The accounting treatment of credit card rewards programmes: a South African perspective (Part II)

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Abstract

Most credit card issuers offer their card holders participation in a customer loyalty programme. On 1 July 2007 the IASB issued IFRIC 13 Customer Loyalty Programmes to give specific guidance to suppliers on the accounting treatment of customer loyalty programme transactions. Despite the fact that credit card rewards programmes are specifically included in the scope of this Interpretation, in practice not all credit card rewards programmes currently account for award credits under the revenue deferral model (IFRIC 13). These divergent practices make one question the relevance of the current guidance provided in IFRIC 13 to credit card rewards programmes; otherwise what is the reason behind credit card rewards programmes accounting for these transactions differently? During May 2014 the IASB and the United States Financial Accounting Standards Board (FASB), published IFRS 15 Revenue from Contracts with Customers intended to replace six existing Standards and Interpretations, including IFRIC 13. The aim of IFRS 15 is to streamline accounting for revenue across all industries and to correct inconsistencies in existing Standards and practices. Credit card rewards programme respondents raised many queries and uncertainties based on the proposed model but despite these concerns the Boards decided against providing any additional guidance to credit card rewards programmes. They indicated that they leave it up to management's judgement to determine how to account for these transactions (in effect not achieving the aim of streamlining accounting for revenue across all industries). The main objective of the research reported in this article is to determine whether or not credit card rewards programmes should have been included in the scope of IFRIC 13 and consequently whether or not credit card rewards programmes should be included in the scope of IFRS 15. It was found that the differences between a credit card rewards programme and a typical customer loyalty programme prove that a credit card rewards programme transaction should be treated differently for accounting purposes and that these transactions should fall outside the scope of IFRIC 13 and IFRS 15.

Keywords

Award credits, customer in relation to the card issuer, IFRIC 13, IFRS 15.

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1. BACKGROUND AND FORMULATION OF THE STUDY

1.1 Background

Most credit card issuers offer their card holders 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 card holders 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 credit card rewards programme – American Express Membership (AMEX) rewards – was launched in 1995 (Conradie, 2007:20) and currently 13 financial institutions or banks 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) and also the largest contributor, 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. Kearney (2013) reported that ABSA rewards clocked up one million rewards members in 2012 and has paid out more than R300 million in cash rewards since the rewards programme was launched in 2009. ABSA indicated a year-on-year growth rate of 64% (Kearney, 2013). Given the popularity of credit card rewards programmes in South Africa, together with the extremely high Rand value associated with it, it is important that suppliers correctly account for credit card rewards programme transactions.

Before 1 July 2007, the International Financial Reporting Standards (IFRS) lacked specific guidance on how companies offering customer loyalty programmes should account for awards or benefits offered to customers in terms of these programmes. Because of a lack of specific guidance, practices diverged (IFRIC 13 Basis for Conclusions, 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). IFRIC 13 specifically includes credit card rewards programmes in its scope. IFRIC 13 Basis for Conclusions (that accompany IFRIC 13) paragraph 4 states: 'In some sales transactions, the entity receives consideration from an intermediate party, rather than directly from the customer to whom it grants the award credits. For example, credit card providers may provide services and grant award credits to credit card holders but receive consideration for doing so from vendors accepting payment by credit card. Such transactions are within the scope of the Interpretation and the wording of the consensus has been drafted to accommodate them.'

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In practice, most credit card issuers reporting under IFRS account for rewards programmes under IFRIC 13 because of this inclusionary language contained in the Basis for Conclusions on IFRIC 13 (FASB & IASB, 2013:7). Deloitte (2010:3) and KPMG (2007:1) also agree that credit card rewards programme transactions fall within the scope of IFRIC 13. KPMG (2007:1-10) explains how to account for a credit card rewards programme transaction within the scope of IFRIC 13: Credit card rewards programmes grant award credits to credit card holders with each credit card purchase transaction at third party vendors. The interchange fees that the credit card company receives for providing those credit facilities to the customer come indirectly from the customer via the fee that the vendor is required to pay to the credit card company. For accounting purposes the vendor's fee or interchange fee can be identified as the revenue from the initial sales transaction which needs to be allocated by the credit card issuer between credit services supplied and the redemption of goods or services under the customer loyalty programme at a later date (KPMG, 2007:4).

Even though the scope of IFRIC 13 includes credit card rewards programmes, KPMG (2013) states that in practice not all credit card rewards programmes account for award credits under the revenue deferral model (IFRIC 13). Some financial institutions provide for the cost of satisfying the award credits (points or miles) as and when the customer earns them by recognising a provision (in terms of International Accounting Standards (IAS) 37 *Provisions, Contingent Liabilities and Contingent Assets*) and related expense. Instead of recognising an expense, other credit card issuers currently 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)

During May 2014, the IASB, together with the United States Financial Accounting Standards Board (FASB), published International Financial Reporting Standards (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, 2012:2). IFRS 15 will replace IAS 11 *Construction Contracts*, IAS 18 *Revenue*, IFRIC 15 *Agreements for the Construction of Real Estate*, IFRIC 18 *Transfers of Assets from Customers*, SIC 31 *Revenue – Barter Transactions Involving Advertising Services* and IFRIC 13 *Customer Loyalty Programmes* (KPMG, 2011:4 ; IFRS 15, par. C10).

The process of compiling a new revenue Standard started in 2010 with the issue 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. Deliberations on the second exposure draft continued throughout 2012 and 2013 with substantial re-deliberations during the first two quarters of 2014 (IASB, 2014). IFRS 15 will be effective for annual reporting periods beginning on or after 1 January 2017 (IFRS 15, par. C1).

In response to the second exposure draft (ED/2011/6), the IASB and FASB 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, 2013). Based on the lack of specific guidance for customer loyalty programmes in the ED/2011/6, with only one reference to

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'customer award credits (points)' (in the Application Guidance paragraph B20) 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 only include one example that specifically applies to customer loyalty programme transactions (vs. the two illustrative examples that accompany IFRIC 13). The main concern raised by respondents from credit card rewards programmes was whether or not all credit card rewards programme transactions are included in the scope of the new revenue Standard (PricewaterhouseCoopers, 2012:15). Despite concerns raised, the Boards decided against providing any additional guidance to credit card rewards programmes and 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.

1.2 Literature review

After the issue of IFRIC 13, most audit firms published documents to provide further guidance on the interpretation and application of the then new Interpretation IFRIC 13. Most of these documents include the following: background and reasons for issuing IFRIC 13, scope of IFRIC 13, accounting for customer loyalty programmes, guidance on determining the fair value to allocate to the elements in the arrangement, illustrating examples, and guidelines regarding the information a supplier needs to gather to account for customer loyalty programme transactions (PricewaterhouseCoopers, 2007; PricewaterhouseCoopers, 2009; Deloitte, 2007; Deloitte, 2010). After 2010, little was written or at least nothing new was published on IFRIC 13 and the accounting treatment of customer loyalty programme transactions. Customer loyalty programmes started to apply IFRIC 13 for annual periods beginning on or after 1 July 2008. Given that no new research was done on the topic and that no one questioned this Interpretation it can be assumed that the requirements of IFRIC 13 were accepted as correct.

