THE ACCOUNTING TREATMENT OF CREDIT CARD REWARDS PROGRAMMES (PART III)

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Received: August 2016 Accepted: December 2016

Abstract

Most credit card issuers offer their cardholders participation in a customer loyalty programme. Currently all credit card rewards programmes fall within the scope of IFRIC 13. For annual reporting periods beginning on or after 1 January 2017 IFRIC 13 will be withdrawn and will be replaced by the new revenue Standard, IFRS 15. In the process of compiling the new revenue model, credit card rewards programmes raised various concerns and uncertainties regarding the application of IFRS 15 to credit card rewards programme transactions. Despite concerns raised, the IASB and FASB decided against providing any additional guidance to credit card rewards programmes and indicated that they leave it up to management's judgement to determine how to account for these transactions. Although the effective date of the new revenue Standard is 1 January 2017, in view of the nature of a credit card rewards programme transaction it would be prudent for credit card rewards programmes to start collecting data immediately for the retrospective application. Given the time limit, the unanswered uncertainties and problem areas identified together with the minimal specific guidance to credit card rewards programmes, the main objective of the research reported in this article was to determine how to account for credit card rewards programme transactions, within the scope of IFRS 15 through the formulation of specific guidelines, and specifically to address the uncertainties raised by credit card rewards programme respondents. The study was also aimed at assisting credit card rewards programmes in converting from IFRIC 13 to IFRS 15 by highlighting the differences between the requirements contained in IFRIC 13 and IFRS 15.

Keywords

Award credits, IFRS 15, new revenue Standard.

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1. BACKGROUND AND FORMULATION OF THE STUDY

1.1 Background

Most credit card issuers offer their cardholders participation in a customer loyalty programme, whether it is the bank's own credit card rewards programme or participation in another company's loyalty programme (Conradie, 2007:29). The main aim of a credit card rewards programme is to encourage credit cardholders to use just one credit card to make their purchases (Creditor Web, 2014). Credit card rewards programmes offer their members direct cash back or award credits (points or miles) that can be used to purchase goods and services in exchange for using their credit card (Buchi, 2014). Award credits are mainly earned for each credit card transaction, but some programmes also offer additional rewards for credit card purchases at any of the rewards programme partners. A credit card rewards programme differs from other customer loyalty programmes in that it awards a payment mechanism rather than the acquisition of goods or services from a qualifying supplier. A credit card rewards programme therefore enables its members to earn rewards on a far wider range of purchases than other customer loyalty programmes (Conradie & Goldstuck, 2003:8).

The first South African credit card rewards programme was launched in 1995 (Conradie, 2007:20), and currently 13 financial institutions are making use of credit card rewards programmes in South Africa (Siddle, 2014). eBucks, one of the most popular credit card rewards programmes (Siddle, 2014), made eBucks allocations to the value of R500 million (Kearney, 2013) and R723 million (Firstrand Group, 2013:38) during the 2012 and 2013 financial years respectively. During 2012 ABSA rewards clocked up one million rewards members and paid out more than R300 million in cash rewards since the rewards programme was launched in 2009. Given the popularity of credit card rewards programmes in South Africa, together with the extremely high rand value associated with them, it is important to account correctly for credit card rewards programme transactions for accounting purposes.

In order to understand the accounting treatment of customer loyalty programmes one must consider International Accounting Standards prescribing rules on how to account for these transactions. Before 1 July 2007, the International Financial Reporting Standards (IFRS) lacked specific guidance on how customer loyalty programmes should account for awards or benefits offered to customers in terms of these programmes. Based on a lack of specific guidance, practices diverged (IFRIC 13 Basis for Conclusion, par. BC 2) and customer loyalty programmes accounted for customer loyalty programme transactions differently. Based on this lack of guidance and the demand for specific guidance that was identified, the International Accounting Standards Board (IASB) issued the Interpretation of International Financial Reporting Interpretation Committee (IFRIC) 13 *Customer Loyalty Programmes*, on 1 July 2007, to give specific guidance to suppliers on the accounting treatment of customer loyalty programme transactions (effective for annual periods beginning on or after 1 July 2008).

During May 2014, the IASB, together with the United States Financial Accounting Standards Board (FASB), published IFRS 15 *Revenue from Contracts with Customers* to streamline accounting for revenue across all industries and to correct inconsistencies in existing Standards and Practices (Lamoreaux, 2012:30). The IASB and FASB initiated this joint project to clarify the revenue recognition principles and to develop a common revenue Standard for IFRS and the United States Generally Accepted Accounting Practices (US GAAP) (IFRS 15, par. IN4). Therefore, IFRS 15 is intended to supersede virtually all existing revenue Standards and Interpretations under IFRS and

US GAAP (Deloitte, 2012:1; Ernst & Young, 2012b:2), including IFRIC 13 *Customer Loyalty Programmes* (IFRS 15, par. C10). The process of compiling a new revenue Standard started in 2010 with the issuing of ED/2010/6 *Revenue from Contracts with Customers* and, based on comments received, significant changes were made to the proposed revenue model. The exposure draft (Exposure Draft ED/2011/6 *Revenue from Contracts with Customers*) was issued for a second time during November 2011.

In response to the second exposure draft (ED/2011/6), the FASB and IASB received approximately 360 comment letters (PricewaterhouseCoopers, 2012:1). Many of these comment letters were received from customer loyalty programme suppliers and more specifically from financial services loyalty programmes (credit card rewards programmes) (KPMG, 2013a). Based on the lack of specific guidance for customer loyalty programmes in the ED/2011/6, with only one reference to 'customer award credits (points)' in the entire 89 page document, these comments were understandable and in a way expected. The illustrative examples that accompany the ED/2011/6 also include only one example that specifically applies to customer loyalty programme transactions (vs. the two illustrative examples that accompany IFRIC 13). The concerns raised included among other things the following: Uncertainty as to whether or not all credit card rewards programme transactions are included in the scope of the new revenue Standard (PricewaterhouseCoopers, 2012:15), what the interaction with financial instruments entail (FASB & IASB, 2013:10), concerns about the accounting for award credits that are provided outside of a revenue transaction, such as upon opening a credit card account (PricewaterhouseCoopers, 2012:16), uncertainty as to whether or not cash and non-cash rewards should be treated differently for accounting purposes even if they are considered economically similar (PricewaterhouseCoopers, 2012:16), which revenue streams should be considered to determine the amount of revenue to be deferred – is it the interchange fee, interest or the participation or linkage fee or a combination of the above (PricewaterhouseCoopers, 2012:16) – and uncertainties about the contract combination guidance contained in the new revenue model and the application thereof (KPMG, 2013a). Despite concerns raised, the Boards decided against providing any additional guidance to credit card rewards programmes and indicated that they would leave it up to management's judgement to determine how to account for these transactions (Ernst & Young, 2013). IFRS 15 therefore does not include any additional guidance, application guidance or examples for different facts and circumstances in a credit card rewards programme. IFRS 15 will be effective for annual reporting periods beginning on or after 1 January 2017 (IFRS 15, par. C1) and will be applied retrospectively for all periods presented in the period of adoption with only limited reliefs.

1.2 Literature review

'The Accounting treatment of credit card rewards programmes Part I' (Brink, 2017a) dealt with the main concern raised by respondents, namely whether or not a credit card rewards programme falls within the scope of IFRS 15 or not. The scope of IFRS 15 (paragraph 6) states that an entity shall apply IFRS 15 to a contract only if the counterparty to the contract is a customer. Therefore, in a credit card rewards programme transaction, the customer in relation to the card issuer determines whether or not the transaction falls within the scope of IFRS 15 or not. There are two alternatives: (1) If the merchant is identified as the customer in relation to the card issuer in the transaction, the transaction falls outside of the scope of IFRS 15; (2) If the cardholder (member of the rewards programme) is identified as the customer in relation to the card issuer in the transaction, the transaction falls within the scope of IFRS 15. This abovementioned article investigated the logical reasons or principles employed in determining the customer in relation to

the card issuer. Based on the assumption that the interchange fee is correctly identified as the revenue stream from the initial sales transaction that needs to be allocated to the goods or services sold and the award credits granted, it was found that both views have merit and can be considered as correct. It is therefore possible, based on management's view, that some credit card rewards programmes fall within the scope of IFRS 15 and some outside the scope.

