EFRAG
European Financial Reporting Advisory Group

INVITATION TO COMMENT ON THE COSTS AND BENEFITS OF IFRIC 13 *Customer Loyalty Programmes*

Comments should be sent to commentletter@efrag.org or uploaded onto the EFRAG website at www.efrag.org by 14 April 2008

EFRAG has been asked by the European Commission to provide it with advice and supporting material on the endorsement of IFRIC 13 *Customer Loyalty Programmes* (IFRIC 13). In order to do that, EFRAG has been carrying out a technical assessment of IFRIC 13 against the criteria for endorsement set out in Regulation (EC) No 1606/2002 and is now carrying out a separate assessment of the costs and benefits that would arise from its implementation in the EU.

A brief summary of IFRIC 13 is set out in Appendix 1.

Although EFRAG has not yet finalised its technical assessment of IFRIC 13, its near-final conclusion is that IFRIC 13 is not contrary to the true and fair principle and that it meets the criteria of understandability, relevance, reliability and comparability. EFRAG's reasoning in reaching this near-final view is explained in Appendix 2.

Before finalising its two assessments, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record unless the respondent requests confidentiality. EFRAG is a transparent organisation and will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

1 Please provide the following details about yourself:

(a) Your name or, if you are responding on behalf of an organisation or company, its name:

German Accounting Standards Board (GASB)________________________

(b) Are you/Is your organisation or company a:

☐ Preparer ☐ User ☒ Other (please specify)

Standard-setter _____________

(c) Please provide a short description of your activity/ the general activity of your organisation or company:

____

(d) Country where you/your organisation or company is located:

Germany____

(e) Contact details including e-mail address:

Liesel Knorr
Zimmerstr.30, 10969 Berlin, Germany
knorr@drsc.de

2 EFRAG is carrying out an assessment of the costs and benefits that will arise for preparers and for users to implement IFRIC 13, both in year one and in subsequent years. Some initial work has been carried out and the need for further consultation with individual entities has been identified. The results of the initial assessment are set out in Appendix 3. To summarise,

EFRAG believes that IFRIC 13 will involve preparers and users in incurring different levels of cost depending upon how closely entities' current approach is to that required by IFRIC 13. EFRAG believes, in particular, that the adoption of IFRIC 13 will:

(a) involve all preparers incurring some year-one costs—in order to read, understand and implement the new requirements retrospectively—but those costs will be not be significant except as described at (b) below (Appendix 3 paragraphs 2 to 6);

(b) involve some of those preparers that currently use the cost-provisioning approach incurring significant costs to modify or create appropriate systems in year one (Appendix 3 paragraph 5);

(c) involve many preparers incurring incremental ongoing costs, although those costs will not be significant (Appendix 3 paragraph 7); and

(d) involve users incurring only insignificant incremental year-one, and no incremental ongoing, costs (Appendix 3 paragraph 8).

Do you agree with this assessment?

Yes No

☐ ☐

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be (ie a description of the type(s) of cost involved, and an indication of what you estimate the costs to be). Please also tell us the turnover of your company to enable to give us a basis for judging the significance of the costs.

We as a national standard-setter are not in a position to answer this question.

3 It has been suggested that the adoption of IFRIC 13 will require companies who currently apply the cost-provisioning approach to accounting for award credits to adjust their key performance indicators to reflect the IFRIC 13 approach.

Do you believe that this will result in significant incremental costs for your company?

Yes ☐ No ☐

If you do, please explain broadly what you believe the costs involved will be. Please include figures for your estimate of the costs, and also the turnover of your company to give us a basis for judging the significance of the costs.

`We as a national standard-setter are not in a position to answer this question.`

4 EFRAG believes (as explained in Appendix 3 paragraph 9) that, when the overall position of preparers and users is taken into account, the benefits that will arise from implementing IFRIC 13 will exceed the costs involved.

Do you agree with this assessment?

Yes ☐ No ☐

If you do not, please explain why you do not and what you think the implications should be for EFRAG's endorsement advice?

`We as a national standard-setter are not in a position to answer this question.`

5 EFRAG is not aware of any factors other than those mentioned in appendices 2 and 3 that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on IFRIC 13.

Do you agree that there are no other factors?

