STAFF PAPER

14 July 2015

IFRS Interpretations Committee Meeting

[November 2014, January 2015]

Project	IAS 32 Financial Instruments: Presentation		
Paper topic	Classification of liability for prepaid cards issued by a Bank in the Bank's financial statements		
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Introduction

1. The purpose of this paper is to brief the IFRS Interpretations Committee (the Interpretations Committee) on the status of our work addressing the question of the classification of the liability for prepaid cards issued by a bank[1] in the bank's financial statements and the subsequent accounting for the unspent balance.

Background

2. The Interpretations Committee received a submission which described a circumstance in which an entity (the 'issuer') issued a 'prepaid' card to a customer (the 'customer') in exchange for cash. The value of the cash paid by the customer to the issuer is 'stored' on the card on issue of the card.

3. The balance stored on the card can be used by the customer to pay for the purchase of goods or services (up to the value of the balance stored on the card) from a retailer (the 'retailer') that accepts prepaid cards from that particular issuer. The balance stored on the card is reduced by the value of the good or services paid for using the card. The issuer pays cash to the retailer for the value of the goods or

[1]Although the submission referred to prepaid cards issued by a bank, this issue would be just as applicable for any entity issuing a card with the same fact pattern.

services paid for using the card on receipt of the claim from the retailer following the use of the card to pay for goods or services. This obligation for the issuer to pay cash to the retailer is therefore a 'demand' obligation.

4. A particular feature of the prepaid card is that the balance stored on the card does not expire[2]; it reduces only if and when it is used by the customer to pay for the purchase of goods or services from a retailer. The balance will therefore remain legally/contractually outstanding indefinitely from the perspective of the issuer if the card is lost or destroyed, or if the customer does not spend the full amount of the balance stored on the card. The customer cannot receive a cash refund of the balance stored on the card. The balance stored on a prepaid card that is never spent is known as 'breakage'.

5. The same submission was also sent to the Emerging Issues Task Force (the EITF) of the US standard-setter, the Financial Accounting Standards Board (the FASB).

The issue

6. The issue raised by the submitter is whether the liability recognised by the issuer when the card is issued should be classified as a financial liability or a non-financial liability. This is important because the initial measurement and the derecognition requirements for financial liabilities differ from those for non-financial liabilities.

7. The guidance on accounting for non-financial liabilities set out in IAS 37 *Provisions, Contingent liabilities and Contingent Assets* requires that an entity's expectations of the probability of future cash outflows are reflected in the measurement of a non-financial liability. Consequently the issuer's expectations of breakage would be reflected in the issuer's measurement of the liability for a prepaid card.

8. The guidance on accounting for financial liabilities set out in IAS 39 *Financial Instruments: Recognition and Measurement*, or IFRS 9 *Financial Instruments*, both require that a financial liability is measured initially at fair value, and that

[2] The indefinite life of the balance on the card is a legal requirement in some jurisdictions.

subsequently it is derecognised only when legally/contractually released from the obligation. The initial measurement of a financial liability at fair value is addressed by IFRS 13 *Fair Value Measurement*. Paragraph 47 of IFRS 13 specifies that 'the fair value of a financial liability with a demand feature…is not less than the amount payable on demand…'. Consequently expected breakage would not be reflected in the initial measurement of the fair value of the financial liability, and the financial liability would be recognised indefinitely for any breakage.

Previous discussions

9. The Interpretations Committee discussed the issue in November 2014 and January 2015. The Interpretations Committee published the following tentative observations in the November 2014 IFRIC *Update* (emphasis added):

> The Interpretations Committee received a request to clarify the classification of the liability for prepaid cards issued by a bank in the bank's financial statements and accounting for the unspent balance of the prepaid cards with the following features:
>
> (a) no expiry date;
>
> (b) cannot be refunded, redeemed or exchanged for cash;
>
> (c) redeemable for goods or services only at selected merchants and, depending upon the card programme, ranges from a single merchant to all merchants that accept a specific card network; and
>
> (d) no inactive balance charges, which means that the balance on the prepaid card does not reduce unless spent by the holder.
>
> The Interpretations Committee was asked to consider whether the liability for those prepaid cards is a non-financial liability, because the issuing bank does not have an obligation to deliver cash to the cardholder.

