Working Draft:
Airlines Revenue Recognition Implementation Issue

Issue #2-8 – Accounting for Contract Costs - Commissions and Selling Costs

Expected Overall Level of Impact to Industry Accounting: Minimal

Wording to be Included in the Revenue Recognition Guide:

Accounting for Commissions and Other Selling Costs

1. In the airline industry typical costs incurred in obtaining a contract with a customer (that is, a ticket) might include credit card fees, travel agency and other commissions paid, and global distribution systems (GDS) booking fees (collectively referred to as *direct selling costs*).

2. FASB ASC 340-40 provides guidance on costs related to a contract with a customer within the scope of FASB ASC 606. FASB ASC 340-40-25-1 states that "An entity shall recognize as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs." Incremental costs of obtaining a contract are defined in FASB ASC 340-40-25-2 as "those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission)." Direct selling costs are incurred at the contract or ticket level. Because an airline would not have incurred these costs if the ticket had not been sold, these costs would be considered incremental costs of obtaining the contract for air travel. Furthermore, airlines typically collect funds associated with air travel in advance of the services being provided. In addition, the direct selling costs represent only a small percentage of the sales price of the ticket (generally 10% or less of the sales price of a ticket) and many of the selling costs (such as commissions and credit card fees) are recoverable from the vendor if the transaction is cancelled or refunded.

3. Frequently a revenue contract or ticket contains two main performance obligations: the purchased travel and the loyalty related performance obligations. Tickets must be used for travel within one year of purchase, while loyalty points can be outstanding for a number of years, until sufficient points are accumulated to allow for redemption. Generally, tickets sold by airlines are the same prices regardless of whether the passenger is a loyalty member and earns miles or not. As to the allocation of the selling costs between the different performance obligations for recognition purposes, FinREC believes that allocating selling costs exclusively to the current travel purchased and none to the loyalty related performance obligations is consistent with the guidance in FASB ASC 340-40-35-1, which states that "An asset recognized in accordance with paragraph 340-40-25-1 or 340-40-25-5 shall be amortized on a systematic basis that is consistent with the transfer to the customer of the goods or services ***to which the asset relates***" (emphasis added). As tickets are sold for the same price with or without the loyalty points, the implication is that there is no incremental cost associated with the miles component of the contract. As

a result, the total selling cost associated with the contract (that is, the ticket) could be allocated to the purchased travel and recognized when the flight occurs.

4. Although direct selling costs would qualify for capitalization, FASB ASC 340-40-25-4 provides a practical expedient such that "an entity may recognize the incremental costs of obtaining a contract as an expense when incurred if the amortization period of the asset that the entity otherwise would have recognized is one year or less." Considering that direct selling costs are determined at the contract level or ticket level, they would qualify for the practical expedient if the ticket is expected to be used within one year from the date of sale, which is generally the case.

5. Airlines that decide not to use the practical expedient would record commissions and related transaction fees that have been allocated to the performance obligations in the contract as an asset and, consistent with guidance in FASB ASC 340-40-35-1, would then expense this asset when the flight occurs.

Comments should be received by September 1, 2016, and sent by electronic mail to Yelena Mishkevich at ymishkevich@aicpa.org, or you can send them by mail to Yelena Mishkevich, Accounting Standards, AICPA, 1211 Avenue of the Americas, NY 10036.