

Financial Reporting Center – Revenue Recognition

Working Draft: Hospitality Revenue Recognition Implementation Issue



Issue #7-3 – Accounting for Owned and Leased Property Revenues

Expected Overall Level of Impact to Industry Accounting:

Moderate

Wording to be Included in the Revenue Recognition Guide:

Background

1. Owned and Leased properties contain the following revenue streams:
 - a. Room revenue
 - b. Package revenue
 - c. Option revenue
 - d. Other ancillary guest services fees

Revenues generated through loyalty programs are addressed in Hospitality Paper #7-4: Loyalty Programs.

Room Revenue

Step 1: Identify the Contract with a Customer

2. Room sales are driven by a fixed fee charged to a hotel guest to stay at the hotel property for an agreed upon period. The hotel agrees to provide a room to the hotel guest for a specified time period for an agreed-upon rate. The hotel reservation includes the terms of the agreement.
3. Cancellation policies vary across room reservations. The contractual terms related to the cancellation policies and the hotel's customary business practices are important components in determining the contract and the enforceable rights and obligations. Some reservations are nonrefundable and non-cancellable, while others allow the customer to cancel the night before or the day of the hotel stay.
4. FASB ASC 606-10-25-3 states that "An entity shall apply the guidance in this Topic to the duration of the contract (that is, the contractual period) in which the parties to the contract have present enforceable rights and obligations."
5. For non-cancellable contracts, FinREC believes that the contract term would be for the entire length of the reservation. For contracts with night-before or day-of cancellation policies, FinREC believes the contract term

would be considered a daily contract with optional purchases for each additional night of the reservation. FASB/IASB TRG Agenda Ref 48: *Customer Options for Additional Goods and Services*, includes a discussion on penalties from terminations of non-cancellable contracts if considered significant for a particular reservation.

Step 2: Identify the Performance Obligations in the Contract

6. According to FASB ASC 606-10-25-14, a good or service is a performance obligation if it is considered distinct or if there are a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer. Further, according to FASB ASC 606-10-25-19, a good or service is distinct if both the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer, and the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.
7. FinREC believes there is one performance obligation to provide lodging facilities as the separate components of providing these services (hotel room, toiletry items, housekeeping, and amenities) are not distinct within the context of the contract as they are all highly dependent and interrelated as part of the obligation to provide the lodging facility.
8. As a result, FinREC believes that there is one performance obligation for non-cancellable reservations. In contrast, FinREC believes there are separate performance obligations for each day of the stay in cancellable reservations (which may be considered daily contracts), unless the option for the additional stay is considered a material right in accordance with ASC 606-10-55-41 through 55-45 (Discussion of optional purchases is included in the Package/Other Ancillary Services Revenue section below.)

Step 3: Determine the Transaction Price

9. FASB ASC 606-10-32-2 states:
An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties. The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.
10. FinREC believes the transaction price is the room rate including any discounts applicable in accordance with FASB ASC 606-10-32-2. In the process for reserving a hotel room, the guest and hotel agree upon the room rate prior to the hotel guest receiving a room key. This fee includes consideration received for a hotel room, toiletry items, housekeeping services, and various amenities such as TV, gym/pool access, etc. Typically, the room rate is the same for each night of the reservation, but could vary depending on demand.

Step 4: Allocate the Transaction Price to the Performance Obligations in the Contract

11. If there is only one performance obligation identified in a contract, then the transaction price would not need to be allocated. If there are multiple performance obligations, FASB ASC 606-10-32-29 requires that the hotel owner allocate the transaction price to each performance obligation identified in the contract on a relative standalone selling price ("SSP") basis. At contract inception, the hotel owner determines the SSP for each performance obligation. As explained in FASB ASC 606-10-32-32 and FASB ASC 606-10-32-33, the SSP may be directly observable or may need to be estimated.

Step 5: Recognize Revenue when (or as) the Entity Satisfies a Performance Obligation

12. In accordance with FASB ASC 606-10-25-24, the hotel owner is required to determine whether the performance obligation is satisfied over time or at a point in time. If the performance obligation is not satisfied over time, then it is satisfied at a point in time.
13. For hotel room only reservations, the hotel owner should consider the guidance in FASB ASC 606-10-25-27 to determine if the room reservation is satisfied over time. FASB ASC 606-10-25-27 states:
An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognizes revenue over time, if one of the following criteria is met:
 - a. The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.
 - b. The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced.