> **The Interpretations Committee observed that the liability for prepaid cards with features as explained above would meet the definition of a financial liability because the issuing bank has a contractual obligation to deliver cash to the merchant that is conditional upon the cardholder using the prepaid card to purchase goods or services**. In such a circumstance an issuing bank would apply the guidance in IFRS 9 *Financial Instruments* (IAS 39 *Financial Instruments: Recognition and Measurement*) to determine when to derecognise the liability for prepaid cards.
>
> However, the Interpretations Committee was concerned about other similar arrangements, such as customer loyalty programmes or prepaid cards issued by a non-banking entity that can be redeemed for goods or services of the issuing entity or of other entities, and requested the staff to analyse those other similar arrangements. The Interpretations Committee requested the staff to specifically consider the basis for distinction between the prepaid cards with features as explained above and other similar arrangements. The Interpretations Committee also asked the staff to follow the discussions of the Emerging Issues Task Force of the Financial Accounting Standards Board of the US on this issue.

Current developments

Analysis of loyalty programmes and other prepaid card arrangements

10. The Interpretations Committee was concerned about the implications of its tentative observations for loyalty programmes and prepaid cards issued by a non-banking entity that can be redeemed for goods or services of the issuing entity or of other entities. We have been focusing our analysis on two example arrangements that we think will be relevant to the Interpretations Committee's

concerns; a shopping mall gift card scheme and an airline frequent flyer programme. We summarise the key features of these two arrangements below.

Shopping mall gift card scheme

11. The example shopping mall gift card scheme that we are analysing has the following features:

    (a) The shopping mall operator (the operator) sells gift cards that can be used to purchase goods or services from any retailer in the shopping mall.

    (b) The balance stored on the gift card is the amount of cash that a customer (the customer) pays to the operator when purchasing the card. The balance does not expire and is reduced only if and when the card is used to pay for goods or services.

    (c) When the customer uses the card to pay for goods or services purchased from a retailer (the retailer) in the shopping mall, the retailer is able to demand payment from the operator for the sales value of the goods or services paid for using the card.

    (d) The question is whether the operator's liability for the prepaid card when the card is sold is a financial liability or a non-financial liability.

Airline frequent flyer programme

12. The example airline frequent flyer programme that we are analysing has the following features:

    (a) When Airline A sells a flight to a customer (the customer), it also issues 'flight mile points' (the points) to the customer. The number of points issued depends on the distance of the flight that has been sold.

    (b) When the customer has accumulated sufficient points, it may use them to purchase a flight, subject to availability, from Airline A, or its partner airline, Airline B. The points never expire.

(c) When the flight purchased using points is provided by Airline B, Airline A must pay cash to Airline B. The amount of cash payable is based on a fixed value per point.

(d) The question is whether Airline A's liability for points issued, when the original flight is sold, is a financial liability or a non-financial liability.

13. We are analysing two variants of this example to consider whether the same or different conclusions are reached:

(a) <u>Variant 1</u>: The customer must purchase all flights using points from Airline A, even if the flight is to be provided by Airline B; and

(b) <u>Variant 2</u>: The customer purchases all flights, using points, from the airline that will provide the flight. In other words the customer will purchase a flight from Airline B directly, using the points. In this case, Airline A is involved only when Airline B demands payment for the points redeemed.

FASB and EITF developments

14. The EITF discussed the submission and reached a consensus-for-exposure that a prepaid stored-value card is a financial liability if the card

(a) does not have an expiration date,

(b) is not subject to unclaimed property laws,

(c) is redeemable for cash or for goods and services (or both) only at third-party merchants, and

(d) is not directly attached to a segregated bank account like a customer depository account.

15. The consensus-for-exposure proposes a narrow scope exception to the guidance in the FASB's Accounting Standards Codification (ASC)® Subtopic 405-20 on derecognition of financial liabilities.

16. The proposed exception will require that breakage be accounted for consistent with Topic 606 Revenue from Contracts with Customers for the sale of a prepaid

stored-value card that is a financial liability. If an entity expects to be entitled to a breakage amount for a liability resulting from the sale of a prepaid stored-value card within the scope exception, the entity would derecognise the amount related to the expected breakage in proportion to the pattern of rights expected to be exercised by the card holder only to the extent that it is probable that a significant reversal of the recognised breakage amount will not subsequently occur. If an entity does not expect to be entitled to a breakage amount, the entity would derecognise the amount related to the breakage when the likelihood of the customer exercising its remaining rights becomes remote. Entities also would disclose the methodology used for recognising breakage for prepaid stored-value cards.

17. The FASB ratified the consensus-for-exposure and issued a Proposed Accounting Standard Update (ASU) on 30 April 2015 with a comment period of 60 days. The EITF expects to discuss the feedback on the Proposed ASU in September 2015.

Timing

18. We expect to bring a paper that includes the analysis of the above fact patterns to the September Interpretations Committee meeting.

Question for Interpretations Committee

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Does the Interpretations Committee have any questions or comments in relation to this status report?