources of the principal that are under the custodianship of the agent and whether or not those resources have been recognised by the agent, any resources remitted during the period along with the expected timing of remittance of any remaining resources, the fee paid as compensation to the agent, and a discussion of the resource or cost implications for the principal if the principal-agent arrangement is terminated.

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The review seeks input from users on whether the information required by GRAP 109 is useful to hold an entity that is party to a principal-agent arrangement accountable, and to make decisions about the entity and the arrangement. The review also seeks to identify the challenges that preparers experience in providing the information required by GRAP 109 in the financial statements.

Information on the nature of transactions with third parties

The review seeks feedback from users on whether the information required by GRAP 109 is useful when the transactions with third parties are interactions between the principal and third parties, rather than financial transactions.

Information on the cash flows in a principal-agent arrangement

In a principal-agent arrangement where the transactions with third parties are financial transactions, there may be cash transfers between the principal and agent. The disclosures required by GRAP 109 on a principal's resources that are in the custody of an agent may be particularly relevant in these instances.

The Standard of GRAP on *Cash Flow Statements* (GRAP 2) requires entities to present information on their gross cash inflows and cash outflows in the cash flow statement. There are limited circumstances when an entity is permitted in GRAP 2 to present cash flows on a net basis, including when an entity is an agent.

The review asks principals and agents about their experiences to provide information on cash flows from principal-agent arrangements in their financial statements, and seeks to understand whether the information is useful and sufficient to meet users needs.

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