The Main Dish

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New revenue recogntion standard impact: Gift card accounting

By Jonathan Poppel, CPA

You may or may have not heard that there is a new revenue recognition accounting standard that is applicable starting in 2019 for private companies. For most restaurants, the main components of the new accounting standard are not expected to have any impact on how your restaurant sales are recognized. However, there are two areas of the new revenue recognition standard that may impact your restaurant:

- Accounting for gift cards, and
- Accounting for loyalty programs

This quarter, we will cover gift card accounting.

Gift card accounting

The new guidance doesn't so much change how gift cards should be accounted for as, in practice, most restaurants were recognizing the amount of expected breakage of gift cards as revenue. However, gift card breakage was not specifically included in the old revenue recognition standard, as the term breakage was only in the accounting guidance related to sales incentives. The new standard includes specific guidance that covers breakage as it applies to various contract liabilities, which includes gift cards.

Breakage refers to the unclaimed goods or services under a contract where the customer has made a non-refundable upfront payment. Quite often with gift cards, customers don't use the full balance of the gift card and may subsequently misplace the gift card or forget about the unused balance, which leaves an unused balance on the card that remains until the gift card expires. Accounting for the gift card breakage allows your restaurant to recognize revenue for the anticipated balances of gift cards that will not be used by the holder.

The new guidance requires your restaurant to estimate the amount of breakage associated with gift cards. This breakage amount is then recognized proportionately as the customer uses the gift card to pay for his or her purchase. To explain how this works, here's an example:

- $100 gift card is purchased
- No inactivity fees
- Card does not expire
- Unused gift card balance is not subject to unclaimed property tax laws

Based upon your historical experience, 10% of gift card balances for your restaurants are never used. Let's say a bill comes to $60 and the customer uses the gift card balance to pay for the purchase. We'll ignore sales taxes for this example.

In this situation, you would recognize total revenue of $66.67 ($60 in restaurant sales plus $6.67 of the expected

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breakage of the gift card of $10). The percentage of the expected breakage of $10 to be recognized is 66.67%, which is based upon $60 of the gift card balance used of the expected $90 of gift card balance to be used.

Please note, this is an example how gift card accounting would work. Aggregate information would likely be used to account for all gift card activity for a period.

Gift card administration

Gift card breakage accounting is impacted by several factors. If you sell gift cards, it is always important to stay abreast of federal and state laws governing gift cards. These federal and state regulations determine:

- Whether a card can expire,
- If fees can be charged for inactivity, or
- Whether the unused gift card balances need to be remitted to the state as unclaimed property

Each state has its own regulations over gift cards so you may need to work with an attorney to make sure you are in compliance when you have operations in multiple states or are starting a gift card program for the first time. You need to make sure the terms of the gift card are adequately outlined on the card.

To account for gift card breakage, you are going to need to make sure that you have detailed reporting for gifts cards. Regular analyses are needed to determine your gift card breakage experience, as breakage percentages can change over time due to economic or demographic factors. Also, be sure to run gift card liability reports at the appropriate level of detail at each reporting period. Often, we have seen gift card tracking programs that can only run reports in real-time and can't capture historical information. In addition, we anticipate that most restaurants will make top level entries at each reporting period to accurately account for gift card breakage under the new guidance, which will make timely run reports even more necessary.

More resources

You can find out more about the new revenue recognition standard in our e-Book. We'll also be covering more about accounting for gift cards and loyalty programs in the book. To download the newest version and get on the email list for updates, just head to **www.hhcpa.com/revrec**.

If you have any questions, Jonathan can be reached at (480) 839-4900 or JonathanP@hhcpa.com.

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