International Financial Reporting for Non Profit Organizations

# Technical Advisory Group

AGENDA ITEM: TAGCP05-03
February 10, 2020 – Virtual Meeting

## Agency Relationships

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| **Summary** | The accounting treatment for agency relationships has been identified as a specific issue for the not-for-profit sector. This paper brings together material gathered from national and international standard setters. |
| **Purpose/Objective of the paper** | To allow TAG members to consider the nature of the issue, potential ways forward and text for inclusion in the Consultation Paper. |
| **Other supporting items** | None |
| **Prepared by** | Sarah Sheen |

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| **Actions for this meeting** | Advise on:<br>• The description of the issue<br>• The list of alternatives to address the issue<br>• Links to other international standard developments, national standards or other guidance<br>• The need for any further input |

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## Agency Relationships

# Part 1 – Advice Sought

1. **Consultation Paper Draft**

1.1 At the TAG meeting on November 4, the TAG agreed that accounting for agency relationships should be included in the short list of issues to be included in the Consultation Paper.

1.2 Part 2 of this paper has been drafted for discussion, with the aim that the text is capable of being inserted directly into the Consultation Paper, subject to comments.

**Question 1: What comments does the TAG have on Sections 1 and 2?**

**Question 2: Do the summaries of national-level and international guidance in Sections 3 and 4, together with Annex A, accurately reflect the current standards/ guidance? Is the TAG aware of any other guidance on agency relationships issued by national standard setters or other regulatory bodies that should be included in the Consultation Paper?**

1.3 The fourth alternative includes an approach based on a 'risks and rewards' assessment of agency relationships principally based on IPSAS 9 *Revenue from Exchange transactions* as this is a part current international GAAP. The accounting treatment in IFRS for SMEs for agency relationships although not explicitly referring to 'risks and rewards' is included in Section 23 *Revenue* where decisions on the supply of goods are taken on the basis of a risk and rewards approach. Both standards, through separate exercises, are subject to update and therefore this alternative will not exist in GAAP.

**Question 3: What is the TAG's view on the inclusion of alternative four?**

**Question 4: Does the TAG agree with the descriptions of the alternatives, their respective advantages and disadvantages, and that they should be included in the Consultation Paper?**

**Question 5: What comments does the TAG have on the standard SMEs in relation to this topic and are there other specific SMEs that could be raised?**

## 2. Next steps

2.1 The text drafted below will be included in the Consultation Paper subject to any further comments from the TAG. The PAG will be consulted on any specific issues raised by the TAG further to this discussion.

**Question 6: Is there specific input to be sought from the PAG?**

January 2020

# Part 2 - Draft Consultation Paper Text

## Agency Relationships

### 1. Description of the issue

1.1 Understanding where an NPO is an agent for another entity and where it is the principal, responsible for its own decisions, can be challenging in the sometimes complex arrangements that surround NPOs. Distinguishing between the two is however important to understanding the accountability of an NPO and to provide transparency over its operating income and expenditure. Where an NPO is acting as an agent or holding the assets of other entities clear disclosure of the relationship is likely to be important.

1.2 NPOs may use or hold the assets of other entities or donors or pass them on to other entities. The NPO may or may not hold the legal title and may only be acting as trustees or custodian. For example, an entity may allow an NPO to use a piece of equipment for the duration of a project and they are the custodian over the asset over that period.

1.3 Agency relationships can exist involving an NPO particularly where it might act as a custodian or a trustee of funds for other entities, or it might be responsible for distributing donor funds or grants from other entities. For example, an NPO may agree to distribute or pass on funds to other NPOs or agencies possibly because it has particular expertise of knowledge in a local area where the principal agency does not.

1.4 Alternatively an NPO can be in receipt of a grant but may act as an accountable body for that grant even where it distributes that grant to other NPOs or organisations. In such situations it may take forward some of the grant related expenditure, or potentially may only be responsible for the administration and or distribution of the monies.

1.5 Other agency/principal relationships may exist in forms of partnerships or consortia. Issues may arise in joint consortia, where an NPO may act as principal in one part of the consortium’s activities, but agent in other areas where it would only recognise expenditure for the administration of the activity.

1.6 Where there are no formal agreements setting out the arrangements between the parties, there may be difficulty in the identification of who is acting as principal, particularly where multiple tiers of entities or consortia exist.

1.7 Identification of whether there is an agency relationship may also be difficult where NPOs use sub-contractors to provide services, or distribute funds, but might still be an agent if they only have the responsibility for distribution.

## 2. Financial reporting challenges

2.1 NPOs need to understand whether they have the rights to control the economic benefits or service potential inherent in an asset, which they are holding as custodian or trustee. In financial reporting terms if an NPO is acting as agent then the funds that it is holding are not recognised as the funds of that NPO (and could be held in some form of holding account).

