IATA Industry Accounting Working Group Guidance IFRS 15, Revenue from Contracts with Customers

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IFRS 15, Revenue from Contracts with Customers

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Accounting for Airline's Brand and Customer Lists

Background:

Airlines with large loyalty programs enter into agreement with a co-branded credit card partner in which miles and other consideration (i.e. award travel, upgrades bag fee waivers, lounge access, branding and marketing services, etc.) are sold to a financial institution, primarily for the purpose of being awarded to qualifying members based on their usage of such co-branded credit cards or their status in the airline's loyalty program.

The miles are ultimately issued to the credit card holders (who are also members in the airline's loyalty program) as they make purchases on their co-branded credit card (rather than directly to the financial institution). Certain other services, principally advertising and branding, and including access to the airline's customer list, are used directly by the financial institution for marketing and solicitation purposes. These services sold to the financial institution help them to obtain new and profitable accounts and promote increased spending on those cards. Airline co-brand credit cards have historically been more profitable to the financial institutions than a typical non-affiliated credit card portfolio, and as such the financial institution is willing to pay the airline for the access to their customers and for use of the airline brand.

Airline members meeting the airline's criteria for award redemptions can redeem the resulting miles for travel or other services and products provided by the terms of the airline's loyalty programs. These transactions are multi-element arrangements they typically contain more than one deliverable. The airline separates the components representing the value of the future travel related deliverables (i.e., the transportation component, as the airline passenger is the end customer in the arrangement) from the marketing component that represents the value associated with the other goods and services acquired by the co-branded partners. Under the arrangements, the airline is required to maintain the customer list and undertake activities that enhance the brand (in line with normal business activities). The financial institution is provided with access to the brand and customer list over time.

Issues:

This paper addresses the following questions in relation to the recognition of revenue for the brand and customer list related deliverables in such an arrangement:

1. Whether maintenance or administration of a customer list database is considered an administrative task and therefore does not represent a transfer of service to the customer, or does it qualify as a distinct service, and thus represents a separate performance obligation?

2. How should the revenue for the access to the customer list and use of the brand name be recognized?

Analysis of Issues:

Maintenance of customer list database - The applicable guidance in IFRS 15.B53-54 provides that the use of the license must be distinct from other goods and services provided in the contract in order to treat it as a separate performance obligation. Although it is possible that these items could be sold separately, their integration into the co-branded credit card agreement appears to meet the definition of a separate performance obligation as these services are highly interdependent or highly interrelated. Although the airline brand may be an important part of such an arrangement, and have significant value, access to the airline customer list is generally considered more valuable within the co-branded relationship.

Therefore, it appears that the use of the airline brand and access to its customer list should be combined as a single value into one performance obligation (intellectual property ("IP") marketing bundle).

Timing of revenue recognition - Based on individual facts and circumstances, airlines may use the following methods, as appropriate, to recognize revenue based on the satisfaction of brand name and customer list performance obligations over time:

a. Output method - direct measurements of the value to the customer of the goods and services promised and transferred to date relative to the remaining goods and services promised under the contract.

b. Sales/usage based royalty method - when the predominant item within the arrangement is the license to access IP, an airline should recognize revenue for a sales-based or usage-based royalty promised in exchange for a license of intellectual property only when (or as) the later of the following events occurs:
   - The subsequent sale or usage occurs.
   - The performance obligation to which some or all of the sales-based or usage- based royalty has been allocated has been satisfied (or partially satisfied).

As both the customer list and branding are IP, the royalty method should be used and be recognized based on the terms of the contract.

IAWG View:

1. **The maintenance or administration of a customer list database is considered an administrative task and therefore does not represent a transfer of service to the customer or qualify as a separate performance obligation. The use of the airline brand and access to its customer list should be combined as a single value into one performance obligation (intellectual property ("IP") marketing bundle).**

2. **The revenue for the access to the customer list and use of the brand name are both the license of IP and therefore the royalty method is appropriate, and revenue recognized based on the terms of the contract.**

Accounting for Contract Costs - Commissions and Selling Costs

Background:

Airlines may incur costs to obtain a customer contract that would otherwise not have been incurred. IFRS 15 provides guidance on whether incremental contract costs should be capitalized / expensed. This paper deals with the accounting for direct selling costs incurred in obtaining passenger tickets.

In the airline industry typical costs incurred in obtaining a contract with a customer may include credit card fees, travel agency and other commissions paid, and global distribution systems (GDS) booking fees (collectively referred to as *direct selling costs*). Direct selling costs are incurred at the contract or ticket level. An entity may consider a portfolio approach in accounting for contract costs. A revenue contract or ticket may contain one or more performance obligations: for example, the purchased travel and the frequent flyer points. Tickets are often required to be used for travel within one year of purchase, while frequent flyer points may be outstanding for a number of years, until sufficient points are accumulated to allow for redemption.

In addition, the direct selling costs represent only a small percentage of the sales price of the ticket and many of the selling costs (such as commissions and credit card fees) are recoverable if the transaction is cancelled or refunded.

Issue:

Do commissions and other direct selling costs qualify for capitalization and, if so, over what period should they be amortized?

Analysis of Issue:

Do commissions and other direct selling costs qualify for capitalization?

Commissions and other direct selling costs may qualify for capitalization where they are considered to be incremental costs of obtaining a contract and they are expected to be recovered (IFRS 15.91).

The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission) (IFRS 15.92). Direct selling costs that are recoverable if the transaction is cancelled or refunded are considered to be incremental costs eligible for capitalization.

Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained shall be recognized as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained (IFRS 15.93).

Expensing the incremental costs of obtaining a customer contract is not permitted unless they qualify for the practical expedient (i.e. the amortization period is less than one year) (IFRS 15.94). Where the practical expedient is used, it should be applied consistently to similar contracts in similar circumstances (IFRS 15 BC235).

<u>What period should capitalized costs be amortized over?</u>

Capitalized costs should be are amortized on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates (IFRS 15.99).

Generally, tickets sold by airlines are the same price regardless of whether the passenger is a loyalty member and earns miles or not. It is expected that that any contract costs, which are attributable to frequent flyer points, are likely to be immaterial and therefore it may be appropriate to allocate the contract costs entirely to the purchased travel performance obligation. In the event that contract costs relating to frequent flyer points are material (expected to be rare), these should be allocated separately.

Capitalized contract costs allocated to the flight performance obligation are expensed when the passenger is uplifted (i.e. when the goods and services are transferred to the customer).

<u>IAWG View:</u>

Commissions and other direct selling costs are capitalized where the criteria in IFRS 15.91-93 are met. IFRS 15.94 provides a practical expedient for costs that would be amortized in one year or less to be instead expensed.

Commissions and sales costs may be allocated entirely to the flight performance obligation where the contract costs attributable to frequent flyer points are expected to be immaterial.

Capitalized costs are amortized on a systematic basis that matches the transfer of goods and services to the customer, which would result in the capitalized costs being expensed when the customer is uplifted.

