

USALI – Part V “Gross v Net Accounting”

Modification of the 11th Edition due to ASC 606 and ASU 2016-08

The determination to report revenue on a gross or net basis influences the classification of a revenue source as either Miscellaneous Income or an Other Operated Department. In many revenue transactions, an entity other than the hotel is involved in delivering the goods and services to the customer. In those situations, a hotel must determine whether it is acting as a principal or as an agent in the transaction. A hotel must determine whether the nature of its promise is to provide the specified goods or services to the customer or to arrange for another entity to provide them. If the nature of the promise is to provide the specified goods or services to the customer, the entity is a principal and recognizes revenue on a gross basis. A principal in a transaction controls the specified goods or services before they are transferred to the customer. An agent arranges for another party to provide the goods or services and therefore recognizes revenue in the net amount it is entitled to for its agency services. The determination that the hotel is acting as an agent in the transaction results in the determination to record the transaction on the net basis. A determination of accounting for the revenues on a gross basis, as a principal, results in the gross (full) amount billed to the customer recorded as revenue. A determination of accounting for the revenues on a net basis, as an agent, results in the net amount retained, the amount billed to the customer less the amount paid to the supplier or the net commission retained, recorded as revenues.

A hotel should apply the following two steps to evaluate whether it is a principal or an agent in transactions involving more than one party delivering goods or providing services:

- Identify the specified goods or services to be provided to the customer
- Assess whether it controls the specified goods or services before they are transferred to the customer

The hotel determines whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer. If a contract with a customer includes more than one specified good or service, the hotel could be a principal for some specified goods or services and an agent for others

The hotel is a principal if it controls the specified good or service before that good or service is transferred to a customer. If a hotel does not control the good or service before it is transferred to the customer, the hotel is an agent in the transaction. Therefore, a key element of the determination is the concept of control. Control of a product or service refers to the ability to direct the delivery of, and obtain substantially all the remaining benefits from, the product or service. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, the product or service. The benefits of the product or service are the potential cash flows that can be obtained directly or indirectly from using, selling, or holding the product or service.

It is not always clear whether the hotel obtains control of the specified good or service. Therefore, the following three indicators of control can be useful in making the determination the hotel is a principal in the transaction:

1. The hotel is primarily responsible for fulfilling the promise to provide the specified good or service.
2. The hotel has inventory risk before the specified good or service has been transferred to a customer, or after transfer of control to the customer.
3. The hotel has discretion in establishing the prices for the specified goods or service.

Estimating gross revenue as a principal

Estimating the proper amount of gross revenue to record as a principal can be difficult in some transactions. The hotel does not always know the price charged to its customer for its goods or services by another entity. Such uncertainty may arise because the hotel does not have, and will not obtain, sufficient transparency into the intermediary's pricing. If the uncertainty related to the transaction price is not ultimately expected to be reasonably resolved, it should not be included in the transaction price. Therefore, in circumstances where the hotel is acting as a principal and the transaction price charged by an intermediary is not known, the amount which the hotel expects to be entitled from the intermediary should be recorded as revenue.