



IGRAP 6

ACCOUNTING STANDARDS BOARD

INTERPRETATION OF THE STANDARDS OF GENERALLY RECOGNISED ACCOUNTING PRACTICE

LOYALTY PROGRAMMES

(IGRAP 6)

Acknowledgement

This Interpretation of the Standards of Generally Recognised Accounting Practice (IGRAP) is drawn primarily from the equivalent Interpretation of the International Financial Reporting Standard on *Customer Loyalty Programmes* (IFRIC 13) issued by the International Financial Reporting Interpretations Committee (IFRIC) of the International Accounting Standards Board (IASB). The IASB has issued a comprehensive body of IFRICs. Extracts of the IFRIC on *Customer Loyalty Programmes* are reproduced in these Interpretations of the Standards of GRAP with the permission of the IASB.

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LOYALTY PROGRAMMES

Introduction

Interpretations of the Standards of Generally Recognised Accounting Practice

The Accounting Standards Board (Board) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for:

- (a) departments (national and provincial);
- (b) public entities;
- (c) constitutional institutions;
- (d) municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and
- (e) Parliament and the provincial legislatures.

The above are collectively referred to as “entities”.

The Board has approved the application of Statements of Generally Accepted Accounting Practice (GAAP), codified by the Accounting Practices Board (APB) and issued by the South African Institute of Chartered Accountants (SAICA) to be GRAP for:

- (a) government business enterprises (GBEs)(as defined in the PFMA);
- (b) trading entities (as defined in the PFMA);
- (c) any other entity, other than a municipality, whose ordinary shares, potential ordinary shares or debt are publicly traded on the capital markets; and
- (d) entities under the ownership control of any of these entities.

The Board believes that Statements of GAAP are relevant and applicable to financial statements prepared by all such entities including those under their ownership control.

Financial statements should be described as complying with Standards of GRAP only if they comply with all the requirements of each applicable Standard of GRAP and any related Interpretations of the Standards of GRAP.

Any limitation of the applicability of specific Standards or Interpretations of the Standards of GRAP is made clear in those Standards or Interpretations of the Standards of GRAP.



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The Interpretation of the Standard of GRAP on *Loyalty Programmes* is set out in paragraphs .01 to .12. All paragraphs in this Interpretation of the Standards of GRAP have equal authority. The status and authority of appendices are dealt with in the preamble to each appendix. This Interpretation of the Standards of GRAP should be read in the context of its objective, its basis for conclusions if applicable, the *Preface to Standards of GRAP*, the *Preface to the Interpretations of the Standards of GRAP* and the *Framework for the Preparation and Presentation of Financial Statements*.

Standards of GRAP and Interpretations of Standards of GRAP should also be read in conjunction with any directives issued by the Board prescribing transitional provisions, as well as any regulations issued by the Minister of Finance regarding the effective dates of the Standards of GRAP, published in the Government Gazette.

Reference may be made to a Standard of GRAP that has not been issued at the time of issue of this Interpretation of the Standards of GRAP. This is done to avoid having to change the Standards already issued when a later Standard is subsequently issued. Paragraph .12 of the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Interpretation of the Standards of GRAP on *Loyalty Programmes*

References

- GRAP 3 *Accounting Policies, Changes in Accounting Estimates and Errors* (as revised in 2010)
- GRAP 9 *Revenue from Exchange Transactions* (as revised in 2010)
- GRAP 19 *Provisions, Contingent Liabilities and Contingent Assets* (as revised in 2010)
- GRAP 23 *Revenue from Non-exchange Transactions (Taxes and Transfers)*

Background

- .01 Loyalty programmes are used by entities to provide customers with incentives to buy their goods or services, or to encourage early settlement of their accounts, debts, etc. in order to earn award credits. If a customer buys goods or services, or settle an account, debt etc. in advance, the entity grants the customer award credits (often described as 'points'). The customer can redeem the award credits for awards such as free or discounted goods or services.
- .02 The programmes operate in a variety of ways. Customers may be required to accumulate a specified minimum number or value of award credits before they are able to redeem them. Award credits may be linked to individual purchases or groups of purchases, or to continued custom over a specified period. The entity may operate the customer programme itself or participate in a programme operated by a third party. The awards offered may include goods or services supplied by the entity itself and/or rights to claim goods or services from a third party.

Scope

- .03 This Interpretation of the Standards of GRAP applies to customer loyalty award credits that:
- (a) an entity grants to its customers as part of a transaction, i.e. a sale of goods, rendering of services, use by a customer of entity assets; and
 - (b) subject to meeting any further qualifying conditions, the customers can redeem in the future for free or discounted goods or services.

The Interpretation of the Standards of GRAP addresses accounting by the entity

that grants award credits to its customers.

