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Using accounting theory to develop a theoretical model for credit card rewards programme transactions

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Abstract

Purpose – After the effective date of International Financial Reporting Standard (IFRS) 15, the accounting treatment of credit card rewards programmes (CCRPs) is no longer explicitly prescribed. Uncertainty regarding what constitutes faithful representation, and the inconsistent accounting practices observed, has created a need for guidance on the appropriate accounting treatment of CCRP transactions. Accounting theory has the potential to provide the foundation for this guidance. As a result, the objective of this study was to develop a theoretical model for the accounting treatment of CCRP transactions using accounting theory.

Design/methodology/approach – This non-empirical qualitative conceptual study utilised document analysis, focussing specifically on accounting theory, to construct an accounting treatment model.

Findings – Applying the relevant accounting theory (International Accounting Standards Board's (IASB's) Conceptual Framework), a theoretical model for the accounting treatment of CCRP transactions was developed, which emphasises the importance of understanding the economic phenomenon (the CCRP transaction) and determining how management views the transaction (in isolation as marketing or as an integral part of the credit card transaction).

Originality/value – Addressing the problem of accounting for CCRP transactions with reference to accounting theory (which is the main element of scholarly activity in accounting) distinguishes this study from previous research on the topic. The CCRP accounting treatment theoretical model could assist CCRP management in faithfully accounting for a CCRP transaction and reduce uncertainty and inconsistency in practice. Moreover, this study identified the procedures to be employed when using accounting theory to determine the appropriate accounting treatment of business transactions. These procedures could be employed by accountants when faced with other transactions not covered by specific accounting standards.

Keywords Credit card rewards programme, IFRS 15, Conceptual framework, Accounting theory

Paper type Research paper

1. Introduction and background

The issue of International Financial Reporting Standard (IFRS) 15 *Revenue from Contracts with Customers* created uncertainty amongst credit card rewards programmes (CCRPs) who apply IFRS regarding the appropriate accounting treatment (recognition and measurement) of CCRP transactions. IFRS 15 did not explicitly include or address CCRP transactions, as its predecessor standard had done. The uncertainty regarding accounting treatment relates only to CCRPs, where multiple parties are involved and not customer loyalty programmes (CLPs) in general, as only two parties are involved in other types of CLPs. Currently, different views and inconsistent accounting practices exist relating to CCRP transactions (Chapple *et al.*, 2010; Brink, 2017a, 2017b; Pidduck *et al.*, 2019), which has a direct impact on the comparability and decision-usefulness of financial information for users of annual financial statements. As most

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credit card issuers offer their cardholders participation in a rewards programme, it is important to ensure that such CCRP transactions are relevantly and faithfully represented in the annual financial statements.

In accounting for their transactions, IFRS compliers need to apply the accounting standards published by the International Accounting Standards Board (IASB). Some guidelines contained in IFRS are clear, unambiguous and easy to apply, whilst others are vague and require management's judgement. Accounting for a CCRP is an example of an issue where IFRS provides minimal guidance. Given the unique and varied nature of these complex agreements, the IASB advised CCRP management to consider all facts and circumstances and then apply judgement to determine the most appropriate accounting treatment for CCRP transactions (Ernst and Young, 2013; PricewaterhouseCoopers, 2016).

Literature indicates that there are four possible ways in which the award credits granted in a CCRP transaction could be recognised initially (on the date the award credits are granted), namely in terms of (Brink, 2017b, 2017c):

(1) IFRS 9 *Financial instruments* (recognising a financial liability and an expense);

(2) IFRS 15's deferred revenue model (allocating a portion of the consideration received from the credit card transaction to the award credits granted and recognising a contract liability equal to this amount);

(3) International Accounting Standard (IAS) 37 *Provisions, Contingent Liabilities and Contingent Assets* (recognising a provision and a marketing expense);

(4) IAS 37 (recognising a provision and a decrease in revenue).

The annual financial statements of companies applying the various possible accounting treatments would be inconsistent, firstly, in respect of whether the award credits would cause a decrease in revenue or an increase in expenses. As the revenue-line on annual financial statements is highly scrutinised by investors and a separately disclosable item in terms of IFRS, this difference is critical. Thus, a revenue recognition issue or cost/provision issue arises that highlights the ambiguity of categorising and measuring economic phenomena in CCRPs (Chapple *et al.*, 2010). Also, the measurement (rand-amount) of the IFRS 9 financial liability, the IFRS 15 contract liability and the IAS 37 provision differs – leading to liabilities (and resultant profit-and-loss) of different magnitudes. Accountants typically endeavour to account for similar transactions in a consistent manner across various entities, but consistent accounting treatment might not be appropriate for CCRPs as they are complex and each transaction is unique. As such, each unique CCRP might require a different accounting treatment.

