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IFRIC 13 Customer Loyalty Programmes

On 28 June 2007, the International Financial Reporting Interpretations Committee (IFRIC) issued a new Interpretation entitled **Customer Loyalty Programmes**. This Interpretation addresses the accounting by entities that provide their customers with incentives to buy goods or services by providing awards (called 'award credits' in the Interpretation) as part of a sales transaction. Common examples are airline and hotel loyalty schemes and credit card reward schemes.

The Interpretation requires the entity that grants the awards to account for the sales transaction that gives rise to the award credits as a 'multiple element revenue transaction' and allocate the fair value of the consideration received or receivable between the award credits granted and the other components of the revenue transaction. This treatment applies irrespective of whether the entity supplies the awards (the discounted goods or services) or whether a third party supplies them. For arrangements falling within the scope of the Interpretation, IFRIC 13 explicitly prohibits the alternative treatment of recognising the full consideration received as revenue, with a separate liability for the cost of supplying the awards.

IFRIC 13 is applicable to annual periods beginning on or after 1 July 2008.

Ken Wild, Deloitte's global IFRS leader and an IFRIC member says:

Customer loyalty programmes are widespread and no two are exactly alike. In addition, some programmes (such as discount vouchers distributed to the general public by supermarkets) have features similar to those of customer loyalty programmes, but are really marketing schemes. In my opinion, the Draft Interpretation D20 **Customer Loyalty Programmes** did not adequately distinguish marketing schemes from customer loyalty programmes. In its redeliberations, IFRIC clarified that marketing schemes are period expenses and that the essential feature of a customer loyalty programme is that the customer has implicitly paid for future goods or services. Once you accept that conclusion, it is inevitable that IAS 18 paragraph 13 provides the appropriate accounting treatment.

Background

Entities use customer loyalty programmes to provide their customers with incentives to buy their goods or services. If a customer buys goods or services, the entity grants the customer **award credits** (described as 'points', 'air miles', etc). Customers subsequently redeem the award credits for **awards** such as free or discounted goods or services.

Scope

IFRIC 13 addresses the accounting by the entity that grants award credits. It applies to customer loyalty award credits that:

- entities grant to their customers as part of an IAS 18 sales transaction (a sale of goods, rendering of services or use by the customer of entity assets); and
- subject to meeting any further qualifying conditions, the customers can redeem in future for free or discounted goods or services.

Deferred revenue or a provision for future costs?

The IFRIC identified two possible approaches to these transactions – dealt with in paragraphs 13 and 19 of IAS 18 **Revenue**. Applying paragraph 13 would result in allocating some of the consideration received or receivable from the sales transaction to the award credits and deferring the recognition of revenue; applying paragraph 19 would result in providing for the estimated future costs of supplying the awards (i.e. recognising a liability).

The IFRIC concluded that IAS 18 paragraph 13 was the appropriate approach. They agreed that some of the consideration received in respect of the initial sale should be allocated to the award credits and recognised as deferred revenue until the entity fulfils its obligations to deliver awards to customers. The amount of revenue deferred would be measured by reference to the fair value of the award credits to the customer (not their cost to the entity) and recognised as an allocation of revenue. The IFRIC noted that:

- award credits granted to a customer as a result of a sales transaction are a separately identifiable element of the transaction itself and represent rights granted to the customer, for which the customer implicitly paid;
- loyalty awards are not delivered to the customer at the same time as the other goods or services and it is therefore necessary to divide the initial sale into components and apply the recognition criteria separately to each component in order to reflect the substance of the transaction; and
- award credits can be distinguished from marketing expenses because they are granted to the customer as an integral part of the sales transaction. Marketing expenses, in contrast, are incurred independently of the sales transactions they are designed to secure.

Accounting treatment

IFRIC 13 requires entities to account for award credits as a separately identifiable component of the sales transaction(s) in which they are granted. The fair value of the consideration received or receivable is allocated between the award credits and the other components of the sale. The consideration allocated to the award credits is measured **by reference** to their fair value, i.e. the amount for which the award credits could be sold separately.

If the entity supplies the awards itself, it recognises the consideration allocated to award credits as revenue when award credits are redeemed and the entity fulfils its obligations to supply awards. The amount of revenue recognised is to be based on the number of award credits that have been redeemed in exchange for awards, relative to the total number expected to be redeemed.

If a third party supplies the awards, the entity is required to assess whether it is collecting the consideration allocated to the award credits on its own account or on behalf of the third party. In other words, it must assess whether it is acting as principal in the transaction or as an agent for the third party.

If the entity is collecting the consideration on behalf of the third party, it:

- measures its revenue as the net amount retained on its own account, i.e. the difference between the consideration allocated to the award credits and the amount payable to the third party for supplying the awards; and
- recognises this net amount as revenue when the third party is obliged to supply the awards and entitled to receive consideration for doing so. (These events may occur as soon as the award credits are granted. Alternatively, if the customer can choose to claim awards from either the entity or a third party, these events may occur only when the customer chooses to claim awards from the third party.)

If the entity is collecting the consideration on its own account, it measures its revenue as the gross consideration allocated to the award credits and recognises the revenue when it fulfils its obligations in respect of the awards.

Measuring the fair value of award credits

The Interpretation requires the consideration allocated to award credits to be measured by reference to their fair value – the amount for which the award credits could be sold separately. If the fair value is not directly observable, it must be estimated, e.g. by reference to the fair value of the awards for which they could be redeemed. That fair value is adjusted to take into account the fair value of awards that would be offered to customers who have not earned award credits from an initial sales transaction and the proportion of the award credits expected to be redeemed. If there is a range of awards from which customers may choose, the fair value of the award credits will reflect the fair values of the range of available awards, weighted in proportion to the frequency with which each award is expected to be selected.

The Interpretation also includes examples of how entities might account both for awards supplied by it and awards supplied by third parties.

Effective date and transition

IFRIC 13 is applicable for annual periods beginning on or after 1 July 2008. Earlier application is permitted.

No specific transition is specified. Therefore, IAS 8 **Accounting Policies, Changes in Accounting Estimates and Errors** requires that any changes be recognised retrospectively, where practicable. If an entity has previously applied IAS 18 paragraph 19 and provided for the future cost of providing the awards, it must treat the adoption of IFRIC 13 as a change in accounting policy. If an entity has previously used the deferred revenue model, but based on an allocation method other than fair value, the adoption of the Interpretation may be treated as a change in an accounting estimate.

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