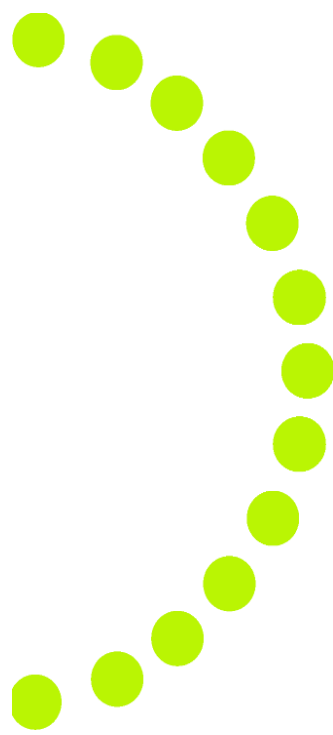
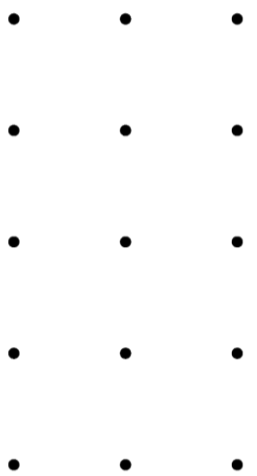




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IFRS 15 Refresher: Principal versus Agent Accounting

19 SEPTEMBER 2021

PRESENTED BY

Tshepiso Segale CA(SA)

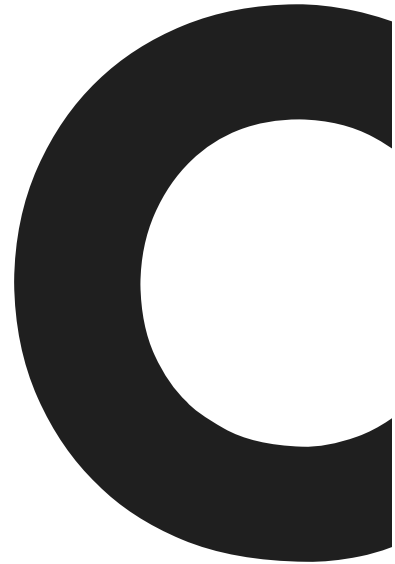
ABOUT THE PRESENTER

Tshepiso Segale CA(SA)

- Tshepiso is a qualified Chartered Accountant having completed her articles at Price Waterhouse Coopers Inc. Johannesburg, qualifying in 2018.
- She is a seasoned professional having expertise in financial reporting, financial modelling and financial management.
- Throughout her career, she has worked a Reporting Specialist and Finance Manager in JSE-listed entities.
- Her industry experience spans across academia, financial services and logistics management.
- Tshepiso is an aspiring webinar presenter 😊
- Connect with me on LinkedIn

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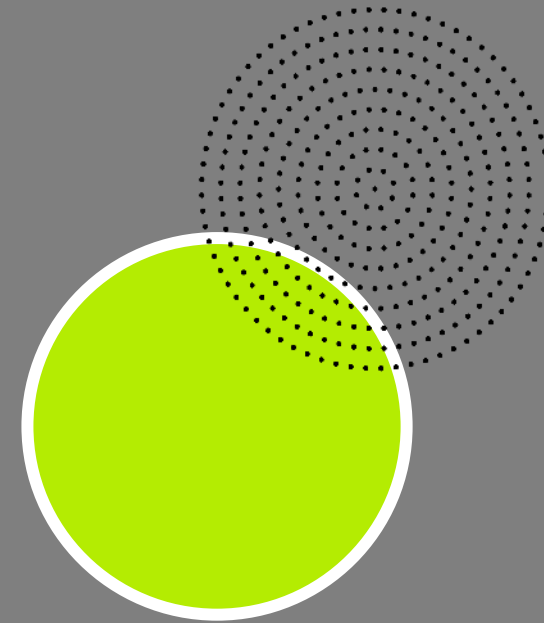
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Learning outcomes from this webinar:

By attending this webinar, you will gain the following competencies:

