Gross vs. Net Revenue Reporting

By Agnes DeFranco and Raymond Schmidgall

The 11 th revised edition of the Uniform System of Accounts for the Lodging Industry (USALI) was published in the spring of 2014, with an implementation date of January 1, 2015. The responsibility for revising the USALI lies with the Financial Management Committee (FMC) of the American Hotel & Lodging Association (AH&LA).

Throughout the implementation process, the FMC has received several questions from the worldwide lodging industry. To answer these questions, the FMC has created a Frequently Asked Questions (FAQ) document available on the USALI resource portal, accessible exclusively to purchasers of the book.

In an effort to assist hotel owners and operators with their implementation, the FMC presents a series of monthly articles that address some of the most frequently asked questions. Some of the topics to be discussed include gross versus net revenue reporting, service charges, the change from cover to customer counts, and mixed-ownership facilities.

For this month we present guidance regarding the reporting of revenue on a gross versus net basis prepared by committee members Agnes DeFranco and Raymond Schmidgall.

The FAQ for USALI 11 th Revised Edition which can be accessed through the AHLEI website has a number of practical and useful guidelines. One of the questions linking to the topic of gross versus net in the FAQ is as follow:

Q: In what department would a hotel record revenue for Sea World Tickets (for example) included in a package?

A: The gross versus net principles should be applied first. If it is determined that reporting would be gross, then it would go into one of the "Minor Operated" departments, however if it is reported net, then any profit on the ticket would go to Miscellaneous Income (Schedule 4).

The 11 th Edition of the USALI offers many new practices. Reporting revenues as a gross amount versus netting certain items makes a huge difference. This is especially true when management fees, owners' profit, or even managerial compensation are linked to either measures. On the surface, it seems the treatment of revenue as gross or net is a very simple decision - if the hotel is the principal in the transaction, then the revenue should booked as gross, under a separate Other Operated Department; on the other hand, if the hotel is acting as an agent, then the revenue should be booked as net, as Miscellaneous Income. Thus the principal-agent dichotomy dictates the decision. However, to ensure fairness can be achieved, and life is not always so black and while, there is actually a list of indicators to which a hotel can answer yes or no. Then, according to the preponderance of strength of all indicators present, the proper treatment is then determined.

To assist users in making the proper decision, the USALI explains each of these indicators one by one (three indicators of net revenue reporting and eight indicators of gross revenue reporting). It also provides examples in recreational activities (such as the Sea World tickers in the FAQ), retail outlets, parking, laundry and dry cleaning, in-room entertainment, and audio visual as to how these revenues should be booked. So, let's start by taking a closer look at the three net revenue reporting indicators.

Three Indicators of Net

According to the USALI, revenues should be booked as net under Miscellaneous Income if the hotel is an agent, not the principal.

1. The supplier is the primary obligor . The supplier is responsible for the fulfillment of the service or product, and such responsibility is clearly indicated normally in the marketing materials and/or sales contract indicating the hotel is an agent.
2. The hotel earns a fixed amount (dollar or percentage) on the transaction regardless of the actual amount billed to the customer, again, indicating that the hotel is the agent.
3. The supplier carries the credit and collection risks , even if a hotel acts as an intermediary to assist in the collection process. Since the hotel does not carry any of the risks, it is again an agent.

All these indicators show revenues earned in products and services under these circumstances should be recorded as net.

Eight Indicators of Gross

According to the USALI, revenues should be booked as gross in a separate Other Operated Department, if the hotel is the principal. So, what constitutes the role of the hotel being a principal?

1. The hotel is the primary obligor. Simply put, the buck stops here.
2. The hotel carries the credit and collection risks, not the supplier.
3. The hotel is primarily responsible for the fulfillment of the product or service.
4. The hotel makes the decision of supplier selection at the time of transaction.
5. The hotel can decide the price charged for the product or service.
6. The hotel assumes the general inventory risk.
7. The hotel assumes the physical loss inventory risk.
8. The hotel adds meaningful value to and provides a significant portion of the product or service

With a total of eleven indicators, surely, there are gray areas. When this situation presents itself, the hotel's role as an agent or principal will be weakened or strengthened, thus altering whether the revenue should be booked as gross or net. Risks might be shared, thus the obligor status is compromised. Prices can be jointly decided by both the hotel and the supplier. Again, this will change the principal-agent relationship. Therefore, ALL indicators need to be evaluated in totality to reach the proper decision.

