

IFRS industry insights: Travel, Hospitality and Leisure sector

New revenue Standard could impact profile of revenue and profit recognition

Headlines

- The **profile of revenue and profit recognition** will change for some entities as the new Standard is more detailed and more prescriptive than the existing guidance and introduces new complexities. In particular, travel, hospitality and leisure companies will need to consider:
 - when **upfront fees** should be recognised as revenue;
 - the accounting for **breakage**;
 - the **types of licence** that are sold and whether the accounting treatment will need to change;
 - the impact of new guidance where pricing mechanisms include **variable amounts**; and
 - the extent to which **distinct goods or services** are supplied, which should be accounted for separately;
- The new Standard requires significantly more **disclosures** relating to revenue and entities will need to ensure that **appropriate processes** are in place to gather the information.

What's happened?

The International Accounting Standards Board (IASB) has published a new Standard, IFRS 15 *Revenue from Contracts with Customers* ('the new Standard'). The new Standard outlines a single comprehensive model of accounting for revenue arising from contracts with customers and supersedes current revenue recognition guidance, which is found currently across several Standards and Interpretations within IFRSs. The core principle is that an entity recognises revenue to reflect the transfer of goods or services, measured as the amount to which the entity expects to be entitled in exchange for those goods or services.

The new Standard is effective for reporting periods beginning on or after 1 January 2017, with earlier application permitted. Entities can choose to apply the Standard retrospectively or use a modified approach in the year of application. It is the result of a convergence project with the US Financial Accounting Standards Board (FASB) that began in 2002. Almost fully converged, the most significant differences between IFRSs and US GAAP relate to interim disclosures and timing of adoption.

Implications for the travel, hospitality and leisure sector

Below, we highlight certain key impacts resulting from the new Standard that will be of particular interest to those in the travel, hospitality and leisure sector and then consider parts of the new Standard that may contribute to those impacts. Of course many more complexities exist and, as described below, Deloitte has produced further guidance which explores these in greater detail.

How might this affect you?

The timing of revenue and profit recognition may be significantly affected by the new Standard

Whereas previously IFRSs allowed significant room for judgement in devising and applying revenue recognition policies and practices, IFRS 15 is more prescriptive in many areas relevant to the travel, hospitality and leisure sector.

Applying these new rules may result in significant changes to the profile of revenue and, in some cases, cost recognition. This is not merely a financial reporting issue. As well as **preparing the market and educating analysts** on the impact of the new Standard, entities will need to consider wider implications. Amongst others, these might include:

- changes to **key performance indicators** and other **key metrics**;
- changes to the **profile of tax cash payments**;
- availability of **profits for distribution**;
- for **compensation and bonus plans**, impact on the timing of targets being achieved and the likelihood of targets being met; and
- potential non-compliance with **loan covenants**.

Current accounting processes may require changes to cope with the new Standard

As explained below, IFRS 15 introduces new requirements to move to a more conceptual approach. The complexity of applying this approach and of producing the detailed disclosures required by the new Standard in the travel, hospitality and leisure sector may require modifications to existing accounting systems and, in some cases, entities may conclude that they should develop new systems processes. Entities should ensure they allow sufficient time to develop and implement any required modifications to processes.

What are the most significant changes?

When should 'upfront' fees be recognised?

New detailed guidance is provided on how to account for upfront fees which may lead to a change in practice when accounting for such fees relating to, for example, health club or casino membership. Unless distinct goods and services, beyond membership, are provided to the customer at the outset, an upfront fee should be regarded as an advance payment for future goods and services and should be recognised as revenue when those future goods and services are provided. Often, upfront fees are charged in order to cover initial sign-up costs, but this is not in itself sufficient to justify upfront revenue recognition.

How should breakage be recognised (e.g. customer loyalty schemes)?

Many entities in the sector receive non-refundable upfront payments in respect of future goods or services, for example, prepayments for hotel rooms or flights. Customers do not always exercise all their contractual rights in these scenarios. Such unexercised rights are often referred to as 'breakage'. Previously, IFRSs included only limited guidance on accounting for these unexercised rights, and only in the context of customer loyalty programmes. As such, a number of practices are currently used in accounting for breakage. IFRS 15 includes specific guidance on breakage, which is applicable to all revenue transactions with customers. If an entity expects to benefit from breakage, it should recognise the expected breakage amount as revenue in proportion to the pattern of rights exercised by the customer (i.e. by comparing the goods or services delivered to date with those expected to be delivered overall). Otherwise, the entity should recognise any breakage amount as revenue when the likelihood of the customer exercising its remaining rights becomes remote. Entities will need to consider whether their current accounting needs to be amended in order to meet the requirements of IFRS 15.

How will the type of licence sold impact when revenue is recognised?

IFRS 15 distinguishes between licences that represent the transfer of a right to use an entity's intellectual property and licences that represent the provision of access, over a period of time, to an entity's intellectual property, and specifies criteria to determine which type of licence is being sold. Revenue for the former will typically be recognised at a point in time; revenue for the latter will typically be recognised over the period of access. Entities within the travel, hospitality and leisure sector will need to examine licence arrangements in the light of this new guidance, and may need to change their existing accounting in some cases. For example, where a franchisor grants a franchisee a licence to operate a hotel, careful analysis will be required to determine whether under the licence agreement revenue should be recognised at a point in time because the licence transfers a right or over time because the license provides access only.

When should variable or uncertain revenues be recognised?

Contracts in the travel, hospitality and leisure sector will often include significant variable elements; for example, hotel management contracts may include incentive fees based on certain performance measures. There are new specific requirements in respect of variable consideration such that it is only included in the transaction price if it is highly probable that the amount of revenue recognised would not be subject to significant future reversals as a result of subsequent re-estimation. This approach to variable and contingent consideration is different from that previously reflected in IFRSs and, in certain scenarios, will require a significant degree of judgement to estimate the amount of consideration that should be taken into account. Accordingly, the profile of revenue recognition may change for some entities as a result.

The Standard also introduces a specific restriction for royalty payments relating to licenses of intellectual property, for example, some types of franchise licenses. If royalty payments are based on usage or onward sale, entities are restricted from recognising the associated revenue until the usage or onward sale has occurred, even if it is possible to make a reliable estimate of this amount based on historical evidence.

How to identify and allocate revenue to different goods and services?

Previously, given the lack of specific guidance in IFRSs, there was greater room for judgement when identifying the goods and services within a contract and then allocating the revenue to those goods and services identified, for example different services provided in a package holiday (flights, hotels, tour guides etc.) and different goods and services provided as part of a franchising arrangement. Entities in the travel, hospitality and leisure sector may have to amend their current accounting policies as a result of the more detailed guidance in IFRS 15. The new Standard requires the revenue from a contract to be allocated to each distinct good or service provided on a relative standalone selling price basis, though a 'residual' approach is permitted in limited circumstances.

This may change the profile of revenue recognition for some entities and there may be some practical challenges to overcome in order to ensure systems are in place to deal with the new requirements.

What else might change?

In addition to the key changes discussed above, the new Standard introduces detailed guidance in many areas regarding the reporting of revenue and entities will need to ensure that they have considered all of these when assessing if their accounting policy for revenue continues to be appropriate.

More detailed information on the impact of IFRS 15 can be found in Deloitte's IFRS in Focus publication available from www.iasplus.com. Further industry publications are also available here.

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