White Paper: Breakage Revenue Recognition for Bank Issued "No Fee, No Expiration" Gift Cards

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Gift cards are a type of prepaid, stored-value card designed to be purchased by one consumer and given to another. Gift cards are issued by a wide variety of retailers and certain banks. Some gift cards can only be redeemed at specific locations, while others may be redeemed at any location where a major credit card is accepted. Recipients typically redeem their gift cards for goods or services, but many recipients leave a small portion of their gift card balances unspent. The unspent balance is referred to in the gift card industry as "breakage."

Gift cards present unique accounting issues. Card issuers must determine how to account for the initial sale of the gift card. Generally, because the card issuer receives money but is obligated in the future to provide goods or services, the issuer debits cash (an asset account on its balance sheet) for the purchase price and credits deferred revenue (a liability account on its balance sheet). As the recipient redeems card balances, the deferred revenue is recognized and the liability of the card issuer is reduced. Some gift cards impose service or inactivity fees that periodically reduce and eventually eliminate unspent card balances. Other cards have expiration dates that eliminate the card issuer's future liability for unspent card balances. However, if a card has no expiration date and no service or inactivity fees, the liability could stay on the card issuer's books indefinitely. Such liability retention would result in the card issuer overstating its liabilities and understating its income, if it fails to recognize that a portion of the unused gift card balances will never be redeemed. A card issuer must determine at what point it will recognize the unspent portion of a gift card as breakage income.

Bank Issued "No Fee, No Expiration" Gift Cards

With the increased popularity of gift cards, numerous consumer advocates and state legislatures have objected to service and inactivity fees that consume card balances and expiration dates that extinguish card issuer liability. In response to such criticisms, some banks and other issuers have begun marketing so called "no fee, no expiration" gift cards ("NFNE Cards"). Unspent balances on NFNE Cards would never be reduced by fees or extinguished by an expiration date. NFNE Cards are very consumer friendly because unspent balances never expire. Banks and other issuers of NFNE Cards remain liable to pay or redeem the unspent balances on the cards indefinitely. There will still be breakage on NFNE Cards, however, because some card balances, in fact, will never be spent. Bank issuers of NFNE Cards must

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recognize the breakage income from such cards. From an accounting perspective, at some point the NFNE Card issuer must derecognize its liability for the unspent card balance and recognize breakage income resulting from such derecognition.

Overcoming Objections to Banks Derecognizing Liabilities

Upon first impression, some analysts and regulators have a visceral objection to a bank derecognizing (writing off for accounting purposes) a legally enforceable liability to a cardholder. Upon closer examination, however, they must realize that GAAP, RAP and tax accounting principles require such result.

Derecognition of a bank's asset is easier to understand. Even though a defaulted and nonperforming loan may remain valid and legally enforceable, there comes a time when the likelihood that the borrower will repay the loan become so remote and improbable, that the loan must be written off the bank's books. Accounting principles require that the bank derecognize the asset, so that the bank's balance sheet does not overstate the value of its assets and the bank's income statement does not understate the amount of its loan losses. After the loan has been written off, the borrower remains liable to the bank and any subsequent recovery on the written off loan would be accounted for as recovery income to the bank. Such derecognition of a nonperforming loan is ubiquitous and uncontroversial. Derecognition of a bank's gift card liability is the flip side of the same coin.

A bank issuing NFNE Cards will show a liability on its balance sheet for the unspent balances on such cards. An unspent gift card balance is a valid liability of the issuing bank, but the longer such balance remains outstanding, the less likely it becomes that the bank will ever be called upon to pay such obligation. At some point the likelihood that the bank will be required to pay the remaining unspent balance on the NFNE Card becomes so remote that accounting principles require the bank to remove such liability from its balance sheet. The issuing bank derecognizes this obligation by debiting the card liability account and recognizing a corresponding amount of breakage revenue on its income statement. Failure to do so would (i) overstate the bank's liabilities, (ii) understate the bank's GAAP income (and possibly its taxable income) and (iii) understate the bank's capital ratios. If a cardholder subsequently spends the unused balance that had been written off for accounting purposes, the redeemed amount would be paid by the bank and recorded as an expense on the bank's income statement. Just as the write-off of the nonperforming loan does not extinguish the borrower's debt to the bank, the write-off of the breakage on the gift card does not extinguish the bank's liability (or the cardholder's ability to use the card). In both cases, however, derecognition of the bank's asset and liability must occur so that the bank's financial statements are not inaccurate or misleading.

