STAFF PAPER

22 March 2016

IFRS Interpretations Committee Meeting

IFRS IC Nov 2014, Jan & Sep 2015, Jan 2016

Project	**IAS 32 *Financial Instruments: Presentation***
Paper topic	Classification of the liability for a prepaid card in the issuer's financial statements

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Introduction

1. In November 2012 the IFRS Interpretations Committee (the 'Interpretations Committee') received a request to clarify how a bank ('issuer') classifies the liability that arises when it issues prepaid cards, and how it should account for any unspent balance on the prepaid cards.[1] The prepaid cards in question have the following features:
   - (a) no expiry date;
   - (b) cannot be refunded, redeemed or exchanged for cash;
   - (c) are redeemable only for goods or services;
   - (d) are redeemable only at selected merchants and, depending upon the card programme, this ranges from a single merchant to all merchants that accept a specific card network. When the cardholder redeems the card at a merchant(s) for goods or services, the issuer delivers cash to the merchant(s); and

[1] 'Bank' in the original submission meant any financial institution. However, in this paper, we have used 'issuer' to mean any entity that issues a prepaid card with the features described in paragraph 1 of the paper. In addition, any reference to prepaid card(s) should be read as prepaid card(s) with the features described in paragraph 1 of this paper, unless otherwise specified.

(e) there are no inactive balance charges, which means that any balance on the prepaid card does not reduce unless it is spent by the cardholder.

The same submission was sent to the Emerging Issues Task Force (EITF) of the US Financial Accounting Standards Board (FASB).

2. The objective of this paper is to:

(a) provide a summary of past discussions and an analysis of the issues raised at the January 2016 Interpretations Committee meeting; and

(b) obtain a recommendation from the Interpretations Committee on the submission received.

3. The paper is structured as follows:

(a) summary of past discussions:

(i) What issue was raised?

(ii) What did the Interpretations Committee decide?

(iii) What was the informal feedback from IASB members?

(iv) What did the FASB decide?

(b) issues raised at the January 2016 Interpretations Committee meeting.

(c) staff analysis:

(i) whether the prepaid card arrangement is within the scope of IFRS 9 *Financial Instruments* (IAS 39 *Financial Instruments: Recognition and Measurement*).

(ii) the scope of the issue and the interaction between IFRS 15 *Revenue from Contracts with Customers* and IFRS 9 (IAS 39).

(iii) whether IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* is applicable to the issue.

(d) staff recommendation.

(e) questions for the Interpretations Committee.

4. This paper has the following appendices:

   (a) Appendix A—Proposed wording for final agenda decision.

   (b) Appendix B—Update on the FASB's discussions.

Summary of past discussions

What issue was raised?

5. The question raised is about the classification of the liability recognised by the issuer on issuance of the prepaid card—should the issuer classify it as a financial liability or a non-financial liability?

6. The classification of the liability is important because recognition of a cardholder's right that ultimately may not be exercised ('breakage') for non-financial liabilities differs from the recognition of breakage for financial liabilities:

   (a) in respect of a non-financial liability, applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, an entity generally considers expected breakage when measuring the liability, ie when determining the best estimate of the outflow of resources required to settle the obligation. Alternatively, an entity might recognise breakage in profit or loss by derecognising the non-financial liability if it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

   (b) in respect of a financial liability, IFRS 9 (IAS 39) requires an entity to derecognise a financial liability only when it is extinguished–ie when the obligation is discharged, cancelled or expires. Furthermore, IFRS 13 *Fair Value Measurement* specifies that the fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. Consequently, in accounting for a financial liability, an entity is unable to reflect expected breakage.

What did the Interpretations Committee decide?

7. Discussion of this issue was put on hold until the joint Revenue Recognition project was completed, because there were concerns that any decision on the issue could conflict with the requirements ultimately issued in that joint project.

8. After completion of the joint project, in November 2014, the Interpretations Committee discussed the submission. The staff presented its view that the prepaid card arrangement is a financial instrument. The rationale presented was that:

   (a) the prepaid card gives rise to a financial asset of the cardholder, because it is similar to a deposit of cash with the issuer; and

   (b) the cardholder has a contractual right to use the card to settle a financial liability arising from the purchase of goods or services from a merchant(s).