Accounting for Passenger Taxes & Related Fees

Background:

IAS 18, Revenue, indicates that revenue includes only the gross inflows of economic benefits received and receivable by the entity on its own account. Amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes are not economic benefits that flow to the entity and do not result in increases in equity. Therefore, they are excluded from revenue. The terms taxes, charges and fees are often used interchangeably, along with other terms. This guidance relates to amounts charged by third parties such as governments and airport authorities that must be remitted to those bodies by the airlines,

Issue:

Should taxes and related fees charged by third parties such as government and airport authorities that are collected on behalf of a third party and remitted by the airline be recorded on a gross or net basis under IFRS 15?

Analysis of Issue:

In accordance with IFRS 15.47, the transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes).

Therefore, there appears to be no change from IAS 18 and the accounting treatment should remain unchanged as:

1. The taxes and related fees that are assessed on the airline operations are presented on a gross basis; and
2. The taxes and related fees assessed on passengers and collected on behalf of a third party are presented on a net basis.

This is consistent with the application guidance in the standard in relation to principal versus agent issues.

IAWG View:

Taxes and fees assessed directly on the airline operations (excluding income taxes) are recorded gross and included in operating expenses (for example, jet fuel taxes or aircraft fees). This is regardless of whether those taxes or fees are then explicitly recharged to the passenger. Taxes and fees charged by third parties such as government and airport authorities that are collected on behalf of third parties from passengers and remitted by the airline (for example, airport taxes, passenger charges, and ticket taxes) should be recorded on a net basis under IFRS 15.

Ancillary Services

Background:

Airlines may charge customers separately for various goods and services that could enhance the travel experience. These ancillary items could include baggage fees (for either checked or carry-on bags), seat assignment fees, priority boarding fees, and so on, and generally occur in conjunction with the flight. Some airlines also have ancillary products and services that are separate from transportation, such as fees to access an airline's airport lounges for which customers may be charged separately.

Issue:

How should the revenue related to various ancillary services be recognized under IFRS 15?

Analysis of Issues:

In determining the appropriate accounting for these ancillary services, airlines should evaluate if such services are distinct from the travel component of the transaction.

A good or service that is promised to a customer is distinct if both of the following criteria are met:

a. the good or service is capable of benefitting the customer either on its own or in conjunction with other readily available resources; and
b. the promise to transfer the good or service is distinct within the context of the contract.

Various factors may provide evidence of this, including the fact that the entity regularly sells a good or service separately. If a promised good or service is not distinct, it is combined with other promised goods or services until it is part of a bundle of goods or services that is distinct.

IAWG believes that some ancillary services provided to airline passengers are not distinct from the travel component because they are not capable of being separated from the travel component as they are highly interdependent or highly interrelated with it. A customer could not separately benefit from an ancillary service that occurs with or during the flight as the service cannot be provided without the purchase of a ticket and is not sold separately.

Some ancillary services are not purchased at the time the travel is purchased, which also raises the question whether ancillary services should be considered distinct. The airline should consider whether the separate purchase of ancillary services represents a modification of the original travel contract or whether it represents a separate contract. Although each airline's ticketing and fee policies are different, in most cases, the purchase of ancillary services would qualify as a modification because the airline's contract of carriage specifies whether such services are included in the price of the ticket.

IFRS 15.18 defines a contract modification as "a change in the scope or price (or both) of a contract that is approved by the parties to the contract". If the contract modification definition is met, IFRS 15.20 further specifies that an entity shall account for a contract modification as a separate contract if both of the following conditions are present:

a. The scope of the contract increases because of the addition of promised goods or services that are distinct.
b. The price increases by an amount that reflects the standalone selling prices of the additional promised goods or services.

In the case of most ancillary services, the price increases, but the ancillary services would not qualify as being distinct, for the reasons given above. Therefore, consistent with guidance in IFRS 15.21, such ancillary services would be combined with the flight into a single performance obligation and accounted for as a bundled transaction with the recognition of revenue occurring at the flight date(s).

Some services offered by airlines may be considered distinct if the customer can benefit from the services without the purchase of a ticket. An example of this would be a one-time or annual fee paid to access a carrier's lounges at various airports. For ancillary services that are considered distinct, and for which the customer could benefit without purchasing or utilizing a ticket for transportation, the airline would allocate the total arrangement consideration between the identified performance obligations and recognize revenue for each performance obligation as it is satisfied. For example, if the lounge access were provided on an unlimited basis for one year, the associated revenue would be recognized on a straight-line basis over that period.

In addition, certain airlines sell non-distinct services using annual subscription fees. One example is that a customer may purchase a subscription from the airline entitling them to unlimited premium seating upgrades for the full year by paying an upfront annual fee. In these cases, the subscription has no benefit to the customer without the purchase of a ticket to fly on the carrier in order to utilize the subscription services. As a result, the subscription contract for the non-distinct service would be combined with the related separately purchased ticket contract(s) to create the combined performance obligation of the ticket with a premium seat. Revenue for such subscription services would be recorded at the same time as the associated travel, based on the satisfaction of the combined performance obligation (i.e., flights taken) during the subscription period. However, the current practice of recognizing revenue associated with these services on a straight-line basis is considered a practical expedient, given the likely materiality of this revenue when compared to overall passenger revenue and the uncertainty over the number of flights likely to be taken over the subscription period.

The table set out in Appendix 1 identifies examples of ancillary services and their likely treatment under IFRS 15. While this paper is limited to ancillary service sold to a customer, non-distinct ancillary services granted to a customer holding tier status would not be a separate performance obligation. See the separate paper on Tier Status Benefits for guidance on those benefits.

IAWG View:

Under IFRS 15, revenue related to ancillary services that are not considered distinct from the contract for a flight should be recognized at the time of the flight. Certain ancillary services which may be distinct services, and which are not specifically associated with a ticket for transportation, may be recognized on a systematic basis that reflects the fulfilment of the related performance obligation.