Only in 2013, against the background of the process of compiling a new revenue Standard (intended to replace six existing Standards or Interpretations, including IFRIC 13), new research on the topic of customer loyalty programmes was done. Brink (2013:795-814) did a critical analysis of IFRIC 13 to determine whether the guidance in IFRIC 13 regarding the accounting treatment of a single-company customer loyalty programme transaction is consistent with other accounting Standards and recent developments. This analysis was aimed at assisting the development of the new revenue Standard (which at that stage was still in the development phase). The scope of the article was limited to single-company programmes and specifically excluded credit card rewards programmes that are mostly categorised as a single-company dominated programme (Brink, 2013:3). The accounting treatment of each component of a customer loyalty programme transaction with a change in estimate was considered. It was found that inconsistencies exist in the initial measurement of the fair value and how a change in accounting estimate is recognised (Brink, 2013:22).

The Accounting treatment of credit card rewards programmes Part I (Brink, 2015) investigated 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 card holder (member of the rewards programme) is identified as

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the customer in relation to the card issuer in the transaction the transaction falls within the scope of IFRS 15. *The Accounting treatment of credit card rewards programmes Part I* (Brink, 2015) investigated the logical reasons or principles employed in determining the customer in relation to the card issuer. It was found, 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, 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.

1.3 Research problem

Despite the fact that IFRIC 13 provides specific guidance, including credit card rewards programme in the scope of IFRIC 13, in practice credit card rewards programmes account for these transactions differently. 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 (points or miles) 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 make one question the relevance of the current guidance provided in IFRIC 13 to credit card rewards programmes; otherwise one may ask what the reason is behind credit card rewards programmes accounting for these transactions differently.

Based on the aim of IFRS 15, namely to streamline accounting for revenue across all industries and to correct inconsistencies in existing Standards and practices, one would expect that inconsistencies like those mentioned above will be addressed. But the Boards' reaction to concerns raised in the response to the ED/2011/6 regarding whether or not credit card rewards programmes fall within the scope of IFRS 15 indicates the opposite.

The Boards (IASB and FASB) observed that credit card arrangements are complex and the facts will vary among the different programmes. The Boards advised credit card rewards programmes to 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). IFRS 15 therefore does not include any additional guidance, application guidance or examples for different facts and circumstances in a credit card rewards programme. The fact that the Boards did not address the concerns raised and did not provide any further guidance might be an indication that they made a mistake by including credit card rewards programmes in the scope of IFRIC 13. The question consequently arises whether credit card rewards programmes should have been included in the scope of IFRIC 13 and ultimately in IFRS 15.

1.4 Research objective

The main objective of the research was to determine whether or not credit card rewards programmes should have been included in the scope of IFRIC 13 and consequently whether or not credit card rewards programmes should be included in the scope of IFRS 15. If it were found that credit card rewards programmes should have fallen outside the scope of IFRIC 13 and fall outside the scope of IFRS 15, the research would determine what other Standard(s) should be applied for accounting for credit card rewards programme transactions. In order to meet the main objective, answers to the following secondary questions first needed to be found:

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- How does a credit card rewards programme differ from a typical customer loyalty programme, and based on the answers, should it be accounted for differently? In order to do this comparison the following questions need to be answered:
  - What are the different types of customer loyalty programmes available in the South African market and is it possible to obtain an in-depth understanding of these programmes with reference to a sample of customer loyalty programmes representing a typical customer loyalty programme?
  - How does a credit card rewards programme function in general and are there different structures of credit card arrangements that will have an impact on the accounting treatment of these transactions?
  - What are the different credit card rewards programmes available specifically in the South African market and what do their terms and conditions entail?
  - Is the interchange fee the correct revenue stream from the initial sales transaction that needs to be allocated to the goods or services sold and the award credits granted?

1.5 Research methodology

The study made use of a qualitative approach based on a literature study of purely theoretical aspects. A document analysis is 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, explain areas of difficulty and, perhaps, predict future developments. The problem-based doctrinal research methodology applied in this research included 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, 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 article is structured as follows:

- Identifying a sample of customer loyalty programmes (excluding credit card rewards programmes) in the South African market representing a typical customer loyalty programme and obtaining in-depth knowledge of the different terms and conditions of these programmes;
- Obtaining an understanding of the functioning and structures of credit card rewards programmes in general;
- Identifying all credit card rewards programmes in the South African market and obtaining in-depth knowledge of the different terms and conditions of these programmes;
- Identifying the differences between a credit card rewards programme and a typical customer loyalty programme in order to shed some light on the rationale why credit card rewards programmes should perhaps be treated differently for accounting purposes;

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- Considering the different revenue streams (the interchange fee, interest and the participation or linkage fee) from the initial sales transaction that needs to be allocated to the goods or services sold and the award credits granted;
- A concise discussion on the Standard(s) to consider if it is found that a credit card rewards programme transaction should fall outside the scope of IFRIC 13 and IFRS 15;
- Summary, conclusion and recommendations.

1.6 Research contribution

The research makes a contribution by providing specific guidance and clarity on whether or not credit card rewards programmes should have been included in the scope of IFRRIC 13 and ultimately in the scope of IFRS 15. The research highlighted the differences between a credit card rewards programme transaction and a typical customer loyalty programme transaction, proving and supporting why credit card rewards programmes should be treated differently for accounting purposes. If it were found that credit card rewards programmes should have fallen outside the scope of IFRIC 13 and fall outside the scope of IFRS 15 the research would also identify relevant Standard(s) to apply together with the reasons why the specific Standard(s) are applicable. This research highlighted important principles that will contribute to the body of knowledge to account for credit card rewards programme transactions. This information can be useful as a tool for serving role players in the accounting environment.

2. DIFFERENCES BETWEEN A CREDIT CARD REWARDS PROGRAMME AND A TYPICAL CUSTOMER LOYALTY PROGRAMME

In order to understand why credit card rewards programmes must possibly be treated differently from other customer loyalty programmes for accounting purposes it was necessary to investigate how a credit card rewards programme transaction differs from a typical customer loyalty programme transaction. The main objective of the research reported in this section was therefore to identify the differences between a credit card rewards programme and a typical customer loyalty programme. In order to meet this objective the structures, functioning and terms and conditions of a credit card rewards programme needed to be compared with a typical customer loyalty programme.

2.1 Typical customer loyalty programmes

An in-depth knowledge of customer loyalty programmes (other than credit card rewards programmes) can be obtained by referring to Conradie's (2007:1-283) and Brink's (2011:1-156) research on customer loyalty programmes in South Africa. Between 2003 and 2007 Conradie conducted comprehensive studies on customer loyalty programmes in South Africa to assess the value that customer loyalty programmes offer their members. The cash value (calculated as a percentage of cash back on actual expenditure), the variety of benefit choices and the user-friendliness of customer loyalty programmes were among the factors considered in order to determine this value (Conradie, 2007:12; Conradie & Goldstuck, 2005:13; Conradie & Goldstuck, 2003:8).

Brink's (2011:1-156) unpublished master's dissertation investigated whether the existing provisions in the Income Tax Act No. 58 of 1962 and related case law provide a basis for taxing

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customer loyalty programme benefits in the hands of the consumer as a natural person. In order to meet this objective a customer loyalty programme transaction had to be measured against the provisions of the Income Tax Act. It was assumed that the functioning and the terms and conditions of customer loyalty programmes would have an impact on this investigation. Therefore Brink wanted to obtain an in-depth knowledge of the different customer loyalty programmes available in the South African market. Brink (2011:16) therefore selected a sample of customer loyalty programmes for further investigation into their terms and conditions. Brink (2011:16-30) started by identifying a population of customer loyalty programme suppliers for sampling based on the report by Conradie (2007:1-283) with reference to the following criteria: the customer loyalty programme must be a technology-enabled chief operator programme, nationally available to the general public, and must have purchase behaviour as incentive. Twenty-seven customer loyalty programmes met these criteria and therefore represented the population.