9. At that meeting, the Interpretations Committee observed that:

   (a) the liability for the prepaid card meets the definition of a financial liability, because the issuer has a contractual obligation to deliver cash to the merchant(s), which is conditional upon the cardholder using the prepaid card to purchase goods or services from that merchant(s); and

   (b) the issuer would apply the requirements in IFRS 9 (IAS 39) to determine when to derecognise the liability for the prepaid card.

10. However, the Interpretations Committee was concerned about the consequences of this view on other similar arrangements, and asked the staff to do the following:

   (a) analyse other similar arrangements, such as customer loyalty programmes, to identify a basis on which to distinguish between those arrangements and the prepaid card; and

   (b) follow the discussions of the EITF on this issue.

11. At its January 2015 meeting, the Interpretations Committee was presented with an analysis of other similar arrangements, such as customer loyalty programmes and prepaid cards issued by a non-banking entity that can be redeemed for goods or services of the issuer or a third party. The Interpretations Committee asked the staff

to analyse other more complex arrangements to further consider the basis for distinguishing between the prepaid cards in question and other arrangements.

12. At its September 2015 meeting, the Interpretations Committee discussed an analysis of whether the prepaid card arrangement is a financial instrument by comparing the following two views:

    (a) a non-financial liability view (*the prepaid card arrangement is not a financial instrument because neither the cardholder nor the merchant has a financial asset*); and

    (b) a financial liability view (*the prepaid card arrangement is a financial instrument and the issuer's liability meets the definition of a financial liability*).

13. In addition, the Interpretations Committee discussed other more complex arrangements in which the cardholder (or customer) can redeem prepaid cards (or loyalty points) from either the issuer or a third-party merchant.

14. At that meeting, the Interpretations Committee concluded that, in the light of the existing requirements in IAS 32 *Financial Instruments: Presentation* and IFRS 9 (IAS 39), neither an Interpretation nor an amendment to a Standard was necessary. Consequently, the Interpretations Committee decided not to add the issue to its agenda after reaching the following conclusions:

    (a) the issuer's liability for the prepaid card meets the definition of a financial liability. This is because:

        (i) the issuer has a contractual obligation to deliver cash to the merchants on behalf of the cardholder, which is conditional upon the cardholder using the prepaid card to purchase goods or services; and

        (ii) the issuer does not have an unconditional right to avoid delivering cash to settle this contractual obligation.

    (b) the issuer would apply the requirements in IFRS 9 (IAS 39) to determine whether and when to derecognise the financial liability for a prepaid card.

(c) the scope of this issue should be limited to the fact pattern of the original submission, ie similar arrangements such as customer loyalty programmes are outside the scope of this issue.

(d) to enhance the usefulness of the agenda decision, the agenda decision should reflect the following:

(i) the issuer of the prepaid card should not be limited to a bank, because it is common for non-banking entities to issue the type of prepaid card described in the submission; and

(ii) the scope of the agenda decision should also include prepaid cards that are redeemable with the issuer itself, as well as third-party merchants.

What was the informal feedback from IASB members?

15. We consulted some IASB members at meetings in July 2015 to obtain their individual views on the issue. We did not ask the IASB members to make any decisions at those meetings.

16. In summary, the informal comments received were as follows:

(a) IASB members observed that the issuer's obligation in respect of the prepaid card is a financial liability, because the issuer does not have an unconditional right to avoid delivering cash to settle its contractual obligation.

(b) those IASB members acknowledged the consequence of this classification as a financial liability, ie the application of the derecognition requirements in IFRS 9 (IAS 39) might result in the financial liability for any unused balance on the prepaid card remaining in the issuer's financial statements in perpetuity, even if the cardholder is not expected to use the prepaid card.