'The Accounting treatment of credit card rewards programmes Part II' (Brink, 2017b) considered why credit card rewards programmes currently account for these transactions differently if the scope of IFRIC 13 clearly includes credit card rewards programme transactions in its scope. Some credit card rewards programmes account for award credits under the revenue deferral model (IFRIC 13), some account for the cost of satisfying the award credits as and when the customer earns them by recognising a provision (in terms of IAS 37) and related expense, and others recognise the cost of award credits as an offset to merchant interchange fee income when award credits are granted, and record a corresponding liability in terms of IAS 37 (PricewaterhouseCoopers, 2012:16). These divergent practices caused the author to question the accuracy of the current guidance provided in IFRIC 13 to credit card rewards programmes. Otherwise, what would the reason be behind credit card rewards programmes accounting for these transactions differently? The article points out the differences between a credit card rewards programme and a typical customer loyalty programme and highlights the differences that indicate that credit card rewards programmes should perhaps be treated differently for accounting purposes.

In a credit card rewards programme transaction the cardholder receives financing for the credit purchase transaction in terms of which interest is charged by the financial institution. The credit card rewards programme grants award credits for all qualifying spend on the credit card. The member is awarded for the payment mechanism and for using the financial institution's services, namely the provision of financing. Taking into account the primary purpose of credit card issuers it can be argued that the incentive behind a credit card rewards programme is to ensure a higher interest income. If this is the case then the interest income (and not the merchant interchange fee) is the revenue stream from the initial sales transaction that needs to be allocated to the goods or services sold and the award credits granted. Even though IFRIC 13 identified the merchant interchange fee as the revenue stream from the initial sales transaction in a credit card rewards programme that needs to be allocated to the goods or services sold and the award credits granted, Brink (2017b) found that the interest income being the rationale behind the rewards programme is the relevant revenue stream to consider. If the interest income (and not the interchange fee) is identified as the relevant revenue stream in a credit card rewards programme transaction the interest (together with the credit card loan) will be accounted for as a financial asset at amortised cost in terms of IFRS 9 *Financial instruments* and therefore falls outside the scope of IFRIC 13 and IFRS 15. The article concludes by discussing which other Standard(s) to apply to account for the different components of a credit card rewards programme transaction.

Even though Brink (2017b) proved that credit card rewards programmes fall outside the scope of IFRS 15, the Boards still indicated that they leave it up to management's judgement to determine whether their programme falls within the scope of IFRS 15 or not and consequently how to account for these transactions. Therefore, theoretically a credit card rewards programme can view its transaction within the scope of IFRS 15 (refer to 'The Accounting treatment of credit card rewards programmes Part I') and if this is the case the credit card rewards programme needs to determine how to apply IFRS 15 to the credit card rewards programme transaction given the minimal guidance provided and the unanswered uncertainties raised in the response to the ED/2011/6.

1.3 Research problem

In response to the second exposure draft (ED/2011/6), various concerns were raised by respondents from financial services loyalty programmes (credit card rewards programmes) (KPMG, 2013a). These concerns and uncertainties can be summarised as follows:

1.3.1 The interaction with financial instruments

The scope of IFRS 15 states that an entity shall apply this Standard to all contracts with customers, except, among other things, financial instruments and other contractual rights or obligations within the scope of IFRS 9 *Financial instruments* (IFRS 15, par. 5(c)). Paragraph 7 of IFRS 15 provides guidance on how to account for contracts when the contract includes both a financial instrument part (the cardholder loan) and another potential part within the scope of IFRS 15. Paragraph 7 of IFRS 15 states: 'A contract with a customer may be partially within the scope of this Standard and partially within the scope of other Standards including amongst other things, IFRS 9 *Financial instruments*.

(a) If the other Standards specify how to separate and/or initially measure one or more parts of the contract, then an entity shall first apply the separation and/or measurement requirements in those Standards. An entity shall exclude from the transaction price the amount of the part (or parts) of the contract that are initially measured in accordance with other Standards and shall apply the guidance provided by step 4 to allocate the amount of the transaction price that remains (if any) to each performance obligation within the scope of this Standard and to any other parts of the contract identified.

(b) If the other Standards do not specify how to separate and/or initially measure one or more parts of the contract, then the entity shall apply this Standard to separate and/or initially measure the part (or parts) of the contract.'

The loan granted to a cardholder in terms of a credit card arrangement is within the scope of the financial instrument guidance. In terms of a credit card rewards programme there is uncertainty as to whether or not other parts of a credit card arrangement should be dealt with under the financial instrument guidance (FASB & IASB, 2013:10).

1.3.2 Lack of specific guidance contained in revenue model

Respondents requested clarification about the application of the revenue model to credit card rewards programmes (IASB, 2014) if they are considered to be within the scope of the Standard. The industry has been vocal both in roundtables and in comment letter responses to the ED/2011/6 that they do not believe that the proposed accounting is appropriate for credit card rewards programmes. There are concerns about the accounting for award credits that are provided outside of a revenue transaction, such as upon opening a credit card account (PricewaterhouseCoopers, 2012:16). Some respondents suggested that accounting for credit card reward credits as performance obligations will introduce significant complexity to existing accounting. Many credit card issuers currently recognise the cost of reward credits as an offset to merchant interchange fee income when rewards are granted, and record a corresponding liability in terms of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Respondents believe that applying the proposed guidance will require cash rewards to be netted against merchant interchange fee income as a reduction of the transaction price, but non-cash rewards will result in only a deferral of recognition, as the transaction price would remain the same. Respondents

consider cash and non-cash rewards to be economically similar and believe they should not have different accounting treatments (PricewaterhouseCoopers, 2012:16).

PricewaterhouseCoopers (2012:16) believes it is also unclear which revenue streams should be considered to determine the amount of revenue to be deferred – that is, whether it is payments made by the cardholder to participate in the programme (participation fee), merchant interchange fees, interest charged to the cardholder or some combination of the above. PricewaterhouseCoopers (2012:16) agrees it is unclear and that the Boards need to provide greater clarity on the accounting for contracts that involve multiple parties.

1.3.3 Contract combination guidance

Some respondents questioned whether credit card issuing banks should combine contracts with their cardholders who participate in their rewards programmes, with merchant contracts (KPMG, 2013a) and whether a portion of the revenue generated from the merchant interchange fees should be allocated to the goods or services provided under the rewards programmes (KPMG, 2013b). The Boards (IASB and FASB) observed that credit card arrangements are complex and the facts will vary among the different programmes. Despite the concerns raised about a lack of guidance the Boards decided against specifically addressing credit card rewards programmes in IFRS 15 (Ernst & Young, 2013). IFRS 15 therefore does not include any additional guidance, application guidance or examples for different facts and circumstances in a credit card rewards programme. IFRS 15 only once refers to 'customer award credits (points)' in the Application Guidance paragraph B39, and the illustrative examples that accompany IFRS 15 also include only one example, namely Example 52, that applies to customer loyalty programme transactions. The introductory paragraph to this example states that Example 52 'may not apply to all customer loyalty arrangements because the terms and conditions may differ. In particular, when there are more than two parties to the arrangement, an entity should consider all the facts and circumstances to determine the customer in the transaction that gives rise to the award credits.' This paragraph was amended to exclude some customer loyalty programme transactions after credit card rewards programme respondents requested clarification in their response to the ED/2011/6. Based on the amendments to the introductory paragraph it is clear that this example is not applicable to all customer loyalty programmes, specifically credit card rewards programmes where multiple parties are involved. The Boards advised that credit card rewards programmes should consider all the facts and circumstances when accounting for credit card reward programmes, given the unique and varied nature of these agreements (Ernst & Young, 2013:2).