This white paper primarily focuses on bank-issued NFNE Cards and presents the methodologies whereby an issuing bank can recognize the unused portion of a gift card as breakage income. Because of the limited accounting guidance on how to recognize breakage income, the recognition methods utilized by major retailers vary greatly. The methods advocated by this paper comply with applicable accounting principles.

I. GIFT CARD INDUSTRY AND BREAKAGE INCOME

A. Types and Prevalence of Gift Cards

With the prevalence of gift card usage, there is an increased need for clear guidance regarding breakage income. The National Retail Federation estimated that in 2006, 80% of all consumers bought at least one gift card and total gift card sales totaled $53 billion.[1] Gift cards have been the most popular holiday gift since 2003, and in 2009, 42% of consumers preferred gift cards to merchandise, up from 35% in 2006.[2] With the increase of gift card usage, breakage income has become significant issue. Consumer research groups have reported that breakage varies from 10% to 19%,[3] and some estimated that breakage totaled $7.8 billion in 2007.[4]

There are two main types of gift cards: closed-loop and open-loop. Closed-loop gift cards can only be redeemed at a particular retailer, shopping center, or website.[5] Open-loop gift cards are sold for a fee by issuing banks or retailers and are often "network branded," meaning they can be redeemed at any establishment that accepts major credit cards.[6] Out of the $97 billion in 2007 gift card sales, approximately $66.2 billion was loaded onto closed-loop retail gift cards, and approximately $5 billion was loaded onto open-loop general-purpose gift cards.[7] The open-loop gift card market is significantly smaller than the closed-loop market, but it enjoyed 44.4% growth in 2007 compared to the 4.9% growth of the closed-loop market during the same period.[8]

In addition to a variety of redemption locations, there can be various parties involved in a gift card program. While some issuers operate their own gift card program, others engage a third-party program manager that keeps records relating to cards, including the computer system that authorizes transactions and maintains balances. Other card issuers engage third-party consultants and specialists to design and manage breakage models used to recognize breakage income.

B. Relevant laws

Over the past several years consumer complaints over certain gift card terms, such as inactivity fees and expiration dates, have resulted in a plethora of state and federal legislation affecting gift cards. At the state level, over forty states have enacted laws applicable to gift cards.[9] The most common type of laws center around service and inactivity fees and the use of expiration dates. While some states only require full disclosure of such fees and dates, most states restrict their use.[10]

Some states require issuers to give consumers the option to receive cash back when their gift card balance falls under a specified amount.[11] In many states, card issuers are required to escheat gift card breakage to the state as unclaimed property after the card has been dormant for a period of time.[12] There is significant variation in state laws, however. For example, in Missouri, all gift cards are subject to escheatment;[13] while in Kansas, gift cards that are not intended for general use are exempt from the unclaimed property laws.[14] Gift card issuers subject to escheat laws are required to file an annual report listing the amount to be escheated to each applicable state.[15]

All state gift card laws apply in some way to closed-loop cards but many do not cover open-loop cards issued by banks.[16]

At the federal level, Congress passed the Credit Card Accountability, Responsibility and Disclosure Act ("CARD Act") in 2009. To implement the CARD Act, the Board of Governors of the Federal Reserve System issued rules, applicable to both closed- and open-loop gift cards, that restrict expiration dates and fees.[17] Banks that issue gift cards are subject to the prohibition against unfair and deceptive acts or practices in the Federal Trade Commission Act, 15 U.S.C. 45(a)(1), and to all other regulations applicable to bank products.[18]

C. Bank Issued NFNE Cards

To simplify compliance with applicable laws and to respond to consumer preferences, many bank issuers are creating gift card products with no fees and no expiration date[19]. These bank issued NFNE Cards are usually open-loop cards. Such cards will generally not be insured by the FDIC because of the anonymous nature of gift cards.[20] Because the NFNE Cards have no expiration date, even when bank issuers have recognized breakage income on their financial statements, they will still honor NFNE Cards that consumers attempt to redeem after years of inactivity.[21]

It should be clearly understood that derecognition of a card balance liability for GAAP accounting purposes does not mean that the card balance is wiped off of the bank's information technology and card processing systems. Even after recognizing breakage income, the NFNE Card number and unspent card balance remains active in the bank's processing system, and available to be redeemed if such card is ever presented by the holder.

II. ACCOUNTING AND REGULATORY GUIDANCE

A. Generally Accepted Accounting Principles

Although there is limited specific guidance regarding how gift card issuers should account for gift card sales and redemptions, GAAP provides guidance on when liabilities should be extinguished and revenue recognized.