***What did the FASB decide?* (see more details in Appendix B)**

(see more details in Appendix B)

17. At its December 2015 meeting, the FASB ratified the consensus reached at the November 2015 EITF meeting. The main aspects of the consensus are as follows:

(a) the scope of the issue should include all prepaid stored-value products (eg prepaid gift cards, prepaid telecommunication cards, and traveller's cheques) in both physical and digital forms that are issued for the purpose of being readily accepted as payment for goods or services. The scope of the issue excludes customer loyalty programmes.

(b) an issuer's liability for a prepaid stored-value product is a financial liability. This is because the issuer's liability ultimately will be settled in cash, payable to either the customer or a third party.

(c) nonetheless, the EITF agreed to provide a narrow-scope exception to the derecognition requirements for financial liabilities to allow the issuer to reflect breakage in the accounting for liabilities resulting from the sale of prepaid stored-value products. This is on the basis that (i) the economics of those transactions are similar to prepaid stored-value card transactions within the new revenue recognition requirements (and the accounting for the latter reflects breakage)[2], and (ii) this guidance is similar to the way in which many issuers with prepaid stored-value card liabilities recognise breakage when applying existing US GAAP (because of a 2005 speech of the SEC staff [3]).

18. The FASB expects to issue a final Accounting Standards Update in Q1 2016.

Issues raised at the January 2016 Interpretations Committee meeting

19. At its January 2016 meeting, the Interpretations Committee was presented with an analysis of the comments received on the tentative agenda decision. Respondents generally supported the Interpretations Committee's decision not to add the issue to its agenda, and also agreed with its conclusion that the issuer's obligation is a financial liability within the scope of IFRS 9 (IAS 39).

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[2] FASB ASC Topic 606, *Revenue from Contracts with Customers*.

[3] Refer to Remarks Before the 2005 AICPA National Conference on Current SEC and PCAOB Developments from 5 December 2005 SEC Speech.

20. Two respondents commented on the scope of the issue as follows:

(a) **(ASBJ)** the scope of the issue should be narrowed to prepaid cards that (i) are not redeemable with the issuer, (ii) are not issued as part of a customer loyalty programme (regardless of whether it is provided in the context of sales transactions), and (iii) do not contain a customer loyalty programme embedded within them.

(b) **(Deloitte)** the agenda decision should clarify that a customer loyalty programme is excluded from the scope of the issue, regardless of whether the issuer applies IFRS 15 or IAS 18 *Revenue* and IFRIC Interpretation 13 *Customer Loyalty Programmes*.

21. One respondent (PwC) disagreed with the Interpretations Committee's conclusions. In their view, the issuer should apply the requirement in IAS 8 to develop an accounting policy for the prepaid card that best reflects the economic substance of the arrangement. They agree that the prepaid card meets the definition of a financial liability but assert that the prepaid card arrangement is outside the scope of IFRS 9 (IAS 39) on the basis that the cardholder does not have a financial asset, and thus that the prepaid card transaction does not meet the definition of a financial instrument in IAS 32. They also expressed concern that the Interpretations Committee's conclusions could be applied more widely to arrangements that had not been considered.

22. At that meeting, on the basis of the feedback received, we proposed a revised agenda decision to emphasise that other similar arrangements are outside the scope of the issue, as follows:

(a) we suggested adding to the fact pattern the feature that the prepaid card does not contain a customer loyalty programme embedded within it, and the observation that if a prepaid card includes an embedded customer loyalty programme, the customer loyalty programme would be analysed separately from the prepaid card.

(b) we suggested clarifying that a card issued as part of a customer loyalty programme is outside the scope of this issue, regardless of whether the issuer applies IFRS 15 or IAS 18 and IFRIC Interpretation 13.

23. A number of Interpretations Committee members expressed concerns that those revisions could raise more questions. They made the following suggestions:

    (a) to narrow the scope of the issue to the fact pattern in the original submission, ie one in which the cardholder could not redeem the prepaid card with the issuer; and

    (b) to delete the revised clarifications and observations that had been added to the tentative agenda decision, as described in paragraph 22 above.

24. In addition, some Interpretations Committee members observed that it might be useful to:

    (a) review the analysis of how to apply the requirements in IFRS 9 (IAS 39) to this transaction and consider the relevance of IAS 8; and

    (b) consider the interaction between IFRS 15 and IFRS 9 (IAS 39) in order to confirm which Standard applies to the fact pattern.