APPENDIX TO PAPER ON ANCILLARY SERVICES

Ancillary service	Distinct good or service from travel ticket?	Recognition	Classification
On-board sale of food, beverage and other merchandise	No	Recognize when service is provided	Food and beverage - Passenger revenue Other merchandise – Other revenue
Checking of baggage and excess baggage	No	Recognize with ticket revenue	Passenger revenue
Upgrades and other assigned seats such as aisle seats	No	Recognize with ticket revenue	Passenger revenue
Call center support for reservations	No	Recognize with ticket revenue as you would ticket revenue	Passenger revenue
Credit card fees	No	Recognize with ticket revenue	Passenger revenue
Airline-sold advertising	Yes	Recognize when performance obligation fulfilled.	Other revenue
Lounge access - single access purchased at time of ticketing	Yes	When service is provided	Passenger revenue
Lounge access – other than single access purchased at time of ticketing	No	Recognize at point of sale unless a subscription and then over time	Determined by whether the service is linked to travel on the airline
Provision of Medical Assistance (e.g. incubators/oxygen)	No	Recognize with ticket revenue	Passenger revenue
In-Flight Entertainment	No	Recognize with ticket revenue	Passenger revenue

Ancillary service	Distinct good or service from travel ticket?	Recognition	Classification
Access to on-board Wi-Fi	No	For single journey access, recognize when service is provided. For bundles of data usage, apply straight line basis	Passenger revenue
Ground Transport (e.g. Bus/Cart Transfer)	No, if principal Yes, if agent	Recognize when performance obligation fulfilled	If principal, passenger revenue unless If agent, commission income
Carbon Offset	No	NA – no value to customer as payment is voluntary	NA
Time to Decide fee (ie pay for an option to hold a booking)	No	Recognize when option expires or exercised unless it forms part of the consideration for the ticket. Then recognize with ticket revenue	Passenger revenue
Store Items (e.g. branded goods like shirts/caps/planes)	Yes	Recognize when performance obligation fulfilled.	Other revenue
Priority Services (e.g. priority check-in/boarding/fast track security/immigration)	No	Recognize with ticket revenue	Passenger revenue
Unaccompanied Minors	No	Recognize with ticket revenue	Passenger revenue
Insurance	Yes	Recognize when performance obligation fulfilled.	Other revenue

Ancillary service	Distinct good or service from travel ticket?	Recognition	Classification
Name Change	No	Recognize with ticket revenue if provided by airline to passenger or at point of sale if to agent	Passenger revenue
Cancellation Penalty (as opposed to changing a reservation, passenger cancels).	Yes	Recognize when performance obligation fulfilled on cancellation	Other revenue

Change Fees

Background

Each fare type that an airline issues will have its own conditions attached, which may include it being restricted, non-upgradeable or non-refundable. This means that if passengers need to make a change to their booking, cancel flights or buy replacement tickets then a change fee (or service fee) may apply.

These fees are often described as “handling charges for processing the changes”. The amount payable in respect of these charges will vary, depending on the nature of the change and how flexible the original ticket was. For example, if a passenger buys a fully flexible ticket (which is typically more expensive than a restricted ticket) then no charges will apply.

Change fees are not refundable and have no separate value to the customer once paid. If the ticket is exchanged again, only the value of the ticket (exclusive of the change fee) can be used against the value of the new ticket; a further change fee will apply.

Under existing accounting standards, airlines generally recognize change fees as revenue at the point the modification is made, and the passenger is charged. Currently, it is considered that a service is being provided to customers to change existing bookings. These fees are often recognized as “Other Revenue” rather than “Passenger Revenue” to reflect the difference between the two services provided. However, some airlines include this revenue within ‘Passenger Revenue’.

Issues

This paper addresses the following specific questions that arise in connection with change fees received by the airline having a related flight performance obligation to the passenger:

1. Do changes made to a passenger ticket as a distinct service, with revenue recognition occurring at the time the ticket change is processed, or should they be combined with the ticket, with revenue recognition occurring on the date of travel?
2. If combined with travel, would the fees be classified as a component of Passenger Revenue or Other Revenue?
3. When should the change fee revenue be recognized?

Analysis of Issues

IFRS 15 requires the identification as a performance obligation each promise to transfer to the customer a distinct good or service. Revenue is recognized when that distinct good or service is transferred. The following points are relevant:

- Performance obligations do not include activities that an entity must undertake to fulfil a contract unless those activities transfer a good or service to a customer. Therefore, administrative tasks to set up a contract would not be a distinct service (IFRS 15.25).
- Promised goods and services may include performing a contractually agreed-upon task for the customer (IFRS 15.26(d)).

The issue to consider is whether:

- The provision of a service to change the flight details on a ticket is purely administrative, does not constitute a distinct service, and should be combined with the ticket; or
- The service of changing a ticket has an economic value to the customer in its own right, and can be considered as a distinct service, and recognized at the time the change is processed.

IFRS 15.27 outlines that a good or service that is promised to a customer is distinct if:

- The customer can benefit from the good or service, either on its own or together with other resources that are readily available to the customer; and
- The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

The decision tree set out in Appendix 1 may be helpful in performing this evaluation.

Change fees may be nominal amounts compared with the value of the ticket, and therefore would not have a material economic value in its own right. Generally, customers will benefit from the change service provided, as they will be able to alter their flight itinerary, thereby preserving the value of their ticket. The fact that passengers pay for these change services would also suggest that they attach economic value to the flexibility that they give.

However, any change service, regardless of its economic value, is highly dependent on the service of providing the flight. The customer cannot benefit from the change service without the provision of the flight. Although the change service is provided in advance of the flight, the benefit from the change service is not provided until the customer is uplifted. In this case, the change service would not be distinct, and forms part of the performance obligation associated with the flight.

Contract modification - In most cases, the change transaction will meet the definition of a contract modification because it amends the original contract, changes the rights to the original flight, and may have an impact on the price of the ticket if fares have changed since the original ticket was booked.

As the contract modification has not resulted in the addition of a distinct service, the promised goods or services should be accounted for in accordance with IFRS 15.21(a). The total consideration, including the consideration paid for the change in ticket is allocated to the performance obligation (flight) and recognized when the flight is taken.

Classification of revenue - As there is only one performance obligation, both the revenue associated with the change fee, and the ticket revenue should be classified as passenger revenue.

Recognition of revenue – revenue should be allocated to each segment flown by the carrier entitled to the change fee and recognized as the segment is completed. As this will cause undue operational complexity and cost, a consistent policy of recognizing the change fee when the first segment flown by the carrier entitled to the change fee departs as this would not produce a significant difference in revenue recognition over a reporting period.

IAWG View

- **The change service is not considered distinct as the customer cannot benefit from the change service without the provision of the flight. Although the change service is provided in advance of the flight, the benefit from the change service is not provided until the customer is uplifted.**