In 2009, the Financial Accounting Standards Board ("FASB") consolidated its GAAP – Statements of Financial Accounting Standards and Concepts – into the comprehensive Accounting Standards Codification ("ASC"). FASB ASC 605-10-25-1 governs revenue recognition.[22] This section provides that an entity may only recognize revenue when the revenue is (1) realizable and (2) earned – with sometimes one and sometimes the other being the more important consideration.[23] It clarifies that revenues are realized when products are exchanged for cash, and are earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues.[24] Accordingly, a gift card issuer must wait until after a gift card is used to recognize breakage. However, how long an issuer must wait to recognize breakage – the point at which an issuer has substantially performed – is unclear.

FASB ASC 405-20-40-1 codifies the general accounting principles governing derecognition of liabilities.[25] This section provides that a debtor can derecognize a liability only if it has been extinguished.[26] A liability has been extinguished once the debtor either pays the

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creditor and is thus relieved of its obligation for the liability, or is legally released from its obligation for the liability.[27] The section defines creditor payment as the delivery of cash.[28] FASB ASC 405 does not provide specific guidance on derecognition of gift card liabilities.[29] The closest FASB ASC topic relates to rebates.

FASB ASC 605-50-25-4 governs rebates, which are analogous to gift card programs because they involve prepayment and redemption.[30] FASB ASC 605-50-25-4 provides that a vendor can recognize a liability based on the estimated amount of rebates that will be claimed by customers.[31] It also provides that a liability must be recognized for the maximum potential amount of the rebate – no reduction for breakage can be made – unless the amount of future rebate claims can be "reasonably and reliably estimated."[32] This section lists three factors that may impair a vendor's ability to make a reasonable and reliable estimate of the amount of future rebates: (1) long periods in which a particular rebate may be claimed; (2) the absence of historical experience with similar types of sales incentive programs; and (3) the absence of a large volume of relatively homogeneous transactions.[33]

B. Securities and Exchange Commission

The Securities and Exchange Commission ("SEC") generally follows the FASB's guidelines for revenue recognition.[34] In 2005, the SEC specifically addressed the issue of gift card breakage, thereby setting the standard that is now followed throughout the gift card industry.[35] The SEC took the position that recognition of breakage income, in any amount, immediately upon the sale of a gift card is inconsistent with GAAP and therefore inappropriate.[36] The SEC instructed that a gift card issuer should apply the derecognition guidance found in what is now FASB ASC 405-20-40-1, but added that "derecognition may also be acceptable in certain circumstances if the vendor can demonstrate that it is remote that the customer would require performance."[37] The SEC further clarified its position:

> Given that immediate recognition of breakage [is] not considered appropriate . . . we were asked what approaches may be acceptable. Consistent with the staff's previous views, recognizing gift card breakage as the vendor is legally released from its obligation, for example at redemption or expiration, or at the point redemption becomes remote, may both be acceptable methods.
>
> Another approach may be to recognize breakage for unused gift card amounts in proportion to actual gift card redemption. Gift cards sold over a certain period of time would be considered on a homogenous pool basis. The estimated values of gift cards expected to go unused would then be recognized over the period of performance, that is, as the remaining gift card values are redeemed. To utilize this approach, a vendor would be required to not only reasonably and objectively determine the amount of gift card breakage, but also reasonably and objectively determine the estimated time period of actual gift card redemption.[38]

This SEC statement remains the definitive accounting standard on breakage income and is consistent with the factors outlined in FASB ASC 605-50-25-5.[39]

The SEC accepts three methods of gift card breakage recognition: (1) when there is no longer a legal obligation on the part of the issuer to honor the gift card; (2) at the point redemption of the gift card is considered remote; or (3) in proportion to actual gift card redemptions based upon an analysis of historical redemption patterns of the issuer. [40]

III. BREAKAGE RECOGNITION APPROACHES

When an issuer's gift cards have no expiration date or service fee, an issuer can conduct a historical redemption analysis and consult the trends in the redemption patterns of previously sold gift cards to calculate an average breakage estimate to be used in the recognition of breakage income.[41]

The use of this breakage estimate and the recognition of breakage income is the mirror image of an allowance for loan and lease losses. Just as the failure to properly determine an allowance for loan and lease losses causes a bank to overstate its assets, failure to properly account for breakage income causes a bank to overstate its liabilities. Such an overstatement of liabilities also results in the bank understating its GAAP income (and possibly its taxable income). In both instances, failure to properly account for loan and lease losses and failure to recognize breakage income, the bank's balance sheet and income statement fail to accurately reflect the entity's current financial position.