25. We address those issues in the following paragraphs.

Staff analysis

Whether the prepaid card is within the scope of IFRS 9 (IAS 39)—whether the prepaid card arrangement is a financial instrument

26. The definition of a financial instrument in paragraph 11 of IAS 32 states that:

> a financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

27. There is little disagreement that, on issuance of the prepaid card, the issuer has a financial liability for the reasons set out in paragraph 14(a) of this paper. However, some question whether the arrangement is a financial instrument on the grounds that, in their view, there is no counterparty that has a financial asset until the cardholder redeems the prepaid card for goods or services:

    (a) the prepaid card cannot be redeemed in exchange for cash.

(b) the merchant(s) does not have a financial asset until it has provided goods or services to the cardholder; only on providing goods or services to the cardholder will it have the right to receive cash from the issuer.

28. Consequently, proponents of this view assert that the issuer's liability for the prepaid card does not arise from a financial instrument and, therefore, they think that the financial instrument requirements need not be applied.

29. Some think that the issuer could, instead, develop an accounting policy by applying the requirements of IAS 8, on the basis that there are no specific requirements in IFRS Standards for this transaction. In developing such an accounting policy that results in information that is relevant to the economic decision-making needs of users of financial statements (as required by paragraph 10 of IAS 8), the issuer might, for example, recognise a non-financial liability on issuance of the prepaid card and reflect the expected breakage in the measurement of that liability.

30. However, we do not agree with this view. We think that the issuance of the prepaid card gives rise to a financial instrument and the issuer's liability meets the definition of a financial liability within the scope of IFRS 9 (IAS 39), for the following reasons:

(a) the issuer has a contractual obligation to pay cash to a merchant(s) on behalf of the cardholder at the discretion of the cardholder, and the issuer does not have an unconditional right to avoid delivering cash to settle this contractual obligation.

(b) if an entity has a contractual obligation to pay cash, this necessarily means that another party must have a contractual right to receive that cash. Both the cardholder and the merchant(s) have contractual rights as follows:

    (a) the cardholder has the contractual right to direct the issuer to pay cash to the merchant(s) as payment for goods or services; and

    (b) the merchant(s) has a right to receive cash from the issuer after providing goods or services to the cardholder.

(c) to meet the definition of a financial instrument, IAS 32 does not require the issuer of a financial liability to identify the specific counterparty that has a financial asset at the time that its obligation arises, nor does it require a counterparty to have recognised a corresponding financial asset. For reference, paragraph AG8 of IAS 32 notes that a contingent right and obligation meet the definition of a financial asset or financial liability, even though such assets and liabilities are not always recognised in the financial statements.

31. We are also concerned about the potential consequences of concluding that the prepaid card meets the definition of a financial liability but is not accounted for as such because the arrangement is not a financial instrument:

   (a) we are not aware of any transactions or arrangements for which an entity has a financial liability, and yet concludes that the financial liability does not arise from a financial instrument (and thus is outside the scope of IFRS 9 (IAS 39)) because the entity could not specifically identify the holder of the corresponding financial asset (for example, if a future event must occur before the specific counterparty is identified and the cash is delivered).

   (b) applying the requirements in this way would potentially encourage entities to avoid financial instruments accounting by asserting that they are unable to identify a specific counterparty for transactions. The risk is that fewer financial liabilities and financial assets would be accounted for applying the financial instruments Standards.

   (c) the FASB ratified the EITF's conclusion that the prepaid card arrangement is within the scope of the financial instruments guidance in US GAAP. If the Interpretations Committee were to conclude that the prepaid card arrangement is not a financial instrument, this could create (or imply) a previously unidentified difference between the respective definitions of a financial instrument in IFRS and US GAAP or the respective scopes of the financial instruments Standards.

32. These concerns about potential wider consequences for financial instruments accounting were also raised by a Board member at the February 2016 Board meeting during the session providing the Board with an update of the January 2016 Interpretations Committee meeting.

