Working Draft:

Airlines Revenue Recognition Implementation Issue

Issue #2.6(C) – Assessment of whether "Tier Status" in an affinity program conveys a material right to goods and services and therefore gives rise to a separate performance obligation

Expected Overall Level of Impact to Industry Accounting:
Moderate

Wording to be Included in the Revenue Recognition Guide:

Background

1. Many entities have incentive affinity programs that enable customers to achieve a Tier Status based on their loyalty and/or their repeat purchases of goods and service in the ordinary course of business. Such Tier Status may also be provided to a customer on a trial basis based on the expectation of the customer achieving the status at some defined point in the future. The Tier Status then entitles the customers to access specific goods and services at a discount in the future. In other cases, although the Tier Status does not entitle the customer to specific discounted goods and services, the entity may have created a reasonable expectation that the customer will receive discounted goods or services. In many cases, the objective of Tier Status programs is to incent high-spending customers through the offer of discounts on future purchases commensurate with each customer's spending level. Affinity programs with Tier Status require careful evaluation because some programs may have elements similar to point loyalty programs which are generally considered to reflect material rights that would be separate performance obligations. In other circumstances, such programs are designed to provide marketing incentives on future revenue transactions which may not be separate performance obligations.

2. For purposes of this paper, the following assumptions and definitions are used:
   a. "Tier Status" is defined as a level (or sub-level) within an affinity program sponsored by an entity that generally accumulates or vests as a result of the customer attaining a defined level predominantly from past revenue transactions (e.g. number or amount of prior purchases).
   b. "Status Benefits" are an option to obtain future goods and services at a discount or at no additional cost provided to a customer that has been designated as having "Tier Status".
   c. Affinity programs are structured to promote customer loyalty and concentration of spending, Status Benefits are generally provided along with the purchase of a future product or service from the entity.

   d. Material benefits provided by affinity programs for which the member is not required to make a future purchase would generally follow basic affinity program accounting.
   e. "Appropriate past qualifying transactions" are transactions under the affinity program which earn tier status. Such transactions may be number of transactions, amount of transactions or other similar types of measurements.

3. The issue is how an entity sponsoring a Tier Status program should apply the guidance in FASB ASC 606 to assess whether the Status Benefits give rise to a separate performance obligation (a material right), or whether they represent a marketing incentive related to future purchases.

FASB ASC 606 Guidance

4. When evaluating whether Tier Status gives rise to a separate performance obligation, sponsoring entities would need to consider the guidance in FASB ASC 606. Specifically, paragraphs 42-43 of FASB ASC 606-10-55 state:

   If, in a contract, an entity grants a customer the option to acquire additional goods or services, that option gives rise to a performance obligation in the contract only if the option provides a material right to the customer that it would not receive without entering into that contract (for example, a discount that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services, and the entity recognizes revenue when those future goods or services are transferred or when the option expires.

   If a customer has the option to acquire an additional good or service at a price that would reflect the standalone selling price for that good or service, that option does not provide the customer with a material right even if the option can be exercised only by entering into a previous contract. In those cases, the entity has made a marketing offer that it should account for in accordance with the guidance in this Topic only when the customer exercises the option to purchase the additional goods or services.

5. Paragraph 11 of TRG Agenda Ref. 54, Considering Class of Customer When Evaluating Whether a Customer Option Gives Rise to a Material Right, notes that paragraph BC386 of ASU 2014-09, Revenue from Contracts with Customers (Topic 606), explains that the purpose of the guidance in paragraphs 606-10-55-42 through 55-43 is to distinguish between:
   a. an option that the customer pays for as part of an existing contract (that is, a customer pays in advance for future goods or services), and
   b. a marketing or promotional offer that the customer did not pay for and, although made at the time of entering into a contract, is not part of the contract (that is, an effort by an entity to obtain future contracts with a customer).

6. Paragraph 12 of TRG Agenda Ref. 54 also explains, "Stated differently, the guidance in paragraphs 606-10-55-42 through 55-43 is intended to make clear that customer options that would exist independently of an existing contract with a customer do not constitute performance obligations in that existing contract."

7. If an entity determines that status benefits provide a customer with a material right that is accounted for as a performance obligation, an entity is required to allocate the transaction price to each performance obligation identified in the contract on a relative standalone selling price basis in accordance with the guidance in paragraphs 28-41 in FASB ASC 606-10-32. This would include allocating a portion of the transaction price of each accumulating purchase (such as an airline ticket or hotel stay) to the option.

8. The guidance in FASB ASC 606 specifies the accounting for an individual contract with a customer. Entities may use a portfolio approach as a practical expedient to account for contracts with customers as a group rather than individually, if as required in FASB ASC 606-10-10-4, the financial statement effects are not expected to materially differ from an individual contract approach.