- Understand key terminology in IFRS 15
- Be able to identify an agency relationship in a transaction
- Identify and critically analyze key information whilst applying indicators to determine if an entity is a principal or an agent in a transaction
- Understand the impact on the accounting and reporting requirements for a principal vs an agent
- Understand the impact on ratio analysis for a principal vs an agent
- Gain some high-level industry knowledge



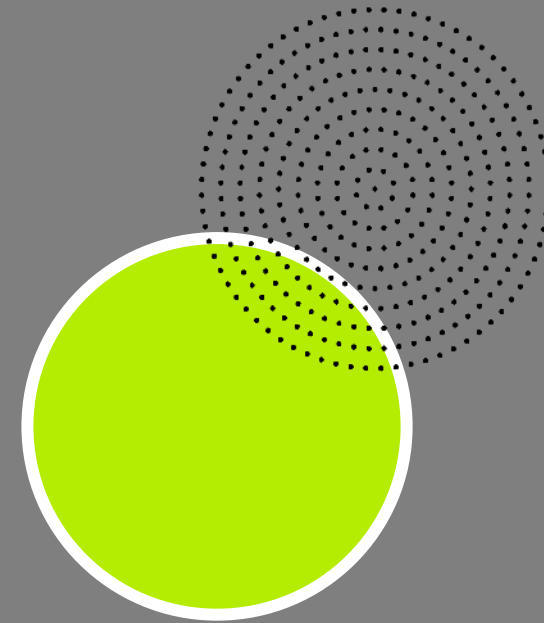
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Introduction

Why is this relevant to you?

- Sub-contracting arrangements exist across many different industries and lines of business
- IFRS 15 mandates that when a party is involved in providing goods or services to a customer, it shall determine whether the nature of its promise is a performance obligation to provide the specified good or service itself OR to arrange for those goods or services to be provided the other party.
- The accounting and reporting implications differ whether you are an agent vs a principal.

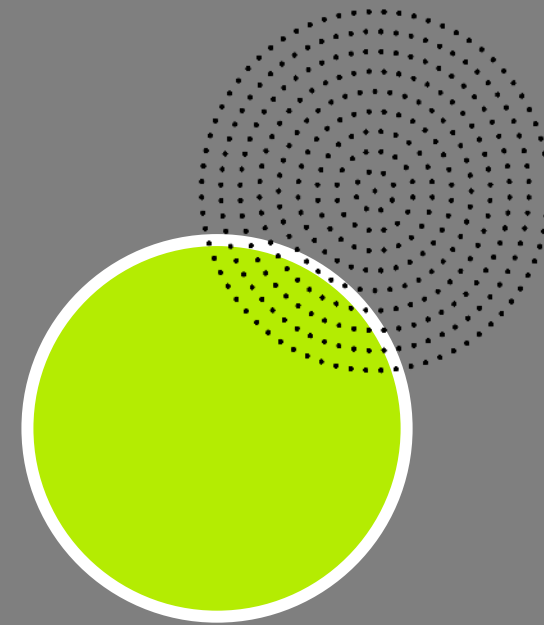


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Key definitions and terminology:

- **Agent** the party that arranges for the goods or services to be provided by another party without taking control over those goods or services.
- **Performance obligation** a promise in a contract with a customer to transfer to the customer either a good or service (or a bundle of goods or services) that is distinct; or a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.
- **Principal** the party that controls the goods or services before they are transferred to the customer.
- **Revenue** income arising in the course of an entity's ordinary activities.
- **Sub-contract** a contract between a party to an original contract and a third party *especially* one to provide all or a specified part of the work or materials required in the original contract



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What does the Standards say?

- IFRS 15, *Revenue from Contracts with Customers* came into effect on 1 January 2018, replacing IAS 18 *Revenue*.
- IAS 18.8 provided the following definition around Revenue: “Revenue includes only the gross inflows of economic benefits received and receivable by the entity on its **own account**. Amounts collected on behalf of third parties are not economic benefits which flow to the entity and do not result in increases in equity. Therefore, they are excluded from revenue. Similarly, in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the entity. The amounts collected on behalf of the principal are **not** revenue. Instead, revenue is the amount of commission”.

What does the Standards say?