Even though accounting theory is crucial when conducting research in accounting (Van der Schyf, 2008), previous studies (Brink, 2017a, 2017b, 2017c) have not considered this theory in addressing the research problem of accounting for CCRP transactions. The reported studies by Brink were conducted before the effective date of IFRS 15. Other CCRP-related studies (Amalyan and Amalian, 2015; Bernoully and Wondabio, 2019; Brink, 2013, 2014, 2016; Chapple *et al.*, 2010; Chun *et al.*, 2020; Fourie, 2018; Johansson and Ringius, 2007; Levanti, 2020; Pidduck *et al.*, 2019; Sava, 2014), however also did not include any reference to accounting theory. After the effective date of IFRS 15 no research specifically related to accounting for CCRP transactions could be found. The objective of this study was to develop a theoretical model for the accounting treatment of CCRP transactions, by considering accounting theory. The scope was limited to the initial recognition and measurement of CCRP transactions.

Scientific research in accounting cannot take place without the integration of theory (Mouton, 1996; Van der Schyf, 2008) and unfortunately existing accounting research misses the main element of scholarly activity in accounting, namely accounting theory (Van der Schyf, 2008). In practice accountants have also been criticised for not understanding accounting theory and for applying accounting practices without questioning the theory behind the practices (Deegan and Unerman, 2006). It is critical for accountants to not only understand accounting techniques but to also understand the structure of accounting theory from which the techniques are derived (Riahi-Belkaoui, 2004).

The study aimed to make both a theoretical and a practical contribution. This study contributes to the existing theoretical financial reporting body of knowledge by developing a theoretical model for the accounting treatment of CCRP transactions after the effective date of IFRS 15. The study responded to Van der Schyf's (2008) call for addressing accounting research problems with reference to accounting theory. The study makes a practical contribution by assisting accountants to understand the theory behind the practice of accounting for CCRP transactions. In addition, addressing the problem of accounting for CCRP transactions with the novel reference to accounting theory could reduce uncertainty amongst CCRP management and assist them in faithfully accounting for CCRP transactions in practice. The theoretical model developed also provides a strong foundation against which different suggested IFRS accounting treatments for CCRP transactions can be evaluated.

This study identified the procedures to apply when solving accounting issues with reference to accounting theory. These procedures include identifying the relevant accounting theory, obtaining an in-depth understanding of the underlying transaction (economic phenomenon) and then critically evaluating the elements to be recognised as well as the most appropriate measurement base. In practice there are sometimes transactions not covered by specific accounting standards. Then accountants should apply their judgement to develop a relevant accounting policy (IASB, 1993), which could be done with reference to accounting theory. The procedures identified in this study could be applied by accountants in developing a relevant accounting policy to faithfully account for other transactions not covered by specific accounting standards. These procedures will also assist accountants in understanding the theory behind accounting techniques and practices.

2. Methods

To develop a theoretical model for the accounting treatment of CCRP transactions, accounting theory needs to be considered. This study was therefore non-empirical and guided by the principles of conceptual research (Jaakkola, 2020; Hirschheim, 2008) which aims to create new knowledge by building on carefully selected theories and concepts to enable theory building unrestricted by the demands of empirical generalisation (Jaakkola, 2020).

In line with Jaakkola's (2020) guidelines, the *focal phenomenon* that is observable but not adequately addressed by existing literature was identified for this study, namely to account for a CCRP transaction after the effective date of IFRS 15. A starting point to address this phenomenon is to refer to accounting theory, which is considered as the main element of the body of accounting knowledge to be applied in the process of scholarly activity in accounting (Van der Schyf, 2008). The choice of the relevant accounting theory should be based on its fit to the *focal phenomenon* and its complementary value in conceptualisation (Jaakkola, 2020). As recommended by Jaakkola (2020), explanations and a justification for selecting the Conceptual Framework for Financial Reporting (Conceptual Framework) as the relevant accounting theory to employ in this study were provided.

A qualitative approach was deemed appropriate as it enables the researcher to consider how processes change over time and adjust to new issues and ideas as they emerge. This approach contributes to the evolution of new theories and is seen as "natural" rather than as “artificial” (McLaughlin, 2012). It makes an effort to gather rich, descriptive data regarding a certain phenomenon or context (Simon, 2011). There are various qualitative data collection methods available, including audio-visual materials, interviews, observations and document analysis (Creswell, 2013).

