



# **Gross Versus Net Revenue Reporting Considerations for Online Travel Agency (OTA) Contracts**

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In recent years, the Financial Accounting Standards Board (FASB) has made significant changes to its guidance in accounting for revenue recognition. Such changes are effective for public companies in 2018; and for all other organizations in 2019.

This article will address the potential impact on hotels when reporting OTA contract revenue.

## **Perspective**

Historically, revenue under OTA contracts has been recognized according to the following two models:

Retail/Commission Model	Merchant Model
Guest makes the reservation via the OTA. Guest pays the hotel at the end of their stay.	<ul> <li>Guest makes reservation via the OTA. An upfront payment is made to the OTA upon booking.</li> </ul>
<ul> <li>Hotel collects the payment and remits a commission to the OTA.</li> <li>Revenue is recognized by the hotel at the gross</li> </ul>	At checkout, the OTA remits payment to the hotel for the net amount of the cash received which is the room rate less the OTA fee.
amount and an expense is recorded for the OTA commission.	<ul> <li>Revenue is recognized by the hotel at the net amount with no commission expense recognized by the hotel.</li> </ul>

### **Principal or Agent**

The new revenue recognition model addresses the inconsistency in financial reporting requiring a hotel to determine if it is the principal **or** the agent in the transaction.

A principal in the transaction is the entity that controls the good or service before it is transferred to the guest.

Some key considerations to determine if an entity has control include:

- Who has primary responsibility for fulfilling the promise to provide the good or service?
- Who has inventory risk?
- Who has control in establishing the price of the good or service?

In both models outlined above, the hotel:

- controls the good or service before it is provided to the guest,
- is essentially responsible for providing the stay, and
- primarily determines the price of the hotel room.

These factors indicate that the hotel is the principal in the transaction and, as such, is required to recognize revenue on a gross basis for both models.

In the event the OTA can package the room with other services not affiliated with the hotel (i.e. flights, rental cars, etc.), establish room rates and commit to obtaining a certain number of rooms or charge additional service fees to guests, then such revenue may continue to be recognized on a net basis.

#### For Consideration

We suggest that hotel owners and operators review the terms of current OTA agreements and determine whether they are the principal or the agent in the transactions that occur under the agreements. Principals in such transactions should report revenues on a gross basis and agents on a net basis.

The gross versus net revenue recognition issue may also apply to other hotel revenue sources in which a third party is involved such as parking, laundry, audiovisual and recreational activities.

In addition, certain charges that are based on a percentage of revenues (including management fees, franchise fees, credit card commissions and sales and occupancy taxes) may increase thus reducing the hotel's operating performance.

#### **Contact Us**

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