The scope of the issue, and the interaction between IFRS 15 and IFRS 9

The scope of the issue

33. During previous discussions, Interpretations Committee members raised concerns about whether its conclusions with respect to the prepaid card arrangement might be inappropriately applied more broadly to other arrangements that the Interpretations Committee did not consider. In particular, some members were concerned about the effect on the accounting for customer loyalty programmes. Interpretations Committee members and respondents to the tentative agenda decision agreed that the agenda decision should explicitly exclude customer loyalty programmes from its scope. We agree with this suggestion. This has been carried forward in the proposed wording of the agenda decision set out in Appendix A to this paper. However, the wording of the tentative agenda decision has been changed in this respect to more directly state that customer loyalty programmes are excluded from the scope of the issue.

34. In addition, at the January 2016 meeting several Interpretations Committee members suggested narrowing the scope of the issue to the fact pattern in the original submission, ie prepaid cards that can be redeemed only with third party merchants and not with the issuer. We agree with this suggestion given the concerns about the scope raised at previous meetings. The fact pattern described in the agenda decision set out in Appendix A to this paper reflects this feature of the original submission.

The interaction between IFRS 15 and IFRS 9

35. The core principle of IFRS 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

36. IFRS 15 is applied to contracts with customers. However, the scope of IFRS 15 excludes financial instruments within the scope of IFRS 9 (IAS 39) (paragraph 5(c) of IFRS 15). Accordingly, if the liability for the prepaid card is within the scope of IFRS 9 (IAS 39), it is not within the scope of IFRS 15.

37. For the reasons noted in paragraphs 30-32 of this paper, we think that the prepaid card arrangement is within the scope of IFRS 9 (IAS 39), and therefore, it is not within the scope of IFRS 15.

Whether IAS 8 is applicable

38. In the absence of an IFRS Standard that specifically applies to a transaction, paragraphs 10-12 of IAS 8 provide requirements stating that management must use its judgement in developing and applying an accounting policy that results in information that is relevant to the economic decision-making needs of users of financial statements, and is reliable.

39. We disagree with the basis described in paragraph 29 of this paper that there are no specific requirements in IFRS Standards for the prepaid card arrangement. This is because we think that the requirements in IFRS 9 apply.

40. However, even ***if*** we were to accept the view that this arrangement is not within the scope of IFRS 9, we do not think that the issuer would apply the requirements in IAS 8. This is because, in that case, we think IAS 37 is likely to apply. Paragraphs 1 and 2 of IAS 37 state that:

> 1 This Standard shall be applied by all entities in accounting for provisions, contingent liabilities and contingent assets, except:
>
> …
>
> (c) those covered by another Standard.
>
> 2 This Standard does not apply to financial instruments (including guarantees) that are within the scope of IFRS 9 *Financial Instruments*.

41. We think that the liability for the prepaid card, if it were not within the scope of IFRS 9 (IAS 39), would meet the definition of a provision in paragraph 10 of IAS 37, which is defined as 'a liability of uncertain timing or amount'.

42. Consequently, in analysing which Standard applies to the prepaid card arrangement, we think that the steps to be followed are as follows:

    (a) if the arrangement is within the scope of IFRS 9, then it is not within the scope of any other Standard.

    (b) if the arrangement is not within the scope of IFRS 9 but is part of a contract with a customer, then it is within the scope of IFRS 15.

    (c) if the arrangement is not within the scope of IFRS 9, IFRS 15 or any other Standard, then the issuer would apply IAS 37 to its liability for the prepaid card.

43. In our view, an entity could not apply the requirements of IAS 8 to this arrangement.

Staff recommendation

44. In line with the previous conclusions of the Interpretations Committee as reflected in its tentative agenda decision published in September 2015 (as well as the majority of comments received on that tentative agenda decision), we think that an issuer's liability arising from the issuance of the prepaid card is within the scope of IAS 32 and IFRS 9 (IAS 39). The reasons are that:

    (a) the prepaid card arrangement is a financial instrument. The cardholder has a contractual right to direct the issuer to pay cash to a third-party merchant(s) as payment for goods or services, and the third-party merchant(s) has a right to receive cash from the issuer after providing goods or services to the cardholder. IAS 32 does not require the issuer to identify the specific counterparty that has a financial asset at the time that its obligations under the contract are created.

