Liabilities—Extinguishments of Liabilities
(Subtopic 405-20)

Recognition of Breakage for Certain
Prepaid Stored-Value Products

a consensus of the FASB Emerging Issues Task Force

An Amendment of the FASB Accounting Standards Codification®
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(Subtopic 405-20)

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Prepaid Stored-Value Products

An Amendment of the FASB Accounting Standards Codification®

Financial Accounting Standards Board
Accounting Standards Update 2016-04

Liabilities—Extinguishments of Liabilities (Subtopic 405-20)

Recognition of Breakage for Certain Prepaid Stored-Value Products

March 2016

CONTENTS

Summary ........................................................................................................... 1–2
Amendments to the FASB Accounting Standards Codification® ....................... 3–9
Background Information and Basis for Conclusions ........................................ 10–14
Amendments to the XBRL Taxonomy ................................................................. 15
Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

Prepaid stored-value products are products in physical and digital forms with stored monetary values that are issued for the purpose of being commonly accepted as payment for goods or services. While the holder of a prepaid stored-value product also may be permitted to redeem the product for cash, prepaid stored-value products are not only redeemable for cash by the product holder. When an entity sells a prepaid stored-value product that is redeemable at a third-party merchant (or merchants), it recognizes a liability for its obligation to provide the product holder with the ability to purchase goods or services at that third-party merchant (or merchants). When the product holder redeems the prepaid stored-value product, the entity’s liability (or part of that liability) to the product holder is extinguished. At the same time, the entity incurs a liability to the merchant that provided the goods or services. That liability is typically extinguished with cash through a settlement process. However, in some cases, a prepaid stored-value product may be unused wholly or partially for an indefinite time period.

Some entities support the view that an entity’s liability that exists after the entity sells a prepaid stored-value product to its product holder and prior to when the product holder redeems the prepaid stored-value product (prepaid stored-value product liability) is a financial liability. Other entities support the view that a prepaid stored-value product liability is a nonfinancial liability. Although Subtopic 405-20, Liabilities—Extinguishments of Liabilities, includes derecognition guidance for both financial liabilities and nonfinancial liabilities, there currently is diversity in the methodology used to recognize the portion of the dollar value of prepaid stored-value products that ultimately is unredeemed (that is, breakage).

Topic 606, Revenue from Contracts with Customers, includes authoritative breakage guidance. However, financial liabilities are excluded from the scope of Topic 606. The guidance in Topic 606 is effective in fiscal years beginning after December 15, 2017, for public business entities, certain not-for-profit entities, and certain employee benefit plans or fiscal years beginning after December 15, 2018, for all other entities.

The objective of this Update is to address the current and potential future diversity in practice related to the derecognition of a prepaid stored-value product liability.

Who Is Affected by the Amendments in This Update?

The amendments in this Update apply to entities that offer certain prepaid stored-value products (for example, prepaid gift cards issued on a specific payment
network and redeemable at network-accepting merchant locations, prepaid telecommunication cards, and traveler’s checks).

What Are the Main Provisions?

Liabilities related to the sale of prepaid stored-value products within the scope of this Update are financial liabilities. The amendments in the Update provide a narrow scope exception to the guidance in Subtopic 405-20 to require that breakage for those liabilities be accounted for consistent with the breakage guidance in Topic 606.

How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

Neither current GAAP nor the pending guidance in Topic 606 contains specific guidance for the derecognition of prepaid stored-value product liabilities within the scope of the amendments in this Update. The amendments are an improvement to GAAP because they specify how prepaid stored-value product liabilities within the Update’s scope should be derecognized, thereby eliminating the current and potential future diversity in practice described above.

When Will the Amendments Be Effective?

The amendments in this Update are effective for public business entities, certain not-for-profit entities, and certain employee benefit plans for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. For all other entities, the amendments are effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Earlier application is permitted, including adoption in an interim period.

The amendments in this Update should be applied either using a modified retrospective transition method by means of a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year in which the guidance is effective or retrospectively to each period presented.
Amendments to the
*FASB Accounting Standards Codification®*

**Introduction**

1. The Accounting Standards Codification is amended as described in paragraphs 2–8. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is struck out.

**Amendments to Subtopic 405-20**

2. Amend paragraph 405-20-15-2, with a link to transition paragraph 405-20-65-1, as follows:

**Liabilities—Extinguishment of Liabilities**

**Scope and Scope Exceptions**

*405-20-15-2* The guidance in this Subtopic applies to extinguishments of all liabilities, including both financial liabilities and nonfinancial liabilities, unless derecognition of a financial or nonfinancial liability is addressed in another Topic (for example, the derecognition guidance for gaming chips in Subtopic 924-405 on casinos or the breakage guidance in Topic 606 on revenue from contracts with customers). For example, derivative instruments that are nonfinancial liabilities (for example, a written commodity option) are included in the scope of this Subtopic.

