

## SYSTEMS OF FINANCIAL ACCOUNTING AND MANAGEMENT ACCOUNTING IN HOTEL INDUSTRY

V. Wadajkar, P.D. Patil and R. Bavskar

Dr. D. Y. Patil B-School, Pune, MH, India

vishal.wadajkar@dpu.edu.in

### ABSTRACT

*Financial accounting and management accounting are important performance evaluation functions for a business. These functions generate useful business information that can be used for various purposes like planning, and controlling. Hotel Industry has its own peculiar features of operation apart from being a service industry. This paper highlights the special features of financial accounting and management accounting related to hotel industries. While the basic principles of accounting remain the same there are customized applications for hotel industry which provide valuable information to the management and other stakeholders to take more informed decisions. Finer analysis is possible in the context of hotel industry with the use of the specialized accounting techniques. A specialized system like the Uniform System of Hotel Accounting (USHA) is also explained in the paper. It is expected that the discussion will help not only those who are working in the hotel industry but also in other service sectors to think and develop customized accounting and analytical applications for their respective areas of business.*

**Keywords:** Accounting, Controlling, Performance, Hotel Industry

### Introduction

Financial accounting is a branch of accounting that deals with recording, classifying, and presenting of financial transactions of an organization for a specific period. As an end product financial accounting leads an organization to preparation of financial statements like the profit and loss account, the balance sheet, and the cash flow statement. These statements provide useful information about the way the financial transactions were carried in a previous period (whether profitably or otherwise) and clarifies the financial standing of the organization on a given date. Management accounting is also a branch of accounting and deals with processing and presentation of financial and other information for management's decision-making, planning, and control. In this paper we highlight the features of financial accounting and management accounting as applicable to hotel industries. While the basic principles of accounting do not change there are some special applications for hotel industry which generate valuable information to the managers and other stakeholders to take more informed decisions. Finer analysis of information is also possible in the context of hotel industry with the use of the specialized accounting techniques. A system specially developed for Hotels like the Uniform system of hotel accounting (USHA) is also discussed in the

paper. It is expected that the discussion will help not only those who are working in the hotel industry but also in other service sectors to think and develop customized accounting and analytical applications for their respective areas of business.

### Hotel Accounting

Kumar et al. (2012) in their special book "financial accounting for hotels" have specified the following:

In ordinary commercial houses, the double entry system of bookkeeping is used in its traditional form. But the nature of hotel business is different from that of other commercial houses in many respects. The following points distinguish the two types of businesses:

1. In hotels, credit is allowed to all guests except a few who appear to be of doubtful nature. As their stay is uncertain and they can check out at any moment, their account is kept ready and whenever they wish to check out, the bill is presented for payment.
2. The hotel business is such where both cash and credit transactions with an individual guest follow each other pretty rapidly.
3. The hotels have to do the job of manufacturer (because they have to prepare dishes) and that of a retailer by selling the dishes according to the requirements of the guests sometimes they purchase the

finished products and sell them in their original shape like cigarettes, newspapers, magazines, etc. therefore, control in hotels is more complicated.

4. In hotels, some departments deal with both cash and credit, but others for credits alone. Thus, cash is collected and credit is allowed at many points. Under such an arrangement, the internal control of receipts and accounts receivable is the most important part of hotel accounting.
5. The accounts of hotel are maintained in a way to ensure that all revenue is accounted for and that all stock in hand is correct. This eliminates wastage and keeps a check on misappropriation of goods.

In hotels, the tabular or analytical system of accounting is used. It is the only successful method to get the analyzed and up to date information about cash receipts and payments, goods purchased and sold, and services rendered by various departments.

**Departmental accounts in a hotel**

Departmental accounts are those accounts which disclose not only the profits of the whole business but also the profits of the various departments in the hotel such as rooms, restaurants, banquets, bar etc.

While preparing the departmental accounts, the expenses and incomes are to be allocated to various departments on a particular basis.