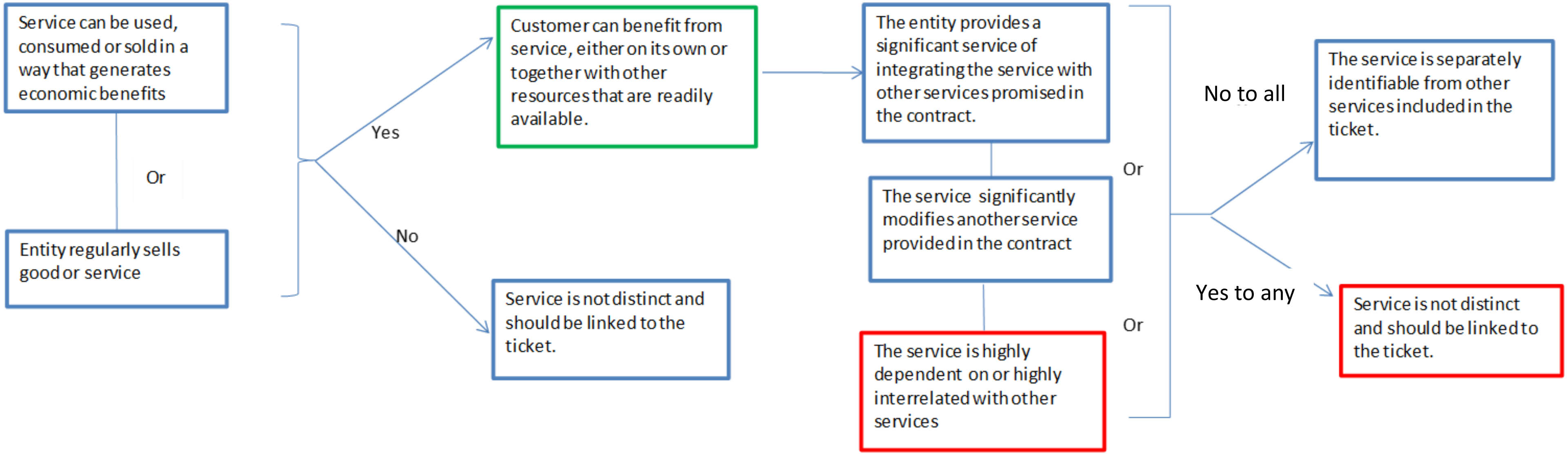
- **While the change service may have economic value, it is highly interrelated with the service of providing the flight and is not considered to be a distinct service. Change fee revenue should be recognized at the time of the flight.**

- **While the change service will meet the definition of a contract modification in most cases, it will not be accounted for separately because it does not result in the addition of a distinct service.**

- **As there is only one performance obligation, both the change fee and ticket revenue should be classified as passenger revenue.**

Revenue should be allocated to each segment flown by the carrier entitled to the change fee and recognized as the segment is completed. As this will cause undue operational complexity and cost, a consistent policy of recognizing the change fee when the first segment flown by the carrier entitled to the change fee departs as this would not produce a significant difference in revenue recognition over a reporting period.

DECISION TREE FOR ANALYSING WHETHER A GOOD OR SERVICE IS DISTINCT



Changes in the Volume of Miles within a Co-branded Credit Card Arrangement

Background:

Compensation paid to the airlines for the various performance obligations under co-brand credit card agreements is exclusively paid at the time that a co-brand credit card is used by the member and coincides with when the financial institution collects their merchant fee on the transaction. As a result, the airline receives the vast majority of the consideration for the two principal performance obligations: the sale of airline miles and the sale of the brand and customer lists to the financial institution at this time. The total transaction price in these contracts are completely variable as the total value of payments are dependent on credit card spend by the cardholders over the term of the contract. Contracts generally range from five to seven years in term.

Issue:

Under a co-brand credit card agreements, when the total amount of contract consideration and the volume of the various performance obligations delivered are both variable how, if at all, should airlines adjust their allocation of the relative standalone selling price ("RSSP") during the term of the contract?

Analysis of Issue:

The airline co-brand arrangements' total contract consideration and volume of the principal performance obligations sold are completely variable. Guidance in IFRS 15.50 states that "If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer".

Variable consideration that is promised in a contract may be attributable to the entire contract or to a specific part of the contract.

An entity shall allocate a variable amount (and subsequent changes to that amount) entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation in accordance with IFRS 15.85 if both of the following criteria are met:

a. The terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service).
b. Allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective in IFRS 15.73 when considering all of the performance obligations and payment terms in the contract.

In applying variable consideration guidance to the co-branded credit card for allocated changes in the total transaction price, it appears that the specific variable consideration guidance would not apply. That is, the variable consideration would not appear to qualify to be allocated exclusively to one of the primary performance obligations. This is because the variability of the transaction price impacts the volume of both of the principal performance obligations: 1) the miles and 2) the brand/customer list deliverables.

Finally, the guidance in IFRS 15.59 suggests updates for changes in the total transaction price as follows:

At the end of each reporting period, an entity shall update the estimated transaction price (including updating its assessment of whether an estimate of variable consideration is constrained) to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period. The entity shall account for changes in the transaction price in accordance with IFRS 15.87-90.

However, IFRS 15.88 provides the following:

Consequently, an entity shall not reallocate the transaction price to reflect changes in standalone selling prices after contract inception. Amounts allocated to a satisfied performance obligation shall be recognized as revenue, or as a reduction of revenue, in the period in which the transaction price changes.

The change in volume results in a change in the allocation of revenue to each performance obligation in the arrangement, however, the standalone selling prices established at contract inception are not modified when applying the volume changes under the RSSP basis.

Although this guidance appears inconsistent, airlines believe that they should update the total transaction consideration for the change in the volume of deliverables directly driven by the variable consideration increases or decreases, as discussed above. The related changes in the volume of the mile and brand/customer list to be provided to the customers over the term of the agreement would need to be adjusted in the RSSP allocation. The prohibition about changing the allocation based on subsequent changes in the standalone selling price does not appear to apply to the volume of performance obligations to be provided which were estimated as part of the original determination of the RSSP Allocation. That is, the original estimate of the RSSP allocation includes both an estimate of the volume or performance obligations to be delivered as well as an estimated RSSP for each of the performance obligations. Over time as the total transaction price changes due to increases in volume, airlines believe that an appropriate interpretation of the guidance is that the volumes of deliverables in the original RSSP allocation should also be updated, while the unit price or estimated standalone selling prices of each of the deliverables is unchanged. The updating of the volumes could result in the RSSP allocation being modified if the change in the deliverables is not proportional to the change in the total transaction value

IAWG View:

Under a co-brand credit card agreement, when the total amount of contract consideration and the volume of the various performance obligations delivered are both variable an entity shall not reallocate the transaction price to reflect changes in standalone selling prices after contract inception. However, a change in volume results in a change in the allocation of revenue to each performance obligation in the arrangement.

Estimating Stand-alone Selling Price of Loyalty Credits in Customer Loyalty Programs

Background:

Many airlines have airline loyalty programs where members are able to earn miles, points, or segments (collectively referred to as *loyalty credits*) by flying on a sponsoring airline and/or by flying on alliance partner airlines. Program members may also earn loyalty credits through purchases from other non-airline partners, such as credit card issuers, retail merchants, hotels, rental car companies, and various other promotional outlets. Loyalty credits are redeemed by program members for free, discounted or upgraded air travel as well as other non-travel rewards.

Loyalty credits are a separate performance obligation if they represent a material right to the passenger and require an allocation of the selling price to this element. This paper addresses the methods to be used when a separate performance obligation exists.

Issue:

What are the acceptable methods for estimating the standalone selling price for loyalty credits in customer loyalty programs?

Analysis of Issue:

IFRS 15.77-80 address this issue directly and is summarized below.

IFRS 15.77 requires that if a stand-alone selling price is observable it must be used if valid. If a stand-alone selling price is not directly observable it should be estimated.