3. Amend paragraph 405-20-40-1 and add paragraphs 405-20-40-3 through 40-4 and their related heading, with a link to transition paragraph 405-20-65-1, as follows:

**Derecognition**

*405-20-40-1* Unless addressed by other guidance (for example, paragraphs 405-20-40-3 through 40-4 or paragraphs 606-10-55-46 through 55-49), a debtor shall derecognize a liability if and only if it has been extinguished. A liability has been extinguished if either of the following conditions is met:

a. The debtor pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes the following:
1. Delivery of cash
2. Delivery of other financial assets
3. Delivery of goods or services
4. Reacquisition by the debtor of its outstanding debt securities whether the securities are cancelled or held as so-called treasury bonds.

b. The debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor. For purposes of applying this Subtopic, a sale and related assumption effectively accomplish a legal release if nonrecourse debt (such as certain mortgage loans) is assumed by a third party in conjunction with the sale of an asset that serves as sole collateral for that debt.

> Prepaid Stored-Value Products

405-20-40-3 Prepaid stored-value products are products in physical and digital forms with stored monetary values that are issued for the purpose of being commonly accepted as payment for goods or services. While the holder of a prepaid stored-value product also may be permitted to redeem the product for cash, prepaid stored-value products do not include products that only can be redeemed by the product holder for cash (for example, nonrecourse debt, bearer bonds, or trade payables). Examples of prepaid stored-value products include prepaid gift cards issued on a specific payment network and redeemable at network-accepting merchant locations, prepaid telecommunication cards, and traveler’s checks. The derecognition guidance in paragraph 405-20-40-4 does not apply to liabilities related to either of the following:

a. Prepaid stored-value products (or portions of those products) for which any breakage (that is, the portion of the dollar value of prepaid stored-value products that ultimately is not redeemed by product holders for cash or not used to purchase goods and/or services) must be remitted in accordance with unclaimed property laws

b. Prepaid stored-value products that are attached to a segregated bank account like a customer depository account.

The guidance also does not apply to customer loyalty programs or transactions within the scope of other Topics (for example, Topic 606 on revenue from contracts with customers).

405-20-40-4 If an entity expects to be entitled to a breakage amount for a liability resulting from the sale of a prepaid stored-value product in the scope of paragraph 405-20-40-3, the entity shall derecognize the amount related to the expected breakage in proportion to the pattern of rights expected to be exercised by the product holder only to the extent that it is probable that a significant reversal of the recognized breakage amount will not subsequently occur. If an entity does not expect to be entitled to a breakage amount for prepaid stored-value products in the scope of paragraph 405-20-40-3, the entity shall derecognize the amount related to breakage when the likelihood of the product holder exercising its
remaining rights becomes remote. At the end of each period, an entity shall update the estimated breakage amount to represent faithfully the circumstances present at the end of the period and the changes in circumstances during the period. Changes to an entity’s estimated breakage amount shall be accounted for as a change in accounting estimate in accordance with paragraphs 250-10-45-17 through 45-20.

4. Add paragraph 405-20-50-2 and its related heading, with a link to transition paragraph 405-20-65-1, as follows:

Disclosure

> Prepaid Stored-Value Products

405-20-50-2 An entity that recognizes a breakage amount in accordance with paragraph 405-20-40-4 shall disclose the methodology used to recognize breakage and significant judgments made in applying the breakage methodology.

5. Add paragraph 405-20-65-1 and its related heading as follows:

Transition Related to Accounting Standards Update No. 2016-04, Liabilities—Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products

405-20-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2016-04, Liabilities—Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products:

a. A public business entity, a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market, and an employee benefit plan that files or furnishes financial statements with or to the Securities and Exchange Commission shall apply the pending content that links to this paragraph for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. All other entities shall apply the pending content that links to this paragraph for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019.

b. Earlier application of the pending content that links to this paragraph is permitted, including adoption in an interim period.

c. An entity shall apply the pending content that links to this paragraph by electing to use one of the following two methods:
1. Retrospectively to each prior period presented in accordance with the guidance on accounting changes in paragraphs 250-10-45-5 through 45-10
2. Retrospectively by means of a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year in which the pending content that links to this paragraph is adopted.
d. An entity shall provide the disclosures required in paragraphs 250-10-50-1(a) and (b)(3) and 250-10-50-2, as applicable, in the period the entity adopts the pending content that links to this paragraph. If an entity elects to apply the pending content that links to this paragraph retrospectively in accordance with (c)(1) above, the entity also shall provide the disclosure required by paragraph 250-10-50-1(b)(1).