A wide variety of credit card rewards programmes exist, each with unique terms, conditions and structures. For annual reporting periods beginning on or after 1 January 2017 IFRIC 13 will be withdrawn. IFRS 15 will replace IFRIC 13, an Interpretation credit card rewards programmes would have applied for almost nine years up until the effective date of IFRS 15. The single new revenue Standard will replace six existing Standards or Interpretations. According to IFRS 15, all entities will apply the single revenue model and a greater degree of judgement will be required, thus increasing the challenge of consistent interpretation by preparers (KPMG, 2011:1). The proposals may not affect all entities, but it is likely that certain entities will experience significant change (KPMG, 2011:1). The initial effective date of 1 January 2015 (ED/2011/6, par. IN35) was extended to 1 January 2017 (Ernst & Young, 2013). The significant delay between the issuance of IFRS 15 (May 2014) and the effective date is intended to provide entities with adequate time to prepare for the adoption of the new Standard (Ernst & Young, 2013). This highlights the drastic changes that can be expected. The Boards also indicated the importance of entities accumulating

adequate transition information on a real-time basis during the extended transition period (Ernst & Young, 2013).

If a credit card rewards programme concludes that their rewards programme falls within the scope of IFRS 15 the credit card rewards programme must determine how to account for credit card rewards programme transactions given the minimum guidance contained in IFRS 15 and the unanswered uncertainties raised in response to the ED/2011/6. Since the new revenue Standard is applicable to a wide variety of revenue transactions and not as specific as IFRIC 13, there is a risk that credit card rewards programmes will experience difficulty in applying the new revenue Standard and might continue to apply the principles of IFRIC 13. With minimal specific guidelines it is clear that credit card rewards programmes will have difficulty in transitioning and applying IFRS 15. 1 January 2017 (the effective date of the new revenue Standard) might seem far off in the future and the risk exists that credit card rewards programmes might delay familiarising themselves with IFRS 15. Due to the nature of a credit card rewards programme transaction (especially programmes where the award credits are not subject to an expiry date), transactions that are concluded today can have an impact on reporting in 2017.

1.4 Research objective and methodology

The main objective of the research reported in this article was to determine how to account for credit card rewards programme transactions within the scope of IFRS 15 through the formulation of specific guidelines and specifically to address the uncertainties raised in the response to the ED/2011/6. The study on which this article is based was aimed at assisting credit card rewards programmes in converting from IFRIC 13 to IFRS 15 by highlighting the differences between the requirements contained in IFRIC 13 and IFRS 15. In order to meet the main objective, satisfactory answers to the following secondary questions first needed to be found:

- For credit card rewards programmes that view the cardholder as the customer in relation to the card issuer and that consequently fall within the scope of IFRS 15, determine how to account for a credit card rewards programme transaction given the minimal guidance:
    - Should credit card issuing banks combine contracts with its cardholders who participate in its rewards programme, with merchant contracts?
    - When do award credits from a credit card rewards programme represent a material right and thus a performance obligation, within the scope of IFRS 15?
    - Should a portion of the revenue generated from the merchant interchange fees be allocated to the goods or services provided under the rewards programme?
    - Is there a different accounting treatment under IFRS 15 for direct cash back rewards and non-cash rewards in a credit card rewards programme?
    - How does one calculate the stand-alone selling price of award credits that are not linked to a specific rand value?
    - Do some award credits fall outside the scope of a revenue transaction, such as award credit granted upon opening a credit card account?
    - If such award credits fall outside the scope of the revenue transaction how would a credit card rewards programme account for those credits?
    - Which revenue streams should be considered to determine the amount of revenue to be deferred in terms of IFRS 15 – that is, whether it is payments made by the cardholder to

participate in the programme, merchant interchange fees, interest charged to the cardholder or some combination of the above?

- What paragraphs in IFRS 15 are applicable to credit card rewards programme transactions?

- What are the differences in the guidelines provided in IFRIC 13 and IFRS 15 and what impact will these differences have on the conversion from IFRIC 13 to IFRS 15?

The study made use of a qualitative approach based on a literature study of purely theoretical aspects. A document analysis was used as the research method. Hutchinson and Duncan (2012:101) describe the research strategy followed, which is doctrinal in nature, as research which provides a systematic exposition of the rules governing a particular topic. They further suggest an analysis of the relationships between rules explains areas of difficulty and, perhaps, predicts future developments.

The problem-based doctrinal research methodology applied in this research includes the following steps (Hutchinson & Duncan, 2012:106):

- Gathering of all relevant and applicable facts;
- Identification of the specific requirements;
- Analysis of the issues from a legislative perspective;
- Studying of sources such as academic text books and journal articles as background;
- The identification of primary sources of information;
- Synthesising of all the relevant issues within the correct context;
- The drawing of an effective and sensible conclusion.

To achieve the abovementioned objectives, the following steps were taken in the study and the article is structured accordingly:

- An understanding of the structure and functioning of credit card rewards programmes was obtained.
- IFRS 15's suggested accounting treatment of credit card rewards programme transactions (given the minimal guidance provided) was clarified.
- The specific paragraphs in IFRS 15 that are applicable to accounting for a credit card rewards programme transaction were identified.
- Uncertainties that arose in response to the ED/2011/6 were addressed.
- The differences in the requirements contained in IFRIC 13 and IFRS 15 were compared.
- Summary, conclusion and recommendations.

In conducting this study it was decided to focus only on a scenario where the card issuer itself supplies the benefits in exchange for the award credits, as this was an initial study and the scope of the study would otherwise be too wide. Most credit card rewards programmes offer their members redeeming opportunities at the rewards programme itself (usually on an online store) and at the various programme partners. The scope of the study therefore excluded the scenario where award credits are exchanged at a programme partner for benefits and where the card issuer acts as an agent in the transaction.

1.5 Research contribution

The research makes a contribution by providing specific guidance and clarity on the accounting treatment of credit card rewards programme transactions. Given the minimum guidelines in IFRS 15 on the accounting treatment of credit card rewards programmes and uncertainties raised by respondents to the ED/2011/6 the aim of the study was to provide specific guidelines on the accounting treatment of a credit card rewards programme transaction within the scope of IFRS 15. The study addressed uncertainties raised by respondents and identified the specific paragraphs in IFRS 15 that are applicable to credit card rewards programme transactions. This study will also assist credit card rewards programmes in converting from IFRIC 13 to IFRS 15 by highlighting the differences between the requirements contained in IFRIC 13 and IFRS 15. This study highlighted important principles that will contribute to the body of knowledge to account for credit card rewards programme transactions. This information can be a useful tool in serving role players in the accounting environment.

2. STRUCTURE AND FUNCTIONING OF CREDIT CARD REWARDS PROGRAMMES

The functioning and more specifically the structures of credit card rewards programmes were explored in 'The Accounting treatment of credit card rewards programmes Part I' (Brink, 2017a). It was found that there are two different structures under which credit card rewards programmes function, namely an open loop structure and a closed loop structure. Refer to FIGURES 1 and 2 for an illustration of the functioning of these two structures. In both structures there are two contracts:

1) The cardholder contract: In both structures this contract is between the issuing bank and the cardholder. The cardholder contract governs the terms and conditions on the use of the credit card by the cardholder and includes the service fees, interest rates and payment schedules.
2) The merchant contract: This contract is between the merchant and
    - the acquirer bank (in the case of an open loop structure), or
    - the issuing bank (in the case of a closed loop structure).

The merchant contract governs the terms and conditions under which the merchant will accept the use of a credit card in the sale of the merchant's goods or services (FASB & IASB, 2013:3) and includes the merchant interchange fees applicable (Wikinvest, 2007). These rules and terms are established by the acquirer bank (in the case of an open loop structure) (Wikinvest, 2007) or the issuing bank (in the case of a closed loop structure). The only difference between these two structures is that in a closed loop structure there is no independent organisation arbitrating between an issuer and an acquirer; there is no association present (Payments-R-Us, 2009). Therefore in a closed loop structure the issuing bank and the acquirer bank are effectively one and the same.

