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TO: MEMBERS OF THE BOARD
FROM: ELIZNA VAN DER WESTHUIZEN
SUBJECT: ED 200 POST-IMPLEMENTATION REVIEW OF GRAP 109 ACCOUNTING BY PRINCIPALS AND AGENTS
DATE: 2 APRIL 2024
FILE REF: ATTACHMENT 5(a)

BACKGROUND TO THE PROJECT

1. The public consultation process on ED 200 *Post-implementation Review of GRAP 109 Accounting by Principals and Agents* concluded in 2023.
2. The results of the review and proposed responses thereto were discussed with two project groups and the Technical Committee. The Technical Committee recommended the proposed responses to comment, as set out in this memorandum, to the Board for consideration and approval.

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 Board to consider the Technical Committee's proposed responses to the issues identified and, if appropriate, approve them.

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;
 - (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.

Board Members: Ms A Carstens, Mr A Hardien, Ms W de Jager, Mr D Dlamini, Mr S Gwabe,
Mr S Khan, Ms A Muller, Ms L Senne, Prof R Small, Mr A van der Burgh,
Chief Executive Officer: Mrs J Poggiolini

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 during the consultation period, by way of virtual and in-person engagements. Stakeholders submitted 19 written responses to ED 200.

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.

APPROACH TO DEVELOP PROPOSED RESPONSES TO COMMENT

9. The approach identified and summarised themes of issues from the detailed issues described in the comment letters and raised verbally during engagements. Proposed responses were developed for each of the themes. These are included in attachment 5(b), which is included for information purposes. The detailed comments received are summarised in the analyses of comments and linked to the themes in attachment 5(b). Where comments were considered unrelated to the identified themes, the analyses of comments include specific responses. The Technical Committee reviewed the analyses of comments. They will be published on the website once the Board agrees the next steps.

10. The proposed responses were determined based on criteria developed 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.

11. The approach considered existing guidance on GRAP 109, which 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).

KEY MATTERS FOR CONSIDERATION

Application of materiality

12. The review identified the application of materiality as a pervasive issue. 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 presented and 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 whether the arrangement 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 transactions from the arrangement the entity accounts for. It may be difficult to determine whether the arrangement is quantitatively material without first determining the nature of the arrangement and the entity's role.

- Whether, and if so, the extent to which, materiality is considered when assessing which party is an agent to the arrangement. There is uncertainty 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 qualitatively material. 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. Some stakeholders are of the view that an arrangement being material does not mean that all the information required by GRAP 109 about the arrangement and the related transactions are material and should be provided. Others' view is that when an arrangement is material, all the information required by GRAP 109 should be provided.
 - The extent to 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. This is difficult in practice.
 - Whether the same materiality should be applied to different statements and the 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 Technical Committee recommended the following actions to address the issued:
- Add a separate project to the work programme to consider various aspects of materiality, and to understand how the environment may have progressed since the Guideline was issued. Such a project can be proposed in the ASB work programme consultation for 2027 to 2029.
 - Approach the OAG to develop case studies and examples to illustrate the application of materiality principles. These case studies and examples could consider both the GRAP and MCS perspectives.
 - Raise further awareness of existing guidance as a new theme for the Enhancing the Application of Standards of GRAP project. Specifically consider different thresholds referred to across the Standards.
 - Develop FAQs to clarify the application of materiality based on existing principles.
 - Discuss different approaches to materiality by preparers and auditors at the trilateral meeting.

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. They are unsure how to distinguish a principal-agent arrangement from other arrangements that are seemingly similar, e.g. where multiple parties are involved, or goods or services are provided to third parties. Stakeholders are also unsure when and how to apply substance over form, as there have been court cases about principal-agent arrangements. The review identified that stakeholders sometimes unknowingly conclude 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 and applying GRAP 109 with other Standards of GRAP.
16. A specific type of arrangement where stakeholders 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 Technical Committee recommended a combination of actions to address the issue. These include:
- (a) Amend GRAP 109 to:
- Explain the type of rights and obligations that the principal and agent respectively have in a principal-agent arrangement. An example could illustrate the principle that an agent receives specific direction from the principal and represents the interests of the principal in transactions with third parties.
 - 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 assessment is per binding arrangement, not at entity level.
 - 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 consistently explained.
- (c) Add 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.
 - Remind that GRAP 109 should be assessed for transactions such as employee related deductions and VAT.
- (d) Request the OAG to consider:
- Providing guidance on subcontracting arrangements.
 - 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.
 - Removing specific accounting treatments for grants prescribed 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. Each entity should assess their own rights, obligations, facts and circumstances.
- Legal form is sometimes applied by auditors instead of assessing the economic substance.