Yes No

☒ ☐

If you do not, please explain why you do not and what you think the implications should be for EFRAG's endorsement advice?

____

____

____

____

____

6 EFRAG's near-final technical assessment of IFRIC 13 is that it is not contrary to the true and fair principle and it meets the criteria of understandability, relevance, reliability and comparability. EFRAG's reasoning in reaching this near-final view is set out in Appendix 2.

Do you agree with this assessment?

Yes No

☒ ☐

If you do not agree, it is presumably because you have a significant concern about IFRIC 13 when judged against the technical criteria. Please would you explain what that concern is, why you have it now (at this late stage in the process) but did not have it earlier, and what you think the implications should be for EFRAG's endorsement advice.

____

____

____

____

____

APPENDIX 1
A SUMMARY OF THE INTERPRETATION IN IFRIC 13

1 Many entities operate schemes that are designed to encourage those who buy their goods or services to buy further goods or services from them. These customer loyalty programmes can take many different forms.

2 There are differing views as to how to account for one particular type of customer loyalty programme: a programme that involves granting points, air miles or other credits ('award credits') to a customer at the time of a sales transaction, which can be redeemed subsequently to purchase of goods and services from that same entity or another entity free or at a discounted price.

(a) Some entities have been interpreting IFRS as requiring the initial transaction to be treated as having both the sale of the goods or services and the sale of award credits. Therefore, sales consideration will be allocated between the two components and a profit or loss on each component will arise depending on whether the revenue allocated to the component exceeds the costs involved. The profit on the sale of award credits will not be recognised immediately; rather it will be recognised when the award credits are redeemed.

(b) Some entities have been interpreting IFRS as requiring the initial transaction to be treated as having a single component (the sale of the goods or services) and the cost of meeting the credits granted will be just one of the costs of that single component transaction.

These different treatments will result in profit being recognised in different periods (the total profit will in the end be the same) and different amounts of liabilities being recognised in the balance sheet.

3 IFRIC 13 *Customer Loyalty Programmes* is intended to eliminate this inconsistency. IFRIC 13 states that approach (a) above is the correct interpretation of IFRS. It then goes on to provide guidance on how the approach should be implemented. In particular it explains that:

(a) The fair value of the total consideration receivable should be allocated between the award credits and the other components of the transaction.

(b) The allocation of the consideration to the award credits is by reference to the fair value of the award credits, i.e. the amount for which the award credits could be sold separately (an exit value).

(c) The consideration allocated to the award credits is recognised as revenue when the award credits are redeemed and the entity's obligation to supply the award credits is fulfilled. Until then, it is recognised as a liability (for payments received in advance) on the balance sheet.

APPENDIX 2
EFRAG'S ASSESSMENT OF IFRIC 13 AGAINST THE ENDORSEMENT CRITERIA

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on IFRIC 13 Customer Loyalty Programmes*.*

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity as a contributor to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of the final IFRS or Interpretation on the issue.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the European endorsement criteria, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

1 When evaluating IFRIC 13 *Customer Loyalty Programmes* -hereafter IFRIC 13- EFRAG considered the following key questions:

   (a) Is there an issue which needs to be addressed?

   (b) If there is an issue which needs to be addressed, is an Interpretation an appropriate way of addressing it?

   (c) Is IFRIC 13 a correct interpretation of existing IFRS?

   (d) Does the accounting treatment that results from the application of IFRIC 13 meet the criteria for endorsement by the EU?

2 Having formed tentative views on the issues and prepared a draft endorsement advice letter, EFRAG issued that draft letter for comment on 7 September 2007 and asked for comments on it by 7 October 2007. EFRAG has considered all the comments received in response, and the main comments received are dealt with in the discussion in this appendix.

IS THERE AN ISSUE WHICH NEEDS TO BE ADDRESSED?

3 There are many different types of customer loyalty programme. EFRAG understands that currently even very similar types of programme are being accounted for differently, and that the amounts involved are often very significant. EFRAG agrees that this diversity in the way entities account for such programmes is undesirable and is an issue that needs to be addressed.

IS AN INTERPRETATION AN APPROPRIATE WAY OF ADDRESSING THIS ISSUE?