IFRS 15 defines the standalone selling price as the price at which an entity would sell a promised good or service separately to a customer. IFRS 15.78 indicates that when estimating a stand-alone selling price, an entity shall consider all information reasonably available and maximize the use of observable inputs and consistently apply estimation methods.

IFRS 15.79 states that suitable methods for estimating the standalone selling price of a good or service include, but are not limited to, the following:

- Adjusted market assessment approach
- Expected cost plus a margin approach
- Residual approach

Adjusted Market Assessment Approaches

There are a number of acceptable valuation techniques under the adjusted market assessment approach including the following:

Redemption Value Approach

The redemption value is often publicly available (either explicitly or implicitly) as part of loyalty redemptions and, therefore, utilized by many airlines to estimate selling prices of loyalty credits. For example, some airlines allow a customer, when purchasing a ticket for travel, to toggle between the cash fare purchase price and the required number of loyalty credits necessary to purchase such ticket, as part of the redemption process. The Redemption Value method generally utilizes more observable inputs in determining standalone selling price than other estimation methods.

Equivalent Ticket Value Approach

An equivalent ticket value (ETV) estimate of the standalone selling price of loyalty credits is computed by using the average award fare for tickets, upgrades, or other loyalty awards similar to those redeemed within the airline's loyalty program divided by the average loyalty credits redeemed to receive the award.

Expected Cost plus Margin Approach

The Expected Cost plus Margin Approach is calculated by forecasting the expected costs of satisfying a performance obligation, such as the overhead costs for a flight award, and then adding an appropriate margin.

Residual Approach

The residual method may only be used if the specific criteria in IFRS 15 are met. This method estimates the standalone selling price as the remainder of the transaction price.

IFRS 15 does not preclude or prescribe any particular method for estimating a standalone selling price so long as the estimate is a faithful representation of the price at which the entity would sell the distinct good or service if it were sold separately to the customer.

The IAWG consider that the assessment of the standalone selling price can be made at a portfolio level.

Regardless of the approach used to estimate the standalone selling price, these estimates will need to continue to be remeasured for changes in inputs and estimates used over time, for example, breakage assumptions and redemption patterns.

IAWG View:

IFRS 15 does not prescribe what method(s) would be acceptable for estimating the stand-alone value of loyalty credits, but does provide that an estimate may only be used if a stand-alone observable price does not exist and establishes the principles that:

1. **the standalone selling price as the price at which an entity would sell a promised good or service separately to a customer;**
2. **the method used must consider all information that is reasonably available;**
3. **maximizes the use of observable inputs; and**
4. **estimation methods be consistently applied in similar circumstances.**

The IAWG believes that IFRS 15 would preclude the use of the incremental cost method (costs incurred that would not be incurred if the award passenger did not occupy the seat) as it does not reflect an appropriate overhead allocation and profit margin.

Interline Cargo Transactions

Background:

Cargo can be transported by passenger, cargo or combi aircraft:

- Passenger aircraft use the spare volume in the airplane's baggage hold (the "belly") that is not being used for passenger luggage - this practice is known as Belly Cargo.
- Cargo aircraft are dedicated to cargo - they carry freight on the main deck and in the belly.
- Combi aircraft carries cargo on the main deck behind the passengers' area and in the belly.

Cargo carriers frequently sell cargo services which one or more segments of the journey will be served by another carrier or mode of conveyance (eg, rail, truck, or sea). It appears that there is divergence in practice in relation to the selling carrier treating these transactions as a principal or agent.

Issues:

1. For interline cargo transactions when the customer is not aware of how the contract is to be fulfilled what are the performance obligations and when is revenue recognized?
2. Is the selling carrier an agent when another cargo carrier that the customer is unaware of fulfils some of the cargo services?

Analysis of Issues:

Identifying Performance Obligations for Cargo

The facts and circumstances of each contract should be evaluated using the principles identified in the standard. This may result in an airline identifying one or more performance obligations for each cargo transaction where the facts and circumstances differ to this paper.

A cargo transaction delivered by multiple carriers generally represents a single performance obligation for the carrier selling the service, but also performance obligations for the other carriers undertaking services under the contract.

Recognition of Revenue for Cargo Carrier

An entity in assessing a contract to transport cargo may or may not form an opinion that the service is consumed by the cargo customer as provided in accordance with IFRS 15.35(a). As a result, they would consider whether another entity would not need to substantially re-perform the work that the seller has completed or has had completed to date if that other entity were to fulfil the remaining performance obligation to the customer (See IFRS 15.B4). Note that this assessment disregards contractual or practical limitations in relation to transferring the obligation to another party (see IFRS 15.B4(a), IFRS 15.BC127). In that the work would not need to be re-performed (see IFRS 15.BC126), revenue would be recognized over time.

The prorated revenue associated with each segment represents a reasonable approximation of measuring progress to completion over time in accordance with IFRS 15.

Classification of Interline Transactions (Principal versus Agent)

Interline transactions in which the selling cargo carrier enters into a contract where one or more segments are to be operated by an interline partner would need to be evaluated under the principal versus agent criteria in IFRS 15.

Indicators that would indicate that an airline is a principal from the selling carrier's perspective:

1. Selling cargo carrier is primarily responsible for fulfilling promise
2. Selling cargo carrier has inventory risk
3. Selling cargo carrier has discretion in establishing prices

Cargo Analysis

For a common cargo contract where the selling carrier provides one or more segments and is responsible for fulfilling the promise and has discretion in pricing, the following analysis would be valid:

1. Selling cargo carrier is primarily responsible for fulfilling promise – Yes (principal)
2. Selling cargo carrier has inventory risk during shipping – Generally not (agent)
3. Selling cargo carrier has discretion in establishing prices for the other party's services – Yes (principal)

The criteria indicates that the transaction is generally controlled by the seller and therefore, the selling carrier acts as the principal and would recognize revenue for the gross selling price of the ticket and cost for payments made to other carriers. Each airline would need to consider the facts and circumstances of their specific transactions in determining whether they act as a principal or agent.

This view differs from our view on Passenger Interline Travel. The reason is that for passenger travel the selling carrier is not primarily responsible for fulfilling the promise to provide transportation services on the segment it does not operate. By comparison, for passenger transactions the customer has visibility on whether the service is provided by a third party for segments not operated by the selling carrier. The airline operating a segment is primarily responsible for fulfilling the promises in the contract.

Note that for the interline carriers providing the cargo service under an interline contract to another carrier that they would treat the transaction as that of a principal as they would have a contract with the seller and not the third party.

IAWG Views:

1. **Revenue should be recognized over time and reflect progress based on segments provided by the selling cargo carrier.**

2. **The selling carrier is considered to be the principal for cargo transactions where they take responsibility for fulfilling the promise to the customer and have discretion in pricing. They would recognize revenue in the gross amount of consideration to which it expects to be entitled in exchange for those goods or services transferred.**

Note that these views are relevant when the customer is not aware of how the contract is to be fulfilled and therefore the seller could not be acting as an agent. If the customer is aware of how the contract is to be fulfilled an analysis would need to be performed to ensure that the seller is not acting as an agent.