Issues

- .04 The issues addressed in this Interpretation of the Standards of GRAP are:
- (a) whether the entity's obligation to provide free or discounted goods or services ('awards') in the future should be recognised and measured by:
 - (i) allocating some of the consideration received or receivable from the sales transaction to the award credits and deferring the recognition of revenue (applying the Standard of GRAP on *Revenue from Exchange Transactions* (as revised in 2010) and the Standard of GRAP on *Revenue from Non-exchange Transactions (Taxes and Transfers)*); or
 - (ii) providing for the estimated future costs of supplying the awards; and
 - (b) if consideration is allocated to the award credits:
 - (i) how much should be allocated to them;
 - (ii) when revenue should be recognised; and
 - (iii) if a third party supplies the awards, how revenue should be measured.

Consensus

- .05 An entity shall apply the Standard of GRAP on *Revenue from Exchange Transactions* (as revised in 2010) and the Standard of GRAP on *Revenue from Non-exchange Transactions (Taxes and Transfers)* and account for award credits as a separately identifiable component of the transaction(s) in which they are granted (the 'initial transaction'). The fair value of the initial transaction shall be allocated between the award credits and the other components of the transaction. The awards granted to the customer are deemed to be an exchange transaction that shall be accounted for in terms of the Standard of GRAP on *Revenue from Exchange Transactions* ((as revised in 2010).
- .06 The consideration allocated to the award credits shall be measured by reference to their fair value, i.e. the amount for which the award credits could be exchanged separately.
- .07 If the entity supplies the awards itself, it shall recognise the consideration allocated to award credits as revenue when award credits are redeemed and it fulfils its obligations to supply awards. The amount of revenue recognised shall be based on the number of award credits that have been redeemed in exchange for awards, relative to the total number expected to be redeemed.

- .08 If a third party supplies the awards, the entity shall assess whether it is collecting the consideration allocated to the award credits on its own account (i.e. as the principal in the transaction) or on behalf of the third party (i.e. as an agent for the third party).
- (a) If the entity is collecting the consideration on behalf of the third party, it shall:
- (i) measure its revenue as the net amount retained on its own account, i.e. the difference between the consideration allocated to the award credits and the amount payable to the third party for supplying the awards; and
 - (ii) recognise this net amount as revenue when the third party becomes obliged to supply the awards and entitled to receive consideration for doing so. These events may occur as soon as the award credits are granted. Alternatively, if the customer can choose to claim awards from either the entity or a third party, these events may occur only when the customer chooses to claim awards from the third party.
- (b) If the entity is collecting the consideration on its own account, it shall measure its revenue as the gross consideration allocated to the award credits and recognise the revenue when it fulfils its obligations in respect of the awards.
- .09 If at any time the unavoidable costs of meeting the obligations to supply the awards are expected to exceed the consideration received and/or receivable for them (i.e. the consideration allocated to the award credits at the time of the initial transaction that has not yet been recognised as revenue plus any further consideration receivable when the customer redeems the award credits), the entity has onerous contracts. A liability shall be recognised for the excess in accordance with the Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets* (as revised in 2010). The need to recognise such a liability could arise if the expected costs of supplying awards increase, for example if the entity revises its expectations about the number of award credits that will be redeemed.

Transitional provisions

- .10 *All changes resulting from the application of this Interpretation of the Standards of GRAP shall be accounted for in accordance with the requirements of the Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Errors (as revised in 2010).***

Effective date

Initial adoption of the Standards of GRAP

- .11 *This Interpretation of the Standards of GRAP becomes effective with***



reference to the effective date of the applicable Standards of GRAP as determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999, as amended.

Entities already applying Standards of GRAP

- .12** *An entity shall apply this Interpretation of the Standards of GRAP for annual financial statements covering periods beginning on or after 1 April 2011.*

Appendix: Illustrative examples

This appendix is illustrative only and does not form part of this Interpretation of the Standards of GRAP. The purpose of the appendix is to illustrate the application of this Interpretation to assist in clarifying its meaning.

Measuring the fair value of award credits

- IE1 Paragraph .06 of the consensus requires the consideration allocated to award credits to be measured by reference to their fair value, i.e. the amount for which the award credits could be exchanged separately. If the fair value is not directly observable, it must be estimated.
- IE2 An entity may estimate the fair value of award credits by reference to the fair value of the awards for which they could be redeemed. The fair value of the award credit takes into account:
- (a) the value of awards that would be offered to customers who have not earned award credits from an initial transaction; and
 - (b) the proportion of award credits that are not expected to be redeemed by customers.

If customers can choose from a range of different awards, the fair value of the award credits will reflect the values of the range of available awards, weighted in proportion to the frequency with which each award is expected to be selected.

