Tourism Is Your Business - A Financial Management Program For Canada's Lodging Industry
Catalogue Number: 11-55-18

How this program can help you

Tourism is your business is a financial management program that has been designed for people who operate tourist accommodations in Canada – especially for those who operate small or medium-sized facilities. Its purpose is to show how you can use sound financial management to increase the profitability of your hotel, motel, resort, country inn, cabins, cottages, and so on. The program is detailed, specific and practical. It will give you an understanding of proven financial management techniques, and it will show you how to apply those techniques to your own lodging facility.

In short, the program will help you improve the financial performance of your business.

Structure of the program

The program has two principal elements — a written one and a video one. The written element is this book (plus a companion study guide); it contains 10 chapters, each one dealing with a separate aspect of financial management. The video element consists of 10 videotapes (each one27‘\z -minutes long); they correspond to the 10 chapters presented here. In addition, there is a 15-minute “introductory” video and a 27 ½ -minute “summary” video. The two elements of the program are clearly linked. However, each one is complete and self-contained. As a result, you can study either of them and know that you have had access to the full program.

The aim of having two elements is to provide the maximum amount of flexibility and understanding. The program can be studied at home, using the book, the video element or a combination of the two. Alternatively, educators can offer in-class courses, associations and government agencies can hold seminars and workshops and larger audience groups can be reached through broadcast media — again, using either element of the program or a combination of the two.

Sponsorship of the program

This financial management program was developed for Tourism Canada with special assistance by the Ontario Hostelry Institute. In addition, many other organizations offered welcome advice. Among them: Tourism Ontario, The Federal Business Development Bank, Ryerson Polytechnical Institute, George Brown College and Georgian College. Valuable source material was contributed by the Nova Scotia Department of Tourism.

Terminology

Throughout this book, the term hotel/motel is used as a convenient shorthand. In its use here, it is meant to include country inns, resorts, cottages, cabins and all other types of lodging facility, as well as hotels and motels.

Contents

1

SOUND FINANCIAL MANAGEMENT what it can do for you. . .

No operator of a hotel/motel needs to be told that he or she has limited financial resources to work with. The question is: How can you put those limited resources to best possible use? That's what sound financial management is all about. It shows you how to deploy your financial resources to get the maximum return.

Sound financial management helps you plan for the future. For example, it can help you decide the answers to questions such as:

- Should you expand your operations?
- If so, by how much and how quickly?
- How should you measure your progress?
- Should you borrow to finance the expansion?
- How should you allocate the funds?
- What kind of return should you reasonably expect?
- Should you discount your room rates in exchange for high volume?
- How would new prices affect your return?

There are, of course, many more questions that financial management can help you answer. But basically, it is about: 1) planning, and 2) decision-making. And ultimately, its purpose is to help you make wise business decisions - knowledgeably, confidently and profitably.

In this chapter, we describe the main components of financial management and define the key terms and concepts that are involved. The idea is to give you a basic understanding of the financial management system and to make you more familiar with some of the jargon it uses. You will need this background to benefit from the many ideas and strategies discussed in later chapters. At this stage, we simply identify the main components; later on, we will show you how to put them to profitable use.

The four components of financial management

Financial management can be divided into four components as follows:

- *Bookkeeping* - ie., the collecting, classifying and recording of your hotel/motel's financial transactions in what are known as books of original entry.
- *Accounting* - *ie.*, the preparation of financial statements, which impose an order upon your hotel/motel's financial transactions.
- *Analysis* - ie., the interpretation of the financial statements so that sound conclusions can be drawn from them,
- *Decision-making and action-taking* - ie., putting the conclusions you have drawn into hard, practical use.

At the back of this book, just inside the back cover, you will find a pull-out chart, which shows the key components of the financial management system and the way they interrelate. The chart pulls out so that it can be readily seen, no matter which page of the book you are reading. You may find it helpful to refer to this chart as you move through the various stages that make up the financial management system.

Here is a more detailed explanation of what each of the four components involves.

Bookkeeping

Bookkeeping involves the collecting and collating of the raw information on which your decision-making and action-taking will eventually be based.

It begins with the raw information itself, which is probably best broken down according to source. Your *sources of information* may include such things as:

- *Guest folios - ie.,* the folios on which all charges incurred by your guests are recorded.
- Guest *ledger* - ie., the total of all guest folios of registered guests.
- *Daily transcripts* - ie., the daily records of all outstanding charges and settled receipts made during the past 24 hours.
- *Night audit* - ie., the daily balancing procedure that keeps a running tab on all charges and receipts.

There are, of course, other sources of information - such as suppliers' invoices, bank deposit slips, employee time records, etc. - and these can also be drawn on when you take the next step in the bookkeeping component, which is to compile your *books of original entry.*

These books of original entry begin the process of imposing order on your raw information. Altogether, there are seven books of original entry. They can be described as follows:

- *Cash receipts journal* - ie., a book that records all the transactions involving the receipt of cash, whether in the form of cash itself, personal cheques or credit card payments.
- *Sales journal* – ie., a book that records all the sales made on credit.
- *Cash disbursements journal* - ie., a book that records all payments made in cash or by cheque.
- *Purchases journal* – ie., a book that records all purchases made on credit.
- *Payroll journal* - ie., a book that records all payments made to, or on behalf of, employees (including salaries and wages, income tax deductions, Canada Pension, Unemployment Insurance, Workmen's Compensation, etc.).
- *General journal* - ie., a book that records all transactions that do not fit into any of the five journals listed above.
- *Monthly journal* - ie., a book that records all recurring, month-end adjusting entries.

These seven books of original entry are the source documents for the *general ledger.* The general ledger is a book that shows the status of all your hotel/motel's accounts at any given time. It is usually updated at the end of each month to reflect the transactions that have taken place during that month. Sometimes, it is called the book of final entry, because all the information from the books of original entry is recorded in it.

The general ledger lists the accounts in the order in which they appear in the financial statements, and it is the main source of information used in the preparation of those statements. It is, in other words, the basis of the next component of financial management, which is accounting.

Accounting

The process of accounting simply arranges the information in the general ledger into a number of financial statements. These financial statements are standardized, so that they can be read and understood by, say, potential investors in your hotel/motel or by your bank manager, accountant, a government auditor or anyone else you care to show them to.

There are many financial statements that can be produced, depending on the kind of information you wish to show. However, we deal only with the four that are of particular interest to hotel/motel operators. They are the *balance sheet, income statement, statement of retained earnings* and the *statement of changes in financial position.* The two most important are the balance sheet and the income statement.

Balance sheet

The balance sheet shows the relationship, at a particular point in time, between the assets, liabilities and owners' equity of your hotel/motel.

Basically, the *assets* of your operation are those goods that you have acquired in order to conduct your business. These assets can be divided into two categories - *current assets,* which consist of items that are either cash now or are expected to be turned into cash during the next 12 months (they would include accounts receivable and inventories); and *fixed assets,* which consist of items of a permanent nature not held for resale (they would include land, buildings, furniture, fixtures and equipment).

The *liabilities* of your operation are the amounts that you owe to your suppliers and to those people or organizations that have provided you with non-equity financing (eg., mortgages and loans). The liabilities can also be divided into two categories. *Current liabilities* are the amounts you must pay within the next 12 months (these would include accounts payable, sales taxes payable and municipal taxes payable). *Long-term liabilities* are the amounts you must pay in more than one year's time (they include long-term loans and mortgages).

As for the *owners' equity,* it represents the portion of your operation that belongs to the owners. It is calculated by taking the difference between the total assets and the total liabilities.

The relationship of assets, liabilities and owners' equity to one another can therefore be expressed by the formula:

OWNERS' EQUITY = ASSETS - LIABILITIES

Alternatively, this could be expressed as:

ASSETS = OWNERS' EQUITY + LIABILITIES

All three of these terms show up in the balance sheet. So if you want any information on any of them, or if you want to see how they interrelate, then the place to look is the balance sheet.

There is one other term that shows up in the balance sheet, and that is *depreciation.* Depreciation is the loss in value of fixed assets due to wear and tear and/or obsolescence. Canadian tax laws allow you to claim a tax deduction for this loss in value; the deduction is called a *capital cost allowance (* CCA). We will have more to say about this in later chapters. For now, it's enough to say that depreciation is a drain on your fixed assets.

Income statement

The income statement gives you a summary of the revenues and expenses that your hotel/motel has generated between two specific points in time. (It is also called the profit and loss statement.) *Revenues* consist of the money earned from the sale of rooms, food, beverages, telephone and other services. *Expenses* consist of the operating expenses incurred in the day-to-day running of your hotel/motel; tax-deductible expenses that relate to what are called fixed charges; depreciation; and income taxes.

Operating expenses might include wages, salaries, employee benefits, supplies and inventories purchased and used, energy costs, marketing costs, maintenance costs, and administration and general expenses. Tax-deductible fixed charges would include expenses such as rent, insurance on buildings and contents, interest charges and municipal taxes. Depreciation is explained above; and income taxes need no explanation.

As we indicated, the income statement shows the relationship between revenues and expenses. In particular, it shows whether your revenues exceed your expenses (giving you a *net income);* or whether your expenses exceed your revenues (giving you a *net loss* and a potential problem). Expressed as an equation, this relationship is:

REVENUES - EXPENSES = NET INCOME (LOSS)

Since expenses are broken down into the categories listed above, the income statement can also be broken down, as follows.

REVENUES - OPERATING EXPENSES = INCOME BEFORE FIXED CHARGES
(also known as gross operating profit)

INCOME BEFORE FIXED CHARGES - FIXED CHARGES - DEPRECIATION
= INCOME BEFORE INCOME TAXES

INCOME BEFORE INCOME TAXES - INCOME TAXES = NET INCOME (LOSS)

The income statement can also be used to calculate your *cash flow.* Your cash flow is the actual cash profit (or loss) that is made by your hotel/motel during a given period of time. It can be calculated by adding depreciation costs to your net income, and then subtracting the amount of principal repaid during that period of time on any long-term loans and mortgages. In other words:

NET INCOME + DEPRECIATION - PRINCIPAL REPAYMENT = CASH FLOW

The reason you calculate cash flow this way is as follows. When working out your net income, you subtracted depreciation from your revenues (see the three formulae grouped above). Now, in calculating cash flow, you have to add depreciation back, because depreciation is a non-cash expense and you are concerned here only with cash. Similarly, when calculating your net income, you subtracted only those fixed charges that were tax-deductible. Now, you have to subtract the repayment of principal, which is not tax-deductible.

The main point to remember here, though, is that cash flow is the actual cash profit (or loss) made by your operation over a given period of time.

Statement of retained earnings

This statement shows how much of your net income has been retained by your hotel/motel over a given period of time, and how much has been paid out to the owners.

In other words, if your hotel/motel has a net income after a period of, say, 12 months, you can plough some, all or none of that income back into the business (as *retained earnings),* and you can distribute whatever is left to the owners (as *dividends).* That means your net income can be split into those two parts - retained earnings and dividends. This can be expressed mathematically by saying that the net income is equal to the sum of the retained earnings and dividends. However, since we are looking at retained earnings here, it is normal to turn that relationship around, so that it is expressed by the equation:

RETAINED EARNINGS = NET INCOME - DIVIDENDS

The main thing about the statement of retained earnings is that it provides the link between the balance sheet and the income statement. That's because when money is ploughed back into the business (ie., when the retained earnings are positive), the owners' equity is automatically increased. Of course, the retained earnings can be negative - eg., if your hotel/motel has a net loss instead of a net income, or if your dividend pay-out is greater than your net income. When that happens, the owners' equity is automatically decreased.

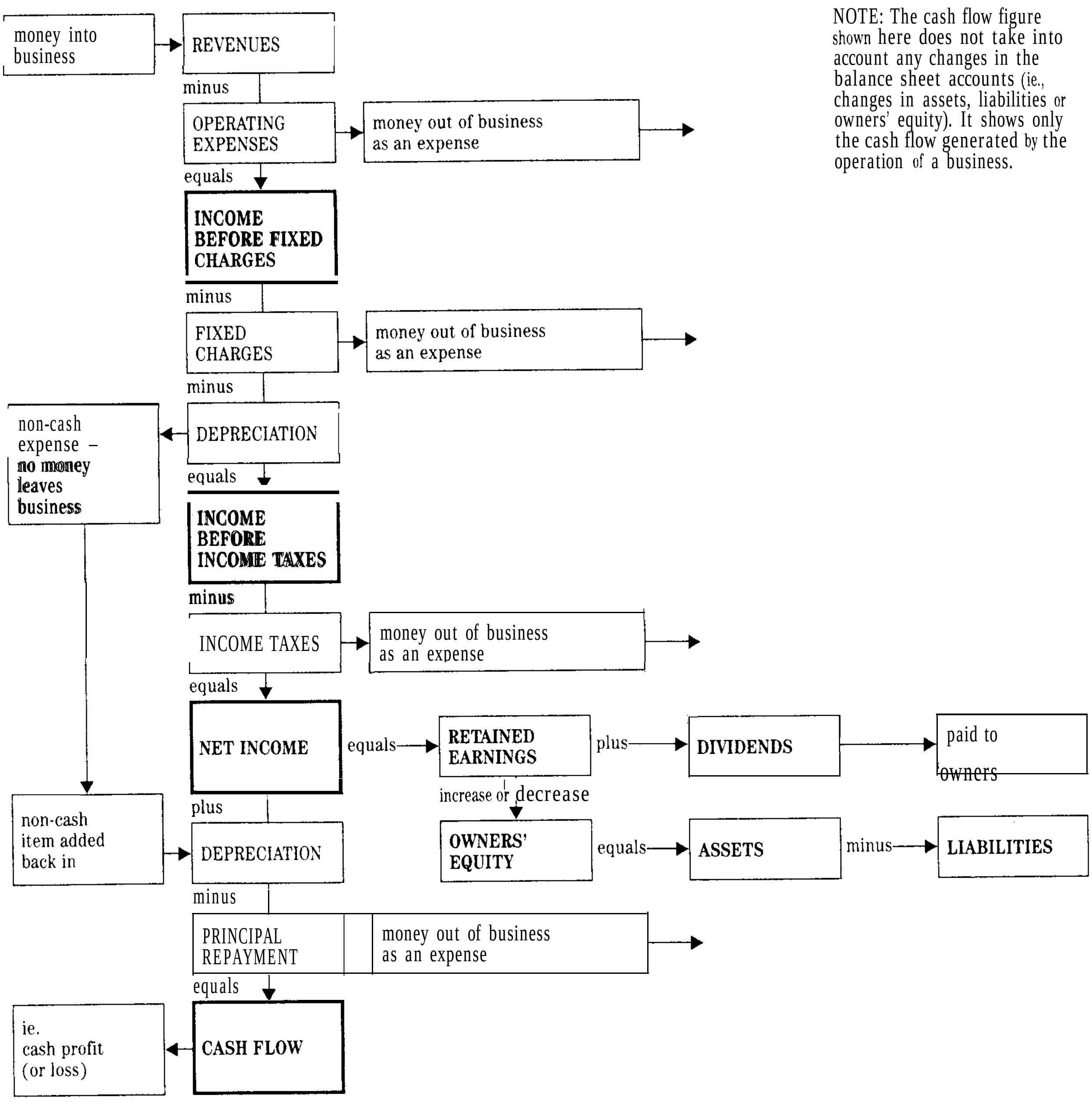
Statement of changes in financial position

This statement links two consecutive balance sheets to show how each of the three main components - assets, liabilities and owners' equity - has changed from the time the first balance sheet was drawn up to the time the second balance sheet was drawn up. It used to be called the statement of source and application of funds, or the statement of source and use of cash. We will have more to say about it in Chapter 7, so we will leave further discussion until then.

These are the only financial statements that we will discuss. To see how they tie together, you can study Figure 1. It shows how money flows through a business and how the financial statements keep track of its progress.

Finally, on the subject of financial statements, it is worth pointing out that although financial statements are based on the information you compile through your bookkeeping, you should not let your financial statements be determined by that bookkeeping. Instead, it should be the other way around. That means the bookkeeping system you set up should be determined by the kinds of financial statements you need - not vice versa.

FIGURE 1 How money flows through a business



NOTE: The cash flow figure shown here does not take into account any changes in the balance sheet accounts (ie., changes in assets, liabilities or owners' equity). It shows only the cash flow generated by the operation of a business.

Analysis

Once you have drawn up your financial statements, you are in a position to analyze and interpret them. There are many techniques for doing this; once again, they depend on the kind of information you wish to extract. However, there are some key techniques that will always be useful. The main ones are:

- *Ratio analysis.* This technique involves calculating the relationships, expressed as ratios, between various figures contained in the financial statements.
- *Operational analysis.* This technique uses the financial statements and other information sources (eg., management information reports) to evaluate efficiency, productivity and profitability.
- *Break-even analysis.* This technique examines the relationship between revenues, expenses and profits. It is used to establish prices and to enhance the profitability of your business.

These techniques will be dealt with in detail in later chapters.

Decision-making and action-taking

Finally, we get to the heart of sound financial management - ie., decision-making and action-taking. Again, we will postpone detailed discussion to later chapters. But here are some of the topics that we will be dealing with:

- How to set prices (of rooms and your menu) to give you the maximum return.
- How to prepare (and then follow) an annual operating budget.
- How to manage your working capital.
- How to manage information.
- How to control your cash, inventory and consumption (to avoid overstocking and to take advantage of suppliers' discounts).
- How to decide whether to lease or buy.
- How to plan for expansion.
- How to acquire an existing operation.
- How to sell an unprofitable venture.
- How to use leverage to increase your profitability.
- How to get credit.
- How to raise new financing.
- How to prepare a feasibility study.
- How to develop a business plan.

Outline of remaining chapters

The above discussion gives you a basic idea of what financial management is all about; and the chart at the back of this book gives you a visual overview of the financial management process. The next nine chapters will take you through the financial management process, following the sequence: 1) bookkeeping, 2) accounting, 3) analysis, 4) decision-making and action-taking.

Apart from a detailed discussion, each of the nine chapters (and this one, too) contains a series of self-test questions and a working example. In addition, each chapter reviews the key points that were covered in that chapter. The idea is that you can use the self-test questions and the working examples to see if you have fully grasped the key points (answers to the questions and solutions to the working examples are provided).

Finally, at the end of the book, you will find a glossary, which should help eliminate any confusion over terminology.

Key points in review

After studying Chapter 1, you should be able to:

- Define financial management and explain its main objectives.
- Identify the four components of financial management.
- Name all the books of original entry.
- Describe the function of the general ledger.
- Identify the four main financial statements.
- Describe what the financial statements show and how they interrelate.
- Define depreciation and capital cost allowance.
- Show how cash flow is calculated.
- Explain how retained earnings are calculated.
- Define or explain all the key terms that appear in italics.

SELF-TEST QUESTIONS -1

(answers on last page this chapter)

1. Cash flow is:
   a. A level of profit shown in the income statement.
   b. The difference between revenues and operating expenses.
   c. A float given to a cashier before going on duty.
   d. The actual cash profit or loss made by a business.
   e. None of the above.

2. Retained earnings are:
   a. The cash drawings taken out of a business by the owners.
   b. The difference between net income and dividends paid to the owners.
   c. Another term used for cash flow.
   d. The salaries or wages that an employer withholds from an employee.
   e. None of the above.

3. Total liabilities and owners' equity:
   a. Always equal the total value of assets.
   b. Are shown in the income statement.
   c. Are the short-term financial obligations of a business.
   d. Must be considered when calculating retained earnings.
   e. None of the above.

4. The income statement provides:
   a. A summary of a business' assets, liabilities and owners' equity at a given point in time.
   b. A summary of the transactions that have changed a business' financial position over a specified period of time.
   c. A summary of the changes in a business' retained earnings over a specified period of time.
   d. A summary of dividends paid to the owners.
   e. None of the above.

5. A list of books of original entry would include:
   a. Cash receipts journal, general journal and purchases journal.
   b. General ledger, cash receipts journal and purchases journal.
   c. Cash receipts journal, balance sheet, general journal and purchases journal.
   d. Cash receipts journal, general ledger and purchases journal.
   e. All of the above.

6. The general ledger shows:
   a. All those transactions that do not fit into any of the other books of original entry.
   b. The status of all the business' accounts at a given time.
   c. Whether the business' cash flow is enough to pay operating expenses.
   d. All the purchases made on credit.
   e. None of the above.

7. Break-even analysis is:
   a. A way of interpreting the books of original entry.
   b. An element of cash control.
   c. The calculation of relationships, expressed in ratios, between various sets of figures in the financial statements.
   d. Used in establishing prices and to enhance profitability.
   e. All of the above.

8. Capital cost allowances are:
   a. Allowances made for future capital expenditures.
   b. Allowances made for interest charges.
   c. Tax deductions to compensate for the cost of depreciation.
   d. Shown in the statement of change in financial position.
   e. None of the above.

9. Income before fixed charges is the same as:
   a. Profit before deducting the cost of fixed assets.
   b. Gross operating profit.
   c. Cash flow.
   d. Income before income taxes.
   e. None of the above.

10. The four major financial statements are:
   a. The cash flow statement, income statement, balance sheet and retained earnings statement.
   b. Drawn directly from the books of original entry.
   c. The balance sheet, income statement, general ledger and statement of changes in financial position.
   d. The balance sheet, income statement, statement of changes in financial position, and retained earnings statement.
   e. None of the above.

11. Operational analysis is:
   a. The same as ratio analysis.

b. Atechnique used in pricing.
c. An evaluation of abusiness' efficiency, productivity and profitability.
d. A predetermined financial plan.
e. All of the above.

12. Depreciation represents:
a. A non-cash expense.
b. An accumulated amount deducted from total liabilities in the balance sheet.
c. The fall in value of the Canadian dollar from one year to the next.
d. The difference between actual and budgeted expenses.
e. None of the above.

13. The assets of a business:
a. Are shown in the income statement.
b. Always equal total liabilities plus owners' equity.
c. Only change when depreciation is deducted from them.
d. Include current assets, fixed assets and owners' equity.
e. None of the above.

14. Ratio analysis is:
a. A pricing technique.
b. A technique used to balance the general ledger.
c. A technique used to analyze the books of original entry.
d. A technique that involves calculating the relationships between various sets of figures contained in the financial statements.
e. None of the above.

15. Long-term liabilities are:
a. Amounts that the business must pay within one year's time.
b. Amounts payable in more than one year's time.
c. Always greater than owners' equity.
d. Never greater than fixed assets.
e. All of the above.

WORKING EXAMPLES -1

Two examples are presented here.

1. Background

You have been given the following incomplete balance sheet:

Assets		Liabilities	
Current assets	$ 35,000	Current liabilities	$ 27,000
Fixed assets		Long-term liabilities	
Land	150,000	Mortgage payable	______
Buildings	250,000	Total liabilities	
Furniture	120,000	Owners' equity	160,000
Sub-total	520,000	Total liabilities plus	
Total assets	$ ______	owners' equity	$ ______

Task

Fill in the numbers to complete the balance sheet.

2. Background

In 1986, the CrossTown Motel had total revenues of $1,800,000. Operating expenses that year were $1,404,000. The motel's fixed charges, depreciation, income taxes and principal repayment figures for 1986 were:

Fixed charges	$247,000
Depreciation	105,000
Income taxes	11,000
Principal repayment	69,000

Task

Calculate the income before fixed charges and the cash flow for the CrossTown Motel in 1986.

NOTES

answers to self-test questions -1

1. d	2. b	3. a	4. e	5. a	6. b	7. d	8. c
9. b	10. d	11. c	12. a	13. b	14. d	15. b	

2

EFFECTIVE BOOKKEEPING

playing the numbers to win . . e

Good bookkeeping is the foundation of sound financial management. If it works effectively, your bookkeeping will give you the financial statements you need to monitor the health of your hotel/motel, and these in turn will give you the capacity for wise decision-making and action-taking. In broad terms, the way to design a good bookkeeping system is first, to decide on the type of information you need in your financial statements, and second, to set up your sources of information and your books of original entry so that they provide you with that information. As mentioned in Chapter 1, it is the demands of the financial statements that determine your bookkeeping system - not the other way around.

Of course, a good bookkeeping system will have many incidental or spin-off benefits. For example, by keeping your records accurately and completely, you will always be sure that you are paying only for what you receive from your suppliers. And you will always be able to meet government requirements that demand (among other things) that you keep certain financial records such as a payroll journal. Nevertheless, the main purpose of a good bookkeeping system is to develop the financial statements you need to manage your operations efficiently and profitably.

In this chapter, we will look at the major components of a good bookkeeping system to see how each of them works in practice. In particular, we will review the key journals you should keep; show you how to set them up; and indicate how the information you record in them can be translated into your financial statements.

The basic principles

In Chapter 1, it was pointed out that the two most important financial statements are the balance sheet and the income statement. The balance sheet is concerned with assets, liabilities and owners' equity. The income statement is concerned with revenues and expenses. It is these five accounts -

assets
liabilities
owners' equity
revenues
expenses

- which are the major accounts your bookkeeping system should serve.

All transactions must be linked to one or more of these accounts. To do this, there are two basic principles you have to follow.

- You must set up a *double-entry system* of bookkeeping.
- You must choose either the *cash basis* method or the *accrual basis* method for recording your transactions.

Here's how the two basic principles work in practice.

Double-entry bookkeeping

Double-entry bookkeeping dictates that for every *credit* recorded in one or other of the five accounts, there must be a corresponding *debit* recorded somewhere else in the five accounts, so that total credits always equal total debits. The reverse is also true - ie., for every debit recorded, there must be a corresponding credit, so that total debits always equal total credits. The reason for this is that it keeps your accounts in balance.

The general rules determining whether a transaction is a creditor a debit are summarized in the following table.

	Assets	Liabilities	Owners' equity	Revenues	Expenses
Debit	Increases	Decreases	Decreases	Decreases	Increases
Credit	Decreases	Increases	Increases	Increases	Decreases

In other words, any transaction that, say, increases the assets account is a debit. If the transaction increases the owners' equity account, then it is a credit. Or if it increases the expenses account, then it is a debit. And so on.

For example, suppose you rent out one of your rooms. You will receive payment, and this will increase your cash assets. From the table above, you can see that anything that increases your assets is a debit. However, when you receive payment for your room, this will increase your revenues account. And from the table, you can see that anything that increases your revenues account is a credit. Consequently, when you rent out your room, you should debit your assets account and credit your revenues account by the same amount.

Let's take another example. Suppose you pay a supplier for some foodstuffs. This will decrease your cash assets account, and from the table above you can see that this will make it a credit. At the same time, though, you will be increasing your expenses account, and that will be a debit.

A credit, then, is anything that decreases your assets or expenses accounts or that increases your liabilities, owners' equity or revenues accounts. And a debit is just the reverse - anything that decreases your liabilities, owners' equity or revenues accounts or that increases your assets or expenses accounts. For each credit, there must be a corresponding debit - and vice versa. And total credits must always equal total debits.

Cash basis vs. accrual basis

There are two alternative ways of handling your transactions - the cash basis method and the accrual basis method. The cash basis method records only those transactions where cash or its equivalent is either received or paid out, The accrual basis method records the same transactions, but in addition it records the non-cash transactions - eg., when a sale is made but the cash is not collected immediately (the sale would be classified as an account receivable until payment is received); or when goods or services are received from a supplier but payment is not made immediately (classified as an account payable until payment is made).

Normally, the smaller the hotel/motel, the more appropriate is the cash basis method. That's because all revenues will be received in cash or its equivalent, and all purchases will be paid for in cash or its equivalent. The accrual method is more appropriate in larger, more sophisticated hotel/motels, where guests are allowed a period of credit and where purchases from suppliers are also made on credit.

The number and types of books of original entry that should be kept are determined by whether your hotel/motel uses the cash basis or the accrual basis method. If you use the cash basis method, you probably only need these books of original entry:

- A cash receipts journal.
- A cash disbursements journal.
- A payroll journal (if you have any employees).

If you use the accrual basis method, you will likely need these books of original entry:

- A cash receipts journal.
- A sales journal.
- A cash disbursements journal.
- A purchases journal.
- A payroll journal.
- A general journal.
- A monthly journal.

The uniform system of accounts

As a general rule of bookkeeping, it is normal for transactions to be assigned to the five accounts in the order in which those five accounts appear in the financial statements. In the balance sheet, the assets always appear on the left-hand side, and the liabilities and the owners' equity always appear on the right-hand side. In the income statement, revenues appear on the left and expenses are shown on the right. Consequently, taking the balance sheet first and the income statement second, and reading from left to right, the five accounts are ordered so that assets come first, followed by liabilities, owners' equity, revenues and expenses.

Furthermore, it is normal for each of the accounts - and for each of the categories within those accounts - to be assigned certain numbers. This increases the accuracy of recording the transactions; also, it speeds the process up. Generally, the assets account has the lowest numbers, rising to the expenses account, which has the highest numbers.

However, because the hotel/motel industry is unique in many important respects, a *uniform system of accounts* has been developed, which applies specifically to the industry. It assigns specific numbers to each of the categories within the five accounts (plus some categories listed under "general groupings"), and it can be adopted by any hotel/motel, regardless of size. You are strongly advised to use this uniform system, because you will then be able to compare the performance of your hotel/motel with that of any other hotel/motel using the uniform system; also you will be able to compare your performance with industry standards and industry averages.

There are two essential elements of the uniform system, which you will need - *the chart of accounts* and the *expense dictionary*. If you have a full-service hotel/motel, you should use the chart of accounts shown in Figure 2. If you have a rooms-only hotel/motel, you should use the chart of accounts shown in Figure 3. lb determine which expense transactions go into which expense accounts, you should use the expense dictionary shown in Figure 4.

FIGURE 2 Chart of accounts for a full-service hotel/motel

GENERAL GROUPINGS

	Group
Assets	100
Liabilities and owners' equity	200
Revenues	300
Cost of sales	400
Departmental or direct operating expenses	500
Undistributed operating expenses:	
Administrative and general expenses	
Marketing	600
Property operation, maintenance and energy costs	700
Fixed charges: (occupancy costs)	
Rent, property taxes and insurance	
Interest expense	
Depreciation and amortization	800
Gain or loss on sale of property	860
Income taxes	870

BALANCE SHEET ITEMS

ASSETS	Account number
Current assets	
Cash	
Cash floats	100
Cash in bank - operating account	101
Cash in bank - bank cards	102
Marketable securities	109
Receivables	
Accounts receivable	110
Allowance for doubtful accounts	119
Inventories	
Food	120
Beverage	121
Gift shop	122
Operating supplies	123
Prepaid expenses	130
Other current assets	135
Investments and advances	140
Fixed assets	
Land	150
Land improvements	151
Buildings	160
Leasehold improvements	165
Furniture and equipment	170
Accumulated depreciation	
Land improvements	A-151
Buildings	A-160
Leasehold improvements	A-165
Furniture and equipment	A-170
China, glass, silver, linen, uniforms	189
Other assets	190

LIABILITIES	Account number
Current liabilities	
Bank loans	200
Accounts payable	210
Income taxes payable	220
Accrued liabilities	230
Other current liabilities	
Employee deductions - tax, CPP, UIC	250
Employee deductions - other	251
Gratuities collected	252
Sales tax collected	253
Long-term liabilities	
Mortgage payable	260
Loans from shareholders	265
Other non-current liabilities	270
Deferred income taxes	280
OWNERS' EQUITY	
Capital stock	290
Retained earnings	291
Profit and loss account	295

Figure 2 (cont.)