To present an accurate balance sheet and income statement, card issuers must adopt a recognition method for gift card breakage income. Estimating breakage income requires the collection of many years worth of redemption data.[42] Card issuers with a long history of redemption data may use a method that begins recognizing breakage income soon after a new gift card program is initiated. Some card issuers without a history of redemption data have adopted a two-step recognition method. The first step consists of a one-time recognition that covers a multi-year start up period during which redemption data is collected, while the second step involves ongoing periodic (typically, monthly) recognition of breakage income from unredeemed gift cards.[43] Home Depot's approach to breakage is an example of a two-step recognition method. In the first quarter of 2005, it recognized $43 million in breakage income, which covered all periods since the launch of its gift card program, and $9 million during the remainder of 2005.[44]

A. Major Retailers

Many retail issuers disclose only limited information in their financial statements and SEC filings regarding their gift card breakage revenues. A 2008 study that examined annual financial statements and 10-K filings of 75 retailers found 45% of the retailers did not disclose any information about their gift card programs.[45] Of the retailers that reported gift card information, many made multiple disclosures relating to various accounting and legal issues, such as revenue recognition and escheatment.[46]

Two other studies, one done by the CPA Journal and the other by the Journal of Accountancy, focused on the breakage recognition methods of two retail giants, Best Buy and Home Depot.[47] In its 2006 Form 10-K, Best Buy stated that it recognizes breakage income for gift cards that are unredeemed after twenty-four months.[48] Best Buy noted that twenty-four months is the point at which the "likelihood of redemption is deemed to be remote," and that the amount of breakage income is based on its "historical redemption pattern."[49] In its 2006 Form 10-K, Home Depot stated the amount of breakage income recognized but did not provide details about its recognition method.[50]

A survey of other retailers issuing gift cards indicates that breakage income recognition is diverse:

- Using historical redemption trends, Borders Group, Inc. recognizes breakage income beginning twelve months after the card's issuance date.

- For its non-expiring gift cards, Macy's, Inc. recognizes income in proportion to and over the time period gift cards are actually redeemed.

- Upon issuance, J.C. Penney Co., Inc. establishes a liability for the face amount of the gift card. The liability remains recorded until the earlier of redemption, escheatment or 60 months.

- Guess?, Inc. recognizes breakage income over the period that remaining gift card values are redeemed based on a historical breakage rate (6.5%).

- Gap, Inc. recognizes breakage income based on historical redemption patterns. Based on historical information, Gap's position is that the likelihood of non-expiring gift cards remaining unredeemed can be determined three years after issuance.

- Using historical redemption data, PetSmart, Inc. recognizes breakage income over a two year period. PetSmart records breakage income monthly.

- Toys "R" Us, Inc., recognizes breakage income proportionately based on the useful life of the gift card, an estimated breakage rate of unredeemed liabilities and management estimates and assumptions of redemption patterns.

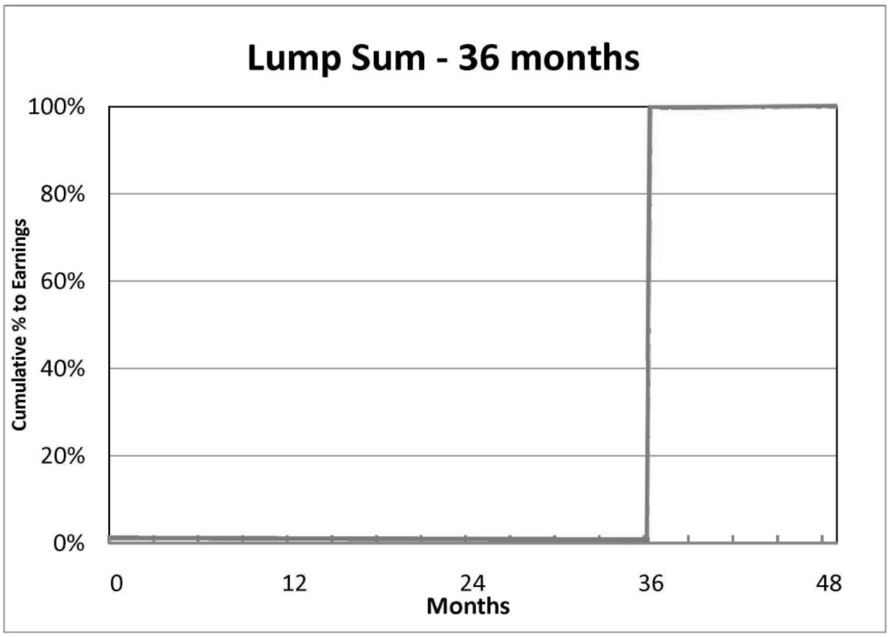
- Barnes & Noble, Inc. records breakage income on a straight-line basis over a 12-month period beginning in the 13th month after the month the gift card was originally sold.