Document analysis, which is based on a study of the literature on a particular topic, allows the researcher to analyse relationships between various accounting rules, comprehend problem areas and even anticipate future developments. Document analyses also provide a systematic exposition of the accounting rules pertaining to CCRP transactions (Hutchinson and Duncan, 2012). A document analysis process, which is doctrinal in nature, was therefore used to obtain and analyse the relevant data (Hutchinson and Duncan, 2012). For this research, the researchers would not have been able to obtain comprehensive data by viewing audio-visual materials or by observing or interviewing CCRP management. Primary sources of information were identified and studied, relevant accounting theory requirements were considered and analysed, pertinent issues pertaining to accounting for CCRP transactions were synthesised and sound and effective conclusions were drawn (Hutchinson and Duncan, 2012). The target material that was consulted was the relevant accounting theory. The document analysis did not focus on relevant IFRS and practitioner reports as these documents could not provide an answer for the most appropriate accounting treatment for CCRP transactions.

The data obtained and analysed were used to develop the CCRP theoretical model. Studies that construct theories or models seek to create new theories and models to explain specific phenomena (Mouton, 2001). According to Mouton (2001), science cannot advance without ideas and models. The objective of this study was to create a theoretical model for the accounting treatment of CCRP transactions, so model building as a design technique was ideal for achieving this objective.

The CCRP accounting treatment theoretical model could serve as a roadmap for understanding accounting for CCRPs after the effective date of IFRS 15 (Jaakkola, 2020) and could be derived from a conceptual framework (Meredith, 1993). The model (embedded in a decision tree) discloses various outcomes of accounting for an CCRP transaction, also explaining why an element leads to a specific outcome (Jaakkola, 2020).

The body of the article is organised as follows: first, the importance of considering accounting theory in this study is justified, followed by an explanation of the IASB’s Conceptual Framework’s selection as the most appropriate accounting theory to employ in this study. The application of the IASB’s Conceptual Framework to account for a CCRP transaction is discussed next. Based on the findings, the development of the CCRP accounting treatment theoretical model is presented.

3. Accounting theory

The research problem of accounting for a CCRP transaction has not been addressed by utilising accounting theory. The framework on scholarly activity in accounting created by Van der Schyf (2008) emphasises the importance of employing accounting theory. This framework, which was based on Mouton’s (2001) three worlds framework, has been employed in various research studies in accounting (Buys, 2010; Koppeschaar, 2010; Lamprecht, 2016; Middelberg, 2011; Scheepers, 2013).

Van der Schyf (2008) identified “world 1” as the world of everyday life, in which the research problem identified in this study exists, namely the uncertainty regarding the appropriate accounting treatment of CCRP transactions. However, scholarly activity in accounting occurs in “world 2” (Van der Schyf, 2008) – here a phenomenon from World 1 is selected as the object of systematic and rigorous inquiry (Mouton, 2001). The research process should interact with the body of accounting knowledge, including previous research findings and accounting theories

(Van der Schyf, 2008). Accounting theory is a central element of the body of accounting knowledge and is vital in scholarly activity in accounting (Inanga and Schneider, 2005; Van der Schyf, 2008). Deegan and Unerman (2006) also assert that accounting research is more effective when the researcher utilises accounting theory, as it provides structure and cohesion to the study.

Several types of accounting theories have been prevalent over the last century, and a distinction is often made between descriptive and predictive (positive) and prescriptive (normative) accounting theories (Oberholser, 2013; Riahi-Belkaoui, 2004; Schroeder *et al.*, 2011; Van der Schyf, 2008). A prescriptive (normative) approach focusses on prescribing *what should be done* in certain circumstances as opposed to explaining or predicting *what is done* in those circumstances (Deegan, 2009). Prescriptive theories are based upon the values or beliefs of the person or organisation proposing the theories (Oberholser, 2013; Vorster, 2007) and make an effort to explain and support accounting practices that should be used. Examples include: what should to be regarded as assets and liabilities and how should these elements be valued (Van der Schyf, 2008; Vorster, 2007). This approach is not based on observations as Godfrey *et al.* (2003, p. 9) explains: “it is impossible to demonstrate empirically what ought to be”. As such, prescriptive accounting theories are developed using deductive reasoning (Deegan, 2009). Nowadays most accounting theories are prescriptive, because they are based on certain objectives of financial reporting (Schroeder *et al.*, 2011). Prescriptive theories cannot and should not be evaluated based on whether the theories reflect actual accounting practice, because normative theories of accounting are not based on observations (Deegan, 2009). Applying normative theories of accounting may lead to radical changes to current accounting practices (Deegan and Unerman, 2006; Lamprecht, 2016). A prescriptive accounting theory was employed in this study for developing the theoretical model for accounting for CCRP transactions.