INCOME STATEMENT ITEMS

ROOMS DEPARTMENT	Account number
Revenues	
Guest rooms	R-300
Expenses	
Salaries and wages	R-500
Employee benefits	R-519
Cleaning supplies and expenses	R-530
Contract cleaning	R-531
Commissions - travel agents	R-540
Laundry and drycleaning	R-550
Linen, bedding supplies, uniforms	R-553
Other operating expenses	R-555
Paper, stationery and guest supplies	R-560

FOOD AND BEVERAGE DEPARTMENT	
Revenues	
Food sales	F-300
Beverage sales	F-310
Other income	F-390
Cost of sales	
Cost of food sales	F-400
Cost of beverage sales	F-410
Expenses	
Salaries and wges	F-5oo
Employee benefits	F-519
China, glass, silver, utensils	F-520
Cleaning supplies and expenses	F-53o
Contract cleaning	F-531
Kitchen fuel	F-545
Laundry and drycleaning	F-550
Licenses	F-552
Linen, uniforms	F-553
Other operating expenses	F-555
Paper, stationery and guest supplies	F-560
Music and entertainment	F-565

TELEPHONE	
Revenues	
Telephone calls	T-300
Cost of sales	
Cost of telephone calls	T-4oo
Equipment rental	T-410
Expenses	
Salaries and wages	T-500
Employee benefits	T-519
Other operating expenses	T-555
Printing and stationery	T-570

GIFT SHOP	Account number
Revenues	
Gift shop sales	G-3oo
Expenses	
Salaries and wages	G-500
Employee benefits	G-519
Other operating expenses	G-555

RENTALS AND OTHER INCOME	
Cash discounts earned	I-391
Concessions and store rentals	I-392
Interest income	I-393
Vending machines (net)	I-394

ADMINISTRATIVE AND GENERAL EXPENSES	
Salaries and wages	600
Employee benefits	619
Bank charges and exchange	620
Cash over/short	625
Credit card commissions	630
Credit and collection charges	632
Donations	635
Dues and subscriptions	637
Insurance - general	650
Printing, stationery and postage	670
Professional fees	672
Provision for doubtful accounts	675
Travel	682
Miscellaneous	684

MARKETING	
Advertising	690
Other selling and promotion expenses	691

PROPERTY OPERATION AND MAINTENANCE	
Salaries and wages	700
Employee benefits	719
Building and furniture	720
Electrical and mechanical equipment	722
Grounds	724
Snow and waste removal	777
Supplies	778
Miscellaneous	784

Figure 2 (cont.)

ENERGY COSTS	Account number
Electricity	790
Fuel	792
Water	794

RENT, PROPERTY TAXES AND INSURANCE	
Rent - building	800
Rent - equipment and furniture	801
Property and business taxes	810
Insurance - building and contents	820

INTEREST EXPENSE	
Long-term debt	830
Other	831

DEPRECIATION AND AMORTIZATION	Account number
Depreciation	840
Amortization - leasehold improvements	850
Gain or loss on sale of property	860

INCOME TAXES	870

HOUSE LAUNDRY	
Expenses	
Salaries and wages	900
Employee benefits	919
Supplies	978
Miscellaneous	984
Charged to	
Rooms department	990
Food and beverage department	991

FIGURE 3 Chart of accounts for a rooms-only hotel/motel

GENERAL GROUPINGS

The same as those shown in Figure 2 for a full-service hotel/motel

BALANCE SHEET ITEMS

The same as those shown in Figure 2 for a full-service hotel/motel

INCOME STATEMENT ITEMS

Revenues	Account number
Guest rooms	300
Telephone	310
Other income	
Sundry sales (net)	390
Interest income	393
Vending machines (net)	394
Payroll	
Salaries and wages	500
Employee benefits	519
Direct operating expenses	
Cleaning supplies and expenses	530
Contract cleaning	531
Commissions	540
Laundry and drycleaning	550
Linen, bedding supplies and uniforms	553
Other operating expenses	555
Paper, stationery and guest supplies	560
Administrative and general expenses	
Bank charges and exchange	620
Cash over/short	625
Credit card commissions	630
Credit and collection charges	632
Donations	635
Dues and subscriptions	637
Insurance - general	650
Printing, stationery and postage	670
Professional fees	672
Provision for doubtful accounts	675
Telephone	680
Travel	682
Miscellaneous	684

Marketing	Account number
Advertising	690
Other selling and promotion expenses	691
Property operation and maintenance	
Building and furniture	720
General electrical and mechanical equipment	722
Grounds	724
Snow and waste removal	777
Supplies	778
Miscellaneous	784
Energy costs	
Electricity	790
Fuel	792
Water	794
Writ, property taxes and insurance	
Rent - building	800
Rent - equipment and furniture	801
Property and business taxes	810
Insurance - building and contents	820
Interest expense	
Long-term debt	830
Other	831
Depreciation and amortization	
Depreciation	840
Amortization-leasehold improvements	850
Gain or loss on sale of property	860
Income taxes	870

FIGURE 4 Expense dictionary

Items	Rooms-Only Accommodation Facility	Full Service Accommodation Facility	Foodservice Facility
A			
Accountants' Fees	A&G* - Professional Fees	A&G-Professional Fees	A&G-Professional Fees
Adding Machine Papar	A&G-Prtg. Stat. & Postage	A&G-Prtg. & Stat.	A& G-Prtg. Stat. & Post.
Adding Machine-Service	POM&E-General Electrical & Mechanical Equipment	POM&E-GE&ME*	POM&E-General Maintenance and Upkeep
Advertising	Marketing-Advertising	Marketing-Advertlslng	Marketing
Advertising-Telephone Directories	Marketing-Adverttslng	Marketing-Advefilslng	Marketing
Air Cooling System Repairs	POM&E-General Electrical & Mechanical Equipment	POM&E-General Electrical & Mechanical Equipment	POM&E-General Maintenance and Upkeep
Air Mail Stickers	DOE -Guest Supplies	Rooms -Guest Supplies	
Alarm Service-Fire or Burglar	A& G-Misc.	A& G-Misc.	A& G-Misc.
Alcohol-Cooking Fuel		F&B-Kitchen Fuel	DOE - Kitchen Fuel
Alkalies (Water Softeners)	POM&E-Supplies	POM&E-Supplies	POM&E-Supplies
Ammonia-Cleanlng	DOE - Cleaning Supplies & Expenses	Rooms, Food & Beverage-Cleaning Supplies	DOE-Cleaning Supplies
Amortization - Leasehold & Improvement	Occupancy Costs -Amortization	Occupancy Costs -Amortization	Occupancy Costs -Amortization
Auto-Truck Repairs	POM&E-General Electrical & Mechanical Equipment	POM&E-GE&ME	POM&E-General Maintenance and Upkeep
Awning Repairs	POM&E-Building	POM&E-Building	POM&E-Ganeral Mainte- and Upkeep
Awnings-Cleantng	DOE-Cleaning Supplies and Expenses	Rooms, Food & Beverage-Cleaning Supples& Expanses	DOE-Cleaning Supplies
B			
Bank Cheques	A& G-Prtg. Stat &Post	A&G -Printing, Stationery & Postage	A&G-Prtg. Stat. & Post
Bank Exchange on Cheques & Currency	A&G-Bank Charges	A&G - Bank Charges	A&G-Bank Charges
Bar Appetizers		Beverage - Cost of Sales	Beverage-Cost of Sales
Bar Supplies		Food & Beverage-Misc	DOE-Misc
Bar Utensils		Food & Beverage-Utensils	DOE-Utensils
Basket Liners, Waste Papar	DOE- Cleaning Supplies & Expenses	Rooms-Cleaning Supplies & Expenses	DOE-Cleaning Supplies
Bathing Caps (Guest)	DOE-Guest Supplies	Rooms-Guest Supplies	
Bath Mats	DOE-Linen	Rooms -Linen	
Bath Room Glass Shelves	POM&E-Building	POM&E-Building	POM&E-Misc.
Batter Bowls		Food & Beverage-Utensils	DOE-Utensils
Batter Mixers		Food & Beverage-Utensils	DOE-Utensils
Batteries & Flashlights	POM&E-Misc.	POM&E-Misc.	POM&E-Misc.
Beaters		Food & Beverage-Utensils	DOE-Utensils
Bed Pads	DOE-Linen	Rooms - Linen	
Bedspreads	DOE-Linen	Rooms -Linen	

*POM&E - Property Operation, Maintenance & Energy Costs
“GE&ME -General Electrical & Mechanical Equipment
“DOE- Direct Operating Expanses
*A& G-Administrative & General Expenses

Items	Rooms-Only Accommodation Facility	Full Service Accommodation Facility	Foodservice Facility
Belts - Rubber	POM&E-General Electrical & Mechanical Equipment	POM&E-General Electrical & Mechanical Equipment	POM&E-Supplies
Beverage Licenses		F&B-Misc	DOE-Licenses & Permits
Billboards	Marketing-Advertising	Marketing-Advertising	Marketing
Billing Machine Supplies	A& G- Prtg., Stat, & Post.	A& G-Printing, Stationery & Postage	A& G- Prtg., Stat. & Post
Bin Cards-Liquor		Food & Beverage-Paper & Guest Supplies	DOE-Paper Supplies
Blades-Razor (Guest)	DOE-Guest Supplies	Rooms-Guest Supplies	
Blankets	DOE- Linen	Rooms - Linen	
Blankets-Cleaning	DOE-Cleaning Supplies & Expenses	Rooms-Cleaning Supplies & Expenses	_
Bleach	DOE-Laundry	House Laundry-Supplies	DOE-Laundry
Blinds	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Blotters-Advertising	Marketing-Advefi(stng	Marketing-Advert!sIng	Marketing
Boiler Inspection	POM&E-Misc.	POM&E-Misc.	POM&E-General Maintenance and Upkeep
Boiler Repairs	POM&E-General Electrical & Mechanical Equipment	POM&E-General Electrical & Mechanical Equipment	POM&E-General Maintenance and Upkeep
Bonds-Fidelity	A&G-Insurance-General	A&G-Insurance -General	A&G - Insurance - General
Bonuses - Employees	Salaries & Wages	Rooms, Focal &Beverage-Salaries & Wages	Salaries & Wages
Booklets-Advertising	Marketing-AdvefilsIng	Marketing-Advert!sIng	Marketing
Books-Account	A& G- Prtg., Stat. & Post.	A& G- Prtg., Stat. & Post.	A& G-Prtg., Stat. & Post.
Books-Records	A&G -Prtg., Stat. & Post.	A&G - Prtg., Stat. &Post.	A& G- Prtg., Stat. & Post
Books-Technical	A& G-MIsc	A& G-Misc.	A& G-Misc
Buttons (Uniforms)	DOE-Uniforms	Rooms-Uniforms	DOE-Uniforms
Bottle Openers		Food & Beverage-Misc	DOE-Misc.
Bottle Openers (Guest)	DOE-Guest Supplies	Rooms-Guest Supplies	
Bowls - Batter		F&B-Utensils	DOE-Utensils
Bowls - China		F&B-China, Glass & Silver	DOE-China, Glass & Silver
Bowls-Glass		F&B-China, Glass & Silver	DOE-China, Glass & Silver
Bowls-Mixing		F& B-Utensils	DOE-Utensils
Bowls-Salad		F&B-China, Glass & Silver	DOE-China, Glass& Silver
Bread & Butter Plates		F&B-China, Glass & Silver	DOE-China, Glass & Silver
Brochures	Marketing-AdvertIsIng	Marketing-AdvertIsIng	Marketing
Brooms	DOE-Cleaning Supplies	Rooms, Food & Beverage-Cleaning Supplies	DOE-Cleaning Supplies
Brushes-Cleaning	DOE-Cleaning Supplies	Rooms, Food &Beverage-Cleaning Supplies	DOE-Cleaning Supplies
Brushes-Paint	POM&E-Supplies	POM&E-Supplies	POM&E-Supplies
Building Repairs	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Burglar Alarm Service	A& G-Misc.	A&G -Misc.	A& G-Misc.
Business Cards	A& G- Prtg., Stat. & Post	A&G-Prtg., Stat. & Post.	A& G- Prtg., Stat. & Post.
Business Promotion	Marketing - Promotion	Marketing-Promotion	Marketing
C			
Calendars	Marketing - Advertising	Marketing-Advertising	Marketing
Candles	DOE-Other Op Exp	Rooms-Other Op. Exp.	DOE-Other Op. Exp.
Can Openers		Food - Utensils	DOE-Utensils
Caps	DOE-Uniforms	Rooms; Food & Beverage-Uniforms	DOE-Uniforms

Items	Rooms-Only Accommodation Facility	Full Service Accommodation Facility	Foodservice Facility
Carafes		Food & Beverage-China, Glass and Silver	DOE-China, Glass & Silver
Carbonated Gas		Beverage - Cost of Sales	Beverage -Cost of Sales
Carbon Paper	A&G -Prtg., Stat & Post,	A&G - Prtg & Stationery	A& G-Prtg., Stat. & Post.
Carpet Repairs	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Carpets & Rugs-Cleaning	DOE-Cleaning Supplies and Expenses	Rooms; Food & Beverage-Cleaning Supplies & Expenses	DOE-Cleaning Supplies & Expenses
Carpet Linings	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Cash Overage & Shortage	A&G-Cash over & short	A&G-Cash over & short	A&G-Cash over & short
Cash Register-Repairs	POM&E - General Electrical & Mechanical Equipment	POM&E-General Electrical & Mechanical Equipment	POM&E-General Maintenance & Upkeep
Cash Register Supplies	A& G-Prtg., Stat &Post	A& G-Printing, Stationery, & Postage	A& G- Prtg., Stat & Post
Cash Reports	A& G-Prtg., Slat &Post	A& G- Prtg, Slat, & Post	A& G-Prtg., Stat & Post.
Cashier Sheets	A& G-Prtg., Stat &Post	A&G -Prtg., Stat. & Post	A&G -Prtg., Stat. & Post
Cement	POM&E-Building	POM&E-Building	POM&E - General Maintenance & Upkeep
Chair Rentals, Non-banquet	Rooms - Equipment Rental	Rooms-Equipment Rental	
Charcoal		Food & Beverage-Kitchen Fuel	DOE- Kitchen Fuel
Cheques-Bank	A& G-Prtg., Stat & Post.	A& G-Prtg., Stat. & Post	A& G-Prtg., Stat &Post
Checks-Restaurant		Food & Beverage-Paper & Guest Supplies	DOE-Prtg., Stat & Post.
Chemical-Laundry	DOE-Laundry	House Laundry-Supplies	DOE-Laundry
Chemicals-Fire Extinguisher	A& G-MIsc	A& G-MIsc	A& G-Misc
Chemicals (Moth-proofing of carpets)	DOE-Cleaning Supplies & Expenses	Rooms, Food & Beverage-Cleaning Supplies & Expenses	DOE-Cleaning Supplies & Expenses
China		F&B-China, Glass & Silver	DOE- China, Glass & Silver
Chlorine	Recreation-Equip't & Supplies	Recreation-Equip't & Supplies	
Christmas Expense	A& G-MIsc	A& G-Misc	A& G-Misc.
Christmas Presents & Gratuities (Other than Employees)	A& G-MIsc	A& G- Misc.	A& G-Misc
Christmas Trees & Decorations	A& G-Misc.	Rooms, Food & Beverage-Misc	A& G-Misc
Circulars	Marketing-Advetilslng	Marketing-Advefllslng	Marketing
Cleaning Fluids	DOE-Cleaning Supplies & Expenses	Rooms; Food & Beverage-Cleaning Supplies & Exp	DOE-Cleaning Supplies & Exp
Cleaning Rags	DOE-Cleaning Supplies & Expenses	Rooms; Food & Beverage-Cleaning Supplies & Exp	DOE-Cleaning Supplies & Exp
Clips	A& G-Prtg., Stat &Post	A& G-Prtg., Stat &Post	A& G-Prtg., Stat &Post
Clothes Hangers Guest	DOE- Guest Supplies	Rooms - Guest Supplies	DOE-Guest Supplies
Clothing Repairs-Outside Establishments	A& G-Misc	A& G-Misc.	A& G-Misc

Items	Rooms-Only Accommodation Facility	Full Service Accommodation Facility	Foodservice Facility
Cocktail Napkins - Paper		Food & Beverage - Paper Supplies	DOE-Paper Supplies
Cocktail Shakers		F&B-China, Glass & Silver	DOE-China, Glass & Silver
Coffee Bags		F& B-Misc	DOE-Misc
coffee Pots		F&B-China, Glass & Silver	DOE-China, Glass & Silver
Coffee Urn Repairs		POM&E - Kitchen	POM&E - General Mainte-nance & Upkeep
Colanders		F&B Utensils	DOE-Utensils
Collecting Guest Accounts	A&G-Credit and Collect	A&G-Credit and Collect	A&G-Credit & Collect
Collection Fees	A&G-Credit and Collect	A& G-Credit and Collect.	A&G-Credit & Collect.
Commissions - Credit Card Charoe	A&G-Credit Card Commission	A& G-Credit Card Commission	A& G-Credit Card Commission
Commissions-Travel Agencies	DOE-Commissions	Rooms-Commissions	
Complimentary Entertaining	Marketing-Promotion	Marketing-Promotton	Marketing
Contract Cleaning	DOE-Contract Cleaning	Rooms-Contract Cleaning	DOE-Contract Cleaning
Contract Cleaning - Dining Rooms		F&B-Contract Cleaning	DOE-Contract Cleaning
Contributions	Marketing-other Expense	Marketing-Other Expense	Marketing
Cooking Utensils (In Kitchenette Apts)	DOE-Misc	Rooms-Misc	
Corkscrews		F& B-Utensils	DOE-Utensils
Creamers		F&B-China, Glass & Silver	DOE- China, Glass & Silver
Credit & Collection Expenses	A&G-Credit and Collect	A& G-Credit and Collect	A&G-Credit and Collect.
Credit Card Commissions	A&G-Credit Card Commissions	A&G-Credit Card Commissions	A& G-Credit Card Commissions
cups		F&B-China, Glass & Silver	DOE- China, Glass & Silver
Cups - Paper		F& B-Paper Supplies	DOE-Paper Supplies
Curtain Cleaning	DOE-Cleaning Supplies & Expenses	Rooms, F& B-Cleaning Supplies & Expenses	DOE-Cleaning Supplies & Expenses
Curtains - Shower	DOE-Linen	Rooms -Linen	
D			
Daily Reports	A& G-Prtg., Stat. & Post.	A& G-Prtg., Stat & Post	A& G-Prtg., Stat & Post
Decorating & Painting	POM&E-Building	POM&E-Building	POM&E - General Mainte nance & Upkeep
Decorations	DOE-Misc	Rooms, F& B-Misc	DOE-Misc
Deferred Finance Charges-Amortization	Occupancy-Amortization of Deferred Finance Charges	Occupancy-Amortization o! Deferred Finance Charges	Occupancy-Amortization of Deferred Finance Charges
Delivery Charges on Beverages		Beverage -Cost of Sales	Beverage-Cost of Sales
Delivery Charges on Food		Food-Cost of Sales	Food-Cost of Sales
Deodorants	DOE- Cleaning Supplies & Expenses	Rooms, F& B-Cleaning Supplies & Expenses	DOE-Cleaning Supplies & Expenses
Depreciation - Building	Occupancy Costs- Deprec	Occupancy Costs- Depre-ciation 01 Building	Occupancy Costs-Deprec
Depreciation - Equipment	Occupancy Costs-Deprec.	Occupancy Costs- Deprec of Furniture & Equipment	Occupancy Costs-Deprec.

items	Rooms-Only Accommodation Facility	Full Service Accommodation Facility	Foodservice Facility
Depreciation - Furniture	Occupancy Costs – Deprec.	Occupancy Costs – Deprec. of Furniture & Equipment	Occupancy Costs – Deprec.
Desk Pads-Guest	DOE-Guest Supplies	Rooms -Guest Supplies	
Detergents	DOE–Cleaning Supplies & Expenses	Rooms; F&B - Cleaning Supplies & Expenses	DOE–Cleaning Supplies & Exp.
Directional Signs (Inside Bldg.)	A&G–Misc.	Rooms, F&B–Misc	A&G–Misc.
Directional Signs (Outside Bldg.)	Marketing-Advertising	Marketing - Advertising	Marketing
Directories - Rooms	DOE-Other Op Exp.	Rooms - OtherOp. Exp	
Directors' Expense	A&G–Misc.	A&G–Misc	A& G- Misc.
Directors' Fee	A&G–Misc.	A&G–Misc.	A&G–Misc.
Directory Advertising	Marketing-Advetilslng	Marketing-Advefllslng	Marketing
Dishes		F&B-China, Glass & Silver	DOE–China, Glass & Silver
Dishwasher Repairs		POM&E-Kitchen	POM&E–General Maintenance & Upkeep
Disinfectants	DOE–Cleaning Supplies & Expenses	Rooms, F&B–Cleaning Supplies & Expanses	DOE–Cleaning Supplies & Expenses
Disinfecting (On Contract)	DOE-Contract Cleaning	Rooms; F&B-Contract Cleaning	DOE-Contract Cleaning
Dollies-Paper		F&B–Paper Supplies	DOE- Paper Supplies
Donations	A&G–Misc	A&G–Misc	A&G–Misc.
Door Repairs	POM&E–Building	POM&E–Building	POM&E–General Maintenance & Upkeep
Doubtful Accounts –Provision for	A&G–Prov. for Doubtf. Accts.	A&G–Prov. for Doubtf. Accts.	A&G–Prov. for Doubtf. Accts.
Drapery Cleaning	DOE–Cleaning Supplies & Expenses	Rooms, F&B–Cleaning Supplies & Expenses	DOE–Cleaning Supplies & Expenses
Drapery Cords	POM&E–Supplies	POM&E–Supplies	POM&E–Supplies
Drapery Linings	POM&E–Supplies	POM&E–Supplies	POM&E–Supplies
Drapery Repairs	POM&E–Supplies	POM&E–Supplies	POM&E–Supplies
Dresser Drawer Liners	DOE–Cleaning Supplies & Expenses	Rooms –Cleaning Supplies & Expenses	DOE–Cleaning Supplies & Expenses
Dresser Tops-Glass	POM&E–Supplies	POM&E–Supplies	POM&E–Supplies
Dresser Tops - Linen	DOE-Linen	Rooms–Linen	
Dresser Trays-Glass	DOE–Other Op. Exp	Rooms-Other Op. Exp.	
Dresses	DOE-Uniforms	Rooms, F&B; House Laundry-Uniforms	DOE-Uniforms
Drinking Glasses	DOE-Guest Supp	Rooms -Guest Supp.; F&B - China, Glass & Silver	DOE–China, Glass & Silver
Dry Cleaning	DOE-Laundry & Dry Cl	Rooms; F&B-Laundry & Dry Cl.	DOE-Laundry & Dry Cl.
Dues-Associations	A&G–Dues & Subscriptions	A&G-Dues & Subscriptions	A&G–Dues & Subscriptions
Dusters	DOE–Cleaning Supplies & Expanses	Rooms; F&B–Cleaning Supplies & Expenses	DOE–Cleaning Supplies & Exp.
Dust Pans	DOE–Cleaning Supplies & Expenses	Rooms; F&B–Cleaning Supplies & Expenses	DOE–Cleaning Supplies & Exp.
E			
Egg Beaters		F&B–Utensils	DOE-Utensils
Electrical & Mechanical Repairs	POM&E–General Electrical & Mechanical Equipment	POM&E–General Electrical & Mechanical Equipment	POM&E–General Maintenance & Upkeep
Electrical System Repairs	POM&E–General Electrical & Mechanical Equipment	POM&E–General Electric & Mechanical Equipment	POM&E–General Maintenance & Upkeep
Electric Bulbs	POM&E–Supplies	POM&E–Supplies	POM&E–Supplies

Items	Rooms-Only Accommodation Facility	Full Service Accommodation Facility	Foodservice Facility
Electric Current	POM&E–Electricity	POM&E–Electricity	POM&E–Electricity
Electric Fan Repairs	POM&E-General Electrical & Mechanical Equipment	POM&E–General Electrical & Mechanical Equipment	POM&E–General Maintenance & Upkeep
Electric Fixture Repairs	POM&E–Building	POM&E–Building	POM&E-General Maintenance & Upkeep
Electric Sign Maintenance Contract	POM&E–General Electrical & Mechanical Equipment	POM&E–General Electrical & Mechanical Equipment	POM&E-General Maintenance & Upkeep
Electricity–Cooking		F&B-Kitchen Fuel	DOE-Kitchen Fuel
Electricity for Refrigeration (In Kitchenette Apts)	DOE–Misc	Rooms–Misc	
Employee Relations Expense	Employee Benefits	Employee Benefits	Employee Benefits
Employee Transportation	DOE-Other Op Exp.	Rooms. F&B–Other Op Exp	DOE-Other Op Exp
Employees' Lodging	Employee Benefits	Employee Benefits	Employee Benefits
Employees' Meals	Employee Benefits	Rooms; F&B; etc - Employee Benefits	Employee Benefits
Entertainers - Professional		Music & Entertainment	Music & Entertainment
Entertaining–Complimentary at Hotel	Marketing-Promotional	Marketing - Promotional	Marketing
Entertainment & Music	DOE-Other Op. Exp	F&B-Music & Entertainment	Music & Entertainment
Envelopes	A&G–Prtg., Stat & Post	A&G - Prtg. & Stat	A& G- Prtg., Stat. & Post.
Envelopes-Guest	DOE-Guest Supplies	Rooms -Guest Supplies	
Exchange on Bank Cheques & Currency	A&G-Bank Charges	A&G–Bank Charges	A&G-Bank Charges
Exterminating (On Contract)	DOE-Contract Cleaning	Rooms; F&B-Contract Cleaning	DOE-Contract Cleaning
F			
Face Cloths (Guest)	DOE-Guest Supplies	Rooms–Guest Supplies	
Facial Tissues & Holders	DOE-Guest Supplies	Rooms–Guest Supplies	
Fan Repairs -Electric	POM&E–General Electrical & Mechanical Equipment	POM&E–General Electrical & Mechanical Equipment	POM&E–General Maintenance & Upkeep
File Cards	A& G- Prtg., Stat. & Post	A& G- Prtg. & Stat.	A& G- Prtg., Stat & Post.
Filter Paoar		F&B–Paper Supplies	DOE- Paper Supplies
Fire Alarm Service	A& G–Misc	A& G-MIsc	A& G–Misc.
Fire Axes	A& G–Misc.	A&G -Misc.	A& G- Misc.
Fire Extinguisher Chemicals	A& G–Misc	A& G–Misc.	A& G–Misc
Fire Hose Repairs	POM&E–Building	POM&E–Building	POM&E–General Maintenance & Upkeep
Firewood–Rooms &	DOE-Other Op. Exp.	Rooms-Other Op. Exp.	
First Aid Supplies	Employee Benefits	Employee Benefits	Employee Benefits
Floor Covering Repairs	POM&E–Building	POM&E–Building	POM&E–General Maintenance & Upkeep
Floor Polish	DOE–Cleaning Supplies & Expenses	Rooms; F& B–Cleaning Supplies & Expenses	DOE–Cleaning Supplies & Expenses
Floor Repairs	POM&E–Building	POM&E–Building	POM&E–General Maintenance & Upkeep
Fluids–Cleaning	DOE–Cleaning Supplies & Expenses	Rooms; F& B–Cleaning Supplies & Expenses	DOE–Cleaning Supplies & Expenses
Fly Paper	DOE–Cleaning Supplies & Expenses	Rooms; F& B–Cleaning Supplies & Expenses	DOE- Cleaning Supplies & Expenses
Fly Swatters	DOE–Cleaning Supplies & Expenses	Rooms; F& B–Cleaning Supplies & Expenses	DOE- Cleaning Supplies & Expenses
Foil Wrapping		F&B - Papar Supplies	DOE-Paper Supplies

Items	Rooms-Only Accommodation Facility	Full Service Accommodation Facility	Foodservice Facility
Food		Food-Cost of Sales	Food -Cost of Sales
Forks -Kitchen		F&B-Utensils	DOE- Utensils
Forks - Silver		F&B-Silver	DOE-Silver
Forms-Printed	A&G -Prtg., Stat. & Post.	A&G-Prtg & Stat	A&G -Prtg., Stat. & Post.
Franchise Fees	A& G-Misc.	A&G- Misc.	A& G-Misc
Freight Charges	A& G-Misc.	A& G-Misc	A& G-Misc
Front Desk Signs	DOE-Other Op. Exp	Rooms-Other Op Exp	
Fuel	POM&E-Fuel	POM&E-Fuel	POM&E-Fuel
Fuel for Cooking		F&B-Kitchen Fuel	DOE-Kitchen Fuel
Fuel-Gas	POM&E-Fuel	POM&E-Fuel	POM&E-Fuel
Fuel-On	POM&E-Fuel	POM&E-Fuel	POM&E-Fuel
Fumigation (On Contract)	DOE-Contract Cleaning	Rooms; F&B-Contract Cleaning	DOE-Contract Cleaning
Furniture Polish	DOE-Cleaning Supplies & Expenses	Rooms; F& B-Cleaning Supplies & Expenses	DOE-Cleaning Supplies & Expenses
Furniture Rental (Public Rooms)	DOE-Other Op. Exp. Rent- Furnit & Equip.	Rooms-Other Op. Exp. Rent-Furnit. & Equip.	DOE-Other Op Exp Rent-Furnit. & Equip.
Furniture Repairs	POM&E-Building	POM&E-Building	POM&E-General Mainte-nance & Upkeep
Fuses	POM&E-Supplies	POM&E-Supplies	POM&E-Supplies
G			
Garbage Cans	POM&E-Misc.	Food-Misc.; POM&E-Misc.	POM&E-Misc.
Garbage Removal	POM&E-Waste Removal	POM&E-Waste Removal	POM&E-Waste Removal
Garment Hangers (Guest)	DOE-Guest Supplies	Rooms-Guest Supplies	
Gas-Carbonated		Beverage-Cost of Sales	Beverage-Cost of Sales
Gas - Cooking		Fed- Kitchen Fuel	DOE-Kitchen Fuel
Gas for Refrigeration	POM&E-Misc.	POM&E-Misc	POM&E-MIsc
Gas-Fuel	POM&E - Fuel	POM&E-Fuel	POM&E-Fuel
Gasoline-Motor Vehicles	A&G –Travel Expenses	A&G-Travel Expenses	A&G-Travel Expenses
Generator Repairs	POM&E-General Electrical & Mechanical Equipment	POM&E-General Electrical & Mechanical Equipment	POM&E-General Mainte-nance & Upkeep
Glass-Dresser & Table Tops	POM&E-Supplies	POM&E-Supplies	POM&E-Supplies
Glassware	DOE-Guest Supplies	Rooms-Guest Supplies; F&B-China, Glass & Silver	DOE-China Glass & Silver
Glassware-Liquor (Cocktail, Highball, Wine, etc.)		F&B-China, Glass & Silver	DOE-China. Glass & Silver
Glass Stirrers-Beverages		F&B-Other Op Exp	DOE-Other Op Exp
Grease	POM&E-Supplies	POM&E-Supplies	POM&E-Supplies
Greeting Cards	Marketing-Advertising	Marketing-Advertising	Marketing
Grounds Expense	POM&E-Grounds	POM&E-Grounds	POM&E-General Mainte-nance & Upkeep
Guest Ledgers	A& G-Prtg., Stat & Post	Rooms-Guest & Paper Supp.	
Guest Registers	A& G-Prtg., Stat. & Post.	Rooms-Guest & Paper Supp	
Guest Soap	DOE–Guest Supplies	Rooms -Guest Supplies	DOE-Guest Supplies
Guest Stationery	DOE-Guest Supplies	Rooms-Guest Supplies	
Guide Book Advertising	Marketing-Advedls!ng	Marketing-Advert!s(ng	Marketing
H			
Help Wanted Ads	A&G-Misc	A& G-MIsc	A& G-Misc
Housekeeper & Maids Reports	A& G-Prtg., Stat. & Post.	Rooms -Guest & Paper Supp.	