Interline Transactions – Identifying Performance Obligations for Air Travel

Background:

Airlines frequently sell tickets for round-trip or multi-city destinations and frequently operate connecting flights under which one or more segments of the journey will be flown by another carrier. Currently, revenue is recognized when the carrier provides the transportation service at the segment level. Interline transactions are settled at the time the passenger flies on the other airline (OAL), at which time the OAL bills the selling carrier per their interline agreements. The existing guidance permits these transactions to be recorded net within passenger revenue (payments to OAL are recorded as a reduction in revenue).

Issue:

1. How should performance obligations be identified for a passenger ticket and how should revenue be recognized by the carrier; and
2. Is the selling carrier an agent when another airline is to provide the flight to the passenger?

Analysis of Issues:

Identifying Performance Obligations for Passenger Air Travel

The facts and circumstances of each contract should be evaluated using the principles identified in the standard. This may result in an airline identifying one or more performance obligations for each ticket.

A ticket with connecting flights operated by multiple carriers represents a separate performance obligation(s) for each carrier.

Recognition of Revenue for Passenger Air Travel

Regardless of the number of performance obligations identified by the operating carrier, revenue is recognized over time as the service is consumed by the passenger as provided. The prorated revenue associated with each segment represents a reasonable approximation of measuring progress to completion over time in accordance with IFRS 15.

Classification of Interline Transactions (Principal versus Agent)

Interline transactions in which the selling carrier sells a ticket to be operated by an interline partner would need to be evaluated under the principal versus agent criteria in IFRS 15.

Indicators that would indicate that an airline is a principal from the selling carrier's perspective:

1. Selling airline is primarily responsible for fulfilling promise
2. Selling airline has inventory risk
3. Selling airline has discretion in establishing prices

Passenger Air Travel Analysis

1. Selling airline is primarily responsible for fulfilling promise – No (agent)
2. Selling airline has inventory risk – No (agent)
3. Selling airline has discretion in establishing prices – Yes (principal)

Although the criteria is mixed with respect to whether the selling carrier is the principal or the agent in these transactions, the predominant criteria is that the Other Airline ("OAL") segment and operation is clearly controlled by the OAL and not the selling carrier, a factor to which the passenger clearly understands as part of the procurement process. Therefore, the selling carrier, as the agent, would recognize revenue for the selling price of the ticket net of the amount transferred to the OAL for satisfying the OAL segment of the ticket.

IAWG View:

1. **Performance obligations in relation to passenger travel should be identified based on the principles in the standard with separate performance obligation (s) for each operating carrier. Revenue should be recognized over time and reflect progress based on segments provided by each operating carrier.**

2. **The selling carrier is an agent in relation to segments flown by another carrier and will recognize revenue net in accordance with current practice.**

Interline Transactions – Loyalty Redemptions – Principal or Agent

Background:

Points issued in an airlines' loyalty program are generally settled by the sponsoring airline providing free travel, upgrades and other services, but in many large loyalty programs the sponsoring airline also provides the option for the loyalty customer to redeem points for travel on certain partner airlines and for certain non-air travel products or services from third-party providers. If the customer chooses the partner airline flight or third-party product or service, the airline will remit a contractually agreed fee to the partner airline or third party for the flight, service or product. As indicated below, at the time of point redemption, the airline would need to determine whether it acted as a principal or agent about the customer's chosen flight, non- air service or non-air product. If the airline concludes that it acted as a principal, it will recognize revenue for the points redeemed and the payment to the third party as an operating cost for providing the service. If the airline concludes that it acted as an agent, it will record the payment as an offset to revenue. In either case, the previously unrecognized revenue attributable to the issued points would be recognized.

Issue:

Is an airline acting as a principal or agent when the airline's loyalty customers redeem their loyalty miles ("points") to purchase flights on other airlines (partner airlines) or to purchase non-air travel services or goods from third-party providers?

Analysis of Issue:

Loyalty points issued to passenger accounts are recorded as deferred revenue by the sponsoring airline, generally having been sold and deferred in connection with a flight or issued in connection with a co-branded credit card. However, at the time they are sold they are not associated with a product or service but are simply a right available for future redemption in accordance with the terms of the program. The number of points required, available flights on the sponsoring airline, partner airlines, or availability of other products and services is not determined until the loyalty member executes a redemption transaction. Prior to redemption of the points, deferred revenue effectively represents an advance payment by the customer (a liability) for the right to a future redemption and is not linked to any specific performance obligation until the time of redemption. IFRS 15, B35 provides that "an entity is a principal if the entity controls a promised good or service before the entity transfers the good or service to a customer." In Airline loyalty programs the principal versus agent evaluation is completed at the time of the redemption transaction because prior to redemption the goods and service to be provided are unknown.

At time of points redemption, the customer can exercise their material right to obtain a flight that is controlled by the partner airline. Therefore, the airline acts as an agent in procuring the partner airline flight and the airline records its payment to the partner airline for the flight as an offset to revenue or deferred revenue.

In regard to a loyalty customer's redemption of points for non-air travel services and products from third-party providers, the airline would need to analyze the nature of its contractual relationship with the third-party provider to determine whether it acts as an agent or principal. The timing of the analysis is the point of redemption. Examples where an airline is acting as an agent may exist where the service or product is never inventoried or controlled by the airline prior to it being shipped to the customer, directly from the provider. An airline may be considered a principal in other circumstances, such as where it runs its own redemption store.

IAWG View:

Generally, an airline is acting as an agent when the airline's loyalty customers redeem their loyalty miles ("points") to purchase flights on other airlines (partner airlines) or to purchase non-air travel services or goods from third-party providers.

Legislated Payments Made to Passengers for Flight Delays or Cancellations

IFRIC Agenda Decision: Compensation for Delays or Cancellations (IFRS 15 *Revenue from Contracts with Customers*)— September 2019

The Committee received a request about an airline's obligation to compensate customers for delayed or cancelled flights. In the fact pattern described in the request:

a. legislation gives a flight passenger (customer) the right to be compensated by the flight provider (entity) for delays and cancellations subject to specified conditions in the legislation. The legislation stipulates the amount of compensation, which is unrelated to the amount the customer pays for a flight.

b. the legislation creates enforceable rights and obligations, and forms part of the terms of a contract between the entity and a customer.

c. applying IFRS 15 to a contract with a customer, the entity identifies as a performance obligation its promise to transfer a flight service to the customer.

The request asked whether the entity accounts for its obligation to compensate customers either: (a) as variable consideration applying paragraphs 50–59 of IFRS 15; or (b) applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, separately from its performance obligation to transfer a flight service to the customer.

Paragraph 47 of IFRS 15 requires an entity to 'consider the terms of the contract and its customary business practices in determining the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer…The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both'. Paragraph 51 of IFRS 15 lists examples of common types of variable consideration— 'discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items'.