B. Proposed Methods for Recognizing Breakage Income

There are three primary methods used to recognize breakage income: (1) Lump Sum Recognition; (2) Straight-Line Recognition; and (3) Statistical Modeling.

1. Lump Sum Recognition of Breakage

Pursuant to the lump sum recognition method, a card issuer debits cash and credits deferred revenue upon the issuance of a gift card. Based on historical redemption analysis, observed trends, management's estimates, etc., the issuer determines a point in time when it deems the likelihood of redemption is remote. At this point in time, the issuer recognizes the entire deferred revenue balance applicable to that card as revenue. For instance, if an issuer determines that the likelihood of a gift card's redemption is sufficiently low at 36 months after issuance, the issuer will recognize all breakage income on the card at 36 months. The amount of this breakage income equals the issuance price less all redemptions prior to 36 months. The following diagram illustration the lump sum recognition method for breakage income:



While the lump sum recognition method is attractive because of its simplicity, it does not accurately reflect what is occurring from an economic perspective. The lump sum recognition method fails to account for the fact that breakage occurs over a period of time, not at a single point in time. Additionally, because the full income statement effect occurs at one moment, issuers may be tempted to "manage" earnings by adjusting the time of recognition.

2. Straight-Line Recognition of Breakage

An issuer utilizing the straight-line recognition method would determine the typical redemption period (usually stated in months) applicable to its gifts cards as well as the typical breakage amount. The issuer would then divide the typical breakage amount by the typical redemption period (in months). The result would be a level amount per month the issuer would recognize as breakage income until the card balance is exhausted. This method is similar to straight line depreciation of an asset. The straight line recognition method complies with applicable accounting and regulatory guidance in that issuers recognize breakage revenues based upon an analysis of historical redemption patterns. The following diagram illustrates the straight-line recognition method for breakage income:

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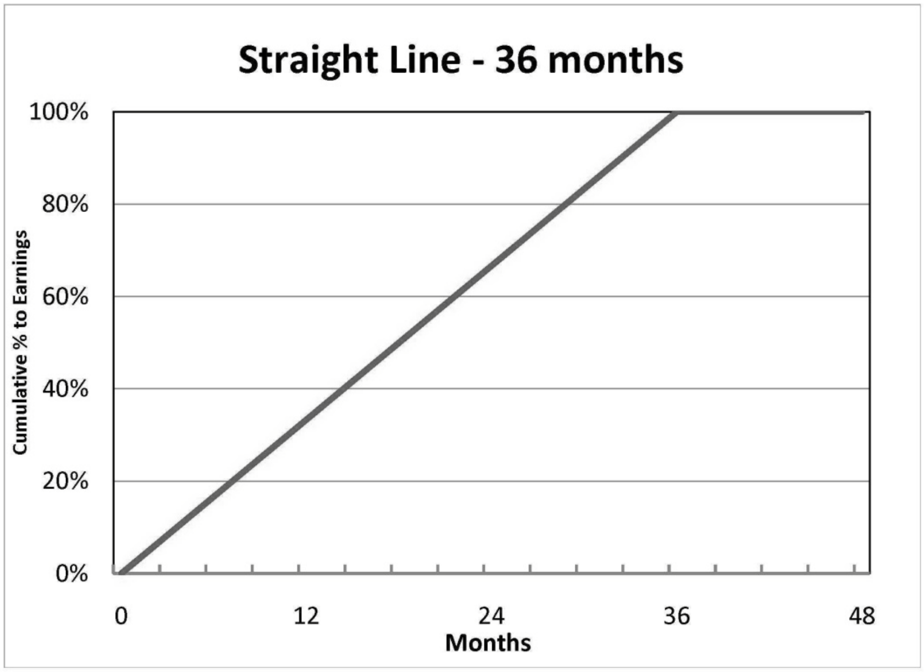

Issuers adopting the straight-line recognition method must not only determine the typical redemption period and the typical breakage amount but also when to begin breakage income recognition. While the SEC disfavors immediate breakage income recognition, it does not prohibit breakage income recognition in subsequent months as long as it is pursuant to the issuers historical redemption patterns. Accordingly, issuers may determine that breakage income recognition should begin in the first month following issuance. Alternatively, issuers may determine that breakage income recognition should not begin until some later date (e.g., Borders Group, Inc., begins recognition twelve months after the card's issuance date).