4 This diversity in practice in accounting for customer loyalty programmes arises out of uncertainty—and, as a consequence, differing views—as to how IAS 18 *Revenue* should be applied to customer loyalty programmes. Where an inconsistency in accounting practice is caused by differing interpretations of one or more existing standards it will generally be appropriate to deal with the issue by means of an Interpretation.

5 Some EFRAG members noted that the IASB and FASB are jointly carrying out a comprehensive review of accounting for revenue and that a Discussion Paper on the subject is due in 2008. They wondered whether it was as a result premature for IFRIC to be developing some new thinking on a revenue issue, particularly as the Interpretation might require changes in accounting that the longer-term joint project might reverse: a situation that would place unnecessary burdens on preparers and users.

6 On the other hand, EFRAG members noted that the IASB's active agenda currently covers many aspects of accounting and that, if IFRIC is debarred from issuing Interpretations on all those aspects of accounting, its scope will be severely restricted. They also noted that it would be several years before the joint IASB/FASB project would result in a standard and, if IFRIC could not act in the meantime, that meant several years of diversity in accounting practice and a lack of comparability.

7 Having taken the above considerations into account, EFRAG concluded that it was appropriate to issue an Interpretation to resolve the issue of accounting for customer loyalty programmes.

IS IFRIC 13 A CORRECT INTERPRETATION OF EXISTING IFRS?

Scope

8 Customer loyalty programmes can take many different forms, and IFRIC 13 applies only to customer loyalty award credits granted by the reporting entity to their customers as part of a sales transaction and which (subject to meeting any further qualifying conditions) the customers can redeem in future for free or discounted goods or services. Thus, awards or gifts that cannot be identified as part of a sales transaction (such as welcome gifts given by a bank to new customers opening an account or periodic or discretionary awards of air miles and similar) are not within IFRIC 13's scope, and neither are awards redeemable in cash.

9 IFRIC explains that it has scoped IFRIC 13 in this way because the transactions within scope are the transactions mainly responsible for the diversity of practice. EFRAG agrees and supports the scope as defined.

Issue 1—Two sales or just one?

10 IFRIC 13 deals with two broad issues. The first issue is which paragraph of IAS 18 should be applied when an entity grants award credits as part of a sales transaction.

(a) One possibility is that paragraph 13 of IAS 18 should be applied. That would mean that the transaction would be treated as involving two separately identifiable components (i.e. it is a multiple-element arrangement): the sale of the goods or services involved and the sale, for delivery at some point in the future, of rights in respect of a second transaction. (For example, in the case of air miles, the transaction would involve the sale of an aeroplane ticket plus the sale of award credits.) As the second sale has not yet been delivered, any consideration received that relates to that component is not recognised immediately but is instead deferred.

(b) The other possibility is that paragraph 19 of IAS 18 should be applied. That would mean that the transaction would be deemed to have only one component and the estimated cost of fulfilling the obligation arising from the award credit is part of the cost of sales for that one component.

(c) The third possibility is that paragraph 13 should be applied to some transactions falling within the scope of IFRIC 13 and paragraph 19 to some others.

11 In IFRIC's view, paragraph 13 applies if a single transaction consists of two or more separate goods or services that are to be delivered at different times. The issue for IFRIC was, therefore, whether the award credits represent an element of the transaction and whether there are two separate deliveries, one of which occurs at a point later than the initial transaction.

(a) IFRIC concluded that award credits granted to a customer as a result of a sales transaction *are* an element of the transaction itself. They represent rights granted to the customer. They are granted to the customer as part of the sales transaction, and can be contrasted with market expenses which are incurred independently of the sales transaction.

(b) The IFRIC also concluded that loyalty awards *are not* delivered to the customer at the same time as the other goods or services. Instead they are delivered when they are used. Put another way, award credits are rights to a future delivery of goods or services, which by definition the entity has not yet delivered.

As a result, the consensus is that paragraph 13 should be applied.

12 EFRAG members discussed a number of issues arising from this consensus and rationale. The main issue was whether award credits granted to a customer as a result of a sales transaction are an element of the transaction itself.

(a) Some EFRAG members argued that in many cases the awards are in effect forced on the customer, in that the customer is seeking to acquire the accompanying goods or services (the primary object of the transaction) and acquires the award credits only because the primary object is not sold separately. However, other EFRAG members noted that a 'forced' sale is still a sale.

