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Purpose of this paper

1. This paper considers feedback on the November 2011 Exposure Draft, *Revenue from Contracts with Customers* ("2011 ED") regarding how the revenue model would apply to credit card reward programs.

Summary of staff recommendations

2. The staff recommend amending paragraph IE21/IG79 to clarify that Example 24 of the 2011 ED (the customer loyalty program example, refer Appendix A) may not apply to all customer loyalty arrangements because the terms and conditions for each may differ. In particular, when there are more than two parties to the arrangement, the entity should consider all of the facts and circumstances to determine the customer in the transaction that gives rise to the award credits.

Structure of this paper

3. The remainder of this paper is structured as follows:

   (a) Background (paragraphs 4 – 20)

      (i) Credit card reward programs (paragraphs 5 – 10)

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(ii) Are credit card arrangements similar to distribution arrangements? (paragraphs 11 – 12)

(iii) Existing guidance and current practice for credit card reward programs (paragraphs 13 – 18)

(iv) The 2011 ED implementation guidance and feedback thereon (paragraphs 19 – 20)

(b) Staff analysis (paragraphs 21 – 32)

(c) Staff recommendation (paragraphs 33 – 34)

(d) Appendix A: Example 24 – *Customer loyalty program,* from the 2011 ED

(e) Appendix B: Extract of IFRIC 13 *Customer Loyalty Programmes* (paragraphs 5 – 8)