*Expenses and their basis of allocation*

**Table 1: Expense allocation in Hotel Industry**

<i>Expenses</i>	<i>Basis of allocation</i>
1. Expenses incurred specially for a particular department.	Changed to the department concerned.
2. Expenses on purchases.	Net purchases (excluding inter departmental purchases)
3. Expenses on sales	Net sales (excluding inter departmental sales )
4. Expenses on building	Floor space occupied
5. Lighting and heating	Meter reading/ light points/ space occupied
6. Power	Meter reading/ floor space occupied
7. Expenses on machines	Value of machines
8. Insurance premium	Value of the subject matter insured
9. Labour welfare expenses (recreation expenses, canteen expenses, etc.)	Number of workers in each dept.
10. Other expenses Interest on capital Interest on debentures GM's salary Audit fees Bank charges Sundry office expenses	Basis of sales/ cost of sales Quantity of goods sold/ equally

Similarly, some of the incomes are to be allocated on the following basis:

**Table 2: Income allocation in Hotel Industry**

<i>Incomes</i>	<i>Basis of Allocation</i>
1. Discount received, reserve, for discount on creditors.	Net purchases
2. Commission earned on sales	Net sales
3. Other incomes Dividend received Transfer fees	Equally

**Uniform system of hotel accounting (USHA)**

USHA is a hotel manual that provides firstly uniform classification of income, expenditure, assets and liabilities for hotels and secondly

standardized, uniform method of presenting financial results of operation.

In 1925, the Hotel Association of New York City appointed a committee of hotel accountants to design a system for classifying, organizing and presenting financial data, so

that uniformity in the classification of revenues, expenses, assets, liabilities and equities for hotels might be attained and to provide comparable (financial) statements. The system designed has since been adopted by the American Hotel Motel Association and has come to be known as “the Uniform System of Accounts for Hotels”. It is widely used throughout the hotel industry and has served as the basis for formulating other uniform systems in the hospitality service industries. Other systems include the uniform system of accounts for Restaurants sponsored by the National Restaurant Association, the Uniform System of Accounts for Clubs” sponsored by the Club Managers Association and the Uniform System of Accounts for Hotels, Motor Hotels Association sponsored by the American Hotel and Motel Association (AHMA) currently known as American Hotel and Lodging Association (AHLA).

**Advantages of USHA**

1. Each hotel can select the head of account according to its requirements and eliminate such items as are not needed by it.
2. By this system hotels can easily compare each head of income and Expenditure of one branch with other branch or branches.

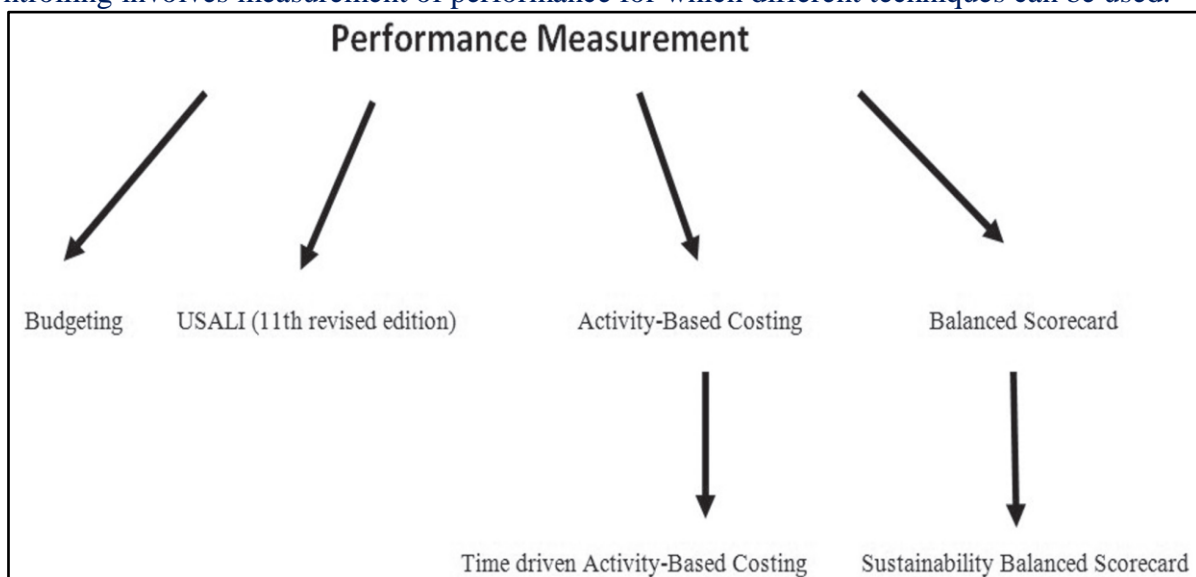
3. A hotel having branches can prepare a consolidated Profit and Loss Account and Balance Sheet of all branches.
4. An employee may not find any difficulty in maintaining the accounts if he is transferred to some other branch of the hotel or seeks a change in a hotel where also the uniform system of accounting is in practice.

