Defining Issues®

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EITF Continues Discussions on Prepaid Stored-Value Cards and Cash Flow Statement Issues

The FASB's Emerging Issues Task Force (EITF) discussed two issues at its September 17, 2015, meeting. While it reached agreement on various issues relating to recognizing breakage for certain prepaid stored-value cards, it did not make a final decision on scope. It also continued discussions on certain cash-flow statement issues.

Key Facts

The EITF redeliberated the following issue but did not reach a final consensus.

- Recognition of Breakage for Certain Prepaid Stored-Value Cards (Issue 15-B)

The EITF also discussed the following issue.

- Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments (Issue 15-F)

Key Impact

Breakage for Certain Prepaid Stored-Value Cards. The EITF reaffirmed its previous decision to provide a narrow scope exception to the financial liability derecognition guidance for prepaid stored-value cards that would require the recognition of breakage if certain conditions are met.[1] However, the EITF has not yet finalized the scope of this exception.

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[1] FASB ASC Subtopic 405-20, Liabilities – Extinguishments of Liabilities, available at www.fasb.org.

While the EITF has reached conclusions on the breakage recognition model, disclosures, transition methods, and effective dates, the EITF will continue to discuss the scope of this issue at its next meeting.

Recognition of Breakage for Certain Prepaid Stored-Value Cards (Issue 15-B)

Consumers may never redeem prepaid stored-value cards (prepaid cards) for goods and services at a third party such as a retailer or restaurant. However, the prepaid card issuer recognizes a financial liability on its balance sheet when the card is issued. The portion of the dollar value of a prepaid card that is ultimately not redeemed by consumers is referred to as breakage.

The EITF reaffirmed its previous decision to allow a narrow scope exception to the financial liability derecognition guidance that would require breakage to be recognized in the same manner as required by the new revenue recognition standard if an entity expects breakage to occur.[2]

A card issuer that expects to be entitled to a breakage amount would be required to recognize it in earnings in proportion to the pattern of rights exercised by the consumer. However, the breakage amount will only be recognized to the extent it is probable that a significant reversal will not subsequently occur. If the card issuer does not expect to be entitled to a breakage amount, it should recognize breakage when the likelihood becomes remote that the consumer will exercise its remaining rights.

At its September 17, 2015, meeting, the EITF also considered a number of potential modifications to broaden the scope of the proposed Accounting Standards Update (ASU), including whether the scope should be modified to include other financial liabilities with characteristics similar to prepaid cards such as travelers checks and money orders.[3] However, no decisions on scope were reached, and the EITF directed the FASB staff to further define the scope of this issue for additional deliberation at the next EITF meeting.

Transition. Two transition options would be allowed:

- A modified retrospective transition approach, with a cumulative catch-up adjustment to opening retained earnings in the period of adoption; or
- A full retrospective transition method (including the use of one or more of the practical expedients on transition specified in ASC Topic 606, *Revenue from Contracts with Customers*).[4]

The transition method selected by an entity for this amendment would not predetermine the entity's transition method for the adoption of the new revenue standard.[5] Early adoption would be permitted for all entities.

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[2] FASB ASC Topic 606, Revenue from Contracts with Customers, available at www.fasb.org.

[3] FASB Proposed Accounting Standards Update, Recognition of Breakage for Certain Prepaid Stored-Value Cards, April 30, 2015, available at www.fasb.org.

[4] FASB ASC paragraph 606-10-65-1(f), available at www.fasb.org.

[5] FASB ASC paragraph 606-10-65-1, available at www.fasb.org.

Effective Dates		
	Annual Periods	**Interim Periods**
Public Business Entities, and Certain Not-for-Profit Entities[6]	Beginning after December 15, 2017	Beginning after December 15, 2017
All Other Entities	Beginning after December 15, 2018	Beginning after December 15, 2019

Disclosures. Entities would be required to disclose the methodology used to calculate breakage and significant judgments made in applying the breakage methodology. Entities would need to disclose the nature of and reason for the change in accounting principle in the first interim and annual period of adoption.

Entities that elect the modified retrospective transition method must disclose the cumulative effect of the change on retained earnings or other components of net assets as of the beginning of the annual period in which the guidance is effective. Entities that elect the full retrospective transition method must describe the prior-period information that has been retrospectively adjusted.