(f) Appendix C: Analysis of card issuer's customer

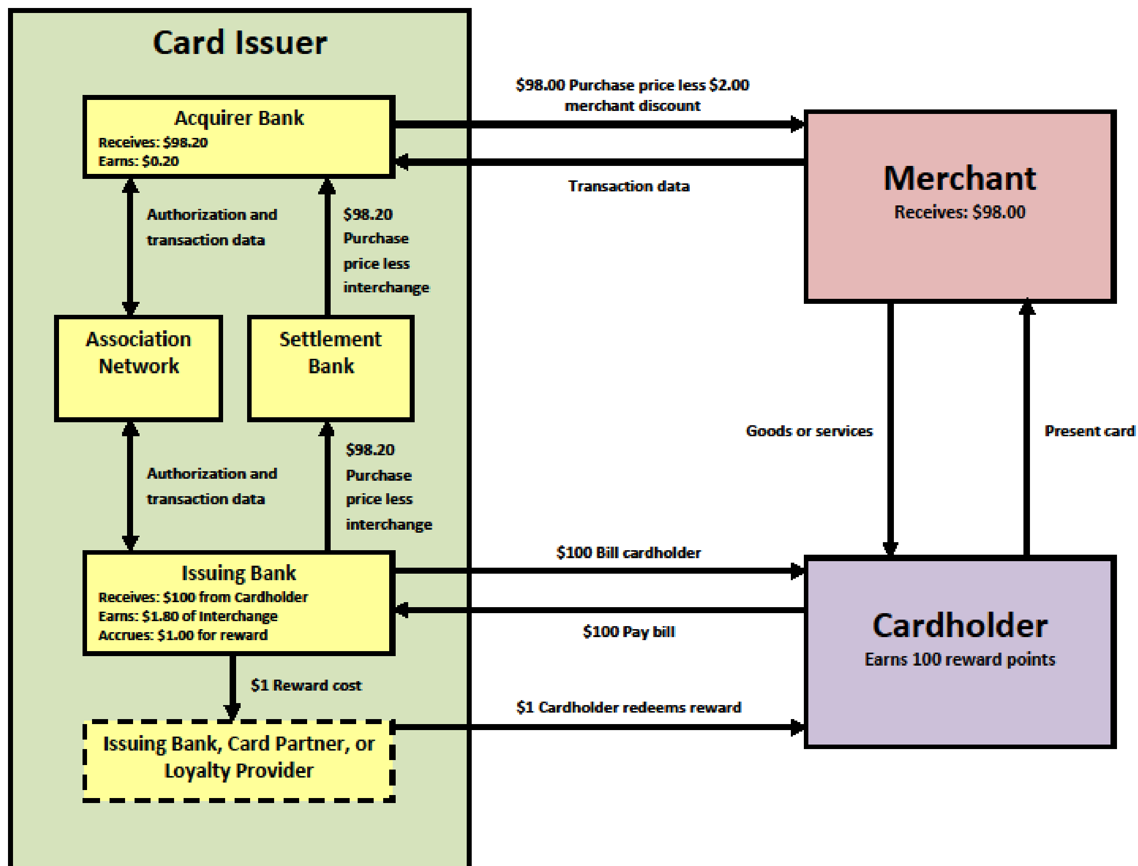
Background

4. In response to the 2011 ED, some preparers in the financial services industry requested clarification about the application of the proposals to credit card reward programs. Specifically, these respondents (primarily U.S. GAAP reporters) were uncertain whether the Boards intended the revenue model to be applied to credit card reward programs based on Example 24 in the 2011 ED.

Credit card reward programs

5. A typical credit card reward program is part of a broad credit card arrangement that involves a network of parties and which, through various contracts, enables a cardholder to purchase goods or services on credit from merchants that accept that type of credit card. There are at least three parties involved— the card issuer (typically a financial institution or bank), the merchant (for example, a retail store), and the cardholder.

6. The cardholder enters into a contract with the card issuer (the cardholder contract) that governs the terms and conditions on the use of the credit card by the cardholder. The merchant enters into a separate contract with the entity, or another entity within the card issuer's credit card network, that 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/services (the merchant contract). The arrangement is illustrated in the diagram below:



Acquirer Bank **promotes and sells card acceptance services to the merchant community.**

Association Network **consists of well known credit card brands, such as Visa and MasterCard, although some banks may issue their own cards. These associations are responsible for creating and enforcing member governing rules, providing and managing authorization and settlement networks, monitoring fraud and enabling effective fraud controls, and mass marketing for their particular brand.**

Settlement Bank **takes charge of the settlement amount owed by a member of the bank.**

7. The diagram above represents the more common structure of a credit card arrangement ("open loop structure" where the card issuer has no direct contract with the merchant). However, in some cases the issuing bank can be the party that enters into both the merchant and cardholder contract ("closed loop structure"). Regardless of the structure, the following are common to all credit card arrangements:

   (a) under the cardholder contract, the card issuer stands ready to lend/provide financing to the cardholder up to a pre-agreed limit such that the cardholder can use the card to acquire goods or services on credit from merchants within the card issuer's network; and

   (b) under the merchant contract, when the cardholder uses a credit card to acquire goods or services from the merchant, the card issuer transfers cash (generally through intermediary financial institutions) to the merchant at the time of the sale. The cardholder is then obligated to repay the outstanding amount to the card issuer based on the terms and conditions in the cardholder contract.

8. In a typical credit card arrangement, when a cardholder purchases goods or services from the merchant, the merchant receives an amount of cash from the card issuer's bank that is slightly less than the invoiced price for the goods and services acquired by the cardholder. This difference between the invoice price and the cash paid to the merchant is commonly referred to as an "interchange" fee (see the diagram in paragraph 6 for a relatively simple representation of a transaction).

9. As indicated above, card issuers may administer a credit card reward program as part of a credit card arrangement. Under these programs, the cardholder receives award credits whenever they use their card to make a purchase from a merchant. The terms and conditions of a credit card reward program are included in the cardholder contract and the characteristics of these programs can vary significantly (for example, some credit card issuers provide the cardholder the option of redeeming award credits for cash, some provide the cardholder with a

choice of goods or services, and some others provide award credits in another entity's reward program (for example, an airline co-branded credit card)).

10. Card issuers can generate cash inflows from interchange fees, fees charged on outstanding credit card balances (ie, interest charges), and annual fees that entitle a cardholder to use a specific type of credit card.

Are credit card arrangements similar to distribution arrangements?

11. In September 2012, the Boards considered how the revenue model should apply to distribution arrangements in which an entity promises to transfer goods or services to its customer's customer; specifically, whether the promises to the customer's customer would give rise to performance obligations for the entity. These types of promises exist in distribution networks in various industries, but are particularly common in the automotive industry. For example, when a manufacturer sells a motor vehicle to its customer (a dealer), the manufacturer may also promise to provide additional goods or services (such as "free" maintenance) to the end consumer that purchases the motor vehicle from the dealer. At that meeting, the Boards confirmed that an entity should account for a promised additional good or service that will be ultimately provided to the customer's customer as a performance obligation if that promise was explicitly stated (or implied by the entity's customary business practices) in the contract negotiated between the entity and its customer.

