



Tel. 011 697 0660
Fax. 011 697 0666
www.asb.co.za

TO: MEMBERS OF THE TECHNICAL COMMITTEE
FROM: ELIZNA VAN DER WESTHUIZEN
SUBJECT: ED 200 POST-IMPLEMENTATION REVIEW OF GRAP 109 ACCOUNTING BY PRINCIPALS AND AGENTS
DATE: 8 FEBRUARY 2024
FILE REF: ATTACHMENT 3(a)

BACKGROUND TO THE PROJECT

1. The public consultation process on ED 200 *Post-implementation Review of GRAP 109 Accounting by Principals and Agents* closed on 15 September 2023. The comment received on ED 200 is included in attachments 3(c) and 3(d). The themes identified from the comment, and the proposed responses thereto, are summarised in attachment 3(b).
2. The Secretariat discussed the results of the review and proposed responses thereto with two project groups in January 2024. The minutes of the project group meetings are included as attachments 3(e) and 3(f). The recommendations from the project groups have been incorporated in the documents and the project groups recommended the proposals to the Technical Committee for consideration.

PURPOSE OF THIS MEMORANDUM

3. The purpose of this memorandum is:
 - (a) to outline the consultation process followed;
 - (b) to share the comment received and related issues identified; and
 - (c) for the Technical Committee to consider the project groups' proposed responses to the issues identified from ED 200 and, if appropriate, recommend them to the Board for approval.

OVERVIEW OF THE CONSULTATION PROCESS

How did the Secretariat raise awareness about ED 200?

4. A Notice was published in the Government Gazette on 23 December 2022 (Notice 47789) outlining a request to ASB stakeholders to participate in the post-implementation review of GRAP 109.
5. The Secretariat actively raised awareness about ED 200 in the following ways:
 - (a) published articles in the ASB Newsletter and on various ASB social media platforms;

Board Members: Ms P Moalusi (Chair), Mr A van der Burgh (Deputy Chair), Mr C Braxton, Ms W de Jager,
Mr D Dlamini, Mr S Khan, Ms A Muller, Ms N Themba
Chief Executive Officer: Ms J Poggiolini

- (b) published a recording on the ASB YouTube Channel and developed further supporting material for the ASB website; and
- (c) informed stakeholders through various engagements and forums, such as the Public Sector Accounting Forum and GRAP update sessions.

6. The Secretariat is of the view that sufficient awareness of ED 200 was raised.

Were all the key stakeholders consulted?

- 7. The Secretariat held 27 sessions to discuss ED 200 with preparers, auditors, consultants and other interested parties by way of virtual and in-person engagements during the comment period. Stakeholders submitted 19 written responses to ED 200. Attachments 3(c) and 3(d) detail these engagements and written submissions.
- 8. The Secretariat is of the view that all the stakeholders identified in the project brief had sufficient opportunity to participate in the due process.

DEVELOPMENT OF PROPOSALS

- 9. The Secretariat identified and summarised themes based on issues described in the detailed comments received. The Secretariat developed proposed responses to each of the themes. These are included in attachment 3(b) for discussion. The detailed comments in attachments 3(c) and 3(d) have been linked to the themes in attachment 3(b). Where comments were considered unrelated to the identified themes, attachments 3(c) and 3(d) include specific responses.
- 10. In developing responses, the existing guidance on GRAP 109 was reviewed. Existing guidance includes:
 - [FAQs](#) issued by the Secretariat - FAQ 4.11 on *When should GRAP 109 be applied?* and FAQ 7.4 on *What is the interaction between GRAP 32, GRAP 36 and GRAP 37, and GRAP 109?*; and
 - A [presentation](#) issued by the OAG, which applies to entities applying Standards of GRAP and departments applying the Modified Cash Standard (MCS).
- 11. The proposed responses were developed based on the below criteria established by the Secretariat. The criteria will be included in the next update of the Due Process Handbook (policy on post-implementation reviews) and/or Procedure Manual.

