ACCOUNTING STANDARDS BOARD

STANDARD OF GENERALLY RECOGNISED ACCOUNTING PRACTICE

ACCOUNTING BY PRINCIPALS AND AGENTS

(GRAP 109)

Issued by the
Accounting Standards Board

July 2015

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Standard of Generally Recognised Accounting Practice

Accounting by Principals and Agents

Introduction

This pronouncement is set out in paragraphs .01 to .69A. All paragraphs in this pronouncement have equal authority. The status and authority of appendices are dealt with in the preamble to each appendix. This pronouncement should be read in the context of its objective, its basis for conclusions and/or the basis for conclusions of its international equivalent, if applicable, the *Preface to the Standards of GRAP* and the *Framework for the Preparation and Presentation of Financial Statements*[1].

Standards of GRAP and Interpretations of the Standards of GRAP should also be read in conjunction with any directives issued by the Board prescribing transitional provisions, as well as any regulations issued by the Minister of Finance regarding the effective dates of the Standards, published in the Government Gazette.

Directives should be read in conjunction with the applicable Standards of GRAP and Interpretations of the Standards of GRAP.

[1] In June 2017, the Board replaced the *Framework for the Preparation and Presentation of Financial Statements* with the *Conceptual Framework for General Purpose Financial Reporting*.

Objective

.01 The objective of this Standard is to outline principles to be used by an entity to assess whether it is party to a principal-agent arrangement, and whether it is a principal or an agent in undertaking transactions in terms of such an arrangement.

.02 This Standard does not introduce new recognition or measurement requirements for revenue, expenses, assets and/or liabilities that result from principal-agent arrangements. This Standard does however provide guidance on whether revenue, expenses, assets and/or liabilities should be recognised by an agent or a principal, as well as prescribe what information should be disclosed when an entity is a principal or an agent.

Scope

.03 An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in determining whether it is a principal or an agent in a principal-agent arrangement.

.04 When an entity is party to a principal-agent arrangement, it shall apply the principles in this Standard to assess whether it is a principal or an agent before applying other Standards of GRAP dealing with the recognition and measurement of revenue, expenses, assets and/or liabilities.

Definitions

.05 The following terms are used in this Standard with the meanings specified:

An agent is an entity that has been directed by another entity (a principal), through a binding arrangement, to undertake transactions with third parties on behalf of the principal and for the benefit of the principal.

A binding arrangement is an arrangement that confers enforceable rights and obligations on the parties to the arrangement as if it were in the form of a contract. It includes rights from contracts or other legal rights.

A principal is an entity that directs another entity (an agent), through a binding arrangement, to undertake transactions with third parties on its behalf and for its own benefit.

A principal-agent arrangement results from a binding arrangement in which one entity (an agent), undertakes transactions with third parties on behalf, and for the benefit of, another entity (the principal).

Terms defined in other Standards of GRAP are used in this Standard with the same meaning as in those other Standards.

Binding arrangements

.05A Binding arrangements can be evidenced in several ways:

(a) a contract concluded between the parties;

(b) legislation, supporting regulations or similar means including, but not limited to, laws, regulation, policies, decisions concluded by authorities such as cabinet, executive committees, boards, municipal councils and ministerial orders; or

(c) through the operation of law, including common law.

A binding arrangement is often, but not always, in writing, in the form of a contract or documented discussions between the parties.

Principal-agent arrangement

.06 The Constitution of the Republic of South Africa, 1996 (the Constitution), sets out the various responsibilities of government, and assigns activities to various spheres of government or to particular types of entities. Supporting legislation within each sphere of government sets out the mandate, authority, roles and responsibilities of specific entities in undertaking the activities outlined in the Constitution. In many cases, this legislation results in the establishment of separate entities to undertake these activities. It is however not feasible to establish separate entities in all instances, and it may be more efficient and effective to utilise other entities to undertake certain activities. As a result, entities frequently have certain activities executed by another entity, or undertake activities on behalf of other entities. The ultimate responsibility, however, for the various activities still rests with the entities identified in legislation.

.07 Where these arrangements exist, it is important to identify which entity should account for the transactions arising from these activities, and what resulting revenue, expenses, assets and/or liabilities should be recognised. Examples of typical arrangements where one entity undertakes activities on behalf of another entity in the public sector may include:

- The collection of revenue, including taxes, fees and other charges from specific parties, e.g. motor vehicle licence fees collected by municipalities for the provincial government, and taxes collected by the Revenue Authority for the national government.
- The construction of assets, e.g. houses built for beneficiaries of the reconstruction and development programme, for national and/or provincial housing departments and organisations.
- The provision of goods and services to recipients, e.g. the provision of water to specific communities by municipalities on behalf of water service authorities.

- Property management services, which may include the maintenance of properties and collection of revenue, for the Department of Public Works and/or municipalities.

.08 Service concession arrangements may be an example of a principal-agent arrangement as one party (the operator, which is usually a private sector entity) carries out certain activities on behalf of the other entity (the grantor, which is usually a public sector entity) in relation to third parties (the public). An entity should assess whether a principal-agent arrangement exists, and whether it is a principal or an agent in such an arrangement using this Standard.

.09 When an entity directs another entity to undertake an activity on its behalf, it must consider whether it is a party to a principal-agent arrangement. The definition of a principal-agent arrangement refers to an entity acting on behalf of another entity in relation to transactions with third parties. In the absence of transactions with third parties, the arrangement is not a principal-agent arrangement, and the entity then acts in another capacity rather than as an agent. This type of assessment may be particularly relevant to the following two scenarios that are often encountered in the public sector:

(a) Entities, particularly national and provincial departments, are often asked to collect money from public entities or other agencies and to subsequently deposit the money into the relevant revenue fund. In these arrangements, although the departments seemingly undertake activities on behalf of the revenue fund, there is no specific direction given by the revenue fund in relation to the transactions with third parties. As a result, such arrangements may not meet the definition of a principal-agent arrangement.

(b) The structure and operation of the public sector means that entities frequently control other entities in accordance with the Standard of GRAP on *Consolidated Financial Statements* (GRAP 35). Although these control relationships mean that the controlling entity is able to direct the activities of an entity so that it benefits from those activities, these relationships by themselves do not indicate the existence of a principal-agent arrangement. Only where a controlling entity specifically directs a controlled entity to undertake transactions with third parties for its benefit will a principal-agent arrangement exist. In control relationships, it is possible for one or more principal-agent arrangements to exist within the context of a control relationship.

.10 "Transactions with third parties" in the context of this Standard includes the execution of a specific transaction with a third party, e.g. a sale or purchase transaction, but it also includes interactions with third parties, e.g. when an agent is able to negotiate with third parties on the principal's behalf. 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. These activities could include the agent transacting with third parties for the procurement or disposal of resources, or the receipt resources from a third party on behalf of the principal.

.11 Principal-agent arrangements usually exist as a result of a binding arrangement between the parties to the arrangement. It is unlikely that an entity would undertake activities on behalf of another entity in the absence of a binding arrangement as the arrangement imposes rights and obligations on the parties to perform in a particular manner.

.12 Where no binding arrangement exists, it is assumed that the entity is acting for itself, rather than on behalf of another entity. As a result, no principal-agent arrangement exists in the absence of a binding arrangement.

Principal and agent

.13 A principal is an entity that directs another (an agent) to undertake transactions with third parties, for the benefit of the principal, in terms of a binding arrangement. The focus of this Standard is establishing whether one entity directs another in relation to specific transactions with third parties within a particular arrangement, rather than considering whether one entity directs or has the power over another entity generally (refer to paragraph .09(b)).

.14 The definition of an agent and principal uses the term “entity” to broadly describe a party to an arrangement. Although principals and agents are usually reporting entities, an individual person may also be a principal or an agent. Legislation may assign certain activities to a political office-bearer, such as a Minister of a particular department, or the accounting officer of an entity, rather than to a specific entity. Individuals may also carry out activities on behalf of public sector entities. The requirements of this Standard apply equally to such arrangements with individuals. However, since individuals are not reporting entities, it is important to identify the reporting entity that the individual agent or principal represents in such scenarios.

.15 In certain instances, an entity may identify that a particular bank account or fund benefits from specific transactions undertaken with third parties in an arrangement. The entity or individual (or the entity he or she represents) that controls that fund or bank account is deemed to be the “entity” which is party to the arrangement.

Identifying whether an entity is a principal or an agent

.16 When an entity is party to a principal-agent arrangement, it shall assess whether it is the principal or the agent in accounting for revenue, expenses, assets and/or liabilities that result from transactions with third parties undertaken in terms of the arrangement. The assessment of whether an entity is a principal or an agent requires the entity to assess whether the

transactions it undertakes with third parties are for the benefit of another entity or for its own benefit.

Binding arrangement

.17 An entity assesses whether it is an agent or a principal by assessing the rights and obligations of the various parties established in the binding arrangement.