- c. The entity's performance does not create an asset with an alternative use to the entity, and the entity has the enforceable right to payment for performance completed to date.
14. FinREC believes that hotel room only reservations are performance obligations satisfied over time as the hotel guest simultaneously receives and consumes the benefits provided by the hotel.
15. For performance obligations satisfied over time, FASB ASC 606-10-25-31 requires the hotel to recognize revenue over time by measuring the progress toward complete satisfaction of that performance obligation. The objective when measuring progress is to depict the hotel's performance in transferring control of the goods or services.
16. For measuring progress, FASB ASC 606-10-25-33 and 606-10-55-16 explain that appropriate measures of measuring progress include output and input methods. In accordance with FASB ASC 606-10-25-33, the owner should consider whether an output method or input method accurately reflects the transfer of control.
17. For example, if the value transferred to the hotel guest is the same each day, then an output method based on time elapsed may be an appropriate method of measuring progress, since the hotel provides the same services throughout the contract. (Note that "value to the customer" refers to an objective measure of the entity's performance, not market prices or value perceived by the customer.) Revenue would then be recognized on a straight-line basis over the performance obligation.
18. For non-cancellable reservation policies with one performance obligation, FinREC believes the transaction price should be recognized as revenue evenly over the hotel stay. For cancellable contracts (which may be daily contracts), revenue would be recognized when the performance obligations are transferred. For example, if there is a 5 night reservation with a day-of cancellation policy, the hotel may consider that one daily contract (at the point the contract is no longer cancellable), with an option to purchase the 4 additional nights (Discussion of optional purchases is included in the Package/Other Ancillary Services Revenue section below). Assuming there is no material right in the contract, revenue would be recognized when the daily hotel stay is provided.

Package/Other Ancillary Services Revenue

Step 1: Identify the Contract with a Customer

19. Ancillary services revenue is generated when a hotel guest chooses to purchase goods or services separately from the hotel room, such as food and beverage/room service, dry cleaning services, mini-bar purchases, spa services, etc. The goods and services are selected on an individual basis.
20. When ancillary guest services are connected with a hotel reservation, the hotel owner should consider the related terms to identify the enforceable rights and obligations created under the hotel room reservation.
21. FASB ASC 606-10-25-9 states:

An entity shall combine two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) and account for the contracts as a single contract if one or more of the following criteria are met:

 - a. The contracts are negotiated as a package with a single commercial objective,
 - b. The amount of consideration to be paid in one contract depends on the price or performance of the other contract, or
 - c. The goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation.
22. If the reservation is for a package of services (hotel room, meals, spa services, etc.) for a stated price, then the contract may cover all of those goods and services.
23. When the ancillary guest services are included with the hotel reservation in a package arrangement, then the hotel owner should consider the guidance in FASB ASC 606-10-25-9 to determine if the contracts for the ancillary guest services and reservation should be combined:
 - a. whether the contracts are negotiated together with a single objective, taking into consideration how and why the guest decides to purchase the ancillary services.
 - b. if the contract prices are interdependent, such as whether the hotel room price changes depending on the purchase of ancillary services, and vice versa.
 - c. whether any of the goods and services across the two contracts are a single performance obligation.

24. FinREC believes that typically goods and services purchased by the customer on a standalone basis, separate from the hotel reservation, are distinct promised goods and services that should be accounted for as separate contracts (e.g. a beverage from the room minibar).

Step 2: Identify the Performance Obligations in the Contract

25. If the goods and services are sold on a standalone basis, separate from the hotel reservation, and control is transferred at a point in time, FinREC believes each ancillary transaction gives rise to a single performance obligation related to that transaction.
26. For package hotel reservations, depending on the specific facts and circumstances of the arrangement, the owner may identify multiple performance obligations; one for the hotel reservation and one for each type of ancillary service, because the hotel regularly sells these items separately.
27. FASB ASC 606-10-25-14 explains that a good or service is a performance obligation if it is considered distinct or if there are a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer. FASB ASC 606-10-25-15 further explains that:
- A series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:
- Each distinct good or service in the series that the entity promises to transfer to the customer would meet the criteria in paragraph 606-10-25-27 to be a performance obligation satisfied over time.
 - In accordance with paragraphs 606-10-25-31 through 25-32, the same method would be used to measure the entity's progress toward complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.
28. BC116 of ASU 2014-09 states:
- The Boards noted that Topic 606 would not need to specify the accounting for concurrently delivered distinct goods or services that have the same pattern of transfer. This is because, in those cases, an entity is not precluded from accounting for the goods or services as if they were a single performance obligation, if the outcome is the same as accounting for the goods and services as individual performance obligations.
29. If the package, option, or other ancillary services offered meet the criteria in FASB ASC 606-10-25-15 to be considered a series of distinct goods or services, then the services should be combined into a single performance obligation.
30. In accordance with FASB ASC 606-10-55-42, the option to acquire additional goods or services is a performance obligation if the option provides a material right that would not be received without entering into the contract (for example, a discount that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market).
31. The hotel owner should consider if the option for the ancillary items is a material right.
32. FinREC believes the option to acquire goods or services in addition to the hotel reservation, is a material right if the guest would not have received it without entering into the hotel stay, and receives a discount incremental to the range typically given. However, a coupon for a discount off a meal at the hotel restaurant, that is offered to both non-guests and guests, would not be considered a material right under FASB ASC 606-10-55-42.
33. As stated above, cancellable room reservations may contain optional purchases for additional nights of the reservation. The hotel will need to determine if those optional purchases represent material rights in accordance with FASB ASC 606-10-55-41 through 55-45. If the price for the additional nights reflects the standalone selling price for the stay, there would not be a material right in the contract and each daily reservation would represent a separate contract and separate performance obligation. If the cancellable room reservation includes a material right, then both the daily room reservation and the discount option would be considered separate performance obligations.