CRITERIA FOR PROPOSED RESPONSES TO COMMENT	
Proposal	Criteria
Amendments to GRAP 109	Principles are unclear and need to be clarified to assist with consistent application.
	Principles need to be amended based on relevant and appropriate comment raised by respondents in the consultation.
	Guidance is needed to understand the principles (without the guidance the principles remain unclear).
	Existing non-authoritative guidance in the Standard needs to be amended to align with principles.
FAQ / Fact Sheet	Guidance is needed to apply the principles in practice.
	Changes are needed to an existing FAQ.

OAG guidance	Practical implementation guidance is needed.
	Transaction or event specific guidance is needed.
	Changes are needed to the existing presentation.
Other actions	Any actions to respond to needs that are not addressed above.

KEY MATTERS FOR CONSIDERATION

Application of materiality

12. The application of materiality was identified as a pervasive issue, as can be seen from attachment 3(b). The issue relates to various aspects of principal-agent arrangements, including:

- Whether, and if so, the extent to which, materiality is considered when assessing whether an arrangement meets the definition of a principal-agent arrangement. To illustrate the issue, the project group of auditors and other technical specialists had differing views:
 - View 1 was that materiality is not considered when assessing the nature of an arrangement. Materiality is applied when determining which arrangements should be disclosed in the financial statements.
 - View 2 was that an arrangement could first be assessed quantitatively and qualitatively to determine if material. Only if material, is it necessary to assess the nature of the arrangement and whether it meets the definition of a principal-agent arrangement. If immaterial, an entity may develop an alternative accounting treatment for the arrangement and need not apply GRAP 109.

On balance, members noted view 2 may be problematic when applied to principal-agent arrangements, as the nature of the arrangement and an entity's role in the arrangement determine which items the entity accounts for. It may be difficult to determine whether the arrangement is quantitatively material without first determining the nature and entity's role.

- Uncertainty exists for assessing which party is an agent to the arrangement, due to GRAP 109 including terms such as "significant" and "substantially" in the criteria of the assessment. These terms can be seen as similar concepts to materiality. For example, an entity may not have the power to determine the *significant* terms and conditions of the transaction between the principal and third parties, and the entity does not have the ability to use *all, or substantially all*, of the resources that result from the transaction for its own benefit. However, the entity may be able to determine some terms and conditions, and derive some benefit from the transaction.
- When is the relationship material from a qualitative perspective. This issue not only applies to principal-agent arrangements. Similar questions have been raised about other relationships, such as related parties, interests in other entities and service concession arrangements.
- What specific information should be presented and disclosed about a material principal-agent arrangement. When an arrangement is material, it does not automatically mean that all the information required by GRAP 109 about the arrangement and the related transactions is material and should be provided. Some

members of the project group of auditors and other technical specialists had a different view that when an arrangement is material, all the information required by GRAP 109 about that arrangement should be provided.

- The level at which information should be aggregated or disaggregated. GRAP 109 requires separate information about each material principal-agent arrangement, and information on immaterial principal-agent arrangements should be aggregated.
 - What materiality should be applied to the different statements and notes. It may not be appropriate to apply the same qualitative criteria and quantitative measures to determine the information that is material for each of the statements and the notes. Different criteria and measures may be needed. This issue was also identified in other previous projects of the Board – most recently the review of the cash flow statement.
13. The [Guideline on the Application of Materiality to Financial Statements](#) was issued by the Board in April 2019. The Board agreed to encourage rather than require the application of the Guideline in Directive 5 on *Determining the GRAP Reporting Framework*. At the time, the Board noted that time is needed for behaviour and thinking on materiality to change, and for practice to develop. It was necessary for conversations to start between entities, oversight structures and external auditors. Alongside the Guideline, the Secretariat developed a [Fact Sheet on Materiality](#) and [FAQ 1.3 on What is the role of materiality in the reporting of information in the financial statements?](#)
14. The project groups recommended that a separate project should be undertaken to consider various aspects of materiality, and to understand how the environment may have progressed since the Guideline was issued. The Secretariat does not have capacity to undertake such a project in the current work programme period. Such a project can be included in the ASB work programme consultation for 2027 to 2029. As part of the project, the OAG could assist by considering case studies and examples to illustrate some of the principles. These case studies and examples could consider both the GRAP and MCS perspectives. Further awareness of existing guidance could be raised as a new theme for the *Enhancing the Application of Standards of GRAP* project. The project groups also proposed amendments to the FAQ on GRAP 109 to clarify the application of materiality, based on existing principles (see attachment 3(b) issue 13).