Prepaid cards within the scope of this issue would be exempt from disclosure requirements in financial instruments guidance.[7]

Background and Observations. The FASB proposed an ASU on the recognition of breakage for certain prepaid cards in April 2015. Except for certain jurisdictions where prepaid cards are escheatable, the proposed ASU would have applied to open-loop or semi-closed loop prepaid cards that may be redeemed for goods and services from a third party or for cash. The proposed ASU also would have scoped out arrangements in which a card issuer directly (or through affiliates) provides goods or services to the consumer through closed-loop cards (i.e., cards that are only redeemable at a retail chain or its affiliates). Instead, these cards would have been covered by revenue recognition guidance.[8]

KPMG Observations

The Task Force was able to reach agreement on many aspects of this issue, however, its scope has not been finalized yet. Although the FASB staff has been asked to further refine the issue's scope for discussion at the next EITF meeting, the inclusion of products redeemable for cash may make scoping more difficult because of the variety of available products.

[6] Not-for-profit entities that have issued, or are conduit bond obligors for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market.

[7] FASB ASC Topic 825, Financial Instruments, available at www.fasb.org.

[8] FASB ASC paragraphs 606-10-55-46 to 55-49, available at www.fasb.org.

Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments (Issue 15-F)

The EITF discussed four statement of cash-flow classification issues with the objective of reducing diversity in practice and improving financial reporting.

Proceeds from the Settlement of Corporate-owned Life Insurance Policies (COLI). COLI policies are purchased by entities for many purposes, including funding the cost of providing employee benefits. Entities pay premiums for the policies, which increase their cash surrender value. The EITF tentatively decided to:

- Require cash proceeds received from the settlement of COLI policies to be classified as cash inflows from investing activities; and
- Permit, but not require, classification of premiums paid in the same cash-flow category as proceeds received.

Distributions Received from Equity Method Investees. The EITF tentatively decided to require the cumulative-earnings approach for distributions received from equity method investees. Under this approach, all distributions received from the investee would be presumed to be returns on investment and classified as operating inflows. However, if the investor's cumulative distributions, excluding distributions in prior years that were determined to be returns of investment, exceed the investor's cumulative equity in earnings, the current period distribution up to this excess is considered a return of investment and classified as investing inflows.

Beneficial Interests in Securitization Transactions. Some entities sell trade accounts receivable in securitization transactions to meet their liquidity needs. If a securitization transaction is accounted for as a sale, the entity may receive both cash proceeds and a beneficial interest in the unconsolidated securitization entity.[9] There is diversity in practice related to the presentation of beneficial interests received and the classification of subsequent cash payments received in the statement of cash flows. The EITF tentatively concluded that:

- The transferor's beneficial interest obtained in a securitization of financial assets should be a noncash activity; and
- Cash receipts from payments on the transferor's beneficial interests in securitized trade receivables should be classified as cash inflows from investing activities.

Application of the Predominance Principle. Significant diversity in practice exists around the interpretation and application of the predominance principle.[10] The lack of clear guidance has resulted in some entities applying the predominance principle differently, particularly when there is a lack of specific guidance for the type of cash flow to be classified. The EITF tentatively decided to:

- Provide additional guidance on when to separate cash flows and when to classify the cash flow based on predominance;

[9] FASB ASC Section 860-10-40, available at www.fasb.org.

[10] FASB ASC paragraph 230-10-45-22, available at www.fasb.org.

- Provide implementation guidance and illustrations to assist with determining the predominant cash flow; and
- Not require specific disclosures when classification is based on the predominant cash flow.

Background and Observations. Classifying cash receipts and cash payments in the statement of cash flows can be challenging. The FASB has received feedback that there is diversity in practice on numerous classification issues. In addition, errors may occur in the classifications in the statement of cash flows that cause restatements by public companies.

The FASB attempted to clarify certain existing principles in cash-flow guidance to address nine specific statement of cash-flow classification issues that were added to its technical agenda in April 2014. However, the Board determined at its April 1, 2015, meeting that clarifying certain existing principles would only incrementally reduce diversity in practice. Therefore, the FASB decided that the EITF will address these nine statement of cash-flow issues based on the existing requirements and guidance.[11]

These nine issues are not the only issues where diversity in practice exists. The Board also added a pre-agenda research item to the FASB's agenda with the intention to improve the classification guidance for the statement of cash flows.

Next Steps. The EITF will discuss issues related to restricted cash and the transition alternatives for all nine cash-flow classification issues at a future meeting. A proposed ASU will be issued for public comment after the EITF has deliberated and reached a consensus-for-exposure on all nine cash-flow classification issues.

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[11] See Defining Issues No. 15-26, EITF Reaches Two Final Consensuses and Two Consensuses-for-Exposure, available at www.kpmg-institutes.com.