Evaluation of Status Benefits

9. A sponsoring entity would view Status Benefits as an option that gives rise to a separate performance obligation if, as described in FASB ASC 606-10-55-42, that option (or benefits similar to Status Benefits) provides a material right to the customer that is not available to customers who have not achieved Tier Status through a defined level of past qualifying revenue transactions with the sponsoring entity. If that option (or benefits similar to Status Benefits) is made available only to customers who have achieved Tier

Status through appropriate past qualifying revenue transactions with the sponsoring entity, this would be evidence that Status Benefits are solely related to the contracts for past revenue transactions and, therefore, should be assessed to determine whether it represents a material right.

10. A sponsoring entity would view the Status Benefits conveyed by Tier Status as a marketing incentive if those Status Benefits are conveyed by other means (that is, not exclusively related to the level of prior revenue transactions with the sponsoring entity) as a part of its customary business practices, such that the discounts provided through Status Benefits are typically available to the class of customer, independent of an individual customer's past revenue transactions with the sponsoring entity. A sponsoring entity will provide such benefits to attract new customers and incent future sales, similar to other marketing incentives. For example, many entities give away Tier Status designation based on an expectation that the customer will spend in the future at Tier Status levels and, as such, will eventually justify the discounts provided. In these situations, the Tier Status is awarded for a period of time with little or no history of spending at the sponsoring entity, based on an expectation that the customer will spend at the specified Tier Status level in the future. This is sometimes done to identify and attract customers who have historically spent at high levels with other entities, or other high value potential customers who might, for example, be identified based on job title, profession, or employer. In substance, the sponsoring entity may view its granting of Tier Status as a means of customer recruitment or retention to entice high-spending customers to spend and become or remain loyal customers of that entity. Entities view the class of customer as customers willing to spend at certain levels, regardless of whether the customer is currently a customer of the entity.

11. Because Tier Status is generally achieved through an accumulation of the customer's past revenue transactions over a period of time, FinREC believes the assessment of whether Tier Status represents a material right should be performed by evaluating the aggregate transactions of the customer over a specified period of time, versus on an individual transaction basis, such as the purchase of an individual airline ticket, hotel room or other transaction. Any assessment would be based on specific facts and circumstances and would require significant judgment.

12. From this point forward through paragraph 17, this paper assumes that any Status Benefits being assessed are material (using both qualitative and quantitative factors), and that Tier Status and associated Status Benefits are not obtained through a nominal level of past revenue transactions.

13. In order to determine whether Tier Status is a material right (as discussed in paragraph 9) or a marketing incentive (as discussed in paragraph 10), it is necessary to analyze the substance of the arrangement. FinREC believes that indicators that discounts on goods and services conveyed as a result of attaining Tier Status are available to a class of customers irrespective of their past qualifying revenue transactions with the sponsoring entity (and, therefore, the Tier Status would not give rise to a separate performance obligation and would be considered a marketing incentive) include, but are not limited to, the following:
    a. The entity has a business practice of providing Tier Status (or similar Status Benefits) to customers who have not entered into the appropriate level of past qualifying revenue transactions with the entity;
    b. Tier Status is provided for a period of time based only on the anticipation by the entity that the customer being provided Status Benefits will enter into future revenue transactions with the sponsoring entity commensurate with that of an individual earning Tier Status through past qualifying revenue transactions, and the entity has a business practice of providing Tier Status or equivalent benefits on a temporary basis as a result of the expectation that a customer will achieve a certain future spending level; or
    c. Tier Status can be earned or accrued by activity with unrelated companies that have a marketing affiliation agreement with the entity sponsoring the affinity program ("marketing partners"), which results in limited or no consideration to the sponsor as compared to actual qualifying revenue transactions with the sponsor.

14. FinREC believes the existence of one or more of the following factors in such a program could indicate that the Tier Status or certain of the benefits received by Tier Status customers are a separate performance obligation.
    a. The program sponsor sells (directly or indirectly through marketing partner arrangements) Tier Status for cash (excluding immaterial "top-off" payments made by customers to retain their previous status when they fall just short of the defined target);
    b. Customers who receive matched status must achieve a higher level of qualifying activity in the specified period than customers who earned equivalent status

c. The discount provided on future goods and services combined with the anticipated future purchases by that customer results in a loss on a customer's anticipated future revenue transactions;
d. The option is transferable by the customer to unaffiliated members, effectively preventing the program sponsor from determining the class of customer being marketed to.