- IFRS 15.B35B provides “When (or as) an entity that is a **principal** satisfies a performance obligation, the entity recognises revenue in the **gross** amount of consideration to which it expects to be entitled in exchange for the specified good or service transferred.
- IFRS 15.B36 further goes on to say: “When (or as) an entity that is an **agent** satisfies a performance obligation, the entity recognises revenue in the amount of any fee or **commission** to which it expects to be entitled in exchange for **arranging** for the specified goods or services to be provided by the other party.”

What does the Standard say?

- Both standards reach the same conclusion regarding what constitutes revenue if you are an agent or a principal:
- A principal will recognize revenue and expenses in **gross** amounts, where an agent merely recognizes **fees** or **commissions** irrespective of whether gross cashflows pass through the agent.
- Where IAS 18 fell short was it provided very little guidance on ***how an agency relationship could be identified.***



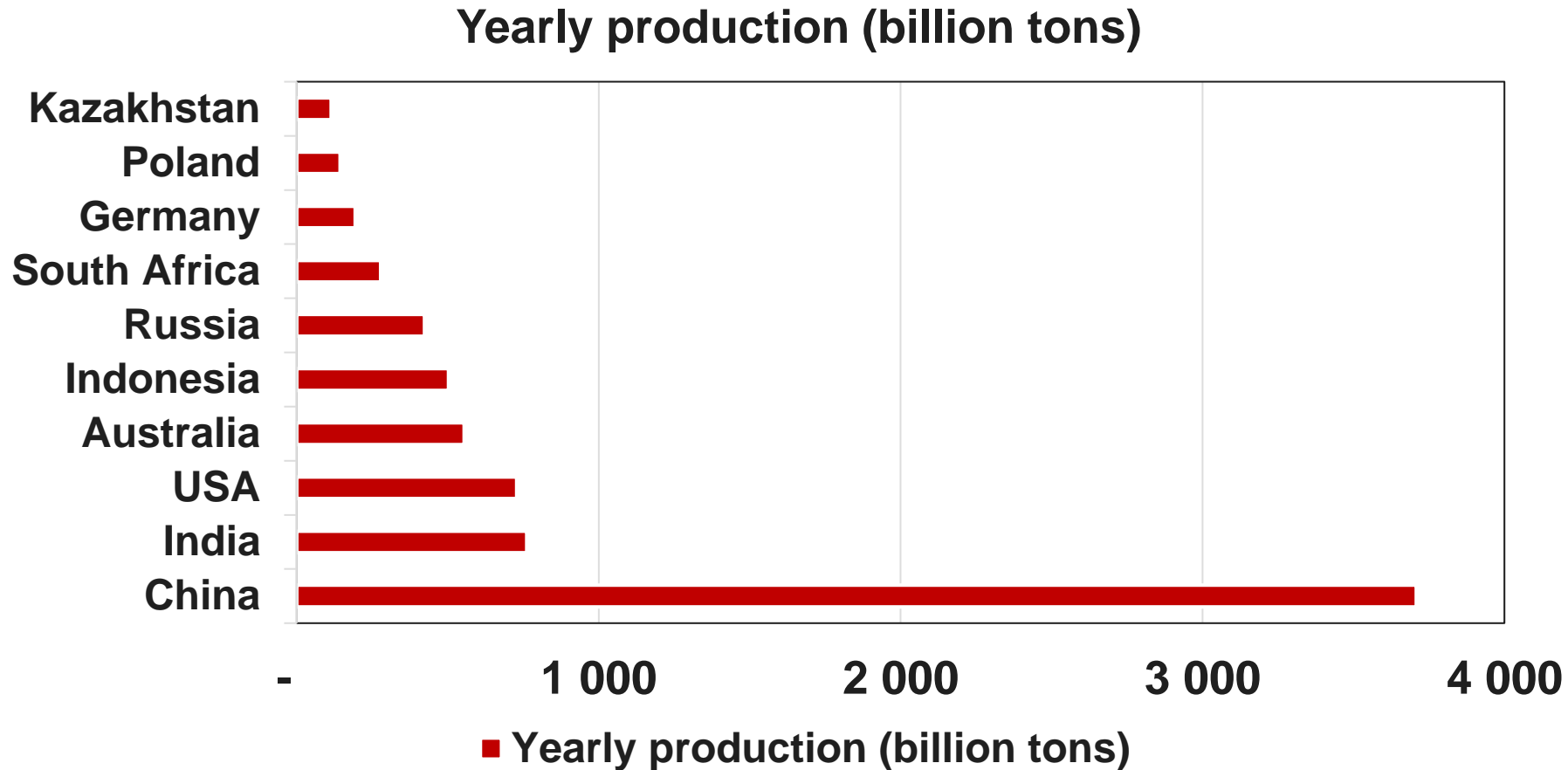
Coal Mining and Exportation in South Africa