(b) Some EFRAG members argued that in any event the granting of the award credits was incidental to the transaction. Many customers do not bother to redeem their award credits. Furthermore, in many cases the grantor is able to alter the value of the award credits subsequent to the grant, and customers will not pay for something whose value is outside their control. In effect, the decision to purchase the item that is the primary object of the transaction is taken independently of the award scheme and therefore as far as the customer is concerned they are entering into only one transaction at an agreed price. However, other EFRAG members noted that, although the granting of the award credits might sometimes be a largely incidental part of the transaction, in other cases that would not be the case. The widespread use of such programmes by entities demonstrates that they are believed to hold value in the eyes of the customer. The fact that the value of the award credits during the post-grant period may not always or fully be under the customer's control does not mean they were incidental to the transaction.

13 EFRAG discussed whether the cost of fulfilling the obligations arising from the grant of award credits might possibly be a marketing expense (as argued in IFRIC 13 BC6) rather than a cost of the sale of the second component of the transaction. EFRAG members noted that in BC7 of the Interpretation the IFRIC states that marketing costs are incurred independently of the sales transactions they are designed to generate, and the cost of fulfilling the obligations arising from the grant of award credits are not independent of the transaction. However, the failure of some customers to redeem award credits was seen by one member as an indication that there is not a direct link between a sale and redemption of an award. In that member's view, the purpose of granting the award credits is to enhance the marketability of the primary object of the transaction, so the cost of fulfilling the obligations is in substance a marketing cost.

Conclusion—Issue 1

14 Having considered the above arguments, the majority of EFRAG members concluded that this aspect of the consensus is a reasonable interpretation of IAS 18.

Issue 2—How should paragraph 13 of IAS 18 be applied to customer loyalty programmes?

15 Having concluded that all customer loyalty programmes falling within the scope of IFRIC 13 should be accounted for in accordance with paragraph 13 of IAS 18, IFRIC then considered how exactly that paragraph should be applied. In particular:

(a) how much consideration should be allocated to the award credit component;

(b) when should the revenue be recognised; and

(c) if a third-party supplies the awards, how revenue should be measured?

Allocation of the consideration

16 Paragraph 13 of IAS 18 in effect requires the total consideration arising on the transaction to be allocated between the two elements of the transaction. IAS 18 says very little about how that should be done.

(a) Paragraph 13 states that, "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 performed."

(b) Paragraph 9 explains that the general principle is that revenue shall be measured at the fair value of the consideration received or receivable.

17 IFRIC concluded in IFRIC 13 that the consideration allocated to the award credits "shall be measured by reference to their fair value, ie the amount for which the

award credits could be sold separately." EFRAG members consider that this is an exit value. It is not clear from IFRIC 13 why the IFRIC chose to define fair value as an exit value when IAS 18.7 already defines fair value more broadly ("the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction"). EFRAG members considered whether the effect could be to create uncertainty. One EFRAG member was also concerned that the IFRIC had chosen to define fair value whilst the IASB is still in the process of deciding what fair value should mean.

18 However, the majority of EFRAG members were not too concerned about these issues. Whilst they agreed that it was unfortunate that IFRIC had chosen to introduce a new definition of 'fair value', particularly as IAS 18 already contains a definition, they noted that applying the exit value notion would result in compliance with both definitions, so again the issue would not have major practical consequences in this case. As a consequence, EFRAG accepted this part of the consensus.

When should the revenue allocated to the award credits be recognised?

19 IFRIC then considered when the revenue allocated to the award credits should be recognised in the income statement. IAS 18.13 requires that, when consideration is received in respect of a multiple-element arrangement but an element has not yet been delivered, the consideration (ie revenue) allocated to that element should be deferred and recognised when delivery takes place. IFRIC concluded that:

(a) if the entity (rather than a third party) supplies the award, delivery will take place when the award credits are redeemed or when the entity otherwise fulfils its obligations in respect of the award credits.

(b) if the awards are supplied by a third party, the entity needs to assess whether it is acting as a principal or as an agent in the arrangement. Revenue is measured by the entity as the gross consideration allocated to the award credits where it is acting as principal or as the net amount (the difference between the consideration allocated to the award credits and the amount payable to the third party) when it is acting as an agent. The entity recognises the revenue when it fulfils its obligations in respect of the awards or when the obligation to supply the awards has passed to the third-party.