15. The factors in paragraphs 13 and 14 provide entities additional guidance in determining whether the principles in paragraph 9 and 10 have been met and do not override the principles in paragraphs 9 and 10. These factors are provided to assist in the analysis of whether such goods or services are made available to customers or classes of customers at a similar discount independent of the contracts for past revenue transactions. These should not be viewed in isolation, do not constitute a separate or additional evaluation, and should not be considered a checklist of criteria to be met in all scenarios. Considering one or more of the indicators often will be helpful in determining whether the entity typically makes such goods or services available to customers or classes of customers at a similar discount independent of the contracts for past revenue transactions. Depending on the facts and circumstances, the indicators may be more or less relevant to the assessment of whether the entity typically makes such goods or services available to customers or classes of customers at a similar discount independent of the contracts for past revenue transactions. Additionally, one or more of the indicators may be more persuasive to the assessment than the other indicators. These indicators are intended to provide guidance to assist the sponsoring entity in evaluating whether the substance of the arrangement is that of a reward for past purchases, or a marketing incentive provided to a class of customers who are expected to spend at future levels which would enable them to attain Tier Status through such past qualifying transactions.

16. FinREC believes that an entity's assessment of Tier Status should generally be performed at each tier level. The benefits available at each tier level are usually different, and sponsoring entities may match demonstrated Tier Status earned on a competitor or partner at certain levels but not at others. For example, a sponsoring entity may match Tier Status that a customer has with a competitor at all levels except the very highest level, in which case the sponsoring entity may grant the second highest Tier Status rather than the top tier. Because each affinity program is unique, it may be necessary for the sponsoring entity to make its assessment at each individual tier level if the criteria described in paragraphs 13 and 14 are not applicable to all tier levels.

17. As a result of an assessment of the preceding principles and indicators, an entity may determine that discounted goods or services available to an individual with Tier Status are typically made available to a particular class of customers. Such an assessment will necessarily require judgment based on facts and circumstances. If the entity reaches the conclusion that it makes Status Benefits (or the underlying discounted goods or services) available to customers or classes of customers who have not earned such benefits as a result of past qualifying revenue transactions with the sponsoring entity, then FinREC believes Tier Status would not give rise to a separate performance obligation.

18. The following airline affinity program example is meant to be illustrative, and the actual determination of whether a Tier Status program is a material right or a marketing incentive should be based on the facts and circumstances of an entity's specific situation. See Gaming Issue #6-8(B): Assessment of whether "Tier Status" in an affinity program conveys a material right to goods and services and therefore gives rise to a separate performance obligation, for an illustrative example of the evaluation of a gaming affinity program.

Background

19. Dream Airlines (Dream) offers a Tier Status program that identifies its customers as Bronze, Silver or Platinum based on historical travel volume. Customers in those tiers have the option to receive Status Benefits (that is, goods or services offered at a discounted price) when the customer purchases a future ticket within a specified period (that is, when the customer enters into a future contract with Dream). The Status Benefits are usable only by the status customer and cannot be transferred to another individual. The discounts provided on future goods and services combined with the anticipated future purchases by that customer are not expected to result in a financial loss to Dream on the customer's future revenue transactions.

20. Customers in the Bronze tier have the option to receive a range of Status Benefits, including checked bags and priority check-in for no incremental fee beyond the price of the ticket. Customers in the higher tiers receive all the benefits associated with the tier levels below theirs, plus have the option to receive additional Status Benefits, including upgrades to business class seating (when and if available and at Dream's discretion) for no incremental fee beyond the price of a ticket. Customers in a higher tier are

more likely to receive upgrades to business class seating for no incremental fee when requested than customers in a lower tier. Dream typically charges a customer without tier status an incremental fee (that is, a fee in addition to the price charged for the ticket) to check a bag and to upgrade to business class seating.

21. Throughout the year, Dream evaluates a customer's purchasing history against its Tier Status program criteria to determine the tier for which the customer qualifies. Status tiers must be achieved by the end of the year. If a customer does not meet the criteria to qualify for a status tier during the defined eligibility period, the progress toward achieving a tier restarts in the following year. Customers who meet the eligibility criteria for Tier Status will receive the associated Status Benefits for the remainder of the current year plus all of the next year. Some customers maintain status for many consecutive years and others fall in and out of status from one year to the next.

Evaluation of Status Benefits

22. When evaluating whether a contract (that is, a ticket purchase) with a customer in its Tier Status program includes a material right, Dream assesses the principles in paragraphs 9 and 10. Dream evaluates whether the Status Benefits offered to status customers are also offered to other customers independent of previous spending (i.e. those who have not met the defined criteria to earn a Tier Status).

