

Clarification USALI 11-01

Group Rebates as Contra Revenue or Expense

Reason for this Clarification

The Eleventh Revised Edition of the *USALI* specifies in the Rooms Department expense section, under *Commission and Fees—Group*, on pages 19 & 20, that “Rebates or subsidies granted directly to a group should be recorded as contra revenue.” This statement has raised a number of questions within the industry and the Financial Management Committee (“FMC”) has determined that further clarification is needed.

Reason for the Change in Language from the Tenth to Eleventh Revised Editions

The Tenth Revised Edition stated that rebates or subsidies granted directly to the group were an expense under the *Commissions and Rebates—Group* section (page 47). During the preparation of the Eleventh Revised Edition, the FMC agreed, consistent with US GAAP, that rebates paid back to the contracting party to the extent that the contracting party has the obligation to perform and the economic risk should be a reduction of revenues per US GAAP (FASB ASC 605-50-25-7 Revenue Recognition Disclosure and FASB ASC 605- 45-45 Revenue Recognition Principal Agent Considerations).

Revenue Recognition Determination

When the contracting party directly receives a rebate/commission as a result of the contract with the hotel, where the analysis of gross versus net reporting would indicate net reporting, the hotel should record the rebate/commission as contra revenue (a reduction of the revenue). The key elements for the hotel to consider in reporting net revenue are (1) the contracting party receives the benefit of the rebate directly and (2) the hotel has no obligation or any economic risk associated with the collection or payment of the rebate (see Gross vs. Net, *USALI* Part V (page 340)).

When as a result of a contractual arrangement, the hotel must make a payment to a non-related third party, where the analysis of gross versus net reporting would indicate gross reporting, the payment would be recorded as part of *Commissions and Fees—Group* expense. The key elements for the hotel to consider in reporting an expense are (1) the non-related third party receives the benefit of the rebate directly and (2) the hotel has an obligation toward a third party that represents an economic risk independent from the revenue recorded and collected (see Gross vs. Net, *USALI* Part V (page 340)).

Clarification Examples

Example 1:

Structure: Group contract terms provide for a rebate of \$x per night to be paid by the hotel to the group for an event where the contracting party is responsible for paying the attendees' nightly room rate.

Evaluation: The review should focus on who is the contracting party and apply the gross vs. net evaluation. In this example, the contract is with the group; the hotel has no economic risk for the amount of the rebate, as they only pay on revenues received. Therefore, the rebate/commission is considered a reduction of the sale price (room rate), and should be recorded as contra revenue.

Example 2a:

Structure: Group contract terms provide for a rebate of \$x per night consumed to be paid by the hotel to the Group for an event where the Group blocks the rooms and the individual guests, not the Group itself, are responsible for paying the nightly room rate. The amount paid to the Group is not dependent upon the hotel receiving payment of the account from the guest.

Evaluation: The gross vs. net evaluation indicates that the predominant factor in the analysis is that the hotel bears the economic risk if it fails to collect from the paying guest, similar to travel agent commissions. The revenues must be recorded as gross and the payment to the Group would be recorded as part of *Commissions and Fees—Group* expense under the Rooms Department.

Example 2b:

Structure: An Association enters into a group contract for the rental of rooms. The contract provides for the collection of a fee of \$x per paid room night by the hotel on behalf of the Association. For the event, the Association blocks the rooms, but the individual guests, not the Association, are responsible for paying the nightly room rate. The contract is clear that the Association will receive the fee only for rooms that are paid in full.

Evaluation: In this example, the gross vs. net evaluation differs because the predominant factor (economic risk) has been eliminated. The hotel will not owe the fee to the Association if the guest has not paid. In this example, because the hotel has no obligation to pay the fee if it is unable to collect and has no discretion in establishing the fee amount, the hotel is merely acting as the collection agent for the fee. Room revenues must be recorded net of the fee and the fee payment to the Association would be recorded as contra revenue.

Note: Examples 2a and 2b are similar and highlight the variance in treatment of the revenue based on the contractual terms. In 2a, the hotel assumes a level of economic risk and must therefore record the revenue gross; in 2b, the hotel has no risk and is deemed to be an agent for the Association with respect to the fee, resulting in net revenue recording.

Example 3:

Structure: Group contract terms provide for a fixed subsidy of \$x paid by the hotel either as a specific dollar amount or as a fixed amount per room available to a third-party Convention Center to defray space rental fees. The subsidy is a fixed pre-set amount that the hotel pays no matter the actual number of rooms booked or room revenues charged and collected.

Evaluation: The review should focus on who is the contracting party and apply the gross vs. net evaluation. In this example, the contract is with the group, but the hotel is responsible for fulfilling the obligation with the Convention Center and has economic risk. The revenues must be recorded as gross. The payment of the subsidy to the Convention Center would be recorded as part of *Commissions and Fees—Group* expense under the Rooms Department.

Example 4:

Structure: Citywide Convention terms require an agreement with the Convention & Visitor Bureau (“Bureau”). For participation in city-wide conventions, the hotel must pay the Bureau to subsidize shuttle bus rental expenses based on the number of registered convention guests.

Evaluation: The agreement is between the hotel and the Bureau, and therefore as the contracting party, the hotel is responsible for fulfilling the obligation with the Bureau and bears the economic risk. The revenues must be recorded as gross. The payment to the Bureau would be recorded as part of *Commissions and Fees—Group* expense under the Rooms Department.