20 EFRAG believes these conclusions are consistent with IAS 18 and therefore accepts this aspect of the consensus.

Conclusion—Issue 2

21 Thus, EFRAG agrees that, if all customer loyalty programmes falling within the scope of IFRIC 13 should be accounted for as multiple-element arrangements in accordance with paragraph 13 of IAS 18, then IFRIC 13's consensus on the issues described in paragraph 15 above is an acceptable interpretation of existing IFRS. EFRAG therefore supports it.

Conclusion on appropriateness of interpretation

22 Having taken into account all the arguments discussed above, the view of the majority of EFRAG members is that IFRIC 13 is, on balance, an appropriate interpretation of existing IFRS.

DOES THE ACCOUNTING TREATMENT THAT RESULTS FROM THE APPLICATION OF IFRIC 13 MEET THE CRITERIA FOR ENDORSEMENT BY THE EU?

23 EFRAG has considered whether it believes that IFRIC 13 meets the requirements of the European Parliament and of the Council on the application of international accounting standards, in other words that the Interpretation:

(a) is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

(b) meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG has also considered whether it is in the European interest to adopt the interpretation.

24 EFRAG has previously concluded that the existing IAS 18 meets the EU endorsement criteria and has concluded in the discussion above that IFRIC 13 is an appropriate interpretation of IAS 18.

Relevance

25 EFRAG has considered whether the information that results from the application of IFRIC 13 is relevant, and has concluded that it is. The effect of IFRIC 13 is to defer the recognition of the revenue related to customer loyalty awards credits until the entity has fulfilled its obligations in respect of these. As the operation of customer loyalty schemes can be an important part of the business model of the entities that use them, EFRAG believes that the deferral of such revenue until the obligation has been fulfilled results in relevant information being provided.

Reliability

26 EFRAG has also considered the reliability of the information that will be provided. In EFRAG's view, the main issue here is whether the requirement that fair value be used as a reference to measure the consideration allocated to the award credits would lead to difficulties in estimation and, as a consequence, unreliable information being presented in the financial statements. In this context it was noted that award credits will rarely, if ever, be sold in an observable, deep and active market. In addition, the guidance provided in the Interpretation on how the award credits should be measured is limited. While it may be comparatively simple to arrive at a fair value where the award credit has a contractual value (such as where points with a monetary value or discounts at a specified percentage rate are given), in other instances it may be more difficult to estimate a fair value as there is no real market to base estimates on (such as in the case of air miles). Entities will therefore be obliged to estimate an amount based on their experience and judgement of customer values and behaviours. Indeed, some EFRAG members questioned whether the resulting range of estimated amounts might be so broad and varied that meaningful comparison between entities will be difficult, even for entities in the same industry.

27 However, EFRAG noted that there are a number of instances under current IFRSs where estimates involving a great deal of judgement are used. Examples include the "expected value" approach to estimating provisions for a large population of items under IAS 37, loan loss provisioning, the estimation of the fair value of

employee share options under IFRS 2, and the assumptions used for valuing pension arrangements under IAS 19. EFRAG believes that the reliability issues that arise when estimating the fair value of award credits under IFRIC 13 are of a similar level to those that arise under other standards. It also believes that they are not dissimilar to the issues that would arise were entities required to make a provision for unredeemed award credits.

28 One EFRAG member, however, believes that reliability remains a concern. In that member's view, in most cases in which a high degree of judgement and subjectivity is involved in arriving at an accounting estimate, that degree of judgement and subjectivity has to be accepted because the next best basis, method or policy is unacceptable; however, that is not the position in this case. The next best policy would have been to treat the award credits as a marketing expense; a policy that is both 'good enough' and would require much less judgement and subjectivity.

29 The majority of EFRAG members were not persuaded by this argument. In their view, the use of the deferred-revenue approach would not introduce a level of judgement or subjectivity that was so much higher than that required for the marketing-cost approach that reliability would be compromised. They therefore concluded that IFRIC 13 will satisfy the reliability criterion.