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Coal Mining and Exportation in South Africa

- South Africa is the world's 7th largest producer of thermal coal producing around 278bn tons per year



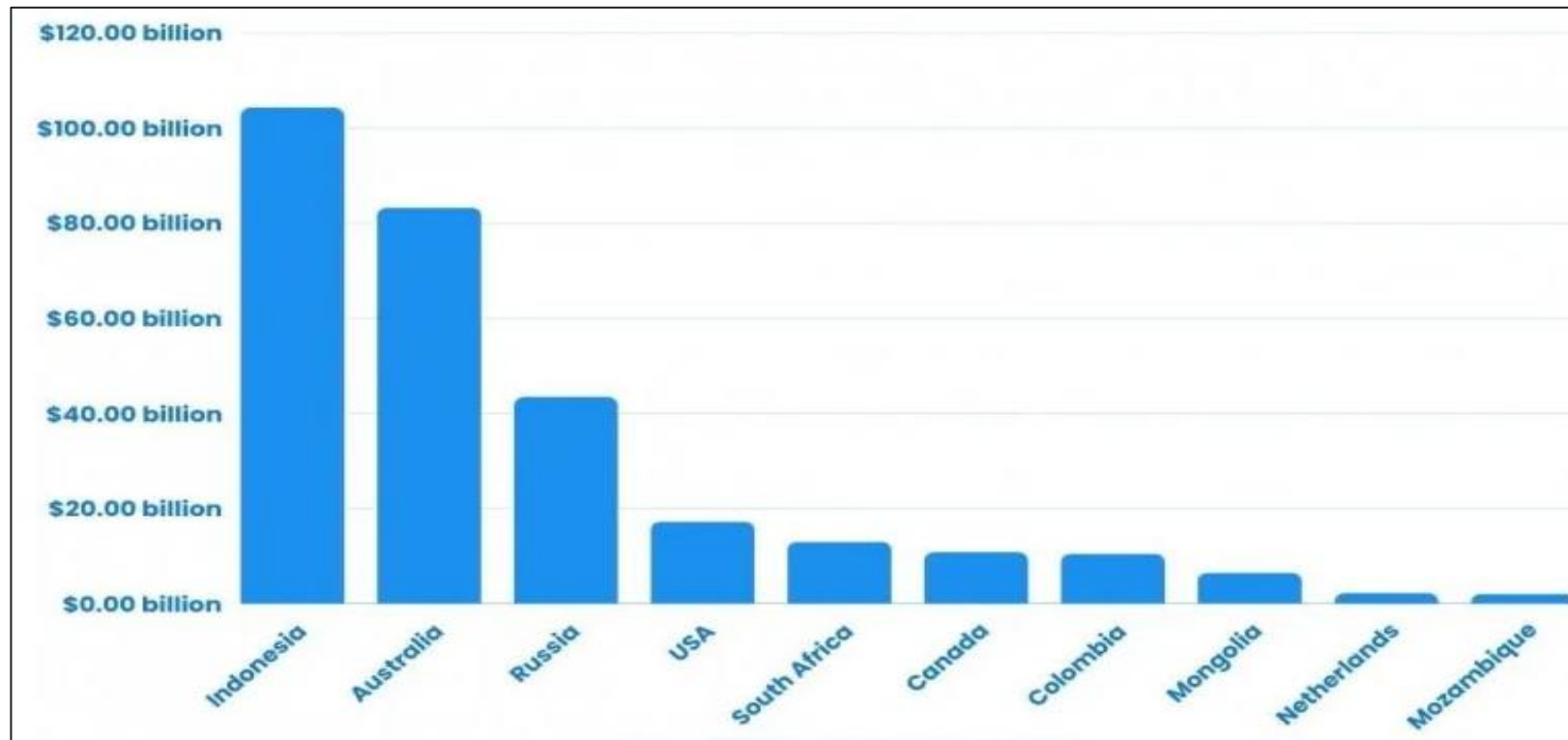
Coal Mining and Exportation in South Africa