.18 Principal-agent arrangements are governed by a binding arrangement. The requirements of these binding arrangements, particularly the rights and obligations established for the various parties, inform an entity's assessment of whether it undertakes transactions for its own benefit, or for the benefit of another entity. The terms and conditions of the binding arrangement should be assessed to determine the roles, responsibilities and authority of parties in relation to the activities and resulting transactions undertaken in terms of that arrangement.

.19 [Deleted].

.20 In the public sector, identifying a binding arrangement may be difficult and often requires a significant degree of judgement due to a lack of formal agreements between entities. In the absence of paragraphs .05A(a) to (c), an arrangement that establishes rights and obligations, for the various parties to the arrangement, through past actions which, over time, results in either party having no realistic alternative but to act in a certain way in relation to the arrangement, may also give rise to a binding arrangement, for purposes of this Standard.

.21 A binding arrangement may use the term "principal" or "agent" for specific parties to the arrangement. Even if these terms are legally assigned to specific parties in the arrangement, an entity should assess, based on the principles in this Standard, whether the arrangement is a principal-agent arrangement and whether the entity is the principal or agent.

.22 Where the terms of a binding arrangement are modified, the parties to the arrangement shall re-assess whether they act as a principal or an agent in accordance with this Standard.

.23 The assessment of whether an entity is a principal or an agent is based on the terms outlined in the binding arrangement. If these terms are modified, it may result in a change in classification as either a principal or an agent, or may have consequences for the recognition and measurement of revenue, expenses, assets and/or liabilities. Any changes are accounted for using the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors.*

Assessing which entity benefits from the transactions with third parties

.24 When an entity in a principal-agent arrangement concludes that it undertakes transactions with third parties for the benefit of another entity,

then it is the agent. If an entity concludes that it is not the agent, then it is the principal in the transactions.

.25 ***An entity is an agent when, in relation to transactions with third parties, all three of the following criteria are present, except as outlined in paragraph .26:***

(a) It does not have the power to determine the significant terms and conditions of the transaction.

(b) It does not have the ability to use all, or substantially all, of the resources that result from the transaction for its own benefit.

(c) It is not exposed to variability in the results of the transaction.

.26 ***Where an entity has been granted specific powers in terms of legislation to direct the terms and conditions of particular transactions, it is not required to consider the criteria in paragraph .25(a) to conclude that is an agent. Entities shall apply judgement in determining whether such powers exist and whether they are relevant in assessing whether an entity is an agent.***

.27 In assessing which entity is the principal or the agent, an entity assesses whether it undertakes transactions with third parties for the benefit of another entity or for its own benefit. An entity assesses whether it is the agent using the criteria outlined in paragraph .25. If the entity assesses that it is not the agent, then by default it is the principal.

.28 All three of the criteria in paragraph .25 must be present for an entity to be an agent. There may however be instances when legislation or equivalent grants powers to an entity to determine the terms and conditions of particular transactions. This is particularly the case where an entity acts in a regulatory capacity or as an enforcement agency. Where these powers are granted to entities, the criteria in paragraph .25(a) may not be a useful determinant in assessing whether an entity is an agent or a principal. In these instances, the criteria in paragraphs .25(b) and (c) are more relevant because even though these entities may have the power to determine the significant terms and conditions, they are often not able to use all or substantially all of the resources that result from the transaction, nor are they exposed to variability in the results of the transactions. There may be a strong link between the powers granted to entities to direct the terms and conditions of transactions as envisaged in paragraph .25(a), and the circumstances that may give rise to the recognition of receivables or payables as an agent as explained in paragraphs .56 to .58.

.29 An entity assesses whether it is the principal or the agent based on the transactions with third parties. This does not require an entity, in all instances, to assess whether it is the principal or the agent in each individual transaction with third parties. Instead, it may be appropriate to make this assessment for specific transaction types where they share similar characteristics, for example, a specific type of revenue transaction, or a specific type of expense transaction.

Power to determine the significant terms and conditions of the transactions with third parties

.30 For an entity to be an agent, it must not have the power to determine the significant terms and conditions of the transactions with third parties. This means that it should not have the power to affect the result of the transaction. The result of a transaction is the economic benefits or service potential (or both) that arise from that transaction. The economic benefits or service potential can therefore be quantitative or qualitative.

.31 The quantitative result of a transaction represents the monetary amount of a transaction and could include:

(a) The amount paid by the third party for a good or a service received, or the amount of any tax, levy or other charge paid.

(b) The amount paid to the third party for goods and services procured, or benefits paid as part of a non-exchange transaction, e.g. a social benefit.

.32 The qualitative result of a transaction could include:

(a) The quality of a particular good or service received by the third party.

(b) The administrative efficiency with which a specific transaction or activity should be performed.

(c) The volume of a good or service provided to the third party.

.33 An entity does not have the power to determine the significant terms and conditions of transactions with third parties if it is not able to decide, for example, the following aspects:

(a) What goods and services should be provided to, or procured from, third parties; or what taxes, levies or other charges should be levied on, or payments made to, third parties.

(b) To whom goods and services should be provided, or from whom goods and services should be procured; or on whom taxes, levies or other charges should be levied, or to whom payments should be made. This does not require the identification of specific individual third parties, and could be groups of affected third parties.

(c) The price to be paid by third parties, or agree on the price to be paid to third parties; or the amount of tax, levies or other charges to be paid by, or the amount of payments to be made to, third parties.

(d) The quality of the goods and services provided to, or received from, third parties. This may be less relevant to transactions that relate to taxes, levies, charges received by, or payment by or to, third parties.

This list is not exhaustive.

.34 When the entity needs to defer significant decisions that affect the results of the transaction to another entity, this is an indicator that it does not have the power to determine the significant terms and conditions of the transactions with third parties. Entities may frequently be required to receive approval for undertaking certain transactions from another authority before finally concluding the transaction. An entity should assess whether such approval is seen as granting regulatory approval for entering into the transaction, or whether it is seen as approving the significant terms and conditions of that specific transaction.

Ability to use all or substantially all of the resources that result from the transactions with third parties

.35 An entity does not have the ability to use the resources that result from the transactions with third parties when it does not have unrestricted access to those resources and cannot use those resources for its own benefit.

.36 To assess whether an entity has unrestricted access to the resources that result from the transactions with third parties or not, it must assess the economic substance of the rights and obligations of the parties specified in the binding arrangement. As an example, the conclusion of a contract (or equivalent) between parties does not in itself indicate that those are the parties that have unrestricted access to, and will benefit from, the resources that result from that contract. Similarly, physical possession of a resource by an entity does not in itself mean that it has unrestricted access to that resource, as possession may have been granted to that entity to enable it to fulfil its obligations under the binding arrangement.

.37 The types of resources that result from transactions with third parties could vary depending on the activities that are to be undertaken in terms of the binding arrangement. The resources that could result from transactions with third parties include:

- Receipts related to specific goods and services provided, or taxes, levies and other charges.
- Disbursements for specific goods and services procured to enable the execution of the transactions with third parties. The goods and services procured could also result in inventory.

.38 In the public sector, entities are frequently required to pay the proceeds of certain transactions or activities to the relevant Revenue Fund. This does not, by itself, mean that the entity is not able to use all or substantially all of the resources that result from transactions with third parties. An entity would need to assess whether the requirement to pay certain proceeds to the Revenue Fund is a cash management arrangement, or whether the type of proceeds collected are of a specific nature (i.e. taxes, levies, certain fines and other charges outlined in legislation) that are collected for the benefit of the Revenue Fund. Where the payment of the proceeds to the Revenue Fund is merely in the interest of managing cash more effectively, the entity may still be able to demonstrate that it uses all or substantially all of the resources that result from the transactions with third parties.

.39 As noted in paragraph .25, an entity must not have the ability to use all, or substantially all, of the resources that result from the transactions with third parties. In principal-agent arrangements, the agent is often permitted to retain a portion of the revenue collected as a fee, e.g. a commission, or administration or transaction fee, for the service provided. This fee is usually nominal in relation to the total revenue collected, and as a result, the entity would not have the ability to use all or substantially all of the resources that result from the transaction.

Exposure to variability in the results of transactions with third parties

.40 As noted in paragraph .30, the results of the transaction are the economic benefits or service potential (or both) generated by the activity. An entity's exposure to the results of a transaction does not only refer to the receipt or sacrifice of economic benefits or service potential. It also refers to the end result achieved by undertaking a particular transaction. Although results include the specific outputs of a transaction, they may also include exposure to broader consequences arising from a transaction. An entity is exposed to variability in the results of the transaction when it has exposure to both the positive and negative results associated with that transaction, and these exposures are not limited or fixed. There may be a number of factors that an entity considers in determining whether it is exposed to the variability in the results of transactions. An entity's exposure to the variability in the results of a transaction are usually limited if:

(a) Another party is responsible for fulfilling the rights and obligations established in the binding arrangement. For example, if the provision of a certain good or service is the responsibility of a specific type of entity in legislation, then it is likely that recipients of that good or service will look to that entity for delivery of those goods or services.

