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Le Président

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D20 Comment Letters

International Accounting Standards Committee Foundation
30 Cannon Street
London EC4M 6XH
United Kingdom

IFRIC DRAFT INTERPRETATION D20 CUSTOMER LOYALTY PROGRAMMES

Dear Sir or Madam ,

I am writing on behalf of the Conseil National de la Comptabilité to give you our comments on the above-mentioned draft interpretation. Our detailed comments are set out in the Appendix.

We agree that the interpretation correctly reflects the economic substance of loyalty programmes that have the character of multiple elements sale transactions.

In our view, this will normally be the case when the award granted to the customer forms an identified part of the normal business activity or activities of an entity .It follows that the entity's liability should be valued on the basis of its existing tariff structure .

However, we believe that where the award does not represent a product or service normally sold in the course of an entity's business it may have the characteristics of a marketing cost (see BC4) and should be treated under IAS 37.

We do not, therefore , agree that a single treatment for all loyalty programmes as deferred revenue correctly reflects the economic substance of these transactions .

Moreover , we believe that an entity's liability for deferred revenue should be measured in accordance with its own tariffs and not by reference to some other "market value".

We trust you have found our comments helpful and would be pleased to give you any further information or explanations you require.

Yours sincerely,

Antoine BRACCHI

APPENDIX

IFRIC DRAFT INTERPRETATION D20 CUSTOMER LOYALTY PROGRAMMES

Summary of the key points of the interpretation

1.Background

" Customer loyalty programmes are used by entities to provide customers with incentives to buy their products. Each time a customer buys goods or services, or performs another qualifying act, the entity grants the customer award credits (variously described as 'points', 'air miles' etc). The customer can redeem the award credits for awards such as free or discounted goods or services."

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2.Issues

" The issues addressed in this [draft] Interpretation are:
(a) whether the entity's obligation to provide free or discounted goods or services should be recognised and measured by (i) allocating some of the consideration received or receivable from the initial sales transaction to the award credits and deferring the recognition of revenue (i.e. applying paragraph 13 of IAS 18), or (ii) providing for the estimated future costs of supplying the goods or services (applying paragraph 19 of IAS 18); and
(b) if consideration is allocated to the award credits, how much should be allocated to them, and when it should be recognised as revenue."

3.Consensus

"An entity shall apply paragraph 13 of IAS 18 and account for award credits as a separately identifiable component of the sales transaction(s) in which they are granted (the 'initial sale'). The fair value of the consideration received or receivable in respect of the initial sale shall be allocated between the components, i.e. the goods and services sold and the award credits granted."

4. Basis for conclusions

BC5 justifies the consensus in the following terms :

-award credits form part of a "multiple element" sales transaction and represent benefits for which the customer is implicitly paying

-award credits are separately identifiable from other goods or services sold as a part of the initial sales transaction

-award credits are not delivered to the customer at the time of the initial sale and it is therefore necessary to divide the initial sale into components and recognise each part separately

The alternative view presented in BC4 is that :

- Award credits do not form a significant part of the sales transaction
- They are by nature marketing costs

- The conditions for recognising the whole of the initial sale under §16 of IAS 18 are met
- The costs of providing the awards should be recognised at the same time as the revenue in application of §19 of IAS 18.

In BC 6 the draft interpretation examines a third approach which considers that the accounting treatment should depend on the nature of the customer loyalty programme .This approach identifies two criteria for determining whether the award should be treated as deferred revenue or as a marketing cost:

-whether the award represents a product or service which forms part of the "ordinary activities" of the entity

-whether the value of the award is significant to the sales transaction as a whole

This approach is rejected by the IFRIC in BC7(c)on the grounds that :

- the substance of the transaction is the same whatever its form or value
- it would be difficult to determine a consistent dividing line(between ordinary business and other)
- where the customer has the choice of the form of the award only some forms might be supplied in the course of ordinary business

5. Position of the CNC on the main issues of the draft interpretation

5.1. Are award credits a separately identifiable part of a single sales transaction ?

5.1.1.Where the purchase of a certain number of articles or services entitles a customer to receive a free or discounted item there would appear to be a single sales transaction with different delivery dates as set out in the Consensus and BC5.
5.1.2. This would normally be the case when the award is of a product or service which forms part of the normal activity of the supplier entity .
5.1.3. It is expected ,that in this case, the supplying entity's tariff structure would reflect the multiple element characteristic of the sale .
5.1.4. It also follows that the sales value of the award would be identifiable .

5.2. Are there cases where the award appears to be a marketing cost rather than an element of a multiple sales transaction ?

5.2.1.Where the award represents a "gift" which does not form part of the supplying entity's normal activity the arguments for considering it as a marketing cost, as set out in BC4, could be valid.
5.2.2.The arguments set out in BC7 for not taking account of the nature of the award are not convincing .We believe that it will often be quite clear when awards are not products sold by an entity in the ordinary course of its business so that the dividing line will not be difficult to fix.
5.2.3.Where the awards are not products sold by the entity , its obligation towards its customers would not be faithfully represented by a reduction in its turnover .We therefore disagree with the affirmation in BC7 that the substance of the transaction is the same whatever form it takes.
5.2.4.Furthermore , where the customer has a choice as to the form of the award , the entity could refer to statistical probability to determine the treatment.

5.3. Practical difficulties in applying the interpretation

5.3.1. Where the business model of the entity treats awards as an element of a multiple sale it is very likely that its information system will provide the necessary valuation information .

5.3.2. However , a number of difficulties of application have been brought to our attention by constituents :

- **Scope**

  Some awards granted as part of a loyalty program are not directly linked to a particular sales transaction – this is the case, for example, of welcome points, discretionary points or seniority points .Such awards are often granted to existing customers to reward continuing custom and are not directly linked to the "initial sale" .The interpretation should clarify whether such awards are within its scope .
- **The time value of money**

  Deferred revenue takes into account the time value of money(See §7 (c)of the consensus). However, because the amount of deferred revenue is fixed from the inception of the contract, there will presumably be no unwinding of this initial discounted value. This should be made clear in the proposed interpretation via an example.
- **Changes in forfeiture rate**

  Changes in forfeiture rate should be taken into account in estimating deferred revenue whether they represent an increase or a decrease in entity's liability. BC 12 could be interpreted as meaning that only increases in the liability should be taken into account. This point should therefore be clarified in the interpretation.
- **Does the interpretation consider that an entity's tariffs constitute "fair value"?**

  According to §5 of the interpretation "the fair value of the consideration received or receivable in respect of the initial sale shall be allocated between the components i.e. the goods and services sold and the award credits granted".

  Many constituents ,who have understood "fair value" as "market value" and possibly different to the entity's own tariffs ,consider it would be impracticable to apply such a valuation basis i.e. a "market value" for which the entity would have to maintain benchmarking information . Furthermore , it is argued that the liability is a component of specific sales transactions of an entity ("entity specific") and a different "market valuation" would not be relevant .

  We believe that the entity's tariffs would normally represent market value and should be applied when the information is available.

  We suggest that the interpretation should clarify whether it considers that an entity's tariffs normally represent fair value.