Issuers utilizing the straight-line recognition method may adopt assumptions that lessen the risk of having to make a corrective journal entry if a gift card is redeemed in full or if the redemption is in excess of the gift card balance less breakage income recognized. For instance, an issuer could establish an earnings reserve applicable to the gift card. This earnings reserve would be analogous to the use of salvage value in straight line asset depreciation.

The method is far superior to the lump sum recognition method because it recognizes that breakage does occur over the life of the gift card. Additionally, because the full impact of the model's assumptions occur over an extended period of time, issuers are less able to manipulate earnings by accelerating or decelerating income recognition.

3. Statistical Modeling

As gift card programs become more automated and third-party processors offer more detailed services, card issuers may choose to adopt a more sophisticated breakage recognition

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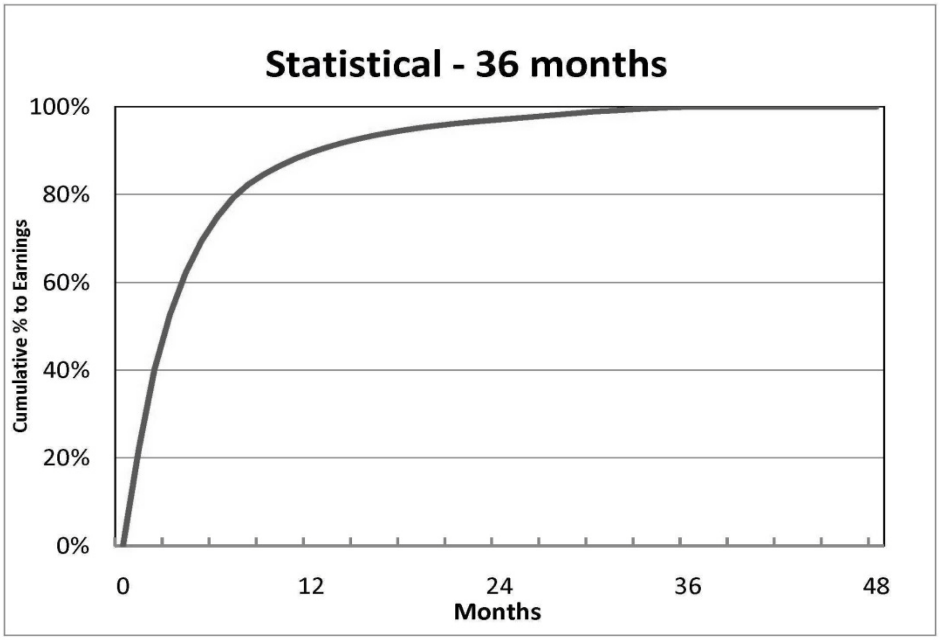
approach using statistical modeling. Using past experience, the card issuer establishes non-linier recognition schedule based on statistical probabilities. The following diagram illustrates the statistical recognition method for breakage income:



The benefits of statistical modeling is its adaptability and predictability. Unlike in the straight-line recognition method where the issuer recognizes the same amount of income each period, issuers utilizing a statistical model may recognize different amounts of income each period as determined by the model updated for new information. Because the statistical models are constantly updating and incorporating new information (e.g., locale of card issuance, initial card balance, issuing entity, and industry), these models can more accurately predict the amount of breakage income in a given period.

The most sophisticated card issuers and third party consultants and specialists can use statistical models to construct pools of homogenous gift cards that recognize breakage income at different rates based upon varying factors supported by historical card data. For example, in some cases it might be possible to statistically show that gift cards sold during the holidays have higher breakage than cards sold at other times of the year. In the future, multi-year gift card data may statistically show that gift cards sold during times of economic prosperity have higher breakage than gift cards sold during recessionary periods.

Statistical modeling is not bound by simplifying assumptions; rather, statistical modeling is able to accurately incorporate all known variables and adjust assumptions accordingly. Finally, because statistical modeling incorporates numerous data points and assumptions, issuers are far less likely, and less able, to "manage" earnings.

Because of its ability to incorporate numerous data points, both issuer-based and industry-based, and its enhanced adaptability and predictability, statistical modeling complies most closely with appropriate accounting and regulatory guidance.

IV. CONCLUSION

It is clear that breakage occurs after a bank issues NFNE Cards. If the bank fails to recognize breakage income and derecognize card liabilities, its financial statements will be inaccurate and misleading. Straight line recognition and statistical modeling recognition of breakage are acceptable methods, with the later method being the more preferable.