(b) The entity has limited inventory risk, i.e. the risk of theft, obsolescence or other losses, as well as changes in value.

(c) The entity receives a fixed fee or a fixed margin, e.g. commission, or administration or transaction fee, for carrying out the transactions.

(d) The entity is not exposed to significant default risk, i.e. the risk of fees, taxes, levies or other charges not being paid by third parties.

This list is not exhaustive and other factors may be relevant in assessing exposure to variability in the results of the transactions with third parties.

.41 Once an entity has established that it is an agent or a principal in relation to specific transactions with third parties it applies the principles in paragraphs .42 to .59 in accounting for the transactions that result from the arrangement.

Accounting by a principal or an agent

.42 A principal recognises revenue and expenses that arise from transactions with third parties in a principal-agent arrangement.

.43 An agent recognises only that portion of the revenue and expenses it receives or incurs in executing the transactions on behalf of the principal.

.44 An entity recognises assets and liabilities arising from principal-agent arrangements in accordance with the requirements of other Standards of GRAP.

Recognising revenue and expenses as a principal or an agent

.45 An entity determines, in accordance with this Standard, whether it is a principal or agent and, in doing so, determines the revenue and expenses that qualify for recognition in its financial statements in accordance with the applicable Standards of GRAP. When an entity determines that it is a principal in accordance with this Standard, it accounts for revenue and expenses arising from the transactions with third parties in its statement of financial performance. This is because the transactions with third parties are concluded for the benefit of the principal. Conversely, when an entity is an agent, it would not recognise revenue and expenses resulting from those transactions with third parties. It only recognises the revenue and expenses associated with undertaking the transactions on behalf of the principal.

.46 Agents are usually compensated for the transactions that they carry out on behalf of their principals. Compensation can take a variety of forms, and may be fixed or variable in amount. Compensation may be received directly from the principal in the form of a commission, administration or transaction fee for the services it provides in an exchange transaction, or it may receive compensation indirectly from a third party, such as another level of government, in a non-exchange transaction. Some arrangements may stipulate that, instead of paying a specific fee to the agent, the agent is entitled to withhold certain fees collected from third parties (e.g. consumers). These types of compensation typically qualify for recognition as revenue by the agent, because they compensate the agent for transactions undertaken on the principal’s behalf.

.47 Compensation should be distinguished from amounts that are paid to the agent to reimburse it for specific costs incurred, or to be incurred on behalf of the principal. These amounts are not recognised as revenue because the associated expenses incurred are not expenses of the agent, i.e. any goods and services procured, or other expenses incurred, are those of the principal.

.48 For example, a municipality is tasked to act as an agent to facilitate the construction of low-cost houses on behalf of a national government department, and the department directs the municipality to incur certain specific reimbursable costs on its behalf. Such costs and the related recovery thereof should not be recognised in the statement of financial performance of the municipality. However, any fee payable to the municipality in respect of the arrangement over and above cost-recoveries may qualify for recognition in accordance with the Standard of GRAP on *Revenue from Exchange Transactions* (GRAP 9). Similarly, any costs incurred in excess of the fee received should be assessed in terms of the Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets* (GRAP 19).

.49 As noted in paragraph .43, an agent does not recognise expenses it incurs on behalf of the principal in its statement of financial performance. The result of the transaction with third parties, in this case suppliers, results in the principal having the ability to use all, or substantially all, of the resources related to that transaction and not the agent.

Recognising assets and liabilities as a principal or an agent

.50 Whether an entity is a principal or an agent, it applies the principles in the applicable Standards of GRAP in recognising assets and liabilities arising from a principal-agent arrangement.

.51 A principal-agent arrangement often gives rise to the agent holding resources on behalf of the principal in order to undertake transactions with the relevant third parties. This may mean that the agent needs to recognise assets and liabilities for these resources held. An agent may also need to recognise assets and liabilities as a result of rights and obligations arising from principal-agent arrangements. An entity refers to other Standards of GRAP in determining whether or not assets and liabilities arising from (or related to) principal-agent arrangements should be recognised.

Resources held on behalf of the principal

.52 The *Framework for the Preparation and Presentation of Financial Statements*[2] requires, inter-alia, that an entity must control an asset, as a result of a past event, before it can be recognised in the statement of financial position. Consequently, an agent assesses whether the resources it holds as a result of undertaking transactions with third parties on behalf of the principal are under its control and would otherwise meet the definition and recognition criteria for such assets in accordance with other Standards of GRAP.

.53 Where the assets held by an agent for the principal are indistinguishable from its own assets, it may be appropriate for the agent to recognise such items as assets

[2] In June 2017, the Board replaced the *Framework for the Preparation and Presentation of Financial Statements* with the *Conceptual Framework for General Purpose Financial Reporting*.

under its control. This would be the case where inventory items are homogenous and cannot be separately identified, such as water reserves held by the agent to distribute to both its customers as well as to those of the principal. A corresponding liability should however be recognised where there is an obligation to transfer resources to the principal in respect of the assets held.

Rights and obligations arising from principal-agent arrangements

.54 Where an agent holds cash or other monetary assets on behalf of its principal, it is necessary to assess whether this should be recognised as an asset by the agent, with a corresponding liability in respect of the obligation to transfer the amounts to the principal. In making this assessment, the agent considers whether it controls (even if this control is temporary) the cash or other asset it holds, and consequently whether it meets the definition of an asset in accordance with the *Framework for Preparation and Presentation of Financial Statements*[2].

.55 Where an agent is required to collect amounts owing to a principal or another entity, consideration should be given to whether or not it is appropriate for the agent to recognise the amounts to be collected as a receivable, along with the corresponding liability to pay over the amounts still-to-be collected to the principal. Similarly, an agent may need to consider whether it should recognise a payable, along with a corresponding receivable, for amounts which it is obligated to settle on behalf of the principal.

.56 The binding arrangement will usually outline an agent's responsibilities in relation to the collection of receivables or the settlement of payables. In most instances, an agent's responsibilities will be restricted to either the actual receipt or payment of cash. Legislation may however give a particular entity the sole authority to collect a particular type of debt, or to settle certain obligations, on behalf of the state. The requirements set out in legislation often create clear rights for, and impose obligations on, specific entities to execute these responsibilities. The rights and obligations established for various entities in legislation should be considered in assessing whether an agent should recognise receivables and payables.

.57 An agent should assess whether it is appropriate to recognise receivables and payables based on the rights and obligations established in the binding arrangement, and after considering any relevant facts and circumstances. The following indicators may be useful in assessing whether an agent should recognise a receivable or a payable:

(a) The debt is due to, or due by, the agent, i.e. the agent is the counterparty in the transaction with the third party.

(b) The agent has the legal right to enforce collection of the debt, or the agent has the legal obligation to settle the debt.

(c) The agent determines the amount that must be paid by, or to, the third party based on the policies determined by the principal.

(d) The agent determines the manner and timing of settlement.

(e) The agent has the power and discretion to write off debts owing by third parties.

(f) The agent has an obligation to undertake certain activities, which it is required to do in terms of the binding arrangement.

The list above merely outlines indicators of when it may be appropriate for an agent to recognise a receivable or payable. An entity does therefore not need to demonstrate that they all exist in each instance.

.58 When an agent recognises receivables for amounts to be collected for the principal as a result of paragraph .57, it applies GRAP 9 and the Standard of GRAP on *Revenue from Non-exchange Transactions (Taxes and Transfers)* (GRAP 23) (whichever is applicable), as well as the Standards of GRAP on *Financial Instruments* (GRAP 104) and *Statutory Receivables* (whichever is applicable) in recognising and measuring the receivable. A corresponding liability is recognised at the same time and at the same amount. The subsequent measurement of any receivables or payables recognised is determined based on the applicable Standard of GRAP.

.59 When an agent recognises payables for obligations to be settled on behalf of the principal, it applies the GRAP 19 or GRAP 104 (whichever is applicable) in recognising and measuring the payable. A corresponding asset is recognised at the same time and at the same amount. The subsequent measurement of any receivables or payables recognised is determined based on the applicable Standard of GRAP.

Presentation

.60 Where assets and liabilities are recognised~~,~~ in accordance with other Standards of GRAP by an agent in respect of those transactions that it undertakes on behalf of its principal, it is inappropriate to offset the assets and liabilities recognised, unless another Standard of GRAP permits the offsetting of such amounts.

Disclosure

.61 In addition to the disclosure requirements set out in paragraphs .62 to .67, the disclosure requirements applicable to revenue, expenses, assets and/or liabilities recognised in accordance with other Standards of GRAP, shall also be applied. The information disclosed in accordance with this Standard shall be provided for each material principal-agent arrangement and in aggregate for other principal-agent arrangements.

