**Solutions – Accounting Essentials for Hospitality Managers (4th edition)**

CHAPTER 1

Introduction

**Problem 1.1: Solution**

a) Functional interdependency exists when the performance of one functional area is affected by the performance of a separate functional area. For example, in a hotel complex that is dominated by a casino, the success of the rooms and food and beverage departments will be affected by the success of the casino operations in attracting clients to the complex.

b) Functional interdependency is an important issue for the designers of a hotel’s system of accountability because care should be taken to hold a manager accountable for only those aspects of the hotel’s performance that he or she can influence. For example, the head of the rooms division should not be held accountable for a decrease in their room sales if it is caused by reduced casino activity.

**Problem 1.2: Solution**

a) The four main dimensions of sales volatility in the hotel industry are:

1. economic cycle induced sales volatility,
2. seasonal sales volatility,
3. weekly sales volatility,
4. intra-day sales volatility.

b) The implications that these dimensions of sales volatility carry for hotel accounting systems are as follows:

1. ***Economic cycle induced volatility***: Hotel sales’ high susceptibility to general economic conditions highlights the importance of hotels carefully forecasting economic cycles as part of the annual budgeting process.
2. ***Seasonal sales volatility***: Three accounting implications arise:
* Seasonal sales volatility can be so severe to warrant temporary closure for some resort properties. This possibility of having to make a closure decision signifies that cost and revenue data should be recorded in a manner that will enable a well informed financial analysis of the pros and cons of closing.
* Seasonal sales volatility can also pose particular cash management issues. During the middle and tail-end of the busy seasons, surplus cash balances are likely to result, while in the off-season and the build up to the busy season, deficit cash balances are likely to result. Careful cash budgeting will therefore need to be conducted.
* Seasonal sales volatility will also affect price discounting decisions. To ensure such decisions are well informed, careful forecasting as part of the annual budgetary process, will have to be conducted.

3. ***Weekly sales volatility***: Accurate forecasting of weekly sales volatility will inform management’s decision making with respect to the amount and timing of room rate discounting, staffing needs as well as restaurant purchasing needs.

4. ***Intra-day sales volatility***: Intra-day demand volatility has led to widely-used pricing strategies such as “early bird specials” in restaurants and “happy hours” in bars. Records concerning demand at different times of the day will have to be maintained in order to inform such hotel pricing issues.

**Problem 1.3: Solution**

Examples of business decisions requiring the use of financial accounting data include:

(a) A bank manager deciding whether to lend money to a company.

(b) A shareholder deciding whether to sell her shares due to a fear that the company she has invested in might go bankrupt.

(c) A potential shareholder thinking about purchasing shares in a company and interested in determining if the company is profitable.

Examples of business decisions requiring the use of management accounting data include:

(a) Determining whether accounts are being collected on time.

(b) Determining whether the business will have sufficient cash over the next year to avoid the need to arrange a line of credit.

(c) Determining whether a drinks vending machine or a confectionary vending machine should be installed in a hotel’s foyer area.

(d) Determining what room rate to charge to achieve a target level of profit.

(e) Determining whether a seasonal hotel should be closed down during the quiet season.

(f) Determining whether a restaurant manager is performing well.

**Problem 1.4: Solution**

a) High product perishability signifies that an item cannot be held in inventory for sale at a later time. Food items have a limited life in inventory because of their rapid physical deterioration. Room nights and conference facilities cannot be placed in inventory because they relate to a particular time period that expires.

b) The absolute perishability of rooms, conference and banquet facilities and the relative perishability of food underlines the importance of accurate hotel demand forecasting as part of the budgeting process. Generally, the most important aspect of forecasting is room occupancy, as room sales drive sales levels of other hotel services. Accurate restaurant forecasting provides the basis for maintaining a full menu of options while also minimising the cost of food wastage.

**Problem 1.5: Solution**

Fixed costs are costs that do not vary as a function of sales activity levels. Hotels involve considerable investment in fixed assets such as buildings on prime land as well as extensive furnishings, fittings and equipment. This investment generates high rent and depreciation costs, which together with significant salary costs, result in a high fixed cost structure for hotels.

**Problem 1.6: Solution**

a) Major hotel activities include room housekeeping, restaurant food preparation and service as well as bar service. Despite the advent of the machine and computer age, the physical aspect of all of these activities has changed little over the last fifty years, as they continue to have a high labour component.

b) High labour intensive activities in hotels signifies the importance of performance measures that focus on labour productivity. Such performance indices include restaurant covers per employee hour worked and restaurant sales per employee hour worked. Monitoring differences between actual labour cost and budgeted labour cost represents another dimension of labour cost management. An appropriate analysis of the difference between budgeted and actual labour cost enables a distinction to be drawn between labour rate and labour efficiency factors.

**Problem 1.7: Solution**

**Financial accounting** concerns the preparation of financial reports for external users such as shareholders, banks and government authorities. In order for these financial reports to be meaningful, it is important that they are produced in a standardised way and are seen to be reliable. **Management accounting** concerns the provision of financial information to internal management. This information is designed to help managers in their decision making and control of businesses. Financial information sought by hotel managers includes determining the cost of providing a meal to inform the menu pricing decision, determining how many delegates need to attend a conference in order to achieve break even, and determining what level of profit is made by each selling unit of a hotel to inform any rationalisation decision to drop a unit. The provision of all these types of financial information falls within the scope of management accounting.

**Problem 1.8: Solution**

The main accounting information users are:

* Managers within the company being accounted for. Managers use accounting information in planning and controlling business activities.
* Outside parties such as shareholders, potential shareholders, creditors and government agencies. These parties use accounting information to make investing, lending, taxing and regulatory decisions.

**Problem 1.9: Solution**

Accounting reports represent the main source of information that the investing community uses when attempting to make wise equity investments. A lack of confidence in accounting systems is bound to translate into a reluctance to invest in companies. This will inhibit the ability of economically viable companies to expand, which in turn will carry negative implications for employment, availability of goods and services, and our standard of living. It is critically important that a reliable financial accounting system that engenders trust and encourages corporate development is established, otherwise economic activity suffers.

**Problem 1.10: Solution**

Any of the elements referred to in Box 1.3 could be used as an answer to this question.

**Problem 1.11: Solution**

Amongst the advantages deriving from the *USALI* are the following:

1. it can save on accounting system design costs as it represents a “blueprint” accounting system that can be adopted by any business in the hotel industry,
2. the system can be viewed as “state of the art” as it benefits from the accumulated experience of the parties that have contributed to the system’s development over many years,
3. by promoting consistent account classification schemes as well as formatting of reports, it facilitates comparison across hotels,
4. it represents a common point of reference for hotels within the same hotel group.

**Problem 1.12: Solution**

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| **3 main organizational forms and their main differences** |
| **Characteristics** | **Sole proprietorship** | **Partnership** | **Company** |
| Number of owners | One | Two or more | Generally many  |
| Business size | Small | Generally small | Larger and can be very large |
| Key decision makers | Owner | Partners | Board of directors |
| Owner liability | Unlimited | Unlimited | Limited |
| Organisation life | Limited | Limited | On-going |
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**Problem 1.13: Solution**

At the outset of a business, ‘capital raised’ refers to the long term funds invested in the business.

**Problem 1.14: Solution**

1. Other Operating Departments Revenue
2. Food and Beverage Revenue
3. Food and Beverage expenses
4. Utility expenses
5. Property Operation and Maintenance expenses
6. Sales and Marketing expenses
7. Interest Expense