Brink (2011:23) then selected the most popular customer loyalty programmes based on known *active* membership numbers from this population to form part of the sample. The population was stratified on the basis of the role that the programme owner plays and the type of industry sector in which the customer loyalty programme finds itself. The sample selection was extended by selecting a further one customer loyalty programme to ensure that the sample was representative of all the different roles that the programme owner can play, as well as all industry sectors (Brink, 2011:24-29). The final sample identified by Brink was used for the purposes of this study and was only adjusted to exclude all credit card rewards programmes. The sample selection (excluding credit card rewards programmes) ensured coverage of 82% of the total known *active* membership numbers of programmes included in the population. Given this percentage one can argue with a reasonable degree of confidence that it substantially represented the terms and conditions of customer loyalty programmes (excluding credit card rewards programmes) in the South African market. The terms and conditions of these programmes, representing a typical customer loyalty programme, were investigated.

2.2 Credit card rewards programmes

In a typical credit card arrangement, when a card holder 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 card holder. 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) and from the card holder (namely interest charged on outstanding credit card balances and annual service fees that entitle a card holder 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 card holder receives award credits for each credit card purchase transaction from a merchant (FASB & IASB, 2013:4). The card holder contract will include the terms and conditions of the rewards programme. Some credit card rewards programmes also charge a participation or linkage fee that enables the card holder (member) to earn award credits in terms of the rewards programme (FASB & IASB, 2013:12).

Structures of credit card rewards programmes

The functioning and more specifically the structures of credit card rewards programmes were investigated in *The accounting treatment of credit card rewards programmes Part I* (Brink, 2015). It was found that there are two different structures under which credit card rewards programmes

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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 card holder contract: In both structures this contract is between the issuing bank and the card holder. The card holder contract governs the terms and conditions on the use of the credit card by the card holder 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).

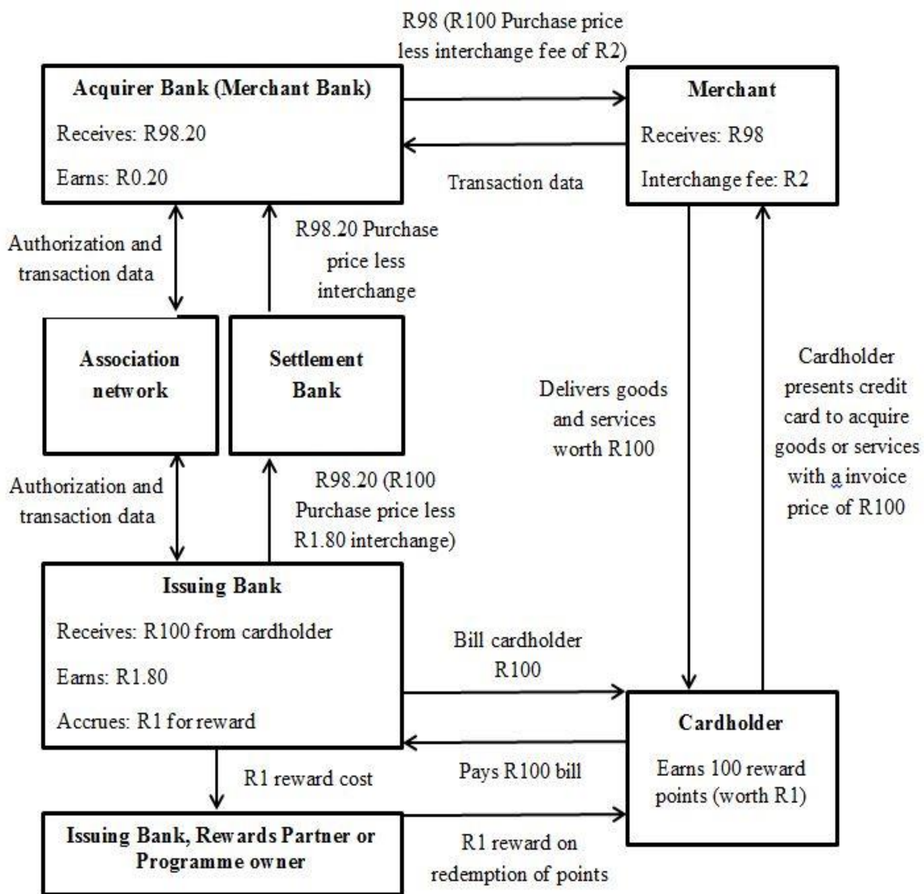

FIGURE 1: Open loop structure

Source: FASB & IASB, 2013:3

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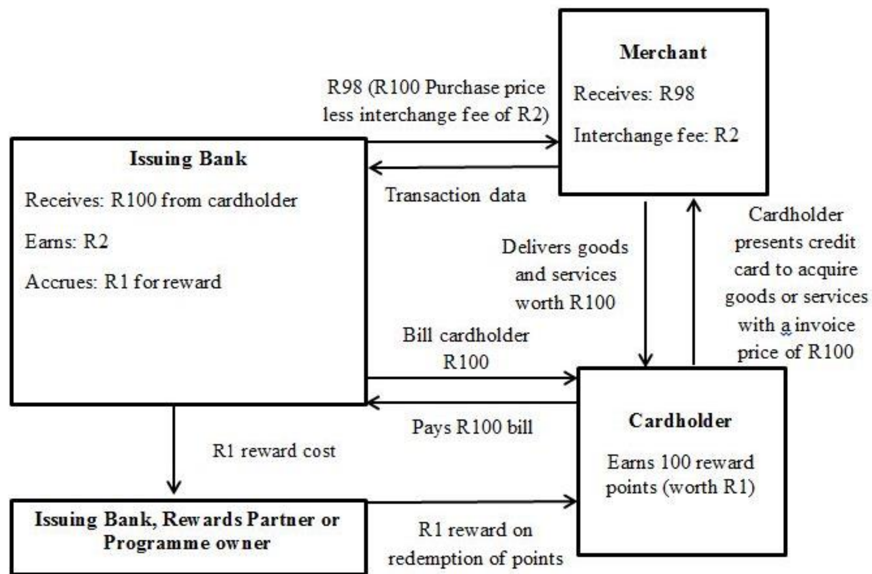

FIGURE 2: Closed loop structure

Source: Payments-R-Us, 2009

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.

Terms and conditions of credit card rewards programmes

There are currently 13 different credit card rewards programmes, each with unique terms and conditions, available in the South Africa market (Siddle, 2014). The 13 credit card rewards programmes identified for further investigation are: eBucks, ABSA Rewards, Standard Bank UCount, Nedbank Greenbacks, American Express (AMEX) Membership Rewards, Discovery Credit Card, Virgin Money, Woolworths Credit Card, Kulula Credit Card, British Airways Credit Card, Avios Credit Card, South African Airways Voyager Credit Card and Investec Dividends Rewards Programme (Siddle, 2014). The terms and conditions of each rewards programme was analysed in detail with reference to the following aspects:

- The structure of the credit card arrangement (an open loop structure and a closed loop structure),
- the role of the programme owner (a single-company programme, a single-company dominated programme or a multi-partner programme),

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- earning opportunities (earn from the bank, from programme partners or from the bank and programme partners),
- the form in which benefits are received (a direct cash back, cash back reward/voucher or award credits accumulating in the membership rewards account),
- additional benefits or rewards offered ('hard' and 'soft' benefits and joining rewards),
- the determinacy of the value of the award credits,
- spending opportunities (programme owner and partners, programme owner or choice of the member) and
- a fee applicable to belong to the rewards programme.