In a typical credit card arrangement, when a cardholder purchases goods or services from the merchant, the merchant receives an amount of cash from the issuing bank (directly or through intermediary financial institutions) that is slightly less than the original invoiced price for the goods and services acquired by the cardholder. This difference between the invoice price and the cash paid to the merchant is referred to as the merchant interchange fee (FASB & IASB, 2013:4).

Card issuers can generate cash inflows from the merchant, namely the interchange fees, as well as from the cardholder, namely interest charged on outstanding credit card balances and annual service fees that entitle a cardholder to use a specific type of credit card (FASB & IASB, 2013:5). Card issuers may also administer a credit card rewards programme as part of a credit card arrangement. In terms of the rewards programme, the cardholder receives award credits for each credit card purchase transaction from a merchant (FASB & IASB, 2013:4). The cardholder contract will also include the terms and conditions of the rewards programme. Some credit card rewards programmes also charge a participation or linkage fee that enables the cardholder (member) to earn award credits in terms of the rewards programme (FASB & IASB, 2013:12).

Against the background provided above, the focus of the article now shifts to the accounting treatment of credit card rewards programme transactions. The accounting treatment of credit card rewards programmes is considered and discussed based on the assumption that the cardholder (member of the rewards programme) is identified as the customer in relation to the card issuer (for the interchange service) in the transaction and that the transaction therefore falls within the scope of IFRS 15.

3. ACCOUNTING FOR CREDIT CARD REWARDS PROGRAMMES UNDER IFRS 15

3.1 Five step revenue model

IFRS 15 determines that a single revenue recognition model should apply to all contracts with customers and therefore affects all entities that enter into contracts to provide goods or services to their customers.

The IFRS states that the core principle for revenue recognition is that an 'entity shall recognise revenue to depict the transfer of promised goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services' (IFRS 15, par. IN7). This core principle is achieved by the application of the following five sequential steps to recognise revenue:

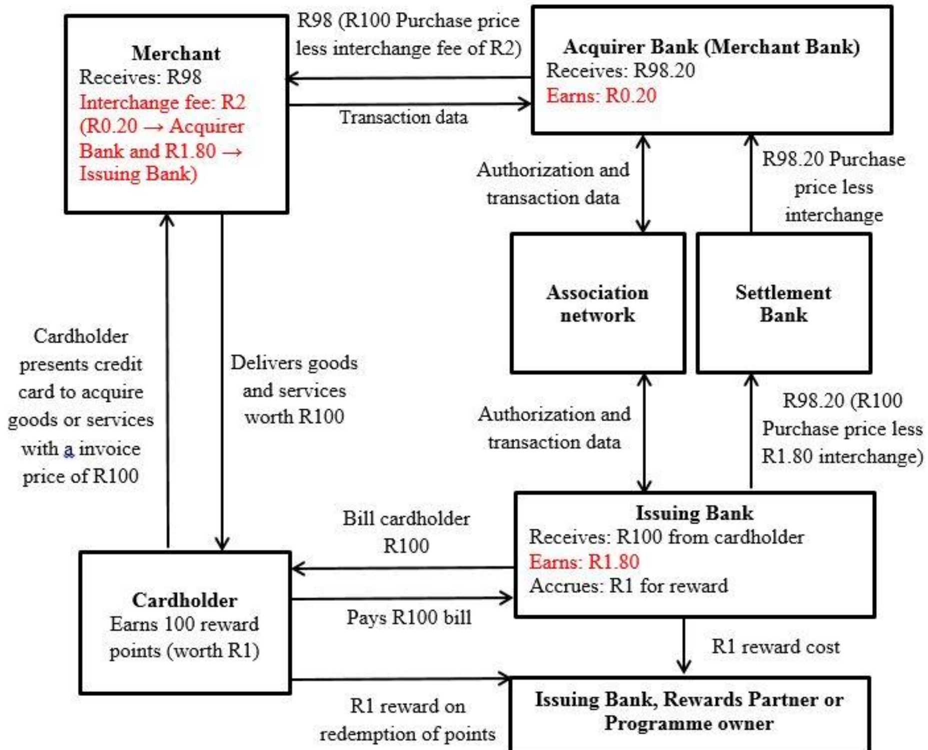
Step 1: Identify the contract with a customer.

Step 2: Identify the separate performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Figure 1: Open loop structure



Source: FASB & IASB, 2013:3

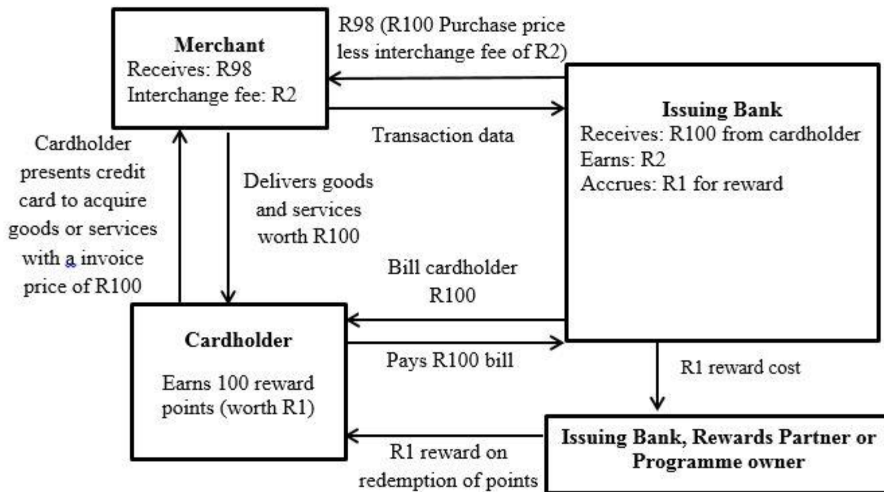
Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation.

These five steps will assist entities in determining when to recognise revenue and in what amount. Entities are required to exercise a high degree of judgement in applying these five steps. The terms of the contract(s) and all surrounding facts and circumstances, including any implied contractual terms, must be considered. An entity will also have to consistently apply the requirements of the revenue model to contracts with similar characteristics and in similar circumstances (Ernst & Young, 2012a:3). The model determines the following two ways to recognise revenue: Revenue may be recognised 1) over time (similar to current stage of completion accounting) or 2) at a point in time (similar to current sales of goods accounting). Each step of applying the model to a contract is discussed individually below.

Step 1: Identify the contract with a customer

The aim of step 1 is to identify the contractual rights and obligations to which the revenue recognition model would be applied (Grant Thornton, 2012:14). IFRS 15 paragraph 10 defines a contract as an agreement between two or more parties that creates legally enforceable rights and obligations. Contracts may be oral, written or implied by an entity's customary business practices (IFRS 15, par. 10).

Figure 2: Closed loop structure



Source: Payments-R-Us, 2009

A contract must be appropriately approved by the parties to the contract, have defined rights for each party and specify the terms and manner of payment for the goods or services to be transferred, and have commercial substance, and it must be probable that the entity will collect consideration in exchange for the goods or services transferred (IFRS 15, par. 9). Entities can combine two or more contracts that are entered into at or near the same time with the same customer, and account for them as a single contract, if one or more of the following criteria are met (IFRS 15, par. 17):

- The contracts are negotiated as a package with a single commercial objective.
- The amount of consideration in one contract depends on the price or performance of the other contract.
- The goods or services promised in the contracts are a single performance obligation (refer to step 2 for identifying performance obligations).