12. The similarity between these types of distribution arrangements and credit card arrangements is that, in both cases, the entity's (that is, manufacturer's or the card issuer's) contract with a customer (that is, dealer or cardholder) is economically linked to another contract (that is, a contract with the end consumer or the merchant). However, the arrangements are different and, as a consequence, the accounting issues are different. In the case of the distribution network, the issue relates to the identification of performance obligations in situations where the entity transfers a good or service to its customer's customer even though the entity has no contract with its customer's customer. In credit card arrangements, the entity clearly contracts directly with the cardholder to provide an automatic credit

facility (that is, the cardholder is clearly the entity's customer for the credit related portion of the arrangement). However, a cardholder's entitlement to award points is based on usage of their credit card at a merchant (for which the card issuer earns an interchange fee). Therefore, the issue is whether the cardholder also receives those award credits in their capacity as the customer of the card issuer.

Existing guidance and current practice for credit card reward programs

U.S. GAAP requirements

13. There is no comprehensive guidance in U.S. GAAP on how to account for credit card reward programs.

14. There is guidance in Subtopic 310-20 (formerly FAS 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*) regarding credit card fees, which are defined as "the periodic uniform fees that entitle cardholders to use credit cards". Fee income that meets the definition of credit card fees "are viewed in part as being loan commitment fees" and "shall be deferred and recognized on a straight-line basis over the period the fee entitles the cardholder to use the card". In practice, the staff understand that most card issuers reporting under U.S. GAAP account for any annual credit card fees collected in accordance with Subtopic 310-20.

15. There is no direct guidance with respect to interchange fees and reward programs. In practice, the staff understand that most card issuers reporting under U.S. GAAP account for the interchange fee as revenue when the cardholder/merchant transaction occurs and at the same time account for award credits by recognizing an expense and accruing a liability in the amount of the cost expected to be incurred in fulfilling the award credits obligation.

16. Furthermore, the staff understand that many card issuers reporting under U.S. GAAP present the interchange fee income net of the cost of the associated award credits while others recognise the interchange fee income and the cost of the associated award credits separately.

IFRS requirements

17. In contrast, under IFRSs, IFRIC 13 *Customer Loyalty Programmes* provides guidance on how to account for reward programs. In practice, the staff understand that most credit card issuers reporting under IFRSs account for reward programs under IFRIC 13 because of the inclusionary language in paragraph BC4, which 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 cardholders 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. [Emphasis added]

18. IFRIC 13 provides guidance on the identification of award credits as a component of the initial sale transaction, the allocation of consideration to the award credits, and the assessment of whether the entity is acting as a principal or agent in situations where a third party will supply the goods or services represented by the award credits (refer to Appendix B for an extract of the relevant guidance from IFRIC 13).

2011 ED implementation guidance and feedback thereon

19. The 2011 ED's implementation guidance (paragraphs B20 – B24/IG20 – IG24) explains that an option granted to a customer to acquire additional goods or services for free or at a discount can represent a separate performance obligation. Specifically, that option to acquire additional goods or services gives rise to a separate performance obligation when that option represents a material right that the customer would not receive without entering into that contract. These options for additional goods or services can come in many forms, including customer

award credits (or points). An example of this is illustrated in Example 24 of the 2011 ED (reproduced in Appendix A).

20. Some respondents questioned whether Example 24 in the 2011 ED implies that award credits in a credit card reward program should always be considered to represent a material right (and thus a performance obligation) within the scope of the revenue proposals. The majority of these respondents highlighted differences between a typical credit card reward program and the fact pattern in Example 24 of the 2011 ED. These respondents also indicated that they think that the differences between a credit card reward program and Example 24 mean that credit card reward programs would not give rise to a performance obligation within the scope of the revenue proposals (based on their interpretation of the 2011 ED requirements). However, some of these respondents were uncertain whether their interpretation of the arrangements that included credit card reward programs would be challenged based on the wording in Example 24.

Staff analysis

Applying the guidance in paragraph B21/IG21

21. The staff think that the guidance in paragraph B21/IG21 of the 2011 ED is clear that when *a customer* obtains award credits or points (that is, an option that represents a material right) as a result of acquiring other goods or services from the entity, these award credits would give rise to a separate performance obligation for the entity.

