SMITH•SCHAFER & ASSOCIATES, LTD.
Certified Public Accountants and Consultants

Revenue Recognition Case Study

HOSPITALITY INDUSTRY:

SCENARIO:

A local restaurant offers a loyalty program to customers. Customers earn 1 point for every $2 spent at the restaurant. When a customer has accumulated 100 points they can $5 off their next purchase.

Through one month of the year the restaurant has had $500,000 in sales, which correlates to 250,000 outstanding loyalty points.

Based on history of the program, the restaurant expects 63% of loyalty points to be redeemed.

STEP ONE - IDENTIFY THE CONTRACT WITH A CUSTOMER

The restaurant will provide meal and a future discount through a loyalty program to customers.

STEP TWO - IDENTIFY PERFORMANCE OBLIGATIONS IN THE CONTRACT

What is the total number of Performance Obligations?

Two – meal and loyalty program

STEP THREE - DETERMINE THE TRANSACTION PRICE

In total, for the quarter, the transaction price is $500,000.

STEP FOUR - ALLOCATION OF TRANSACTION PRICE

The transaction price should be allocated to the performance obligations based on standalone price of each performance obligation.

	CONTRACT	STANDALONE	ALLOCATION
Sales	$500,000	$500,000	$492,247
Loyalty Program	-	$7,875	$7,753
	$500,000	$507,875	$500,000

The stand alone selling price of the loyalty program is calculated as follows:

Total loyalty points value ((250,000/100)*5)	$12,500
Likelihood of use	63%
Loyalty program standalone price	$7,875

STEP FIVE - RECOGNIZE REVENUE

Below are the required journal entries to recognize the above transactions:

RECORD MONTHLY SALES					
Cash			$500,000		
	Contract Liability		-		$7,753
	Revenue				$492,247
End of Month 1 - 111,000 loyalty points had been redeemed					
Contract Liability			$5,464		
	Revenue			$5,464	
	Redeemed	111,000			
	Anticipated Redeemed	157,500	70.5%	$5,463.94	% times allocation
Balance of contract liability at the end of month 1.					$2,289
End of Month 2 - 44,610 additional loyalty points had been redeemed					
Contract Liability			$2,196		
	Revenue			$2,196	
	Redeemed	155,610			
	Anticipated Redeemed	157,500	98.8%	$7,660	% times allocation
Balance of contract liability at the end of month 2			93		

If at the end of month 2 we determine our estimated usage was too low, the standard requires breakage to be accounted for by way of a cumulative catch up adjustment to revenue. A change in price is not the same as a change in estimate (breakage), therefore the allocation of price is not recalculated.

During Month 2 - 44,610 additional loyalty points had been redeemed and the breakage is now expected to be at 67%					
Contract Liability			$1,739		
	Revenue				$1,739
	Redeemed	155,610			
	Anticipated Redeemed	167,500	92.9%	$7,203	% times allocation
Balance of contract liability at the end of month 2		550			

DO YOU UNDERSTAND THE IMPACT OF THE NEW ACCOUNTING STANDARDS ON YOUR HOSPITALITY COMPANY?

Smith Schafer is a recognized leader in providing accounting, auditing and consulting services to the hospitality industry since 1971. Our Hospitality Group is committed to **serving over 100 Minnesota hospitality entities** and stays on top of industry issues, trends, tools and technologies to ensure we give you the best possible advice.

For additional details on the new revenue recognition accounting rules or to learn more about how we can help, please contact a Smith Schafer professional at info@smithschafer.com.