- SA exports about 25% of the coal it produces \approx 69bn tons yearly
- How much is that exactly? A tipper truck can carry on average 34 ton \approx 2bn truck loads



Coal Mining and Exportation in South Africa

- South Africa is one of the largest exporters of thermal coal in the world with a total export value (2023) of 13 billion USD \approx 230 billion ZAR



Coal Mining and Exportation in South Africa

- How does this coal reach its intended customers?
- Mines can transport the coal themselves to their customers
- Alternatively, and in most cases, mines and coal brokers will sub-contract these services to logistics management/ freight companies who in turn may also sub-contract these services to various third parties.

Coal Mining and Exportation in South Africa

Mine



Customer (e.g. Asia/ Europe)



I'd like to place an order for 50 000 tons of RB1 by the end of October.

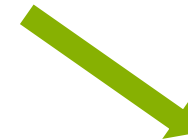


Coal Mining and Exportation in South Africa

Mine

Freight Company

Customer (e.g. Asia/ Europe)



Principal or Agent

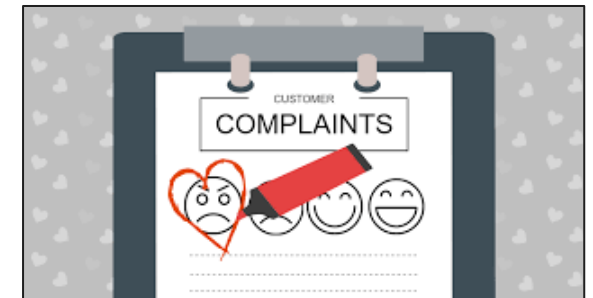


Principal or Agent?

- IFRS 15.B34 mandates a party involved in providing goods or services to a customer to determine whether the nature of its performance obligation is to provide the specified good or service to another party OR whether its performance obligation is to *arrange* for the goods or service to be provided by the other party.
- To perform this assessment, a two-step approach should be followed IFRS 15.B34A:
 1. Identify the specified good or service to be provided to the customer i.e. what is the performance obligation towards the customer; and
 2. Assess whether it **controls** the good or service before that good or service is transferred to the customer.

Indicators of Control

- IFRS 15.B37 provides some indicators of control:
- **The entity is primarily responsible for fulfilling the promise to provide the specified good or service** i.e. the entity is responsible for fulfilling the performance obligation:
- ✓ Who is the entity responsible for meeting customer specifications?
- ✓ If there is a service issue, who is responsible for rectifying it?
- ✓ In the event of a refund or an exchange, whose responsibility, is it?



Indicators of Control

- The entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer
 - ✓ Inventory risk is any uncertainty or adverse consequences associated with the management and holding of inventory i.e. theft & physical loss of stock, damaged stock through handling or transportation.
 - ✓ Who becomes liable in the event of inventory loss or damage?



Indicators of Control

- Video Links:

- <https://www.youtube.com/watch?v=PNykNiFAiLE>

- <https://www.youtube.com/watch?v=tNTvmndqQ-4>



Indicators of Control

- **The entity has discretion in establishing the price for the specified good or service.**
- ✓ An entity that can establish the price is an indication that the entity has the ability to direct use of that good or service and obtain substantially all of the remaining benefits
- ✓ An agent may also have discretion in setting the price to generate additional revenue.
- ✓ In the same token, not having discretion in establishing the price does not necessarily mean an entity is an agent.
 - ✓ An entity might be limited in how the price is set or how much of a mark-up is added in order to preserve the business or due to Group instruction- referred to as a “lean” price. e.g. another entity in the market may add a 15% mark-up but you decide to only add a 5% that results in your entity only covering costs or not turning a profit. This factor on its own does not preclude the entity from being a principal.

