ROOMSERVICE

News for the Hotels industry

Welcome to the March 2017 edition of Room Service, a new regular newsletter from PKF Littlejohn's Hotel and Leisure team, providing a round-up of the main developments in accounting and general market matters.

Unbundling the new IFRS 15 revenue recognition rules

The new revenue recognition accounting standard, International Financial Reporting Standard (IFRS 15 - Revenue from Contracts with Customers), comes into force from 1 January 2018. Whilst that might seem a long way off, hotel businesses adopting IFRS for their financial statements should not underestimate the amount of preparatory work that may need to be undertaken and ought to keep in mind that the 2017 financial statements may need to be restated or adjusted as the comparative period.

In addition, there already exists a requirement for entities that adopt IFRS to consider and disclose the impact of yet to be implemented new accounting standards on future financial statements, and that applies to financial statements to 31 December 2016. So what should hoteliers start thinking about over the next few months?

What is IFRS 15 – a recap

IFRS 15 introduces a five step revenue recognition approach that requires businesses to:

- Identify the contract(s) with the customer
- Identify the separate performance obligations
- Determine the transaction price
- Allocate the transaction price to the performance obligations
- Recognise revenue when the performance obligations are satisfied

It's worth spending some time now working through the steps to make sure you're correctly recognising revenue when you should and that you're capturing the reasoning. The relevant documentation you'll need is not just for your own reporting requirements but also to help support the year-end audit.

Companies with a single non-complex product (or service) with a transparent pricing structure should find working through these steps relatively straightforward. However, many hotel operating companies provide bundled products and services to guests (such as package deals incorporating other service lines (e.g. spa package deals, long weekend breaks with benefits thrown in) or the provision of several services within a single room rate which would otherwise be purchased separately) and will need to unbundle the underlying product and service components. As a result they may find certain elements being dealt with by different accounting standards.

When unbundling, it's important that the less obvious components are identified and accounted for appropriately. Once unbundled, a value will need to be attributed to each of the performance obligations. Where there are observable prices for similar discrete products and services, this should not be too onerous. Where prices are less observable, the task is harder and will undoubtedly require the exercise (and disclosure) of judgement.

It's worth noting that IFRS 15 recognises that in certain circumstances the delivery of the product and service are inextricably linked to such an extent that there is a single performance obligation – such as the provision of free tea and coffee in a room, included within the room rate – each case will need to be looked at on its own merits.

The need to look at each service or product being provided to guests might appear daunting - and it may well be if each guest experience is bespoke. However, IFRS 15 takes a pragmatic view by allowing a portfolio approach to be adopted if you have a large number of similar customer agreements – for example, the widely promoted packages and deals noted above.

You will need to apply the new standard not just in the year it comes into effect, but also for the comparative period. The good news is that businesses have two options. You can either opt to fully restate all of the comparative figures for open contracts for each prior period presented. Alternatively, you could leave the comparative figures unaltered but show the financial impact of the change under IFRS 15 as a current period adjustment to the opening brought forward retained earnings

It's worth investing time as early as possible to quantify the likely financial impact of the new standard. Even where only additional disclosures arise from the adoption of IFRS 15, time will still need to be taken to ensure all of the underlying details are known and available for reporting. It is also important to start managing the expectations of key interested parties such as:

- Analysts and the investment community - if your revenue and earnings forecasts are going to change materially;
- Funding providers - where you have financial covenants linked to profitability; and/or
- Employees - where you have an employee incentivisation scheme also linked to profit.

A business's tax base will typically be affected in cases where amendments to revenue recognition policies alter the business's profit. In the first period of implementation, adjustments to prior period profits will also be brought into charge.

However, such changes may be overridden by existing legislation that prescribes specific treatment that is not affected by accounting practice (for example, in respect of leases) or by any legislative changes introduced by the Government in light of the changes to IFRS 15. As things stand, no such changes have been identified, but this will be monitored as we approach implementation.

IFRS 15 is coming, and now is the time to begin your preparations. While undertaking this exercise, check that your finance team and accounting systems will be able to capture and maintain this information on a regular basis to ease the interim and financial reporting obligations.

VAT and loyalty schemes

A recent VAT case heard by the VAT tribunal may be of interest to hotel businesses that operate or participate in customer loyalty schemes.

The facts were essentially that Marriott, the operator of a loyalty scheme based in the USA, agreed to pay participating UK hotels (referred to from now on as the 'redeemers') for their agreement to give free hotel nights to members of the loyalty scheme. Members accumulated loyalty points under the terms of the scheme which they were entitled to exchange for a stay or other service offered by the redeemers. The case raised the following important VAT questions:

1. Whether the payment by the operator of the loyalty scheme to the redeemer should be seen as a third party payment for a supply of services (e.g. hotel accommodation) by the redeemer to the member, or for a supply of services by the redeemer to the operator; and
2. If the supply was of services by the redeemer to the operator, the place of supply of that service and whether it related to UK land (as in this particular case the operator belonged in the US and was making payments to UK redeemers on which VAT had been charged).

The two important findings by the tribunal are that:

- the operator was not paying third party consideration but was the recipient of supplies made to it by the redeemers; and
- the supplies by the UK redeemers are not land related supplies.

These two findings could be beneficial to those involved in similar reward schemes. UK operators may be entitled to recover VAT charged by UK redeemers in similar circumstances, and VAT may not be chargeable by UK redeemers to non-UK operators. So businesses involved in similar promotion schemes may wish to review their VAT accounting position.

If you have any issues you would like to discuss arising from this case please contact Nick McChesney at nmcchesney@pkf-littlejohn.com

Hot topics – what you need to know

Here's our round-up of what's been making the news in the market over the past few weeks*.

Paris claims top spot – French capital named top European destination for hotel investment. **Read more**

Airbnb moves upmarket – Airbnb acquires Luxury Retreats, the luxury sharing platform. **Read more**

Spring Budget - what does it mean for you and your business? **Read more**

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We hope you've found this issue useful. If anyone within your business would like to receive future issues, please send their details to Ruby Crowley (rcrowley@pkf-littlejohn.com).

Our specialist team is here to help. If you would like advice on any of the issues discussed in this newsletter, please contact one of our Hotel and Leisure team.

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