

Financial Reporting Center – Revenue Recognition

Working Draft: Airlines Revenue Recognition Implementation Issue



Issue #2-5A – Timing and Classification of Commissions in Interline Transactions

Expected Overall Level of Impact to Industry Accounting: May change current practice regarding classification but should not change current practice on timing of recognition

Wording to be Included in the Revenue Recognition Guide:

Introduction

1. Airlines frequently sell tickets for round-trip or multi-city destinations and frequently operate connecting flights under which one or more segments of the journey will be flown by another carrier. Interline transactions are generally settled at the time the passenger flies on the other airline (OAL), at which time the OAL bills the selling carrier per their interline agreement. Generally, under the terms of the interline agreement, the selling carrier retains an agreed upon commission intended to compensate it for the selling costs associated with the ticket. Primary selling costs include commission, credit card fees, GDS fees and certain other related costs.
2. FASB ASC 606-10-15-3 defines a *customer* as “a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration. A counterparty to the contract would not be a customer if, for example, the counterparty has contracted with the entity to participate in an activity or process in which the parties to the contract share in the risks and benefits that result from the activity or process (such as developing an asset in a collaboration arrangement) rather than to obtain the output of the entity’s ordinary activities.” FinREC believes that in interline transactions the passenger is the customer of the selling carrier for the flight segments it operates as well as for the OAL flight segments it arranges; the passenger is also the customer of the OAL for the segments the OAL operates. FinREC also believes that the OAL is the customer of the selling carrier in the agency relationship of arranging the flight segments operated by the OAL. This view is consistent with paragraph 15 of TRG Agenda ref 44, *July 2015 Meeting – Summary of Issues Discussed and Next Steps*,¹ which indicates that “an entity that is acting as an agent (that is, arranging for another party to provide goods or services), might identify multiple customers depending on the facts and circumstances of the arrangement. That is, the entity might view both the principal and the end customer as customers in the arrangement.”

¹ See [TRG Agenda ref 44, July 2015 Meeting – Summary of Issues Discussed and Next Steps](#) – Topic 1: Consideration payable to a customer.

3. As discussed in Issue No. 2-5, *Interline Transactions*, each segment in an interline transaction would generally represent a separate performance obligation and the selling carrier needs to consider the guidance in paragraphs 36-40 of FASB ASC 606-10-55 to determine whether it acts as a principal or agent with respect to the services it provides under the interline agreement for each segment. FinREC believes that the selling carrier would typically be considered an agent on behalf of the OAL for flight segments operated by the OAL (the principal versus agent determination is not addressed in this paper and is discussed in Issue No. 2-5). Therefore, the OAL would typically be the principal for flight segments it operates and the selling carrier would typically be the principal for the flight segments it operates.

Selling Carrier

4. FASB ASC 606-10-55-38 states, in part:

When (or as) an entity that is an agent satisfies a performance obligation, the entity recognizes revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the specified goods or services to be provided by the other party. An entity's fee or commission might be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.

5. In order to determine when to recognize commission revenue for the OAL segment, the selling carrier (which acts as an agent on OAL segments) needs to evaluate when it satisfies its performance obligation as it relates to the OAL segment. As discussed in Issue No. 2-5, the selling carrier's nature of the overall promise is to transport the passenger in accordance with the contract for the portion of the trip that it is responsible for and to arrange transportation on the OAL for the portion of the trip for which the OAL is responsible. The commission is earned based on the arrangement of the travel provided by the OAL.
6. The selling carrier's performance obligation as it relates to the OAL segment is to arrange for the OAL to provide transportation. While the OAL is responsible for fulfilling the promise of transportation for its segment, the selling carrier is party to the overall contract and is ultimately responsible for all transportation promised in the contract until the OAL assumes responsibility to provide the passenger with the specified transportation. If, for any reason, the OAL does not assume responsibility, the selling carrier has not satisfied its obligation of arranging for the OAL to provide transportation and must arrange for alternative transportation (e.g., by another OAL or by the selling carrier itself). Therefore, the selling carrier has not satisfied all obligations to the customer at time of sale. After time of sale, the selling carrier manages the relationship with the customer for all contract activities until time of flight – for either the segment operated by the selling carrier or the segment operated by the OAL. As a result, the selling carrier's promise to arrange for the flight services is not complete until the point in time that the OAL assumes responsibility to provide the passenger with the specified transportation. Accordingly, FinREC believes commission revenue should be recognized at the time of flight and not upon sale of the ticket, as the selling carrier has not earned the commission until the OAL assumes the passenger. FinREC also believes that the selling carrier's commission revenue should be recorded in other revenue from contracts with customers in the net amount retained as it relates to arranging for transportation on the OAL.²