While statistical modeling offers the most accurate recognition method, it may be impractical for some card issuers. First, statistical modeling may be too costly for smaller issuers. Second, because of the infancy of many card programs, the limited results of statistical modeling may not be superior to that of the straight-line recognition method. The lump sum recognition method allows for earnings management and fails to recognize that breakage occurs over the life of the card. It is not an appropriate recognition model for banks. For banks that are unable, either because of insufficient resources or historical card data, to implement statistical modeling, the straight-line recognition method is acceptable.

Once adopted, the issuing bank, as well as regulatory agencies, must monitor the assumptions incorporated into the recognition model. As the NFNE Card industry continues to grow, issuing banks may need to update assumptions or incorporate new assumptions into their breakage recognition models.

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1. Ronald E. Marden & Timothy B. Forsyth, *Gift Cards and Financial Reporting*, CPA J., Nov. 2007, http://www.nysscpa.org/cpajournal/2007/1107/essentials/p28.htm.

2. *24th Annual Holiday Survey Results*, DELOITTE LLP, http://www.deloitte.com/view/en_US/us/industries/Retail-Consumer-Business/aedae0c400315210VgnVCM200000bb42f00aRCRD.htm (last visited July 15, 2010).

3. Charles Owen Kile Jr., *Accounting for Gift Cards*, J. OF ACCT., Nov. 2007, http://www.journalofaccountancy.com/Issues/2007/Nov/AccountingForGiftCards.htm.

4. Dan Mitchell, *Fruitcake Might Be a Better Gift*, N.Y. TIMES, Jan. 5, 2008, http://www.nytimes.com/2008/01/05/technology/05online.html?_r=1&ref=tower-group-inc.

5. Bulletin, Office of the Comptroller of the Currency, Gift Card Disclosures (Aug. 14, 2006), http://www.occ.treas.gov/ftp/bulletin/2006-34.txt (explaining retail gift cards are usually issued "by a major retail, entertainment, or food service company, to be used at establishments owned and operated by that company").

6. *Id.* Bank-issued gift cards are usually issued by a financial institution, carry the logo of a payment card network like VISA or MasterCard, and can be used at any location that accepts cards from that network. *Id.* (noting "bank-issued gift cards may be co-branded and offered through, or jointly with, a retailer or other company such as a retail shopping mall").

7. Mitchell, *supra* note 4; Christine Bradley et al., *Alternative Financial Services: A Primer*, 3 FDIC Q., no. 1, 2009 at 42-43.

8. Bradley, *supra* note 7, at 43.

9. Electronic Fund Transfers, 12 C.F.R. pt. 205, 4 (Mar. 23, 2010) (to be published in Fed. Reg.), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20100323a1.pdf.

10. *Id.*

11. Electronic Fund Transfers, 12 C.F.R. pt. 205, 4 (Mar. 23, 2010) (to be published in Fed. Reg.), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20100323a1.pdf.

12. As applied to gift cards, the purpose of escheat laws does not match their effect:

> The stated purpose of escheat laws is to unite lost or abandoned property with its rightful owner. But when it comes to unclaimed gift cards, the money paid for the card is seldom united with the gift card owner, given that owner information is rarely recorded, ownership is easily transferable, and it is highly unlikely that a gift card owner who fails to redeem his or her card will, in turn, take the necessary steps to trace funds to a given state and initiate a claim for reimbursement. Instead, most escheated gift card money reverts to the state's general fund.

Charles Owen Kile Jr., *States Bite Into Broken Gift Cards*, J. OF ACCT., Dec. 2008, http://www.journalofaccountancy.com/Issues/2008/Dec/StatesBiteIntoBrokenGiftCards.htm.

13. *Id.*

14. *Id.*

15. *Id.* An issuer operating in multiple states must look to the Supreme Court's decision in *Texas v. New Jersey*, 379 U.S. 674 (1965), to determine which state has priority over the gift card breakage (unclaimed property). *Id.* The rules are as follows:

> [I]f the holder [the business obligated to redeem the gift card] of unclaimed property can determine the state of the property owner's residence using registration address data, then the holder escheats the property to that state . . . In such cases in which this information is unavailable, the holder would escheat the property to the state of the holder's domicile [the place of incorporation].

Id.

16. *Id.*

17. The rules were issued by amending Regulation E, which implements the Electronic Fund Transfer Act. *Id.* The rules are effective August 21, 2010 and "prohibit dormancy, inactivity, and service fees on gift cards unless: (1) the consumer has not used the certificate or card for at least one year; (2) no more than one such fee is charged per month; and (3) the consumer is given clear and conspicuous disclosures about the fees." Press Release, Board of Governors of the Federal Reserve System (Mar. 23, 2010), http://www.federalreserve.gov/newsevents/press/bcreg/20100323a.htm. The rules also require "[e]xpiration dates for funds underlying gift cards [to] be at least five years after the date of issuance, or five years after the date when funds were last loaded." Press release, *supra*.