Items	Rooms-Only Accommodation Facility	Full Service Accommodation Facility	Foodservice Facility
I			
Ice		F&B-Other Op Exp.	DOE-Other Op Exp
Ice Tongs - Bar		F&B-Utensils	DOE-Utensils
Index Cards	A& G- Prtg., Stat. & Post	A&G-Prtg. & Stat	A&G - Prtg., Stat. & Post.
Insecticides	DOE-Cleaning Supplies & Expenses	Rooms: F& B-Cleaning Supplies & Expenses	DOE-Cleaning Supplies & Expenses
Inspection - Mechanical	POM&E-General Electrical & Mechanical Equipment	POM&E-General Electrical & Mechanical Equipment	POM&E-General Maintenance & Upkeep
insurance-Building & Contents	Occupancy Costs-insurance	Occupancy Costs-insurance	Occupancy Costs-Insurance
Insurance - Business Interruption	A&G-Insurance	A&G - Insurance	A&G-Insurance
Insurance –Fire	Occupancy Costs-Insurance	Occupancy Costs-Insurance	Occupancy Costs-insurance
Insurance-Group	Employee Benefits	Employee Benefits, Group Insurance	Employee Benefits
insurance–Vehicles	A&G - Insurance	A&G-Insurance	A&G-Insurance
Insurance – Workmen's Comp	Employee Benefits	Employee Benefits	Employee Benefits
Interest	Occupancy Costs-Interest	Occupancy Costs- Interest	Occupancy Costs-interest
Interest on Mortgages	Occupancy Costs–interest	Occupancy Ccsts-interest	Occupancy Costs - Interest
Interest on Taxes in Arrears	Occupancy Costs-Interest	Occupancy Costs - Interest	Occupancy Costs- Interest
K			
Kettles		F&B - Utensils	DOE-Utensils
Key Repairs	POM&E-Mist.	POM&E-Misc	
Keys for Safe Deposit Boxes	DOE-Other Op Exp.	Rooms -other Op. Exp	
Kitchen Equipment Repairs		POM&E-Kitchen	POM&E-General Maintenance & Upkeep
L			
Ladders	POM&E-Supplies	POM&E-Supplies	POM&E-Supplies
Ladles - Kitchen		F&B–Utensils	DOE-Utensils
Ladles - Restaurant		F& B-China, Glass & Silver	DOE-China, Glass & Silver
Landscaping	POM&E-Grounds	POM&E-Grounds	POM&E-General Maintenance & Upkeep
Laundry	DOE-Laundry	Rooms; F&B- Laundry House Laundry	DOE-Laundry
Legal Fees	A&G - Professional Fees	A&G-Professional Fees	A&G – Professional Fees
Lemon 011	DOE-Cleaning Supplies & Expenses	Rooms, F& B - Cleaning Supplies & Expenses	DOE-Cleaning Supplies
Lemon Squeezers		F& B-Utensils	DOE-Utensils
Licenses - Beverages		F&B-Licenses	DOE-Licenses
Licenses-Gift Shop		Gift Shop-Other Op. Exp	
Licenses-General	A&G-Misc.	A& G-Misc	A& G-Misc.
Light Bulbs	POM&E-Supplies	POM&E - Supplies	POM&E-Supplies
Linen	DOE-Linen	Rooms, F&B-Linen	DOE -Linen
Linen Napkins		F&B-Linen	DOE-Linen
Linen Rental	DOE-Linen	Rooms, F&B-Linen	DOE-Linen
Linen Towels	DOE-Linen	Rooms F&B-Linen	DOE-Linen
Lobby Cleaning (On Contract)	DOE-Contract Cleaning	Rooms - Contract Cleaning	
Lock Repairs	POM&E-GE&ME	POM&E-GE&ME	POM&E-General Maintenance & Upkeep

Items	Rooms-Only Accommodation Facility	Full Service Accommodation Facility	Foodservice Facility
Losses on Sales of Fixed Assets	Other Additions & Deductions–Losses on Sales of Capital or Fixed Assets	Other Additions& Deductions–Losses on Sales of Capital or Fixed Assets	Other Additions & Deductions–Losses on Sales of Capital or Fixed Assets
Losses on Sales of Securities	Other Additions & Deductions – Losses on Sales of Securities	Other Additions & Deductions -Losses on Sales of Securities	other Additions & Deductions–Losses on Sales of Securities
Lost & Damaged Articles (Guest)	A& G–Misc.	A& G–Misc.	A&G–Misc.
Lubricating Oils & Greases	POM&E–Misc	POM&E–Misc.	POM&E–Misc.
Lumber	POM&E-Building	POM&E–Building	POM&E–Supplies
M			
Machine Oil	POM&E–Supplies	POM&E–Supplies	POM&E–Supplies
Machine Repairs	POM&E–GE&ME	POM&E–GE&ME	POM&E–General Maintenance and Upkeep
Magazine Advertising	Marketing-Adverflslng	Marketing–Advertising	Marketing
Magazines (Guest)	DOE- Guest Supplies	Rooms –Guest Supplies	
Magazines–Trade	A&G –Subscriptions	A&G - Subscriptions	A&G - Subscriptions
Maid'sReWrts	A&G–Prtg., Stat. & Post	Rooms - Guest and Paper Supplies	
Mailing Lists	Marketing-Advetilstng	Marketing-Advert!slng	Marketing
Maintenance Contracts - Electric Signs	POM&E–GE&ME	POM&E–GE&ME	POM&E–General Maintenance and Upkeep
Maintenance Contracts–Office Equip	POM&E–GE&ME	POM&E–GE&ME	POM&E - General Maintenance and Upkeep
Management Fees	A&G–Misc	A&G–Misc.	A&G-Mist
Masonry Repairs	POM&E–Building	POM&E–Building	POM&E–General Maintenance and Upkeep
Matches (Guest)	DOE-Guest Supplies	Rooms; F&B -Guest Supplies	DOE-Guest Supplies
Mats - Floor	POM&E–Supplies	POM&E–Supplies	POM&E–Supplies
Mats - Bath	DOE–Linen	Rmms - Linen	
Mats–Rubber	POM&E - Supplies	POM&E–Supplies	POM&E–Supplies
Mattress Protectors	DOE-Linen	Rooms -Linen	
Mattress Repairs	POM&E–Building	POM&E–Building	
Meals-Employees	Employee Benefits	Employee Benefits	Employee Benefits
Mechanical Inspection	POM&E–GE&ME	POM&E–GE&ME	POM&E - General Maintenance and Upkeep
Membership Dues–	A&G - Dues & Subscr.	A&G-Dues & Subscr.	A&G - Dues &Subscr.
Menus		F&B –Paper, Stat., & Guest S.	DOE- Paper, Stat., & Guest Sup.
Message Envelopes (Telephone)	A&G -Prtg., Stat. & Post.	Telephone–Printing & Stat.	A&G–Prtg., Stat. & Post
Metal Polish	DOE-Cleaning Supplies	Rooms; F&B–Cleaning Supplies	DOE-Cleaning Supplies
Mixers		F&B–Utensils	DOE–Utensils
Mixing Bowls		F&B–Utensils	DOE-Utensils
Mixing Spoons		F&B-Utensils	DOE–Utensils
Molds		F&B–Utensils	DOE-Utensils
Mop Handles & Wringers	DOE–Cleaning Supplies & Expenses	Rooms; F&B–Cleaning Supplies & Expenses	DOE–Cleaning Supplies
Mops	DOE–Cleaning SupPiles & Expenses	Rooms; F&B–Cleaning Supplies & Expenses	DOE–Cleaning Supplies
Mortgage Interest	Occupancy Costs - Interest	Occupancy Costs - Interest	Occupancy Costs - Interest
Moth Proofing Chemicals	DOE–Cleaning Supplies & Expenses	Rooms; F&B–Cleaning Supplies & Expenses	DOE–Cleaning Supplies

Items	Rooms-Only Accommodation Facility	Full Service Accommodation Facility	Food service Facility
Motor Repairs	POM&E-GE&ME	POM&E-GE&ME	POM&E-General Maintenance and Upkeep
Mouse Traps	DOE-Cleaning Supplies & Expenses	Rooms; F&B-Cleaning Supplies & Expenses	DOE-Cleaning Supplies
Muddlers		F&B-Utensils	DOE-Utensils
Musicians	Music & Entertainment	Music & Entertainment	Music & Entertainment
Music Licenses	Music & Entertainment	Music & Entertainment	Music & Entertainment
Music-Mechanical	Music & Entertainment	Music & Entertainment	Music & Entertainment
N			
Napkins-Linen		F&B-Linen	DOE-Linen
Napkins-Pa~r		F&B-Paper Supplies	DOE- Paper Supplies
Needles & Thread	POM&E-Supplies	POM&E-Supplies	POM&E-Supplies
Needles-Brochette		F&B-Utensils	DOE- Utensils
Needles-Larding		F&B-Utensils	DOE- Utensils
Newspaper Advertising	Marketing-Advert!sIng	Marketing-Advefl!sIng	Marketing
Newspapers-Guest	DOE- Guest Supplies	Rooms: F&B-Guest Supplies	DOE - Guest Supplies
Newspapers –For Resale	Other Income	Other Income	Other Income
Night Auditors' Reports	A&G - Prtg., Stat & Post	A&G - Prtg., Stat & Post,	
O			
Off Ice Equipment Repairs	POM&E-GE&ME	POM&E-GE&ME	POM&E-General Maintenance and Upkeep
Off Ice Supplies	A&G -Prtg., Stat. & Post.	A&G -Prtg., & Stat	A&G-Prtg Stat. & Post.
Oil-Fuel	POM&E-Fuel	POM&E-Fuel	POM&E-Fuel
Oils & Greases Lubrication	POM&E-Supplies	POM&E-Supplies	POM&E-Supplies
Oils & Greases-Lubrication (Hotel Vehicles)	A&G-Travel Expenses	A&G-Travel Expenses	
Openers - Bottle		F& B- Utensils	DOE-Utensils
Openers - Bottle	DOE- Guest Supplies	Rooms-Guest Supplies	
Openers-Can		F&B-Utensils	DOE-Utensils
Outdoor Advertising	Marketing–Adverttstng	Marketing-Advertising	Marketing
Overages & Shortages -Cash	A&G-Cash over & short	A&G–Cash over & short	A&G-Cash over & short
Overalls	DOE-Uniforms	Rooms -Uniforms	
Oyster Knives		F&B-Utensils	DOE-Utensils
P			
Pails	DOE-Cleaning Supplies & Expenses	Rooms, F&B-Cleaning Supplies & Expenses	DOE-Cleaning Supplies & Expenses
Paint	POM&E-Supplies	POM&E-Supplies	POM&E-Supplies
Paint Brushes	POM&E-Supplies	POM&E - Supplies	POM&E-Supplies
Paint Cleaners	DOE-Cleaning Supplies	Rooms; F& B-Cleaning Supplies	DOE-Cleaning Supplies
Pamphlets	Marketing-Advertising	Marketing-Advertising	Marketing
Pans		F&B-Utensils	DOE-Utensils
Pants	DOE-Uniforms	Rooms, F&B-Uniforms	DOE-Uniforms
Paper Bags		F&B-Paper Supplies	DOE-Paper Supplies
Paper Butter Chips		F&B-Paper Supplies	DOE-Paper Supplies
Paper Cases		F&B-Paper Supplies	DOE-Paper Supplies
Paper Clips	A&G -Prtg., Stat, & Post,	A& G-Prtg & Stat.	A& G-Prtg., Stat & Post.
Paper-Cooking		F&B-Paper Supplies	DOE- Paper Supplies

Items	Rooms-Only Accommodation Facility	Full Service Accommodation Facility	Foodservice Facility
Papar Doilies		F&B-Paper Supplies	DOE- Paper Supplies
Paper Napkins		F&B-Paper Supplies	DOE- Paper Supplies
Paper Towels (Employee)	A& G-Misc	A&G-Mist	A& G-MIsc
Papar Towels (Guest)	DOE-Guest Supplies	Rooms, F&B-Guest Supplies	DOE-Guest Supplies
Pastry Bags (Paper)		F&B-Paper Supplies	DOE-Paper Supplies
Pastry Boxes		F&B-Paper Supplies	DOE- Paper Supplies
Pastry Tubas		F&B-Utensils	DOE-Utensils
Pencils	A&G- Prig., Stat. & Post	A&G-Prtg & Stat.	A&G-Prtg., Stat. & Post
Pencil Sharpeners	A& G-Prtg., Stat. & Post	A&G-Prtg & Stat	A& G-Prtg., Stat. & Post.
Pens (Employee)	A&G-Prtg., Stat & Post	A& G-Prtg & Slat	A& G-Prtg., Stat & Post.
Pens (Guest)	DOE-Guest Supplies	Rooms -Guest Supplies	
Periodicals-For Sale	Other Income	Other Income	Other Income
Piano Rentals	Music & Entertainment	Music & Entertainment	Music & Entertainment
Piano Tuning	Music & Entertainment	Music & Entertainment	Music & Entertainment
Picture Frames	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Pillow Cases	DOE-Linen	Rooms -Linen	
Pins (Employees)	A&G-Prtg., Stat & Post	A&G-Prtg. & Stat	A&G-Prtg., Stat & Post
Pipe Repairs	POM&E-GE&ME	POM&E-GE&ME	POM&E-General Maintenance and Upkeep
Pitchers		F&B–China, Glass & Silver	DOE-China, Glass & Silver
Plants	DOE-Other Op Exp	Rooms; F&B-Other Op. Exp	DOE-Other Op Exp
Plantings	POM&E-Grounds	POM&E-Grounds	POM&E-General Maintenance and Upkeep
Plaster Repairs	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Plates		F&B-China, Glass & Silver	DOE-China, Glass & Silver
Plates-Paper		F&B-Paper Supplies	DOE-Paper Supplies
Platters		F&B-China, Glass & Silver	DOE-China, Glass & Silver
Playgrounds -Maint	POM&E-Grounds (See Grounds "Expenses")	POM&E-Grounds	
Playing Cards	DOE-Guest Supplies	Rooms - Guest Supplies	
Plumbing Repairs	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Poles-Curtains	POM&E-Supplies	POM&E-Supplies	POM&E-Supplies
Polish - Brass	DOE-Cleaning Supplies & Expenses	Rooms, F&B-Cleaning Supplies & Expenses	DOE-Cleaning Supplies
Polish	DOE-Cleaning Supplies & Expenses	Rooms, F&B-Cleaning Supplies & Expenses	DOE-Cleaning Supplies
Post Office Box Rental	A&G-Misc	A&G-Misc	A&G-Misc
Postage	A& G-Prtg., Stat. & Post.	A&G-Prtg., Stat. & Post	A& G-Prtg., Stat & Post.
Postage-For Promotional Mailing	Marketing-Advertising	Marketing-Advertising	Marketing
Postcards-For Resale	Other Income	Other income	Other Income
Pots		F&B-Utensils	DOE-Utensils
Preopening Expenses (Amortization)	Occupancy-Amortization of Preopening Expenses	Occupancy -Amortization of Preopening Expenses	Occupancy-Amortization of Preopening Expenses
Printed Matter-Advertising	Marketing-Advertising	Marketing- Advertising	Marketing

Items	Rooms-Only Accommodation Facility	Full Service Accommodation Facility	Foodservice Facility
Prizes-Employees Awards for Suggestions	Employee Benefits	Employee Benefits	Employee Benefits
Professional Entertainers	Music & Entertainment	Music & Entertainment	Music & Entertainment
Programs–Entertainers	Music & Entertainment	Music & Entertainment	Music & Entertainment
Protective Services	A& G–Misc	A& G-Misc	A& G–Misc
Protectors - Mattress	DOE–Linen	Rooms-Linen	
Protectors-Table		F&B-Linen	DOE-Linen
Public Address System Repairs	POM&E–GE&ME	POM&E–GE&ME	POM&E–General Maintenance and Upkeep
Pump Repairs	POM&E–GE&ME	POM&E–GE&ME	POM&E–General Maintenance and Upkeep
Purifiers & Softeners for Water	POM&E–Misc.	POM&E–Misc.	POM&E–Misc.
R			
Rack Cards	DOE-Paper & Guest Suppl.	Rooms-Paper & Guest Suppl.	
Radio Broadcasting	Marketing-Advertising	Marketing-Advertising	Marketing
Radio Repairs	POM&E–GE&ME	POM&E–GE&ME	POM&E–General Maintenance and Upkeep
Raincoats	DOE-Uniforms	Rooms - Uniforms	
Range Repairs		POM&E–Kitchen	POM&E - General Maintenance and Upkeep
Real Estate Taxes	Occupancy Cost-Property Taxes	Occupancy Cost - Property Taxes	Occupancy Cost -Property Taxes
Record Books	A&G–Prtg., Stat. & Post	A&G - Prtg. & Stat	A&G - Prtg., Stat. & Post,
Refrigerants	POM&E–Supplies	POM&E–Supplies	POM&E–Supplies
Refrigeration Supplies	POM&E–Supplies	POM&E–Supplies	POM&E–Supplies
Register Repairs - Cash & Checking	POM&E–GE&ME	POM&E–GE&ME	POM&E–General Maintenance and Upkeep
Registration Cards	A& G–Prtg., Stat & Post,	Rooms –Prtg. & Stat,	
Removal of Garbage	POM&E-Waste Removal	POM&E–Waste Removal	POM&E–Waste Removal
Rentals–Automatic Telephones	A&G–Misc.	A&G–Misc	A&G–Misc.
Rentals–Autos	A&G–Travel	A&G–Travel	A&G-Travel
Rentals-Piano	Music & Entertainment	Music & Entertainment	Music & Entertainment
Rental–Television	Occupancy Cost - Equipment Rental	Occupancy Cost - Equipment Rental	
Rent–Building & Land	Occupancy Cost-Rent	Occupancy Cost - Rent	Occupancy Cost-Rent
Replating Silver		F&B–China, Glass & Silver	DOE–China, Glass & Silver
Reservation Tabs	A&G - Prtg., Stat, & Post.	Rooms - Prtg. & Stat	
Reservation Cards - Dining Room Tables		F&B –Paper, Stat., & Guest Suppl	A& G–Prtg. & Stat,
Restaurant Checks		F&B -Paper, Stat., & Guest Suppl.	A& G–Prtg &Stat.
Ribbon-Billing Machines	A& G- Prtg. &' Stat	A&G–Prtg &Stat.	A& G–Prtg &Stat
Ribbons–Typewriter, Checking & Cash Register	A&G - Prtg., Stat. & Post.	A&G –Prtg., Stat. & Post.	A&G - Prtg., Stat. & Post.
Rings - Window Shades, Screens & Awnings	POM&E–Supplies	POM&E–Supplies	POM&E–Supplies
Road Signs (Rental of)	Marketing–Advertising	Marketing-Advertising	Marketing

Items	Rooms-Only Accommodation Facility	Full Service Accommodation Facility	Food service Facility
Roadways-Maintenance	POM&E-Grounds	POM&E-Grounds	POM&E-General Maintenance and Upkeep
Road Salt	POM&E-Misc	POM&E-Misc	POM&E-Misc.
Roof Repairs	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Room Guides	DOE-Paper, Stat. & Guest Suppl	Rooms-Paper, Stat. & Guest Suppl.	
Rope	POM&E-Misc.	POM&E-Misc.	POM&E-Misc.
Royalties		Music & Entertainment	Music & Entertainment
Rubber Bands	A& G-Prtg., Stat & Post	A& G- Prtg. & Stat.	A& G- Prtg., Stat. & Post.
Rubber Wits	POM&E-Supplies	POM&E - Supplies	POM&E-Supplies
Rubber Boots	DOE-Uniforms, POM&E-Misc	Rooms; F&B-Uniforms; POM&E-Misc	
Rubber Mats	POM&E-Misc	POM&E-Misc	POM&E-Misc.
Rubber Stamps	A& G-Prig., Stat & Post	A&G-Prtg & Stat	A&G-Prtg., Stat & Post
Rug Repairs	POM&E-Building & Furnit	POM&E-Building & Furnit.	POM&E-General Maintenance and Upkeep
S			
safe Deposit Box Keys	DOE-Other Op. Exp	Rooms-Other Op. Exp.	
Safe Deposit Box Rentals	A& G-Misc.	A& G-Misc.	A& G-Misc
Safety Matches (Guest)	DOE-Guest Supplies	Rooms; F&B-Guest Supplies	DOE-Guest Supplies
Salad Bowls		F&B-China, Glass & Silver	DOE-China, Glass & Silver
Sales Checks		A& G-Prtg., Stat.; Gift Shop -Supplies	A& G- Prtg. & Stat
Salt-Rock	POM&E-Misc.	F&B; POM&E-Misc.	DOE; POM&E-Misc
Sand-Blasting	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Sandpaper	POM&E-Misc.	POM&E-Misc	POM&E-Misc.
Saucers		F&B-China, Glass & Silver	DOE-China, Glass & Silver
Scissors	DOE-Other Op. Exp.	Rooms: F&B; etc.-Other Op Exp.	DOE-Other Op. Exp.
Scotch Tape	A&G - Prtg., Stat. & Post.	A&G -Prtg., Stat. & Post.	A&G - Prtg., Stat. & Post.
ScraWrs-Paint	POM&E-Supplies	POM&E-Supplies	POM&E-Supplies
Screening	POM&E-MIsc	POM&E-Misc	POM&E-Misc.
Septic Tank Repairs	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Sewer System Repairs	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Shades	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Shakers - Beverage		F&B-Utensils	DOE-Utensils
Sharpeners-Pencil	A& G-Prtg., Stat. & Post.	A& G-Prtg &Stat	A&G - Prtg., Stat. & Post.
Sharpening Knives		F&B-Utensils	DOE-Utensils
Sheets -Linen	DOE-Linen	Rooms -Linen	
Shelf Paper	DOE-Other Op Exp.	Rooms-Other Op Exp.	
Shoe Cloths (Guest)	DOE- Guest Supplies	Rooms -Guest Supplies	
Shoes	DOE-Uniforms	Rooms, F&B-Uniforms	DOE-Uniforms
Shortages & Overages -Cash	A&G-Cash Short & Over	A&G-Cash Short & Over	A&G-Cash Short & Over
Shovels	POM&E-Misc.	POM&E-Misc.	POM&E-Misc
Shower Curtains	DOE-Linen	Rooms-Linen	

Items	Rooms-Only Accommodation Facility	Full Service Accommodation Facility	Foodservice Facility
Shrubbery	POM&E-Grounds	POM&E-Grounds	POM&E-General Maintenance and Upkeep
Sidewalk Repairs	POM&E-Grounds	POM&E-Grounds	POM&E-General Maintenance and Upkeep
Sign Repairs	POM&E-GE&ME	POM&E-GE&ME	POM&E-General Maintenance and Upkeep
Signs-Directional	DOE-Other Op Exp	Rooms-Other Op Exp.	DOE-Other Op Exp
Signs - Front Desk	DOE-Other Op. Exp.	Rooms-Other Op. Exp.	
Signs-Restaurant		F&B-Other Op. Exp	DOE-Other Op. Exp
Signs-Road (Rental Of)	Marketing-Advertising	Marketing- Advertising	Marketing
Silver Dishes, Utensils, Etc		F&B-China, Glass & Silver	DOE- China, Glass & Silver
Silverwash		F&B-Cleaning Supplies & Expenses	DOE-Cleaning Supplies & Exp
Skewers		F&B-Utensils	DOE-Utensils
Smocks	DOE-Uniforms	Rooms; F&B; Laundry - Uniforms	DOE-Uniforms
Soap for Cleaning	DOE-Cleaning Supplies & Expenses	Rooms; F&B-Cleaning Supplies & Expenses	DOE-Cleaning Supplies & Exp
Soap (Guest)	DOE-Guest Supplies	Rooms -Guest Supplies	DOE-Guest Supplies
Soap (Laundry)	DOE-Laundry	House Laundry- Supplies	DOE-Laundry
Social & Sports Activities - Employees	Employee Benefits	Employee Benefits	Employee Benefits
Soda (Laundry)	DOE-Laundry	House Laundry-Supplies	DOE-Laundry
Soft Drinks		Beverage-Cost of Sales	Beverage-Cost of Sales
Solvents	POM&E-Supplies	POM&E-Supplies	POM&E-Supplies
Souffle Cases		F&B-Paper Supplies	DOE- Paper Supplies
Souvenirs-For Resale	Other Income	Other Income, Gift Shop	Other Income
Souvenirs	DOE-Guest Supplies	Rooms, F&B-Guest Supplies	DOE-Guest Supplies
Souvenirs (Advertising)	Marketing-Advertising	Marketing-Advertlstng	Marketing
Sponges - Painters	POM&E-Supplies	POM&E-Supplies	POM&E-Supplies
Sponges-Cleaning	DOE-Cleaning Supplies & Expenses	Rooms; F& B-Cleaning Supplies & Expenses	DOE-Cleaning Supplies & Exp
Spoons		F&B-Utensils	DOE-Utensils
SDoons-Silver		F&B-China, Glass & Silver	DOE-China, Glass & Silver
Springs, Mattresses & Pillow Repairs	POM&E-Building	POM&E-Building	
Springs, Bed	POM&E-Building	POM&E-Building	
Stamp Pads	A&G-Prtg., Stat & Post	A&G-Prtg. & Stat	A&G - Prtg., Stat & Post
Stamps-General	A&G- Prig., Stat & Post.	A& G-Prtg., Stat. & Post.	A&G-Prtg., Stat. & Post
Staplers	A& G- Prtg., Stat & Post.	A&G, etc-Prtg. & Stat.	A& G-Prtg., Stat. & Post
Staples	A&G-Prtg., Stat. & Post.	A&G; etc.-Prtg. & Stat.	A& G-Prtg., Stat. & Post
Starch	DOE-Laundry	House Laundry-Supplies	Doa - Laundry
Stationery	A&G-Prtg., Stat, & Post.	A& G-Prtg., Stat. & Post.	A&G-Prtg., Stat. & Post
Stationery (Guest)	DOE-Guest Supplies	Rooms-Guest Supplies	
Steak Planks		F&B-Utensils	DOE-Utensils
Steel -Structural	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Steel Woo	DOE-Cleaning Supplies & Expenses	Rooms; F&B-Cleaning Supplies & Expenses	DOE-Cleaning Supplies & Exp.
Stencils	A&G-Prtg., Stat. & Post.	A&G-Prtg. & Stat,	A& G- Prtg., Stat. & Post

Items	Rooms-Only Accommodation Facility	Full Service Accommodation Facility	Foodservice Facility
Stick - Swizzle		F&B-Other Op. Exp.	DOE-Other OD. Exp.
Storage of Equipment	A& G-Misc	A& G- Misc.	A& G-MIsc
Storage Charges on Food & Beverages		Food; Beverage -Cost of Sales	Food, Beverage-Cost of Sales
Strainers		F&B-Utensils	DOE-Utensils
Straws-Bar		F&B-Other Op. Exp	DOE-Other Op Exp
Subscriptions-Trade	A&G - Dues and Subscript.	A&G -Dues and Subscript	A&G - Dues and Subscript
Swatters-Fly	DOE-Cleaning Supplies & Expenses	Rooms, F& B-Cleaning Supplies & Expenses	DOE-Cleaning Supplies & Exp
Sweepers-Carpet	DOE-Cleaning Supplies & Expenses	Rooms, F& B-Cleaning Supplies & Expenses	DOE-Cleaning Supplies & Exp.
Swimming Pool Repairs	POM&E-Building; Grounds	POM&E-Building; Grounds	POM&E-General Mainte-nance and Upkeep
Switchboard Repairs	POM&E-GE&ME	POM&E-GE&ME	
Switchplates	POM&E-Building	POM&E-Building	POM&E - General Mainte nance and Upkeep
T			
Table Top	POM&E-Building & Furnit	POM&E-Building & Furnit.	POM&E-General Mainte nance and Upkeep
Table Tent Cards		F&B-Paper, & Guest Suppl	DOE-Paper, & Guest Suppl
Tape-Masking	POM&E-Supplies	POM&E-Supplies	POM&E-Supplies
Tar	POM&E-Building	POM&E-Building	POM&E -General Mainte-nance and Upkeep
Table Cloths		F&B-Linen	DOE - Linen
Table Covers	POM&E-Building & Furnit.	POM&E-Building and Furnit	POM&E-Supplies
Table Pads		F&B-Linen	DOE-Linen
Table Protectors		F&B -Linen	DOE-Linen
Table Tops		F&B-Linen	DOE-Linen
Tableware		F&B-China, Glass & Silver	DOE-China. Glass & Silver
Tape	POM&E-Supplies	POM&E-Supplies	POM&E - Supplies
Taxicab Fares	A& G-Misc.	A& G-Misc.	A& G-Misc.
Teapots		F& B-China, Glass & Silver	DOE-China, Glass & Silver
Telegrams	A&G-Prtg., Stat, & Post	A& G- Prtg., Stat. & Post.	A&G-Prig, Stat & Post
Telephone Charges	A& G- Telephone	Telephone - Cost of Sales	A& G-Telephone
Telephone Directories	A&G–Telephone	Telephone-Other Expenses	A&G-Telephone
Telephone Directories –Out of Town	A&G-Telephone	Telephone–Other Expanses	A&G-Telephone
Telephone Directory Advtg.	Marketing-Advertising	Marketing- advertising	Marketing
Telephone Equipment Rental	Rent-Equipment Rental	Telephone-Equipment Rental	Rent - Equipment Rental
Television Repairs	POM&E-GE&ME	POM&E-GE&ME	POM&E-General Mainte-nance and Upkeep
Television Rentals	Rent-Equipment Rental	Rent -Equipment Rental	Rent-Equipment Rental
Ties	DOE-Uniforms	Rooms: F& B-Uniforms	DOE-Uniforms
Toilet Items	DOE-Guest Supplies	Rooms - GuestSupplies	DOE-Guest Supplies
Toothpicks		F&B -Guest Supplies	DOE-Guest Supplies
Tourist Guides	Marketing-Advertlstng	Marketing–Advetilsing	Marketing
Towels-Linen	DOE - Linen	Rooms, F&B, etc -Linen	DOE -Linen
Towels-Paper	DOE-Other Op. Exp.	Rooms; F&B; etc.-other Op. Exp.	DOE-Other Op. Exp.