In terms of a credit card rewards programme transaction the merchant interchange fee is payable with each credit card transaction in terms of which award credits are granted to the cardholder. There are two contracts to consider in a credit card rewards programme, namely

1) the cardholder contract (in terms of which award credits are granted) between the card issuer and the cardholder, and
2) the merchant contract (in terms of which a merchant interchange fee is charged) between the merchant and the acquirer bank (in the case of an open loop structure), or between the merchant and the issuing bank (in the case of a closed loop structure).

The question arises whether or not these two contracts can be combined for purposes of step 1 of the revenue model. Many respondents are of the opinion that the contract combination guidance

is not applicable as the card issuer, the merchant and the cardholder are unrelated parties, and there is no price interdependency among these contracts (PricewaterhouseCoopers, 2012:15). Another problem area identified is that in an open loop structure (representing the majority of credit card structures) the card issuer has no direct contract with the merchant – the contract is between the acquirer bank and the merchant.

If the logical reasons or principles employed in concluding that the cardholder is the card issuer's customer for the interchange service the following is applicable: Based on the examination of the functioning of credit card rewards programmes, the contractual rights and obligations, to which the revenue recognition model would be applied in the rewards transaction, can be identified. A credit card rewards programme transaction may be regarded as a single transaction consisting of two separate identifiable components, namely enabling a cardholder to purchase goods or services on credit by electronically transferring cash (obtained from the loan) to the merchant and the granting of award credits that gives the cardholder a right to benefits. There are two contracts that arise in a credit card rewards programme transaction. The first contract arises in the credit card transaction under which the card issuer is obliged to transfer cash to the merchant electronically, thus enabling the credit purchase transaction. A second contract arises under which the card issuer is obligated to grant award credits to the member (cardholder) that gives the member a right to benefits.

Contract 1: In terms of the first contract the card issuer provides to the cardholder a service of electronically transferring cash to the merchant for the goods or services purchased on credit in exchange for an interchange fee. Even though there is no physical contract between the card issuer and the cardholder for the interchange fee, if the cardholder is identified as the card issuer's customer for the interchange service a physical contract is irrelevant. It might also be argued that the contract is implied by the card issuer's customary business practices. In terms of the agreement, the card issuer is obliged to transfer cash to the merchant electronically for each credit card purchase transaction and the cardholder is indirectly responsible for paying the card issuer an interchange fee.

Contract 2: The terms and conditions as stipulated in the application form of a credit card rewards programme determine the percentage reward or earn rate (granted as award credits) for qualifying credit card purchase transactions and that these award credits can be exchanged for certain benefits. The approval of the signed application form and the linking of the credit card to the rewards programme can be seen as an agreement or contract between the card issuer and the member (cardholder). The contract is also implied, as it is the credit card rewards programme's practice to grant award credits on all qualifying credit card expenditure to members and to supply benefits when the member exchanges the award credits. In terms of the contract, the member therefore has a right to award credits with each credit card purchase transaction and a right to receive benefits with the exchange of the award credits. In terms of the contract, the credit card rewards programme has an obligation to grant award credits to members with each credit card purchase transaction and to supply benefits with the exchange of award credits.

A credit card rewards programme transaction therefore meets the criteria of two contracts. If the goods or services promised in the two contracts are a single performance obligation, then the two contracts can be accounted for as a single contract. Refer to 'Step 2: Identify the separate performance obligations in the contract' below for further discussion.

Step 2: Identify the separate performance obligations in the contract

The aim of the second step is to identify promised goods or services that are distinct and therefore would be accounted for separately (Grant Thornton, 2012:20). A contract includes promises to transfer goods or services to a customer. If those goods or services are distinct, the promises are performance obligations and are accounted for separately. A good or service is distinct if the customer can benefit from the good or service on its own or together with other resources that are readily available to the customer and the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (IFRS 15, IN7(b)). IFRS 15 requires an entity to evaluate the terms of the contract to identify a performance obligation in terms of which the entity promises to transfer to the customer a good or service (or a bundle of goods or services) that is distinct (IFRS 15, par. 22). A performance obligation is a promise in a contract with a customer to transfer a good or service, and may be stated explicitly or may be implicit. If not stated explicitly, a contract with a customer may also include promises that are implied by an entity's customary business practices, published policies or specific statements if, at the time of entering into the contract, those promises create a valid expectation of the customer that the entity will transfer a good or service to the customer (IFRS 15, par. 24). IFRS 15 paragraph 26 provides a list of examples of distinct goods or services and includes among other things the following: granting options to purchase additional goods or services (when those options provide a customer with a material right). Specific guidance on customer options for additional goods or services is supplied in IFRS 15 Appendix B, which is considered to be an integral part of the Standard (refer to discussion below).

If the logical reasons or principles employed in concluding that the cardholder is the card issuer's customer for the interchange service, the following is applicable: In terms of the agreement between the card issuer and the cardholder the card issuer will provide the cardholder with a service of electronically transferring cash to the merchant for the goods or services purchased on credit together with the granting of award credits in exchange for an interchange fee. The agreement also determines that when the member exchanges these award credits the card issuer will supply benefits. The promised goods or services under a credit card rewards programme transaction consists of the services supplied (electronic transfer of funds) in the initial credit card purchase transaction as well as the goods or services supplied with the exchange of the award credits. Each member will have a valid expectation to receive goods or services when award credits are exchanged. Not only do the terms and conditions in the application form (the contract) create this expectation but there is also the fact that it is the credit card rewards programme's practice to grant award credits on credit card purchase transactions to members and to supply benefits when the member exchanges award credits.

The services supplied initially and the goods or services in exchange for the award credits are distinct, as the member can benefit from the goods or services on their own or together with other readily available resources. The card issuer's promise to transfer the goods or services to the member is also separately identifiable from other promises in the contract. The two distinct goods or services in a credit card rewards programme transaction can therefore be accounted for as separate performance obligations. The goods or services promised in the two contracts are therefore not a single performance obligation, and the two contracts should be accounted for separately (refer to 'Step 1: Contract combination guidance'). In order to assist preparers with the application of the revenue model, Appendix B (which is considered to be an integral part of the Standard) gives guidance on specific issues and includes a section entitled *Customer option for additional goods or services.*

Customer option for additional goods or services

Customer options to acquire additional goods or services for free or at a discount include award credits granted in a customer loyalty programme transaction (IFRS 15, par. B39). IFRS 15 paragraph B40 states that an option to acquire additional goods or services for free or at a discount would represent a performance obligation if it gives the customer a material right that it otherwise would not have received without entering into the contract. An entity may need to use significant judgement when determining whether this option gives the customer a material right that it otherwise would not have received without entering into the contract (Deloitte, 2012:3). If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services and the entity recognises revenue when those future goods or services are transferred or when the option expires (IFRS 15, par. B40). If a customer has the option to acquire an additional good or service at a price that would reflect the stand-alone selling price for that good or service, that option does not provide the customer with a material right even if the option can be exercised only because of entering into a previous contract. In those cases, the entity has merely made a marketing offer that it shall account for in accordance with this Standard only when the customer exercises the option to purchase the additional goods or services (IFRS 15, par. B41).

In a credit card rewards programme transaction the member receives an option to receive goods or services with exchange of the award credits. When award credits are exchanged, the member therefore does not pay a price that reflects the stand-alone selling price for the goods or services received; the member simply exchanges the award credits previously earned. It can therefore be concluded that the member receives a material right and that this option to acquire additional goods or services represents a performance obligation.

Step 4 determines that an entity must allocate the transaction price to each of the identified performance obligations based on the relative stand-alone selling prices of the underlying goods and services (refer to Step 4 discussed below). The section entitled *Customer option for additional goods or services* also provides guidance on the allocation of the transaction price: If the stand-alone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity shall estimate it. That estimate shall reflect the discount the customer would obtain when exercising the option, adjusted for both of the following: 1) any discount that the customer could receive without exercising the option, and 2) the likelihood that the option will be exercised (IFRS 15, par. B42).

Step 3: Determine the transaction price

The transaction price is the amount of consideration that an entity expects to be entitled to in exchange for transferring promised goods or services to a customer (IFRS 15, par. 47).