Comparability

30 The IFRIC's objective in issuing IFRIC 13 was to eliminate the cause of the current diversity in practice in the accounting treatment of customer loyalty programmes and thereby improve the comparability of the information provided in financial statements. EFRAG believes that has been done. EFRAG accepts that, in addressing the current uncertainty as to how existing IFRS should be applied, IFRIC 13 requires measures to be used that involve a degree of judgement being applied, and that some EFRAG members have questioned whether (as explained above) that degree of judgement might raise subjectivity and therefore comparability issues of its own. The majority of EFRAG members concluded however for the reasons set out in the previous paragraph that the comparability criterion was still met.

Understandability

31 One EFRAG member had concerns about the understandability of the information that results from the application of IFRIC 13. That member was concerned that the degree of judgment involved would, for the reasons explained in paragraphs 26 and 28 above, introduce unacceptable—and unnecessary—arbitrariness into the performance information. However, other EFRAG members believe, for the reasons set out in paragraphs 27 and 29, that this is not a significant concern. In their view, by requiring a single method of accounting for the customer loyalty programmes within its scope, IFRIC 13 will in fact enhance the understandability of financial statements.

True and fair

32 One EFRAG member agrees with the argument set out in BC6 of IFRIC 13, and thus believes that the correct interpretation of IAS 18 is that award credits are marketing costs. As a result, that member believes the consensus does not enable the revenue to be recognised when it has been earned. For that reason this member believes that the "true and fair" principle is not satisfied. However, other EFRAG members believe that the consensus is either the correct interpretation of

IAS 18 or at the very least an acceptable interpretation of IAS 18. In their view there is no inconsistency between the requirements of IFRIC 13 and the true and fair requirement.

European interest

33 EFRAG members considered whether adoption of the Interpretation in the EU might result in costs that are in excess of the benefits that would arise.

34 EFRAG's assessment is that, for entities already using a variant of IFRIC 13, the initial costs of implementation and subsequent recurring costs will not be significant. For some entities which currently use the cost-provisioning approach, EFRAG believes the initial modification or creation of appropriate systems could involve significant costs, although for others EFRAG believes the adaptation of the estimates currently used for cost provisioning would not involve significant costs.

35 EFRAG also noted that IFRIC 13 will eliminate the diversity of accounting that currently exists in respect of customer loyalty programmes, and will therefore enhance the comparability of the information provided. It will also ensure that the already endorsed IAS 18 is applied appropriately.

36 For the purpose of its endorsement advice EFRAG has to assess the costs and benefits on the preparers and users in the EU as a whole, rather than for individual entities. EFRAG's tentative assessment is that, although the incremental costs of applying IFRIC 13 may be significant for some companies, when viewed as a whole the benefits derived from IFRIC 13 seem likely to outweigh the costs that will arise from its implementation.

Conclusion

37 After considering all the above arguments, the majority of EFRAG members has concluded that on balance IFRIC 13 satisfies the criteria for EU endorsement and EFRAG should therefore recommend its endorsement.

Dissenting View

38 Two EFRAG members have reached a different conclusion to that described in the preceding paragraph; in their view IFRIC 13 does not satisfy the criteria for endorsement and should therefore not be endorsed. Paragraph 39 explains the views of one of those EFRAG members; the other member believes his own views are adequately set out in paragraph 32 above.

39 One EFRAG member believes that IFRIC 13 should not be endorsed for use in the European Union and therefore dissents from EFRAG's decision to recommend its endorsement. This member believes that the endorsement criteria of reliability, comparability and understandability are not met by the accounting required by IFRIC 13, for the reasons set out in paragraphs 28 and 31 above.

APPENDIX 3
EFRAG'S EVALUATION OF THE COSTS AND BENEFITS OF IFRIC 13

Costs for preparers

1 EFRAG has considered whether applying the accounting treatment required by IFRIC 13 would involve significant incremental costs for preparers. Implementing IFRIC 13 will involve some year-one work and some ongoing work. The extent of that work is dependent upon the entity's current degree of compliance with the accounting treatment required by IFRIC 13, but will involve some or all of the following.

(a) The year-one work will involve reading and understanding IFRIC 13 and ensuring that it is implemented correctly. This will include the restatement of the earliest prior periods presented in the financial statements as IFRIC 13 is to be applied retrospectively. If the necessary procedures and systems are not already in place, that will include designing procedures and modifying or creating systems that will allow entities to:

(i) estimate the fair value of award credits by reference to the amount for which they could be sold separately, and

(ii) estimate the total number of award credits expected to be redeemed, and

(iii) calculate and record the amount of revenue to be deferred, and

(iv) track the granting and redemption of award credits and the related fair values.