Step 3: Determine the Transaction Price

34. FASB ASC 606-10-32-2 states:
- An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties. The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

35. FinREC believes the transaction price for ancillary guest services and room reservation packages is similar to the method detailed in the “Room Revenue” section above as goods and services are typically provided for a fixed rate.

Step 4: Allocate the Transaction Price to the Performance Obligations in the Contract

36. If more than one performance obligation has been identified, FASB ASC 606-10-32-29 requires that the entity allocate the transaction price to each performance obligation identified in the contract on a relative standalone selling price basis. Allocation is not necessary if the contract contains only one performance obligation.
37. If an option for free or discounted ancillary services, contains a material right and is determined to be a separate performance obligation, then in accordance with FASB ASC 606-10-32-31, the transaction price should be allocated to each performance obligation, including the material right, on a relative SSP basis.
38. It is likely that the SSP for the option will need to be estimated if there is a material right. FinREC believes the estimate for the option for free or discounted ancillary services should reflect the discount that the customer would obtain when exercising the option, adjusted for any discount that could be received without exercising the option and the likelihood that the option will be exercised. In addition, the hotel owner considers the average amount of additional products purchased with the option.
39. Example 49 – Option That Provides the Customer With a Material Right (Discount Voucher) in FASB ASC 606-10-55-336, will be helpful when estimating the SSP of the option for free or discounted ancillary services that contains a material right. FASB ASC 606-10-55-338 depicts the entity calculating the estimate of the standalone selling price of the discount voucher by applying the formula: average price of additional products * X% of incremental discount * X% likelihood of exercising the option.

Step 5: Recognize Revenue when (or as) the Entity Satisfies a Performance Obligation

40. The performance obligation related to the ancillary guest service could relate to a number of different goods or services provided on a one-time and individual basis. For the ancillary guest services, in accordance with FASB ASC 606-10-25-24, the hotel owner should analyze each type of good or service to determine when control transfers and if the performance obligation is satisfied over time or at a point in time.
41. FinREC believes that typically most ancillary goods or services do not meet the criteria in FASB ASC 606-10-25-27 to be considered performance obligations satisfied over time.
42. As explained in FASB ASC 606-10-25-30, if a performance obligation is not satisfied over time, then it is satisfied at a point in time.
43. FASB ASC 606-10-25-30 includes indicators that should be considered when determining at what point the hotel guest obtains control of the promised asset:
- The entity has a present right to payment for the asset;
 - The customer has legal title to the asset;
 - The entity has transferred physical possession of the asset;
 - The customer has the significant risks and rewards of ownership of the asset;
 - The customer has accepted the asset.
44. For some of the ancillary services, the guest obtains control simultaneously at the point of sale (mini-bar items), while for others control may be transferred several hours later (such as dry cleaning).
45. For package reservations, in accordance with FASB ASC 606-10-25-24, if more than one performance obligation is identified, the hotel owner is required to determine the pattern of recognition (over time or at a point in time) for each performance obligation. The hotel reservation is recognized similar to the ‘hotel only reservations’ section.
46. Similarly, if an option for free or discounted ancillary services is determined to be a separate performance obligation, then the owner determines when to recognize revenue for the option. In accordance with FASB ASC 606-10-55-42, the owner should recognize revenue from the option for free or discounted ancillary services that contains a material right, when those future goods or services are transferred or when the option expires.

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