Items	Rooms-Only Accommodation Facility	Full Service Accommodation Facility	Foodservice Facility
Trade Magazines & Publications -Subscriptions	A&G-Dues and Subscript.	A&G -Dues and Subscript	A&G-Misc.
Transportation Charges on Food & Beverages		Food; Beverage-Cost of Sales	Focal; Beverage-Cost of Sales
Transportation of Employees	A&G-Travel Expense	A&G-Travel Expense	A&G-Travel Expense
Travelling Expanses	A&G -Travel Expanse	A&G-Travel Expense	A&G-Travel Expense
Travelling Expenses-Business Promotion	Marketing - Promotional	Marketing-Promotional	Marketing
Trays		F&B-Utensils	DOE-Utensils
Trousers	DOE-Uniforms	Rooms; F&B-Uniforms	DOE-Uniforms
Trucking (Not Otherwise Distributed as Cost of Goods Purchased)	A&G - Misc.	A&G-Misc.	A&G-Misc
Tubes-Pastry		F&B-Utensils	DOE-Utensils
Turpentine	POM&E-Supplies	POM&E-Supplies	POM&E-Supplies
Twine (Laundry)	DOE-Laundry	House Laundry- Supplies	DOE- Laundry
Typawnter Repairs	POM&E-GEM&E	POM&E-GE&ME	POM&E-General Maintenance and Upkeep
-U			
Uncollectable Accounts	A&G-Misc.	A&G-Misc.	A&G-Misc
Uniforms Repairs	DOE-Uniforms	Rooms; F&B-Uniforms	DOE- Uniforms
Upholstery Supplies	POM&E-Supplies	POM&E-Supplies	POM&E-Supplies
Utensils-Bar		F&B-Utensils	DOE- Utensils
Utensils-Kitchen		F&B-Utensils	DOE-Utensils
Uniforms	DOE-Uniforms	Rooms; F&B, etc - Unif orms	DOE-Uniforms
Uniform Cleaning	DOE - Uniforms	Rooms; F&B; etc.- Uniforms	DOE-Uniforms
V			
Vacuum Cleaner Accessories	DOE-Cleaning Supplies & Expenses	Rooms; F&B-Cleaning Supplies & Expenses	DOE-Cleaning Supplies & Exp
Vacuum Cleaner Repairs	POM&E-GE&ME	POM&E-GE&ME	POM&E-General Maintenance and Upkeep
Valances	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Valve Repairs	POM&E-GE&ME	POM&E-GE&ME	POM&E-General Maintenance and Upkeep
Varnish	POM&E - Supplies	POM&E-Supplies	POM&E-Supplies
Vehicle Depreciation -Hotel Vehicles	Occupancy Costs - Depreciat.	Occupancy Costs-Depreciat	Occupancy Costs-Depreciat.
Vehicle Repairs-Hotel Vehicles	POM&E-GE&ME	POM&E-GE&ME	POM&E-General Maintenance and Upkeep
Venetian Blinds	POM&E-Building	POM&E-Building	POM&E-General Maintenance and UPkeeP
Vouchers	A& G-Prtg., Stat &Post	A&G - Prtg. and Stat	A&G-Prtg., Stat & Post.
W			
Wall Hangings	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Wall Paper	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Wall Repairs	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Wall Washers	DOE-Cleaning Supplies & Expenses	Rooms; F& B- Cleaning Supplies & Expenses	DOE-Cleaning Supplies
Want Ads (Help Wanted)	A& G-Misc.	Rooms; F&B; etc.-Misc.	A&G-Misc.

Items	Rooms-Only Accommodation Facility	Full Service Accommodation Facility	Foodservice Facility
Warehouse Costs-Beverages		Beverage-Cost of Sales	Beverage-Cost of Sales
Wash Cloths	DOE-Guest Supplies	Rooms-Guest Supplies	
Water	POM&E - Water	POM&E-Water	POM&E-Water
Water-Drinking	POM&E-Water	POM&E-Water	POM&E- Water
Water-Glasses	DOE- Guest Supplies	Rooms-Guest Supplies; F&B-China, Glass & Silver	DOE-China, Glass & Silver
Water Pitchers	DOE-Guest Supplies	Rooms -Guest Supplies; F&B-China, Galss & Silver	DOE-China, Glass & Silver
Waterproofing Repairs	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Water Purifiers & Softeners	POM&E - Water	POM&E- Water	POM&E-Water
Water System Repairs	POM&E-GE&ME	POM&E-GE&ME	POM&E-General Maintenance and Upkeep
Water Tests	POM&E-Water	POM&E - Water	POM&E-Water
Wax	DOE-Cleaning Supplies & Expenses	Rooms; F&B -Cleaning Supplies & Expenses	DOE-Cleaning Supplies & Exp.
Wax Paper		F&B-Paper Supplies	DOE- Paper Supplies
Wicks for Chafing Dishes		F&B-Other Op. Exp	DOE-Other Op. Exp
Window Cleaning (On Contract)	DOE-Contract Cleaning	Rooms; F&B-Contract Cleaning	DOE-Contract Cleaning
Window Glass Replacing (Glazing)	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Window Repairs	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Window Shades, Screen & Awning Repairs	POM&E-Building	POM&E-Building	POM&E-General Maintenance and Upkeep
Window Shades - Cleaning	DOE-Cleaning Supplies & Expenses	Rooms; F& B-Cleaning Supplies & Expenses	DOE-Cleaning Supplies & Exp
Wine Baskets		F& B-Utensils	DOE-Utensils
Wine Lists		F& B-Paper, Stat & Guest Suppl.	DOE-Paper, Stat. & Guest Suppl.
Wiring Repairs	POM&E-GE&ME	POM&E-GE&ME	POM&E-General Maintenance and Upkeep
Wrapping Paper (Gift Shop)		Gift Shop Supplies	
Writing Supplies (For Guests & Writing Room)	DOE-Guest Supplies	Rooms -Guest Supplies	

How a bookkeeping system works

Now that we have covered the basics of bookkeeping, we can look at the way a typical bookkeeping system works. The one that is described below is based on a system that appears in "Accounting Systems and Financial Management Information for the Hospitality Industry", a financial management manual commissioned by the Nova Scotia Department of Tourism and by the (former) federal Department of Regional Economic Expansion.

The best place to start is at your hotel/motel's front office, where three basic bookkeeping functions are performed:

- Recording of charges and payments to accounts receivable.
- Recording of non-charged revenues from all departments.
- Night audit.

The way the system works is this. First of all, as each guest checks in, you open a *guest folio* for that guest or for that guest's room. All charges the guest incurs during his stay are recorded on this folio. In effect, you are automatically extending credit to each of your registered guests, so each guest folio becomes an account receivable.

The account receivable comes due upon check-out, so at that time the guest folio must be rendered inactive in any one of the following ways:

- The guest pays you for all his outstanding charges, using cash, a personal cheque or a bank card. This is a simple cash settlement.
- The guest pays you in full, using any accepted non-bank credit card. This requires you to transfer the charges from the guest folio to your *city ledger*. (A city ledger consists of the accounts receivable of guests who are no longer registered in your hotel/motel.)
- The guest can ask you to bill him or his company. Again, you would have to transfer the outstanding charges from the guest folio to the city ledger.
- The guest can have some other registered guest pay for his bill. This requires you to transfer the charges from one guest folio to another.

At the end of the day, you should add the outstanding charges that appear on the guest folios for all the guests still registered. This sum, representing the amount charged by all registered guests, is then recorded in your *guest ledger*.

That deals with the first of the three functions performed at the front desk. The second function is simply recording all the money that is actually received (as opposed to being charged). Here, you should indicate that payment has indeed been made by your guests; and you should assign the receipts to the appropriate department - ie., the department that received the payment.

The third function performed at the front desk is the *night audit*. It is the balancing procedure that closes one day's business. It is usually performed at night, but it can be done at any time, as long as the previous day's business is complete.

The night audit is a simple procedure if all charges and receipts have been properly recorded. All you do is take the previous day's guest ledger, showing you the amount that all registered guests owed to you at the close of the previous day. You then add to it any new charges that have been made since then, and you subtract amounts for which payment has been received. In other words, your calculation is:

PREVIOUS DAY'S GUEST LEDGER + CHARGES - RECEIPTS = NEW GUEST LEDGER

A typical system in action

Now let's see how a typical bookkeeping system actually works when you put it into practice. The system we will examine is suitable for any full-service hotel/motel or any medium-sized, rooms-only hotel/motel.

First of all, any good system should avoid time-consuming duplication of effort when identical entries have to be recorded in different places. That means it should use a *one-write system*. The basic components of a one-write system are:

- A guest folio, in duplicate, which incorporates a registration card (shown in Figure 5).
- A daily transcript (shown in Figure 6).

The guest folio and the *daily transcript* both have three transaction blocks of columns, which are headed:

- Charges (to record all guest charges).
- Receipts (to record all guest settlements).
- Balance (to record all outstanding guest charges).

The format for these three blocks of columns is the same on both the guest folio and the daily transcript. Consequently, when you use the one-write system, any guest charges, settlements and balances you enter on the guest folio are automatically copied onto the daily transcript. (In our example, the entry on the guest folio shown in Figure 5 shows up on line 13 of the daily transcript shown in Figure 6.) In addition, the daily transcript has a column headed "previous balance", which shows the amount each guest owed at the close of the previous day's business.

FIGURE 5 Registration card and guest folio

ROOM NO	NAME	GUESTS
9	MR. JOHNGINSBERG	1

Nº 0216

STREET ADDRESS 48 QUEEN STREET

CITY MONTREAL

MAKE OF CAR	LICENSE NO	PROVINCE OR STATE
DODGE	4 8 1 2 3 3	P. Q

DATE OF ARRIVAL JUNE 5 DATE OF DEPARTURE JUNE 8

	CHARGES							RECEIPTS			
OATE	ROOMS	TAX	TELEPHONE	RESTAURANT			OTHER	C ASH	CREDIT CARO	OTHER	BALANCE
June 5	20 00	1 60		8 64							30 24

THIS AMOUNT WILL BE
CASH ☑
CHEQUE ❑

CHARGED TO
COMPANY ❑
PERSONAL ❑

CREDIT CARO
CHARGEX ❑
AMERICAN EXPRESS ❑
MASTER CHARGE ❑
NO. ______

FIGURE 6 Daily transcript: record of charges and receipts

				CHARGES									RECEIPTS			
ROOM NO.	NAME	GUESTS	FOLIO NO.	PREVIOUS BALANCE	DATE	ROOMS	TAX	TELEPHONE	RESTAURANT			OTHER	CASH	CREDIT CARD	OTHER	BALANCE
2	JONES		209	40.00	JUNE 5								40.00			-0-
11	KELMAN		210	32.00	JUNE 5								MC 32.00			-0-
15	OWEN		211	57.00	JUNE 5										57.00	-0-
3	ALLEN		212	85.00	JUNE 5					OWEN FOLIO		57.00				142.00
3	ALLEN		212	142.00	JUNE 5			.50	6.36							148.86
3	ALLEN		212	148.86	JUNE 5									AX 148.86		-0-
—	AMERICAN EXPRESS		103	200.00	JUNE 5					ALLEN FOLIO		148.86				348.86
8	HORNE		211	69.00	JUNE 5										C/L 69.00	-0-
—	FRASER + HORNE		142	300.00	JUNE 5					HORNE FOLIO		69.00				369.00
7	JOHNSON		214	24.84	JUNE 5	<3.00>	<.24>									21.60
1	SMITH	1	213	30.00	JUNE 5	20.00	1.60	1.25	2.50							55.35
7	JOHNSON	1	214	21.60	JUNE 5	20.00	1.60									43.20
9	GINSBERG	1	216	-0-	JUNE 5	20.00	1.60		8.64							30.24
11	SHERWOOD	1	215	-0-	JUNE 5	18.00	1.44									19.44
12	BRUCE	2	157	<25.00>	JUNE 5	30.00	2.40									7.40
—	HART, T+T.		145	93.00	JUNE 5								93.00			-0-
	SUB-TOTAL			1218.30		105.00	8.40	1.75	17.50			274.86	165.00	148.86	126.00	1185.95
	RESTAURANT								112.20				112.20			
	VENDING MACHINE											18.00	18.00			
	CASH OVER <SHORT>											.75	.75			
5	TOTAL	6		1218.30		105.00	8.40	1.75	129.70			293.61	295.95	148.86	126.00	1185.95

CROSS-BALANCE TAPE

	0•	T
CHARGES	105.00	+
	9.40	+
	1.75	+
	129.70	+
	293.61	+
	538•46	T
RECEIPTS	295•95	+
	143•86	+
	126•00	+
	570•31	T
PREV. BAL.	1218•30	+
	538•46	+
	570•31	
CLOS. BAL.	1185.95	T

GUEST LEDGER CONTROL

BALANCE FROM PREVIOUS DAY	$1030.84
ADD CHARGES	538.46
DEDUCT RECEIPTS	<570.81>
NEW GUEST LEDGER BALANCE	$998.49

GUEST LEDGER TRIAL BALANCE

*	
0•	T
55.35	+
43•20	+
30. ?4	+
19•44	+
7.40	+
348•86	+
369•00	+
125•00	+
998•49	T

DATE JUNE 5 19 — PAGE NO. 5

Now let's get to our bookkeeping system in action. For the purposes of our example, we will assume that the following events take place on, say, June 5- a typical business day:

1. Mr. Ginsberg checks into your hotel/motel. At that time, your clerk selects the next prenumbered guest folio and completes the registration card at the top (Figure 5). The clerk then files the folio in the guest ledger under the appropriate room number, which in this case is Room 9.
2. Mr. Jones, who was registered in Room 2, checks out. He has a balance of $40.00 carried forward from the previous day (see line 1 of the daily transcript in Figure 6), and has not incurred any charges for June 5. Mr. Jones settles his account in cash, and the clerk records the payment. The original of the guest folio is then given to Mr. Jones as a receipt, and the duplicate copy (not shown) is retained by the clerk.
3. Mr. Kelman, who was registered in Room 11, checks out. He has a balance of $32.00, and settles his account by Master Card (see line 2 of the daily transcript).
4. Mr. Owen, who was registered in Room 15, checks out. He has a balance of $57.00, and has arranged for Mr. Allen in Room 3 to pay his bill. Mr. Owen's folio is closed out (line 3). The transfer of $57.00 is posted to Mr. Allen's account, leaving a closing balance of $142.00 (line 4). Mr. Owen's name and guest folio number are noted beside the charge.
5. Mr. Ginsberg has lunch in the restaurant and the waitress records the meal on a prenumbered guest check (not shown). Mr. Ginsberg charges the meal, totalling $8.64, to his room. The guest check is recorded through the restaurant cash register as a charge sale. It is forwarded to the front desk, where it is entered on the guest folio and on the daily transcript (line 13).
6. Mr. Allen, in Room 3, checks out. On June 5, he has incurred charges of $6.36 for a meal in the restaurant and $0.50 for the use of a telephone. These charges are posted on Mr. Allen's guest folio and on the daily transcript (line 5), which now shows a balance of $148.86. Mr. Allen settles his account by American Express, and his account is closed out (line 6). The amount of $148.86 is transferred to the American Express account in the city ledger. The name of the guest and his guest folio number are noted beside the charge. This account had a previous balance of $200.00 and, after posting the charge, shows a balance of $348.86 (line 7).
7. Mr. Home checks out. His balance of $69.00 is to be billed to his firm, Fraser and Home. The clerk closes out Mr. Home's account (line 8), indicating on the guest folio and daily transcript that the outstanding balance has been transferred to the city ledger. The name of the guest and his guest folio number are noted beside the charge. This account had a previous balance of $300.00 and, after posting the new charge, shows a balance of $369.00 (line 9).
8. Mr. Sherwood checks in. He occupies Room 11, vacated by Mr. Kelman. The desk clerk completes the registration card of a new guest folio.

9. Mr. and Mrs. Bruce check in. They had previously sent an advance deposit of $25.00, at which time a guest folio was started and the deposit recorded. Now, the desk clerk locates the folio (it would be in the *city* ledger under the tab "advance deposits"), reviews the registration card for completeness, and files it in the guest ledger under Room 12.
10. Mr. Smith, who has already spent one night in Room 1, incurs charges of $2.50 in the restaurant and $1.25 for the telephone. The guest check from the restaurant is processed as before, and the check, along with the telephone slip, is filed under Room 1 in the guest ledger. At the same time, both charges are entered on the daily transcript (line 11).
11. Mr. Johnson, in Room 7, who has stayed over from the previous day, complains that he is being overcharged for his room. An adjustment of $3.00 plus tax is authorized, and is recorded on Mr. Johnson's guest folio and on the daily transcript (line 12).
12. A cheque for $93.00 is received from the telephone company, representing payment of its account with your hotel/motel. The clerk posts this payment to the appropriate city ledger account.
13. The soft-drink vending machine is refilled and the change, amounting to $18.00, is turned in to the front desk. The clerk makes a memo of transaction and deposits the change and the memo in the cash drawer.
14. The restaurant sales for the day are balanced to the cash register tape, and the cash is turned in to the front desk. The restaurant sales are balanced to the cash register tape as shown at the top of the *daily cash reconciliation* in Figure 7. It shows that total restaurant sales for the day are $122.05 plus tax of $7.65. Of this amount, $17.50 has been charged by registered guests; there have been no payments by credit card; the amount of cash taken in by the restaurant is therefore $112.20. This is the amount that is turned in to the front desk.

The night audit

We now assume that there are no more transactions up to the close of business on June 5. We can therefore complete the night audit as follows:

1. All charges by guests still registered are posted to the appropriate guest folios, starting with Room 1.

	Room	Tax	Telephone	Restaurant
Room 1 (Smith)	$20.00	$1.60	$1.25	$2.50
Room 7 (Johnson)	$20.00	$1.60		
Room 9 (Ginsberg)	$20.00	$1.60		$8.64
Room 11 (Sherwood)	$18.00	$1.44		
Room 12 (Bruce)	$30.00	$2.40		

These figures are taken from the daily transcript.

2. The payment of $93.00 on the telephone company ledger account is posted (line 16 of the daily transcript).
3. A sub-total is taken of the transactions recorded on the daily transcript (line 18). The transcript is cross-balanced to check for clerical errors. (Total of previous balances, plus charges, less receipts must equal total of closing balances.) Any cross-balancing errors must be located and corrected on both the daily transcript and applicable guest folios at this time.
4. The restaurant charges on the daily transcript ($17.50) are checked against the daily cash reconciliation (see top of Figure 7).

FIGURE 7 Daily cash reconciliation

June 5, 19--

Restaurant		
Sales	$122.05	
Tax	7.65	129.70
Less: Charged revenues	$ 17.50	
Payments by credit card		17.50
		112.20
Cash received on guest and city ledger accounts per daily transcript		165.00
Other cash receipts		
Vending machine		18.00
Total		295.20
Cash over (short)		0.75
Cash for deposit		$295.95
Deposits		
Operating account		$263.95
Bank card account (Master Card)		32.00
Total		$295.95

5. Non-charged revenues are entered on the daily transcript (lines 19, 20 and 21) as follows:

Restaurant sales	$112.20
Vending machine	18.00
Cash over	0.75

6. The daily transcript is totalled and cross-balanced (see line 23 and the adding-machine tape attached to the daily transcript).

7. The total cash in the daily transcript is checked against the total cash deposited as shown in the daily cash reconciliation (see bottom of Figure 7).

8. The guest ledger control balance is computed as follows:

PREVIOUS DAY'S GUEST LEDGER + CHARGES - RECEIPTS = NEW GUEST LEDGER

This calculation is shown on the daily transcript, lines 26, 27, 28 and 29.

9. A trial balance tape of active guest folios is taken, and the total ($998.49) agrees with the new guest ledger balance. You will note there is one active account with a balance of $125.00 for which there were no transactions on June 5th. (See adding-machine tape attached to the daily transcript).

Books of original entry

You are now in a position to compile your books of original entry. As indicated earlier, if your hotel/motel has adopted the accrual basis method of recording your transactions, you will need these books of original entry - a cash receipts journal, a sales journal, a cash disbursements journal, a purchases journal, a payroll journal and a general journal. These six journals were briefly described in Chapter 1. We will now examine them in more detail, continuing with the front-office bookkeeping system outlined above.

For the purposes of our on-going example, we will make some minor modifications to the list of books of original entry. That's because, in most cases, you will find that the modifications apply to you. Specifically y, we plan to combine the cash receipts journal and the sales journal into one. And we plan to introduce a supplementary journal, called the monthly journal. It, too, was briefly described in Chapter 1.

Here, then, is how you compile your books of original entry.

Cash receipts/sales journal

This journal records all cash receipts and sales transactions including transfers of funds from the bank card account to the operating account, and commissions on funds deposited to the bank card account. The lay-out of a cash receipts/sales journal is shown in Figure 8. To see how it is used, consider these three transactions, which take place on June 5:

- A series of cash receipts and sales transactions, which are taken directly from the daily transcript and the daily cash reconciliation (Figures 6 and 7).
- The transfer of $50.00 from the bank card account to the operating account.
- The payment of $8.00 commission on amounts deposited to the bank card account.

These three transactions are recorded as shown in Figure 8. Note that for

			STATISTICS		BANKS		ACCT.	CASH	COMMISSIONS		REVENUE				SALES	ACCT.	OTHER	
	DATE	EXPLANATION	ROOMS OCC.	NO. OF GUESTS	OP. ACCT. 101	B. CARD 102	RECEIV. 110	SHORT (OV.) 625	CR CARD 630	T.A. R-540	ROOMS R-300	FOOD F-300	BEVER. F-310	TELEPH. T-300	TAX 253	RECEIV. 110	DETAIL	AMOUNT
1	JUNE 1																	
2	↑																	
3	to																	
4	↓																	
5	JUNE 4																	
6	JUNE 5	DAILY TRANSCRIPT	5	6	26395	3200	53846	(25)			1095	12205		175	765 840	791	139	1800
7	JUNE 5	TRANSFER			5000	(5000)												
8	JUNE 5	COMMISSION				(900)			900									
9	↑																	
10	to																	
11	↓																	
12	JUNE 30																	
13		TOTAL			861457	3200	1233417	300	3000		576000	327000		18000	45000	1133768	1394	1800
14																		
15																		
16																		
17																		
18																		
19																		
20																		
21																		
22																		
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32																		
33																		
34																		
35																		

each transaction, the debits equal the credits, as indicated by the following tape of the cash receipts and sales transactions:

0.	T	
26395,	+	Cash receipts
3200	+	Bank card receipts
53846.	+	Charges (per transcript)
83441.	T	Total debits
10500.	+	Room revenues
12205.	+	Food revenues
175,	+	Telephone revenues
765.	+	Food taxes
840.	+	Room taxes
57081.	+	All settlements (per transcript)
1800,	+	Vending machine revenue
75.	+	Cash over (short)
83441.	T	Total credits

At the end of each month, the cash receipts/sales journal is totalled and cross-balanced to ensure that the total debits equal the total credits. The monthly totals are then posted to the appropriate general ledger accounts (which we'll get to in a moment in Figure 13), using the account names and numbers outlined in the chart of accounts for a full-service hotel/motel (Figure 2).

Cash disbursements and purchases journals

You should not make any cash disbursements until you have received a properly approved invoice. Invoice approval generally involves verifying the quality and quantity of goods and services delivered, verifying the price you've been charged, and checking for any extensions and additions. If you like, you can use a simple stamp to speed up the approval process. A suitable stamp might look like this:

DATE REC'D ______________________

QUANTITY O.K. ______________________

QUALITY O.K. ______________________

PRICE O.K. ______________________

EXTENS. O.K. ______________________

APPR FOR PAYM. ______________________

As soon as you receive and approve an invoice, that invoice should be recorded in your purchases journal (Figure 9). The approved and recorded invoices should then be filed according to the date when payment is due (the best place to file them is in a harmonica folder). As a general rule, you should pay an invoice when it is most convenient for you to do so - ie., late enough to benefit from any credit that has been extended, but early enough to take advantage of any discount due to early payments.

When you make the payment, the invoices for each supplier should be totalled and stapled together with the adding machine tape, and the cheque number and the date of payment should be noted on the tape. Your paid invoices should then be filed alphabetically, with separate files for major suppliers.

When you're writing and recording your cheques, you have to enter the same information on the cheque, the cheque stub, the envelope and in the cash disbursements journal. To avoid all that duplication, we recommend that you use a one-write cash disbursements system. Its components are:

- Cheques with a carbon strip.
- Cash disbursements journal (Figure 10).
- Window envelopes.

You place each cheque above the journal, and as each one is prepared, the cheque number, payee, date and the cheque amount are all automatically entered in the journal.

At the end of each 'month, the cash disbursements journal and the purchases journal are totalled and cross-balanced to ensure that total debits equal total credits. The monthly totals are then posted to the appropriate general ledger accounts (as in Figure 13).

One other point should be made here. In the purchases journal (Figure 9), Big John's Bakery shows an invoice of $120.00. However, Big John normally extends a small cash discount for invoices that are paid within 30 days. That's why you paid only $115.00, as shown in the cash disbursements journal (Figure 10). Although, in this case, you have paid just $115.00, you have still received $120.00 worth of goods, and the principle behind recording a cash discount is to expense the total invoice, without any reference to discounts. In other words, discounts reduce the invoice payable, not the expense incurred.

Please fold out for Figure 9 ——▶

Monthly journal

At this stage, we introduce the monthly journal. It is used to record all recurring month-end adjusting entries, and for each month it shows a debit and a credit column (Figure 11).

For purposes of illustration, we have made the following entries for June:

To accrue property taxes for the month	$ 500.00
To record depreciation for the month	1,000.00
To setup food inventory at the end of the month	200.00
To accrue purchase and expense invoices, which have not been paid	1,125.00

It is not necessary to total the columns in the monthly journal, since each entry is posted individually to the general ledger (Figure 13).

Payroll journal

This journal is dealt with in detail later in this chapter. For now, in order to keep our example going (and for illustrative purposes only), we have assumed the following payroll costs:

Rooms department	$1,000.00
Food and beverage department	1,400.00
Total	2,400.00

General journal

This journal is used to record all those adjustments or entries, which are not recurring and which are not handled in any of the other journals described above. We've illustrated its use with an entry to record the purchase of a motel property for $450,000.00 (see Figure 12).

Each entry in the general journal is posted individually to the general ledger, so (as with the monthly journal) it is not necessary to total the columns.

◄—— Please fold out for Figure 10

MONTHLY JOURNAL

NO. L42 01088 12 COLUMNAR SHEET

	ACCOUNT NO.	EXPLANATION	JUNE DEBIT	JUNE CREDIT	JULY DEBIT	JULY CREDIT	AUGUST DEBIT	AUGUST CREDIT	SEPTEMBER DEBIT	SEPTEMBER CREDIT	OCTOBER DEBIT	OCTOBER CREDIT			
1	810	PROP. + BUS. TAXES	500 00												1
2	230	ACCRUED LIABILITIES		500 00											2
3		TO ACCRUE PROPER-													3
4		TY TAXES FOR JUNE													4
5															5
6	840	DEPRECIATION	1000 00												6
7	A-160	ACC. DEP. - BUILDING		1000 00											7
8		TO RECORD DE-													8
9		PRECIATION FOR JUNE													9
10															10
11	120	INVENTORY - FOOD	200 00												11
12	F-400	COST OF FOOD SALES		200 00											12
13		TO SET UP MONTH-													13
14		END INVENTORY													14
15															15
16															16
17															17
18															18
19															19
20															20
21															21
22															22
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28															28
29															29
30															30
31															31
32															32
33															33
34															34
35															35

FIGURE 12 General journal

	DATE 19__	EXPLANATION	ACC. NO.	DEBIT	CREDIT	
1	June 1	LAND	150	50000 00		1
2		BUILDING	160	400000 00		2
3		MORTGAGE PAYABLE	260		450000 00	3
4						4
5		TO RECORD PURCHASE				5
6		OF HOTEL PROPERTY				6
7						7
8						8
9						9
10						10
11						11
12						12
13						13
14						14
15						15
16						16
17						17
18						18
19						19
20						20
21						21
22						22
23						23
24						24
25						25
26						26
27						27
28						28
29						29
30						30
31						31
32						32
33						33
34						34
35						35
36						36

Keeping score in the general ledger

The general ledger is the total of all accounts used in your hotel/motel. You make entries into the ledger on the basis of the column totals of the journals described above (with the exceptions of the monthly journal and the general journal, as just mentioned).

The physical set-up of the general ledger is very much an individual choice. However, we recommend that you use a standard ledger sheet for each account. The ledger sheets should be bound together and arranged in sequence, following the order assets, liabilities, owners' equity, revenues and expenses.

Figure 13 shows how the general ledger would look in our on-going example. (Remember that the general ledger draws on the monthly totals of the journals described above. In the case of Figures 8, 9 and 10, the monthly totals are shown, even though many of the daily entries are not.)

After all the entries have been posted, and the general ledger accounts added, you should prepare a *trial balance* tape to determine if the ledger is in balance. In our example, the trial balance tape would look like:

General ledger trial balance	O.	T
June 30, 19--	5319,51	+
	32,00	+
	998,49	+
	200.00	+
	50000,00	+
	400000,00	+
	1000,00	−
	1250.00	
	500.00	
	450,00	
	450000,00	
	5760.00	
	1000,00	+
	275.00	+
	3270,00	
	1200,00	+
	1400,00	+
	300.00	+
	180.00	
	5.00	−
	18,00	−
	3,00	+
	30.00	+
	25,00	+
	150,00	+
	500.00	+
	1000,00	+
	-0,00	o
	-0.00	T

FIGURE 13 General ledger

NAME BANK OPERATING ACCOUNT ACCOUNT NO. 101 CARD NO.

ADDRESS TERMS CREDIT RATING

DATE	ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
JUNE 30		CR	8614 57	✓			DR	8614 57	
JUNE 30		PJ			2400 00		DR	6229 51	
JUNE 30		CD		✓	895 00		DR	5319 51	

NAME BANK CARD ACCOUNT (MASTERCHARGE) ACCOUNT NO. 102 CARD NO.

