

EITF ABSTRACTS

Issue No. 00-22

Title: Accounting for “Points” and Certain Other Time-Based or Volume-Based Sales Incentive Offers, and Offers for Free Products or Services to Be Delivered in the Future

Dates Discussed: September 20–21, 2000; November 15–16, 2000; January 17–18, 2001; November 14–15, 2001

References: FASB Statement No. 5, *Accounting for Contingencies*
FASB Statement No. 48, *Revenue Recognition When Right of Return Exists*
FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*
FASB Technical Bulletin No. 88-1, *Issues Relating to Accounting for Leases—Lease Incentives in an Operating Lease*
FASB Technical Bulletin No. 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts*
FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*
FASB Concepts Statement No. 6, *Elements of Financial Statements*
AICPA Statement of Position No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*
AICPA Statement of Position No. 93-7, *Reporting on Advertising Costs*
AICPA Statement of Position No. 97-2, *Software Revenue Recognition*
AICPA Statement of Position No. 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions*
Proposed AICPA Statement of Position, *Accounting for Frequent Travel Awards Programs, Development and Preoperating Costs, Purchases and Exchanges of Take-Off and Landing Slots, and Airframe Modifications*, dated June 30, 1987
Proposed AICPA Statement of Position, *Accounting for Frequent Travel Awards Programs* (Proposed Amendment to AICPA Industry Audit Guide, *Audits of Airlines*), dated August 31, 1988
SEC Staff Accounting Bulletin No. 101, *Revenue Recognition in Financial Statements*

ISSUE

1. Membership-based loyalty programs have long been an integral part of many companies' incentive and customer relationship management programs. Loyalty programs currently operating in the United States serve businesses as diverse as supermarkets, telecommunications companies, airlines, hotels, automobile rental companies, credit cards, and music and book sellers. In addition, as the number of Internet users and websites increases, Internet merchants and content providers are increasingly launching and testing loyalty programs in an effort to retain their most valuable customers.

2. The general purpose of loyalty programs is to build brand loyalty and increase sales volume. Loyalty programs are structured so that a specified volume of transactions, or membership over a specified period of time, is required in order for a customer or program member to earn sufficient award credits to redeem an award. Each time a customer or program member purchases a product or service, or performs an action specified as a requirement of the loyalty program, he or she earns award credits that, subject to specified minimum thresholds, may be redeemed in the future for awards such as free, or deeply discounted, products or services.

3. Loyalty programs addressed by this Issue include (a) vendor-sponsored programs that offer awards consisting of the vendor's products or services, (b) broad-based programs operated by program operators whose business consists solely of administering the loyalty program, and (c) combination programs operated by vendors for their own customers as well as other participating vendors and their customers. Vendors that do not sponsor their own loyalty programs may participate in a loyalty program operated by either another vendor or a broad-based program operator. In such instances, the vendor

generally purchases award credits, either directly or indirectly, from the other vendor (program operator) for distribution to its customers.

4. The scope of this Issue includes vendor offers to a customer for (a) free or discounted products or services that will be delivered (either by the vendor or by another unrelated entity) at a future date (1) as a result of a single revenue transaction with the customer or (2) only if the customer completes a specified cumulative level of revenue transactions with the vendor or remains a customer of the vendor for a specified time period and (b) a rebate or refund of a determinable cash amount only if the customer completes a specified cumulative level of revenue transactions with the vendor or remains a customer of the vendor for a specified time period. The scope of this Issue also includes the accounting by broad-based program operators¹ for revenues from sales of award credits to other vendors or customers and the cost of redeeming awards.

5. The issues are:

Issue 1—How a vendor should account for an offer to a customer, in connection with a current revenue transaction, for free or discounted products or services delivered by the vendor that is redeemable (becomes earned) only if the customer completes a specified cumulative level of revenue transactions or remains a customer for a specified time period

Issue 2—How a vendor should account for an offer to a customer, in connection with a current revenue transaction, for free or discounted products or services from the vendor that is redeemable by the customer at a future date without a further exchange transaction with the vendor

¹ The term *program operators* includes broad-based program operators whose business consists solely of administering a loyalty program and vendors that operate loyalty programs for their own customers as well as other participating vendors and their customers.

Issue 3—How a vendor should account for an offer to a customer to rebate or refund a specified amount of cash that is redeemable only if the customer completes a specified cumulative level of revenue transactions or remains a customer for a specified time period

Issue 4—How a vendor should account for an offer to a customer, in connection with a current revenue transaction, for free or discounted products or services delivered by an unrelated entity (program operator) under an arrangement between the program operator and the vendor that is redeemable only if the customer completes a specified cumulative level of revenue transactions or remains a customer for a specified time period

Issue 5—How a program operator should account for award credits sold (directly or indirectly) to other vendors and consumers.

EITF DISCUSSION

6. At the September 20–21, 2000 meeting, the Task Force discussed Issues 1, 2, and 3 but was not asked to reach any consensuses. For Issues 1 and 2, some Task Force members expressed a preference for an accounting approach that would allocate a portion of the revenue on the transaction to the product or service that may be delivered in the future, while other Task Force members expressed a preference for an accounting approach that would be based on the significance of the value of the award product(s) or service(s) as compared to the value of the transactions necessary to earn the award(s). If the value of the award product(s) or service(s) is insignificant in relation to the value of the transactions necessary to earn the award, a liability would be recorded for the estimated cost of the award product(s) or service(s). On Issue 3, a majority of the Task Force members expressed the view that offers for cash rebates or refunds should be classified as a reduction of revenue in the income statement. The Task Force requested

that the FASB staff, together with the Working Group established to address Issue No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables," obtain certain additional information about loyalty program arrangements and further develop an approach to Issues 1, 2, and 3 based on the significance of the value of the award in relation to the value of the transactions necessary to earn the award.

7. At the November 15–16, 2000 meeting, the Task Force reached a tentative conclusion on Issue 3 that the vendor should recognize the rebate or refund obligation as a reduction of revenue based on a systematic and rational allocation of the cost of honoring rebates or refunds earned and claimed to each of the underlying revenue transactions that results in progress by the customer toward earning the rebate or refund. Measurement of the total rebate or refund obligation should be based on the estimated number of customers that will ultimately earn and claim rebates or refunds under the offer.

8. The Task Force also discussed the related issue of how to account for a vendor's change in estimate with respect to the number of customers that will ultimately earn and claim rebates or refunds under the offer but was not asked to reach a consensus. The Task Force asked the FASB staff to discuss this issue with the Working Group.

9. While the Task Force did not discuss Issues 1, 2, 4, and 5, the Task Force observed that any consensus on Issue 00-21 likely would influence any proposed answers on those Issues.

10. At the January 17–18, 2001 meeting, the Task Force reached a consensus on Issue 3 that the vendor should recognize the cash rebate or refund obligation as a reduction of revenue based on a systematic and rational allocation of the cost of honoring rebates or refunds earned and claimed to each of the underlying revenue transactions that result in progress by the customer toward earning the rebate or refund. Measurement of the total

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