The concept of control

- IFRS 15.B35 provides “An entity is a principal if it **controls** the specified good or service before that good or service is transferred to a customer.”
- IFRS 15.B35A provides: *When another party* is involved in providing goods or services to a customer, an entity that is a principal obtains **control** of any one of the following:
 - (a) a good or another asset from the other party that it then transfers to the customer or
 - (b) a right to a service to be performed by the other party, which gives the entity the ability to direct that party to provide the service to the customer on the entity’s behalf

The concept of control

- IFRS 15.B35A (c) goes onto further say that when another party is involved in providing goods or services:
- “... an entity that is a principal obtains **control** of a good or service from the other party that it then *combines* with other goods or services in providing the specified good or service to the customer.
- For example, if an entity provides a **significant service** of integrating goods or services provided by another party into the specified good or service for which the customer has contracted, the entity controls the specified good or service **before** that good or service is transferred to the customer”

The concept of control

- **Significant service?**

- Look at the arrangement between the Mine and the Freight Company, what are some of the services the Freight Company is going to provide:
 - Arrange for transport - whether by road, rail or both
 - Arrange for a vessel
 - Ensure they meet the loading deadline at the port
 - Clear the coal through Customs
- Evaluating these services, they seem significant in nature because without them, the Mine cannot get the coal to the customer.
- What also makes these services significant is the fact that the Mine cannot recognize revenue in relation to the transaction until these services are performed and the customer takes delivery of the coal.

The concept of control

- IFRS 15.33 Control of an asset refers to the ability to **direct the use** of, and obtain substantially all of the remaining benefits from, the asset it includes the ability to prevent other entities from directing the use of, and obtaining the **benefits** from, an asset.
- The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways:
 - Using the asset
 - Selling or exchanging the asset
- Legal title ≠ Control



Are you a principal or an agent?

- Although IFRS 15 provides some guidance that can be used to determine if an entity is an agent or a principal, the determination requires a lot of judgement and detailed analysis of the specific facts and circumstances of the transaction concerned.
- Indicators must be considered collectively, and each arrangement should be considered on a case-by-case basis.
- Are you a principal or an agent?
- Short answer: **It depends!**



Why does it even matter?

The most significant difference to consider is the presentation of the revenues received from the customer:

Principal

Gross revenue 1 200

Cost of sales 800

Gross π **400**

There is no effect on the profit and loss.

Agent

Revenue/commission **400**

When does it matter?

- Bonus performance indicators e.g. meeting sales targets
- Financial statement ratios and bank covenants that assess margin ratios

Principal or Agent?

- Financial ratios that are largely impacted are margin ratios i.e. speak to a business is able to convert sales (revenue) into profit e.g:
- **Gross Profit Margin** *compares gross profit to sales revenue*

Gross profit / revenue

- **Operating Profit Margin** *earnings as a % of sales*

EBITDA / revenue

Resources

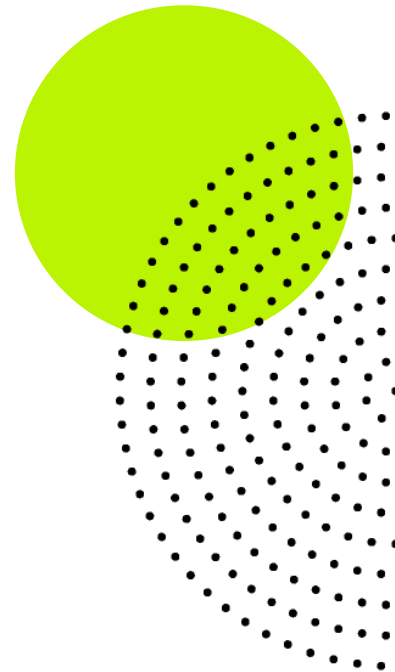
- IAS 18, Revenue
- IFRS 15, Revenue from Contracts with Customers
- <https://intuendi.com/resource-center/inventory-risk/>
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QUESTIONS & ANSWERS

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