4. Identifying the IASB’s conceptual framework as the most appropriate accounting theory to employ

The IASB indicated that they leave it up to management’s judgement to determine how to account for CCRP transactions (Ernst and Young, 2013). Based on the IASB’s recommendation that CCRPs should consider all the facts and circumstances when accounting for CCRP transactions (Ernst and Young, 2013), it can be argued that this implies that no specific Standard applies to accounting for CCRP transactions. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that in “the absence of an IFRS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

(1) relevant to the economic decision-making needs of users; and

(2) reliable, in that the financial statements: represent faithfully the financial position, financial performance and cash flows of the entity; reflect the economic substance of transactions, other events and conditions and not merely the legal form; are neutral, i.e. free from bias; are prudent; and are complete in all material respects” (IASB, 1993).

The qualities mentioned in the points in the paragraph above are also the qualitative characteristics of useful financial information listed in the IASB’s Conceptual Framework. The above quotation from IAS 8 correlates with one of the listed purposes of the IASB’s Conceptual Framework, i.e. to “assist preparers to develop consistent accounting policies when no Standard applies to a particular transaction or other event, or when a Standard allows a choice of accounting policy” (IASB, 2018). Therefore, in the absence of clear guidance, the IASB’s

Conceptual Framework can provide the theory (set of principles) to assist preparers to develop consistent accounting policies if CCRPs are not in the scope of IFRS 15 (IASB, 2018). On the other hand, if a Standard is applicable to CCRP transactions (be it IFRS 15 or another Standard) the IASB's Conceptual Framework can help in understanding and interpreting the relevant Standard(s) (IASB, 2018). But before that is even possible, the relevant Standard must first be identified and the IASB's Conceptual Framework can assist in determining which Standard is most appropriate for application purposes in a CCRP transaction.

Lamprecht (2016) compared the IASB's Conceptual Framework to the structure of accounting theory. The four different elements of an accounting theory structure, namely the objectives, postulates, theoretical concepts and principles, were individually aligned with the IASB's Conceptual Framework. Lamprecht (2016) concluded that the IASB's Conceptual Framework fulfils the requirements of an accounting theory. Van der Schyf (2008) contends that in the process of scholarly activity in accounting, there is one accounting pronouncement that should always be considered, namely the IASB's Conceptual Framework. This is the accounting standard that comes closest to the conceptual foundations of accounting (one of the main elements of the body of accounting knowledge) (Van der Schyf, 2008). Likewise, Wolk *et al.* (2004, p. 3) state: "We interpret the definition of accounting theory broadly. Clearly the drafting of a Conceptual Framework that is supposed to provide underlying guidance for making of accounting rules falls within the coverage of accounting theory." In the same vein, Schroeder *et al.* (2005, p. 63) argue that the role of the IASB's Conceptual Framework is to "attempt to develop concepts useful to guide [practitioners] in establishing accounting standards and in providing a frame of reference for resolving accounting issues".

The IASB's Conceptual Framework is an example of a prescriptive theory of accounting (Deegan and Unerman, 2006; Vorster, 2007), since it seeks to provide a set of principles (Alexander *et al.*, 2005) that should be applied when accounting for a given phenomenon. This theory (a set of principles) will determine how information should be provided to users and different practices are not expected to prevail (Alexander *et al.*, 2005). In the case of a transaction or event not specifically addressed in IFRS, the purpose of the IASB's Conceptual Framework is to assist preparers in dealing with such transactions or events (Alexander *et al.*, 2005).

The above discussion justified the choice of the IASB's Conceptual Framework as the appropriate and relevant accounting theory to apply in this study. Similarly, other research studies in accounting (Lamprecht, 2016; Oberholser, 2013; Scheepers, 2013), also identified the IASB's Conceptual Framework as the relevant accounting theory to apply.

5. Applying the IASB's conceptual framework to account for a CCRP transaction

Foundational to the IASB's Conceptual Framework is the objective of general-purpose financial reporting: to provide financial information about the reporting entity that is useful for external users when making economic decisions (IASB, 2018). The IASB's Conceptual Framework identifies the qualitative characteristics that make financial information useful (IASB, 2018), dividing them between fundamental and enhancing characteristics. The fundamental qualitative characteristics are relevance and faithful representation (IASB, 2018). The enhancing qualitative characteristics are comparability, verifiability, timeliness and understandability. These enhancing characteristics determine which accounting treatment should be used to account for a transaction if two (or more) accounting treatments provide equally relevant and faithfully represented financial information (IASB, 2018).