ADDRESS TERMS CREDIT RATING

DATE	ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
JUNE 30		CR	32 00				DR	32 00	

NAME ACCOUNTS RECEIVABLE ACCOUNT NO. 110 CARD NO.

ADDRESS TERMS CREDIT RATING

DATE	ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
JUNE 30		CR	12334 17	✓	11335 68		DR	998 49	

NAME INVENTORY - FOOD ACCOUNT NO. 120 CARD NO.

ADDRESS TERMS CREDIT RATING

DATE	ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
JUNE 30		MJ	200 00	✓			DR	200 00	

NAME LAND ACCOUNT NO. 150 CARD NO.

ADDRESS TERMS CREDIT RATING

DATE	ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
JUNE 30		GJ	50000 00				DR	50000 00	

NAME BUILDING ACCOUNT NO. 160 CARD NO.

ADDRESS TERMS CREDIT RATING

DATE	ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
JUNE 30		GJ	400000 00				DR	400000 00	

General ledger (cont.)

NAME ACCUMULATED DEPRECIATION-BUILDING ACCOUNT NO. A-160 CARD NO.

ADDRESS TERMS CREDIT RATING

DATE	ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
June 30		MJ		✓	1000 00		CR	1000 00	

NAME ACCOUNTS PAYABLE ACCOUNT NO. 210 CARD NO.

ADDRESS TERMS CREDIT RATING

DATE	ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
June 30		MJ		✓	1250 00		CR	1250 00	

NAME ACCRUED LIABILITIES ACCOUNT NO. 230 CARD NO.

ADDRESS TERMS CREDIT RATING

DATE	ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
June 30		MJ		✓	500 00		CR	500 00	

NAME SALES TAX COLLECTED ACCOUNT NO. 253 CARD NO.

ADDRESS TERMS CREDIT RATING

DATE	ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
June 30		CR		✓	450 00		CR	450 00	

NAME MORTGAGE PAYABLE ACCOUNT NO. 260 CARD NO

ADDRESS TERMS CREDIT RATING

DATE	ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
June 30		GJ			450 000 00		CR	450 000 00	

NAME REVENUE - GUEST ROOMS ACCOUNT NO. R-300 CARD NO.

ADDRESS TERMS CREDIT RATING

DATE	ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
June 30		CR		✓	5760 00		CR	5760 00	

General ledger (cont.)

NAME ROOMS-SALARIES AND WAGES ACCOUNT NO. R-500 CARD NO.

ADDRESS TERMS CREDIT RATING

DATE		ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
JUNE	30		J	1000 00				DR	1000 00	

NAME ROOMS-CLEANING SUPPLIES AND EXPENSES ACCOUNT NO. R-530 CARD NO

ADDRESS TERMS CREDIT RATING

DATE		ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
JUNE	30		HJ	200 00	✓			DR	200 00	
JUNE	30		CD	75 00				DR	275 00	

NAME REVENUE-FOOD ACCOUNT NO. F-300 CARD NO.

ADDRESS TERMS CREDIT RATING

DATE		ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
JUNE	30		CR		✓	3270 00		CR	3270 00	

NAME COST OF FOOD SALES ACCOUNT NO. F-400 .... NO.

ADDRESS TERMS CREDIT RATING

DATE		ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
JUNE	30		CD	800 00	✓			DR	800 00	
JUNE	30		HJ		✓	200 00		DR	600 00	
JUNE	30		HJ	600 00	✓			DR	1200 00	

NAME FOOD + BEV. DEPTMT. - SALARIES AND WAGES ACCOUNT NO. F-500 CARD NO.

ADDRESS TERMS CREDIT RATING

DATE		ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
JUNE	30		PJ	1400 00				DR	1400 00	

NAME FOOD + BEV. DEPTMT.- CLEANING SUPPLIES AND EXPENSES ACCOUNT NO. F-530 CARD NO.

ADDRESS TERMS CREDIT RATING

DATE		ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
JUNE	30		HJ	300 00				DR	300 00	

General ledger (cont.)

NAME REVENUE - TELEPHONE CALLS — ACCOUNT No. 1-300 CARD NO.

ADDRESS — TERMS — CREDIT RATING

DATE		ITEMS	FOLIO	DEBITS	✓	CREDITS	✓	DR. OR CR.	BALANCE	✓
JUNE	30		CR		✓	180 00		CR	180 00	

NAME CASH DISCOUNTS EARNED — ACCOUNT NO. 1-391 CARD No.

ADDRESS — TERMS — CREDIT RATING

DATE		ITEMS	FOLIO	DEBITS	✓	CREDITS	✓	DR. OR CR.	BALANCE	✓
JUNE	30	–	CD			5 00		CR	5 00	

NAME OTHER INCOME - VENDING MACHINES — ACCOUNT NO. 1-394 CARD NO.

ADDRESS — TERMS — CREDIT RATING

DATE		ITEMS	FOLIO	DEBITS	✓	CREDITS	✓	DR. OR CR.	BALANCE	✓
JUNE	30		CR			18 00		CR	18 00	

NAME CASH OVER (SHORT) — ACCOUNT NO. 625 CARD NO.

ADDRESS — TERMS — CREDIT RATING

DATE		ITEMS	FOLIO	DEBITS	✓	CREDITS	✓	DR. OR CR.	BALANCE	✓
JUNE	30		CR	3 00				DR	3 00	

NAME CREDIT CARD COMMISSIONS — ACCOUNT NO. 630 CARD NO.

ADDRESS — TERMS — CREDIT RATING

DATE		ITEMS	FOLIO	DEBITS	✓	CREDITS	✓	DR. OR CR.	BALANCE	✓
JUNE	30		CR	30 00				DR	30 00	

NAME PRINTING, STATIONERY + POSTAGE — ACCOUNT NO. 670 CARD NO.

ADDRESS — TERMS — CREDIT RATING

DATE		ITEMS	FOLIO	DEBITS	✓	CREDITS	✓	DR. OR CR.	BALANCE	✓
JUNE	30		CD	25 00				DR	25 00	

General ledger (cont.)

NAME ADVERTISING — ACCOUNT NO. 690 — CARD NO.

ADDRESS — TERMS — CREDIT RATING

DATE		ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
JUNE	30		HJ	150 00	✓			DR	150 00	

NAME PROPERTY AND BUSINESS TAXES — ACCOUNT NO. 810 — CARD NO.

ADDRESS — TERMS — CREDIT RATING

DATE		ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
JUNE	30		HJ	500 00				DR	500 00	

NAME DEPRECIATION — ACCOUNT NO. 840 — CARD NO.

ADDRESS — TERMS — CREDIT RATING

DATE		ITEMS	FOLIO	DEBITS	√	CREDITS	√	DR. OR CR.	BALANCE	√
JUNE	30		HJ	1000 00	✓			DR	1000 00	

Having balanced the general ledger, you can use a form called a *work sheet* to assist in the preparation of your financial statements. The work sheet is not essential, but it is extremely helpful in determining whether or not you need to make adjustments. In Figure 14, we have developed a work sheet that is based upon the general ledger on Figure 13. Then using the work sheet as a base, we have prepared a balance sheet (Figure 15) and an income statement (Figure 16).

That brings us to the next stage of our financial management system - accounting - which we will discuss in the next chapter. Before we get to that, however, we want to double back and (as promised earlier) take another look at payroll and the payroll journal.

FIGURE 14 Work sheet June 30, 19__

	No.	ACCOUNT	TRIAL BALANCE DEBIT	TRIAL BALANCE CREDIT	ADJUST DEBIT
1	101	BANK OPERATING ACCT.	5319.57		
2	102	BANKCARD ACCT.	32.00		
3	110	ACCOUNTS RECEIVA.	998.49		
4	120	INVENTORY-FOOD	200.00		
5	150	LAND	50000.00		
6	160	BUILDING	400000.00		
7	A-160	ACCUM. DEPRE.-BUILDING		1000.00	
8	210	ACCOUNTS PAYABLE		625.00	
9	230	ACCRUED LIABILITIES		500.00	
10	253	SALES TAX COLLECTED		460.00	
11	260	MORTGAGE PAYABLE		450000.00	
12	R-300	REVENUE-GUEST ROOMS		5760.00	
13	R-500	ROOMS-SALARIES	1000.00		
14	R-530	ROOMS-CLEANING	275.00		
15	F-300	FOOD SALES		3270.00	
16	F-400	COST OF FOOD SALES	1200.00		
17	F-500	FOOD + BEV.-SALARIES	1400.00		
18	F-530	FOOD + BEV.-CLEANING	300.00		
19	T-300	REVENUE-TELEPHONE		180.00	
20	1-391	CASH DISCOUNTS EAR.		5.00	
21	1-394	VENDING MACHINE		18.00	
22	625	CASH OVER-SHORT	3.00		
23	630	CREDIT CARD COMM.	30.00		
24	670	PRTG., STAT. + POST.	25.00		
25	690	ADVERTISING	150.00		
26	810	PROP. + BUSIN. TAXES	500.00		
27	840	DEPRECIATION	1000.00		
28					
29			$462433.00	$462433.00	-0-
30		INCOME			
31					
32					
33					
34					
35					
36					

FIGURE 15 Balance sheet

as at ____________, 9

ASSETS

CURRENT ASSE S	This Year	Last Year
Cash:		
Floats	$	$
Operating Account	5319.51	
Bank Card Account	32.00	
Payroll Account		
Marketable Securities		
Receivables:		
Guest Ledger	998.49	
City Ledger		
Other Receivables		
Allowance for Doubtful Accounts	( )	( )
Inventories	200.00	
Prepaid Expenses		
Other Current Assets		
Total Current Assets	6550.00	
INVESTMENTS AND ADVANCES		
FIXED ASSETS		
Land	50,000.00	
Building	400,000.00	
Leasehold Improvements		
Furniture and Equipment		
	450,000.00	
Accumulated Depreciation	(1000.00)	( )
	449,000.00	
China, Glass, Silver, Linen Uniforms		
Total Property and Equipment	449,000.00	
OTHER ASSETS		
TOTAL ASSETS	$ 455,550.00	$

LIABIL TIES

CURRENT LIABILITIES	This Year	Last Year
Bank Loans	$	$
Accounts Payable	1250.00	
Income Taxes Payable		
Accrued Liabilities:		
Salaries and Wages		
Interest		
Other	500.00	
Current Portion of long-term debt		
Other Current Liabilities	450.00	
Total Current Liabilities	2200.00	
LONG-TERM DEBT, .ess current portion	450,000.00	
O HER NON-CURRENT IABILI ES		
DEFERRED INCOME TAXES		
Total .iabilities	452,200.00	
SHAREHOLDERS' EQUITY		
CAPITAL STOCK		
RETAINED EARNINGS	3350.00	
Total Shareholders' Equity	3350.00	
TOTAL LIABILITIES AND SHAREHOLDERS' Y	$ 455,550.00	$

FIGURE 16 Income statement

_____ MONTHS ENDED _______ 19 __

Year To Date Actual	Year To Date Budget		Current Month Actual	Current Month Budget
		REVENUES		
$5760.00	$	Rooms	$5760.00	$
3270.00		Food	3270.00	
		Beverage		
180.00		Telephone	180.00	
		Gift shop		
23.00		Other income	23.00	
9233.00		Total	9233.00	
		COST OF SALES		
1200.00		Food	1200.00	
		Beverage		
		Telephone		
		Gift shop		
1200.00		Total	1200.00	
		DEPARTMENTAL EXPENSES		
1275.00		Rooms	1275.00	
1700.00		Food and beverage	1700.00	
		Telephone		
		Gift shop		
2975.00		Total	2975.00	
5058.00		DEPARTMENTAL INCOME	5058.00	
		UNDISTRIBUTED OPERATING EXPENSES		
58.00		Administrative and general	58.00	
150.00		Marketing	150.00	
		Property operation and maintenance		
		Energy costs		
208.00		Total	208.00	
4850.00		INCOME BEFORE FIXED CHARGES	4850.00	
		FINANCIAL AND OTHER EXPENSES		
		Rent		
500.00		Property taxes	500.00	
		Insurance		
		Interest		
500.00		Total	500.00	
4350.00		INCOME BEFORE DEPRECIATION AND AMORTIZATION	4350.00	
1000.00		Depreciation	1000.00	
1000.00		Total	1000.00	
$3350.00	$	INCOME BEFORE INCOME TAXES	$3350.00	$

Beating the costs of payroll

The chances are that one of your most time-consuming and therefore costly activities is the location, hiring, training, supervision and termination of employees. This section of the book is designed to help you deal with the various problems and costs of payroll. In addition, it will help you meet the many reporting requirements, which can also be time-consuming and costly.

The payroll cycle starts with your search for a new employee, and that is when your payroll records should start, too. A *personal history form (similar* to the one in Figure 17) should be completed for every person you interview for a job. If the person is hired, you should file the form in that person's personnel folder. If the person is not hired right away, but seems a likely candidate for future hiring, then you should file the form for future reference. If the person is totally unsuitable, you should still retain the form, filing it under a category such as "not satisfactory".

But let's assume the person is hired. The first thing he or she must do is complete a TD-1 form, which is required by federal government regulations for all employees who are claiming income tax exemptions other than the basic amount. It will give you basic information such as the person's full name, address, birth date, social insurance number, etc.

FIGURE 17 Personal history form

Location ______ Inn ❑ Restaurant ❑ (CHECK ONE)

1. NEW EMPLOYEE ❑ REHIRE ❑ (CHECK ONE)

Name ______ (LAST) (FIRST) (MIDDLE INITIAL)

JOB CLASSIFICATION ______

Address. Street ______

City ______ Province ______ Phone ______

3. NUMBER OF DEPENDENTS (including Employee) ______

Date of Birth ______ Sex ______

Marital Status. O Single ______ 1. Married ______ 2. Separated ______ (CHECK ONE)

4. SOCIAL INSURANCE NUMBER ______

3 Divorced ______ 4. Widowed ______ 5. Single but Head of Household ______

Call in Emergency ______

5, DATE OF FIRST WORK OAY Mo Day Year

Address Street ______

6. RATE OF PAY: ❑ Hrly 0 Sal ______

City ______ Province ______ Phone ______

Hired By: ______

Reason for Termination 1. Wages ______ 2. Working Conditions ______ 3 Personal ______ 4 Health _
5. Opportunity Elsewhere ______ 6 Unsatisfactory Work ______ 7. Company Rules — 8. Other ______

Oate of Termination ______ Explain Reason Fully ______ (Use back if necessary)

Next, you will need a *time record (as* in Figure 18) for the new employee. And you will need to add the new employee to your *weekly payroll schedule (shown in* Figure 19). The weekly schedule is best placed in a non-public area of your hotel/motel, where staff members can refer to it. At the end of each week, time records for all your employees should be sent to the person responsible for maintaining payroll records and for preparing payroll cheques (or pay envelopes). The time records should be sorted according to whether the employees are salaried or paid by the hour (since payroll preparation for salaried employees usually does not vary from one payroll period to another).

FIGURE 18 Time record

NAME ______________________ LOCATION ______________

ADDRESS ______________ POSTAL CODE ________ PHONE NO. ________

PAY PERIOD FROM: TO:

DATE MO	DAY		IN	OUT	LESS	TOTAL HOURS	EMPLOY. INITIAL	SPVR INITIAL
		M						
		T						
		W						
		T						
		F						
		S						
		S						
	TOTAL							
		M						
		T						
		W						
		T						
		F						
		S						
		S						
	TOTAL							

	RATE	HOURS	EARNINGS
OTHER	$		$
REGULAR	$		$
OVERTIME (REG/STAT HOL)	$		$
SUB TOTAL			$
HOLIDAY PREMIUM	$		$
TOTAL			

FOOD DEDUCTIONS

WEEK 1 $ ________

WEEK 2 $ ________

TOTAL $ ________

MANAGER'S COMMENT & APPROVAL

FIGURE 19 Weekly payroll schedule

WEEKLY SCHEDULE FOR WEEK ENDING ________

POSITIONS: / NAMES OF STAFF:	SUNDAY SCHED. HRS	MONDAY SCHED. HRS	TUESOAY SCHED. HRS	WEONESDAY SCHED. HRS	THURSDAY SCHED. HRS	FRIDAY SCHEO. HRS	SATUROAY SCHED. HRS	WEEKLY TOTAL HOURS
JOHN - STEWARD	OFF -	6A-3P 8	6A-3P 8	6A-3P 8	6A-3P 8	6A-3P 8	7A-4P a	48
BILL - AM COOK	6A-5P 10	6A-3P 8	6A-3P 8	5A-3P 9	6A-3P 8	6A-3P 8	OFF -	51
FRANK - PM COOK	1P-11P 10	3P-11P 8	3P-12P 9	3P-11P 8	OFF -	3P-11P 8	2P-11P 9	52
TIM - EXTRA COOK	4P-8P 4	OFF -	OFF -	OFF -	OFF -	OFF -	3P-6P 3	7
SUE-TOTAL HOURS								158
8UD - COOK'S HELPER	7A- 4P 8	7A-4P 8	OFF -	7A-4P 8	7A-4P 8	9A-6P 8	7A-4P 8	48
KEN - COOK'S HELPER	OFF -	3P-11P 8	7A-4P 8	6A-3P 8	3P-11P 8	OFF -	OFF -	32
SUB-TOTAL HOURS								80
ELAINE - PANTRY	5A- 3P 9	6A-3P 8	6A-3P 8	OFF -	5A-3P 9	6A-3P 8	6A-3P 8	50
RUTH - PANTRY	1P-11P 10	OFF -	OFF -	3P-11P 8	3P-11P 8	3P-11P 8	2P-11P 9	43
SUB-TOTAL HOURS								93
JESS - WAREWASHER	6A-4P 10	7A-4P 8	7A-4P 8	7A-4P 8	7A-4P 8	7A-4P 8	OFF -	50
B08 - WAREWASHER	2P-11P 9	3P-11P 8	3P-11P 8	3P-11P 8	OFF -	3P-11P 8	3P-12P 9	50
OAVE - WAREWASHER	8A-5P 8	OFF -	OFF -	OFF -	3P-11P 8	OFF -	7A-4P 8	24
OTTO - POTWASHER	OFF -	8A- 5P 8	8A- 5P 8	19A-7P 8	8A-5P 8	8A-5P 8	OFF -	40
TOM - NIGHT CLEANER	11P-8A 8	11P-8A 8	OFF -	OFF -	11P-8A 8	11 P-8A 8	11P-8A 8	40
SUB-TOTAL HOURS								204
WEEKLY TOTAL HOURS								

Next comes the preparation of the *payroll earnings record* (Figure 20), the *payroll journal (Figure* 21) and the *pay cheque*. Since a lot of duplicate records must be kept here, it is best to use a one-write system. When choosing a one-write payroll system (they are available from specialized office forms suppliers), it is a good idea to pick one that is compatible with the one-write system recommended earlier for your cash disbursements journal.

The actual process of payroll preparation is a straightforward series of steps as follows:

1. The numbers of hours worked are taken from each time record and added to columns 1 and 2 of the corresponding earnings record (see Figure 20).

2. Regular hours are paid at the normal rate, and the total amount is inserted in column 3. Overtime hours are paid at a higher rate (usually 1½ times the normal rate) and recorded in column 4.

3. Other items, such as gratuities, are recorded in column 5. This column may also be used for recording bonuses, vacation pay and other taxable earnings that occur infrequently.

4. The dollar amounts recorded in columns 3, 4, and 5 are added up, and the total is entered in column 6.

5. If the employee is subject to Canada Pension Plan deductions (ie., he or she is at least 18 years old but less than 70, during the month to which the pay relates), then column 8 should be checked to ensure that the maximum deduction for the year has not already been made. If it has not been made, you should use the federal publication "Canada Pension Plan Contribution and Unemployment Insurance Premium Tables" to compute the appropriate deduction. This deduction is then recorded in column 7. (However, if the deduction, when added to the previous deductions, exceeds the maximum, then you should reduce the deduction so that the maximum is met exactly.)

6. You should now determine if the employee is subject to any unemployment insurance deductions. As a rule, "Canada Pension Plan Contribution and Unemployment Insurance Premium Tables" will indicate the appropriate deduction. It is entered in column 9, and the insurable earnings on which the deduction is based are entered in column 17. The number of weeks of insured earnings is entered in column 18, along with the cumulative number of insured weeks.

7. The dollar totals recorded in columns 7 and 9 are then deducted from the gross pay in column 6 to determine the taxable pay. The publication "Income Tax Deductions at Source" will tell you the amount to deduct for income tax. That amount is entered in column 10.

8. Any other deductions, such as payments for Canada Savings Bonds, group insurance or Blue Cross, are determined from the appropriate tables and documents; they are entered in columns 11 through 14.

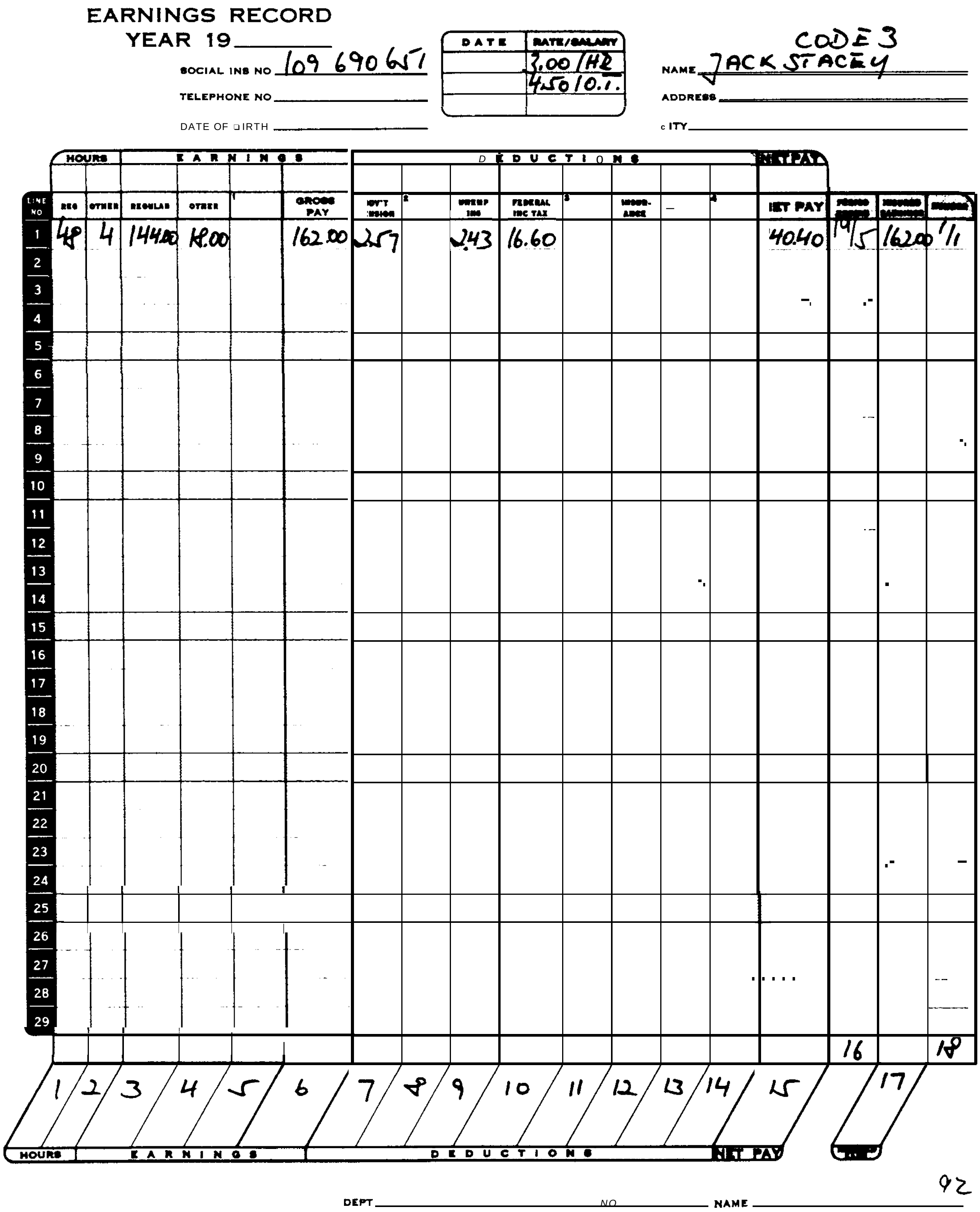
9. The total dollar amount shown in columns 7 through 14, subtracted from the gross pay in column 6, is the net pay due to the employee. It is entered in column 15.

This completes the entries into the earnings record, and with the one-write system, it also completes the entries on the top portion of the payroll cheque and the entries on the left side of the payroll journal (see Figure 21). However, the journal preparation is not yet finished. The right side of the journal (not covered by the one-write system) is used to distribute the payroll cost to the appropriate department within your hotel/motel.

Usually, the cost of each employee will be charged entirely to one department, in accordance with the chart of accounts (either Figure 2 or Figure 3) and the expense dictionary (Figure 4). However, sometimes an employee will work in more than one department, and his or her gross pay must then be allocated among the various departments, so that payroll costs for each of your profit centres are recorded as accurately as possible.

If an employee leaves or is terminated, any outstanding pay must be calculated in the same way as regular pay. In addition, vacation pay (calculated at 4% of the employee's gross earnings since the last vacation or last vacation pay) must be added.

FIGURE 20 Payroll earnings record



EARNINGS RECORD

YEAR 19

SOCIAL INS NO 109 690 651

TELEPHONE NO

DATE OF BIRTH

DATE	RATE/SALARY
	3.00/HR
	4.50 O.T.

CODE 3

NAME JACK STACEY

ADDRESS

CITY

LINE NO	HOURS REG	HOURS OTHER	EARNINGS REGULAR	EARNINGS OTHER	1	GROSS PAY	GOV'T PENSION	2	UNEMP INS	FEDERAL INC TAX	3	INSURANCE	—	4	NET PAY			
1	48	4	144.00	18.00		162.00	2.57		2.43	16.60					40.40	19/5	162.00	1/1
2																		
3																		
4																		
5																		
6																		
7																		
8																		
9																		
10																		
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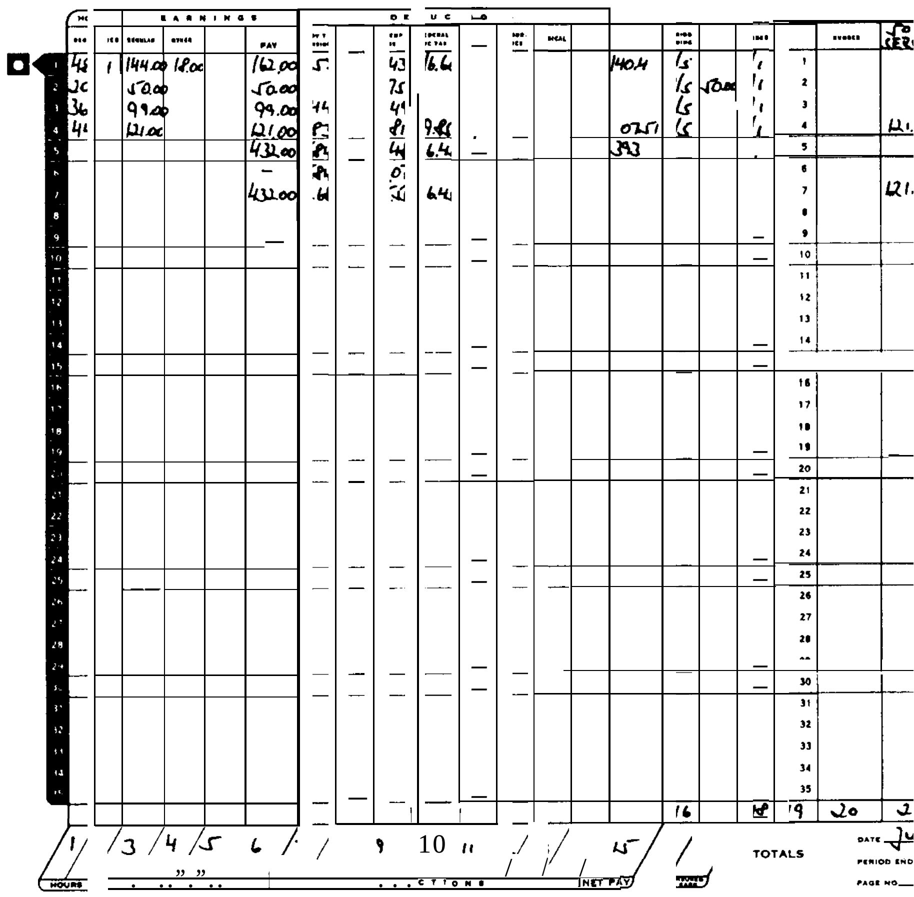
21																		
22																		
23																		
24																		
25																		
26																		
27																		
28																		
29																		
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18

HOURS EARNINGS DEDUCTIONS NET PAY

92

DEPT NO NAME

FIGURE 21 Payroll journal



The preparation of the payroll journal is finished once you have prepared your (ie., the employer's) contribution to the Canada Pension Plan and Unemployment Insurance. The employer's contribution to the Canada Pension Plan is equal to the employee's, and the employer's contribution to Unemployment Insurance is equal to 1.4 times the employees.

Your contributions should be recorded in columns 7 and 9 respectively of your payroll journal, with the explanation "company share" written on the same line in column 24 (see Figure 21). The total of the company share contribution (ie., the sum of the contributions shown in columns 7 and 9) should be recorded in column 33.

Finally, the entries in the payroll journal should be transferred to the general ledger. The distribution is as follows:

The totals of these columns	are entered under these account numbers
7,9,10	250 (credit)
12,13,14	251 (credit)
15	101 (credit)
21,22,23	500 (debit)
33	519 (debit)

As always, total credits must equal total debits

Key points in review

After studying Chapter 2, you should be able to:

- Outline the benefits of an effective bookkeeping system.
- Explain how double-entry bookkeeping works.
- Indicate whether increases or decreases in assets, liabilities, owners' equity, revenues and expenses are debit or credit entries in your books of original entry.
- Differentiate between the cash basis and the accrual basis methods of recording transactions.
- Use the uniform system of accounts.
- Explain the procedures of front office bookkeeping.
- Know how to record transactions in your books of original entry.
- Show how the entries are posted to the general ledger and how a trial balance is prepared.
- Use the procedures of a payroll system.
- Define or explain all the key terms that appear in italics.

To see if you have mastered these points, we invite you to tackle the self-test questions and the working example that appear on the following pages.

SELF-TEST QUESTIONS -2

(answers on last page this chapter)

1. Bookkeeping is:
   a. The preparation of financial statements based upon the business' books of original entry.
   b. The process of collecting, classifying, recording and summarizing all transactions of a financial nature.
   c. Used in setting rates and prices
   d. A capital budgeting technique
   e. None of the above.