22. The staff think that award credits in a credit card reward program would meet the definition of a material right because they entitle the cardholder to goods or services that the cardholder would not otherwise obtain. However, the staff think that the feedback from respondents suggests that in credit card arrangements that include a credit card reward program, it is unclear whether the cardholder receives award credits in its capacity as a customer or as part of the card issuer's transaction with another customer (ie, the merchant).

23. The staff think that there are two alternatives for the Boards to consider in addressing this issue:

    (a) **Alternative A: Provide specific guidance to address the issue** – this would require the Boards to (a) agree on the appropriate accounting in a credit card reward program, and (b) include some incremental guidance in the final standard to specify the accounting for these types of arrangements.

    (b) **Alternative B: Rely on the application of the revenue model** – this would require an entity to apply the principles in the revenue model to the facts and circumstances for a specific credit card reward program. The guidance would clarify that the appropriate accounting for a credit card reward program will depend on the facts and circumstances and that Example 24 is not intended to provide definitive guidance for all credit card reward programs.

Alternative A: Provide specific guidance to address the issue

24. The staff think that to be able to provide specific guidance on the accounting for credit card reward programs, the Boards would need to consider at least two key aspects of a credit card arrangement: (a) identification of the customer, and (b) the scope interaction with financial instruments.

Identification of the customer

25. The Boards would need to determine whether additional guidance should be provided in making the judgment as to whether the card issuer's customer is the merchant or the cardholder in the transaction that results in the award credits being granted to the cardholder. Specifically:

    (a) **View 1: Merchant is the customer** – if the interchange fee represents consideration in exchange for a service provided by the card issuer to the merchant, the award credits would be accounted for as a cost.

(b) **View 2: Cardholder is the customer** – if the interchange fee represents consideration in exchange for a service provided by the card issuer to the cardholder, the award credits promised to the cardholder would be accounted for as a performance obligation (unless they were in the form of cash, in which case they would be accounted for as consideration payable to a customer).

26. A more detailed analysis of these views is included in Appendix C.

The scope interaction with financial instruments

27. Paragraph 11 of the 2011 ED states that if another Topic/IFRS specifies how to separate and initially measure one or more parts of a contract, an entity first applies those separation and/or measurement requirements. The loan granted to a cardholder that uses its credit card is within the scope of the financial instrument guidance. The staff think that if the Boards want to be more specific in terms of which other parts of a credit card arrangement should be dealt with under the financial instrument guidance, the Boards would need to amend their respective financial instrument guidance, rather than the 2011 ED.

Contract combination guidance in the 2011 ED

28. Additionally, the staff considered whether the guidance in the 2011 ED on contract combinations was applicable and whether the merchant contract and cardholder contract should be combined before identifying the separate performance obligations in the arrangement. However, the staff think that the guidance on contract combinations is not applicable because the merchant contract and cardholder contract are not entered into at or near the same time with the same customer, and the cardholder and merchant are not related parties (paragraph 17 of the 2011 ED). Additionally, the staff think that the guidance on contract combinations should not be modified to consider combining these two separate contracts (merchant and cardholder) as that might result in unintended consequences for other transactions and/or industries.

Alternative B: Rely on the application of the model

29. This alternative proposes to not provide specific guidance on the accounting for a credit card reward program. Instead, this alternative acknowledges that any decisions related to the card issuer's customer for the interchange service and, consequently, the accounting for any credit card reward program, will depend on the specific facts and circumstances in the arrangement and how they relate to the application of the principles of the revenue model. This view acknowledges that, in some cases, the card issuer might determine that its customer is the merchant, while in other cases, the card issuer might determine that its customer is the cardholder (the resulting accounting treatment would follow that explained in paragraph 25 above).

