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IMS Knowledge Brief

Topic: Prepaid Value, Breakage and Revenue Recognition – Setting the Record Straight

Overview:

IMS has noticed increasing confusion among its customers and prospective customers regarding the revenue recognition of prepaid value, gift cards, gift certificates and other types of stored value breakage. For purposes of this POV, “gift card” refers to prepaid value, gift cards, gift certificates and other types of stored value and devices. IMS will not delve into specific federal or state prepaid value or gift card law details at this time.

The objective of this Point-of-View is to highlight key factors for breakage revenue recognition consideration.

IMS does not offer financial nor legal advice, and recommends customers consult their respective counsel for the revenue recognition method that meets their specific situation.

Background:

All stored value vehicles have the opportunity to generate revenue three ways:

- Redemption
- Breakage
- Uplift

Some relevant gift card highlights:

- \$118 billion loaded onto gift cards in 2013 (CEB Towers 2013 gift card state of the union)
- Spillage (breakage) is declining yearly, and is running at an approximately 2% level or \$2+ billion annually (CEB Towers 2013 gift card state of the union)
- Best Buy annual gift card breakage for 2012 was \$54 million (Best Buy annual report)
- Starbucks annual gift card breakage for 2012 was \$65.8 million (Starbucks annual report)
- Starbucks processed more than 40 million new card activations valued at more than \$610 million in the U.S. and Canada during Q1. (Starbucks Q1 conference call transcript)
 - This included 2-plus million new activations per day in the period immediately leading up to Christmas, and \$1.4 billion of card loads globally.
- Mobile and gift card payments now represent more than 30 percent of total U.S. payments for Starbucks. (Starbucks Q1 conference call transcript)



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Definitions:

- Redemption: Amount of prepaid value that is spent or redeemed
- Breakage or Unused Value: Amount of prepaid value available to be redeemed that is remaining, unspent or unused
- Uplift: Amount spent or acquired over and above the original prepaid value
 - IMS/STADIS© measures uplift on the “split tender” when the last remaining portion of prepaid value is spent and either cash or credit card (or some other type of tender) is used to pay the remaining amount due on that transaction.
 - Note: A gift card/prepaid value holder may spend additional money through the event or eligible period, but if they don’t identify themselves (with ticket/gift card or some type of trackable or scanable personal identifier), on remaining purchases or acquisitions during the event or eligible period, their acquisitions cannot be captured or measured.

Key Questions:

- When does unused value escheat to the state?
- What are the situations when unused value does not escheat to the state?

Key Factors:

IMS finds the following to be key drivers in providing answers to the two questions posed above:

1. Exclusions
2. Expiration dates
3. Fees
4. Non-escheat breakage revenue recognition
5. Financial accounting

1. Exclusions

While most exclusions vary state by state, the following Federal Reserve exclusions tend to apply:

- a. Cards used solely for Telephone services
- b. Reloadable Cards Not Marketed or Labeled as a Gift Card or Gift Certificate
- c. Loyalty, Award, and Promotional Gift Cards
- d. Cards Not Marketed to the General Public
- e. Cards Issued in Paper Form Only
- f. Cards Redeemable Solely for Admission to Events or Venues



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- i. This exclusion is limited to cards, codes, or other devices that do not state a specific monetary value but instead are redeemable for admission to an event or venue.
- ii. Furthermore, the exclusion covers any goods or services that may be obtained at specific locations affiliated with and in geographic proximity to the event or venue.

2. Expiration Dates

Unless falling under the exclusions for that particular state, if a gift card has some type of expiration date, unused value or breakage can escheat to the state.

3. Fees

Unless falling under the exclusions for that particular state, if a gift card charges some type of fee(s), unused value or breakage can escheat to the state.

4. Non-Escheat Breakage Revenue Recognition

While varying state by state, IMS's findings show that for states where gift cards do not fall under that state's exclusions, if a gift card does not have an expiration date nor charge inactivity fees, breakage may not escheat to the state.

According to Grant Thornton, "But if these transactions are not covered under state escheat rules, the question arises as to when companies can recognize revenue for gift cards that are not used. In most transactions, GAAP does not allow a company to derecognize a liability until the company is relieved from the liability — in this case, when the gift card is used. However, a special exception has been made for gift cards: When the company can establish that the chance of redemption is remote and estimate the amount that will not be used, the company can recognize that breakage" (Grant Thornton 2011, Gift Cards: Opportunities and issues for retailers).

Two acceptable methods for recognizing breakage include specific identification and homogenous pool.

5. Financial Accounting

According to Bill Bishop, Audit manager for Grant Thornton, "For companies to recognize revenue from breakage, they need to have accurate current and historical redemption data to support that there is a remote chance of the cardholder redeeming that card." "Most retailers use a third party to manage their gift card programs, and these third parties typically provide this data, but companies that administer their own gift card programs have to track redemption on their own."

Summary:

IMS research has uncovered prudent circumstances where gift card breakage can and should be recognized as revenue, as long as the proper applications and processes are put in place. IMS is happy to



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discuss and assist your specific efforts through the use of our knowledge, applications and breakage, redemption and uplift guidelines based on our 10 years of implementation history through STADIS© - The Stadium and Arena Data Integration Service.

IMS's STADIS© provides detailed tracking of outstanding cards, balances, aging, last use, as well as item level purchases associated with said cards. STADIS© also allows gift card values to be managed and allocated in multiple ways to accommodate many specific use cases.

STADIS© provides a management platform enabling behavior based, item level, time based, location based, and either/or engagement, as well as progressive real time rewards. Any of these engagement activities can be deployed as stand-alone tactics or in conjunction with stored value. Of course, all engagement activity is tracked at the customer level in real time.

Reporting on any of the above uses and other KPIs can be created through any number of Business Intelligence tools STADIS© utilizes, including STADIS© Insights Powered by IBM Cognos.