Before applying the Conceptual Framework to determine the appropriate accounting treatment of a CCRP transaction, a broad understanding of the functioning of a typical credit card arrangement containing a CCRP is required to identify relevant information about the economic phenomenon (IASB, 2018). When a cardholder uses a credit card to make purchases from a merchant, the merchant receives cash from the issuing bank (either directly or through intermediary financial institutions) that is less than the total invoiced cost of the goods and services the cardholder purchased. This difference between the invoice price and the cash paid to the merchant is referred to as the merchant interchange fee, earned by the financial institution that issued the credit card (FASB and IASB, 2013). In addition to providing the interchange service, the financial institution (card issuer) may also reward cardholders for using their credit card through a CCRP in accordance with which the cardholder receives award credits from the card issuer (CCRP supplier) (FASB and IASB, 2013). In future, the awards credits can then be exchanged for specified goods or services which the CCRP supplier is obliged to fund.

To determine the accounting treatment of a CCRP transaction based on accounting theory, the definitions, recognition criteria and measurement bases of the IASB's Conceptual Framework should be considered. The most recent issue of the IASB's Conceptual Framework, i.e. the 2018 Conceptual Framework, was employed in this study. In the Conceptual Framework, a liability is defined as "a present obligation of the entity to transfer an economic resource as a result of past events" (IASB, 2018, p. 3). A present obligation arises in the hands of the CCRP when award credits are granted in a CCRP transaction. The CCRP has an obligation to supply specified goods or services (economic resources) to the cardholder or to pay a third party (programme partner) consideration for supplying goods or services with the redemption of the award credits – constituting a transfer of economic resources by the CCRP in future. The event in the past is indicated by the original credit card transaction and granting of the award credits. The CCRP application form, including the specific terms and conditions of the CCRP, can be regarded as a contract between the CCRP and the cardholder giving rise to the obligation. On the other hand, the obligation may also arise from the CCRP's customary practices, i.e. to supply goods or services with the redemption of award credits. Either way, the CCRP has no practical ability to avoid providing benefits when award credits are redeemed (an uncertain future event). The award credits granted in a CCRP transaction therefore meet the requirements of the definition of a liability.

The liability can be recognised if it provides information that is useful (relevant and faithful) (IASB, 2018). There is certainty that the liability exists and the probability of an outflow of economic benefits is high, meaning that relevant information will be provided by recognising the liability (IASB, 2018). Faithful representation (one of the fundamental qualitative characteristics of useful financial information) is affected by measurement uncertainty (IASB, 2018), but it is not expected that the measurement uncertainty would be so extreme as to prohibit the recognition of the liability.

When selecting a measurement base for the liability, it is important to consider the economic phenomenon of the transaction, including the estimated future cash flows (IASB, 2018). Therefore, how the CCRP transaction is viewed will affect the appropriate measurement base for the liability. How the CCRP transaction is viewed by management will also affect the counter-entry for the liability that arises. If the CCRP transaction is viewed as a marketing tool, then the CCRP transaction should be considered in isolation. If the CCRP transaction is viewed as an integral part of the larger credit card transaction, then the whole credit card transaction should be considered. This again highlights the complexity and uniqueness of CCRP transactions. Both views are considered: firstly, the award credits granted in isolation, and, secondly, the whole transaction (including the credit card transaction that gives rise to granting the award credits).

5.1 Management view: in isolation as marketing

If the award credits granted are regarded as a marketing tool (i.e. the CCRP transaction is viewed in isolation), a liability will arise. Furthermore, the counter-entry for the liability will be a marketing expense (an expected outflow of economic benefits). The award credits granted in a CCRP will increase liabilities that result in decreases in equity (other than those relating to distributions to holders of equity claims), therefore meeting the definition of an expense.

To recognise the liability and expense, an appropriate measurement base needs to be selected. The measurement base will provide certain information about the award credits, either information with reference to historical cost, or information with reference to the current value of the award credits. The Conceptual Framework determines that the historical cost of a liability when it is incurred is the value of the consideration received to incur that liability (IASB, 2018). When award credits granted in a CCRP transaction are considered in isolation and thus viewed as a marketing tool, there is no historical cost for the transaction as no consideration is received for the award credits granted. At the date the liability (and expense) is recognised, the liability refers to amounts payable in the future (to supply goods or services to the cardholder or to pay a programme partner consideration for supplying goods or services with the redemption of the award credits). Thus, when award credits granted are considered in isolation, the current value measurement base is applicable, reflecting conditions at the measurement date. The selection of the most appropriate current value measurement base to measure the award credits liability will be discussed later in the article.