30. The staff think that credit card arrangements can be complex and include terms and conditions which could result in different economics between credit card reward programs. The terms and conditions of these programs can vary significantly, for example:

    (a) some card issuers have an agreement with both the merchant and the cardholder ("closed loop arrangements"), whereas in other arrangements, the card issuer has no direct contractual relationship with the merchant and the merchant contracts with unrelated third parties in the network association ("open loop arrangements" as illustrated in the diagram in paragraph 6). In cases where the link between the merchant and issuing bank is only indirect through the network association, this might indicate that the card issuer's customer is the cardholder;

    (b) many credit card issuers' primary purpose in a credit card arrangement is the provision of financing on which they expect to earn interest income when outstanding balances are not paid on the credit card. Consequently, the cardholder is the customer of the card issuer for a transaction that is within the scope of the financial instruments guidance. Because the cardholder is already acting as the customer for a part of the contract, this makes the identification of the customer for the other goods and services in the arrangement difficult;

(c) some credit card issuers charge the cardholder a fee for participation in the reward program while other card issuers do not. In addition, some credit card issuers' participation fee gives the cardholder rights to other goods or services (for example, airport lounge access). If the cardholder's participation fee is substantive when compared to the goods or services excluding the reward program, this may indicate that the cardholder is the customer for a bundle of goods and services, including the loyalty reward program (in addition, U.S. GAAP preparers would need to consider whether this indicates that the entire arrangement is in the scope of Subtopic 310-20 rather than the revenue proposals); and

(d) some credit card issuers actively manage the credit card reward program (for example, the card issuer has a catalogue of goods or services that the cardholder can choose from), while other card issuers provide a co-branded card product (for example, an airline miles credit card), which limits redemption to the goods or services of a particular merchant. This introduces complexity into determining whether the credit card issuer has a customer for the satisfaction of the award credits, or whether the third party has a customer for the satisfaction of the award credits.

31. The staff note that the Boards have previously considered the issue of identifying the customer when redeliberating distribution networks and collaboration agreements. Furthermore, the staff note that in both of those cases, the Boards decided that it would not be feasible to further define a customer for the purposes of applying the revenue proposals. Proponents of Alternative B think that the issue of identifying the customer in a credit card arrangement is another example where trying to further refine the definition of a customer would be counterproductive because the respondents who raised this issue as a concern are focused on their very specific fact patterns. Proponents of this alternative think that amending the definition of a customer to try and address respondents' concerns may have unintended consequences in other industries and/or arrangements.

32. Furthermore, proponents of this alternative think that the differing types of credit card arrangements mean that it might not be possible to amend the definition of a

customer (or provide other guidance) in a way that would capture all of the complexity in these types of arrangements. Proponents of this alternative think that the 2011 ED already includes all of the guidance that an entity would need in order to apply the revenue model to these types of arrangements, specifically the 2011 ED:

(a) provides guidance for how to account for contracts when the contract includes both a financial instrument part (the cardholder loan) and another potential part within the scope of the 2011 ED (paragraph 11 of the 2011 ED);

(b) requires an entity to identify the customer as the party that contracts to obtain goods or services that are an output of the entity's ordinary activities (paragraph 10 of the 2011 ED);

(c) explains when contracts should (or should not) be combined (paragraph 17 of the 2011 ED); and

(d) provides guidance for identifying separate performance obligations (including material rights), allocating consideration to those identified performance obligations and recognising revenue when the obligations are satisfied.

Staff recommendation

33. The staff think that Alternative B is the most appropriate alternative, that is, that entities should rely on the principles in the 2011 ED. In addition, the identification of the card issuer's customer as the merchant or the cardholder (and consequently the accounting for any credit card reward program) will depend on the facts and circumstances of the credit card arrangement.

34. The staff note that much of the respondent feedback related to credit card reward programs is related to Example 24 from the 2011 ED, specifically, that this example implied that award credits always give rise to a performance obligation and, therefore, that award credits in a credit card reward program always give rise to performance obligations. Consequently, the staff recommend that an

amendment be made to paragraph IE21/IG79 to clarify that Example 24 should not be interpreted to mean that all customer loyalty arrangements give rise to a performance obligation. In particular, when there are more than two parties to the arrangement, the entity should consider all the facts and circumstances in determining the customer in the arrangement that gives rise to the award credits.

Questions for the Boards

Question 1: Do the Boards agree that the 2011 ED includes the principles that an entity would need to apply to determine the accounting for a variety of credit card reward programs?

Question 2: Do the Boards agree that paragraph IE21/IG79 (ie, the introductory paragraph to Example 24) should be clarified to explain that the existence of a "customer loyalty program" does not automatically result in award credits being classified as a performance obligation, and that when there are more than two parties to the arrangement, the entity should consider all the facts and circumstances in determining the customer in the arrangement that gives rise to the award credits?

