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November 16, 2006

Mr. Robert P. Garnett, Chairman
International Financial Reporting Interpretations Committee

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

Dear Robert,

Comments on IFRIC D20 "Customer Loyalty Programmes"

Accounting Standards Board of Japan (ASBJ) is pleased to comment on IFRIC draft interpretation D20 "Customer Loyalty Programmes". The views expressed in this letter are those of International Issues Standing Committee of ASBJ.

Our Opinion:

(1) We disagree with the draft interpretation D20 that requires a portion of the consideration received from customers should be always allocated to the award credits and deferred as a liability until the entity fulfils its obligations to deliver awards to customers, irrespective of difference in the substance of transactions.
Paragraph 5 of D20 states that "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')".
However, paragraph 13 of IAS 18 requires that the recognition criteria should be applied to the separately identifiable components of a single transaction only when it is necessary to reflect the substance of the transaction, as quoted below.

> ***IAS 18, paragraph 13***
> *The recognition criteria in this Standard are usually applied separately to each transaction. However, in certain circumstances, it is necessary to apply the*

recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. . . . Conversely, the recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole.

Therefore, we consider that D20 is beyond the scope of interpretation in that it requires applying the recognition criteria to the separately identifiable components of a single transaction without exception, regardless of the substance of the transaction.

(2) We believe that the recognition criteria should be applied to the separately identifiable components when (a) the award credits are redeemable for goods or services provided by the reporting entity in the course of its ordinary activities and/or (b) their value is significant.
The reasons for the condition (a) and (b) above are explained in the following.

(3) Condition (a) – the award credits are redeemable for goods or services provided by the reporting entity in the course of its ordinary activities

Assume the two cases below:

Case A: Award credits granted by a consumer-electronics retailer that can be redeemed for an electrical appliance

Case B: Award credits granted by a credit card company that can be redeemed for an electrical appliance (or airline mileage points, electric money and so on) supplied by a third party

According to D20, in both cases the portion of the consideration allocated to the award credits by reference to their relative fair value, i.e., the amounts at which the consumer electronics could be sold, is recognised as revenue when the customer redeems the award credits. In Case A, the delivery of an electrical appliance in exchange for award credits has the substance of a sales transaction for the consumer-electronics retailer. However, in Case B, the delivery in exchange for award credits does not have the substance of a sales transaction for the credit card company. Therefore, we believe that in Case B delivery of an electrical appliance should be considered as a transaction resulting in selling expenses rather than sales and accordingly it should be accounted for by recognizing expenses and provisions. In summary, if the award credits are not redeemable for goods or services provided by the reporting entity in the course of its ordinary activities, the award credit should not be considered as a separately identifiable component in applying paragraph 13 of IAS 18, because to do so would not reflect the substance of the transaction.

(4) Condition (b) – the value of the award credit is significant

Sometimes, the award credits of insignificant value do not have the substance of a component of a sales transaction.

Assume the two cases below:

Case C: A consumer-electronics retailer offers customers the award credits equivalent to 20% of the amount of the initial sales. In this case, the customers can redeem the award credits for the goods right away.

Case D: A grocery retailer offers customers the award credits equivalent to 0.1% of the amount of the initial sales. The customers can redeem the award credits for the groceries when the award credits are accumulated enough.

In both cases, the award credits are redeemable for goods or services provided by the entity in the course of its ordinary activities. However, we believe that in Case D the award credits should be considered as market expenses for enhancing sales volumes rather than a component of a sales transaction. Thus, the award credits of insignificant value might not have the substance of a component of a sales transaction, even if they are redeemable for goods or services provided by the reporting entity in the course of its ordinary activities.

Other Comment:

IASB "Revenue Recognition" project addresses the issue of what is a "separately identifiable components" in paragraph 13 of IAS 18 and does not reach the conclusion. Since whether the award credits in customer loyalty programmes are separately identifiable components is dependent on the outcome of the project, we consider that D20 would need reconsideration as the Revenue Recognition project progresses.

We hope that our comments will contribute to the work of the IFRIC in arriving at its final decision.

Best Regards,

Ikuo Nishikawa
Chairman, International Issues Standing Committee
Vice-Chairman, Accounting Standards Board of Japan