Operating Carrier

7. FASB ASC 606-10-55-37B provides the following guidance that should be considered when evaluating the treatment of commissions from the perspective of the operating carrier as the principal of interline transactions.

When (or as) an entity that is a principal satisfies a performance obligation, the entity recognizes revenue in the gross amount of consideration to which it expects to be entitled for the specified good or service transferred.

8. The amount due to the OAL is the pro-rata share of the ticket price for segments operated by the OAL (as the principal), less the specified commission that will be retained by the selling carrier. While the OAL receives an amount net of commissions retained by the selling carrier for segments it operates, FinREC believes that method of settlement is not relevant to the reporting revenue gross versus net considerations. This is supported by the following views expressed in paragraph BC380 of ASU 2014-09, *Revenue from Contracts with Customers (Topic*

² Please note that conclusions in this paragraph are specific to the airline industry and should not be analogized to by entities that are agents in other industries. Entities in other industries should consider their specific facts and circumstances when analyzing their transactions under FASB ASC 606.

606), and paragraph BC3 of ASU 2016-08, *Revenue from Contracts with Customers (Topic 606) - Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*:³

BC380 of ASU 2014-09 ...A principal controls the goods or services before they are transferred to a customer. Consequently, the principal's performance obligation is to transfer those goods or services to the customer. Therefore, recognizing revenue at the gross amount of the customer consideration faithfully depicts the consideration to which the entity is entitled for the transfer of the goods and services...

BC3 of ASU 2016-08 ...The TRG discussed both the principal versus agent considerations guidance in the new revenue standard and the issue of determining the transaction price when an entity is a principal but is unaware of the price charged to the customer for its goods or services by an intermediary (that is, whether an entity should estimate the price charged to the customer by the intermediary and recognize that amount as its gross revenue as a principal in the transaction)...

FinREC believes that paragraphs BC380 and BC3 imply that if the principal receives a payment net of an amount retained by the agent but is aware of the price charged to the customer by the agent for the principal's goods or services, the principal should recognize that amount as its gross revenue. Consistent with the guidance in FASB ASC 606-10-55-37B and paragraphs BC380 and BC3, FinREC believes the gross amount of the transaction price (i.e. the pro-rata share of the ticket price) should be recognized as passenger revenue as it relates to the transportation provided. The agreed upon commission that is retained by the selling carrier for the OAL segment should, therefore, be recognized as a selling cost by the OAL and classified as an operating expense. The recognition of passenger revenue and commission expense by the operating carrier should occur at time of flight because this is when the operating carrier satisfies its performance obligation by operating the flight and transporting the passenger.

Comments should be received by December 1, 2017, and sent by electronic mail to Yelena Mishkevich at yelena.mishkevich@aicpa-cima.com, or you can send them by mail to Yelena Mishkevich, Accounting Standards, AICPA, 1211 Avenue of the Americas, NY 10036.

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³ Paragraph BC380 of ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, paragraph BC3 of ASU 2016-08, *Revenue from Contracts with Customers (Topic 606) - Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, and other paragraphs from the "Background Information and Basis for Conclusions" sections were not codified in FASB ASC; however, FinREC believes these paragraphs provide helpful guidance and, therefore, decided to incorporate them in this guide.