Appendix A: Example 24 – *Customer loyalty program*, from the 2011 ED

IG79. The following Example illustrates the proposed guidance in paragraph IG23 on determining the amount of the transaction price to allocate to an option as part of a customer loyalty program.

Example 24-Customer loyalty program

An entity has a customer loyalty program that rewards a customer with one customer loyalty point for every CU10 of purchases. Each point is redeemable for a CU1 discount on any future purchases. During a reporting period, customers purchase products for CU100,000 and earn 10,000 points redeemable for future purchases. The stand-alone selling price of the purchased products is CU100,000. The entity expects 9,500 points to be redeemed on the basis of its past experience that it concludes is predictive of the amount of consideration to which it will be entitled. The entity estimates a stand-alone selling price of CU0.95 per point (or CU9,500 total) on the basis of the likelihood of redemption.

The points provide a material right to customers that they would not receive without entering into a contract. Hence, the entity concludes that the points are a separate performance obligation.

The entity allocates the transaction price to the product and the points on a relative stand-alone selling price basis as follows:

Product $91,324a
Points $8,676b

a$100,000 × $100,000 ÷ $109,500
b $100,000 × $9,500 ÷ $109,500

At the end of the first reporting period, 4,500 of the points have been redeemed and the entity continues to expect 9,500 points to be redeemed in total. The entity recognizes revenue for the loyalty points of CU4,110 [(4,500 points ÷ 9,500 points) × CU8,676].

During the second reporting period, an additional 4,000 points are redeemed (cumulative points redeemed are 8,500). The entity expects that 9,700 points will be redeemed in total. The cumulative revenue that the entity recognizes is CU7,603 [(8,500 ÷ 9,700) × CU8,676]. The entity has recognized CU4,110 in the first reporting period, so it recognizes revenue for the loyalty points of CU3,493 (CU7,603 – CU4,110) in the second reporting period.

In the third reporting period, an additional 1,200 points are redeemed (cumulative points redeemed are 9,700). The entity expects that no additional points will be redeemed. The entity has already recognized revenue of CU7,603 so it recognizes the remaining revenue for the loyalty points of CU1,073 (CU8,676 – CU7,603).

Appendix B: Extract of IFRIC 13 *Customer Loyalty Programmes* (paragraphs 5 – 8)

5. 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 award credits and the other components of the sale.

6. The consideration allocated to the award credits shall be measured by reference to their fair value.

7. 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.

8. 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 (ie as the principal in the transaction) or on behalf of the third party (ie 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, ie 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.

Appendix C: Analysis of card issuer's customer

View 1: Merchant is the customer

C1. This view identifies the merchant as the card issuer's customer for the interchange service. That is because when a credit card is used at a merchant, the card issuer provides the merchant with the service of enabling the cardholder to purchase the merchant's goods or services with increased convenience, and it enables merchants to transact with a class of customer that may not have access to sufficient funds at the time of purchase. In exchange for providing the merchant with a service of greater access to potential customers, the card issuer charges the merchant an interchange fee. The merchant pays this interchange fee by accepting a reduction in the cash received for the goods or services as full settlement of its customer's purchase (for example, cash receipt of CU98, inclusive of a CU2 fee for a CU100 sale).

C2. Separately, in accordance with the terms and conditions of a credit card reward program, the cardholder is rewarded with "free" goods or services (in the form of award credits) based on the amount of purchases they make when they engage in transactions with merchants (eg, retailers). The cardholder is rewarded with these award credits because they are generating fee income for the card issuer by initiating transactions with merchants which result in an interchange fee for the card issuer. Thus, in this view, the award credits are similar to a typical commission payment. In other words, the cardholder acts as a sales agent on behalf of the card issuer for the interchange service.

C3. Consequently, in this view, the award credits would not be within the scope of the 2011 ED requirements. The award credits would be recognised as a cost of providing services when the obligation is incurred in accordance with the applicable IFRSs or U.S. GAAP.