Factors to consider when determining the transaction price are:

- variable consideration,
- constraining estimates of variable consideration,
- the existence of a significant financing component in the contract (the effect of time value of money),
- non-cash consideration, and
- consideration payable to a customer (IFRS 15, par. 48).

When considering credit card rewards programme transactions, the following is applicable: During the credit card purchase transaction an interchange fee for the service of electronically transferring funds to the merchant as well as for the award credits granted becomes payable by

the member. The member in effect does not only compensate the card issuer for services of electronically transferring funds, but this consideration includes an amount paid in advance for future goods or services in terms of the award credits granted. The total amount of consideration (interchange fee) in the credit card transaction is the transaction price for the credit card rewards programme transaction. The consideration payable to the card issuer is fixed (and not variable) and equals a fixed percentage of the invoice price of goods or services obtained from the merchant on credit. The issuing bank (directly or through intermediary financial institutions) immediately pays the merchant an amount of cash that is slightly less than the original invoiced price for the goods and services acquired by the cardholder and recognises an amount receivable from the cardholder equal to the total invoice price. The total invoice price becomes payable within the credit terms of the credit card contract (most financial institutions offer an interest-free period on their credit cards of up to 55 days). When the cardholder settles the outstanding amount the issuing bank receives the interchange fee (the difference between the amount transferred to the merchant and the invoice price). Normal credit terms of financial institutions do not represent a significant financing component and the effect of time value of money is not applicable. The IFRS Interpretations Committee Meeting on long-term prepayments in supply contracts agenda also states that in the case of customer loyalty points where the customer pays for goods or services in advance and the transfer of the goods or services is at the customer's discretion, the purpose of the payment terms is not related to a financing arrangement between the parties. The Boards decided that the costs of requiring an entity to account for the time value of money in these cases would outweigh any perceived benefit because the entity would need to continually estimate when the goods or services will transfer to the customer (IFRS, 2014:14).

Non-cash consideration is not applicable, as the amount receivable from the cardholder represents cash. The credit card rewards programme must allocate the total consideration (transaction price) to the services sold and to the award credits granted (the separate performance obligations) as discussed in Step 4. Award credits can be granted in three different forms: direct cash back, a cash back reward/voucher, and award credits (points or miles) that accumulate in the membership rewards account. If the award credits are in the form of direct cash back, the guidance related to consideration payable to a customer would apply (FASB & IASB, 2013:19).

Consideration payable to a customer

Paragraph 70 of IFRS 15 states: 'Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity's goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity's goods or services from the customer). An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs 26–30) that the customer transfers to the entity. If the consideration payable to a customer includes a variable amount, an entity shall estimate the transaction price (including assessing whether the estimate of variable consideration is constrained) in accordance with paragraphs 50–58.'

Some credit card rewards programmes' rewards (for example Absa Rewards) are granted in the form of direct cash back (Mather, 2013) and in terms of IFRS 15 paragraph 70 this consideration payable to a customer should be accounted for as a reduction of the transaction price, i.e. of the interchange fee (consideration) received. It is important to note that the coupon or voucher

referred to in paragraph 70 is a coupon or voucher received for no consideration as opposed to a credit card rewards programme cash back reward/voucher that is received together with services of electronically transferring funds for consideration (and not for free).

Even though the direct cash back meets the paragraph 70 requirements one must first consider whether IFRS 15 is even applicable to this component of the contract. The scope of IFRS 15 states that an entity shall apply this Standard to all contracts with customers, except, among other things, financial instruments and other contractual rights or obligations within the scope of IFRS 9 *Financial instruments* (IFRS 15, par. 5(c)). The question arises whether or not the consideration payable to the customer represents a financial liability in terms of IAS 32 and therefore whether IFRS 9 is applicable. This question was addressed in Brink (2017b). It was found that consideration payable in a credit card rewards programme in the form of cash (direct cash back) meets the definition of a financial liability and IFRS 9 (and not IFRS 15) should therefore be applied to this part of the transaction. None of the factors that will require an adjustment to the transaction price are applicable for credit card rewards programmes and it can therefore be concluded that the total interchange fee, without any adjustments, represents the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract

An entity must allocate the transaction price to each of the identified performance obligations based on the relative stand-alone selling prices of the underlying goods and services (IFRS 15, par. 73–74). The stand-alone selling price is the price at which an entity would sell a promised good or service separately to a customer, for example the list price of the goods or services (IFRS 15, par. 77). If stand-alone selling prices are not directly observable, an entity will need to use estimates, based on reasonably available information. Suitable estimation techniques include the adjusted market assessment approach, the expected cost plus a margin approach, and the residual approach (IFRS 15, par. 78–79).

In a credit card rewards programme transaction consideration is paid for the services of electronically transferring funds in the credit card purchase transaction and for the goods or services supplied in exchange for award credits granted in the credit card transaction. A credit card rewards programme should therefore allocate the interchange fee to the services of electronically transferring funds and to the goods or services supplied in exchange for award credits granted. A credit card rewards programme will be able to determine the value of the services supplied in the credit card transaction (with reference to the interchange fee being a fixed percentage of the invoice price) as well as the goods or services that will be supplied in the future with reference to the number and corresponding value of the award credits granted. The problem with allocating these values to the performance obligations is that these values do not equal the consideration received (interchange fee). The value of the goods or services that will be supplied in the future will also be influenced by any discount that the member could receive without exchanging the award credits, and the likelihood that all the award credits granted will be exchanged. The credit card rewards programme has to use an estimation technique to determine the relative stand-alone selling prices of the underlying goods and services.

IFRS 15 paragraph 79(c) specifies the circumstances in which a residual approach would be a suitable method to estimate a stand-alone selling price: If the stand-alone selling price of a good or service is highly variable or uncertain, then an entity may estimate the stand-alone selling price by referring to the total transaction price less the sum of the observable stand-alone selling prices of other goods or services promised in the contract. A selling price is highly variable when an entity sells the same good or service to different customers (at or near the same time) for a

broad range of amounts. A selling price is uncertain when an entity has not yet established a price for a good or service and the good or service has not previously been sold on a stand-alone basis.

In view of the requirement of 'highly variable' provided above, the following is applicable to credit card rewards programme transactions: In all credit card transactions an interchange fee is levied at a fixed percentage of the invoice price of goods or services acquired on credit. Whether the credit cardholder is a member of the rewards programme or not the interchange fee is fixed; therefore the same selling price for the services of electronically transferring funds is asked whether the cardholder is a member and award credits are granted or whether the cardholder is not a member and no award credits are granted. In a credit card rewards programme transaction services of electronically transferring funds together with award credits granted to a member are sold for the same price as services of electronically transferring funds (without award credits granted) to a cardholder in a credit card transaction. Different goods and services are therefore sold for the same price. It can be concluded that the stand-alone selling price of a credit card rewards programme's goods or services is highly variable. It is only required that the stand-alone selling price meet one of the abovementioned requirements and therefore a credit card rewards programme can apply the residual approach to estimate the stand-alone selling price of a good or service.

The only reference to customer loyalty programmes in IFRS 15 can be found in the Application guidance (Appendix B), paragraph B39. Paragraphs B39–43 give guidance on the recognition of revenue in transactions where customer options for additional goods or services are present. Paragraph B42 determines that if the stand-alone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity shall estimate it. That estimate shall reflect the discount the customer would obtain when exercising the option, adjusted for both of the following: 1) any discount that the customer could receive without exercising the option, and 2) the likelihood that the option will be exercised (IFRS 15 AG, par. B42).