.62 An entity that is a party to a principal-agent arrangement shall disclose:

(a) a description of the arrangement, including the transactions undertaken;

(b) whether the entity is the principal or agent and any significant judgement applied in making this assessment;

(c) significant terms and conditions of the arrangements and whether any changes occurred during the reporting period; and

(d) an explanation of the purpose of the principal-agent relationship and any significant risks (including any risk mitigation strategies) and benefits associated with the relationship.

Disclosure by agents

.63 ***An entity that is the agent in a principal-agent arrangement shall disclose the following in the notes to the financial statements:***

(a) a description of any resources (including the carrying value and description of any assets recognised) that are held on behalf of a principal, but recognised in the agent's own financial statements. Such disclosure shall include:

(i) the remittance of any resources during the period, as well as the expected timing of remittance of any remaining resources to the principal; and

(ii) risks that are transferred from the principal to the agent (if any), including risks flowing to the entity as a result of its custodianship over the resources held on behalf of a principal;

(b) the aggregate amount of revenue that the entity recognises as compensation for the transactions carried out on behalf of the principal; and

(c) a description of any liabilities incurred on behalf of a principal that have been recognised by the entity, as well as any corresponding rights of reimbursement that have been recognised as assets.

.64 ***An agent shall disclose information in the notes to the financial statements about the revenue and expenses that relate to transactions with third parties undertaken in terms of the principal-agent arrangement. An agent shall disclose:***

(a) The category of revenue received or to be received, as well as the category of expenses paid or accrued on behalf of the principal.

(b) The amount of revenue received or to be received, as well as the amount of expenses paid or accrued on behalf of the principal during the reporting period per category of revenue or expense.

.65 ***Where an agent recognises receivables or payables in accordance with paragraph .57, it shall provide a reconciliation of the carrying amount of the receivable or the payable at the beginning and end of the period showing:***

(a) For receivables:

(i) The amount of revenue that the principal is entitled to.

(ii) The value of any write-offs, settlements or waivers of amounts that reduce the amount that the principal is entitled to.

(iii) The amount of cash received on behalf of the principal.

(b) For payables:

(i) The amount of any expenses incurred on behalf of the principal.

(ii) The amount of cash paid on behalf of the principal.

.66 ***An entity provides the disclosures in paragraphs .64 and .65 when this information is useful to users in assessing the accountability of the agent in relation to the transactions undertaken with third parties in a principal-agent arrangement.***

Disclosure by principals

.67 ***An entity that is the principal in a principal-agent arrangement shall disclose the following:***

(a) the resources (including assets and liabilities) of the entity that are under the custodianship of an 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 back to the entity (where applicable) or to third parties;

(b) the fee paid as compensation to the agent; and

(c) a discussion of the resource or cost implications for the principal if the principal-agent arrangement is terminated.

Transitional provisions

.68 ***The transitional provisions to be applied by entities on the initial adoption of this Standard are prescribed in a directive(s). The provisions of this Standard should be read in conjunction with each applicable directive.***

Effective date

Initial adoption of the Standards of GRAP

.69 ***An entity shall apply this Standard for annual financial statements covering periods beginning on or after a date to be determined by the Minister of***

Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999, as amended.

Entities already applying Standards of GRAP

.69A ***Paragraphs .05, .09 and .20 were amended, paragraph .19 was deleted and paragraph .05A was added by GRAP 35 issued March 2017. An entity shall apply these amendments retrospectively for annual financial periods beginning on or after 1 April 2020. If an entity elects to apply these amendments earlier, it shall disclose this fact.***

Appendix A - Illustrative guidance and examples

This appendix is illustrative only and does not form part of this Standard. The purpose of the appendix is to illustrate the application of this Standard and to assist in clarifying its meaning.

Identifying transactions with third parties

Example 1: Identifying transactions with third parties

Provincial Department A is directly responsible in legislation for providing housing in a particular province. It has identified, and received the necessary approvals to undertake, a housing project within Town X. Town X falls within the boundaries of Municipality B.

Provincial Department A enters into a contractual arrangement with Municipality B to assist it in constructing the houses within the housing project, and to hand over the houses once completed to the beneficiaries of the project. Municipality B receives a fee of R1 000 per house to undertake this process. Provincial Department A has outlined clear specifications for the houses, the individuals who are eligible to receive houses, and the price to be paid by the individual beneficiaries (if any). Any amounts paid by the beneficiaries are to be paid to Provincial Department A.

The contract concluded between Provincial Department A and Municipality B requires Municipality B to provide completed houses to the relevant beneficiaries of the project, for a fixed fee per house. The contract requires the municipality to inform Provincial Department A once the houses are occupied by a beneficiary, and to collect any amounts payable by beneficiaries. Any amounts paid to Provincial Department A in this respect are limited to the amounts actually received by the municipality.

Analysis

Assume the analysis is undertaken from the perspective of Municipality B.

The municipality should assess whether a principal-agent arrangement exists.

There are three types of transactions which Municipality B undertakes for Provincial Department A:

- It constructs houses to the necessary specifications for a fixed fee per house.
- It administers the process of handing over the completed houses to the beneficiaries identified by Provincial Department A, and receives a fee of R1 000 per hand over administered.
- It collects any fees due by the beneficiaries to the Provincial Department.

A principal-agent arrangement is an arrangement where one entity directs another to undertake transactions with third parties on its behalf.

<u>Construction of houses</u>

The municipality is responsible to construct houses for identified beneficiaries at a fixed fee.

The municipality is therefore responsible for the actual construction of the house and therefore acts as contractor (irrespective of whether it physically undertakes the construction itself or appoints a contractor). As a contractor, the municipality is responsible for procuring the relevant goods and services from suppliers and service providers to construct the houses. The municipality does not act on behalf of Department A in relation to the suppliers or service providers, and as a result, this transaction is not the subject of a principal-agent arrangement.

<u>Handing over of completed houses</u>

The municipality constructs houses for Provincial Department A to distribute to its beneficiaries. Municipality B is responsible for administering the process of handing over the completed houses to the beneficiaries of the housing project, which are identified by Provincial Department A. In this instance, the municipality is undertaking transactions with third parties on behalf of another entity, i.e. distributing houses of Department A to beneficiaries of the housing project. These transactions are therefore the subject of a principal-agent arrangement, and the houses are treated as inventory of Provincial Department A.

<u>Collection of fees payable by the beneficiaries</u>

The municipality is responsible for collecting any fees due by the beneficiaries for the houses once they take occupation. Any fees collected are paid by Municipality B to Provincial Department A. As the municipality is undertaking a transaction with a third party for another, i.e. amounts are collected by Municipality B from housing beneficiaries which are to be paid to Provincial Department A, these transactions are the subject of a principal-agent arrangement.

Principal-agent arrangements related to the collection of revenue

Example 2A: Collection of revenue

Scenario

The provincial government, through the respective provincial departments of transport, is mandated to collect motor vehicle licences on an annual basis. The provincial departments determine the fee that is payable annually by motor vehicle owners, which varies depending on the type of motor vehicle owned.

To make the payment of the motor vehicle licences easier, the provincial departments enter into a contractual arrangement with municipalities across the country to undertake this activity on their behalf. In terms of the arrangement:

- The provincial departments issue the motor vehicle licence renewal form to the respective owners of the motor vehicles, indicating the amount due for the year.
- The municipalities provide facilities for owners of motor vehicles to pay their licences.
- The provincial departments provide the municipalities with access to its IT systems so that they can capture the amounts received and issue the motor vehicle licences on their behalf. The system automatically generates the motor vehicle licence upon capturing the payment of the fees due.

- The municipalities collect the fees due from motor vehicle owners and simultaneously issue the new licences on behalf of the provincial government.
- The municipalities are required to pay over any revenue (cash) collected to the provincial government in respect of motor vehicle licences.
- The municipalities are entitled to retain 5% of the cash collected for undertaking this activity for the provincial departments.

Analysis

The arrangement is a principal-agent arrangement as one entity (the provincial departments) directs another (the municipalities) to undertake transactions with third parties (motor vehicle owners) on its behalf.

The entities should test whether they are an agent in the arrangement. The discussion that follows outlines the considerations from the perspective of the municipalities. For the municipality to conclude that it is an agent, the following must be present:

(a) It does not have the power to determine the significant terms and conditions of the transactions with third parties: The provincial departments issue the renewal notices and as a result determine who is illegible to pay motor vehicle licences during the period, as well as the amount due.

(b) It does not have the ability to use all or substantially all of the resources that result from the transactions with third parties: In this instance, the transactions with the third parties are limited to the collection of the motor vehicle licence fees due, and thus the result of the transaction is any cash collected as revenue. The municipality is not entitled to use all or substantially all of the resources that result from these transactions as it is only entitled to 5% of the total cash collected.

(c) It is not exposed to variability in the results of the transactions with third parties: The municipality is not exposed to quantitative or qualitative results from the transactions with third parties as (i) the system operated by the provincial departments automatically generates the licence and therefore any errors or other defects in the licence are the responsibility of the relevant provincial department; and (ii) the municipality is only liable to pay over actual cash collected and is therefore not exposed to any financial variability in the transaction. Note: The fact that the municipality receives a fixed fee for providing this service, and whether the 5% is sufficient to cover the cost of providing the service, is not considered in this assessment. Only the results of the transactions with the third parties, i.e. the motor vehicle owners, are considered.