This investigation into the terms and conditions of the credit card rewards programmes was applied in the comparison with a typical customer loyalty programme in number 2.6 *Differences in terms and conditions of the programmes*. The functioning, structures and terms and conditions of credit card rewards programmes were compared with the functioning, structures and terms and conditions of a typical customer loyalty programme. The following differences that were identified might shed some light on the rationale for credit card rewards programmes perhaps being treated differently for accounting purposes:

2.3 Differences in the functioning of the programmes

A typical customer loyalty programme rewards customers (members) by granting award credits based on the acquisition of goods or services from the programme owner and/or from qualifying programme partners. These purchases could be paid for in cash or by debit or credit card. A credit card rewards programme differs from a typical customer loyalty programme in that it awards a payment mechanism rather than awarding the acquisition of goods or services (Conradie & Goldstuck, 2003:8).

2.4 Differences in the rationale behind the programmes

A typical customer loyalty programme is seen as a marketing strategy (Garcia Gómez, Gutiérrez Arranz, Gutiérrez & Cillián, 2006:387) that is designed to encourage consumers to repeatedly acquire goods or services from a specific supplier (Dick & Basu, 1994:99). On the other hand, the primary purpose of credit card issuers in a credit card arrangement is the provision of financing on which they expect to earn interest income (FASB & IASB, 2013:11). Credit card rewards programme therefore encourage credit card holders to use just one credit card to make their purchases (Creditor Web, 2014), because if credit card holders use one credit card only they are more likely to make use of the financing service offered by the card issuer.

2.5 Differences in the structures of the programmes

A credit card rewards programme differs from other customer loyalty programmes in that there are more parties involved in a credit card rewards programme. There are two ways in which a credit card rewards programme can be structured, namely an open loop structure and a closed loop structure. Under an open loop structure there are seven possible parties involved: 1) the issuing bank or card issuer (typically a financial institution or bank), 2) the merchant (for example, a retail store), 3) the card holder, 4) the acquirer bank or merchant bank, 5) the association network, 6) the settlement bank, and 7) the rewards partner or loyalty provider. Under a closed loop structure there are four possible parties involved: 1) the issuing bank or card issuer (typically

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a financial institution or bank), 2) the merchant (for example, a retail store), 3) the card holder, and 4) the rewards partner or loyalty provider. In a typical customer loyalty programme there are at most three parties involved: 1) the programme owner, 2) the programme partners and 3) the member of the customer loyalty programme.

2.6 Differences in terms and conditions of the programmes

2.6.1 Rewards programme fee

A credit card rewards programme is the only type of customer loyalty programme that charges a participation or linkage fee from a member of the rewards programme.

2.6.2 'Hard' and 'soft' benefits

A credit card rewards programme is the only type of customer loyalty programme that offers their members extensive 'soft' benefits over and above the 'hard' benefits. 'Hard' benefits are usually economic in nature, such as a discount on a future purchase transaction while 'soft' benefits are of a non-economic nature and include exclusive benefits such as access to airport lounges (Standard Bank, 2014a, Nedbank, 2014a). There seems to be a link between the fact that a credit card rewards programme is the only type of customer loyalty programme that charges a participation or linkage fee and also the only type of customer loyalty programme that offers their members extensive 'soft' benefits over and above the 'hard' benefits.

Absa Rewards specifically states that included in a member's monthly membership fee the member obtains access to Bonus Benefits (Absa, 2014a) including the following benefits: the Home Assist benefit, the Dial-A-Discount benefit, The Healthy Lifestyle benefit and the Lifestyle Concierge benefit (Absa, 2014b). SAA Voyager credit card rewards programme distinguishes between travel benefits and financial benefits that can be enjoyed over and above the award credits. The travel benefits include, amongst other things, access to SAA Business Class check-in and the financial benefits include, amongst other things, no transaction fee on purchases, local and international ATM access and automatic travel insurance cover (Nedbank, 2014a). The financial benefits seem to be benefits that a credit card programme not offering a rewards programme also offers its card holders.

2.6.3 Forms in which benefits are received

A credit card rewards programme differs from other customer loyalty programmes in that benefits can also be received as direct cash back. The form in which benefits are received in a typical customer loyalty programme is limited to award credits accumulating on the membership card or a cash back voucher (a voucher stipulating a specific Rand value which can be redeemed for discount on a future purchase transaction).

2.6.4 Differences in the redeeming opportunities

The redeeming opportunities in a typical customer loyalty programme are limited to goods, services or a discount on future purchase transactions. Most credit card rewards programmes redeeming opportunities are also limited to goods, services or a discount on future purchase transactions. However, some credit card rewards programmes also offer their members a redeeming benefit of obtaining money (foreign currency) in exchange for award credits. Other

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virtual currency can also be obtained in a credit card rewards programme, for example exchanging points from one rewards programme for points of another rewards programme.

2.6.5 Differences in the revenue streams to consider

In a typical customer loyalty programme transaction there is only one possible revenue stream to consider for accounting purposes, namely the consideration paid by the customer for the goods and services in terms of which the award credits are granted. In a credit card rewards programme transaction the following revenue streams should be considered: the interchange fee, interest, and the participation or linkage fee.

3. THE IMPACT OF THE DIFFERENCES IDENTIFIED ON THE ACCOUNTING TREATMENT OF A CREDIT CARD REWARDS PROGRAMME TRANSACTION

IFRIC 13 Basis for Conclusions provides insight into the Board's thought process in arriving at the final Interpretation. This thought process, together with the final Interpretation, should be taken into account when the differences between a credit card rewards programme and a typical customer loyalty programme transaction are considered. IFRIC 13 Basis for Conclusions includes a section entitled *Issues* and discusses the three different views that emerged on how a customer loyalty programme should recognise and measure its obligation to provide free or discounted goods or services if and when customers redeem award credits (IFRIC 13 Basis for Conclusions, par. BC 5). The three different views can be summarised as follows:

- A customer loyalty programme should account for award credits in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets,* in terms of which the obligation should be recognised as an marketing expense at the time of the initial sale and be measured by reference to the amount required to settle it (IFRIC 13 Basis for Conclusions, par. BC 6). Under this view, paragraph 19 of IAS 18 *Revenue* is applied; it requires expenses relating to the sale, including those for costs still to be incurred to be recognised at the same time as the revenue.
- A customer loyalty programme should account for award credits in accordance with IAS 18 *Revenue* (specifically applying paragraph 13). This means that some of the consideration received in respect of the initial sale should be allocated to the award credits and recognised as a liability (deferred revenue) until the entity fulfils its obligations to deliver benefits to customers. The liability would be measured by reference to the value of the award credits to the customer (not their cost to the entity) and recognised as an allocation of revenue (not an expense) (IFRIC 13 Basis for Conclusions, par. BC 7).
- The accounting treatment of customer loyalty programmes should depend on the nature of the programme and more specifically the relative value or nature of the awards or the method of supplying them. In terms of this view, award credits could be regarded as a marketing expense (in line with view 1) if their value were insignificant and/or they were redeemable for goods or services not supplied by the entity in the course of its ordinary activities. Award credits could also be regarded as a separate component of the initial sales transaction (in line with view 2) if their value were significant and/or they were redeemable for goods or services supplied by the entity in the course of its ordinary activities (IFRIC 13 Basis for Conclusions, par. BC 8).