2.2 Donors and grant providers are likely to be interested in the security and fiduciary responsibilities that an NPO might have for those funds and therefore important issues arise as to how these funds should be reported in the agent's financial statements. This raises the question as to whether disclosure is required of the gross amounts relating to agency activity or assets in custody, (including cost pass through and assets held on behalf of another entity/person).

2.3 There is a need for clarity and transparency where an NPO determines it is acting as principal or agent and disclosures could provide relevant information. Further, for consortia there may be a need for users (e.g. donors and other funders) to fully understand the financial performance and the risks faced by the NPOs for the funds donated. Therefore financial reporting will need to cover the full scope of a programme that includes funds provided that are not within the control of the entity (its agency relationships) and those which are (where it is acting as principal).

## 3. Current international guidance

3.1 Currently international guidance focusing on agency arrangements is included in the following standards:

- IFRS 10 *Consolidated Financial Statements*
- IFRS 15 *Revenue from Contracts with Customers*
- Section 23 *IFRS for SMEs*[1]

[1] The International Accounting Standards Board has initiated a programme to review IFRS for SMEs and in particular to consider updates for standards issued since the last update. This will include IFRS 15 *Revenue from Contracts with Customers.*

- IPSAS 9 *Revenue from Exchange Transactions*[2]
- IPSAS 23 *Revenue from Non-exchange Transactions* (Taxes and Transfers), and
- IPSAS 35 *Consolidated Financial Statements*.

3.2 Generally the guidance provided by the standards is based on the core principle that an entity is principal if it controls the transaction(s). IFRS 15 focuses on control where revenue is provided in exchange for a good or service. IPSAS 9[3] is similar but sets out that an entity is acting as an agent when it does not have exposure to the significant risks and rewards associated with the sale of goods or the provision of services.

3.3 The guidance in both standards provides indicators to assist entities with the determination of whether an entity would be acting as principal, focusing on an entity's ability to control (or whether it is subject to risks and rewards of the good or service provided). These indicators include consideration of which entity has primary responsibility for the provision of the good or service to the customer, inventory risk, credit risk exposure and the ability to set prices for the good or service provided.

3.4 IFRS for SMEs establishes that the amounts collected on behalf of the principal are not revenue of the entity. It also specifies that in an agency relationship, the agent must recognise in revenue only the amount of its commission. The accounting treatment in IFRS for SMEs for agency relationships although not explicitly referring to 'risks and rewards' is included in Section 23 *Revenue* where decisions on the supply of goods are taken on the basis of a 'risk and rewards' approach.

3.5 Both IFRS for SMEs and IPSAS 9 are in the process of being updated. The principles in IFRS 15 are specifically included within both these work programmes.

3.6 IFRS 15 does not provide guidance on non-exchange transactions. However, both IPSAS 9 and IPSAS 23 establish that amounts collected as an agent of the government (or another government organisation/other third party) will not give rise to an increase in net assets or revenue of the agent. This is because the agent cannot control the use of, or otherwise benefit from, the collected assets in the pursuit of its objectives. It establishes the same principle for fines. These principles are capable of being applied to other non-exchange transactions such as the distribution of grants.

[2] The International Public Sector Accounting Standards Board will shortly consult on a new standard to replace IPSAS 9 *Revenue from Exchange Transactions* to reflect IFRS 15, as well as a linked update of IPSAS 23.

[3] Although there is a difference in the principles established for the determination of whether an entity is acting as agent or principal (i.e. the control or risk and reward framework) it is arguable that any outcomes are likely to be similar as risks and rewards are a subset of control though different decisions are possible.

3.7 IFRS 10 and IPSAS 35 require entities to decide whether an investor is acting as principal or agent and/or whether it controls the entity it has an interest in. Both standards provide guidance, which establish that an investor engaged primarily to act on behalf of other parties does not control the investee and is an agent.

3.8 International standards both within their conceptual frameworks and in specific standards, (for example, property, plant and equipment and the leasing standards) follow the principle that holding legal title to an asset is not sufficient to require its recognition in an entity's balance sheet. Again what must be established is that an entity controls or has the right to control the economic benefits and service potential inherent in the asset.

## 4. National-level guidance

4.1 Where national standard setters follow either IFRS or IPSAS standards the principles established in section three largely apply. Also, one national GAAP was issued on a largely converged basis to IFRS for revenue recognition.

4.2 One national standard setter, following the general approach under international standards for accounting for transactions as principal or agent, provides specific guidance for charities i.e. accounting for custodian funds as agents or trustee (custodian trustee). It establishes the principles for when a charity would treat such transactions as agent or principal. For example, as agent, the trustees of a charity are not able to take decisions about the use to which the funds received are put. It also provides for situations where a charity holds the title of a property on behalf of another charity.