5.2 Management view: as an integral part of credit card transaction

If the CCRP transaction is viewed as being an integral part of the larger credit card transaction, then the whole transaction should be considered to decide on the most appropriate accounting treatment. For each credit card transaction, the card issuer is entitled to an interchange fee in terms of the merchant contract. The card issuer receives the interchange fee in cash and therefore a right that has the potential to produce economic benefits, as the card issuer can decide how to use the cash and obtain the benefits that may flow from it. The interchange fee received (cash) in a CCRP transaction therefore meets the requirements of the definition of an asset (a present economic resource controlled by the entity as a result of past events as defined by the Conceptual Framework). The award credits granted meet the definition of a liability (refer to earlier discussion). The balancing counter-entry meets the definition of an income (an increase in assets that results in an increase in equity as defined by the Conceptual Framework).

The interchange fee received (cash) will be measured at the cash flow received, applying the historical cost measurement base. This will represent the transaction price of (or consideration received for) the goods or services sold. The goods and services sold include both the service of facilitating electronic payment through the credit card and the right to redeem the award credits earned for specified goods and services in future. When award credits granted are considered as being an integral part of the credit card transaction, the historical cost of the liability can be determined with reference to the consideration received to incur the liability or the price of the transaction that gave rise to the liability (IASB, 2018). The interchange fee received must be allocated between the services sold (the service of electronically transferring cash) and the award credits granted. Evans (2003) points out that accounting practice relies heavily on allocations and no theories incorporate allocations. The Conceptual Framework therefore does not provide guidance on how to allocate the historical cost between the services sold and the award credits granted. The first option would be to allocate the historical cost proportionally based on other guidance not contained in the Conceptual Framework. An alternative solution would be to apply one of the current value measurement bases to determine the value of the award credits (liability) and allocate the balancing figure to the services sold. Measuring the CCRP liability using a current value measurement base will be explored in the next section.

5.3 Measurement of the CCRP liability

To recognise the CCRP liability, an appropriate current value measurement base needs to be selected for both of the views that could be held by management. The measurement base will provide certain information about the award credits. If more than one measurement base can be applied, it needs to be determined which measurement base will provide the most relevant information with regard to financial position and performance and ensure the most faithful representation (i.e. information that is complete, neutral and free from measurement error).

If the CCRP transaction is viewed as a marketing tool, the economic phenomenon of the marketing transaction indicates that initially there is no historical cost and that one of the current value measurement bases is applicable. Management intends to fulfil the CCRP liability upon redemption by the cardholder, by supplying goods or services to the cardholder or by paying a programme partner consideration for supplying goods or services. If the CCRP transaction is viewed as being an integral part of the larger credit card transaction, the economic phenomenon of the income transaction indicates that initially the historical cost (interchange fee) should be allocated to the services sold and the award credits granted. In essence, consideration has already been received, in exchange for which management will in future supply goods or services to the cardholder or to pay a programme partner consideration upon redemption of the reward credits. One way to allocate a portion of the historical cost to the award credits granted is by employing a current value measurement base to measure the CCRP liability.

It needs to be determined which current value measurement base will provide the most relevant and faithful representation: the fulfilment value, current cost, or fair value? During the process of compiling IFRS 15, the IASB determined that customer loyalty programs are not required to measure the award credits at their present value, since the cost (to continually estimate when the goods or services will transfer to the customer) will outweigh the perceived benefit (Brink, 2017c). Thus, it is assumed that none of the current value measurement bases will adjust for the time value of money.

In terms of the fulfilment value, the award credits will be measured at the value the CCRP expects to incur to supply the goods or services or to pay a programme partner consideration for supplying the benefits (IASB, 2018). The fulfilment value represents an exit price, measured from the card issuer's perspective and takes into account the number of award credits expected to be redeemed in the future (based on entity-specific expectations, for example using historical information). No adjustment would be made for own credit risk (the credit risk inherent in the CCRP entity) (IASB, 2018).

If the fair value base is applied, award credits will be measured at a price the CCRP will pay to transfer the liability. This also represents an exit price, but it is measured from the perspective of a market participant (for example an insurance company) who would take over the liability from the CCRP. The market participant would price the liability using a method similar to that employed to calculate the fulfilment value, but would employ the market (and not entity-specific) expectations regarding redemption rates, include a risk premium for uncertainty in the cash flows and adjust for the credit risk of the CCRP (IASB, 2018). On the other hand, if the current cost base is applied, the award credits will be measured at the consideration that would be received (by the CCRP) to take over an award credits liability. It is an entry value and represents an entity-specific value – reflecting the price the entity would be charged to take over (incur) the liability. The value would therefore be determined from the card issuer's perspective adjusted for an entity-specific expected redemption rate and risk premium (IASB, 2018).