(b) The ongoing work will involve:

(i) estimating the fair values of the award credits;

(ii) estimating, and re-assessing the appropriateness of, the redemption rates to be applied ,

(iii) tracking the granting and redemption of award credits and the related fair values, and

(iv) calculating the appropriate amounts of revenue to be deferred and to be recognised in the income statement.

2 Of course some companies will already be following the accounting treatment described in IFRIC 13 exactly. However, many companies with customer loyalty programmes within the scope of IFRIC 13 will not be. Instead they will either be applying a variant of the accounting required by IFRIC 13 or will be treating the sales transaction as involving just a single component and, as a result, providing for the cost of awards.

Year-one costs

3 In the case of entities already applying a variant of IFRIC 13 (in other words, already applying paragraph 13 of IAS 18 to customer loyalty programmes), EFRAG believes that the main changes are likely to be how the sale consideration is allocated between the main sale and the sale of award credits and how the revenue

is recognised based upon actual and expected redemption rates. The examples given in IFRIC 13 indicate that simplifying approaches and estimates are acceptable and the evidence EFRAG has to date suggests that the costs of adapting to a fully compliant approach would not be significant. Consequently, although EFRAG is carrying out some additional research to confirm this, its initial assessment is that the additional costs involved will in most cases not be significant.

4 In the case of entities that have been treating the sales transaction as involving just a single component, many will already have a system that allows them to track the numbers of award credits outstanding and to estimate the redemption rates in order to be able to accrue for the cost of fulfilling their obligations. What may be new is the need for a methodology to arrive at an estimate of fair value for the award credits and a system which will facilitate the tracking of the fair values of the award credits which are expected to be redeemed. Developing this methodology and system will involve year-one costs.

5 EFRAG's initial assessment is that this will not involve significant costs for most preparers because of the simplifying approaches and estimates available to mitigate the costs for companies; however, for some the costs may be significant because it might be necessary to link award-tracking systems to revenue accounting systems, particularly where there are large numbers of transactions. EFRAG intends to carry out further research into this matter.

6 As mentioned above, IFRIC 13 is to be applied retrospectively. This involves the entity in arriving at a fair value for the award credits at a time when no methodology was in place and the necessary information may no longer be available. In theory this could be quite an extensive exercise. However, EFRAG believes that it will often be possible to apply simplified methodologies and make approximations. As a result, its initial assessment is that, across all preparers as a whole, the year-one costs will not be significant. It intends however to carry out further work into the matter.

Ongoing costs

7 EFRAG believes that, once the necessary systems and procedures have been put in place, the ongoing incremental costs are unlikely to be significantly higher than the costs being incurred currently.

Costs for users

8 EFRAG has also considered whether the requirements of IFRIC 13 will in some way increase the burden on users of financial statements. Its tentative view is that they impose no additional ongoing burden on users, although some insignificant year-one costs might arise in understanding the changes that many companies will have made to their accounting.

Benefits for preparers and users

9 EFRAG has concluded, for the reasons explained in Appendix 2, that the interpretation set out in IFRIC 13 will reduce uncertainty about how to account for customer loyalty programmes and consequently result in a reduction in divergence in practice, thereby enhancing consistency and comparability of the information provided. This should be a benefit to all stakeholders.

Conclusion

10 For entities already using a variant of IFRIC 13, the initial costs of implementation and subsequent recurring costs are not expected to be significant. For some entities which currently use the cost-provisioning approach, EFRAG believes the initial modification or creation of appropriate systems could involve significant costs, although for others EFRAG believes the adaptation of the estimates currently used for cost provisioning would not involve significant costs. For the purpose of its endorsement advice EFRAG has to assess the costs and benefits on the preparers and users in the EU as a whole, rather than for individual entities. EFRAG's tentative assessment is that, although the incremental costs of applying IFRIC 13 may be significant for some companies, when viewed as a whole the benefits derived from IFRIC 13 seem likely to outweigh the costs that will arise from its implementation.