2. Transactions that increase an assets and an expenses account are:
   a. Both credit entries.
   b. Credit and debit entries respectively.
   c. Debit and credit entries respectively.
   d. Both debit entries.
   e. None of the above.

3. The accrual basis for recording transactions means that:
   a. The double-entry concept is not followed.
   b. Transactions are recorded only when cash is received or paid out.
   c. Cash and non-cash transactions are both recorded.
   d. Depreciation is calculated semi-annually.
   e. None of the above.

4. When an assets account increases and a liabilities account increases, the bookkeeping entries are:
   a. Both debit entries.
   b. Both credit entries.
   c. Debit and credit entries respectively.
   d. Credit and debit entries respectively.
   e. None of the above.

5. A uniform system of accounts represents:
   a. A method of accounting for staff uniforms.
   b. A standard method for allocating revenues and expenses and for presenting financial statements.
   c. A chart of accounts and an expense dictionary.
   d. An accounting system used in all industries.
   e. None of the above.

6. The city ledger is:
   a. A ledger containing the accounts receivable of guests who are no longer registered at the hotel/motel.
   b. A ledger used only in large city hotels.
   c. Another name for the general ledger.
   d. A ledger containing your accounts payable.
   e. None of the above.

7. The night audit represents:
   a. A procedure used to count the cars remaining overnight in your parking lot.
   b. A physical inventory count taken at the close of a day's business.
   c. The preparation of the general ledger by the night auditor.
   d. The recording of transactions into the books of original entry by the night auditor.
   e. None of the above.

8. Which of the following does not represent a method of payment of a guest's account?
   a. A transfer from one guest folio to another.
   b. A straight cash settlement.
   c. A transfer of the guest folio to the city ledger.
   d. A transfer of the guest folio to the general ledger.
   e. All of the above.

9. A trial balance is:
   a. A way of determining if the general journal is in balance.
   b. A way of determining if the city ledger is in balance.
   c. A way of determining if the guest ledger is in balance.
   d. A preliminary balance sheet.
   e. None of the above.

10. Payments made to suppliers in cash or by cheque are recorded in:
    a. The sales journal.
    b. The cash receipts journal.
    c. The cash disbursements journal.
    d. The city ledger
    e. None of the above.

11. The work sheet is:
    a. Used in the night audit.
    b. Used in preparing a trial balance.
    c. Used in establishing prices.
    d. Used in capital budgeting.
    e. All of the above.

12. The chart of accounts represents:
    a. Another name for the balance sheet and income statement.
    b. A drawing or model of the entire accounting system.
    c. A listing of account headings under the uniform system of accounts.

d. Alisting of theaccount headings contained in the general journal.
e. None of the above.

13. The daily transcript shows:
a. A daily record of charges and receipts.
b. A daily record of charges, receipts and cash disbursements.
c. A daily record of room-occupancy percentages
d. A daily record of staff hours.
e. All of the above.

14. A bank card is:
a. Any credit card used by guests to settle their accounts.
b. A form used for cash deposits into a bank account.
c. A credit card issued by a bank.
d. A card used to maintain a constant record of a business' bank balance.
e. None of the above.

15. The general ledger provides:
a. A record of all the guest accounts.
b. A summary of all the transactions that do not fit into any of the other books of original entry.
c. The information needed to prepare the night audit.
d. The information used to prepare the balance sheet and income statement.
e. None of the above.

WORKING EXAMPLE -2

Background
The following events occurred at your motel, the Sunset Motel, on November 5:

- Mr. and Mrs. Pratt, who had stayed for two nights in a room (#3) with a daily rate of $21.00 (double), checked out and paid in cash.
- Mr. James, who had stayed for one night in a room (#9) with a daily rate of $18.00 (single), checked out and paid in cash.
- Mr. and Mrs. White, who had stayed for one night in a room (#10) with a daily rate of $21.00 (double), checked out and paid in cash.
- Mr. White made long distance telephone calls that cost $7.00. Tax at 7% was added to this amount.
- Newspaper and confectionery cash sales were $8.50.

In addition, the daily transcript for the remaining days in November showed the following revenues, all earned from cash sales:

Date	Room Revenues	Telephone	Newspaper and confectionery	Sales tax	Total
Nov. 7	$ 60.00	$10.00		$4.90	$ 74.90
Nov. 10	$ 20.00			$1.40	$ 21.40
Nov. 13	$ 35.00	$ 5.00		$2.80	$ 42.80
Nov. 15	$100.00	$20.00		$8.40	$128.40
Nov. 18	$ 50.00	$10.00		$4.20	$ 64.20
Nov. 20	$ 25.00	$ 5.00		$2.10	$ 32.10
Nov. 23	$ 90.00	$20.00		$7.70	$117.70
Nov. 30	$ 80.00	$30.00		$7.70	$117.70

Also, the following cheques were written on November 30:

#101 Downtown Cleaners (re cleaning)	$ 25.00
#102 Mrs. Jensen (part-time housekeeper)*	86.50

*Mrs. Jensen's gross wages were $100 for November. Her net wages were calculated as follows:

Gross wages	$100.00
Income tax	(10.00)
UIC	(2.00)
CPP	(1.50)
Net wages	$ 86.50

#103	Receiver General for Canada	
	Employee deductions (Mrs. Jensen)	13.50
	Employer contribution	
	($2.00 x 1.4 + $1.50x 1.0)	4.30
		17.80
#104	Texaco Fuels (re fuel for October)	115.00
#105	Bob's Hardware (re paint for Room #1)	35.00
#106	Towne Furniture (re new bed for Room #2)	120.00
#107	Towne Herald (re advertising)	200.00
#108	Bell Canada	50.00

Tasks

1. Using the forms supplied, complete registration cards and guest folios for Mr. and Mrs. Pratt, Mr. James and Mr. and Mrs. White.
2. Using the form supplied, complete a daily transcript for November 5. This should incorporate the previous day's transactions.
3. Using the form supplied, complete the cash receipts/sales journal for November.
4. Using the form supplied, complete the cash disbursements journal for November.
5. Using the general ledger cards supplied, post all of the transactions taking place in November to the general ledger.
6. Using the work sheet supplied, complete a trial balance for November and calculate the income before fixed charges.

Note: You should assume that all sales are made in cash and that no transactions occurred on days other than those indicated.

The solution to this example can be found following Chapter 10.

Registration card and guest folio

№ 527

ROOM NO.	NAME	GuESTS
	MR. AND MRS. PRATT	

STREET ADDRESS 121 ISLINGTON AVENUE

CITY TORONTO

MAKE OF CAR	LICENSE NO.	PROVINCE OR STATE
BUICK	RKB 376	ONTARIO

OATE OF ARRIVAL

DATE OF DEPARTURE

DATE	CHARGES							RECEIPTS			BALANCE
	ROOMS	TAX	TELEPHONE	RESTAURANT			OTHER	CASH	CREDIT CARO	OTHER	

THIS AMOUNT WILL BE
CASH ❑
CHEQUE ❑

CHARGED TO
COMPANY ❑
PERSONAL ❑

VISA ❑
AMERICAN EXPRESS ❑

MASTERCARD ❑

CREDIT CARO
NO. ______

Registration card and **guest** folio

ROOM NO.	NAME	GUESTS
	MR. JAMES	

№ 528

STREET ADDRESS	27 CAIRNS AVENUE
CITY	WINNIPEG

MAKE OF CAR	LICENSE NO	PROVINCE OR STATE
FORD	JKX 523	MANITOBA

OAT' OF ARRIVAL	"ATE OF DEPARTURE

DATE	CHARGES							RECEIPTS			BALANCE
	ROOMS	TAX	**TELEPHONE**	**RESTAURANT**			OTHER	*CASH*	CREDIT CARO	OTHER	

THIS AMOUNT WILL **BE**
CASH ❑
CHEQUE ❑

CHARGED TO
COMPANY D
PERSONAL O

VISA ❑
AMERICAN EXPRESS ❑
MASTERCARD ❑

CREDIT CARD
NO ____________________

Registration card and guest folio

ROOM NO.	NAME	GUESTS
	MR. AND MRS. WHITE	

Nº 529

STREET ADDRESS 1025 DORCHESTER BLVD.

"TM ON TREAL

MAKE OF CAR	LICENSE NO.	PROVINCE OR STATE
HONDA	539 271	QUEBEC

DATE OF ARRIVAL	OATE OF OEPARTURE

OATE	CHARGES							RECEIPTS			BALANCE
	ROOMS	TAX	TELEPHONE	RESTAURANT			OTHER	CASH	CREDIT CARO	OTHER	

THIS AMOUNT WILL BE
CASH ☐
CHEQUE ☐

CHARGED TO
COMPANY ☐
PERSONAL ☐

VISA ☐
AMERICAN EXPRESS ☐
MASTERCARD ☐

CREDIT CARO
NO ____________________

Please fold out for daily transcript
and cash receipts/sales journal →

General ledger

ACCOUNT No. 101 SHEET NO.
NAME BANK OPERATING ACCOUNT TERMS
ADDRESS RATING

DATE		DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE

ACCOUNT No. 170 SHEET No.
NAME FURNITURE AND EQUIPMENT TERMS
ADDRESS RATING

DATE		DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE

ACCOUNT No. 253 SHEET No.
NAME SALES TAX COLLECTED TERMS
ADDRESS RATING

DATE		DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE

ACCOUNT No. R-300 SHEET No.
NAME REVENUE GUEST ROOMS TERMS
ADDRESS RATING

DATE		DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE

ACCOUNT No. T-300 SHEET No.
NAME REVENUE TELEPHONE CALLS TERMS
ADDRESS RATING

DATE		DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE

ACCOUNT No. G-500 SHEET No.
NAME REVENUE - GIFT SHOP TERMS
ADDRESS RATING

DATE		DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE

◄—— Please fold out for cash disbursements journal

General ledger (cont.)

ACCOUNT No. 7 - - 4 0 0 SHEET No.
NAME COST OF TELEPHONE CAUS TERMS
ADDRESS RATING

DATE		DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE

ACCOUNT NO. R 500 SHEET No.
NAME ROOMS - SALARIES AND WAGES TERMS
ADDRESS RATING

DATE		DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE

ACCOUNT No R S 30 SHEET No.
NAME ROOMS - CLEANING SUPPLIES AND EXPENSES TERMS
ADDRESS RATING

DATE		DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE

ACCOUNT No. 690 SHEET No.
NAME ERTISING TERMS
ADDRESS RATING

DATE		RESCRIPT, ON	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE

ACCOUNT No 778 SHEET No
NAME PROPERTY OPERATION AND MAINTENANCE - SUPPLIES TERMS
ADDRESS RATING

DATE		DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE

ACCOUNT No. 792 SHEET No.
NAME ERG OSTS FUEL TERMS
ADDRESS RATING

DATE		DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE
				1				

Please fold out for work sheet →

NOTES

answers to self-test questions -2

1. b	2. d	3. c	4. c	5. b	6. a	7. e	8. d
9. e	10. c	11. b	12. c	13. a	14. c	15. d	

3

ACCOUNTING AND RATIO ANALYSIS

making the numbers talk . . .

Understanding financial statements and being able to interpret them is an essential part of sound financial management. Without this knowledge and ability, you cannot hope to run your hotel/motel successfully.

So what can financial statements tell you? First of all, the balance sheet can demonstrate the liquidity of your hotel/motel, and this will play a major part in your ability to raise new money. It can also show how effectively you are using your inventories, and how well you are turning your accounts receivable into cash. The income statement can show you how profitable your business is. And if it is organized by departments (rooms, food, beverages, etc.), it can also show you which department is generating the most profit, and which is generating the least profit (or even showing a loss). Furthermore, some of the supplementary statements, such as the statement of changes in financial position, can show you how your company's assets, liabilities and owners' equity are changing from one period to another.

However, before you can extract this kind of information from your financial statements, you have to be able to interpret them. That's what this chapter is all about. We will explain the main components that make up each of the four financial statements that are of particular interest to you, and then we will illustrate how to use them to measure the performance of your hotel/motel and its various departments. That means we will examine the four financial statements and then interpret them through the technique of ratio analysis.

Users of financial statements

Before we get into the financial statements themselves, we should point out that people other than you will want to use them. For example, any one of the following may have occasion to examine your financial statements:

- Department heads within your hotel/motel. They will want to examine the statements to see if their departments are operating profitably, and to see if they have any major trouble areas.
- Existing owners. They will want to know what kind of profit the hotel/motel is making; what kind of return it is generating; whether it can meet its obligations; and so on.
- Potential new owners. They will want to know if they should invest in the hotel/motel; how much the operation is worth; what portion they should acquire; and so on.
- Creditors. They will want to know if they should lend money to your hotel/motel, and if they should extend it credit.
- Revenue Canada and provincial tax authorities. Officials will want to know if the hotel/motel is paying its taxes and if it is conforming to the numerous tax rules and regulations.

In spite of all this, the financial statements must primarily be of use to you. They must perform the functions that you want them to perform.

Too often, financial statements used by small and medium-sized hotel/motels in Canada are of limited value only. That's because the income statements are not broken down according to departments (rooms, food, beverages, etc.), and because the statements are not prepared according to the uniform system of accounts described in Chapter 2. Remember: Your financial statements must serve your needs.

Let's now look at the four financial statements.

The balance sheet

The balance sheet (like the other financial statements, it was described in Chapter 1) gives you a summary of your assets, liabilities and owners' equity at a particular point in time. You can think of it as a snapshot of your operation - one that freezes it at that particular time.

In a standard balance sheet, the assets of the operation are shown on the left hand side, while both the liabilities and owners' equity are shown on the right hand side (see Figure 22). The dollar totals of the two sides are always equal, because the two sides are really just two views of the same thing. The assets show all the items that the business owns, while the liabilities and owners' equity show how those assets were financed. Everything a business owns has been supplied either by the creditors or by the owners. Therefore, the total claims of the creditors plus the claims of the owners must equal the total assets of the business.

Assets

All assets have two characteristics in common:

- The business has title to the asset (ie., it owns the asset).
- The asset must exist.

Assets can be broken down into the two categories defined in Chapter 1:

- Current assets.
- Fixed assets.

All fixed assets (except for land) normally decrease in value, because of wear and tear and/or obsolescence. This decrease in value is called depreciation, and the total depreciation is called *accumulated depreciation*.

FIGURE 22 **Sample** balance sheet

as at ______ , 19 ___

ASSETS				LIABILITIES AND OWNERS' EQUITY	
Current assets				Current liabilities	
Cash		$		Accounts payable	$
Accounts receivable				Taxes payable	
Inventory		______		Sales tax payable	______
Total current assets		______		Total current liabilities	______
Fixed assets	cost	Accumulated depreciation	Net book value	Long-term liabilities	
				Loan payable	$
				Mortgage payable	______
Land	$		$	Owners' equity	______
Land improvements					
Building					
Furniture, fixtures and equipment	______	______	______		
Total	______	______	______		
Total assets			$ ______	Total liabilities and owners' equity	$ ______

The *net book value* of an asset is calculated by subtracting the accumulated depreciation from the purchase cost. The *replacement value* is the cost of purchasing the asset today. It may or may not be equal to the net book value.

Assets are always recorded on the balance sheet at their original purchase cost, even though their current market value may be significantly greater than or less than this amount. This basic accounting principle is used simply because it would not be practical to determine the replacement value of every asset every year.

Liabilities

All liabilities have the following two characteristics:

- The business received either goods or services (or both).
- The company has not paid for the goods or the services (or both).

As with assets, liabilities can be broken into two categories:

- Current liabilities.
- Long-term liabilities.

These were defined in Chapter 1.

Owners' equity

Owners' equity is simply that portion of the operation that belongs to the owners. It is equal to the assets minus the liabilities, and it may be calculated at any point in time as follows:

Owners' original investment
Plus accumulated retained earnings (if positive)
Plus additional equity investments by owners
Minus accumulated retained earnings (if negative)
Minus owners' drawings to date
Equals owners' present equity.

What this calculation is saying is simply that the owners' equity increases either when money is ploughed back into the business (ie., earnings are retained) or when the owners make additional investments in the business; and that the owners' equity decreases either when the business shows a loss or when the owners take money out of it.

The income statement

The income statement shows the revenues and expenses of your hotel/motel over a specified period of time, and by subtracting one from the other, it also shows your net income (or loss). A major difference between the income statement and the balance sheet is that the balance sheet applies to a single specific day, whereas the income statement covers a specific period of time, such as three, six, nine or twelve months.

The elements of the income statement were described in Chapter 1, but here again is a brief run-down of the major ones.

Revenues

The revenues of your hotel/motel represent the total sales from rooms, food, beverages, telephone and all other departments and income sources. Your revenues should be allocated among the different departments, in line with the uniform system of accounts described in Chapter 2.

Expenses

These include your day-to-day operating expenses, fixed charges, depreciation and income taxes. Like your revenues, your expenses should be allocated according to the uniform system of accounts. This means you should divide both your revenues and your expenses using either the chart of accounts for a full-service hotel/motel (Figure 2) or the chart of accounts for a rooms-only hotel/motel (Figure 3), plus the expense dictionary (Figure 4).

Net income (loss)

This is simply the difference between your revenues and expenses.

An example of an income statement for a full-service hotel/motel is shown in Figure 23. And an example of an income statement for a rooms-only hotel/motel is shown in Figure 24.

Looking at Figure 23, you can see that the three main components of an income statement can be further divided. For example, operating expenses can be broken down into three main categories:

- *Cost of sales.* This includes the cost of food, beverages, telephone service and any other items sold to guests.
- *Departmental expenses.* These cover the salaries, wages, employee benefits and other expenses incurred in running the various departments.
- *Undistributed operating expenses.* These include the expenses that cannot be assigned to the various departments. There are four types of undistributed operating expenses - administrative and general; marketing; property operation and maintenance; and energy costs.

FIGURE 23 Sample income statement for full-service hotel/motel

______ MONTHS ENDED ______ 19 _

Year to date			Current month	
Actual	Budget	REVENUES	Actual	Budget
$ ______	______	Rooms	$ ______	$ ______
______	______	Food	______	______
______	______	Beverages	______	______
______	______	Telephone	______	______
______	______	Gift Shop	______	______
______	______	Other income	______	______
______	______	Total revenues	______	______
		COST OF SALES		
______	______	Food	______	______
______	______	Beverages	______	______
______	______	Telephone	______	______
______	______	Gift shop	______	______
______	______	Total cost of sales	______	______
		DEPARTMENTAL EXPENSES	______	______
______	______	Rooms	______	______
______	______	Food and beverages	______	______
______	______	Telephone	______	______
______	______	Gift shop	______	______
______	______	Total departmental expenses	______	______
______	______	DEPARTMENTAL INCOME	______	______
		UNDISTRIBUTED OPERATING EXPENSES		
______	______	Administrative and general	______	______
______	______	Marketing	______	______
______	______	Property operation and maintenance	______	______
______	______	Energy costs	______	______
______	______	Total undistributed operating expenses	______	______
______	______	INCOME BEFORE FIXED CHARGES	______	______
		FINANCIAL AND OTHER EXPENSES		
______	______	Rent	______	______
______	______	Municipal taxes	______	______
______	______	Insurance (buildings and contents)	______	______
______	______	Interest	______	______
______	______	Total	______	______
______	______	INCOME BEFORE DEPRECIATION	______	______
______	______	Depreciation	______	______
______	______	INCOME BEFORE INCOME TAXES	______	______
______	______	Income taxes	______	______
$ ______	$ ______	NET INCOME	$ ______	$ ______

FIGURE 24 Sample income statement for rooms-only hotel/motel

________ MONTHS ENDED ________ 19 —

Year to date Actual	Year to date Budget		Current month Actual	Current month Budget
		Revenues		
$ ______	$ ______	Guest rooms	$ ______	$ ______
______	______	Telephone	______	______
______	______	Other income	______	______
______	______	Total revenues	______	______
		OPERATING EXPENSES		
______	______	Salaries and wages	______	______
______	______	Employee benefits	______	______
______	______	Direct operating expenses	______	______
______	______	Administrative and general	______	______
______	______	Marketing	______	______
______	______	Property operation and maintenance	______	______
______	______	Energy costs	______	______
______	______	Total operating expenses	______	______
______	______	INCOME BEFORE FIXED CHARGES	______	______
		FINANCIAL AND OTHER EXPENSES		
______	______	Rent	______	______
______	______	Municipal taxes	______	______
______	______	Insurance (buildings and contents)	______	______
______	______	Interest	______	______
______	______	Total	______	______
		INCOME BEFORE DEPRECIATION		
______	______	Depreciation	______	______
______	______	INCOME BEFORE INCOME TAXES	______	______
______	______	Income taxes	______	______
$ ______	$ ______	NET INCOME	$ ______	$ ______

In the income statement for a rooms-only hotel/motel (Figure 24), there is usually little value in departmentalizing the expenses, so there is only one category. Under the heading of "operating expenses" are salaries and wages, employee benefits, direct operating expenses (eg., room supplies, guest room, laundry costs, etc.), administrative and general, marketing, property operation and maintenance, and energy costs.

Now here are the other main elements of the income statement, and what they represent.

- *Departmental income.* This is one of the measures of profitability used by full-service hotel/motels. It is the difference between total revenues and the combined value of the total cost of sales and total departmental expenses.

- *Income before fixed charges.* This is sometimes referred to as gross operating profit. It is the difference between total revenues and total operating expenses.
- *Financial and other expenses.* The financial and other expenses cannot normally be controlled in the short-run. Consequently, they are classified as non-operating expenses or fixed charges. They include rent, municipal taxes, insurance on buildings and contents and interest charges.
- *Income before depreciation.* This represents the difference between total revenues and the combined value of total operating expenses and financial and other expenses.
- *Depreciation.* As stated earlier, depreciation represents the loss in value of fixed assets due to wear and tear and/or obsolescence. (If the income statement is being prepared for income tax return purposes, the depreciation expenses must not exceed the capital cost allowances.)
- *Income before income taxes.* This represents the differences between total revenues and the combined value of total operating expenses, total financial and other expenses, and total depreciation expenses.

The statement of retained earnings

The retained earnings statement, as explained in Chapter 1, shows changes in your retained earnings over a specified period of time. Also, it links the balance sheet and the income statement, as shown in the following example.

Suppose at the end of year 1, your owners' equity is $19,000. This would show up in the balance sheet. Suppose, too, that your retained earnings at the end of year 1 are $2,000. This would show up in the retained earnings statement. Now suppose that your net income for year 2 is $5,000. This would show up in the income statement. Of this amount, assume that $1,450 is paid out in dividends. That leaves $3,55o in retained earnings at the end of year 2, which would show up in your retained earnings statement for year 2.

If you added this amount to the retained earnings of year 1 and the owners' equity at the end of year 1, you would get the owners' equity at the end of year 2. The calculation would look like this:

Owner's equity at end of year 1	$19,000
+	+
Retained earnings at end of year 1	2,000
+	+
Retained earnings at the end of year 2 (net income - dividends)	3,550
Owners' equity at end of year 2	24,550

The statement of changes in financial position

The statement of changes in financial position is a supplementary statement to the balance sheet. It reflects the transactions that have changed your financial position - ie., affected your assets, liabilities and owners' equity - over a specified period of time. (It used to be called the statement of source and application of funds or the statement of source and use of cash.)

To prepare this statement, you simply compare the balance sheets of two successive periods, and calculate the differences between the assets, liabilities and owners' equity for the two periods.

In effect, the statement shows how you have used your financial resources (or funds), and how you have acquired new resources (or funds) from various sources. As a rule, sources of funds (or cash) are represented by decreases in the value of assets and by increases in the value of liabilities and owners' equity. Uses of funds, on the other hand, are represented by increases in the value of assets and by decreases in the value of liabilities and owners' equity.

The net change in funds (or cash) during the two consecutive periods must equal the difference between the total value of sources of funds and the total value of uses of funds.

The statement of changes in financial position has several uses. For example, it shows the trend in the mix of short-term and long-term financing; and it indicates if your hotel/motel is expanding too rapidly, to the point where its financing is becoming strained. We will have more to say about this statement in Chapter 7.

Ratio analysis

Theoretically, that completes the section on accounting, which (as the chart at the back of this book shows) consists of the preparation of financial statements. You really don't need to know anything more about it. However, the financial statements are only of value to you if you analyze and interpret them. That's where ratio analysis comes in; it is a technique that allows you to extract vital information from your financial statements.

Ratio analysis simply expresses, as ratios, different sets of numbers contained in the financial statements. Four groups of ratios are generally prepared. Each one gives you different information as follows:

- *Liquidity ratios.* They tell you if you will be able to meet your short-term obligations to creditors.
- *Leverage ratios.* They tell you if long-term lenders are adequately protected by your fixed assets.
- *Activity ratios.* They tell you how effectively you are using your assets.

FIGURE 25 Ratio analysis of a hotel/motel

LIQUIDITY RATIOS		
Current ratio	$= \dfrac{\text{Current assets}}{\text{Current liabilities}}$	Should be 2:1 or slightly higher
Acid test ratio	$= \dfrac{\text{Cash + Accounts receivable + Marketable securities}}{\text{Current liabilities}}$	Should be 1:1 or slightly higher
LEVERAGE RATIOS		
Debt-to-total-assets ratio	$= \dfrac{\text{Total liabilities}}{\text{Total assets}}$	No rule-of-thumb
Debt-equity ratio	$= \dfrac{\text{Total long-term liabilities}}{\text{Total owners' equity}}$	Should not be higher than 3:1
Times interest earned	$= \dfrac{\text{Income before income taxes and interest expenses}}{\text{Interest expenses}}$	As high as possible, but no rule-of-thumb
Fixed charge coverage	$= \dfrac{\text{Income before income taxes and fixed charges}}{\text{Fixed charges}}$	As high as possible, but no rule-of-thumb
ACTIVITY RATIOS		
Food inventory turnover	$= \dfrac{\text{Total cost of food sold}}{\text{Average food inventory}}$	No rule-of-thumb
Beverages inventory turnover	$= \dfrac{\text{Total cost of beverages sold}}{\text{Average beverage inventory}}$	No rule-of-thumb
Accounts receivable to total revenues	$= \dfrac{\text{Accounts receivable}}{\text{Total revenues}}$	No rule-of-thumb
Average collection period	$= \dfrac{\text{Accounts receivable}}{\text{Average daily revenues}}$	No rule-of-thumb (depends on level of credit and mix of clientele served by hotel/motel; may range from one-five days)
Fixed asset turnover	$= \dfrac{\text{Total revenues}}{\text{Total fixed assets}}$	No rule-of-thumb
PROFITABILITY RATIOS		
Return on owners' equity	$= \dfrac{\text{Net income}}{\text{Owners' equity}}$	No rule-of-thumb
Return on total assets	$= \dfrac{\text{Income before interest and income taxes}}{\text{Total assets}}$	No rule-of-thumb
Net return on total assets	$= \dfrac{\text{Net income}}{\text{Total assets}}$	No rule-of-thumb
Profit margin	$= \dfrac{\text{Net income}}{\text{Total revenues}}$	No rule-of-thumb

- *Profitability ratios.* They tell you how profitable your operation has been, and whether or not you are earning an equitable return on your investment.

Figure 25 shows the main ratios in each of the four groups, and the way they are calculated. Since hotel/motels are so different from one another, benchmark ratios or rules-of-thumb can be misleading. However, where appropriate, the third column of Figure 25 shows you the ratios you should be aiming for.

Example of ratio analysis

To show you an example of ratio analysis in operation, we have drawn up a balance sheet and an income statement for a rooms-only motel, called the Maple Leaf Motel. The balance sheet is shown in Figure 26, and the income statement is shown in Figure 27. (Since we're dealing with a rooms-only motel, the income statement is patterned after the one shown earlier in Figure 24.)

Using the numbers contained in the two financial statements, you can now calculate the ratios shown in Figure 28. (Since the Maple Leaf Motel is a rooms-only motel, there is no food inventory turnover and no beverages inventory turnover (ie., these two activity ratios do not apply in this case).

FIGURE 26 **Maple** Leaf Motel balance sheet

as at ________ , 1 9 _

ASSETS

Current assets			
Cash			$1,300
Accounts receivable			200
Inventory			250
Total current assets			$1,750
Fixed assets	cost	Accumulated depreciation	Net book value
Land	$ 60,000	$ -	$ 60,000
Land improvements	10,000	2,000	8,000
Building	100,000	10,000	90,000
Furniture, fixtures and equipment	20,000	2,000	18,000
Total	190,000	14,000	176,000
Total assets			$177,750

LIABILITIES AND OWNERS' EQUITY

Current liabilities	
Accounts payable	$ 100
Taxes payable	800
Sales tax payable	300
Total current liabilities	1,200
Long-term liabilities	
Loan payable	5,000
Mortgage payable	150,000
	155,000
Total liabilities	$156,200
Owners" equity	21,550
Total liabilities and owners' equity	$177,750

FIGURE 27 Maple Leaf Motel income statement

for the period ended ________ ,19____

REVENUES		FINANCIAL AND OTHER EXPENSES	
Guest rooms	$72,000	Municipal taxes	2,250
Telephone	2,500	Insurance	1,500
Other income	500	Interest	15,800
Total revenues	$75,000	Total financial and other expenses	$19,550
		Income before depreciation	$20,950
OPERATING EXPENSES		Depreciation	$14,000
Salaries and wages	$18,000	Income before income taxes	$ 6,950
Employee benefits	2,000	Income taxes	$ 1,950
Direct operating expenses	3,000	Net income	**$ 5,000**
Administrative and general	2,500		
Marketing	2,625		
Property operation and maintenance	3,375		
Energy costs	3,000		
Total operating expenses	$34,500		
Income before fixed charges	$40,500		

FIGURE 28 Ratio analysis of Maple Leaf Motel

Liquidity ratios

Current ratio $= \frac{1,750}{1,200} = 1.46$

Acid test ratio $= \frac{1,300 + 200}{1,200} = 1.25$

Leverage ratios

Debt-to-total-assets ratio $= \frac{156,200}{177,750} = 0.88$

Debt-equity ratio $= \frac{155,000}{21,550} = 7.19$

Times interest earned $= \frac{6,950 + 15,800}{15,800} = 1.44$

Fixed charge coverage $= \frac{6,950 + 15,800 + 2,250 + 1,500}{19,550} = 1.35$

Activity ratios

Accounts receivable to total revenues $= \frac{200}{75{,}000} = 0.003$

Average collection period $= \frac{200}{\frac{75{,}000}{365}} = 0.97$ days

Fixed asset turnover $= \frac{75{,}000}{176{,}000} = 0.43$

Profitability ratios

Return on owners' equity $= \frac{5{,}000}{21{,}550} = 0.23$ (or 23%)

Return on assets $= \frac{6{,}950 + 15{,}800}{177{,}750} = 0.13$ (or 13%)

Net return on assets $= \frac{5{,}000}{177{,}750} = 0.028$ (or 2.8%)

Profit margin $= \frac{5{,}000}{75{,}000} = 0.067$ (or 6.7%)

Key points in review

After studying Chapter 3, you should be able to:

- Explain what financial statements can tell you about a business.
- Identify the potential users of financial statements.
- Describe the contents and the functions of the balance sheet, income statement, statement of retained earnings and the statement of changes in financial position.
- Identify the liquidity ratios, leverage ratios, activity ratios and profitability ratios.
- Calculate the ratios when given a balance sheet and an income statement.
- Know when some of these ratios are too high or too low.
- Define or explain all the key terms that appear in italics.

