

when the receivables are sold. We also charge third parties an ongoing servicing fee for facilitating the repayment of these receivables through our payment processing platform. The servicing fee is calculated as a fixed percentage of each repayment transaction processed and is collected and recognized as the servicing is performed.

- Caviar is a courier order management app which facilitates food delivery services to restaurants. We charge restaurants a commission fee based on total food order value for these services. We also charge consumers a fixed delivery fee per transaction, as well as a service fee which is based on total food order value. All fees are recognized upon delivery of the food, net of refunds.

### **Hardware revenue**

Hardware revenue is generated from sales of Square Stand, third-party peripherals, and Square Readers for EMV chip cards and NFC. Hardware revenue is recorded net of returns and is recognized upon delivery of hardware to the end customer.

### **Accrued Transaction Losses**

We are exposed to transaction losses due to chargebacks, which represent a potential loss due to a dispute between a seller and their customer or due to a fraudulent transaction. We establish reserves for estimated losses arising from processing payment transactions. These reserves represent the estimated amounts necessary to provide for transaction losses incurred as of the consolidated balance sheet date, including those for which we have not yet been notified.

The reserves are based on known facts and circumstances as of the reporting date, including subsequent events, and historical trends related to loss rates. Additions to the reserve are reflected in current operating results, while charges to the

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### **Table of Contents**

reserve are made when losses are recognized. These amounts are classified as transaction and advance losses on our consolidated statements of operations and comprehensive loss.

The establishment of appropriate reserves for transaction losses is an estimate based on the available data and is inherently an uncertain process. Ultimately, losses may vary from the current estimates. We regularly update our reserve estimates as new facts become known and events occur that may impact the settlement or recovery of losses.

### **Provision for Uncollectible Receivables Related to MCAs**

Merchant cash advance receivable, net represents the aggregate amount of MCA-related receivables owed by sellers as of the consolidated balance sheet date, net of an allowance for potential uncollectible amounts in the event of merchant fraud or default. We are not exposed to losses for the receivables that are sold to third parties in accordance with our arrangements with them. These third-party arrangements cover a majority of the dollar value of receivables outstanding. For the remaining receivables, we are generally exposed to losses related to uncollectibility, and similar to the accrued transaction loss, we establish losses for uncollectible receivables. We estimate the allowance based on an assessment of various factors, including historical experience, sellers' current processing volume, and other factors that may affect the sellers' ability to make future payments on the receivables. Additions to the allowance are reflected in current operating results, while charges against the allowance are made when losses are recognized. These additions are classified within transaction and advance loss on the consolidated statements of operations. Recoveries are reflected as a reduction in the allowance for uncollectible receivables related to MCAs when the recovery occurs. No provision existed prior to 2014 as Square Capital launched in 2014.

### **Marketing Expenses**

Marketing expenses are expensed as incurred and include customer acquisition costs and advertising costs. Customer acquisition costs include manufacturing and distribution costs associated with Square Readers for magnetic stripe cards, which are offered for free on our website and provided through various marketing events and distribution channels. We also offer rebates to new sellers who become customers for the retail price of the credit card readers purchased. The expected future rebates related to card readers distributed are accrued in other current liabilities on the consolidated balance sheets. These costs are partially offset by amounts received from distribution partners. Marketing expenses also include costs associated with Square Cash, which enables individuals to initiate peer-to-peer cash transfers free of charge. Customer acquisition costs are expensed as incurred.