Amendments to Subtopic 825-10

6. Amend the following pending content for paragraph 825-10-50-8, with a link to transition paragraph 405-20-65-1, as follows:

Financial Instruments—Overall

Disclosure

> Applicability of This Subsection
> > Transactions

Pending Content:

Transition Date: (P) December 16, 2017; (N) December 16, 2018 | Transition Guidance: 825-10-65-2

825-10-50-8 In part, this Subsection requires disclosures about fair value for all financial instruments, whether recognized or not recognized in the statement of financial position, except that the disclosures about fair value prescribed in paragraphs 825-10-50-10 through 50-16 are not required for any of the following:

a. Employers’ and plans’ obligations for pension benefits, other postretirement benefits including health care and life insurance benefits, postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements (see Topics 710, 712, 715, 718, and 960)

b. Substantively extinguished debt subject to the disclosure requirements of Subtopic 405-20
c. Insurance contracts, other than financial guarantees (including financial guarantee insurance contracts within the scope of Topic 944) and investment contracts, as discussed in Subtopic 944-20

d. Lease contracts as defined in Topic 840 (a contingent obligation arising out of a cancelled lease and a guarantee of a third-party lease obligation are not lease contracts and are subject to the disclosure requirements in this Subsection)

e. Warranty obligations (see Topic 450 and the Product Warranties Subsections of Topic 460)

f. Unconditional purchase obligations as defined in paragraph 440-10-50-2

g. Investments accounted for under the equity method in accordance with the requirements of Topic 323

h. Noncontrolling interests and equity investments in consolidated subsidiaries (see Topic 810)

i. Equity instruments issued by the entity and classified in stockholders’ equity in the statement of financial position (see Topic 505)

j. Receive-variable, pay-fixed interest rate swaps for which the simplified hedge accounting approach is applied (see Topic 815)

k. **Fully benefit-responsive investment contracts** held by an employee benefit plan.

l. Investments in equity securities accounted for under the measurement guidance for equity securities without readily determinable fair values (see Topic 321)

m. Trade receivables and payables due in one year or less

n. Deposit liabilities with no defined or contractual maturities.

o. Liabilities resulting from the sale of prepaid stored-value products within the scope of paragraph 405-20-40-3.

In addition, amend the following pending content for paragraph 825-10-50-8, with no additional link to transition:

**Pending Content:**

**Transition Date:** (P) December 16, 2018; (N) December 16, 2019 | **Transition Guidance:** 842-10-65-1

**825-10-50-8** In part, this Subsection requires disclosures about fair value for all financial instruments, whether recognized or not recognized in the statement of financial position, except that the disclosures about fair value prescribed in paragraphs 825-10-50-10 through 50-16 are not required for any of the following:

a. Employers’ and plans’ obligations for pension benefits, other postretirement benefits including health care and life insurance benefits,
postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements (see Topics 710, 712, 715, 718, and 960)

b. Substantively extinguished debt subject to the disclosure requirements of Subtopic 405-20

c. Insurance contracts, other than financial guarantees (including financial guarantee insurance contracts within the scope of Topic 944) and investment contracts, as discussed in Subtopic 944-20

d. Lease contracts as defined in Topic 842 (a contingent obligation arising out of a cancelled lease and a guarantee of a third-party lease obligation are not lease contracts and are subject to the disclosure requirements in this Subsection)

e. Warranty obligations (see Topic 450 and the Product Warranties Subsections of Topic 460)

f. Unconditional purchase obligations as defined in paragraph 440-10-50-2

g. Investments accounted for under the equity method in accordance with the requirements of Topic 323

h. Noncontrolling interests and equity investments in consolidated subsidiaries (see Topic 810)

i. Equity instruments issued by the entity and classified in stockholders’ equity in the statement of financial position (see Topic 505)

j. Receive-variable, pay-fixed interest rate swaps for which the simplified hedge accounting approach is applied (see Topic 815)

k. **Fully benefit-responsive investment contracts** held by an employee benefit plan

l. Investments in equity securities accounted for under the measurement guidance for equity securities without readily determinable fair values (see Topic 321)

m. Trade receivables and payables due in one year or less

n. Deposit liabilities with no defined or contractual maturities.