Identifying principal-agent arrangements

15. The most significant issue identified from the review was that entities have difficulty identifying whether an arrangement is principal-agent or another type of arrangement (see attachment 3(b), issue 2 to issue 11). They are unsure how to distinguish a principal-agent arrangement from other arrangements that are seemingly similar, i.e. where multiple parties are involved, or goods or services are provided to third parties. The Secretariat identified that entities sometimes unknowingly concluded incorrectly on the nature of an arrangement. This was identified through issues raised on applying other parts of the Standard, such as the criteria to identify which party is the agent.
16. A specific type of arrangement where entities are unsure about the nature of the arrangement is subcontracting arrangements. These arrangements could be part of a larger binding arrangement, or “spin-offs” of a binding arrangement. They are often misclassified as principal-agent arrangements because there are usually multiple parties involved and a “subcontractor” could be seen as providing goods or services on behalf

of a “contractor”. Examples where subcontracting arrangements are prevalent are housing arrangements, Integrated National Electrification Programme (INEP) and Regional Bulk Infrastructure Grant (RBIG) arrangements and arrangements in the education sector, often involving SETAs.

17. The project groups proposed a combination of actions to assist entities with identifying principal-agent arrangements. As explained in attachment 3(b), issue 2 to issue 11, these proposals include:

(a) Amendments to GRAP 109 to:

- Explain the type of rights and obligations that the principal and agent respectively have in a principal-agent arrangement.
- Use clear sub-headings to highlight the steps entities should follow.
- Add guidance from the FAQ on assessing arrangements with multiple rights and obligations.
- Align examples in the core text with the appendix (e.g. on housing arrangements).
- Explain the principle on the level of assessment - it is not at entity or "overall arrangement" level, but per transaction.
- Explicitly state that substance over form is applied when assessing whether an arrangement meets the definition of a principal-agent arrangement.

(b) Review the Guideline on *Accounting for Arrangements Undertaken in terms of the National Housing Programme* alongside the amendments to GRAP 109 to ensure the principles are applied consistently.

(c) Adding guidance to FAQs to:

- Explain that whether or not consideration or similar is paid to an “agent” is irrelevant in determining whether the arrangement is a principal-agent arrangement.
- Explain that an entity’s role is assessed for each arrangement, irrespective of overarching relationships that may exist, or specific designations being assigned to entities (e.g. municipalities in housing arrangements).
- Provide further guidance on substance over form.
- Illustrate how legislated requirements for grants could be complied with while complying with the requirements of GRAP 109.
- Add a reminder that GRAP 109 should be assessed for employee related deductions and VAT.

(d) Request the OAG to consider:

- Providing guidance on subcontracting arrangements (see paragraph 15).
- Providing specific guidance on transversal issues, such as:
 - employee related deductions and VAT;

- grants to an entity that is an agent, including mSCOA requirements for grants; and
 - the interaction of control criteria in GRAP 35 on *Consolidated Financial Statements* with principal-agent arrangements.
 - As part of considering guidance on grants, reconsider prescribing specific accounting treatments for grants in grant allocation letters.
 - Amending the flowchart in the presentation so that the principles that distinguish principal-agent arrangements from other types of arrangements are explained, instead of listing the Standards that could apply.
 - Providing guidance on the need to apply economic substance over legal form, even when there is a legal interpretation or legal opinion about an arrangement.
 - Assessing whether the Guidelines on INEP and RBIG grants have resolved the issues that were identified by the review.
- (e) Communicate the following concerns to the AGSA:
- Auditors sometimes expect entities that are counterparties to an arrangement to come to the same conclusion about the nature of the arrangement. This may not always be the case. Each entity should assess their rights, obligations, facts and circumstances.
 - Legal form is sometimes applied by auditors instead of assessing the economic substance.