Paragraph B33 of IFRS 15 specifies requirements for an entity's obligation to pay compensation to a customer if its products cause harm or damage. An entity accounts for such an obligation applying IAS 37, separately from its performance obligation in the contract with the customer.

The Committee observed that, in the fact pattern described in the request, the entity promises to transport the customer from one specified location to another within a specified time period after the scheduled flight time. If the entity fails to do so, the customer is entitled to compensation. Accordingly, any compensation for delays or cancellations forms part of the consideration to which the entity expects to be entitled in exchange for transferring the promised service to the customer; it does not represent compensation for harm or damage caused by the entity's products as described in paragraph B33. The fact that legislation, rather than the contract, stipulates the compensation payable does not affect the entity's determination of the transaction price—the compensation gives rise to variable consideration in the same way that penalties for delayed transfer of an asset give rise to variable consideration as illustrated in Example 20 of the Illustrative Examples accompanying IFRS 15.

Consequently, the Committee concluded that compensation for delays or cancellations, as described in the request, is variable consideration in the contract. Accordingly, the entity applies the requirements in paragraphs 50–59 of IFRS 15 in accounting for its obligation to compensate customers for delays or cancellations. The Committee did not consider the question of whether the amount of compensation recognised as a reduction of revenue is limited to reducing the transaction price to nil.

Passenger Ticket Breakage and Accounting for Travel Vouchers

Background:

Definition of the ticket breakage: tickets for which the passenger is not expected to exercise their rights under the ticket contract with the airline and, as a result, the ticket will expire unused.

This paper addresses the recognition of revenue for passenger ticket breakage under the guidance in IFRS 15, specifically guidance regarding unexercised customer rights. This paper also addresses accounting and breakage considerations related to travel vouchers. This paper does not address identification of distinct performance obligations included in passenger tickets sold to customers, such as flight segments, which are addressed in a separate paper.

Issue:

1. How should revenue be recognized for passenger ticket breakage?
2. How should revenue be recognized for compensation provided to a customer such as in the form of a voucher?

Analysis of Issue:

Passenger Ticket Breakage

Passenger ticket breakage consists of refundable and non-refundable tickets that remain unused past the departure date, have continuing validity (valid tickets) and are expected to ultimately expire unused, as well as valid travel vouchers that are not expected to be redeemed prior to their contractual expiration date. Invalid tickets (non-refundable/non- exchangeable tickets or tickets where fare rules are violated and now invalid) have rights that expire on the travel date and therefore revenue is recognized irrespective of whether the passenger travels.

Consistent with IFRS 15, B46, if the airline expects to be entitled to breakage because the passenger has not required the airline to perform and is unlikely to do so, the airline should recognize the expected breakage amount as revenue in proportion to the pattern of rights exercised by the passenger (or flown revenue). If the airline does not expect to be entitled to a breakage amount, the airline should recognize the expected breakage amount as revenue only when the likelihood of the passengers exercising their remaining rights becomes remote, which would occur no later than the expiration date of the ticket.

As indicated in IFRS 15, B46, to determine whether an airline expects to be entitled to a breakage amount, it should consider the guidance IFRS 15.56-58 on constraining estimates of variable consideration.

Passenger ticket breakage would typically consist of the following elements:

- Non-refundable tickets (unused) that remain valid after the scheduled travel date because the customers complied with the airline's ticketing rules to preserve their rights to use or exchange the ticket. These rules typically allow a customer to exchange the value of the ticket towards the value of a ticket on different flight provided they notify the carrier in advance of the original departure. A portion of these tickets will likely never be used prior to legal expiration (breakage).

- Refundable tickets (including partially used) which can be refunded or exchanged within one year or until the ultimate expiration date. A portion of these tickets will likely never be submitted for refund or exchange/reissue prior to legal expiration (breakage).

Any impact of ancillary fees that are not distinct from the flight obligation would need to be combined with the flight obligation on actual ticket breakage. For example; baggage, seat assignment fees and priority boarding fees.

<u>Travel Vouchers</u>

This section is limited to travel vouchers issued as an accommodation for the passenger's inconvenience when a passenger is voluntarily or involuntarily denied boarding and placed on another flight. It does address vouchers issued and deemed to be contra-revenue, but It does not address vouchers issued under legislation that an airline deems to meet the criteria of a warranty under IFRS 15. That is addressed in a separate paper on that issue.

Issuance of a travel voucher for free or discounted travel as compensation to a passenger would generally be considered as a contract modification under guidance in IFRS 15 and would create an additional performance obligation if the voucher is determined to be a material benefit to the passenger. Consistent with IFRS 15.74, the allocation of the consideration between these two performance obligations (the voucher and the original flight obligation) is based on the relative standalone selling price of each performance obligation. This would lead to a reduction in passenger revenue recognized on the original flight as a portion of this would be allocated against the later flight (as a result of the travel voucher). The estimated standalone selling price of the voucher, determined under IFRS 15.79, would generally be based on its face or estimated value, less a consideration of breakage. The amount recorded at issuance would need to be adjusted so that it reflects the value of only those vouchers that are expected to be redeemed. Revenue is recognized when the flight booked with the voucher is flown.

For compensation issued for other reasons, if the scope or price of travel is changed, and a new performance obligation is created the compensation would be treated as described above.

IFRS 15.70 indicates that an entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue, unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity. IFRS 15 also provides for the treatment of legislated compensation to customers as a cost. That is addressed in a separate paper on that issue.

Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity's goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity's goods or services from the customer).

If the compensation is of the nature of a penalty, discount, rebate or refund on the original performance obligation; the value of the consideration provided should be treated as a reduction in revenue. For example, if the passenger's class of travel was downgraded and the passenger was given a partial refund.

Otherwise, it would be treated as a cost as there is no modification to the scope of service or the price. This would include meal vouchers or items in kind (valued at cost) provided due to inconvenience caused to passengers; such as for delays or faulty equipment. Payments made to reimburse customers for damage or loss (for example lost or damaged baggage) would be treated as costs as these amounts would not be a reduction of the transaction price, but rather a payment to reimburse the customer for their costs.

In practice, it is understood that vouchers recorded at face value and adjustments to value would be taken on a portfolio basis. It would likely be impractical to allocate value to the voucher and attribute breakage on a standalone basis, therefore as a practical expedient the voucher could be recorded at face value. This section is limited to travel vouchers issued as an accommodation for the passenger's inconvenience when a passenger is voluntarily or involuntarily denied boarding and placed on another flight.

<u>IAWG View:</u>

1. **Revenue should be recognized for passenger ticket breakage as follows:**

    a. **if the airline expects to be entitled to breakage because the passenger has not required the airline to perform and is unlikely to do so, the airline should recognize the expected breakage amount as revenue in proportion to the pattern of rights exercised by the passenger, using historical trend information; and**

    b. **If the airline does not expect to be entitled to a breakage amount, the airline should recognize the expected breakage amount as revenue only when the likelihood of the passengers exercising their remaining rights becomes remote, which would occur no later than the expiration date of the ticket.**

2. **Revenue should be recognized for compensation provided to a customer such as in the form of a voucher as follows:**

    If the scope or price of travel is changed, and a new performance obligation is created the revenue related the original travel obligation would be allocated to the travel obligation and voucher, with the value assigned to the voucher shown as deferred revenue until the flight received for the voucher is flown.