4.3 This national GAAP stipulates that for transactions where a charity is acting as agent (e.g. receipt) of funds they are not recognised in a charity's accounts, because they are not the income of the charity. Fees receivable are recognised. It also provides the accounting requirements for consortia indicating that the:

'*lead charity is not acting as agent if it is the principal under the contract and is then subcontracting work to third parties'.*

There are also requirements to disclose an analysis of funds and assets held as agent and as custodian trustees.

4.4 The guidance provided in another national GAAP is similar but includes detailed provisions on the treatment of transactions including the treatment of financial intermediaries. Whether a recipient NPO that is an intermediary is either principal or agent is dependent on whether the NPO has discretion in the distribution of the money to the beneficiaries. If discretion exists, or if the NPO is a financially related entity, the NPO is the principal in the transaction. If it has no discretion, it recognises an asset and a liability (for amounts which have not yet been distributed).

4.5 Under this national GAAP if the asset is cash or another financial asset the NPO is able to choose an accounting policy to not recognise this transaction. This accounting policy choice would need to be disclosed and must be consistent between reporting periods. Under this national GAAP there is no requirement to present the gross amount received.

## 5. Alternative financial reporting treatments

5.1 Largely both international GAAP and national GAAP require transactions to be recognised in the financial statements based on whether the entity controls the transaction.

5.2 One national GAAP includes examples, guidance and disclosure requirements to assist the NPO in determining whether it is acting as agent or principal.

5.3 Alternative 4 accommodates a risks and rewards approach, which is the basis of IPSAS 9 and IFRS for SMEs. IPSAS 9 is in the process of being updated and current proposals are for a controls basis consistent with IFRS 15. Similarly IFRS for SME’s is being updated to consider newly issued IFRS, which includes IFRS 15. This alternative may therefore soon be inconsistent with international GAAP.

5.4 The alternatives in the table below consider alternatives based on national and international GAAP.

| | Description | Advantages | Disadvantages |
|---|---|---|---|
| **Alternative 1 – follow international GAAP where decisions on principal and agent are based on control.** | • NPOs would determine whether they were acting as principal or agent based on whether they control the resources involved in a relevant transaction.<br>• No transactions (other than cash flows) would be recognised in the financial statements where the NPO determines that it is acting as an agent in a relationship or for a set of transactions. | • Consistent with IFRS and based on a framework that aligns with the decisions taken on consolidation and asset recognition.<br>• For those NPOs currently using IFRS this would be the most cost effective option. | • Lack of transparency as there is no explicit record of the agent transaction in the financial statements[4].<br>• No guidance to assist NPOs in their potentially complex arrangements.<br>• Inconsistent treatment of transactions as a result of differing interpretations. |
| **Alternative 2– follow international GAAP based on control with additional guidance and not for profit examples.** | • NPOs would determine whether they were acting as principal or agent based on whether they control the resources involved in a relevant transaction.<br>• No transactions (other than cash flows) would be recognised in the financial statements where the NPO determines that it is acting as an agent in a relationship or for a set of transactions.<br>• Additional guidance on how control is determined for agency and principal relationships with specific examples to illustrate NPO arrangements. | • Consistent with IFRS and based on a framework that aligns with the decisions taken on consolidation and asset recognition.<br>• Practical guidance for NPO accounts preparers against which they could make the relevant judgements.<br>• Increased consistency.<br>• For those NPOs currently using IFRS this would be the most cost effective option. | • Lack of transparency as there is no explicit record of the agent transaction in the financial statements.<br>• It might be difficult to provide examples that work and illustrate the relationships for all forms of NPOs. |

[4] though an entity could choose to disclose the relevant transactions

| | Description | Advantages | Disadvantages |
|---|---|---|---|
| **Alternative 3 - follow international GAAP based on control with additional guidance and not for profit examples and including specific disclosure requirements.** | • NPOs would determine whether they were acting as principal or agent based on a whether they control the resources involved in a relevant transaction.<br>• Additional guidance on how control is determined for agency and principal relationships with specific examples to illustrate NPO arrangements.<br>• Require disclosure of material agency relationships, including year end balances, movements and major variances. | • Consistent with IFRS and based on a framework that aligns with the decisions taken on consolidation and asset recognition.<br>• Practical guidance for NPO accounts preparers against which they could make the relevant judgements.<br>• Increased consistency.<br>• For those NPOs currently using IFRS this would be the most cost effective option.<br>• Transparency of material transactions and balances for assets held as agents. | • New disclosure requirements would increase the reporting burden (and potentially audit fees), particularly for smaller NPOs.<br>• It might be difficult to provide examples that work and illustrate the relationships for all forms of NPOs. |
| **Alternative 4 – follow international GAAP where decisions on agent and principle are made on an exposure to risks and rewards.** | • NPOs would determine whether they were acting as principal or agent based on whether the NPO was exposed to significant risks or rewards in a transaction or relationship.<br>• No disclosure of transactions (other than cash flows) where the NPO determines that it is acting as an agent in a relationship or for a set of transactions. | • This would be consistent with the current versions of IPSAS and IFRS for SMEs and therefore easier for NPOs already accounting in this way.<br>• For those NPOs operating under this framework this would be the most cost effective option. | • Inconsistent with NPOs determining whether they are acting as agent or principal under a control framework[5].<br>• Lack of transparency as there is no explicit record of the agent transaction in the financial statements.<br>• No guidance to assist NPOs in their potentially complex arrangements with inconsistent treatment of transactions as a result of differing interpretations. |