**Amendments to Status Sections**

7. Amend paragraph 405-20-00-1, by adding the following items to the table, as follows:

**405-20-00-1** The following table identifies the changes made to this Subtopic.

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<th>Action</th>
<th>Accounting Standards Update</th>
<th>Date</th>
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<td>2016-04</td>
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<td>2016-04</td>
<td>03/08/2016</td>
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<td>Added</td>
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<td>03/08/2016</td>
</tr>
</tbody>
</table>

8. Amend paragraph 825-10-00-1, by adding the following item to the table, as follows:

825-10-00-1 The following table identifies the changes made to this Subtopic.

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<td>Amended</td>
<td>2016-04</td>
<td>03/08/2016</td>
</tr>
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</table>

The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, Chairman
James L. Kroeker, Vice Chairman
Daryl E. Buck
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith
Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Task Force’s considerations in reaching the conclusions in this Update. It includes the Board’s basis for ratifying the Task Force conclusions when needed to supplement the Task Force’s considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force and Board members gave greater weight to some factors than to others.

Background Information

BC2. Prepaid stored-value products are products in physical and digital forms with stored monetary values that are issued for the purpose of being commonly accepted as payment for goods or services. While the holder of a prepaid stored-value product also may be permitted to redeem the product for cash, prepaid stored-value products do not include products that only can be redeemed by the product holder for cash. Common examples of prepaid stored-value products include prepaid gift cards issued on a specific payment network and redeemable at network-accepting merchant locations, prepaid telecommunication cards, and traveler’s checks. GAAP does not contain specific guidance for the derecognition of liabilities resulting from the sale of prepaid stored-value products. In the absence of specific guidance, there has been diversity in practice on how prepaid stored-value product liabilities are derecognized. The FASB received an unsolicited comment letter from a stakeholder requesting that the Task Force clarify how (and whether) a prepaid stored-value product liability should be derecognized.

BC3. The stakeholder questioned whether a prepaid stored-value product liability meets the definition of a financial liability. Some stakeholders stated that the determination of whether a financial liability exists depends on whether the transaction between the entity that sells the prepaid stored-value product and the product holder is viewed as a separate transaction from the transaction between the entity and the merchant. That is, the obligation the entity has to the merchant is settled in cash and would meet the definition of a financial liability, while the obligation the entity has to the product holder is settled through the delivery of goods and services by the merchant and would not meet the definition of a financial liability.

BC4. However, other stakeholders view the substance of prepaid stored-value product sales as a single transaction between the entity and the product holder that is settled in cash through the merchant. Accordingly, in their view, the liability
recognized upon sale of a prepaid stored-value product meets the definition of a financial liability.

BC5. Many entities, but not all entities, apply the views expressed in a speech given by a U.S. Securities and Exchange Commission (SEC) staff member and recognize breakage for a prepaid stored-value product liability prior to when the product is redeemed regardless of whether the liability is considered a financial liability. Topic 606 establishes breakage guidance for transactions within its scope. However, financial liabilities are excluded from the scope of that breakage guidance.

BC6. The objective of the amendments in this Update is to provide specific guidance on the derecognition of prepaid stored-value product liabilities to eliminate the diversity in accounting treatment.

BC7. At its March 19, 2015 meeting, the Task Force reached a consensus-for-exposure on this Issue to require that breakage for prepaid stored-value product liabilities that are financial liabilities be accounted for consistent with the breakage guidance in Topic 606. The Board subsequently ratified the consensus-for-exposure and on April 30, 2015, issued a proposed Accounting Standards Update, Liabilities—Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Cards, for public comment, with a comment period that ended on June 29, 2015. The Board received 13 comment letters on the proposed Update. Overall, respondents supported the narrow-scope exception to the guidance in Subtopic 405-20.

BC8. The Task Force considered the feedback received on the proposed Update at its September 17, 2015 meeting. Based on the feedback received from comment letter respondents and discussions at that meeting, the Task Force directed the staff to remove the scoping characteristics included in the proposed Update and to develop a scoping principle. The Task Force reached a consensus at its November 12, 2015 meeting. The Board subsequently ratified the consensus, resulting in the issuance of this Update.

Scope

BC9. The Task Force reached a consensus that the guidance in the amendments in this Update should apply only to financial liabilities resulting from the sale of prepaid stored-value products. The scope of the amendments does not apply to financial liabilities related to prepaid stored-value products (or portions of those products) for which any breakage or unused portion of the prepaid stored-value product must be remitted in accordance with unclaimed property laws, or prepaid stored-value products that are attached to a segregated bank account like a customer depository account. The guidance also does not apply to customer loyalty programs or transactions within the scope of other Topics (for example, Topic 606).
BC10. The Task Force decided that a scoping principle provides the most operable framework to identify prepaid stored-value products that are subject to the guidance resulting from this Update.