    In practice, the voucher's face value may be adjusted in full against the revenue on the original flight and recognized when the flight paid for with the voucher is flown. Breakage on the vouchers would be reflected on a portfolio basis.

    If the compensation is of the nature of a penalty, discount, rebate or refund on the original performance obligation; the value of the consideration provided should be treated as a reduction in revenue.

    Otherwise, it would be treated as a cost, as there is no modification to the scope of service or price on the flight performance obligation.

Revenue from Maintenance Services

Background:

Airlines and non-airlines provide aircraft maintenance as a service and provides these services under a number of types of contracts to include:

- Time and Material Contracts - agreements where the customer is charged for the service based on actual labor and material.
- Maintenance per Flight Hour/Cycle Contracts - services invoiced by a predetermined rate per flight hour.
- Fixed Priced Contracts – services are provided at a fixed price for the maintenance activity.

Issues:

1. Is maintenance revenue recognized over time or at a point in time?
2. How is progress measured if maintenance revenue is recognized over time?

Analysis of Issues:

When is maintenance revenue recognized?

IFRS 15.35 provides guidance that an entity satisfies a performance obligation and recognizes revenue over time, if one of the following criteria is met:

(a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;
(b) the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
(c) the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

The first criteria needs to be evaluated to determine if the performance obligation is consumed as provided. The second criteria are not met as the asset is not controlled during the maintenance process as it is effectively taken out of service. The first element of the third criteria is met as the maintenance service cannot be transferred to another entity as it becomes an integrated part of the customer's asset. The issue then will be whether the entity has an enforceable right to payment for performance completed to date and whether this would be subject to commercial dispute with the customer.

IFRS 15.37 requires an entity to consider the terms of the contract, as well as any laws that apply to the contract, when evaluating whether it has an enforceable right to payment for performance completed to date. The right to payment for performance completed to date does not need to be for a fixed amount. However, at all times throughout the duration of the contract, the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated. Paragraphs IFRS15.B9–B13 provide guidance for assessing the existence and enforceability of a right to payment and whether an entity's right to payment would entitle the entity to be paid for its performance completed to date.

If the entity determines that one or more of the criteria is met, then the revenue for the relevant performance obligation is recognized over time if it is reliably measured. If not, it should be recognized using the guidance for point in time recognition.

How is progress measured if revenue is recognized over time?

Methods that can be used to measure an entity's progress towards complete satisfaction of a performance obligation satisfied over time include output methods and input methods.

Output methods

Output methods recognize revenue based on direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract. Output methods include methods such as surveys of performance completed to date, appraisals of results achieved, milestones reached, and time elapsed, and units produced or units delivered. When an entity evaluates whether to apply an output method to measure its progress, the entity shall consider whether the output selected would faithfully depict the entity's performance towards complete satisfaction of the performance obligation.

As a practical expedient, if an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date (for example, a service contract in which an entity bills a fixed amount for each hour of service provided), the entity may recognize revenue in the amount to which the entity has a right to invoice.

Input methods

Input methods recognize revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (for example, resources consumed, labor hours expended, costs incurred, or machine hours used) relative to the total expected inputs to the satisfaction of that performance obligation. If the entity's efforts or inputs are expended evenly throughout the performance period, it may be appropriate for the entity to recognize revenue on a straight- line basis.
The use of flight hours as an input method is unlikely to reflect the progress made in delivering the maintenance services.

IAWG Views:

1. **Revenue is recognized over time if the seller has a legal right to payment for the work performed to date and it can be reliably measured. If not, the revenue would be recognized at a point in time when control transfers to the customer.**

2. **Measurement is preferably based on a valid input measure, which would generally be cost incurred. The method used should best reflect the transfer of the asset to the customer. While billing is frequently done based on flight hours that measure does not align to the performance of the maintenance service.**

Do Tier Status benefits constitute a separate performance obligation?

Background:

At many airlines, loyalty status designations ("Tier Status") can be earned by loyalty members who achieve a certain number of miles, trips flown, or dollars spent in a given year. Status points have no redemption value. They are simply a tracking mechanism to measure progress towards the achievement of certain levels of status and are then eligible for Tier Status benefits ("Status Benefits").

Issue:

Do Status Benefits constitute a separate performance obligation?

Analysis of Issue:

Are Status Benefits distinct?

In determining whether Status Benefits are a separate performance obligation, an airline should look to determine whether the Status Benefits are distinct using the criteria in IFRS 15 that follows:

IFRS 15.22 defines a performance obligation as each promise to transfer to the customer either a good or service (or a bundle of goods or services) that is distinct; or a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

IFRS 15.27 requires the following criteria be met for a good or service to be distinct:

(a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer; AND
(b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

Status benefits are well defined independent of the passenger ticket and therefore IFRS 15.27(b) should be met in all instances leaving the issue to be determined as whether the customer can benefit from the good or service on its own.

Status Benefits that the customer can benefit from on their own

Status Benefits that the customer can benefit from on their own (for example: mileage credits, duty free vouchers or free tickets) would be treated as a separate performance obligation if they are material. This is because the customer can benefit from the Status Benefit independent of a passenger flight or other performance obligation that would confer status.

The airline would need to develop a method to allocate the value of the benefit to associated transactions as Tier Status is generally not earned through a single flight. This could be done on a portfolio basis using a model based on historical patterns.

Status Benefits that the customer cannot benefit from on their own

Those Status Benefits that the customer cannot benefit from on their own would not be considered distinct and therefore would be combined with the performance obligation with which they would be consumed by the customer. That would very likely be a flight.
Some examples of Status Benefits that would most likely not be distinct include: lounge access; priority boarding; additional baggage allowance; preferred seats; upgrades; waivers on ticketing fees; express security clearance; guaranteed reservations; and priority standby.

AICPA Guidance

Note that the guidance issued by the AICPA in relation to this issue contains the same conclusion, but it is based on a different analysis. Briefly, that guidance holds a view that an airline would view Status Benefits as a separate performance obligation if Status Benefits are made available only to customers who have achieved Tier Status through appropriate past qualifying revenue transactions with the airline. 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. An airline would view the Status Benefits conveyed by Tier Status as a marketing incentive if those Status Benefits are conveyed by other means and not exclusively related to the level of prior revenue transactions with the airline.

The IAWG supports this view in addition to the one contained in this guidance.

IAWG View:

Status Benefits that provide the customer with additional goods or services that are distinct do constitute a separate performance obligation.

Status Benefits that do not provide the customer with additional goods or services that are distinct do not constitute a separate performance obligation.