18. Bulletin, *supra* note 5.

19. Many non-bank issuers of gift cards used to have expiration dates for their cards.

20. FDIC has determined that for FDIC insurance to attach to a gift card program, the cardholder must be identifiable. Unless a particular gift card program offers or requires registration of gift cards by recipients, neither the bank issuer nor any program manager will be able to discover the identity of the card owner. Therefore, unregistered gift cards are not FDIC insured.

21. Issuers may not honor NFNE gift card monies disposed of through escheatment. An issuer that can track gift card balances and usage will have a legitimate basis for reclaiming breakage funds from the state upon redemption of an escheated gift card balance. Kile, *supra* note 11.

22. This section is the codification of Statement of Financial Accounting Concepts No. 5.

23. CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, Revenue Recognition, § 605-10-25-1 (Fin. Acct. Standards Bd. 2010). "The issue with gift cards is not realization, but rather when the earnings process is actually completed." Marden, *supra* note 1.

24. Revenue Recognition, *supra* note 29.

25. This section is the codification of Statement of Financial Accounting Standards No. 140.

26. CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, Extinguishments of Liabilities, Derecognition, § 405-20-40-1 (Fin. Acct. Standards Bd. 2010).

27. *Id.*

28. *Id.*

29. One accounting professor has written:

> The contentious issue [with respect to gift cards] is when to book the expected breakage and an appropriate amount. No specific Generally Accepted Accounting Principle (GAAP) has been issued to clarify the issue. The only general guidance comes from the Securities and Exchange Commission's (SEC) Pamela Schlosser who indicated, at an American Institute of Certified Public

> Accountants' conference in 2005, that income recognition at the time the card is sold is not appropriate. She went on to add that it was her staffs previous view that it would be appropriate to recognize revenue when "the vendor is legally released from its obligation" to deliver the goods or services or "at the point redemption becomes remote". No further guidance is given and no specific accounting standard has been issued regarding breakage.

Ronald R. Rubenfield, Integrating Gift Cards into the Accounting Curriculum, http://www.cengagesites.com/academic/assets/sites/3099_AccountingGift/gift%20card%20paper-inst.doc.

30. CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, Customer Payments and Incentives, Recognition, § 605-50-25-4 (Fin. Acct. Standards Bd. 2010). "Certain sales incentives entitle a customer to receive a reduction in the price of a product or service by submitting a form or claim for a refund or rebate of a specified amount of a prior purchase price charged to the customer at the point of sale." *Id.*

31. *Id.*

32. *Id.*

33. *Id.*

34. CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, Securities and Exchange Commission, Revenue Recognition, § 605-10-S99-1 (Fin. Acct. Standards Bd. 2010) (cross-referenced at § 605-10-S25-1) (explaining that "in the absence of authoritative literature addressing a specific arrangement or a specific industry, the [SEC] will consider the existing authoritative accounting standards as well as the broad revenue recognition criteria specified in the FASB's conceptual framework that contain basic guidelines for revenue recognition").

35. Pamela R. Schlosser, Prof'l Accounting Fellow, Office of the Chief Accountant, Statement by SEC Staff: Remarks Before the 2005 AICPA National Conference on Current SEC and PCAOB Developments (Dec. 5, 2005).

36. *Id.*

37. *Id.*

38. *Id*.

39. See *supra* note 29 and *infra* note 40.

40. *Id.*; *see* Carla Feinson, *The Steep Rise of Gift Card Purchases by the Consumer is Changing the Method of Accounting and Reporting of Gift Card Income by Corporate Retailers*, 6 J. BUS. & ECON. RES., no. 4, 2008 at 10; *see also* Grant Thornton LLP, *Gift Cards: Opportunities and issues for retailers*, March 1, 2011, http://www.grantthornton.com/staticfiles/GTCom/CIP/Retail/Gift%20Cards%20-%20Opportunities%20and%20Issues%20for%20Retailers_FINAL.pdf ("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." *discussing* Schlosser, *supra* note 35.)

41. Kile, *supra* note 3.

42. Kile, *supra* note 3.

43. Kile, *supra* note 3.

44. Kile, *supra* note 3.

45. Feinson, *supra* note 38, at 9.

46. Feinson, *supra* note 38, at 9.

47. Marden, *supra* note 1; Kile, *supra* note 3.

48. Marden, *supra* note 1

49. Marden, *supra* note 1.

50. Marden, *supra* note 1.