Accounting and assurance

Loyalty Programs and other tools used to attract and retain the enlightened consumer

Loyalty Programs and other tools used to attract and retain the enlightened consumer

The growth of online retail as well as new retailers entering the Australian market from overseas has increased the need to attract and retain loyal customers. We have seen an expansion in the number and types of loyalty schemes being offered in the market in recent years. Loyalty programs that are easy to understand, personalised and innovative appear to be successful in the market.

The financial reporting implications will depend on the specific facts and circumstances of each program. The IASB sought to bring about uniformity among accounting practices and developed guidance in the form of IFRIC 13. While this guidance has been in existence since 2009, the experience in application of the accounting for such programs is mixed.

IFRIC 13 splits the sales transaction in which credits or points are awarded into multiple elements. It mandates for the consideration to be allocated between goods or services delivered and the points that will be redeemed in future. If an element of the sale is determined to be 'unearned' at the point of sale, and rather will be 'redeemed' at a future point, the fair value of this amount is recorded as a deduction from revenue, and recorded as a liability on the balance sheet (deferred revenue) and not recognised until redemption date.

In our experience, determining the fair value of an award credit where the fair value is not directly observable in the market can be challenging. Entities need to develop valuation methodologies and models to estimate their fair value, and this may require valuation/actuarial experts.

Some of the factors that should be taken into account when estimating fair value include:

- An appropriate forfeiture rate and how it is applied in the valuation model
- The discount each customer obtains when redeeming the award credits compared to the discount that could be obtained by customers who do not redeem award credits.

IFRIC 13 does not mandate a specific approach for estimating fair value, but requires that it is based on the fair value to the holder (not the cost of redemption of the issuer). The following is a list for illustrative purposes rather than a comprehensive clarification of how individual fair value should be determined:

Type of incentive	*Indicative individual fair values*
Money off coupon attached to product	Cash value of voucher
Points earned as goods are purchased	Based on value of goods points can buy
Points earned at one store to be used at other stores	Based on value of goods points can buy

Loyalty Programs and other tools used to attract and retain the enlightened consumer

Some awards have a 'use by' date and therefore a finite life. Any deferred revenue not released previously would be released when the awards expire, although this amount should not be material if expected redemptions have been updated regularly. Awards that have an indefinite life are more difficult and the issuing entity should estimate the period over which they will be used. The estimate should be revised regularly to ensure that award credits are released to reflect the updated redemption rate.

Beyond loyalty programs, there are also complexities in accounting for other mechanisms retailers are using in response to the challenging economic environment. While the following examples are the more traditional mechanisms used, often these are offered in combination with other types of arrangements.

In summary, it is important to note the devil is in the detail and a small variation in a program could result in a slightly different accounting treatment.

Program	Accounting treatment
Discounts	Accounted for as a reduction in revenue (not a marketing expense) at the time of the sale.
Vouchers/Gift cards – issued as part of the sale transaction	Revenue should be the amount of consideration received less the voucher's fair value. The voucher's fair value is deferred on the balance sheet until redeemed. An estimate of redemption rates is incorporated into the deferred amount at inception and throughout the life of the reward.
Vouchers – granted without consideration (e.g. discount coupons in newspaper)	No liability is recognised unless the product is then sold at a loss (which creates an onerous contract). When redeemed, revenue reflects the discounted value.
Free products – 'buy one get one free'	Revenue reflects the sales proceeds. The additional cost of offering the second product at discount is recorded as cost of sales, not as a marketing expense.

For more information, please contact:

Paddy Carney
Partner
+ 61 3 8603 7312
paddy.carney@au.pwc.com

Alison Tait
Partner
+61 3 8603 2131
alison.tait@au.pwc.com

Kim Challenor
Partner
+61 7 3257 5022
kim.challenor@au.pwc.com

- *Revenue transactions involving a loyalty program must be split and the fair value of the loyalty element deferred*
- *The accounting treatment may vary depending on the terms of each loyalty program*
- *The estimation of fair values of loyalty schemes and redemption rates can be complex*
- *Close attention will also need to be paid when accounting for discounts, vouchers, free products and memberships*

www.pwc.com.au/industry/retail-consumer

Retail & Consumer contacts:

Stuart Harker
Australian Retail & Consumer Goods Leader
Global Retail & Consumer Goods Advisory Leader
+61 3 8603 3380
+61 418 339 231
stuart.harker@au.pwc.com

Australia:

John Riccio
National Digital Change Leader
+61 3 8603 4968
+ 61 419 275 097
john.riccio@au.pwc.com

Paddy Carney
Partner
Assurance
+61 2 8266 7312
paddy.carney@au.pwc.com

Peter Konidaris
Partner
Specialist Taxes and National Business to Consumer Leader
+61 3 8603 1168
peter.konidaris@au.pwc.com

Suzi Russell
Partner
Specialist Tax
+61 2 8266 1057
suzi.russell@au.pwc.com

Lisa Harker
Partner
Assurance
+61 3 8603 2147
lisa.harker@au.pwc.com

Sarah Saville
Partner
Corporate Tax
+61 2 8266 8665
sarah.saville@au.pwc.com

Daniel Rosenberg
Partner
Private Clients
+61 3 8603 3886
daniel.rosenberg@au.pwc.com

John Cannings
Partner
Legal
+61 2 8266 6410
john.cannings@au.pwc.com

Kate Warwick
Partner
Advisory
+ 61 3 8603 3289
kate.warwick@au.pwc.com

New Zealand:

Julian Prior
Partner
+64 9 355 8591
julian.m.prior@nz.pwc.com

Nathan Wylie
Director
+64 3 374 3015
nathan.j.wylie@nz.pwc.com

If you have any feedback for us, or if there are any topics or issues you would like to see in upcoming editions, please contact:

Stuart Harker
+ 61 3 8603 3380
+ 61 418 339 231
stuart.harker@au.pwc.com

Andrea Marffy
R&C Industry Manager
+ 61 3 8603 3245
andrea.marffy@au.pwc.com