The municipality is the agent in the arrangement, and accounts for the following in its financial statements:

Effect on the financial statements

Based on the analysis above, the municipality will recognise the following in its financial statements:

- As revenue: the 5% fee earned from the collection of the cash.
- As expenses: any costs it incurs in providing the service, e.g. employee costs, depreciation on assets etc.
- As an asset: Any cash held in its bank account for amounts to be remitted to the provincial departments.
- As a liability: The amount of cash held in its bank account to be remitted to the provincial departments.

Example 2B: Collection of revenue

Scenario

In terms of legislation, Department X is the line ministry responsible for issuing licences to companies who wish to undertake Activity Y. It establishes Public Entity A and grants it the necessary powers and responsibilities to regulate Activity Y and to issue the relevant licences. In terms of legislation, Public Entity Y is required to develop Regulations governing the issuing of the licences, including determining the licencing conditions, which companies are required to acquire licences and, on an annual basis, determining the licence fees payable.

Legislation requires that any fees collected to undertake Activity Y are direct receipts of the relevant Revenue Fund. Public Entity A is required to pay over any cash collected to the Revenue Fund. Public Entity A receives a transfer payment from Department X to fund the activities that it undertakes on its behalf.

Analysis

The arrangement is a principal-agent arrangement as one entity (Department X) directs another (Public Entity Y) to undertake transactions with third parties (issue licences to companies to undertake Activity Y) on its behalf.

The entities should test whether they are an agent in the arrangement in relation to the licence fees collected. The discussion that follows outlines the considerations from the perspective of Public Entity A. For Public Entity A to conclude that it is an agent, the following must be present:

(a) It does not have the power to determine the significant terms and conditions of the transactions with third parties: Public Entity A is granted specific powers in legislation to "regulate" Activity Y by issuing licences to qualifying companies. As such, it is able to direct the terms and conditions of the transactions with third parties. Paragraphs .27 and .28 indicate that where specific powers are granted to entities to determine the terms and conditions of specific transactions, for example, as a regulator, then it may not be relevant for an entity to determine that this requirement is met. As a result, Public Entity A should focus on criteria (b) and (c) to assess whether it acts as a principal or an agent in relation to the fees collected.

(b) It does not have the ability to use all or substantially all of the resources that result from the transactions with third parties: Legislation indicates that any licence fees received is for the Revenue Fund. As such, Public Entity A is not able to use all or substantially all of the resources related to the transactions with third parties.

(c) It is not exposed to variability in the results of the transactions with third parties: Public Entity A is only required to pay over any cash collected, and as such it bears no risk in relation to non-payment. It may be exposed to variability if the process of issuing licences is deficient, or any licences themselves are deficient.

Based on the analysis above, Public Entity A is an agent. As a result, it accounts for the following in its financial statements:

Effect on the financial statements

Based on the analysis above, the municipality will recognise the following in its financial statements:

- As revenue: the transfer payment is received from Department X to regulate Activity Y on its behalf.
- As expenses: any costs it incurs in regulating Activity Y, e.g. employee costs, depreciation on assets etc.
- As an asset: Any cash held in its bank account for amounts to be licences fees to be remitted to Department X. (Note: This example assumes that a receivable should not be recognised in accordance with paragraph .57.)
- As a liability: The amount of cash held in its bank account to be remitted to the provincial departments.

Principal-agent arrangement related to the incurring of expenditure

Example 3A: Services related to construction projects

Scenario A: Using the information outlined in Example 1 for the principal-agent transactions

Example 1 indicated that, in terms of the principal, agent arrangement, Municipality B undertakes the following principal-agent transactions for Provincial Department A:

- It administers the process of handing over the completed houses to the beneficiaries identified by Provincial Department A, and receives a fee of R1 000 per hand over administered.
- It collects any fees due by the beneficiaries to the Provincial Department.

Analysis

The entities should test whether they are an agent in the arrangement. The discussion that follows outlines the considerations from the perspective of the municipalities.

For the municipality to conclude that it is an agent, the following must be present:

(a) It does not have the power to determine the significant terms and conditions of the transactions with third parties.

(b) It does not have the ability to use all or substantially all of the resources that result from the transactions with third parties.

(c) It is not exposed to variability in the results of the transactions with third parties.

As there are two different transactions with third parties, the analysis should be undertaken for each type of transaction (although there are linkages between the two types of transactions). The table below outlines the considerations in relation to each transaction:

Criteria	Administration of hand over of houses	Collection of amounts due from beneficiaries
Power to determine the significant terms and conditions of the transaction with 3rd party	The municipality does not (a) determine the type or quality of houses transferred to the beneficiaries of the programme, or (b) identify which beneficiaries should receive houses. Provincial Department A determines both these aspects.	The municipality does not determine the significant terms and conditions of the contract, as Provincial Department A identifies the beneficiaries of the programme, and identifies how much should be paid by each beneficiary.
Ability to use all or substantially all of the resources that result from the transaction with 3rd party	The municipality does not have the ability to use the resources that result from the transaction as it (a) has no ability to direct who benefits from the transaction and is therefore not able to use the resources to fulfil its objectives, and (b) it is only entitled to a nominal fee for administering the hand-over process and is not entitled to receive any compensation from the beneficiaries for the houses transferred.	The municipality is required to pay over any amounts received by it to the Provincial Department. As a result, it cannot use the resources that result from the transaction.
Exposure to variability in the results of the transaction with 3rd party	The municipality is not exposed to any variability in the result of the hand over process to beneficiaries. As Provincial Department A specifies the type and quality of houses provided, if beneficiaries are not satisfied with the house received, the Department is responsible for remedying the situation. Any defects in construction will	The municipality is only required to pay over the amounts received by it from the beneficiaries to Provincial Department A. The municipality is therefore not exposed to the variability in the results of the transaction.

	remain with Municipality B in terms of the contractual arrangement between the municipality and the department.	
Conclusion	Municipality B is the agent in this transaction.	Municipality B is the agent in this transaction.

The municipality is the agent in the arrangement, and accounts for the following its financial statements:

Effect on the financial statements

Based on the analysis above, the municipality will recognise the following in its financial statements:

- As revenue: the R1 000 fee earned for the hand-over of each house administered from the collection of the cash.
- As expenses: any costs it incurs in providing the administration and collection service, e.g. employee costs, depreciation on assets, etc.
- As an asset: Any cash held in its bank account for amounts received from beneficiaries to be remitted to Provincial Department A.
- As a liability: The amount of cash held in its bank account to be remitted to Provincial Department.

Scenario B: Using the information outlined in Example 1 for the construction of the houses

Using the same information as in Example 1, except that for the construction of houses, Municipality B does not construct the houses for a fee, but project manages the construction of the houses and receives 2% of the total project expenditure incurred each month.

In this scenario, Municipality B is asked to undertake the following activities on behalf of Provincial Department A:

- Provide project management services to Provincial Department A in relation to the construction of the houses.
- The scope of the project management service includes (a) engaging with suppliers and contractors appointed by Provincial Department A, (b) managing and monitoring work performed in terms of those contracts, and (c) managing payments from the department to the relevant suppliers and contractors once work has been certified as complete by the engineer appointed by the department. Department A reimburses Municipality A for any payments made to suppliers or contractors.

Analysis

The entities should test whether they are an agent in the arrangement. The discussion that follows outlines the considerations from the perspective of the municipalities.

For the municipality to conclude that it is an agent, the following must be present:

(a) It does not have the power to determine the significant terms and conditions of the transactions with third parties: The municipality engages with, and manages the performance of, the contractors and suppliers appointed by Provincial Department A. As such, Provincial Department A, and not Municipality B, determines the significant terms and conditions with the third parties (suppliers and contractors).

(b) It does not have the ability to use all or substantially all of the resources that result from the transactions with third parties: The suppliers and contractors provide goods and services to Provincial Department A for the housing development. Municipality B merely manages the output of those contracts and is not able to benefit from those goods and services provided. Although the municipality receives a percentage of the project expenditure incurred in the year, the fee is marginal in relation to the resources that result from the transaction. The municipality therefore does not have the ability to use all or substantially all of the resources that result from the transaction.

(c) It is not exposed to variability in the results of the transactions with third parties. As Provincial Department A concluded the contracts with the suppliers and contractors, it agreed the nature, type, quality and price of the goods and services to provided. Municipality B is therefore not exposed to any risk that the resources (or the final product) that result from the transactions are inappropriate. Provincial Department A also reimburses Municipality B for any payments made to suppliers or creditors, and hence there is also no exposure in relation to the payments made.