    (b) the issuer's liability meets the definition of a financial liability because when it issues a prepaid card the issuer has an obligation to pay cash to the third-party merchant(s) on behalf of the cardholder, and it does not have an unconditional right to avoid delivering cash to settle this contractual obligation.

45. Accordingly, the issuer applies the requirements in IFRS 9 (IAS 39) to its financial liability.

46. In line with the suggestions of several Interpretations Committee members at the January 2016 meeting, we recommend narrowing the scope of the issue to the original submission, ie prepaid cards that are not redeemable with the issuer. We also recommend continuing to exclude customer loyalty programmes from the scope of the issue.

47. On the basis of our analysis and our assessment of the Interpretations Committee's agenda criteria, we recommend that the Interpretations Committee reaffirm its view that it should not add this issue to its agenda.[4]

48. If the Interpretations Committee agrees with the staff's views in this paper, we also recommend finalising the agenda decision on the grounds that the Interpretations Committee has considered the comments received on the tentative agenda decision and revised the wording of the agenda decision accordingly.

49. Appendix A to this paper sets out proposed wording for the final agenda decision.

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff recommendation to finalise the agenda decision?
2. Does the Interpretations Committee have any comments on the proposed wording of the final agenda decision set out in Appendix A to this paper?

[4] Refer to Agenda Paper 13 of the Interpretations Committee's November 2014 meeting.

Appendix A—Proposed wording for final agenda decision

A1. We propose the following revised wording for the final agenda decision, which is marked from the tentative agenda decision issued after the September 2015 Interpretations Committee meeting. New text is underlined and deleted text is struck through.

IAS 32 *Financial Instruments: Presentation*—classification of the liability for a prepaid card in the issuer's financial statements

The Interpretations Committee ~~discussed~~ received a request to clarify how an entity would classify the liability that arises when it issues a prepaid card, and how the entity would account for ~~the~~ any unspent balance ~~of~~ on such a card. Specifically, the Interpretations Committee discussed a prepaid card with the following features:

(a) no expiry date~~.~~ and no back-end fees, which means that any balance on the prepaid card does not reduce unless it is spent by the cardholder;

(b) ~~cannot be refunded, redeemed or exchanged~~ non-refundable, non-redeemable and non-exchangeable for cash~~.~~;

(c) redeemable only for goods or services; and

(d) redeemable only at ~~selected~~ specified third-party merchants ~~(which may include the entity, however, is not redeemable only with the entity), and~~ that, depending upon the card programme, range~~s~~ from a single merchant to all merchants that accept a specific card network. Upon redemption by the cardholder at a merchant(s) ~~to purchase~~ for goods or services, the entity ~~has a contractual obligation to pay~~ delivers cash to the merchant(s).

~~(e) no back-end fees, which means that the balance on the prepaid card does not reduce unless spent by the cardholder; and~~

~~(f) is not issued as part of a customer loyalty programme.~~

The Interpretations Committee was asked to consider whether the liability for the prepaid card is a non-financial liability~~, because~~ on the basis that the entity does not have an obligation to deliver cash to the cardholder.

The Interpretations Committee observed that the entity's liability ~~of the entity~~ for the prepaid card meets the definition of a financial liability~~,~~. This is because the entity:

(a) has a contractual obligation to deliver cash to the merchants on behalf of the cardholder, which is conditional upon the cardholder using the prepaid card to purchase goods or services~~,~~; and

(b) ~~the entity~~ does not have an unconditional right to avoid delivering cash to settle this contractual obligation. ~~The Interpretations Committee decided that even if redemption with the entity is one possibility, the entity's obligation is still a financial liability because the entity does not have an unconditional right to avoid delivering cash when the cardholder redeems the prepaid card at a third party merchant(s).~~

Consequently, an entity that issues such a card ~~would apply~~ applies the ~~guidance~~ requirements in IFRS 9 *Financial Instruments* (IAS 39 *Financial Instruments: Recognition and Measurement*) to ~~determine whether and when to derecognise~~ account for the financial liability for ~~a~~ the prepaid card.