23. Because Dream offers similar benefits to all members of a Tier Status, Dream believes that its evaluation of a contract with an individual status customer would be reflective of whether its contracts with other status members include a material right. Therefore, Dream believes that it can use the practical expedient in FASB ASC 606-10-10-4 that permits an entity to apply FASB ASC 606 guidance to a portfolio of contracts or performance obligations (that is, it is not necessary for Dream to perform the evaluation on a contract-by-contract basis).

24. Dream maintains a business practice of granting status to individuals who have not earned it through meeting the eligibility criteria defined in its Tier Status program. Dream's program consists of the following:
    a. Dream matches the status of competitor airlines' tier members for a prescribed period with no historical minimum amount of prior purchases on Dream. The purpose of the limited period is to ensure that the customer is spending at a level on Dream that would likely result in the customer eventually earning the status on their own.
    b. Dream nominates selected individuals for status, such as high level executives at targeted corporations, based on the expectation that those individuals will be frequent travelers on Dream.
    c. Dream has agreements with certain hotel chains to offer status to the hotel chain's tier status customers on a reciprocal basis.
    d. Dream also allows loyalty members to earn Tier Status principally through accumulating status miles from flights taken on a partner airline. Although the partner airline pays the sponsoring airline for the points the sponsoring airline provides to the passenger, the bulk of the consideration from the flight is earned and retained by the partner airline that actually operated the flight on which the passenger flew. These arrangements are generally reciprocal in nature, with limited or no consideration to the sponsoring airline as compared to consideration that would be received from a passenger who earned Tier Status by flying on the sponsoring airline.
    e. Dream does not directly or indirectly sell Tier Status, but grants all members who carry a co-branded credit card a limited amount of credit towards achieving Tier Status. However, the status credit granted is such that to achieve any Tier Status the customer would have to spend at a significant level with Dream.
    f. Dream allows members of its affinity program to purchase status credits which are added to credits earned as a result of past qualifying activity in order to determine progress towards attaining Tier Status. These purchased status credits are substantially limited to allow a program member to "top-off" the member's account. In Dream's case, a member must achieve 95% of progress towards Tier Status through past qualifying activity. In this case, the program member may acquire the remaining 5% to reach the next or to maintain the existing Tier Status level. Dream's status credit sales are generally not significant and are limited to "topping off" a program member's account.

25. Dream's analysis indicates that of all customers with status, some received status as a result of the matching program without regards to their history of prior purchases of Dream flights and, therefore, Dream has determined the following indicators in paragraph 13 are applicable:

a. The entity has a business practice of providing Tier Status (or similar Status Benefits) to customers without those customers having entered into the appropriate level of past qualifying revenue transactions
b. Tier Status is provided for a period of time based only on the anticipation by the entity that the customer being provided Status Benefits will enter into future revenue transactions with the sponsoring entity commensurate with that of an individual earning Tier Status through past qualifying revenue transactions, and the entity has a business practice of providing Tier Status or equivalent benefits on a temporary basis as a result of the expectation that a customer will achieve a certain future spending level
c. Tier Status can be earned or accrued by activity level with partners of the entity sponsoring the affinity program, which results in limited or no consideration to the sponsor as compared to actual qualifying revenue transactions with Dream

Further, Dream assessed the factors in paragraph 14, noting that none of these indicators exist in its program.

26. Having assessed the indicators in paragraphs 13 and 14, Dream considers whether the discounts provide through Status Benefits are typically available to the class of customer irrespective of previous purchases from Dream. Dream views the class of customers as frequent travelers in general, irrespective of whether previous travel has been completed with Dream. The key test in Dream's assessment is whether Dream makes Status Benefits available to frequent travelers irrespective of whether those individuals have completed a minimum level of travel with Dream. Dream's business practice of providing similar benefits to individuals who have a history of frequent travel with other carriers indicates that Status Benefits are not a material right. Dream matches Tier Status of other airlines, has reciprocal arrangements with hotel chains, gives status to individuals (such as high level executives at targeted corporations) based on the expectation that those individuals will be frequent travelers on Dream at equivalent status levels, and allows Status accrual in its own program when customers fly on partner airlines. Dream assesses its "top-off" sales of qualifying credits and does not believe that represents a sale (either directly or indirectly) of Tier Status as such sales are limited to a small portion of an individual's qualifying activity. The existence of these attributes helps support that Dream is seeking to provide a marketing incentive to frequent travelers in general rather than a reward to individuals who have made past purchases. As such, Dream's Tier Status program does not constitute a material right under FASB ASC 606.

Comments should be received by February 1, 2017, and sent by electronic mail to Yelena Mishkevich at ymishkevich@aicpa.org, or you can send them by mail to Yelena Mishkevich, Accounting Standards, AICPA, 1211 Avenue of the Americas, NY 10036.