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The third view therefore determines that, based on the facts and circumstances of the customer loyalty programme, two different accounting methods are possible. This is in line with the Boards' recommendation, after considering the response to the ED/2011/6, 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). Even though IFRIC 13 applies the second view, considering the Boards' current recommendation that credit card rewards programmes should consider all the facts and circumstances when accounting for credit card reward programmes, the third view contained in IFRIC 13 Basis for Conclusions is now perhaps more appropriate when considering the accounting treatment of specifically credit card rewards programme transactions. It can therefore be argued that this third view is an appropriate basis for determining the accounting treatment of credit card rewards programme transactions, based on the Board's response to the ED/2011/6.

3.1 Applying IFRIC 13 Basis for Conclusions' third view to credit card rewards programme transactions

3.1.1 Award credits regarded as a marketing expense

In considering the two requirements for award credits to be regarded as a marketing expense, namely 1) award credit's value is insignificant (to the value of the revenue stream from that transaction) and/or 2) award credits are redeemable for goods or services not supplied by the entity in the course of its ordinary activities, the following should be considered: In a typical customer loyalty programme the value of the award credits can be calculated as a percentage of the revenue stream from the loyalty programme transaction (the value of the goods or services sold). In a credit card rewards programme transaction, the value of the award credits granted is calculated as a percentage of the credit card expenditure at the merchant, not representing the relevant revenue stream in the rewards programme transaction (the relevant revenue stream is discussed in 3.2 *Relevant revenue stream to consider in a credit card rewards programme transaction*). Taking into account that an 'or' requirement is present and only one of the requirements needs to be met to fall into the mentioned category, the second requirement should be considered.

The investigation of the 13 credit card rewards programmes' terms and conditions in South Africa revealed that 11 of the 13 credit card rewards programmes offer their members redeeming opportunities at the rewards programme itself (usually from an online store) and at the various programme partners. The goods and services displayed on the website and offered by the rewards programme represent goods or services not supplied by the financial institution in the course of its ordinary activities.

Accounting treatment of credit card rewards programmes that award credits are redeemable for goods or services not supplied by the entity in the course of its ordinary activities

Most South African credit card rewards programmes fall into this first category. The third view included in IFRIC 13 Basis for Conclusions is that rewards programmes in this category should account for their award credits as a marketing expense applying paragraph 19 of IAS 18. Paragraph 19 of IAS 18 states that revenue and expenses that relate to the same transaction are recognised simultaneously; this process is commonly referred to as the matching of revenues and expenses. Most credit card rewards programmes in the South African market should therefore recognise the award credits granted as an expense when the award credits are granted.

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3.1.2 Award credits regarded as a separate component of the initial sales transaction

In considering the two requirements for award credits to be regarded as a separate component of the initial sales transaction, namely 1) award credit's value is significant (to the value of the revenue stream from that transaction) and/or 2) award credits are redeemable for goods or services supplied by the entity in the course of its ordinary activities, the following: As discussed in 3.1.1 *Award credits regarded as a marketing expense* the award credit's value is not calculated with reference to the relevant revenue stream from the rewards programme transaction. Taking into account that an 'or' requirement is present and only one of the requirements needs to be met to fall into the mentioned category, the second requirement is considered.

The investigation of the 13 credit card rewards programmes' terms and conditions in South Africa revealed that two of the 13 credit card rewards programmes offer their members redeeming opportunities that represent goods or services supplied by the entity in the course of its ordinary activities. Absa Rewards grants its members cash back rewards (Mather, 2013) and therefore the cash can be spent as the member chooses. Theoretically, the member can therefore use the cash back to acquire other services from the financial institution. Investec Dividends offer their members the opportunity to exchange their award credits to pay the monthly bank account fee or to exchange it for foreign exchange (Investec, 2014). These two reward programmes' award credits can therefore potentially fall into one or both categories mentioned.

Accounting treatment of credit card rewards programmes whose award credits are redeemable for goods or services supplied by the entity in the course of its ordinary activities

The third view included in IFRIC 13 Basis for Conclusions is that rewards programmes in this category should account for their award credits by applying paragraph 13 of IAS 18. Applying paragraph 13 of IAS 18 is in line with the second view included in IFRIC 13 Basis for Conclusions that was adopted as the correct view and prescribed in IFRIC 13. Paragraph 13 of IAS 18 states that the accounting treatment referred to in IAS 18 is usually applied separately to each transaction. In certain circumstances it is necessary to apply the accounting treatment to the separately identifiable components of a single transaction in order to reflect the true substance of the transaction. For example, when the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and recognised as revenue over the period during which the service is rendered. When applying the above guideline to a credit card rewards programme transaction, one must identify the selling price (relevant revenue stream) that includes an identifiable amount for subsequent servicing. There are three different possible revenue streams to consider in a credit card rewards programme transaction, namely the interchange fee, the interest, and the participation or linkage fee. Identifying the correct revenue stream will be considered in the next section of the article.

3.2 Relevant revenue stream to consider in a credit card rewards programme transaction

In order to identify the correct revenue stream in a credit card rewards programme transaction, the application of paragraph 13 of IAS 18 (and in effect the guidelines contained in IFRIC 13) to a typical customer loyalty programme transaction can be considered.

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3.2.1 Applying paragraph 13 of IAS 18 to a typical customer loyalty programme

In a typical customer loyalty programme transaction consideration is paid for goods or services and in the same transaction award credits are granted, and this gives the member (customer) a right to future benefits. Therefore, a typical customer loyalty programme transaction may be regarded as a single transaction consisting of two separate identifiable components, namely the sale of goods or services, and the granting of award credits that gives the member a right to benefits. In terms of paragraph 13, the accounting treatment must be applied separately to each of the components in the transaction. The award credits granted are linked to an identifiable amount or value, i.e. the value of the benefits receivable by the member in the future. The selling price therefore includes an identifiable amount for the future supplying of benefits. A typical customer loyalty programme transaction is thus similar to the example referred to in paragraph 13 of IAS 18 (a sales transaction where the selling price includes an amount for subsequent servicing). The consideration received or receivable from the sale can be identified as the relevant revenue stream and should be allocated to the goods or services sold and the award credits granted. The portion allocated to the goods or services sold will be recognised as revenue during the sales transaction. The portion allocated to the award credits will only be recognised as revenue when the award credits are exchanged for benefits, and the recognition of this portion of the revenue is therefore deferred. Against the background of understanding how the guidelines are applied in a typical customer loyalty programme transaction, the focus can now move to the differences between a credit card rewards programme transaction and a typical customer loyalty programme transaction in pursuit of identifying the correct revenue stream in a credit card rewards programme transaction.

3.2.2 Comparing credit card rewards programmes with typical customer loyalty programmes in order to identify the relevant revenue stream

The differences between a credit card rewards programme and a typical customer loyalty programme as identified in number 2 *Differences between a credit card rewards programme and a typical customer loyalty programme* will assist in identifying the relevant revenue stream in a credit card rewards programme transaction and might shed some light on the issue of whether or not credit card rewards programme transactions should be treated differently from a typical customer loyalty programme for accounting purposes.