The municipality is the agent in the arrangement, and accounts for the following its financial statements:

Effect on the financial statements

Based on the analysis above, the municipality will recognise the following in its financial statements:

- As revenue: the 2% fee earned on project expenditure incurred during year. The amounts paid to Provincial Department A as reimbursements are not recognised as revenue in the financial statements of Municipality B as they are reimbursements of payments to suppliers and contractors for Provincial Department A.
- As expenses: any costs it incurs in providing the project management service, e.g. employee costs, depreciation on assets etc. The disbursements made to suppliers and contractors of Provincial Department A are not expenses of the municipality and are therefore not reflected in Municipality B's financial statements.
- As an asset: Any amounts paid to suppliers and contractors for Provincial Department A that are to be reimbursed by the department.

Example 3B: Disbursement of grants

Scenario

Department S is responsible for the disbursement of old-age pensions on a monthly basis in Province Y. Department S establishes Entity T to administer new applications and to make the actual disbursements to pensioners on a monthly basis.

Department S has developed clear guidelines of the pension scheme indicating who is eligible to receive old-age pensions, and the amount of the pensions to be paid. Entity T is responsible for administering new applications and accepting new pensioners onto the scheme, based on the guidelines developed by Department S. The guidelines indicate that all new entrants accepted onto the scheme by the 20th of each month are eligible to receive a pension in the next month. Department S transfers money to Entity T on the 15th of each month for disbursement to the relevant beneficiaries. Department S and Entity T have also signed a service delivery agreement which outlines the quality of the service to be provided, including application processing time, the time waited by beneficiaries in queues to receive benefits etc. Remedial action may be taken by Department S is these requirements are not adhered to by Entity T.

Department S makes a transfer payment to Entity T to cover the costs of administering the applications and disbursements process.

Analysis

The arrangement is a principal-agent arrangement as one entity (Department S) directs another (Entity T) to undertake transactions with third parties (disburse old age pensions) on its behalf.

The entities should test whether they are an agent in the arrangement in relation to the pensions disbursed. The discussion that follows outlines the considerations from the perspective of Entity T. For Entity T to conclude that it is an agent, the following must be present:

(a) It does not have the power to determine the significant terms and conditions of the transactions with third parties: Although Entity T administers the application process for Department S, and ultimately accepts new beneficiaries onto the scheme, it does so within the guidelines prescribed by Department S. Entity T does not have the ability to determine the significant terms and conditions of the transactions with 3rd parties, as Department S has developed guidelines indicating which individuals qualify for old age pensions, as well as the amount they are entitled to.

(b) It does not have the ability to use all or substantially all of the resources that result from the transactions with third parties: Entity T receives funds on the 15th of each month to be disbursed to qualifying beneficiaries. As these funds are required to be disbursed to pensioners at the direction of Department S, it is not able to use all or substantially all of the resources related to the transactions with third parties to fulfil its obligations.

(c) It is not exposed to variability in the results of the transactions with third parties: Entity T performs the service in accordance with the specifications set out in the service level agreement. If it does not perform as required, remedial action will be taken by Department S. Entity T is however not exposed to any variability in the transactions with the third parties (the beneficiaries) as it does not determine the quantity or quality of the services and benefits provided.

Based on the analysis above, Entity is an agent. As a result, it accounts for the following in its financial statements:

Effect on the financial statements

Based on the analysis above, the municipality will recognise the following in its financial statements:

- As revenue: the transfer payment it receives from Department S to administer the application and disbursement process.
- As expenses: any costs it incurs in regulating Activity Y, e.g. employee costs, depreciation on assets etc.
- As an asset: Any cash held in its bank account for amounts to be disbursed.
- As a liability: The equivalent of the amount of cash held in its bank account which is either to be disbursed to beneficiaries or paid back to Department S.

Note: Based on the fact pattern above, Entity T is required to make payments to all beneficiaries who qualify for benefits as at the 20th of each month, while the cash for the month is received from the Department on the 15th of each month. As Entity T is required to make payments even if funding has not been received for that beneficiary, then it should consider whether it should recognise an obligation for these amounts. Such an assessment is made in accordance with paragraph .57.

Recognition of receivables as an agent

Example 4: Recognition of receivables as an agent

Entity A is established to collect taxes for Revenue Fund B based on the prevailing Tax Legislation determined by the Treasury. For purposes of this example, assume that the Revenue Fund is a bank account under the control of the Treasury.

Entity A is in turn governed by its own legislation which outlines its powers and responsibilities both generally, as well as in relation to the collection of taxes. Legislation requires Entity A to provide an appropriate system for administering tax collection, identifying taxpayers, assessing amounts due from (or to) the identified taxpayers, enforcing the collection of amounts due, and where appropriate, entering into settlements or write-offs of debts owing. Entity A receives a transfer payment from the Treasury to cover the costs associated with undertaking these functions. All tax revenue is paid to the Revenue Fund.

In assessing whether Entity A is an agent or a principal, it is important to identify which transactions are subject to a principal-agent arrangement. Entity A essentially:

- Receives a transfer payment from the Treasury to fund its operations.
- Incurs expenditure, by contracting with employees, suppliers and other parties in order to perform the activities expected of it in legislation.
- Receives tax revenue from taxpayers, which is paid over to the Revenue Fund (which is a bank account controlled by the Treasury).

The only transactions which are subject to a principal-agent arrangement are the transactions with specific taxpayers (which may include both assessing the amount of taxes due, enforcing payment of those taxes, etc.). Entity A engages with taxpayers on behalf of the Revenue Fund/Treasury. In the other transactions, there are no transactions with third parties. Entity A undertakes transactions with either the Treasury, or with suppliers, creditors or employees on its own terms and conditions. As a result, these transactions are not the subject of a principal-agent arrangement.

In assessing whether Entity A is an agent, it is clear that while it may have some ability to determine the terms and conditions of the transaction as it is responsible for assessing/determining the amounts of tax due, the Tax Legislation sets out the specific terms and conditions of the transactions with taxpayers. Entity A is however not able to use all or substantially all of the resources that result from the transaction as any tax receipts are for the benefit of the Revenue Fund/Treasury. Entity A is also not exposed to variability in the results of the tax collection process as it merely pays over what is collected and is as a result not exposed to any risk of non-payment. Entity A is therefore the agent in relation to the transactions related to the collection of tax revenue, and will not recognise revenue related to taxes in its statement of financial performance.

However, because legislation specifically grants Entity A the power and responsibility to enforce the collection of taxes, it should assess whether it should recognise receivables for amounts to still be collected. In making this assessment, Entity A considers the indicators described in paragraph .57:

(a) The debt is due to it, i.e. Entity A is the counterparty in the transaction with the taxpayer.

(b) It has the legal right to enforce collection of the debt.

(c) It determines the amount that must be paid by the taxpayer.

(d) It determines the manner and timing of settlement.

(e) It has the power and discretion to write off debts owing by taxpayers.

(f) It has an obligation to undertake certain activities, which it is required to do in terms of legislation.

As many of these indicators exist, Entity A should recognise receivables relating to taxes still to be collected even though it does not recognise revenue from tax receipts.

Basis for conclusions

This basis for conclusions gives the Accounting Standards Board's (the Board's) reasons for accepting or rejecting certain proposals related to the identification of, and accounting for, principal-agent activities. This basis for conclusions accompanies, but is not part of, this Standard.

Introduction

BC1. As a result of entities in the public sector working together to achieve the activities of the public sector outlined in legislation, they often enter into arrangements to undertake activities on behalf of one another. Where these arrangements exist, it is often difficult to identify which entity acts as the agent or the principal, and consequently, which entity should account for the transactions that result from these activities. As a result, the Board agreed to undertake a project to identify whether more comprehensive guidance could be provided to assist entities in identifying when they are a principal or an agent, and what accounting and reporting requirements would be appropriate for such arrangements.

BC2. In its research, the Board noted that there was no authoritative pronouncement or guidance available internationally (either from the International Public Sector Accounting Standards Board or the International Accounting Standards Board®) dealing with the identification of principals and agents. The Board also noted that, while the GRAP 9 and GRAP 23, which are drawn from the equivalent international standards, refer to accounting for revenue as an agent or a principal, this guidance is insufficient to deal with the range and types of arrangements in the public sector.

BC3. Based on the need for more comprehensive guidance, the Board issued the Discussion Paper on *Accounting for Principal-Agent Activities in the Public Sector* (Discussion Paper 8) in July 2012. Respondents to Discussion Paper 8 supported the need for more detailed guidance and consistency in accounting for these arrangements. At its meeting in May 2013, the Board agreed to develop a Standard of GRAP. Based on this decision, this Standard has been developed and prescribes the principles that should be applied by an entity to identify whether it is as a principal or an agent in an arrangement, along with the accounting and disclosure requirements for such arrangements. The Board agreed that this Standard should be applied before considering the other Standards of GRAP and, as a result, this Standard does not prescribe new recognition or measurement requirements in respect of revenues, expenses, assets and/or liabilities.