- IE3 In some circumstances, other estimation techniques may be available. For example, if a third party will supply the awards and the entity pays the third party for each award credit it grants, it could estimate the fair value of the award credits by reference to the amount it pays the third party, adding a reasonable profit margin. Judgement is required to select and apply the estimation technique that satisfies the requirements of paragraph .06 of the consensus and is most appropriate in the circumstances.

Example 1 - Awards supplied by the entity

- IE4 A municipality operates a loyalty programme to encourage early settlement. Council has approved the granting of loyalty points to customers when they settle their accounts for the consumption of water and electricity before due date. Customers can redeem the points earned for discounts when entering a museum within the municipal region. The points have no expiry date. In one period, the municipality grants 100 points. Management estimates that each loyalty point can

be redeemed for R1.25. Management expects only 80 of these points to be redeemed. Therefore, the fair value of each point is R1, being the value of each loyalty point granted for R1.25 reduced to take into account points not expected to be redeemed $((80 \text{ points}/100 \text{ points}) \times R1.25 = R1$. Accordingly, management defers recognition of revenue and recognise a liability in the statement of financial position of R100.

Year 1

IE5 At the end of the first year, 40 of the points have been redeemed in exchange for entering into a museum, i.e. half of those expected to be redeemed. The municipality recognises exchange revenue of $(40 \text{ points}/80^* \text{ points}) \times R100 = R50$.

Year 2

IE6 In the second year, management revises its expectations. It now expects 90 points to be redeemed altogether.

IE7 During the second year, 41 points are redeemed, bringing the total number redeemed to $40^* + 41 = 81$ points. The cumulative revenue that the municipality recognises is $(81 \text{ points}/90^{\infty} \text{ points}) \times R100 = R90$. The entity has recognised exchange revenue of R50 in the first year, so it recognises exchange revenue R40 in the second year.

Year 3

IE8 In the third year, a further nine points are redeemed, taking the total number of points redeemed to $81 + 9 = 90$. Management continues to expect that only 90 points will ever be redeemed, i.e. that no more points will be redeemed after the third year. So the cumulative revenue to date is $(90 \text{ points}/90^* \text{ points}) \times R100 = R100$. The municipality has already recognised exchange revenue of R90 (R50 in the first year and R40 in the second year). So it recognises the remaining exchange revenue R10 in the third year. All of the revenue initially deferred has now been recognised.

Example 2 - Awards supplied by a third party

IE9 A municipality participates in a loyalty programme operated by an airline. It grants

* total number of points expected to be redeemed

♦ number of points redeemed in year 1

∞ revised estimate of total number of points expected to be redeemed

* total number of points still expected to be redeemed

customer one air travel point with each R1 they spend on public transport. Programme members can redeem the points for air travel with the airline, subject to availability. The municipality pays the airline R0.009 for each point.

- IE10 In one period, the municipality receives revenue from fares charged to passengers totalling a million Rand. It grants 1 million points.

Allocation of consideration to travel points

- IE11 The municipality estimates that the fair value of a point is R0.01. It allocates to the points $1 \text{ million} \times R0.01 = R10 \text{ 000}$ of the fares it has received from customers utilising the public transport.

Revenue recognition

- IE12 Having granted the points, the municipality has fulfilled its obligations to the customer. The airline is obliged to supply the awards and entitled to receive consideration for doing so. Therefore the municipality recognises exchange revenue from the points when it provides the public transport.

Revenue measurement

- IE13 If the municipality has collected the consideration allocated to the points on its own account, it measures its revenue as the gross R10 000 allocated to them. It separately recognises the R9 000 paid or payable to the airline as an expense. If the municipality has collected the consideration on behalf of the airline, i.e. as an agent for the airline, it measures its revenue as the net amount it retains on its own account. This amount of revenue is the difference between the R10 000 consideration allocated to the points and the R9 000 passed on to the airline.

Comparison with the Interpretation of IFRS on *Customer Loyalty Programmes* (IFRIC 13) (June 2007)

This Interpretation of the Standards of GRAP on *Loyalty Programmes* (IGRAP 6) is drawn primarily from the Interpretation of IFRS on *Customer Loyalty Programmes* (IFRIC 13). The main differences between this Interpretation and IFRIC 13 are as follows:

- The heading and text of this Interpretation have been amended to *Loyalty Programmes* to be South African specific. The equivalent heading and text in IFRIC 13 is *Customer Loyalty Programmes*.
- The principles in this Interpretation are applicable to both exchange and non-exchange transactions. The term “sale” has therefore been amended to “transaction” to incorporate both exchange and non-exchange transactions. This Interpretation further clarifies how award credits from non-exchange transactions should be accounted.
- The examples in this Interpretation and the appendix to this Interpretation have been amended to be South African specific.