For introducing the USHA, the activities of a hotel is divided into two main departments. The first is Operated or Revenue Earning Departments and the second Services or Overheads Departments. The Operated departments are further divided into two parts-Major Revenue Earning Departments and Minor Revenue Earning Departments. Under the former one, we can keep Rooms, Food and Beverage department and in the latter category we can keep Telephone, Guest handling, etc. the assets and Liabilities are also analyzed in detail.

Under USHA, all accounting heads can be identified by Specific Code numbers. Say, for example, Account no. 1 to 11 can be representing the Revenue Earning Departments, Account no. 12 to 16 can be kept for the Expenditure or Overheads and Account no. 17 onwards can be assigned for Assets, Liabilities and Equities.

**Controlling techniques in hotel industry**

Controlling involves measurement of performance for which different techniques can be used.



**Figure 1: Performance Measurement in Hotel Industry**  
(Source: Jankovic and Ivanković 2016)

**Budgeting** – Following budgets can be prepared for a hotel:

- a. Segment-wise and overall revenue budget
- b. Cost budget
- c. Budgeted balance sheet
- d. Budgeted cash flow statement

### **USALI - Uniform System of Accounts for the Lodging Industry**

A uniform system of accounting like USALI can facilitate intra-firm and inter-firm comparison.

### **Activity Based Costing**

Raaband Mayer (2004) have stated that traditional cost accounting systems in recent years have been replaced in the manufacturing sector by Activity Based Costing (ABC) systems. Despite this trend in manufacturing, Activity Based Costing (ABC) systems have made few inroads in the services and hospitality sector, particularly in the hotel industry. In this study, restaurant controllers in the United States were interviewed to identify their knowledge about, and use of, ABC systems. The results showed that the use of ABC in the restaurant industry is almost non-existent for a number of reasons. However the authors feel that, hotels may be an ideal setting for the use of ABC tools due to the inherent characteristics of the industry.

### **Balanced Score Card**

Benedetti (n/d) has stated that the balanced scorecard allows hotel managers to measure progress toward strategic objectives in a well-balanced manner. The Balanced Scorecards have financial & non-financial metrics that measure performance focusing on different aspects of operations. In the hotel industry, critical scorecard categories provide the management with a meaningful feedback for use in optimizing their organizations.

The four-dimensions of a Balanced Score Card with reference to Hotel industry are briefly explained below -

#### ***Financial***

Income per guest and income per available room are common financial metrics found on a hotel company's balanced scorecard. Monitor

these key variables, as well as the total amount of revenue the properties are generating and how efficiently the space is being utilized. If income is down relative to available rooms, adjustments need to be made. Other financial metrics, such as net income, earnings per share and stock price, also are listed in the financial category for bigger hotels.