Project group recommendation not added to the above:

18. Some members of the project group of preparers recommended that the definition of a principal-agent arrangement should be amended to require that the agent should be authorised to legally bind the principal in a transaction with third parties. The recommendation primarily arose from a court ruling. The Secretariat has not incorporated this recommendation for the following reasons:
- It would be inappropriate to change the definition to align to a specific court ruling. The review considered legal definitions of principal-agent arrangements, e.g. the VAT Act, and found the principles to be aligned.
 - Refer to the proposal in paragraph 17(a) above to amend GRAP 109 to explain the type of rights and obligations that the principal and agent respectively have in a principal-agent arrangement.
 - GRAP 109 already explains that there must be enforceable rights and obligations for the parties to the arrangement for it to be binding. To meet the definition of a principal-agent arrangement, the nature of the rights and obligations should be such that the "principal" instructs the "agent" to undertake transactions with third parties on behalf of and for the benefit of the principal. An arrangement is not a principal-agent arrangement if there is no specific direction given by the "principal" in relation to transactions with third parties.

Disclosure of principal-agent arrangements in financial statements

19. The review identified that entities do not comply with the disclosure requirements of GRAP 109 (see attachment 3(b) issue 16). Preparers indicated that the disclosures can be difficult to provide and the requirements of GRAP 109 are sometimes unclear. As a result, not all the requirements are complied with and boilerplate information is provided. This results in users not receiving the information they need about principal-agent arrangements from the financial statements.
20. To respond to the issue, the project groups proposed to develop disclosure objectives and guidance on how to meet the objectives, including on the level of disclosure. This approach is aligned with the latest best practice internationally. Disclosure objectives allows entities to efficiently communicate relevant information to users. The project groups recommended that with the development of disclosure objectives, the following should be reconsidered:
 - The need for all the disclosures currently required by GRAP 109.
 - The current guidance in GRAP 109 on providing the information for each material arrangement separately, and for immaterial arrangements in aggregate.
21. Specific clarifications to the requirements were identified, as outlined in attachment 3(b) issue 16. A further proposal is to explain in an FAQ how the requirement in GRAP 1 on *Presentation of Financial Statements* to disclose significant judgements may apply to the assessment of the nature of the arrangement, an entity's role in the arrangement and materiality. The project groups noted that the issue is not only related to GRAP 109. The Secretariat will more broadly raise awareness of the GRAP 1 requirement on disclosure of significant judgements.

Other issues

22. Attachment 3(b) includes further themes of issues identified from the review, with related proposals. The project groups recommended the proposed actions to these issues to the Technical Committee for consideration.

OTHER ACTIONS

23. Participants at verbal roundtable discussions shared written information with the Secretariat to understand how GRAP 109 is applied in practise. This information included:
 - Service level agreements with entities' assessments of and consultations on the nature of the arrangement.
 - Specific legislation that applies to transactions.
 - Assessment tools used to identify whether an arrangement is principal-agent.
 - Entities' position papers on accounting for specific types of arrangements.
24. The Secretariat reviewed the information to understand the issues that may exist with the application of GRAP 109. The review confirmed the issues that were identified from verbal stakeholder engagements. No further issues or actions were identified.

25. There is no GRAP Accounting Guideline for GRAP 109. Considering such a Guideline will be an overall recommendation to the National Treasury. The Guideline could incorporate guidance included in the OAG's presentation.

ACTION REQUESTED

The Technical Committee is requested to:

- (a) REVIEW the themes of issues identified and the Secretariat's proposed responses thereto in attachment 3(b);**
- (b) REVIEW the analysis of verbal and written comment in attachments 3(c) and 3(d); and**
- (c) If deemed appropriate, RECOMMEND the proposed responses to the Board for consideration.**

NEXT STEPS

26. The Board will consider the proposed responses in March 2024. A review report may be developed to communicate the outcome of the review after March 2024. Any amendments to GRAP 109 will be developed following the ASB's due process. Other guidance will be developed or amended as an outcome of the review after March 2024.