The Interpretations Committee noted that customer loyalty programmes were outside the scope of its discussion on this issue.

~~The Interpretations Committee therefore concluded that i~~ In the light of the existing ~~guidance~~ requirements in IAS 32 *Financial Instruments: Presentation* and IFRS 9 (IAS 39), the Interpretations Committee determined that neither an Interpretation nor an amendment to a Standard was necessary. Consequently, the Interpretations Committee ~~[~~decided~~]~~ not to add this issue to its agenda.

Appendix B—Update on the FASB's discussions

1. At its November 2014 meeting, the FASB discussed the submission and added the prepaid card issue to the EITF agenda.
2. At its March 2015 meeting, the EITF reached a consensus that:
   (a) the scope of this issue should include only liabilities resulting from the sale of prepaid stored-value cards with the features that they (i) do not have an expiration date; (ii) are not subject to unclaimed property laws; (iii) are redeemable for cash or for goods and services (or both) only at third-party merchants; and (iv) are not attached to a segregated bank account such as a customer depository account.
   (b) the issuer's liability for a prepaid stored-value card is a financial liability within the scope of Subtopic 405-20 *Liabilities─Extinguishments of Liabilities*. This is because the liability will ultimately be settled in cash that is paid to either the customer or a third party.
   (c) however, it is appropriate to propose a narrow-scope amendment to US GAAP so that, in limited circumstances, breakage would be recognised in respect of the issuer's financial liabilities. This is on the basis that:
      (i) the economics of those transactions are similar to prepaid stored-value card transactions within the scope of Topic 606 *Revenue from Contracts with Customers*; and
      (ii) this guidance is similar to the way in which many issuers with prepaid stored-value card liabilities recognise breakage today.
3. In April 2015, the FASB issued the Proposed Accounting Standards Update (ED), (Subtopic 405-20) *Recognition of Breakage for Certain Prepaid Stored-Value Cards*. The comment period on this ED ended on 29 June 2015, and 13 comment letters were received.
4. At its September 2015 meeting, the EITF considered the feedback received on the ED. The EITF reached a tentative conclusion to remove the characteristics of the proposed scopes and instead develop a principle to determine the scope of this issue.
5. At its November 2015 meeting, the EITF reached a final consensus that:

(a) the scope of this issue should include all prepaid stored-value products (eg, prepaid gift cards, prepaid telecommunication cards, and traveller's cheques) in both physical and digital forms that are issued for the purpose of being readily accepted as payment for goods or services. However, prepaid stored-value products exclude products that can be redeemed only by the holder for cash (eg, nonrecourse debt, bearer bonds or trade payables).

(b) an issuer's liability for a prepaid stored-value product is a financial liability within the scope of Subtopic 405-20.

(c) however, it is appropriate to provide a narrow-scope exception to the derecognition guidance in Subtopic 405-20 to require breakage to be accounted for in a manner consistent with Topic 606 for liabilities resulting from the sale of prepaid stored-value products.

(d) if an issuer has an in-scope financial liability, the issuer would apply the breakage and subsequent measurement guidance in a manner consistent with Topic 606; ie if the issuer expects to be entitled to a breakage amount (an amount that will not be redeemed) of the financial liability, the issuer would recognise the effects of the expected breakage 'in proportion to the pattern of the breakage' by the holder to the extent that a significant revenue reversal of the breakage will not occur. Otherwise, the issuer would recognise the expected breakage of the financial liability when the likelihood that the holder will exercise its remaining rights becomes remote.

(e) the scope of this issue excludes (i) any unused amounts required to be remitted under unclaimed property laws, (ii) any amount attached to a segregated bank account (ie a customer deposit account), (iii) customer loyalty programmes, and (iv) transactions within the scope of Topic 606. Entities should not apply the final consensus to account for other liabilities settled in cash with a counterparty.

6. At its December 2015 meeting, the FASB ratified the consensuses reached at the November 2015 EITF meeting.

7. The FASB expects to issue a final Accounting Standards Update in Q1 2016.