#### ***Customer***

The metrics in the customer category focus on the perception of a hotel's target market. Market survey results, complaints, customer retention rates or other customer-related data are used in this category of information. Given the fact that the hotel industry provides a service, customer satisfaction is a key measure of competitive advantage and operational effectiveness. If customer complaints are on the rise and survey results indicate a decline in their affinity towards the hotel, action needs to be taken to improve the service the organization is providing.

#### ***Internal Business Process***

Maintenance costs, accidents and quality measures are found in the internal business process category of the balanced scorecard. These directly affect net profit and earnings per share. Competition in the hotel industry requires that operators run as efficiently as possible to retain their market share and win patrons' business. Also, if rooms are in disarray and are in need of serious maintenance, it lets management know the new capital expenditures are needed. Effective and efficient internal processes are critical to a hotel's competitive edge.

#### ***Learning and Growth***

Training hours, levels of skill attained and human resource turnover are among the learning and growth metrics related to hotel operators. In particular, human resource turnover is an important indicator of how an organization is developing its employees. If the hotel personnel are unhappy, it can lead to poor customer experiences. Employees have the capacity to set a hotel apart from competitors and help their enterprise realize its true revenue potential.

Falite (2013) has given the following key performance indicators of hospitality industry:

**Table 3: Key performance indicators of hospitality industry**

Accommodation	Food	Beverage
Average Room Rate	Cost of Sales Ratio;	Cost of Sales Ratio
Bedroom Occupancy Rate	Gross Profit Ratio	Gross Profit Ratio
Revenue per Available Room	Average Spend per customer	Average Spend per customer
Cost per Occupied Room	Labor Cost Ratio.	Labor Cost Ratio.
Labor Cost Ratio		

(Source:Failte 2013)

Hotel industry utilizes indexes to measure performance in three key areas: Occupancy, Average daily rate (ADR) and Revenue per available room (Rev PAR). An index of 100 means a hotel is capturing a fair share compared to the aggregated group of hotels.

Brief introduction of KPI Indicators are as follows:

*Average Room Rate:*It refers to the average room revenue per occupied room in a hotel for a specific period. It is also known as Average daily rate. Managers rely on this ratio in determining whether, or not, the premises are being utilized efficiently and whether expansion is possible.

$ARR = \text{Total revenue generated} / \text{Total number of rooms sold}$ .

*Bedroom Occupancy Rate* is calculated by dividing the number of rooms sold by the number of rooms available, as follows:

$\text{Bedroom occupancy rate} = \% \text{ number of rooms sold} / \text{number of rooms available} \times 100$

*Occupancy Percentage Rate:*Refers to the ratio of total number of occupied rooms to the total number of rooms available for sale.

*Cost per Occupied Room /Average Room Rate per Guest (ARG):*Calculation for this is developed by dividing the total room revenue by the total number of guests in the hotel. The formula is as follows:

$\text{Cost per occupied room} = \text{€ total rooms department cost} / \text{number of rooms sold}$

*Revenue available per room:*It is a performance measure used in hotel industry computed by dividing a hotel's total guestroom revenue by the room count and the number of days in the period being measured.

$\text{Rev Par} = \text{Rooms revenue} / \text{Revenue available}$

### Conclusion

The accounts of a hotel are maintained in a way to ensure that all revenue is accounted for and that all stock in hand is correct. This eliminates wastage and keeps a check on misappropriation of goods. It is also possible to generate department-wise accounting information apart from that of the whole hotel. For this income and expenditure is allocated to different departments on the basis of appropriate parameters. Various management accounting and performance management techniques can be applied to the hotel industry. These include budgeting, activity-based costing, and balanced score card. Information generated through the application of these techniques can be useful to the management in more than one ways. It can do planning on the basis of such information. The information also can be used to control things. Additionally the information facilitates managerial decision-making. It is expected that the outcomes of this paper will help not only those who are working in the hotel industry but also in other service sectors to think and develop customized accounting and analytical applications for their respective areas of business.

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