The self-test questions and working examples that follow will help you grasp these points. In particular, they will help you see how to use the various ratios once you have calculated them.

SELF-TEST QUESTIONS -3

(answers on last page this chapter)

1. The five types of users of financial statements are:
   a. Banks, universities, Revenue Canada, creditors and existing owners.
   b. Creditors, Revenue Canada, existing owners, potential owners and department heads.
   c. Bookkeepers, universities, Revenue Canada, existing owners and creditors.
   d. Revenue Canada, existing owners, creditors, department heads and night auditors.
   e. None of the above.
2. Which of the following can be established by reviewing the financial statements of a business?
   a. The changes in the business' financial position from one period to another.
   b. How effectively inventories have been used.
   c. How profitable the business has been.
   d. The business' liquidity, solvency and ability to borrow money.
   e. All of the above.
3. The balance sheets shows:
   a. The financial position of a business at a certain point in time.
   b. The financial activity of a business during a certain period of time.
   c. Assets, liabilities, owners' equity, revenues and expenses.
   d. The operating efficiencies of various departments.
   e. None of the above.
4. Net book value is equal to:
   a. The purchase cost of a fixed asset less accumulated depreciation.
   b. The purchase cost of a current asset less accumulated depreciation.
   c. The value of overdue accounts receivable shown in a business' books.
   d. The loss in the value of the dollar from one year to the next.
   e. None of the above.
5. The three categories of operating expenses found in a hotel/motel are:
   a. Income taxes, depreciation and departmental expenses.
   b. Undistributed operating overhead, departmental expenses and financial and other expenses.
   c. Cost of sales, undistributed operating overhead and departmental expenses.
   d. Cost of sales, departmental expenses and depreciation.
   e. None of the above.
6. Net income equals:
   a. Total revenues less total operating expenses.
   b. Income before income taxes less income taxes and the repayment of principal.
   c. Income before fixed charges less depreciation and income taxes.
   d. Total revenues less the combined value of total operating expenses, total financial and other expenses, total depreciation expenses and total income taxes.
   e. None of the above.
7. The financial and other expenses category includes:
   a. Depreciation, interest charges, rent, municipal taxes. insurance on buildings and contents, and repayment of principal.
   b. Undistributed operating overhead, interest charges, municipal taxes and insurance on buildings and contents.
   c. Administrative and general, marketing, property operation and maintenance, and energy costs.
   d. Interest charges, rent, municipal taxes and insurance on buildings and contents.
   e. All of the above.
8. In a full-service hotel/motel, **wages**, salaries and employee benefits are:
   a. Accumulated in one central account referred to as wages, salaries and employee benefits.
   b. Allocated to the various operating departments.
   c. Recorded in the purchases journal.
   d. Never paid out on a weekly basis.
   e. None of the above.
9. Assets are always recorded on the balance sheet:
   a. At their current market value.
   b. At their current market value less accumulated depreciation.
   c. At their replacement value.
   d. At their original purchase cost.
   e. None of the above.

10. Departmental income represents:
    a. Total revenues less the combined value of total cost of sales and total departmental expenses.
    b. A business' gross operating profit.
    c. Income before income taxes plus depreciation.
    d. The revenues earned by an operating department.
    e. None of the above.

11. Depreciation expenses must:
    a. "Be deducted from net income to arrive at cash flow.
    b. Always equal capital cost allowances.
    c. Be deducted from an asset's market value to give its net book value.
    d. Not exceed the capital cost allowances.
    e. All of the above.

12. The net change in funds (or cash) during two periods of time is:
    a. Always an indication of the changes in a business' working capital.
    b. Always equal to the difference between the total value of sources and the total value of uses of funds (or cash).
    c. Always an indicator of a business' profitability.
    d. Always shown in the general journal.
    e. None of the above.

13. Current assets include:
    a. Accounts receivable, owners' equity and cash.
    b. Inventories, accounts receivable, owners' equity and cash.
    c. Cash, inventories, marketable securities, prepaid expenses and accounts receivable.
    d. Cash, inventories, marketable securities, prepaid expenses and accounts payable.
    e. All of the above.

14. Which of the following ratios shows a business' liquidity?
    a. Average collection period.
    b. Fixed asset turnover.
    c. Accounts receivable to total revnues.
    d. Current ratio.
    e. Debt-equity ratio.

15. An acid test ratio of 1:1 is:
    a. A desirable ratio for most hotel/motels.
    b. Too low for most hotel/motels.
    c. Calculated by dividing current liabilities into accounts receivable.
    d. Too high for most hotel/motels.
    e. None of the above.

WORKING EXAMPLE -3

Two examples are presented here:

1. Background

You have just bought the Beach Lodge for a purchase price of $195,000. That price has been allocated as follows:

Land	$ 80,000
Building	80,000
Furniture and fixtures	35,000
	$195,000

You financed your purchase by investing $50,000 of your own money and by obtaining a long-term mortgage of $145,000 from a trust company. In addition, you have negotiated a short-term loan of $5,ooO with your local bank to cover on-going expenses. The loan is to be repaid in full within six months. The money is now in the Beach Lodge's chequing account at the bank.

Task

Prepare a balance sheet for the Beach Lodge, applicable to the first day of operation under your ownership.

2. Background

The Frontier Resort is a 20-unit hotel/motel with a 40-seat coffee shop. It operates from May to October each year (ie., for six months). As the owner-manager, you have just received a balance sheet and an income statement for the fiscal year ending December 31, 1985. These are shown in Figures 29 and 30 respectively.

Task

Using ratio analysis, evaluate the performance of the Frontier Resort during 1985, so that you can answer the questions:

- Should you be satisfied with your investment?
- Would a creditor be willing to extend you credit?

As a guideline, consider using the following ratios: profitability ratios (return on owners' equity, return on total assets, net return on total assets and profit margin); liquidity ratios (current ratio); and leverage ratios (debt-to-total-assets ratio, debt-equity ratio and times interest earned).

Solutions to these two examples can be found following Chapter 10.

FIGURE 29 Frontier Resort balance sheet

as at December 31, 1985

ASSETS	1985	1984	LIABILITIES	1985	1984
Current assets	$ 10,000	$ 18,000	Current liabilities	$ 18,000	$ 18,000
Fixed assets			Long-term liabilities		
Land	$100,000	100,000	Mortgage payable	87,000	102,500
Buildings and fixtures	30,000	37,500			
Total	130,000	137,500	Owners' equity	35,000	35.000
Total assets	$140,000	$155,500	Total liabilities and owners' equity	$140,000	$155,500

FIGURE 30 Frontier **Resort** income statement

for the year ended December 31, 1985

	1985	1984
REVENUES		
Rooms	$57,880	$60,282
Food	26,750	28,087
Telephone	2,400	2,283
Rentals and miscellaneous income	750	684
Total revenues	87,780	91,336
OPERATING EXPENSES		
Wages, salaries and employee benefits	27,866	29,227
ROOMS EXPENSE		
Cleaning supplies and expenses	486	379
Guest supplies	700	651
Laundry	509	433
Linen	164	144
Uniforms		39
Miscellaneous	488	162
Total	2,347	1,808
COST OF FOOD AND OTHER ITEMS PURCHASED FOR RESALE	17,370	16,852
ENERGY COSTS		
Electricity	1,290	1,176
Fuel	3,210	2,646
Water	430	328
Total	4,930	4,150

Figure 30 (cont.)

PROPERTY OPERATION AND MAINTENANCE	111	51
Accounting and legal	596	438
Advertising and sales promotion	2,170	1,863
Insurance	767	767
Printing, stationery and postage	410	328
Office telephone	3,211	3,036
Travel expense	760	986
Miscellaneous	420	356
Total	8,334	7>774
TOTAL OPERATING EXPENSES	60,958	59,862
INCOME BEFORE FIXED CHARGES	26,822	31,474
FINANCIAL AND OTHER EXPENSES		
Mortgage interest	16,000	16,250
Municipal taxes	3,500	3,000
Total financial and other expenses	19,500	19,250
INCOME BEFORE DEPRECIATION	$ 7,322	$12,224
Depreciation	6,000	7,500
INCOME BEFORE INCOME TAXES	$ 1,322	$ 4,724
Income taxes	331	1,181
NET INCOME	$ 991	$ 3,543

NOTES

answers to self-test questions -3

1. b	2. e	3. a	4. a	5. c	6. d	7. d	8. b
9. d	10. a	11. d	12. b	13. c	14. d	15. a	

4

OPERATIONAL AND BREAK-EVEN ANALYSIS

measuring your rate of financial success. . .

In this chapter, we examine two other analysis techniques - operational analysis and break-even analysis. Our purpose is to explain how you can use these techniques to evaluate the efficiency, productivity and profitability of your hotel/motel (the function of operational analysis), and to determine the prices of rooms, food, beverages, etc., which will give you the maximum profit (the function of break-even analysis).

Operational analysis

Operational analysis draws not only on your financial statements to measure your degree of financial success, but also on other information sources that relate directly to the operations of your hotel/motel. It doesn't just look at the numbers; it also looks at the way your business works. For this reason, it can give you a clear picture of your efficiency, productivity and profitability. It might therefore be said that ratio analysis produces broad measures of profitability, whereas operational analysis delves more deeply into your hotel/motel's operations to find the reasons behind those broad measures.

Specifically, operational analysis goes further than ratio analysis in two main areas:

- It examines profitability on a department-by-department basis.
- It relates revenues and expenses to the major resources of the hotel/motel (rooms, restaurant seats, bar seats, etc.) and to volumes of activity (occupied room nights, covers served, etc.).

A simple example can demonstrate the importance of these two points. Let's assume the Mountain Motel had total room revenues of $57,600 in year 1 compared with $72,000 in year 2. Its direct operating expenses for rooms were $20,160 and $23,000 respectively.

Mountain Motel

	Year 1		Year 2	
Room revenues	$57,600	100%	$72,000	100%
Direct operating expenses	20,160	35	23,000	32
Room income	$37,440	65%	$49,000	68%

In an initial evaluation of these figures, it seems that the Mountain Motel was more efficiently operated in year 2 than in year 1, since profits were up (to $49,000 from $37,440) and the operating expenses percentage was down (to 329o from 3590). However, if we now introduce the fact that the volumes of activity (ie., the number of occupied room nights) remained unchanged from year 1 to year 2, we cannot be so confident about saying that the motel was more efficiently operated. Assuming that 2,400 occupied room nights were recorded in both years, the average cost per occupied room night in year 2 (roughly $9.58) was actually higher than in year 1 ($8.40).

The primary benefit of operational analysis, therefore, is that it provides more in-depth information to help you operate your hotel/motel more efficiently and more profitably. It does this by pinpointing problem areas, which are usually caused by ineffective pricing, increasing costs (due to deteriorating employee productivity, waste, etc.) and by falling demand (or volume).

There are several operational ratios commonly used by hotel/motels. All of them draw on the income statement (the only financial statement used here) and on two management information reports: the *manager's daily report,* and the *food and beverage daily report.* Examples of these two reports for a full-service hotel/motel are shown in Figures 31 and 32 respectively. Figure 33 lists the commonly used operational ratios. As you can see, there are three groups of ratios:

- *Rooms department ratios.*
- *Food and beverage department ratios.*
- *Other department ratios.*

FIGURE 31 Example of a manager's daily report for full-service hotel/motel

Weather ______________________

____

____

Date ______________________

Week ending ______________________

Period ______________________

	Sales					Cost of sales		
	Actual				Budget	Beverage		Food
	For day	For week	Period to date		For entire period	For week	For month	For month
			This year	Last j ear				
Rooms								
Guests								
Public								
Subtotal								
Food								
Dining room								
Banquets								
Cocktail lounge								
Subtotal								
Beverage								
Dining room								
Cocktail lounge								
Banquets								
Subtotal								
Total food and beverage								
Total revenues								

						Group rooms for the day				
Telephone										
						Name	Suites	Single	Double	Total $
Other										
Total sales										

Room statistics	For day		Period to date	
	This year	Last year	This year	Last year
Occupied				
Complimentary				
Vacant				
Available				
Unavailable				
Occupancy %				
Number of guests				
Double occupancy				
Average rate/room				
Average rate/guest				

Bank balance this morning	
Yesterday's cash receipts	
Yesterday's A/R collection	
Total cash receipts	
Less: Yesterday's cash paid out	
Today's deposit	
Yesterday's opening bank balance	
Less: Yesterday's cheques issued	
Numbers To	
Today's opening bank balance	
Prepared by:	
Approved by:	

FIGURE 32 Example of a food and beverage daily report for a full-service hotel/motel

	Sales			Service			
	For day	Period to dale		No. covers (meals) served	Average check	No. staff on duty	No. covers per staff
		This year	Last year				
Breakfast							
Dining room							
Banquets							
Subtotal							
Lunch							
Dining room							
Food							
Beverage							
Subtotal							
Banquets							
Food							
Beverage							
Subtotal							
Cocktail lounge							
Food							
Beverage							
Subtotal							
Subtotal							
Dinner							
Dining room							
Food							
Beverage							
Subtotal							
Banquets							
Food							
Beverage							
Subtotal							
Cocktail lounge							
Food							
Beverage							
Subtotal							
Subtotal							
Total							

FIGURE 33 Operational ratios commonly used by hotel/motels

Rooms department ratios		
Occupancy percentage	=	$\dfrac{\text{Occupied room nights} \times 100}{\text{Available room nights}}$
Double occupancy factor	=	$\dfrac{\text{Number of guests}}{\text{Occupied room nights}}$
Average rate per occupied room night	=	$\dfrac{\text{Room revenues}}{\text{Occupied room nights}}$
Cost per occupied room night	=	$\dfrac{\text{Direct rooms department operating expenses}}{\text{Occupied room nights}}$
Rooms department efficiency percentage	=	$\dfrac{\text{Rooms department income} \times 100}{\text{Room revenues}}$
Food and beverage department ratios		
Ratio of food and beverage revenues to room revenues	=	$\dfrac{\text{Food and beverage revenues}}{\text{Room revenues}}$
Seat turnover	=	$\dfrac{\text{Number of covers}}{\text{Number of seats}}$
Revenues per seat	=	$\dfrac{\text{Food and beverage revenues}}{\text{Number of seats}}$
Average check	=	$\dfrac{\text{Food and beverage revenues}}{\text{Number of covers}}$
Food cost percentage	=	$\dfrac{\text{Cost of food sold} \times 100}{\text{Food revenues}}$
Beverage cost percentage	=	$\dfrac{\text{Cost of beverages sold} \times 100}{\text{Beverage revenues}}$
Food and beverage cost percentage	=	$\dfrac{\text{Cost of food and beverages sold} \times 100}{\text{Food and beverage revenues}}$
Food and beverage labour cost percentage	=	$\dfrac{\text{Food and beverage department wages, salaries and employee benefits} \times 100}{\text{Food and beverage revenues}}$
Food inventory turnover	=	$\dfrac{\text{Cost of food sold}}{\text{Average food inventory (\$)}}$
Beverage inventory turnover	=	$\dfrac{\text{Cost of beverages sold}}{\text{Average beverage inventory (\$)}}$
Food and beverage department efficiency percentage	=	$\dfrac{\text{Direct food and beverage department operating expenses} \times 100}{\text{Food and beverage revenues}}$

Figure 33 (cont.)

Other departmental ratios

Telephone charges per occupied room night	=	$\frac{\text{Telephone revenues}}{\text{Occupied room nights}}$
Telephone department efficiency percentage	=	$\frac{\text{Direct telephone department operating expenses} \times 100}{\text{Telephone revenues}}$
Other departmental efficiency percentages	=	$\frac{\text{Direct operating expenses allocated to other departments} \times 100}{\text{Other departments revenues}}$

Example of operational analysis

Now let's look at an example of operational analysis in practice. Figure 34 shows the income statement for the Northern Lodge for the year ending December 31, 1986. Figure 35 shows some other statistical information for the Northern Lodge, all of which is taken from summaries of the manager's daily reports and the food and beverage daily reports, and from the average values of periodic inventories.

Finally, Figure 36 shows the operational ratios for the Northern Lodge, calculated from the information contained in Figures 34 and 35. Under each ratio, we've added a comment to explain what the ratio tells you. Figure 36 is worth studying in some detail, since it shows how revealing operational ratios can be.

FIGURE 34 Northern Lodge income statement

for the year ended December 31, 1986

	1986	1985
REVENUES		
Rooms	$60,000	$53,000
Food	20,500	20,000
Beverage	11,000	10,750
Telephone	2,000	1,750
Other income	400	400
Total revenues	$93,900	$85,900

Figure 34 (cont.)

	1986	1985
COST OF SALES		
Food	8,200	8,400
Beverage	3,300	3,120
Total cost of sales	11,500	11,520
DEPARTMENTAL EXPENSES		
ROOMS		
Wages, salaries and employee benefits	10,800	10,070
Other direct expenses	7,200	6,360
FOOD AND BEVERAGE		
Wages, salaries and employee benefits	12,000	11,800
Other direct expenses	3,150	3,080
Telephone	2,800	2,490
Total departmental expenses	35,950	33,800
DEPARTMENT INCOME	46,450	40,580
UNDISTRIBUTED OPERATING OVERHEAD		
Administrative and general	2,500	2,400
Marketing	2,000	1,900
Property operation and maintenance	3,500	3,100
Energy costs	3,000	2,700
Total undistributed operating overhead	11,000	10,100
INCOME BEFORE FIXED CHARGES	$35,450	$30,480

FIGURE 35 Northern Lodge statistical information

	1986	1985
ROOMS		
Number	12	12
Number of days available	365	365
Number of occupied room nights[1]	3,150	2,865
Total number of guests[1]	5,700	5,800
Number of available room nights[1]	4,380	4,380
FOOD AND BEVERAGE		
Number of seats	25	25
Total number of covers[2]	8,500	8,800
Average food inventory[3]	$410	$480
Average beverage inventory[3]	$550	$575

1 Obtained from the manager's daily report summaries.
2 Obtained from the food and beverage daily report summaries.
3 obtained from averaging the value of periodic inventories.

FIGURE 36 Northern Lodge operational ratios

ROOMS DEPARTMENT RATIOS	1986	1985
Occupancy percentage		
$\frac{\text{Occupied room nights x 100}}{\text{Available room nights}}$ Comment: Shows a healthy increase in rooms occupancy of 6.5% or 285 additional occupied room nights	$\frac{3,150 \times 100}{4,380} = 71.9\%$	$\frac{2,865 \times 100}{4,380} = 65.4\%$
Double occupancy factor		
$\frac{\text{Number of guests}}{\text{Occupied room nights}}$ Comment: Shows a significant decrease in the double occupancy factor. This indicates that a higher proportion of rooms was rented on a single occupancy basis.	$\frac{5,700}{3,150} = 1.81$	$\frac{5,800}{2,865} = 2.02$
Average rate per occupied room night		
$\frac{\text{Room revenues}}{\text{Occupied room nights}}$ Comment: Shows only a modest (3%) increase in the average rate was achieved.	$\frac{\$60,000}{3,150}$ \$19.05	$\frac{\$53,000}{2,865} = \$18.50$
Cost per occupied room night		
$\frac{\text{Rooms, wages. salaries and employee benefits, plus other direct expenses}}{\text{Occupied room nights}}$ Comment: Shows only a tiny improvement in rooms cost efficiency.	$\frac{\$10,800 + \$7,200}{3,150} = \$5.71$	$\frac{\$10,070 + \$6,360}{2,865} = \$5.73$
Rooms department efficiency percentage		
$\frac{\text{Rooms department income x 100}}{\text{Room revenues}}$ Comment: Shows the rooms department was more efficient by 1% in 1986.	$\frac{\$60,000 - (\$10,800 + \$7,200) \times 100}{\$60,000} = 70.0\%$	$\frac{\$53,000 - (\$10,070 + \$6,360) \times 100}{\$53,000} = 69.0\%$

FOOD AND BEVERAGE DEPARTMENT RATIOS	1986	1985
Ratio of food and beverage revenues to room revenues		
$\frac{\text{Food and beverage revenues}}{\text{Room revenues}}$ Comment: Shows a significant increase in room revenues relative to food and beverage revenues.	$\frac{(\$20,500 + \$11,000)}{\$60,000} = 0.525$	$\frac{(\$20,000 + \$10,750)}{\$53,000} = 0.580$

Figure 36 (cont.)

	1986	1985
Seat turnover per day		
$\frac{\text{Number of covers}}{\text{Number of seats x 365 days}}$	$\frac{8{,}500}{25 \times 365}$ = 0.93	$\frac{8{,}800}{25 \times 365}$ = 0.96
Comment: Despite a slight increase in food and beverage sales, actual volume was down in 1986.		
Revenues per seat		
$\frac{\text{Food and beverage revenues}}{\text{Number of seats}}$	$\frac{\text{S20,500 + \$11,000}}{25}$ = \$1 260	$\frac{\text{\$20.000 + \$10,750}}{25}$ = \$1 230
Comment: Revenues per seat were up slightly in 1986 over 1985. This was due to price increases, since actual volume was down over 1985.		
Average check		
$\frac{\text{Food and beverage revenues}}{\text{Number of covers}}$	$\frac{\text{\$20,500 + \$11,000}}{8{,}500}$ = \$3.71	$\frac{\text{\$20,000 + \$10,750}}{8{,}800}$ = \$3,49
Comment: The average revenue per customer was up by 6.3% in 1986 over 1985.		
Food cost percentage		
$\frac{\text{Cost of food sold x 100}}{\text{Food revenues}}$	$\frac{\text{\$8,200 x 100}}{\text{\$20,500}}$ = 40 0%	$\frac{\text{\$8,400 x 100}}{\text{\$20,000}}$ = 42.0%
Comment: The cost of food sold was two percentage points less in 1986, indicating greater efficiency than in 1985.		
Beverage cost percentage		
$\frac{\text{Cost of beverages sold x 100}}{\text{Beverage revenues}}$	$\frac{\text{\$3,300 x 100}}{\text{\$11,000}}$ = 30.0%	$\frac{\text{\$3,120 X 100}}{\text{\$10,750}}$ = 29 0%
Comment: The beverage cost percentage, was one percentage point more in 1986, indicating less efficiency than in 1985.		
Food and beverage cost percentage		
$\frac{\text{Cost of food and beverages sold x 100}}{\text{Food and beverage revenues}}$	$\frac{\text{\$11,500 x 100}}{\text{\$20,500 + \$11,000}}$ = 36.5%	$\frac{\text{\$11,520 x 100}}{\text{\$20,000 + \$10.750}}$ = 37.5%
Comment: The cost of food and beverages sold was one percentage point less in 1986, indicating greater efficiency than in 1985.		

Figure 36 (cont.)

	1986	1985
Food and beverage labour cost percentage		
Food and beverage department wages, salaries and employee benefits x 100 / Food and beverage revenues	$12,000 x 100 / $20,500 + $11,000 = 38.1%	$11,800 X 100 / $20,000 + $10,750 = 38.4%
Comment: Food and beverage costs were down slightly in percentage terms in 1986.		
Food inventory turnover		
Cost of food sold / Average food inventory ($)	$8,200 / 410 = 20.0 times	$8,400 / 480 = 17.5 times
Comment: The food inventory turned over more rapidly in 1986 than in 1985.		
Beverage inventory turnover		
Cost of beverages sold / Average beverage inventory ($)	$3,300 / 550 = 6.0 times	$3,120 / 575 = 5.43 times
Comment: The beverage inventory turned over more rapidly in 1986 than 1985.		
Food and beverage department efficiency percentage		
Food and beverage department operating expenses x 100 / Food and beverage revenues	$31,500- ($11,500 + $12,000 + $3,150) x 100 / $20,500 + $11,000 = 15.4%	$30.750- ($11,520 + $11,800 + $3,080) x 100 / $20,000 + $10.750 = 14.1%
Comment: The overall efficiency of the food and beverage department improved by 1.3% in 1986.		

OTHER DEPARTMENTAL RATIOS

	1986	1985
Telephone charges per occupied room night		
Telephone revenues / Occupied room nights	$2,000 / 3,150 = $0.63	$1,750 / 2,865 = $0.61
Comment: Telephone charges per occupied room night increased only marginally in 1986,		
Telephone department efficiency percentage		
Direct telephone department operating expenses x 100 / Telephone revenues	$2,800 X 100 / $2,000 = 140.0%	$2,490 X 100 / $1,750 = 142 3%
Comment: The telephone department was slightly more efficient in 1986.		

Break-even analysis

Break-even analysis is a financial management technique that examines relationships between volumes of activity, prices, expenses and profits. In the area of pricing, break-even analysis can tell you:

- How much additional profit you would make if you raised your room rates by a certain dollar amount, assuming the volume (ie., the number of occupied room nights) remains the same.
- How much you would have to increase your volume to make up for any discounting of your room rates.
- How much your room rates could be discounted to attract group business such as bus tours and meeting/seminar groups.

In the area of planning, break-even analysis can tell you:

- How much you would have to earn in total revenues to achieve a certain profit level.
- How much your revenues would have to increase to cover certain expected increases in expenses - eg., additional interest charges.

Before we get to these questions, we should explain the four key concepts involved in break-even analysis. They are listed and described below.

- *Variable costs.* Variable costs are those operating costs that change in direct proportion to changes in sales volumes. An example of a variable cost in, say, the rooms department would be laundry expenses, which either increase or decrease in direct proportion to the number of occupied room nights.

- *Fixed costs.* Fixed costs are those expenses - operating, financial and others - which do not change even if sales volumes change. An example of a fixed cost would be interest on a long-term loan or mortgage.

  In the lodging industry, it is not possible to say that a given cost is always fixed or always variable. Sometimes it is clearly one or the other; but at other times, costs will be both fixed and variable. For example, you may have a housekeeper on staff whose salary is fixed, but you may also hire maids whose wages will vary with the number of rooms you sell; your salaries and wages for the rooms department would then be both fixed and variable.

  In Figure 37, we have drawn up a list of costs, and designated each one fixed, variable or both. The designations should be helpful, but they are meant as a guideline only, since there are bound to be differences from one hotel/motel to another.

- *Contribution margin.* The contribution margin is the difference between total revenues and variable costs. This difference goes towards paying the fixed costs of the business and to supplying a profit.

FIGURE 37 Categorization of a hotel/motel's expenses into variable and fixed costs

EXPENSE CATEGORIES	VARIABLE	FIXED	EXPLANATION
COST OF SALES			
Food	✓		All these costs vary directly with number of units sold
Beverage	✓		
Telephone	✓		
Gift shop	✓		
DEPARTMENTAL EXPENSES			
Rooms			
Wages, salaries employee benefits	✓	✓	Salary of head housekeeper maybe fixed while maids' wages will vary with number of rooms sold
Other direct expenses	✓		Cleaning supplies, guest supplies, laundry, linen, uniforms, etc, are all variable
Food and beverage			
Wages, salaries employee benefits	✓	✓	Some salaries and wages may be fixed, while others vary with sales volumes
Other direct expenses	✓		All variable
Telephone		✓	Rental of equipment and telephonists' salaries tend to be fixed
Gift shop		✓	Gift shop attendants' salaries tend to be fixed
UNDISTRIBUTED OPERATING EXPENSES			
Administrative and general	✓	✓	Mostly fixed, but such items as credit card commissions vary directly with revenues
Marketing	✓	✓	Mostly fixed, but certain special promotions may produce expenses in direct proportion to revenues
Property operation and maintenance	✓	✓	Mostly fixed, but some costs do rise with increases in volumes of use
Energy costs	✓	✓	A portion of electricity, fuel and water charges is fixed and a portion is variable
FINANCIAL AND OTHER EXPENSES			
Rent		✓	Rent is usually based upon floor area and not on revenues
Municipal taxes		✓	Taxes are usually based upon assessment values and not on revenues
Insurance		✓	Insurance premiums are usually based on asset values and not on revenues
Interest		✓	Interest charges are based upon amount of financing and interest rates, not on revenues
DEPRECIATION		✓	Depreciation charges are based upon the book value of fixed assets, not on revenues

- *Break-even point.* The break-even point, expressed either as a dollar figure or in volume units (eg., occupied room nights, number of covers, etc.), is the point where total revenues equal the combined value of variable and fixed costs. These two ways of expressing the break-even point can be illustrated by an example. Suppose you run a rooms-only motel, which we'll call the Sand Castle Motel, and suppose it has the following characteristics:

Average rate per occupied room night	$24.00
Variable costs per occupied room night	$8.00
Fixed costs	$35,000.00
Contribution margin per occupied room night ($24.00 - $8.00)	$16.00

You would calculate the two ways of expressing the break-even point by using these two formulae:

$$\text{Break-even point in unit sales (ie., occupied room nights)} = \frac{\text{Fixed costs}}{\text{Contribution margin per occupied room night}}$$

$$\text{Break-even point in dollars} = \frac{\text{Fixed costs}}{\dfrac{\text{Contribution margin per occupied room night}}{\text{Average rate per occupied room night}}}$$

Applying these formulae to the Sand Castle Motel, you would get:

$$\text{Break-even point in unit sales (ie., occupied room nights)} = \frac{\$35,000}{\$16}$$

$$= 2,187.5 \text{ occupied room nights}$$

$$\text{Break-even point in dollars} = \frac{\$35,000}{\$16\text{-}\$24}$$

$$= \$52,500$$

At these levels -2,187.5 occupied room nights per year and $52,500 in revenues per year - your revenues would equal your expenses, so no profit would be earned (and no loss would be incurred). Clearly, to earn a profit, your unit sales and your revenues must exceed the break-even point.

Example of break-even analysis

To show you how to use break-even analysis, let's continue with our Sand Castle Motel example.

We've shown you how to calculate the break-even point, and we've stated that your unit sales and dollar revenues must be greater than the break-even point if you are to show a profit. But how much greater? And what kind of profit? Break-even analysis can help you determine the answers to those questions - ie., it can help you plan to get whatever level of profit you want.