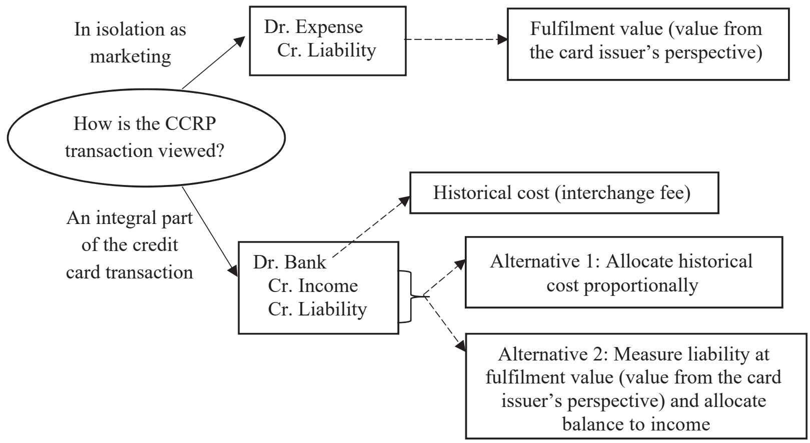
The relevance of information (predictive and confirmatory relevance) provided by a measurement base is affected by the characteristics of the liability and how the liability affects cash flows (IASB, 2018). Fulfilment value provides information about the value of the estimated cash flows needed to fulfil a liability. Considering the economic phenomenon under study, the CCRP intends to fulfil the liability itself whether the CCRP is viewed as a marketing tool or as an integral part of the larger credit card transaction. Therefore, the fulfilment value has predictive value indicating the future cash outflow to supply the goods or services or to pay a programme partner consideration for supplying the benefits (IASB, 2018). Seeing that the CCRP itself intends to fulfil the liability, the fair value (indicating a value to transfer the award credits) or current cost (indicating a value to take over award credits) measurement base will not have predictive value and thus not be the most appropriate choice (IASB, 2018). The current fulfilment value measurement base therefore provides the most relevant information about the economic phenomenon. Faithful representation of the underlying CCRP transaction is considered next.

When a measure cannot be determined directly and must instead be estimated, measurement uncertainty arises that in turn influences faithful representation (IASB, 2018). For a CCRP, the current fulfilment value base requires estimating the expected number of award credits to be redeemed in the future. However, measurement uncertainty does not prevent the use of a measurement base if it provides relevant information (IASB, 2018), which is the case when using the current fulfilment value base. Also, this uncertainty can be mitigated through proper disclosure in the annual financial statements of the estimation technique applied. It can therefore be concluded that the current fulfilment value measurement base will provide a faithful representation of the underlying CCRP transaction. Thus, the current fulfilment value measurement base can be selected as the most appropriate measurement base for measuring the CCRP liability for both management views.

In addition to information being relevant and faithfully presented the information should be, as far as possible, comparable, verifiable, timely and understandable (IASB, 2018). The fulfilment value reflects an entity-specific value which could differ for identical liabilities in different entities that will reduce comparability (IASB, 2018). However, in practice it is expected that different CCRPs will have differing historical and expected future redemption rates for award credits. To ensure comparable information (across entities), a measurement base that considers the specific CCRP's expected redemption rate is recommended. The fulfilment value measurement base adjusts for the expected redemption rate and will thus provide comparable information (across entities). Even though the fulfilment value uses estimations, the value can still be verified and understood by providing explanatory information about the inputs (for example, the number of award credits expected to be redeemed in the future, based on historical trends) (IASB, 2018). The CCRP will also have access to all information required to apply the fulfilment value (i.e. the cost to supply the goods or services or to pay a programme partner as well as historical redemption rates) resulting in timely information.

6. Theoretical model

Relevant accounting theory was used to build the CCRP accounting treatment theoretical model. For application purposes the CCRP accounting treatment theoretical model is embedded in a decision tree and includes possible alternatives on accounting for CCRP transactions. There are two possible options to account for a CCRP transaction in terms of accounting theory, namely as an expense (when viewed as a marketing tool), or as a reduction of income (when viewed as an integral part of the larger credit card transaction). How CCRPs determine whether the transaction is viewed as a marketing tool or as an integral part of the credit card transaction is uncertain. Also, when applying accounting theory, it is unclear how to allocate the historical cost to the services sold and the award credits granted when the CCRP transaction is viewed as an integral part of the credit card transaction. Figure 1 illustrates the CCRP accounting treatment theoretical model (embedded in a decision tree) developed based on accounting theory (Conceptual Framework).