Therefore, let us examine three sample cases of audiovisual revenue and see if such revenues should be booked as gross or let.

Case One: Hotel Azul

Facts:

Hotel Azul has an audiovisual (AV) department in house with a full staff and a supervisor for that area who Azul's own human resources department hires. Azul sets all the prices from easels to screens to overheard projectors. All revenues are billed with all other hotel billings. While Azul reaps all the benefits and are not sharing the AV revenue with any outside party, it also bears all the risk if clients do not pay.

Analysis:

1. Hotel Azul is the primarily obligor (indicator #1 for gross reporting)
2. Hotel Azul has credit/collection risk (indicator #2 for gross reporting)
3. Hotel Azul is primarily responsible for the fulfillment of the service and product (indicator #3 of gross reporting)

4. Hotel Azul has control over the establishment of the price (indicator #5 of gross reporting)
5. Hotel Azul provides a significant portion of the service, they hire and train all AV employees, and clients have the right to return the product or service if they are not up to standard (indicator #6 of gross reporting)

Decision:

Categorically Gross Revenue Reporting. Hotel Azul has total control and absorbs any risks and loss.

Case Two: Hotel Blue

Facts:

Hotel Blue is a resort property with its clientele mostly couples and families on vacation. As such, there is not a major demand on AV thus Hotel Blue contracts with Amazing AV to provide AV services for its guests. Amazing AV sets the rates. The revenue is collected by Hotel Blue and then remitted to Amazing AV. Hotel Blue earns a fixed percentage of the AV revenue and that percentage is predetermined in the contract. Amazing AV owns all the AV equipment and sets the price. Amazing's employees work on-site alongside Hotel Blue's employees, but wear nametags that shows Amazing's logo rather than that of Hotel Blue's.

Analysis:

1. Amazing AV, the supplier is the primary obligor (indicator #1 for net reporting)
2. The amount Hotel Blue earns is fixed (indicator #2 for net reporting)
3. Amazing AV assumes all collection and credit risk (indicator #3 for net reporting). Hotel Blue has no risk, nor rewards, of operating the AV service.

Decision:

Net Revenue Reporting for Hotel Blue is evident. The revenue should be recognized as Miscellaneous Income.

Case Three: Hotel Capri

Facts:

Hotel Capri is a high-end luxury property and has a good amount of AV demand from its clients. Superb service is their motto and thus everything they do is always of very high standards. With regard to their AV, they contract with Awesome AV. To stay true to its high standards, Hotel Capri sets all the rules for Awesome. Hotel Capri even screens and hires the employees in the AV area and trains them on all customer service aspects while Awesome takes care of the technical training. The contract states that Awesome AV charges Hotel Capri a fixed percentage of revenue as its monthly fee. Hotel Capri also takes care of all the credit checks and collections.

Analysis:

1. Hotel Capri is the primarily obligor (indicator #1 for gross reporting)
2. Hotel Capri has credit/collection risk (indicator #2 for gross reporting)
3. Hotel Capri has control over the nature and type of services (indicator #4 of gross reporting)
4. Hotel Capri has control over the establishment of the price (indicator #5 of gross reporting)
5. Hotel Capri provides a significant portion of the service, they actually hire and train all parking employees (indicator #6 of gross reporting)
6. Awesome AV receives a fixed percentage (indicator #2 of net reporting - with Awesome AV as the agent)

Decision:

Preponderance of Gross Revenue Reporting. Hotel Capri has the majority control and Awesome is simply the contractor.

Principal-Agent, Gross-Net. All these may be just a tiny bit unclear. However, as you encounter a few more scenarios and apply the indicators a few more times, the decision will come easier and quicker. In the end, this is simply the fair and proper way.

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To purchase a copy of the 11 th edition of the USALI, view the nearly 100 questions and answers on the FAQ, or submit your own question for the FMC, please visit[www.ahlei.org/usali.](http://www.ahlei.org/usali)