Scope

BC4. As the objective of this Standard is to outline when an entity is a principal or an agent, the Board agreed that entities should first assess in what capacity they act in an arrangement, based on the principles in this Standard, before applying other

Standards of GRAP that deal with the recognition and measurement of transactions arising from that arrangement.

BC5. Entities that (a) mandate other entities to undertake, transactions with third parties on their behalf, or (b) undertake transactions with third parties on behalf of another entity, usually do so in the form of a binding arrangement. The Board agreed that where a binding arrangement exists that results in one entity (an agent) undertaking transactions with third parties for another (a principal), then they are part of a principal-agent arrangement and are within the scope of this Standard. The Board considered that both the existence of a binding arrangement and third parties are critical in assessing whether an arrangement between parties is a principal-agent arrangement.

BC6. The Board agreed that, because an entity is unlikely to act on behalf of another entity in the absence of a binding arrangement, a binding arrangement must be present to meet the definition of a principal-agent arrangement. Binding arrangements are further discussed in paragraphs BC21. to BC23.

BC7. As an agent represents or acts on behalf of a principal in an arrangement, the Board agreed that a key factor in assessing whether an arrangement is a principal-agent arrangement is the existence of third parties. Given the types of arrangements in the public sector, the Board agreed that an agent may undertake specific transactions with third parties on behalf of the principal, or it may merely represent a principal in relation to third parties. The term "transactions with third parties" used this Standard encompasses both situations.

Approach to distinguishing principals and agents and the impact on definitions

Approach to distinguish agents and principals

BC8. Previously, the identification of a principal or an agent in an exchange transaction was based on an analysis of risks and rewards. GRAP 9 provided a list of indicators that preparers used in making this assessment. These indicators were largely derived from private sector scenarios and were often not relevant or appropriate for the types of transactions entered into by public sector entities, particularly those transactions where entities have similar mandates. Entities had to apply a significant degree of judgement, which resulted in subjectivity in the preparation of financial statements and a lack of comparability. Given the shortcomings with using "risks and rewards" to assess whether an entity acts as a principal or an agent, the Board proposed in Discussion Paper 8, as well as the proposed Standard of GRAP on *Accounting by Principals and Agents* (ED 122) issued for comment, that the concept of "beneficial control" may be more relevant in identifying principals and agents in the public sector.

BC9. The Board believed that using beneficial control would be less subjective in practice given the nature of the binding arrangements frequently encountered in the public sector. The Board believed that this would be particularly relevant where entities have similar mandates or responsibilities, as only one entity can have control over a particular activity, whereas in an assessment of risks and rewards, both may be present for both parties in relation to a particular activity.

BC10. Discussion Paper 8 as well as ED 122, identified beneficial control over a particular activity as being the criteria to distinguish when an entity is an agent or a principal. It was proposed that when an entity demonstrated beneficial control over an activity, then it is the principal in that arrangement. Likewise, if an entity did not beneficial control then it was an agent. An entity demonstrated beneficial control if it demonstrated all three of the following: (a) it had the power to direct the activities in the binding arrangement, (b) it had the ability to use all or substantially all of the activity related resources, and (c) it was exposed to the variability in the results of the activity.

BC11. While respondents were supportive of these criteria at the Discussion Paper stage, respondents highlighted potential issues with the application of beneficial control during the comment process on ED 122. In particular, respondents noted that if an entity did not demonstrate these criteria, then it would not have beneficial control over an activity and by default it would be the agent. The agent, by definition, would however not be able to demonstrate that it could direct activities, benefit from the activity related resources and would not be exposed to variability in the results of the activity. As a result, respondents suggested identifying the criteria or circumstances when an entity is an agent rather than when it is a principal.

Level of assessment

BC12. A key proposal in Discussion Paper 8 and ED 122 was the assessment of beneficial control over a set of activities. The approach to identifying a principal and an agent in Discussion Paper 8 explicitly required an entity to identify whether it acted as a principal or an agent in relation to specific activities, and required that these specific activities be identified as the starting point in the analysis. Discussion Paper 8 also proposed a clear definition of an activity. Respondents did not support the emphasis placed on the identification of specific activities as the starting point in the identification of principals and agents. The Board agreed that to do so would be too onerous, and may restrict the recognition of individual transactions. As a result, the Board agreed that "activity" should be used in ED 122 in the context of assessing beneficial control and that the term "activity" would not be formally defined or used in the same way as proposed in Discussion Paper 8.

BC13. Respondents to ED 122 disagreed with the focus on activities as assessing beneficial control at such a high level may result in inappropriate accounting for specific transactions. In particular, entities may conclude that they largely have beneficial control over a high level activity, but still acted as an agent for specific transactions within that arrangement. Respondents that typically collect revenue provided persuasive arguments in this regard. During consultations with constituents it also became clear that assessing activities raised significant questions about whether entities established by another, e.g. public entities, to undertake activities on their behalf would then be seen as agents. The Board agreed that the focus on activities had unintended consequences, and revised this Standard to focus to transactions with third parties and identifying specific criteria at a transaction level.

Criteria to identify whether transactions with third parties undertaken as an agent or a principal

BC14. The Board's decision to focus on transactions rather than activities meant that it could no longer focus on beneficial control, even if from the perspective of the agent, as control cannot be demonstrated over a transaction. The Board agreed that the basic premise of the revised approach should require an entity to assess whether it has been directed by another entity to undertake transactions with third parties, and to assess whether it, or the other entity, benefits from those transactions. Despite the shortcomings with beneficial control noted in paragraph BC11., most respondents did agree that the three criteria were useful considerations to apply. As a result, the Board agreed that the criteria used to assess beneficial control could be reformulated as criteria to assess whether an entity undertakes transactions for its own benefit or not. These criteria could not be separately defined within a specific concept or term, and hence are embedded within the requirements of this Standard itself.

BC15. In reformulating the beneficial control criteria to make them relevant to assessments on a transaction level, the Board considered whether all three criteria are relevant in assessing whether an entity is an agent. In particular, the Board considered the ability of entities to make decisions about the significant terms and conditions of transactions. The Board observed that some entities have the ability to make significant decisions about transactions because they have been granted certain powers in legislation that are necessary to exercise to their mandate. As an example, regulators or agencies that undertake enforcement responsibilities, may be given the rights to determine which parties will be affected by a specific transaction, the amounts they should pay, and how the amounts should be settled. Given the nature of such entities' operations and mandates, assessing whether they have the power to make significant decisions about the terms and conditions of a transaction may not be a relevant factor in determining if they are an agent. The Board therefore agreed that all three criteria should be used to assess if an entity is an agent, except where specific powers are granted to an entity in terms of legislation in relation to the terms and conditions of specific transactions.

BC16. As a result of the respondents' observations, which are outlined in paragraph BC11., the Board agreed that an entity should first assess whether it is an agent using the criteria. If an entity determines that it is not an agent using these criteria, then by default it is a principal.

Defining a principal and agent

BC17. In Discussion Paper 8, the Board had not proposed formal definitions of the terms "principal" and "agent" and instead outlined descriptions of "own activities" and "agency activities". "Own activities" were described as those activities over which an entity has beneficial control, that it carries out itself, or are carried out by another entity on its behalf. "Agency activities" were described as those activities carried out by an entity which are not its own activities. Respondents to Discussion Paper 8 did not support these descriptions as they placed too much emphasis on the identification of "activities". Respondents were also concerned about the lack of clear definitions for principals and agents.

BC18. Based on the comments received, the Board agreed to clearly define "principal" and "agent" as they are central to identifying the relevant parties to a principal-agent arrangement. The definitions of a principal and an agent included in ED 122 were based on the existence of beneficial control. Given the issues raised by respondents on beneficial control, the definitions of a principal and an agent needed to be revised. The Board agreed that the definitions of a "principal" and an "agent" should be based on the fact that one entity directs another to undertake transactions with third parties on its behalf. The definitions also make it clear that if the transactions are for the benefit of the other party, then that party is the principal rather than the agent in the arrangement.

BC19. When the Board analysed legislation that governs certain principal-agent arrangements, it identified that an individual, such as a Minister, rather than an entity, may be tasked with certain responsibilities. As a result, the Board considered whether the definition of a principal and an agent should refer to an "individual" or an "entity". The Board agreed that, because an individual is not a reporting entity, it should be established which entity the individual represents, and consider whether that entity acts as a principal or an agent in that context.

BC20. The beneficiary of many principal-agent transactions is often a bank account or fund. In may not be clear in all instances to which entity this bank account or fund belongs. The Board agreed that because these accounts or funds are party to principal-agent arrangements, it may be important to assess whether the entity that controls these accounts or funds are the principal or the agent in an arrangement. Guidance on this issue has been added to this Standard after publishing ED 122.