Source(s): Figure created by author

Figure 1.
Decision tree for accounting for a CCRP transaction based on accounting theory

Accounting theory provides the basis for developments in accounting practice (Godfrey *et al.*, 2003) and plays an important role in solving accounting issues in practice (Deegan and Unerman, 2006; Riahi-Belkaoui, 2004). However, it is not always possible to apply theory as is in practice, as accounting is a pragmatic discipline and most theories have practical limitations (Evans, 2003; Hendriksen and Van Breda, 1992). In this study the Conceptual Framework (accounting theory) did not provide a clear and simple answer for accounting for award credits (specifically measuring award credits) in a CCRP transaction when the CCRP transaction is viewed as an integral part of the credit card transaction.

The IASB's Conceptual Framework can assist in determining which Standard is most appropriate for application purposes and considering the above findings it might be argued that when the CCRP transaction is viewed as a marketing tool the accounting treatment based on accounting theory indicates the application of IAS 37 (which prescribes a similar accounting treatment with reference to recognition and measurement). When the transaction is viewed as an integral part of the credit card transaction the accounting treatment based on accounting theory indicates the application of IFRS 15 (which prescribes a similar accounting treatment with reference to recognition and in terms of measurement the option of allocating the historical cost proportionally).

7. Conclusion and recommendations

There is uncertainty regarding the appropriate accounting treatment (recognition and measurement) of CCRP transactions after the effective date of IFRS 15. Even though literature (Inanga and Schneider, 2005; Van der Schyf, 2008; Deegan and Unerman, 2006) emphasises the importance of considering accounting theory in the process of scholarly activity in accounting, accounting theory had not been considered in addressing the research problem prior to this study. This study proposed that accounting theory should be the starting point when seeking to account for transactions not covered by specific accounting standards, such as CCRP transactions. Thus, the objective of this study was to develop a theoretical model for the initial recognition and measurement of CCRP transactions, by considering accounting theory.

The IASB's Conceptual Framework was identified as the most appropriate accounting theory to employ by IFRS compliers. Accounting theory identified two possible management views on the economic phenomenon of CCRP transactions, namely in isolation as marketing and as an integral part of the credit card transaction. If the transaction is viewed in isolation as marketing, the granting of CCRP award credits should be accounted for as an expense and a liability measured at the current fulfilment value. If the transaction is viewed as an integral part of the credit card transaction, the granting of CCRP award credits should be accounted for as a reduction of income (deferred income). The historical cost of the transaction (interchange fee received) should be allocated to the services sold and the award credits granted, but the Conceptual Framework does not incorporate allocations. The first option would be to allocate the historical cost proportionally based on other guidance not contained in the Conceptual Framework. An alternative solution would be to measure the CCRP liability at current fulfilment value and to allocate the balance to the services sold (income).

This study contributed to accounting research in several ways. The researcher responded to a call for addressing accounting research problems with reference to accounting theory (Van der Schyf, 2008), making a theoretical contribution. The study makes a practical contribution by assisting accountants to understand the theory behind the practice of accounting for CCRP transactions. Also, the theoretical model developed could address and reduce uncertainties experienced by CCRP management after the effective date of IFRS 15. Applying the model developed in this study could also ensure that CCRPs faithfully recognise CCRP transactions, based on how the transaction is viewed. Clear guidance relating to recognition and measurement was provided for CCRPs that view the CCRP transaction as a marketing tool. Guidance was also developed for CCRPs that view the CCRP transaction as an integral part of the credit card transaction, indicating the elements (such as asset, income and liability) that need to be recognised. However, the Conceptual Framework does not provide a clear-cut answer on the appropriate allocation of the historical cost (interchange fee received) between the services sold (income) and the award credits granted (CCRP liability).

It is therefore recommended that future research expand and refine the CCRP accounting treatment theoretical model by referring to existing literature (including IFRS), obtaining an in-depth understanding of the experiences of CCRP management and validating the model by utilising the opinions of experts in the field. The theoretical model could be utilised by future researchers to evaluate the accounting treatment of CCRP transactions in practice. Auditors could also apply the theoretical model in assessing the appropriateness of CCRP accounting treatment.

This study identified the procedures to be applied when using accounting theory to determine the appropriate accounting treatment of transactions, which could be useful when accountants are faced with other transactions not covered by specific accounting standards. The procedures are:

(1) Identifying the relevant accounting theory (for IFRS compliers, the IASB's Conceptual Framework)

(2) Obtaining a clear understanding of all components of the underlying transaction (the economic phenomenon)

(3) Determining which elements need to be recognised (for the IASB's Conceptual Framework, this is done by considering the elements' definitions and recognition criteria in the Conceptual Framework)

(4) Determining the most appropriate measurement base for each element (for the IASB's Conceptual Framework, this is done with reference to the fundamental and enhancing qualitative characteristics of useful financial information in the Conceptual Framework)

Applying these procedures in practice will help accountants to understand the theory behind accounting techniques and practices.

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