Disclosure of principal-agent arrangements in financial statements

18. The review identified that entities do not comply with the disclosure requirements of GRAP 109. 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.
19. The Technical Committee proposed that GRAP 109 should be amended to include 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 allow entities to efficiently communicate relevant information to users. With the development of disclosure objectives, the following should be reconsidered:
- The need for all the disclosures currently required by GRAP 109.
 - Clarifying the current guidance on providing the information for each material arrangement separately, and for immaterial arrangements in aggregate.
 - Clarifying specific requirements that are unclear.
20. The Technical Committee further proposed that the Secretariat raises awareness of the requirement in GRAP 1 on *Presentation of Financial Statements* to disclose significant judgements. In relation to GRAP 109, management may apply judgement to assess the nature of the arrangement, an entity's role in the arrangement and materiality. The issue does however not only relate to GRAP 109.

Other issues

21. The table below summarises other themes of issues identified from the review not discussed above. The Technical Committee recommended the following proposed actions to these issues.

<i>Theme of issue</i>	<i>Proposed actions</i>
Difficulty in identifying the binding arrangement and understanding the rights and obligations from the binding arrangement	<ul style="list-style-type: none"> • Amend GRAP 109 to include guidance in the definition section, and consider IPSAS 47 <i>Revenue</i> and IPSAS 48 <i>Transfer Expenses</i>. Add guidance on multiple rights and obligations from the FAQ. • Explain the difference between contracts and binding arrangements in an FAQ. • Request the OAG to consider a checklist on the process to enter a binding arrangement and characteristics of binding arrangements.

<i>Theme of issue</i>	<i>Proposed actions</i>
Misapplication of the criteria to assess which party is the agent	<ul style="list-style-type: none"> • Clarify in GRAP 109 that an entity's role in an arrangement is assessed for each principal-agent arrangement. • Simplify the explanation of the criteria in GRAP 109. • Emphasize in an FAQ that judgement is applied to assess the criteria and the criteria are applied to the transaction between the principal and third parties, only considers the rights and obligations from the arrangement. • Clarify in an FAQ how criterion (c) – the entity is not exposed to variability in the results of the transaction – is assessed, considering guidance in GRAP 35 <i>Consolidated Financial Statements</i>. • Request the OAG to consider illustrating the application of the criteria with a diagram.
Unsure how to apply GRAP 109 with other Standards of GRAP	<ul style="list-style-type: none"> • Consider amending GRAP 109 to remove the example that service concession arrangements could also be principal-agent arrangements. • Link the FAQ on GRAP 109 to the FAQs on presenting expenses by nature or function and providing information when two or more Standards have similar disclosure requirements. • Amend the FAQ on the interaction of GRAP 109 with other Standards to add the accounting implications.
Unsure when to recognise assets and liabilities as an agent	Clarify in the FAQ on 109 there is no impact on the statement of financial performance of the agent when an agent recognises and derecognises assets and liabilities. Request the OAG to consider illustrating this in the agent's financial statements.
Divergence in how cash flow information is provided	<ul style="list-style-type: none"> • Add a link in GRAP 109 to GRAP 2 on Cash Flow Statements which encourages information on the nature and amount of restricted cash balances. • Amend GRAP 2 to link the option to present information on the net basis to principal-agent arrangements, for the agent. The principal should disclose the gross inflows and outflows. • Develop guidance in an FAQ to explain when it may be appropriate to provide the cash flow information on the net or the gross basis, how it could be provided, and as which activity to classify the cash flows.
Other matters	<ul style="list-style-type: none"> • Consider amending GRAP 109 to replace vague terminology with specific terminology, where possible. • Request the OAG to consider developing an Accounting Guideline on GRAP 109.

ACTION REQUESTED

The Board is requested to:

(a) CONSIDER the themes of issues identified and the Technical Committee's proposed responses thereto; and

(b) If deemed appropriate, APPROVE the proposed responses.

NEXT STEPS

22. A review report or other communication material may be developed to communicate the findings and outcomes of the review to stakeholders. Amendments to GRAP 109 and any other authoritative pronouncements of the Board will be developed following the ASB's due process. Other guidance will be developed or amended as an outcome of the review after the April 2024 Board meeting.