Recognizing Breakage for Prepaid Stored-Value Products

BC11. The Task Force reached a consensus that because an entity’s liability for a prepaid stored-value product ultimately will be settled in cash paid to either the product holder or a third-party, that liability is a financial liability within the scope of Subtopic 405-20. However, the Task Force agreed that 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 within the scope of the Update. The Task Force believes that providing a means for those financial liabilities to be derecognized provides better information to users than potentially recognizing those liabilities in perpetuity. For example, if a prepaid stored-value product is lost and never used, the liability related to the product may never meet the derecognition criteria in Subtopic 405-20. The Task Force concluded that the breakage guidance for those prepaid stored-value products should be similar to the breakage guidance in Topic 606 because the economics of those prepaid stored-value product transactions are similar to the economics of prepaid stored-value product transactions that are expected to be within the scope of Topic 606. The Task Force also considered that the guidance in the amendments in this Update is similar to the way in which many entities with prepaid stored-value product liabilities within the scope of this Update recognize breakage today.

Technical Correction

BC12. The Task Force observed that the guidance in Subtopic 405-20 applies to both financial liabilities and nonfinancial liabilities. However, the guidance in Subtopic 405-20 does not acknowledge the existence of other derecognition guidance in GAAP (for example, Topic 606 and Subtopic 924-405, Entertainment—Casinos—Liabilities). Accordingly, the Task Force reached a consensus that a technical correction to the guidance in Subtopic 405-20 should be made to acknowledge the existence of other derecognition guidance in GAAP.

Disclosure

BC13. The Task Force reached a consensus that an entity should be required to disclose the methodology used to recognize breakage. That disclosure should be similar to the disclosures required for entities that will apply the breakage guidance in Topic 606. The Task Force observed that a prepaid stored-value product liability also should be subject to the disclosure requirements for financial liabilities in Topic
825, Financial Instruments. However, the Task Force concluded that an exception should be provided that permits an entity to exclude from its financial statements the disclosures required by Topic 825 as they relate to prepaid stored-value products.

Transition

BC14. The Task Force reached a consensus that an entity should apply the amendments in this Update using a modified retrospective transition method by means of a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year in which the guidance is adopted. The Task Force also reached a consensus that an entity may apply the amendments using a full retrospective transition method, similar to the transition provisions in Topic 606. However, an entity is not required to use the same transition methodology used to apply Topic 606.

BC15. The Task Force reached a consensus that an entity should provide the transition disclosures required in paragraphs 250-10-50-1(a) and (b)(3) and 250-10-50-2, as applicable, in the fiscal period in which the amendments in this Update are adopted. An entity applying a full retrospective transition also is required to provide the transition disclosure in paragraph 250-10-50-1(b)(1).

Effective Date

BC16. The Task Force reached a consensus that the effective date of the amendments in this Update should be aligned with the effective date of the amendments in Topic 606; that is, for public business entities, certain not-for-profit entities, and certain employee benefit plans for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. All other entities should apply the amendments in this Update for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Earlier application is permitted, including adoption in an interim period.

Benefits and Costs

BC17. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Task Force’s assessment of the costs and benefits of
issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC18. The Task Force does not anticipate that entities will incur significant costs as a result of the amendments in this Update because the amendments do not represent a significant change in practice for most entities selling prepaid stored-value products. Furthermore, the incremental disclosures required by this Update should not be costly. The Task Force agreed that derecognition of liabilities related to prepaid stored-value products within the scope of this Update will benefit users because there is a means to recognize breakage for those liabilities, rather than potentially recognizing those liabilities in perpetuity. Thus, on balance, the Task Force concluded that those benefits justify the limited costs that entities are expected to incur as a result of applying the amendments in this Update.

Comparison with International Financial Reporting Standards (IFRS)

BC19. IFRS does not provide specific guidance for the derecognition of prepaid stored-value product liabilities. The IFRS Interpretations Committee currently is discussing this issue. However, the International Accounting Standards Board (IASB) has not proposed amendments to IFRS as a result of those discussions. As such, the amendments differ from IFRS.
Amendments to the XBRL Taxonomy

The amendments to the FASB Accounting Standards Codification® in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those changes, which will be incorporated into the proposed 2017 Taxonomy, are available for public comment through ASU Taxonomy Changes provided at www.fasb.org, and finalized as part of the annual release process.