[5] Some transactions may not be fairly presented under a risks and rewards framework

**Specific Matters for Comment**

**Do you agree that the list of alternative treatments that should be considered is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.**

**Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment? If you do not agree, please set out the changes you propose, and why these should be made.**

**Please identify the alternative treatment that you favour, and the reasons for your view.**

**[Draft generic questions for further discussion]**

**Annex A – Agency Relationships - Analysis to support alternatives**

| | IFRS and IPSAS | UK | Australia | New Zealand | USA |
|---|---|---|---|---|---|
| **Alternative 1 – follow international GAAP where decisions on principal and agent are based on control.** | IFRS 15 - an entity is principal if it controls the good or service before that service is passed to the customer.<br><br>IFRS 10 and IPSAS 35 specify that an agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore does not control the investee when it exercises its decision-making authority. | | An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer.<br><br>An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore does not control the investee when it exercises its decision-making authority. | | |
| **Alternative 2– follow international GAAP based on control with additional guidance** | | | | | |

| | IFRS and IPSAS | UK | Australia | New Zealand | USA |
|---|---|---|---|---|---|
| **and not for profit examples.** | | | | | |
| **Alternative 3 - follow international GAAP based on control with additional guidance and not for profit examples and including specific disclosure requirements.** | | The Charity SORP stipulates that funds received by a charity as agent are not recognised as an asset in its accounts because the funds are not within its control. Therefore, the receipt of funds as agent is not recognised as income nor is its distribution recognised as the agent's expenditure.<br>It requires disclosure of funds and balances held as agents and as 'custodian trustees'. | | | |
| **Alternative 4 – follow international GAAP where decisions on agent and principle are made on an exposure to risks and rewards.** | IFRS for SMEs stipulates that the amounts collected on behalf of the principal are not revenue of the entity.<br><br>IPSAS 9 requires entities to determine | UK GAAP under FRS 102 specifies that an entity is acting as a principal when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of | | PBE IPSAS 9 Amounts collected as an agent of the government or another government organisation or on behalf of other third parties are not economic benefits or | An agency transaction is a type of exchange transaction in which the reporting entity acts as an agent, trustee, or intermediary for another party that |

| | IFRS and IPSAS | UK | Australia | New Zealand | USA |
|---|---|---|---|---|---|
| | when they do not have exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. It stipulates that amounts collected as an agent of the government or other organization will not give rise to an increase in net assets or revenue of the agent. | services. An entity is acting as an agent when it does not have exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. The amounts collected by an agent on behalf of a principal are not revenue. Instead, revenue is the amount of commission. | | service potential that flow to the entity, and do not result in increases in assets or decreases in liabilities. | may be a donor or donee.<br><br>Whether a recipient NPO that is an intermediary is either principal (or agent) is dependent on whether the NPO has the discretion in the distribution of the money to the beneficiaries Substantial guidance is provided to determine if the intermediary has discretion. If such a discretion exists or if the NPO is a financially related entity the NPO is principal in the transactions. If not it recognises an asset and a liability (for amounts which have not yet been distributed. |

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| | IFRS and IPSAS | UK | Australia | New Zealand | USA |
|---|---|---|---|---|---|
| **Standards References** | IFRS 15 *Revenue from Contracts with Customers*, IFRS 10 *Consolidated Financial Statements*, IASB *Conceptual Framework for Financial Reporting* (March 2018). IPSAS 9 *Revenue from Exchange Transactions*, IAS 35 Consolidated Financial Statements, and IPSASB *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (IPSASB October 2014), IFRS for SMEs section 23. | FRS 102 Section 23, *Revenue,* Appendix 1 *Definitions*, Charities SORP (FRS 102) (Second Edition) Module 19 *Accounting for funds received as agent or as custodian trustee* | AASB 15 *Revenue from Contracts with Customers* | PBE IPSAS 9 *Revenue from Exchange Transactions* | ASC 958-605-20, 958-605-25-23 to 958-605-25-27 and 958-605-55-75 to 958-605-55-79 |

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