In a credit card rewards programme transaction the card holder receives financing for the credit purchase transaction in terms of which interest is charged (when the amount becomes payable) 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 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.

From investigating the differences between a typical customer loyalty programme and a credit card rewards programme (refer to 2.4 *Differences in the rationale behind the programmes*) the following can be concluded: A typical customer loyalty programme grants award credits for the acquisition of goods and services and the amount received from selling these goods or services is also the relevant revenue stream in the customer loyalty programme transaction. A credit card rewards programme grants award credits for the payment mechanism ensuring higher interest

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income. The interest income should therefore be the relevant revenue stream in the rewards programme transaction.

However, in practice, and based on IFRIC 13's guidance (IFRIC 13 Basis for Conclusions, par. 4), the interchange fee is identified as the revenue stream from the initial credit card sales transaction that needs to be allocated to the goods or services sold and the award credits granted. Even though the interchange fee is received from the merchant (an intermediate party rather than directly from the customer) it is sometimes argued that the interchange fee comes indirectly from the customer (KPMG, 2007:4). The following arguments prove the contrary:

- There is a separate contract between the acquirer bank and the merchant (in the case of an open loop structure) or between the card issuer and the merchant (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). The acquirer bank (in the case of an open loop structure) or the issuing bank (in the case of a closed loop structure) provides the merchant with physical means for accepting the cards (providing the merchant with the service of enabling the card holder to purchase the merchant's goods or services with increased convenience) and receiving payment (Payments-R-Us, 2009). In exchange for these transactions processing services, a merchant interchange fee is payable. Without these services there would be no rationale for the merchant to enter into a contractual arrangement with the card issuer (FASB & IASB, 2013:18).
- Over and above the transactions processing service, the card issuer (directly or through intermediary financial institutions) also enables merchants to transact with a class of customer that may not have access to sufficient funds at the time of purchase. The card issuer (directly or through intermediary financial institutions) therefore provides the merchant with a service of greater access to potential customers and in exchange charges the merchant an interchange fee (FASB & IASB, 2013:17).
- The merchant bears the cost of the interchange service and therefore the merchant is the party who receives the service related to that cost (FASB & IASB, 2013:18). If a merchant were to charge a card holder a higher price for a good or service when paid for by a credit card rather than cash then it can be argued that the merchant passes on this interchange fee cost to the card holder and the card holder indirectly pays for the interchange fee by implicitly paying the merchant a higher price for the goods or services than they would otherwise have to pay. However, in the South African market, goods or services are sold by merchants for the same price regardless of the payment mechanism (cash or on credit) and the merchant bears the cost of the interchange fee.

In summary: Based on the fact that a credit card rewards programme awards a payment mechanism and in effect the utilisation of the financial institution's provision of financing (also the primary purpose of credit card issuers), it can be argued that the interest can be identified as the relevant revenue stream in the credit card rewards programme transaction. The differences between the rationale of a typical customer loyalty programme and a credit card rewards programme also provide further support for this conclusion. The research also proved that the interchange fee is not the relevant revenue stream in the credit card rewards programme transaction and therefore the only possible remaining revenue stream is the interest (refer to 4.3 *Participation or linkage fee in terms of the credit card rewards programme* for reasons why the participation fee is not regarded as the relevant revenue stream).

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3.2.3 Accounting treatment of relevant revenue stream identified

If the interest (and not the 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 then the following is applicable: IFRIC 13's guidance contains nothing regarding the interest component of a credit card rewards programme transaction. Therefore one can now consider the guidelines provided in IFRS 15.

IFRS 15 *Revenue from Contracts with Customers* effective for annual reporting periods beginning on or after 1 January 2017 will replace IFRIC 13. The objective of IFRS 15 is to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer (IFRS 15, par 1). The scope of IFRS 15 specifically excludes Financial Instruments and other contractual rights and obligations within the scope of IFRS 9 *Financial Instruments* (IFRS 15, par 5(c)). The research showed that the loan and interest part of a credit card arrangement falls within the financial instruments guidance (the scope of IFRS 9) (refer to 4.1 *Loan and interest in terms of the credit card arrangement*). Therefore applying IFRS 15 paragraph 5(c) the revenue stream identified in the credit card rewards programme, namely the interest (and not the interchange fee), falls outside the scope of IFRS 15.

In summary: The third view contained in IFRIC 13 Basis for Conclusions is in line with the Board's response to the ED/2011/6 stating 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). In terms of this view, credit card rewards programmes that award credit's value is insignificant and/or whose award credits are redeemable for goods or services not supplied by the entity in the course of its ordinary activities should account for award credits as a marketing expense. Most credit card rewards programmes in the South African market should therefore have fallen outside the scope of IFRIC 13 and should recognise award credits as a marketing expense and provide for this expense in terms of IAS 37.

Considering the other credit card rewards programmes (whose award credits are redeemable for goods or services supplied by the entity in the course of its ordinary activities) the following is applicable: 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, the research proves that the interest income, being the rationale behind the rewards programme, is identified as the relevant revenue stream to consider. If the interest income (and not the interchange fee) is identified as the relevant revenue stream, a credit card rewards programme transaction should have fallen outside the scope of IFRIC 13 and falls outside the scope of IFRS 15.

Therefore, applying the third view contained in IFRIC 13 Basis for Conclusions (together with the Board's response to the ED/2011/6) and the differences between a credit card rewards programme and a typical customer loyalty programme, all credit card rewards programmes should have fallen outside the scope of IFRIC 13 and fall outside the scope of IFRS 15.

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4. IDENTIFYING OTHER RELEVANT STANDARD(S) TO ACCOUNT FOR A CREDIT CARD REWARDS PROGRAMME TRANSACTION AND OTHER RELATED TRANSACTIONS

It was found that credit card rewards programmes should have fallen outside the scope of IFRIC 13 and fall outside the scope of IFRS 15. The main objective of this section is therefore to determine what other Standard(s) should be applied for accounting for each component of a credit card rewards programme transactions. In order to meet this objective, each component of a credit card rewards programme transaction is considered and discussed separately.

4.1 Loan and interest in terms of the credit card arrangement

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 card holder (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 (card holder) and the loan to a credit card holder meets the definition of a financial asset. There are four categories of financial assets, namely 1) financial assets at fair value through profit or loss, 2) held-to-maturity investments, 3) loans and receivables, and 4) available-for-sale financial assets (IAS 39, par. 9). The loan to a credit card holder 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)).

The IASB is currently compiling a new financial instruments Standard, IFRS 9, intended to replace IAS 39. The first phase of the IFRS 9 project was completed during July 2014 and the final version of IFRS 9 including classification and measurement was published (IFRS, 2014). IFRS 9 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: A financial asset 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 card holders in order to earn interest income and the card holder contract includes, amongst 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.

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4.2 Award credits in terms of the credit card rewards programme

4.2.1 Benefits in the form of goods or services

IAS 37 deals with the accounting treatment of provisions, contingent liabilities and contingent assets. According to paragraph 10 of IAS 37, a liability can be defined as 'a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits'. For a liability to arise, an obligating event (previous event that leads to a present obligation) must occur. An obligating event is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation. A legal obligation is an obligation that derives from a contract, legislation or other legal operation of law, while a constructive obligation is an obligation that derives from an entity's actions where:

- by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
- as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities (IAS 37, par. 10).

