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

By Jonathan Zuckerman, CPA, Partner

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:

<table>
<thead>
<tr>
<th>Retail/Commission Model</th>
<th>Merchant Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guest makes the reservation via the OTA. Guest pays the hotel at the end of their stay.</td>
<td>Guest makes reservation via the OTA. An upfront payment is made to the OTA upon booking.</td>
</tr>
<tr>
<td>Hotel collects the payment and remits a commission to the OTA.</td>
<td>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.</td>
</tr>
<tr>
<td>Revenue is recognized by the hotel at the gross amount and an expense is recorded for the OTA commission.</td>
<td>Revenue is recognized by the hotel at the net amount with no commission expense recognized by the hotel.</td>
</tr>
</tbody>
</table>

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

Should you have any questions regarding this matter, please feel free to contact any of the following:

Clare E. Cella, CPA, Partner  
ccella@pkfod.com  
646.699.2846

Jonathan Zuckerman, CPA, Partner  
jzuckerman@pkfod.com  
646.699.2842

Henry A. Freire, CPA, Partner  
hfreire@pkfod.com  
646.699.2847

About PKF O'Connor Davies

PKF O'Connor Davies, LLP is a full-service certified public accounting and advisory firm with a long history of serving clients both domestically and internationally. With roots tracing to 1891, nine offices in New York, New Jersey, Connecticut and Maryland, and more than 700 professionals, the Firm provides a complete range of accounting, auditing, tax and management advisory services.

PKF O'Connor Davies is ranked 28th on Accounting Today's 2017 "Top 100 Firms" list and is recognized as one of the "Top 10 Fastest-Growing Firms." PKF O'Connor Davies is also recognized as a "Leader in Audit and Accounting" and is ranked among the "Top Firms in the Mid-Atlantic," by Accounting Today. In 2017, PKF O'Connor Davies was named one of the 50 best accounting employers to work for in North America, by Vault.

PKF O'Connor Davies is the lead North American representative in PKF International, a global network of legally independent accounting and advisory firms located over 400 locations, in 150 countries around the world.

Our Firm provides the information in this e-newsletter for general guidance only, and it does not constitute the provision of legal advice, tax advice, accounting services, or professional consulting of any kind.