Using the guidelines in paragraph B42, credit card rewards programmes can estimate the stand-alone selling price for the award credits granted in the credit card transaction. Most credit card rewards programmes' award credits have a determinable value (a specific value can be linked to an award credit, for example 1 eBuck is worth R0.10) (eBucks, 2014). Some credit card rewards programmes' award credits cannot be linked to a specific rand value. For example, Investec Dividends' dividends points can be redeemed from a list of options including travel, flight, finance, charity, shopping and leisure offered by Investec and different programme partners. A spending schedule on the Investec website displays the various travel, shopping and leisure benefits per programme partner in rand value together with the price in the virtual currency (dividends points) (Investec, 2014). The rand value per dividends point for each programme partner differs; for example, 6 000 points can be exchanged for a R250 travel redemption rebate at Travel latitude and 7 500 points can be exchanged for a R250 Europcar voucher (Investec, 2014). Determining the value of award credits that cannot be linked to a specific rand value has been identified and is recommended as an area for further research and study.

For credit card rewards programmes that award credits that have a determinable value the credit card rewards programme can determine the stand-alone selling price of the award credits granted with reference to the rand value linked to the award credits granted. This value can be adjusted for any discount the member could receive without exchanging the award credits and also for the number of award credits expected to be exchanged. After determining the stand-alone selling price of the award credits granted, the credit card rewards programme can now estimate the stand-alone selling price of the services of electronically transferring cash in the credit card

transaction by applying the paragraph 79(c) residual approach. The stand-alone selling price of the services supplied in the credit card transaction equals the total consideration received (transaction price) less the stand-alone selling price for the award credits granted (the observable stand-alone selling prices of other goods or services promised in the contract).

Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

IFRS 15 paragraph 31 states that an entity shall recognise revenue when or as it satisfies a performance obligation by transferring control of a promised good or service (i.e. the asset) to a customer. The entity must also determine whether the performance obligations are satisfied over time or at a point in time (IFRS 15, par. 32). In a credit card rewards programme transaction the credit card rewards programme will allocate the total consideration received (transaction price) to the award credits granted (option to acquire additional goods or services) and to the services initially rendered. The credit card rewards programme must defer the part of revenue allocated to the award credits. The consideration allocated to the services initially rendered will be recognised as revenue when the credit card transaction takes place, because control is transferred to the cardholder (member). The deferred revenue will be recognised only when control of the goods or services underlying the award credits is transferred to the member or when the award credits expire (applying IFRS 15, par. 32 and par. B40). If a member does not exercise all of its rights under the option at once it will result in 'breakage' of the contract liability (Deloitte, 2012:3). In order to assist preparers with the application of the new model, Appendix B (which is considered to be an integral part of the Standard) gives guidance on specific issues and includes a section entitled *Customers' unexercised rights.*

Customers' unexercised rights (breakage)

Upon receipt of a non-refundable prepayment from a customer that gives the customer the right to receive goods or services in the future, the entity shall recognise a contract liability. The entity shall derecognise the contract liability when it satisfies its performance obligation (when it transfers the goods or services) (IFRS 15, par. B44). There is a possibility that the customers do not exercise all of their contractual rights (IFRS 15, par. B45). If an entity is reasonably assured to be entitled to the amount of expected breakage, the entity would recognise the effects of the expected breakage 'in proportion to the pattern of rights exercised by the customer' (IFRS 15, par. B46). Otherwise, the expected breakage would be recognised 'when the likelihood of the customer exercising its remaining rights becomes remote' (ED/2011/6, par. B27).

In a credit card rewards programme transaction it is possible that the award credits granted during the credit card transaction are not all exchanged for benefits at once. If the credit card rewards programme accounted for the total award credits granted during the credit card transaction, it will be possible to determine with reasonable assurance when only a portion of the award credits are exchanged for benefits. The credit card rewards programme can then recognise a part of the deferred revenue as revenue in proportion to the award credits exchanged. It is therefore crucial that rewards programmes should have sufficient systems in place to accumulate sufficient historical transaction information in order to recognise the effects of breakage as revenue over time (Deloitte, 2012:5). If a credit card rewards programme does not accumulate historical transaction information it will be impossible to identify the total unexercised rights (breakage) and it will not be able to recognise the breakage as revenue until the 'likelihood of the customer's exercising its remaining rights becomes remote' (IFRS 15, par. B46).

4. ADDRESSING UNCERTAINTIES RAISED IN RESPONSE TO THE NEW REVENUE MODEL

4.1 The interaction with financial instruments

IAS 32 *Financial instruments: Presentation*, paragraph 11 provides the following definition of a financial asset: 'A financial asset is any asset that is a contractual right to receive cash or another financial asset from another entity.' In terms of the credit card agreement, the cardholder (as the customer of the card issuer) is obliged to repay the credit card loan (capital) and interest on the loan. The card issuer (financial institution) therefore has a contractual right to receive cash (capital and interest) from the customer (cardholder), and the loan to a credit cardholder meets the definition of a financial asset. There are four categories of financial assets: financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables, and available-for-sale financial assets (IAS 39, par. 9). The loan to a credit cardholder meets the definition of the third category, loans and receivables, based on the following: The loan has fixed or determinable payments that are not quoted in an active market. This financial asset shall initially be measured at fair value plus transaction costs that are directly attributable to the issue of the financial asset (IAS 39, par. 43) and subsequently be measured at amortised cost using the effective interest method (IAS 39, par. 46(a)).

IFRS 9 *Financial instruments* (intended to replace IAS 39) has a mandatory effective date for annual periods beginning on or after 1 January 2018, with earlier application permitted (Deloitte, 2014). In applying IFRS 9 to this component of the credit card rewards programme transaction, the following is applicable: Financial assets can be classified as financial assets subsequently measured at either amortised cost or fair value (IFRS 9, par. 4.1.1). A financial asset shall be measured at amortised cost if both of the following conditions are met: 1) The asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows and 2) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (IFRS 9, par. 4.1.2). Both these requirements are met in terms of the credit card arrangement based on the following: The card issuer's objective is to lend money to credit cardholders in order to earn interest income and the cardholder contract includes, among other things, payment schedules. These payments include capital and interest. The card issuer will therefore classify the credit card loan as a financial asset subsequently measured at amortised cost. The financial asset will initially be measured at its fair value plus transaction costs that are directly attributable to the issue of the financial asset (IFRS 9, par. 5.1.1) and subsequently be measured at amortised cost (IFRS 9, par. 5.2.1). The accounting treatment of the loan and interest component of the credit card rewards programme transaction is therefore the same applying IAS 39 and IFRS 9. Therefore the loan and interest part of a credit card arrangement falls within the scope of IAS 39 / IFRS 9 (and outside the scope of IFRS 15 (IFRS 15, par. 5(c)) and should be accounted for accordingly.

The question now arises whether any parts of the credit card rewards programme fall within the scope of IFRS 9 and should therefore either be accounted for under IFRS 9 (IFRS 15, par. 5(c)) or only partially be treated under IFRS 9 (IFRS 15, par. 7). In the credit card rewards programme transaction the interchange fee is identified as the relevant revenue stream to consider and the interchange fee is considered to be in exchange for the service of electronic payment facilitation rendered to the cardholder. In addressing the question whether any part of the credit card rewards programme falls within the scope of IFRS 9 one should consider whether the interchange fee relates only to the service of electronic payment facilitation or whether a part of the fee

represents compensation for providing credit to the cardholder. The difference between the interchange fee charged for a debit card and a credit card might shed some light on this question. The interchange fee charged when using a debit card is significantly lower than when using a credit card (FASB & IASB, 2013:20). If the interchange fee represents only a fee charged for electronic payment facilitation then why is there such a big differential between a debit card and a credit card interchange fee? The staff of the IFRS Foundation and the FASB did not raise this issue during the public meeting of the IASB and the FASB that was convened based on concerns raised by respondents in the financial services industry regarding how the revenue model would apply to credit card rewards programmes (FASB & IASB, 2013:1–20). The reason for this might be that no financial institution regards or recognises the interchange fee, or part thereof, as interest. This is also supported by the response obtained during a survey circulated to all South African credit card rewards programmes. The respondents were requested to indicate what the interchange fee represents, and none of the respondents indicated that it, or part thereof, represents interest (refer to Brink, 2017a).