Binding arrangement

BC21. In Discussion Paper 8, the Board considered whether a principal-agent relationship could exist in practice outside of a binding arrangement. It concluded that although this is not necessarily impossible, it is highly unlikely given that the basis of principal-agent relationships is the granting of a mandate by the principal to the agent to undertake transactions with third parties on its behalf. In the public sector, entities would not undertake transactions with third parties on behalf of another entity unless there was an arrangement compelling them to do so. Consequently, the Board agreed that the existence of a binding arrangement is critical in identifying the rights and obligations conferred on the parties to the arrangement. It also agreed that, in the absence of a binding arrangement, an entity is considered to be undertaking activities for its own account and not part of a principal-agent arrangement.

BC22. In describing what a binding arrangement means, the Board recognised the broad range of arrangements that exist in the public sector that may give rise to a principal-agent relationship, and in particular, that these may not necessarily be reduced to a contractual arrangement. Consequently, the Board agreed to describe binding arrangements as broadly as possible to ensure that entities also consider arrangements governed by legislation or equivalent means, i.e. government policy, directives, instructions or orders issued by ministers, councils or similar bodies, as well as those created through the operation of law, including common law.

BC23. The Board observed that there is often no evidence of a formally documented binding arrangement arising from the sources described in paragraph BC22. When such instances exist, the Board agreed that an entity should consider whether an entity's past actions indicate whether it is a principal or an agent.

Accounting by a principal and an agent

Revenue and expenses

BC24. The key accounting consideration in accounting by a principal and an agent is whether an entity should account for the transactions undertaken on behalf of another as its own or not. In Discussion Paper 8 and ED 122, the Board agreed that the accounting principle should follow the approach used to identify when an entity acts as a principal or an agent, i.e. the existence of beneficial control. The Board proposed that when an entity demonstrates that it has beneficial control over an activity, it should account for revenues and expenses arising from those activities as its own transactions and present these in the statement of financial performance. This meant that a principal would reflect revenues and expenses in its statement of performance when it had beneficial control over an activity. Similarly, an agent would not recognise transactions as its own in its statement of financial performance where the principal has beneficial control over the related activities, as doing so would distort the agent's own financial position and performance.

BC25. Given the change in focus from demonstrating beneficial control over an activity to assessing which entity benefits from the transactions with third parties, the Board had to revisit this proposed approach. The Board agreed that it should specifically indicate that revenues and transactions arising from transactions undertaken with third parties should be recognised by the principal, and that the agent should only recognise that portion of the revenue or expenses it incurs in relation to undertaking the transactions on behalf of the principal.

Assets and liabilities

BC26. The Board agreed that, while it is possible to express a clear principle for the recognition of revenue and expenses in the statement of financial performance when an entity acts as an agent or a principal, a similar principle could not be provided for the recognition of assets and liabilities arising from principal-agent arrangements. The Board agreed that an assessment should be made by an entity of whether any rights and obligations arising from the arrangement give rise to assets and liabilities in the *Framework for the Preparation and Presentation of Financial Statements*[2], and whether those assets and liabilities meet the recognition criteria in the applicable Standards of GRAP.

BC27. The Board concluded that it should, however, provide guidance on when, or under what circumstances, certain assets and liabilities that may arise from principal-agent arrangements should be recognised. In particular, the Board agreed that guidance should be provided where cash or another monetary asset is held by an agent for a principal, or when assets such as inventories are held by agents to execute the activities specified in the principal-agent arrangement. Given the potential complexity of specific scenarios, the Board also agreed to provide guidance on the recognition of receivables and payables arising from principal-agent arrangements. The Board's conclusions on this are outlined in the paragraphs that follow.

BC28. The Board identified that, in the public sector, many principal-agent arrangements require an agent to collect cash or pay cash on behalf of the principal. Some of the arrangements examined by the Board required more than just the collection or payment of cash, and posed specific rights and obligations on the agent. The Board agreed that in specific circumstances, the rights and obligations outlined in the binding arrangement may give rise to a receivable or a payable for the agent. The Board noted that the principal is likely to have a receivable or a payable in all circumstances, albeit that the counterparty to these transactions may be the agent rather than the specific third parties with whom the transactions were undertaken.

BC29. The Board is of the view that if all an agent is required to do in a binding arrangement is collect (and/or pay) cash for a principal, then recognising a receivable or a payable would be inappropriate. In these circumstances, the Board concluded that it would be appropriate to recognise cash as an asset once it is received, and recognise a corresponding liability to remit the cash to the principal.

BC30. However, if an agent is required to do more than collect (and/or pay) cash, the Board agreed that a thorough examination of the rights and obligations in the binding arrangement should be undertaken. In particular, the Board agreed that where certain rights and obligations exist, recognition of a receivable or a payable may be appropriate because they demonstrate the inflow or outflow of service potential required to fulfil an entity's objectives. The specific rights and obligations may indicate that an entity should recognise a receivable or payable. These are as follows:

- The debt is due to, or due by, the agent, i.e. the agent is the counterparty in the transaction with the 3rd party.
- The agent has the legal right to enforce collection of the debt, or the agent has the legal obligation to settle the debt.
- The agent determines the amount that must be paid by, or to, the 3rd party based on the policies determined by the principal.
- The agent determines the manner and timing of settlement.

- The agent has the power and discretion to write off debts owing by 3rd parties.
- The agent has an obligation to undertake certain activities, which it is required to do in terms of the binding arrangement.

BC31. The Board considered whether more explicit guidance on the timing of the recognition or receivables and payables in paragraph BC30. should be provided. The Board agreed that the principles in the applicable Standards of GRAP should be considered in assessing when a receivable or payable should be recognised, and how it should be measured. The Board did however provide guidance that if a receivable or payable is recognised based on the specific circumstances outlined in this Standard, that a corresponding receivable or payable is recognised (whichever is applicable) at the same time and for the same amount.

BC32. During the consultation process on ED 129, some respondents questioned whether, as in the scenario outlined above, it is appropriate for an agent to recognise non-monetary assets in certain circumstances. The Board is of the view that it would be difficult to conclude that an agent should recognise such assets if the benefit of any revenue received from the use of the asset, or the risks or expenses incurred to operate the asset, do not accrue to the agent.

Presentation

BC33. Consistent with the principles in the existing Standard of GRAP on *Presentation of Financial Statements*, the Board agreed that it is inappropriate for an agent to offset amounts of assets and liabilities held under a principal-agent arrangement. The Board did not support the offsetting of these amounts as they often represent separate transactions. The Board did however note that if the requirements of another Standard of GRAP permitted the offsetting of an asset and liability, then the requirements in that Standard could be applied.

Disclosure

BC34. The Board proposed disclosures in respect of principal-agent arrangements in Discussion Paper 8 on the basis that users of financial statements would be likely to find the disclosure of information useful where it meets the following objectives:

Principals:

(i) It provides information about the nature of the activities of the entity and its role in relation to other entities (usually, but not always a related party).

(ii) It provides information about the financial and non-financial risks associated with the entity being a party to the principal-agent arrangement.

(iii) It provides information about the entity’s capacity to carry out its own activities, including its reliance on other parties.

(iv) It provides information about resources of the entity that are in the custody of another party.

Agents

(i) It provides information about the nature of the activities of the entity and its role in relation to other entities (usually, but not always, a related party).

(ii) It provides information about the financial and non-financial risks associated with the entity being a party to the principal-agent arrangement.

(iii) It provides information about the entity's custodial responsibilities and financial performance as an agent (accountability).

(iv) It provides information about the use and allocation of entity resources in agency activities.

BC35. Respondents to Discussion Paper 8 did not agree with the extent of the disclosures proposed, particularly the reconciliation of the movements between amounts owing between the parties at the beginning and end of the reporting period, and describing disclosure requirements already required by other Standards of GRAP. The Board agreed that the disclosures should be streamlined to respond more specifically to the objectives outlined above, and should not duplicate information already provided in other parts of the financial statements in accordance with other Standards of GRAP.

BC36. During the comment process, a respondent indicated that it would be useful to know whether any termination clauses existed in such arrangements, and what their potential implications might be on the arrangement from the perspective of the principal. The Board agreed that this disclosure meets the overall objectives outlined in paragraph BC34. and agreed to include it in this Standard.

BC37. Respondents to ED 122 supported the proposed disclosures, but indicated that additional information may be required in the notes to an agent's financial statements about the revenues and expenses related to the transactions with third parties. Respondents noted that these disclosures would support assessments of accountability where the agent has clear performance measures in relation to these activities. Whether, and to what extent, these detailed disclosures may depend on the nature and complexity of the arrangements in place, as well as the level of accountability required. The Board agreed with the comments made by respondents and included these disclosures in this Standard.

BC38. The respondents to ED 129 noted that additional information is needed in the financial statements of an agent to assess accountability. In particular, they supported earlier proposals to include a reconciliation of the opening and closing balances of assets and liabilities recognised by the agent in the notes to the financial statements, particularly where they recognise receivables or payables in accordance with paragraph .57. The Board was persuaded by the arguments provided and agreed that such a reconciliation may be useful where receivables and payables are recognised by the agent.