C4. Proponents of this view think that the merchant is the customer for the interchange service for the following reasons:

(a) there is a separate contract between the card issuer and the merchant (or there is a separate contract with an association such as Visa or

MasterCard and the merchant) that outlines the terms and conditions for the arrangement;

(b) the merchant bears the cost of the interchange service because the merchant will obtain the invoiced price for its goods or services less the interchange fee. If the merchant is the one that bears the cost of the interchange service, proponents of this view think that the merchant must be the party that receives the service related to that cost. Supporters of this view also observe that some merchants (for example, petrol/gas stations) try to pass on this cost to the cardholder by charging the cardholder a higher price for a good or service when paid for by a credit card rather than cash. Supporters of this view think that this is evidence that the merchant bears the cost of the interchange service because, in some cases, the merchant passes that cost on to the card holder;

(c) the contractual promises in the merchant contract typically state that the services that will be provided to the merchant are transactions processing services (that is, the interchange service). If these services are not provided to the merchant, then why would a merchant enter into a contractual arrangement with the card issuer?

View 2: Cardholder is the customer

C5. This view identifies the cardholder as the card issuer's customer for the interchange service (and thus the award points). This is because when a credit card is used at a merchant, the card issuer provides the cardholder with two goods or services:

(a) a loan to purchase the merchant's goods or services on credit, for which the card issuer will earn interest (a financial instrument transaction); and

(b) the service of electronically transferring the cash (obtained from the loan) to the merchant to enable the cardholder to purchase the goods or services. This view looks at this as a separate service because this

service is often provided by the card issuer in other cases such as debit cards where the loan portion of the arrangement will not exist.

C6. In exchange for providing the cardholder with a service of electronic transfer of funds, the card issuer earns an interchange fee from the cardholder. The cardholder pays for this service by implicitly paying the merchant a higher price for the goods or services than they would otherwise have to pay. This is evidenced by the fact that, in some cases, the merchant will charge the cardholder a different price if a credit card is used compared to cash. However, in many cases, the merchant is prepared to have the cost of the interchange service passed on by the cardholder – in those cases, the merchant takes this cost into account when determining the selling price of the goods or services on a portfolio basis. Under this view, when a credit card reward program is in place, the cardholder obtains goods or services from the card issuer in the form of the interchange service *and* the award credits.

C7. Consequently, the award credits would be within the scope of the 2011 ED requirements. If the award credits are in the form of cash, the guidance related to consideration payable to a customer would apply (paragraphs 65 – 67 of the 2011 ED). If the award credits are not in the form of cash, the card issuer would need to determine whether it is acting as the principal or the agent in satisfying the performance obligation represented by the award credits. That determination affects whether the entity recognises revenue in the gross amount of consideration to which the entity is entitled in exchange for the award credits (if a principal) or in the amount of any fee or commission received in exchange for arranging for the other party to provide its goods or services (if an agent). In either case, the card issuer would allocate a portion of the consideration for the interchange service to the award credit obligation and recognise this amount as revenue when it satisfies the related performance obligation.

C8. Proponents of this view think that the cardholder is the customer for the interchange service for the following reasons:

(a) in the majority of credit card arrangements, the card issuer has a direct contractual relationship only with the cardholder – often another party in the credit card network association has the direct contract with the merchant (as per the diagram in paragraph 6). If the card issuer has a direct contract with only the cardholder and the contract combination guidance does not apply, proponents of this view think that the merchant cannot be the customer of the card issuer because in most cases there is no direct contract between the card issuer and the merchant;

(b) the cardholder is receiving the interchange service and the cardholder pays for this service by implicitly paying more for the goods or services from the merchant. Supporters of this view agree that some merchants (for example, petrol/gas stations) charge the cardholder a higher price for a good or service when paid for by a credit card rather than cash. However, supporters of this view think that this is evidence that the *cardholder* bears the cost of the interchange service because, in those cases where the merchant charges a surcharge for the use of the credit card, the merchant has explicitly acknowledged that the cardholder is paying for this service;

(c) in arrangements where a debit card is used rather than a credit card, the interchange fee obtained by the card issuer is significantly lower. Proponents of this view think that the relatively higher interchange fee for a credit card relates to the card issuer recovering their incremental costs (plus a margin) of providing credit related services *to the cardholder*. Although those credit related services might be linked to the loan portion of the arrangement, proponents of this view indicate that it is the cardholder (and not the merchant) who is the customer that obtains the services in the arrangement.