4.2 Accounting for award credits that are provided outside of a revenue transaction, such as upon opening a credit card account

If award credits are granted upon the opening of a credit card it represents an incentive granted outside a sales transaction and will therefore fall outside the scope of IFRS 15. This is in line with the application of IFRIC 13, namely that IFRIC 13 does not apply where there is no link to a sales transaction (PricewaterhouseCoopers, 2009:5; KPMG, 2007:1). These award credits granted can be treated as a marketing expense and a corresponding liability (provision) can be recognised in terms of IAS 37.

4.3 Different treatment for direct cash back rewards and non-cash rewards

A direct cash back reward meets the definition of a financial liability in terms of IAS 32, and therefore IFRS 9 is applicable. Even though the direct cash back reward meets the IFRS 15 paragraph 70 requirements (consideration payable to a customer), IFRS 15 is a residual Standard and will be applied only if other Standards (including IFRS 9) specified in the scope of IFRS 15 are not applicable. The card issuer shall therefore classify the financial liability as subsequently measured at amortised cost, but as the direct cash back reward already represents the future value as it is immediately claimable or due, no adjustments in terms of the effective interest method is necessary. Therefore the financial liability will be recognised at fair value and the contra-entry for the financial liability will be an expense, recognised when the direct cash back reward is granted (refer to Brink (2017b) for a detailed discussion). Award credits granted represent non-cash rewards and the recognition of the consideration allocated to the award credits is deferred until award credits are exchanged for benefits or when the award credits expire (if applicable) in terms of IFRS 15. In addressing the respondents' query it is firstly important to note that direct cash back rewards should be accounted for under IFRS 9 (and not under IFRS 15 paragraph 70 as the respondents believed) and secondly that even though cash and non-cash rewards are considered to be economically similar, IFRS 15 (together with IFRS 9) clearly requires different accounting treatment for these two different benefits.

4.4 Identifying the relevant revenue stream in a credit card reward programme transaction

In practice, and based on IFRIC 13's guidance (IFRIC 13 Basis for Conclusions, paragraph 4), the merchant interchange fee is identified as the revenue stream from the initial sales transaction that needs to be allocated to the goods or services sold and the award credits granted. This is also in line with the logical reasons or principles employed in concluding that a credit card rewards programme falls within the scope of IFRS 15 because the cardholder is the card issuer's customer for the interchange service. The interchange fee is the only revenue stream that flows with each credit card rewards programme transaction (in terms of which award credits are granted) and provides further support or evidence for why the interchange fee is identified as the relevant revenue stream to consider.

4.5 Contract combination guidance

The uncertainty as to whether credit card-issuing banks should combine contracts with their cardholders who participate in their rewards programmes with merchant contracts (KPMG, 2013a), and whether a portion of the revenue generated from the merchant interchange fees should be allocated to the goods or services provided under the rewards programmes (KPMG, 2013b), can be addressed as follows: The contract combination guidance states that entities can combine two or more contracts that are entered into at or near the same time with the same customer, and account for them as a single contract, if among other things, the goods or services promised in the contracts are a single performance obligation (IFRS 15, par. 17). *Step 1: Identify the contract with a customer* identified two contracts with the same customer (the cardholder) for the following two goods or services: the service of electronic transfer of funds in the initial credit card purchase transaction and the goods or services supplied with the exchange of the award credits. *Step 2: Identify the separate performance obligations in the contract* proved that these two goods or services are distinct and the promises represent performance obligations and should be accounted for as separate performance obligations. The goods or services promised in the two contracts are therefore not a single performance obligation and the two contracts should be accounted for separately. *Step 4: Allocate the transaction price to the performance obligations in the contract* showed how to allocate the transaction price (interchange fee) to the services of electronically transferring funds and to the goods or services supplied in exchange for award credits granted. Refer to section 3.1 of this article *(Five step revenue model)* for a detailed discussion of the abovementioned.

5. DIFFERENCES IN THE GUIDELINES PROVIDED IN IFRIC 13 AND IFRS 15

Any differences in the guidelines of IFRIC 13 and IFRS 15 will have an impact on credit card rewards programmes converting from IFRIC 13 to IFRS 15. In investigating the effect of the new revenue model on customer loyalty programmes Brink (2014:406-407) found that although different terms are used in IFRIC 13 and the new model there is only one difference in the accounting treatment of a customer loyalty programme transaction. The difference in the accounting treatment of a customer loyalty programme transaction under IFRIC 13 and under the new model is found in the allocation of the fair value (IFRIC 13) or the transaction price (ED/2011/6) to the goods or services sold in the initial transaction and the award credits granted (performance obligations). Under IFRIC 13 the fair value of the consideration received is allocated to the goods or services

and to the award credits granted. The value allocated to the award credits is calculated with reference to the fair value of the benefits for which they could be exchanged (the fair value of the award credits adjusted for any discounts that would otherwise be offered to customers who have not earned award credits from an initial sale, the expected redemption rate and non-performance risk), and the balance is allocated to the goods or services supplied (Brink, 2014:406-407). Under the new model the transaction price (consideration received) is allocated to the goods or services and to the award credits granted (the identified performance obligations) based on the *relative* stand-alone selling prices of the underlying goods and services. The stand-alone selling price of the award credits granted can first be calculated (with reference to the rand value linked to the award credits granted and this value can be adjusted for any discount the member could receive without exchanging the award credits and also for the number of award credits expected to be exchanged) and the balance can be allocated to the goods or services supplied in the initial purchase transaction by applying the residual approach.

The effect of the new model on the accounting treatment of a customer loyalty programme transaction is that less revenue will initially be deferred and this will result in an acceleration of revenue recognition. The presentation of the liability for the award credits granted and not exchanged will no longer be presented as deferred revenue (as per IFRIC 13) in the statement of financial position, but under the new model as a contract liability. The new revenue Standard also requires entities to disclose more information about revenue and therefore about customer loyalty programme transactions (Brink, 2014:411).

6. CONCLUSION AND RECOMMENDATIONS

For annual reporting periods beginning on or after 1 January 2017, IFRIC 13 will be withdrawn and will be replaced by the new revenue Standard, IFRS 15. If a credit card rewards programme concludes that the cardholder is the card issuer's customer for the interchange service and the credit card rewards programme falls within the scope of IFRS 15, the credit card rewards programme must determine how to account for credit card rewards programme transactions given the minimum guidance contained in IFRS 15 and the unanswered uncertainties raised.

IFRS 15 – as opposed to IFRIC 13 – is not only applicable to customer loyalty programme transactions but will be applied to account for all revenue transactions. At first IFRS 15 may seem overwhelming (the Standard consists of 89 pages and is not specific to customer loyalty programme transactions) to credit card rewards programmes, but this article has highlighted the paragraphs specifically applicable to the accounting treatment of credit card rewards programme transactions. The article has also addressed uncertainties raised in response to the ED/2011/6 and has highlighted the differences between the requirements contained in IFRIC 13 and IFRS 15 that will assist credit card rewards programmes in converting from IFRIC 13 to IFRS 15.

All credit card rewards programmes should determine, based on their facts and circumstances, whether the cardholder is the card issuer's customer for the interchange service and whether their credit card rewards programme consequently falls within the scope of IFRS 15. If a credit card rewards programme concludes that the rewards transactions fall within the scope of IFRS 15 the credit card rewards programmes should familiarise themselves with the requirements of IFRS 15. It is crucial for credit card rewards programmes to start collecting data for the retrospective application of the new Standard (Lamoreaux, 2012:30). Even though the effective date of the new revenue Standard was moved to 1 January 2017, award credits (not subject to an expiry date) granted today can still have an impact on reporting in 2017. Without examining the comprehensive

Standard, which consists of 89 pages (excluding the illustrative examples and the Basis for conclusion), credit card rewards programmes can gain the necessary knowledge regarding the new revenue model from this article.

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