Award credits granted (that will be exchanged for goods and services) can be measured against the definition of a liability as follows: When the credit card rewards programme grants award credits to a card holder, a *present obligation* arises in the hands of the rewards programme to supply benefits to the card holder or to pay a third party (programme partner) consideration for supplying benefits with the exchange of these award credits. The original credit card transaction (giving rise to a loan) and granting of the award credits indicates the *event in the past*. When the card holder (member) exchanges award credits and the rewards programme supplies benefits or pays a third party consideration for supplying benefits, an *outflow of economic benefits* will occur because goods or services are given or consideration is paid by the rewards programme. The obligating event indicates a legal obligation under the terms and conditions of the credit card rewards programme application form which provides that benefits will be supplied when the member exchanges award credits (before the expiry date, if applicable). It can be seen as an agreement or contract between the credit card reward programme and the card holder. The obligating event may also be seen as a constructive obligation because it is the rewards programme's practice to provide benefits when the member exchanges award credits (before the expiry date, if applicable). The award credits granted therefore meet the requirements of the definition of a liability.

Paragraph 10 of IAS 37 defines a provision as 'a liability of uncertain timing or amount'. Therefore a liability (as defined above) must be present for any provision to exist. In applying IAS 37's definition of a provision on a credit card rewards programme transaction, the following: The award credits granted meet the definition of a *provision* based on the following: a *liability* occurs (as discussed above) and the timing and amount are uncertain, as there is no certainty about when or whether the member will exchange the award credits. The requirements of the definition of a provision (provision for the supplying of benefits) are therefore met.

IAS 37 paragraphs 36-42 provide clear guidelines on the measurement of a provision. The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period or to transfer it to a third party at that time (IAS 37, par. 36 and 37). The estimates of outcome and financial effect are determined by the

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judgement of the management of the entity, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The evidence considered includes any additional evidence provided by events after the reporting period (IAS 37, par. 38). Uncertainties surrounding the amount to be recognised as a provision are dealt with by various means according to the circumstances. Where the provision being measured involves a large population of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities. The name for this statistical method of estimation is 'expected value' (IAS 37, par. 39). The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate of a provision (IAS 37, par. 42).

The question arises whether or not there would be any difference in *measuring* the award credits under IAS 37 compared to under IFRIC 13. The following addresses this question: Brink (2013:805-806) compared the guidelines contained in IAS 37 in determining the value of the provision (award credits granted) with IFRIC 13's guidelines on determining the value of the deferred revenue (award credits granted). The following conclusion was reached: The measurement of the provision in terms of IAS 37 is in essence consistent with the requirements contained in IFRIC 13. The only differences noted are as follows:

- IAS 37 does not explicitly state whether or not credit risk should be taken into account. IAS 37 paragraph 42 only refers to 'the risks and uncertainties that inevitably surround many events and circumstances' and paragraph 47 only refers to 'the risks specific to the liabilities'. During the March 2011 update, the Interpretations Committee received a request for interpretation of this last-mentioned phrase. The Committee noted that this request for guidance would be best addressed as part of the Board's project to replace IAS 37 with a new liabilities Standard.
- IAS 37 determines the value of the provision from the perspective of the supplier (issuer) and IFRIC 13 determines the value of the liability (deferred revenue) from the perspective of the consumer.
- IAS 37 does not refer to the value of the provision as the fair value.

Considering the first and second differences, the following was noted: IFRIC 13 paragraph 6 states that the portion of consideration allocated to the award credits granted (liability) shall be measured by reference to their fair value. IFRS 13 *Fair Value Measurement* (issued 18 May 2011) applies when another IFRS requires or permits fair value measurement (IFRS 13, par. 5). IFRS 13 paragraph 9, together with paragraph 24, defines fair value as the price paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions regardless of whether that price is directly observable or estimated using another valuation technique. The fair value can therefore be defined as the exit price.

IFRS 13 distinguishes between liabilities held by other parties as assets and liabilities not held by other parties as assets. There is a difference in measuring the fair value of these two categories of liabilities. In a credit card rewards programme, the award credits granted give the card holder (member) a right to future benefits. The award credits earned by the card holder will therefore be an asset in the hands of the card holder and the first category of liability is applicable. When a quoted price for the transfer of an identical or a similar liability is not available and the identical item is held by another party as an asset, an entity shall measure the fair value of the liability from the perspective of a market participant that holds the identical item as an asset at the measurement date (IFRS 13, par. 37). The fair value of a liability reflects the effect of *non-performance risk (including the* entity's own credit risk) (IFRS 13, par. 42). The entity shall

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therefore take into account the effect of its own credit risk and any other factors that might influence the likelihood that the obligation will or will not be fulfilled (IFRS 13, par. 43).

The value of the award credits from the perspective of the rewards programme (as per IAS 37) equals the *cost price* (and not the selling price) of benefits to be supplied or the consideration payable to a third party (programme partner) for supplying the benefits. The measuring of the provision in terms of IAS 37 correlates with the second category mentioned in IFRS 13, i.e. liabilities not held by other parties as assets. IFRS 13, paragraph 40 states that for liabilities not held by other parties as assets the fair value is measured from the perspective of a market participant that owes the liability. IAS 37 has not been updated to include the first category of liability (liabilities held by other parties as assets).

If the current IAS 37 is applied, the award credits should be measured with reference to the cost price of benefits to be supplied or the consideration payable to a third party (programme partner) for supplying the benefits. The credit card rewards programme should therefore estimate the expenditure required to settle the obligation arising from the award credits granted (applying IAS 37, paragraph 36 and 37) and adjust this value with the expected exchange rate of award credits (with reference to historical trends or information) (applying IAS 37 paragraph 39). The contra-entry for the provision will be an expense, recognised when the award credits are granted. The provision will be derecognised when the award credits are exchanged for benefits, when the award credit's expiry date lapses, if applicable, or in the case of a change in estimate.

It could also be argued that IAS 37 should be updated to include the category of liabilities held by other parties as assets and if this is the case the following is applicable: The value of the award credits should then be measured by reference to the fair value of the benefits they could be exchanged for, in other words, the value of the award credits (held as an asset) in the hands of the card holder (applying IFRS 13 paragraph 37). In nine of the 13 credit card rewards programmes investigated 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). The other four 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 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. The credit card rewards programmes, which award credits have a determinable value, can therefore determine the value of the provision with reference to the amount of award credits granted and the value of the award credits (in the hands of the card holder that also equals the value linked to the award credits). This value can be adjusted with the expected exchange rate of award credits (with reference to historical trends or information) (applying IFRIC 13 Application guidance paragraph 2 and IFRS 13 paragraph 42-43). The contra-entry for the provision will be an expense, recognised when the award credits are granted. The provision will be derecognised when the award credits are exchanged for benefits, when the award credit's expiry date lapses, if applicable, or in the case of a change in estimate.

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4.2.2 Benefits in the form of a direct cash back

As discussed in 4.2.1 *Benefits in the form of goods or services,* award credits granted meet the definition of a liability. *In order to determine the type of liability that arises, the definition in IAS 32 paragraph 11 is considered: A financial liability is 'any liability that is a contractual obligation to deliver cash or another financial asset to another entity ...' In some credit card rewards programme transactions (for example Absa Rewards) a contractual obligation arises to supply cash (a direct cash back) (Mather, 2013). The liability that arises in these credit card rewards programme transactions therefore meets the definition of a financial liability and IAS 39 or IFRS 9 (*for annual periods beginning on or after 1 January 2018) *is applicable.* IAS 39 paragraph 43 and IFRS 9 paragraph 5.1.1 states that an entity shall measure a financial liability at its fair value. IFRS 13 applies when another IFRS requires or permits fair value measurement (IFRS 13, par. 5); therefore the fair value measurement of a financial liability is applicable.

The direct cash back offered by some credit card rewards programmes gives the member a right to cash (a financial asset). Therefore the direct cash back represents a liability held by another party as an asset. IFRS 13 paragraph 37 states that when a quoted price for the transfer of an identical or a similar liability is not available and the identical item is held by another party as an asset, an entity shall measure the fair value of the liability from the perspective of a market participant that holds the identical item as an asset at the measurement date. The credit card rewards programme shall classify the financial liability as subsequently measured at amortised cost, but as the direct cash back already represents the future value as it is immediately claimable or due, no adjustments in terms of the effective interest method are necessary. This correlates with IFRS 13 paragraph 47 (previously IAS 39 paragraph 49) that states that the fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. The credit card rewards programme should derecognise the financial liability when the card holder uses or claims the direct cash back reward. The credit card rewards programme will therefore recognise a financial liability to the value of the direct cash back rewards granted with reference to their face value. The contra-entry for the financial liability will be an expense, recognised when the direct cash back reward is granted.

4.3 Participation or linkage fee in terms of the credit card rewards programme

Some credit card rewards programmes charge a monthly or annual participation or linkage fee specifically to belong to the rewards programme. Examples of such programmes are, eBucks (Kearney, 2013), ABSA Rewards (Mather, 2013), Standard Bank UCount (Standard Bank, 2014b), Nedbank Greenbacks (Nedbank, 2014b), AMEX Rewards (American Express, 2014) and Discovery Credit Card (Discovery, 2014). This fee ranges from R179 to R350 per year for the mentioned credit card rewards programmes.

The question arises if this participation or linkage fee can be identified as the revenue from the initial sales transaction which needs to be allocated by the credit card issuer between credit card rewards programme services supplied and the award credits granted. As this is a monthly or annual fee, it is not charged with each credit card rewards programme transaction and it will be impossible to make an allocation of the participation or linkage fee income. The amount of the income is also not substantive and in most cases the value of the award credits granted will exceed the participation or linkage fee income. The rationale behind a credit card rewards

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programme is not to receive a participation fee; this fee can rather be seen as a fee paid for the administration of the rewards programme.

From investigating the differences between a credit card rewards programme and a typical customer loyalty programme it was noted that credit card rewards programmes are the only rewards programmes that charge a participation or linkage fee and they are also the only rewards programmes that offer their member 'soft' benefits over and above the 'hard' benefits (refer to 2.7.2 *'Hard' and 'soft' benefits*). This might indicate that the participation or linkage fee is paid to give the members access to these 'soft' benefits.

In terms of IAS 18, this might be treated in terms of paragraph 25: Rendering of services, intermediate number of acts. Paragraph 25 states that 'when services are performed be an indeterminate number of acts over a specified period of time, revenue is recognised on a straight-line basis over the specified period'. In terms of IFRS 15, this participation or linkage fee income might be accounted for with reference to the *Performance obligations satisfied over time* as described in IFRS 15 paragraph 35 (as part of step 2 'Identifying performance obligations'). Paragraph 35 determines that an entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs. IFRS 15 Application Guidance (Appendix B) further states that for some types of performance obligations, the assessment of whether a customer receives the benefits of an entity's performance as the entity performs and simultaneously consumes those benefits as they are received will be straightforward. Examples include routine or recurring services (such as a cleaning service) in which the receipt and simultaneous consumption by the customer of the benefits of the entity's performance can be readily identified. The credit card rewards programme might recognise the participation or linkage fee income over a straight-line basis over the financial year applicable.

4.4 Interchange fee in terms of the contract with the merchant (closed loop structure)

In terms of the merchant contract, an interchange fee is payable to the card issuer (in the case of a closed loop structure). This interchange fee income is earned in exchange for a transactions processing service rendered by the card issuer. The card issuer provides the merchant with physical means for accepting the cards (providing the merchant with the service of enabling the card holder to purchase the merchant's goods or services with increased convenience) and receiving payment (Payments-R-Us, 2009). The card issuer also enables merchants to transact with a class of customer that may not have access to sufficient funds at the time of purchase and therefore provides the merchant with a service of greater access to potential customers. The interchange fee income can therefore be accounted for by applying IAS 18: Rendering of services (paragraph 20). The requirements of paragraph 20 are met with each credit card transaction in terms of which an interchange fee is charged. In terms of IFRS 15 the card issuer will satisfy the performance obligation at a point in time (in accordance with paragraph 38). The interchange fee income will therefore be recognised with each credit card transaction.

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5. CONCLUSION

It was found that the differences between a credit card rewards programme and a typical customer loyalty programme prove that a credit card rewards programme transaction should be treated differently for accounting purposes. The third view contained in IFRIC 13 Basis for Conclusions is in line with the Board's response to the ED/2011/6 stating 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). Even though IFRIC 13 applies the second view, considering the Board's current recommendation, it was concluded that the third view contained in IFRIC 13 Basis for Conclusions also represents an appropriate basis when considering the accounting treatment of specifically credit card rewards programme transactions. In terms of this view, credit card rewards programmes that award credit's value is insignificant and/or whose award credits are redeemable for goods or services not supplied by the entity in the course of its ordinary activities, should account for award credits as a marketing expense. Most credit card rewards programmes in the South African market should therefore have fallen outside the scope of IFRIC 13 and should recognise award credits as a marketing expense and provide for this expense in terms of IAS 37.

The other credit card rewards programmes (whose award credits are redeemable for goods or services supplied by the entity in the course of its ordinary activities) should also have fallen outside the scope of IFRIC 13 and falls outside the scope of IFRS 15 based on the following: 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, the research proved that the interest income – being the rationale behind the rewards programme – is identified as the relevant revenue stream to consider. If the interest income (and not the interchange fee) is identified as the relevant revenue stream, a credit card rewards programme transaction falls within the scope of IFRS 9 and outside the scope of IFRIC 13 and IFRS 15. So whether or not IFRIC 13 Basis for Conclusions and the Board's response to the ED/2011/6 is considered an appropriate basis for evaluating if a credit card rewards programme transaction falls within or outside the scope of IFRIC 13 and IFRS 15, the research still proved that all credit card rewards programme transactions with the interest identified as the relevant revenue stream should have fallen outside the scope of IFRIC 13 and fall outside the scope of IFRS 15.

The loan and interest in terms of the credit card arrangement should be accounted for as a financial asset subsequently measured at amortised cost in terms of IAS 39 (and IFRS 9). The award credits granted redeemable for goods or services should be recognised as an expense and a provision in terms of IAS 37 and measured at the expenditure required to settle the obligation arising from the award credits granted and adjusted for the expected exchange rate of the award credits. The award credits granted in the form of direct cash back should be recognised as an expense and a financial liability in terms of IAS 39 (and IFRS 9) and measured at their face value. The participation or linkage fee income should be recognised over a straight-line basis over the financial year applicable. The interchange fee income should be recognised when the transaction processing service is rendered and therefore recognised with each credit card transaction.

This research highlights important principles that contribute to the body of knowledge of guidelines on the accounting treatment of credit card rewards programme transactions. This information can be useful as a tool for serving role players in the South African accounting environment.

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