Let's suppose you would like to earn a profit (or net income) of, say, $13,000 a year. How many occupied room nights and what room revenues would you need to reach this target? To find out, you would adapt the break-even formulae shown above, so that they read as follows:

Required number of unit sales (ie., occupied room nights) $= \dfrac{\text{Fixed costs + Desired net income}}{\text{Contribution margin per occupied room night}}$

Required dollar revenues $= \dfrac{\text{Fixed costs per year + Desired net income}}{\text{Contribution margin per occupied room night} \div \text{Average rate per occupied room night}}$

Applying these formulae to the Sand Castle Motel, you get:

Required number of unit sales (ie., occupied room nights) $= \dfrac{\$35{,}000 + \$13{,}000}{\$16}$

= 3,000 occupied room nights

Required revenues $= \dfrac{(\$35{,}000 + \$13{,}000)}{\$16 \text{-} \$24}$

= $72,000

You can check these figures as follows. If you had 3,000 occupied room nights, your variable costs would be $24,000 (3,000 x $8.000 of variable costs per occupied room night). Your fixed costs would be $35,000, regardless of the number of occupied room nights, so your total costs would be $59,000. If you had revenues of $72,000, then your profit, or net income, would be $72,000 minus $59,000, which equals $13,000, the figure you were aiming for.

Alternatively, you could construct a break-even analysis chart like the one shown in Figure 38. The vertical axis of this chart shows room revenues and the horizontal axis shows the number of occupied room nights. The way you construct the chart is this.

First, you draw a horizontal line from the $35,000 point on the vertical axis. This represents your fixed costs (which don't change with the number of occupied room nights). Secondly, you draw a slanting line that represents your fixed costs plus your variable costs (ie., your total costs). It starts at $35,000 (since your fixed costs would equal your total costs if no rooms were sold) and it increases as your variable costs increase (ie., as more rooms are sold).

This line (representing total costs) passes through $51,000 at 2,000 occupied room nights as shown. This is determined as follows:

Total costs = Fixed costs (of $35,000) + Variable costs (of 2,000 occupied room nights x $8.00 of variable costs per occupied room night)

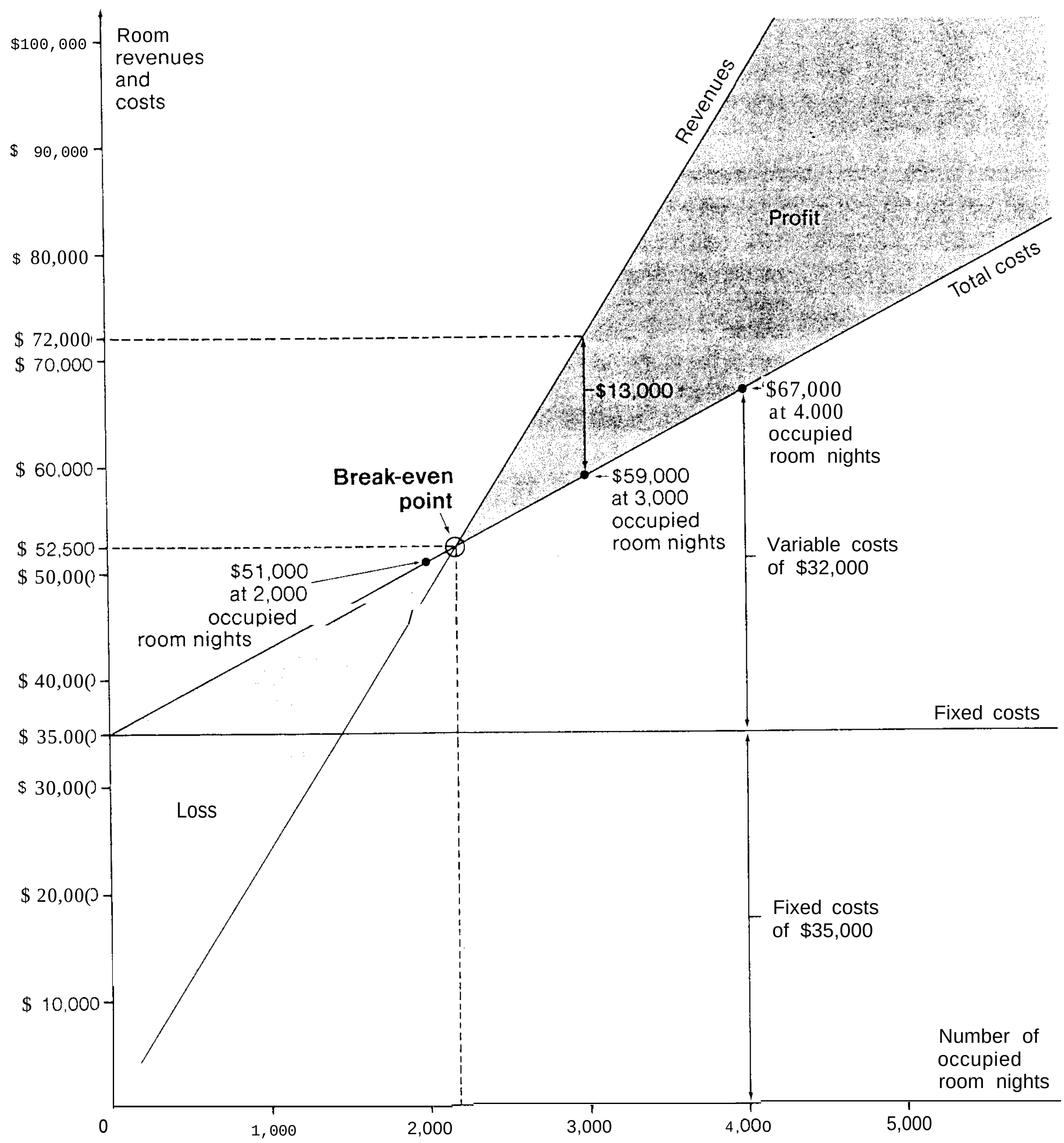
= $35,000 + (2,000X $8.00)

= $35,000 + $16,000

= $51,000

Similarly, the line passes through $59,000 at 3,000 occupied room nights [$35,000 + (3,000 x $8.00)]; as well as $67,000 at 4,000 occupied room nights [$35,000 + (4,000 x $8.00)]. The solid vertical line shows how the $67,000 of total costs is made up of $35,000 of fixed costs and $32,000 of variable costs.

FIGURE 38 Break-even analysis chart for the Sand Castle Motel



Thirdly, you draw a line from zero through the break-even point (which, in this case, is $52,500 of room revenues or 2,187.5 occupied room nights).

You are now in a position to plan for your desired level of profitability. For example, suppose you want to earn (as before) a profit of $13,000. You would look in the shaded (profit) area to find where the two diverging lines are $13,000 apart (see Figure 38). This represents your desired profit, and as you can see from the chart, it corresponds to required room revenues of $72,000 and required sales of 3,000 occupied room nights.

Two other points can be seen from this chart. First of all, the more your unit sales and dollar revenues exceed the break-even point, the greater your profit - but also the greater your efficiency percentage. For example, at 3,000 occupied room nights per year, your rooms department income is $13,000, and your rooms department efficiency percentage (calculated according to one of the formula from Figure 33) is 18.170:

$$\text{Rooms department efficiency percentage} = \frac{\$13{,}000 \times 100}{\$72{,}000} = 18\,1\%$$

However, if the number of occupied room nights rises to 4,000, then your rooms department income rises to $29,000 and your rooms department efficiency percentage rises to 30.2%. The reverse of this is also true - ie., the more your unit sales and dollar revenues fall below your break-even point, the more your losses build up - and the more your efficiency percentage declines.

The second point is that break-even analysis can be helpful in gauging the effects of cost increases on profitability levels. To demonstrate this point, let's assume that the Sand Castle Motel's interest charges increase by $5,000. This would raise your fixed costs to $40,000. Assuming that your rates and contribution margin remain the same, your break-even point would increase to 2,500 occupied room nights per year and $60,000 in room revenues per year.

Finally, while the next chapter is devoted exclusively to pricing, it is appropriate here to mention the role of break-even analysis in pricing. Break-even analysis has two principal applications in this area:

- Gauging the impact on profitability y of price increases.
- Gauging the impact on profitability of price decreases, including special discounted rates.

As an example of the first application, assume that the Sand Castle Motel is trying to determine the impact on its profitability of a $2.00 increase in its average rate per occupied room night. The $2.00 increase would raise the contribution margin to $18 from $16, and this would decrease the break-even point to 1,944.4 occupied room nights per year and $50,556 in room revenues. (Note: We are basing this calculation on the original fixed costs of $35,000.)

Break-even analysis also has an important role to play in planning price discounts. Since fixed costs remain fixed, regardless of the volume of sales, you may find that it sometimes pays to discount rates to a level where variable costs are covered and where some contribution to fixed costs is achieved.

But we're getting ahead of ourselves here. That is a topic for the next chapter. For now, it's enough to say that you should avoid offering a rate for a service that's less than the variable costs of providing that service.

Key points in review

After studying Chapter 4, you should be able to:

- Define and explain operational analysis.
- Describe the contents of the manager's daily report and the food and beverage daily report.
- Identify the major operational ratios used by hotel/motels.
- Calculate these ratios and understand the significance of the results.
- Define and explain break-even analysis.
- Explain the concepts of variable costs, fixed costs, contribution margin and break-even point.
- Identify which of your costs are fixed, variable or both.
- Calculate the break-even point in unit sales and dollar revenues.
- Construct a break-even analysis chart.
- Define or explain all the key terms that appear in italics.

SELF-TEST QUESTIONS -4

(answers on last page this chapter)

1. The difference between total revenues and variable costs is known as:
   a. Income before fixed charges.
   b. Gross operating profit.
   c. Contribution margin.
   d. Net income.
   e. None of the above.

2. The average rate per occupied room night is calculated by:
   a. Dividing-room revenues by the number of occupied room nights.
   b. Averaging the advertised room rates for a given night.
   c. Dividing room revenues by the number of available room nights.
   d. Expressing occupied room nights as a percentage of available room nights.
   e. None of the above.

3. The break-even point can be:
   a. Expressed as-dollar revenues or in unit sales.
   b. Important to know in setting prices and rates.
   c. Important to know in attempting to enhance the profitability of a business.
   d. Calculated by dividing fixed costs by the contribution margin per unit.
   e. All of the above.

4. Information on a hotel/motel's occupied room nights is usually drawn from:
   a. The manager's daily report.
   b. The income statement.
   c. The daily transcript.
   d. The daily cash reconciliation.
   e. None of the above.

5. If a year-round motel has 20 rooms and records 5,110 occupied room nights in one year, its occupancy percentage is equal to:
   a. 50%.
   b. 70%.
   C. 65%.
   d. 62%.
   e. None of the above.

6. A hotel has fixed costs **equalling** $60,000, an average rate per occupied room night of S35.00, and variable costs per occupied room night of $ 13.00. The hotel owners would like to achieve a net income of. $28,000. Their target level of occupied room nights should therefore be:
   a. 3,500.
   b. 3,800.
   c. 4,000.
   d. 3,000.
   e. None of the above.

7. A hotel/motel's income statement shows that it has food revenues of $150,000, food and beverage wages, salaries and employee benefits of $63,000, and a cost of food sales of $57,000. Its food cost percentage is therefore equal to:
   a. 38%.
   b. 40%.
   C. 80%.
   d. 45%.
   e. None of the above.

8. An 80-seat restaurant has total food and beverage revenues of $165,000, received from 10,000 covers. Its average check is therefore equal to:
   a. $16.
   b. $15.50.
   c. $16.50.
   d. $20.63.
   e. None of the above.

9. Cost of sales is:
   a. Always a variable cost.
   b. Sometimes a variable cost and sometimes a fixed cost.
   c. Always equal to the difference between total revenues and variable costs.
   d. Partially a variable cost and partially a fixed cost.
   e. None of the above.

10. A hotel/motel has a food inventory turnover of 15 and an average inventory valued at $675. Its cost of food is therefore equal to:
    a. $4,500.
    b. $10,125.
    c. $45,000.
    d. $10,250.
    e. None of the above.

11. A hotel/motel has fixed costs of $72,000, an average rate per occupied room night of $25.00, and a contribution margin per occupied room night of $12.00. Its break-even point, expressed as dollar revenues, is therefore:
    a. $194,595.
    b. $55,385.
    c. $86,400.
    d. $150,000.
    e. None of the above.

12. Ratio, operational and break-even analysis are all:
    a. Special financial management techniques
    b. Part of the accounting procedure.
    c. Done only once per year.
    d. Calculated by your accountant each year.
    e. All of the above.

13. The two sources of information needed to calculate rooms department ratios are:
    a. Break-even chart and manager's daily report.
    b. Daily transcript and income statement.
    c. Manager's daily report and income statement.
    d. Daily transcript and food and beverage daily report.
    e. None of the above.

14. Which of the following is not an operational ratio?
    a. Telephone department efficiency percentage.
    b. Revenues per seat.
    c. Ratio of food and beverage revenues to room revenues.
    d. Double occupancy factor.
    e. None of the above.

15. Which of the follow ratios does not show a business' profitability?
    a. Return on owners' equity.
    b. Net return on total assets.
    c. Current ratio.
    d. Return on total assets.
    e. Profit margin.

WORKING EXAMPLES -4

Two examples are presented here:

1. Background

The Frontier Resort, used in the second working example of Chapter 3, is a 20-unit hotel/motel with a 40-seat coffee shop. It operates from May to October each year (ie., for six months). As the owner-manager, you have received the income statement shown in Figure 30 for the year ended December 31, 1985. In addition, a summary of your manager's daily reports shows you the following:

	1985	1984
Occupied room nights	2,642	2,694
Available room nights	3,682	3,682
Number of guests	5,890	6,073

Task

Using the tools of operational analysis, evaluate the operating performance of the Frontier Resort during 1985. Identify any major problem areas that you should investigate further. As a guideline, consider using the following percentages and ratios in structuring your answer: occupancy percentage; double occupancy factor; average rate per occupied room night; ratio of food revenues to room revenues; and revenues per seat.

2. Background

The Towne Motel is a 10-room motel, open year-round. It is a rooms-only motel. A recent income statement for the motel is shown in Figure 39. In addition, the manager's daily reports show that the number of occupied room nights for the year was 2,373 and the number of available room nights was 3,650.

Task

Determine how many occupied room nights the Towne Motel would need:

- To break-even.
- To achieve an income before depreciation of $20,000.

Solutions to these two examples can be found following Chapter 10.

FIGURE 39 **Towne** Motel income statement

for the year ended December 31, 19_

Revenues	
Room revenues	$63,228
Expenses	
Wages, salaries and employee benefits	27,000
Room expenses	2,527
Energy costs	3,400
Property operation and maintenance	3,000
Administrative and general	750
Marketing	750
Financial and other expenses	11,500
Total expenses	$48,92'7
Income before depreciation	$14,301

NOTES

answers to self-test questions -4

1. c	2. a	3. e	4. a	5. b	6. C	7. a	8. C
9. a	10. b	11. d	12. a	13. c	14. e	15. c	

5

SETTING THE RIGHT PRICES and maximizing your profits. . .

Setting the right prices for the rooms and other services you offer is an extremely important responsibility. For the uninitiated, it can also be an extremely difficult one. Pricing inevitably has a major impact on your profitability, since it obviously has a radical effect on your revenues. Basically,

PROFITS = REVENUES - COSTS

and

REVENUES = VOLUMES X PRICES

Therefore,

PROFITS = (VOLUMES x PRICES) - COSTS

In this chapter, we will discuss how to price your operation to get the maximum profit possible. The two methods we will recommend will allow you to answer the following kinds of questions with a high degree of confidence:

- If your biggest competitor drastically cuts his rates to get more business, can you afford to follow his lead? Can you afford not to?

- Can you afford to accept a large reservation from, say, a bus-tour operator, even though the operator insists on a large discount? Can you afford to turn the business away?
- How much extra would you have to charge to recoup the costs of a proposed renovation?

Before we get to our two pricing methods, here's a review of some of the pricing methods that are used by many hotel/motel operators. We call them the unsophisticated pricing methods.

Unsophisticated pricing methods

Most of the unsophisticated pricing methods should be avoided, even though they are easy to use. The unsophisticated methods we are talking about are as follows:

- *Intuitive method.* We might call this the "gut feel" approach. It requires no research into costs, competitive prices or market expectations - just some common sense.

  Disadvantages: Your intuition may be excellent, but how do you know if you are making a satisfactory profit? If you set your prices too low, you will probably earn less than you should. If you set them too high, you may lose business, so again you will be earning less than you should.

  Advantages: This method has no redeeming features. It should be avoided altogether.

- *Competitive method.* We could call this the "me-too" method. In this case, research is conducted into competitive pricing, but not into operational cost or market expectations.

  Disadvantages: This method does not take into account differences in quality or cost/financing variations from one hotel/motel to another. A competitive rate may be too low for you to achieve a reasonable profit; or it may be too high based on your hotel/motel's cost structure.

  Advantages: Clearly, you have to pay attention to your competitors' prices. However, if used on its own, this method is almost as dangerous as intuitive pricing. It should also be avoided.

- *Follow-the-leader method.* This is a variation of the competitive pricing method. The difference is that your prices follow those of your largest or most successful competitor, rather than those of several of your competitors.

  Disadvantages: This method suffers from the disadvantages of the competitive pricing method.

  Advantages: Once again, this method cannot be recommended on its own.

- *Traditional or rule-of-thumb method.* A traditional pricing method is simply one that has been widely used by the lodging industry in the past. For example, one rule-of-thumb used to be that for every $1,000 of investment, you should charge a room rate of $1.00.

  Disadvantages: The l-to-l ,000 ratio is out of date, since construction costs have risen more sharply than room rates. Anyway, the past is not the best basis upon which to predict the future. Also, this method does not consider operating, financial and other costs; nor does it consider competitive price levels or market expectations.

  Advantages: There are no outstanding advantages to traditional pricing methods - only weaknesses.

- *Trial-and-error method.* Here, you vary your prices over a period of time to see what volume the different prices generate. The price/volume combination that produces the highest revenue is eventually identified, and your prices are set accordingly.

  Disadvantages: If you change your prices too frequently, you can upset your customers, particularly if they are regular customers. An even greater drawback is that there are many other factors affecting demand other than price (eg., seasonalit y, growth in competition, general economic conditions and changing vacation patterns). These factors muddy the supposedly direct relationship between prices and volumes.

  Advantages: Only if you have a thorough knowledge of costs and other variables can this method be considered effective - and only then for setting restaurant prices. Its use in establishing room rates is much riskier.

- *Exclusive method.* You may feel that your operation is vastly superior to your competitors' or that you have a clear-cut advantage due to location, accessibility or some other important factor. You may then decide to set prices - normally on the high side - that are significantly different from your competitors'.

  Disadvantages: The market has shown that many places are not as exclusive as their prices suggest. Charging a high price does not by itself guarantee exclusivity.

  Advantages: This method may work only if your competitive advantage is so strong that it makes your customers pay the exclusive price. But in an increasingly competitive world, the probability of success is low.

- *Price cutting.* Price cutting here means lowering your prices below competitive levels to gain a bigger market share. (This is not the same as the discounting method, which will be described in a moment.)

  Disadvantages: You may get all the business in the world, but you may also lose money if you can't at least cover your variable costs.

  Advantages: Price cutting is extremely dangerous if it is done without a thorough knowledge of your costs of operation. It has no inherent advantages if you do not have this depth of knowledge.

Sophisticated pricing methods

Now let's look at our two sophisticated pricing methods. Both of them require more work and less "gut feel" than the unsophisticated methods. Also, they are both cost-based methods that depend on the availability of accurate cost data.

Target pricing with the Hubbart formula

Target pricing is based on your costs and on the profit levels you want to attain. This means you must have accurate cost figures and you must know what rate of return you need. The *Hubbart formula* is one target pricing method used by many hotel/motels. It is a cost-based method through which a targeted average rate per occupied room night is calculated. It is best demonstrated by means of an example.

Suppose the owners of the 35-room, full-service Concorde Hotel have established the following from a review of their latest balance sheet and income statement. At the end of year 1:

- The value of their total assets is $750,000.
- Their long-term liabilities, consisting of a first mortgage on the property, are $400,000. In year 2, they expect to pay interest on the outstanding principal at a rate of 18%.
- Their current liabilities are $20,000.
- The value of their equity is $330,000 ($750,000 -$400,000-$20,000).

Based upon these figures and on their management information reports, the owners have drawn up an operating budget for year 2, which calls for:

- An occupancy percentage of 75% on their 35 rooms. This would translate to 9,581 occupied room nights (75% x 35 rooms x 365 nights).
- An income tax rate of 28% on income before income taxes.
- Food department revenues of $175,000.
- A cost of food sales equal to 38% of food revenues.
- Beverage department revenues of $115,000.
- A cost of beverage sales equal to 34% of beverage revenues.
- A food and beverage labour cost equal to 40% of combined food and beverage revenues.
- Other direct food and beverage department expenses equal to 10% of combined food and beverage revenues.
- Telephone department revenues of $11,500.
- Telephone department expenses equal to 140% of revenues (meaning a loss of 4090 on telephone revenues).
- A rooms department efficiency of 68% at the 75% occupancy level.

In addition, the owners have calculated their depreciation, financing and other expenses, and their undistributed operating expenses. These figures (we'll get to the actual numbers in a moment) are based on their year 1 financial statements and on their known fixed costs, contained in the operating budget for year 2. Finally, the owners have set a target after-tax return on equity of 20%.

So the question is: What average rate per occupied room night must the owners charge in year 2 so that they reach that target after-tax return of 20% on equity? That's where the Hubbart formula comes in. It gives you the answer.

The Hubbart formula is shown in Figure 40, and its application to the Concorde Hotel is shown in Figure 41. The calculations used in Figure 41 require some careful study, but all the numbers used there are drawn from the information on the Concorde Hotel, listed above.

Figure 41 shows that the average rate per occupied room night that the owners of the Concorde Hotel must charge is $45.10. It does this by calculating the room revenues needed to give the desired after-tax return on owners' equity (ie., $432, 157), and then dividing the required room revenues by the projected number of occupied room nights (ie., 9,581).

FIGURE 40 The **Hubbart** formula

Desired after-tax return on equity ($)

PLUS

Income taxes
Depreciation
Insurance
Municipal taxes
Interest
Administrative and general expenses
Marketing
Energy costs
Property operation and maintenance

MINUS

Food and beverage department revenues
Telephone department revenues
Other department revenues

PLUS

Food and beverage department expenses
Telephone department expenses
Other department expenses

PLUS

Rooms department expenses

ALL DIVIDED BY

Projected number of occupied room nights

EQUALS

Average rate per occupied room night ($)

FIGURE 41 Applying the **Hubbart** formula to the Concorde Hotel

Desired after-tax return on owners' equity	20% x $330,000		$ 66,000
PLUS			
Income taxes	$\frac{\$66{,}000 \text{ X } 28}{100-28}$	$ 25,667	
Depreciation		28,000	
Insurance[1]		2,000	
Municipal taxes[1]		12,000	
Interest	18% X $400,000	72,000	
Administration and general expenses[2]		40,000	
Marketing[2]		20,000	
Energy costs[2]		28,000	
Property operation and maintenance		35,000	
		$262,667	$262,667
MINUS			
Food and beverage department revenues	$175,000 + $115,000	$290,000	
Telephone department revenues		11,500	
		$301,500	301,500
PLUS			
Food and beverage department expenses	38% X $175,000	$ 66,500	
	+ 3470x $115,000	39,100	
	+ 407. X $290,000	116,000	
	+ 10% X $290,000	29,000	
Telephone department expenses	140% x $ 11,500	16,100	
		$266,700	266,700
			293.867
PLUS			
Rooms department expenses	$\frac{\$293{,}867}{68} \text{ x } (100-68)$		138,290
Required room revenues			$432,157
ALL DIVIDED BY			
Projected number of occupied room nights			9,581
EQUALS			
Average rate per occupied room night			$ 45.10

[1] These are fixed costs that are predicted for year 2. We've assumed the numbers shown.
[2] These are budgeted figures for year 2. We've assumed the numbers shown.

Applying break-even analysis

Once the targeted average rate per occupied room night has been calculated by the Hubbart formula, break-even analysis can be used to judge the impact of any fluctuations in prices or volumes. Let's continue With the Concorde Hotel example, calculating the average rate per occupied room night that would allow the owners to break-even in year 2.

As explained in Chapter 4, the break-even point is where total revenues equal total costs (fixed plus variable). We haven't broken down the Concorde Hotel's costs into fixed and variable, but we have identified the following year 2 costs:

Incomes taxes	$ 25,667
Depreciation	28,000
Financial and other expenses	86,000
Undistributed operating expenses	123,000
	$262,667

The owners have also projected that the Concorde's food and beverage department will contribute $39,400 towards paying for these costs, and that the telephone department will end up costing another $4,600. To break-even, therefore, the rooms department will have to produce a rooms department income of:

$262,667-39,400 + 4,600 = $227,867

Assuming that the rooms department efficiency percentage remains at 68% and that the number of occupied room nights remains at 9,581, the following average rate per occupied room night would be needed to break-even:

$$\frac{\$227{,}867}{0.68 \times 9{,}581} = \$34.98$$

Let's check that figure back to see if it's correct. With an average rate per occupied room night of $34.98, the Concorde Hotel's room revenues would equal about $335,100 ($34.98 x 9,581). These revenues would produce $227,867 in rooms department income ($335,100 x 0.68) - a figure that equals the other fixed and variable costs anticipated. The break-even average rate per occupied room night is indeed $34.98.

Discounting method

The other sophisticated pricing method is the discounting method. It is not the same as the unsophisticated price cutting method mentioned above. Instead, it is a precision method designed either to attract particular types of business (eg., bus tour groups) or to attract any types of business at specific times of the day, week, month or year.

Discounting, like targeting, is a cost-based method of pricing. But it relies more heavily than does targeting on break-even analysis. That's because the basic principle behind discounting is that certain fixed costs are incurred regardless of whether you have any sales. Therefore, if you can attract guests during traditionally slow periods, then you should probably do so; at least some contribution towards meeting your fixed costs will then be made. The trick is to reduce rates close to the break-even point, but to make sure that at all times your costs are covered.

The use of discounting can be demonstrated by the following example of the In-Can Inn. We'll assume that the Inn has 15 rooms and that it has an occupancy percentage of 70%. However, in both November and December, only three rooms are occupied each night. We'll also assume that you are the owner and that one day a tour operator approaches you and suggests that you accept tour guests over a 60-day period in November and December. The tour guests will occupy 12 of your rooms each night. In exchange, the tour operator naturally wants a discount on the regularly advertised room rate, which we'll say is $21 per night. Should you accept the business? And if so, what kind of discount should you offer?

Certainly, the deal looks attractive, since on average you have been renting only three of your 15 rooms during November and December and it would be good to have the other 12 filled. You could go ahead on that basis alone and make a guess at the kind of discount you should offer. However, there's a much better way of deciding. It requires analysis of your operation, so to that end we've drawn up an operating budget for the In-Can Inn. It covers the next 12 months, beginning with November, and it is shown in Figure 42.

Figure 43 shows how you can use the discounting method to determine your prices - ie., it shows you how to calculate the size of the discount you can affort to offer. To simplify matters, we have assumed that there are no guest expenditures outside the rooms department. This does not change the principles involved. The In-Can Inn example can be applied to any hotel/motel.

FIGURE 42 Operating budget for the In-Can Inn for 12 months starting in November

Departmental revenues	
Rooms	$ 80,483
Food	73,113
Beverage	19,088
Telephone	4.010
Total	176,694
Departmental expenses	
Rooms	19,436
Food	62,726
Beverage	10,887
Telephone	4,770
Total	97,819
Departmental income	78,875
Undistributed operating overhead	
Administrative and general	12,545
Marketing	5,478
Energy cost	4.947
Property operation and maintenance	3,900

Total	26,870
Income before fixed charges	52,005
Fixed charges	
Insurance	4,000
Municipal taxes	8,000
interest expenses	26,053
Depreciation	13,500
Total	51,553
Income before income taxes	$ 452

FIGURE 43 Discounting pricing at the In-Can Inn (looking at the rooms department only)

Step 1. Calculate total fixed costs for the next 12 months, which apply to the rooms department.

From the operating budget for the In-Can Inn, you can see that fixed charges amount to $51,553. A portion of these fixed charges should be assigned to the rooms department, using the formula:

$$\text{Rooms department fixed charges} = \text{Total fixed charges} \times \left(\frac{\text{Rooms department revenues} - \text{Rooms department expenses}}{\text{Total departmental income}}\right)$$

$$= \$51{,}553 \times \frac{(\$80{,}483 - \$19{,}436)}{\$78{,}875}$$

$$= \$51{,}553 \times 0.774$$

$$= \$39{,}902$$

To the fixed charges attributable to the rooms department must be added those undistributed operating expenses, which are also attributable to the rooms department. That's because some of the undistributed operating expenses are fixed, as long as the In-Can Inn remains open (you have to spend a certain amount on administration, energy costs, maintenance, etc., regardless of the number of room nights you sell, and this amount is fixed.) We have to make some estimates here: We'll assume that $14,000 of the undistributed operating expenses are fixed, and that 50% of these expenses can be assigned to the rooms department.

That means the fixed portion of the undistributed operating expenses, attributable to the rooms department, is:

$$\$14{,}000 \times 0.50$$
$$= \$7{,}000$$

Adding this amount to the fixed charges allocated to the rooms department, calculated above, gives you the total fixed costs for the next 12 months, which apply to the rooms department. This figure is:

$$\$39{,}902 + \$7{,}000$$
$$= \$46{,}902$$

Figure 43 (cont.)

Step 2. Calculate amount of total fixed costs attributable to the rooms department, which would be incurred during the 60-day tour period.
This is calculated as follows:

Rooms department fixed costs for 60-day period $= \text{Total rooms department fixed costs for 12 months} \times \frac{60 \text{ days}}{365 \text{ days}}$

$= \$46,902 \times \frac{}{365}$

$= \$7,710$

Step 3. Calculate total variable costs for the next 12 months, which apply to the rooms department.
From the operating budget, you can see that rooms department expenses for the next 12 months are expected to be $19,436.

To this amount, you must add the variable portion of the undistributed operating expenses, which can also be assigned to the rooms department. Since we assumed earlier that the fixed portion of the undistributed operating expenses was $14,000, and since the total undistributed operating expenses, (as seen in the operating budget) was $26,870, then the portion that can be considered variable must be $26,870-$14,000 = $12,870.

We will once again assume that 50% of this amount can be attributed to the rooms department. That means that the variable portion of the undistributed operating expenses, attributable to the rooms department, is:

$\$12,870 \times 0.50$

$= \$6,435$

Adding this amount to the rooms department expenses gives you the total variable costs for the next 12 months, which apply to the rooms department. This figure is:

$\$19,436 + \$6,435$

$= \$25,871$

Step 4. Calculate variable rooms department costs per occupied room night.
This is calculated as follows, remembering that the In-Can Inn has 15 rooms and an occupancy percentage of 70%:

Variable costs per occupied room night $= \frac{\$25,871}{365 \text{ days} \times 15 \text{ rooms} \times 70\%}$

$= \$6.75$

Figure 43 (cont.)

Step 5. *Calculate the rooms department variable costs, which would be incurred during the 60-day tour period.*
Altogether, the tour operator plans to fill 12 of your rooms over the 60-day period. 'I'he number of room nights you would be selling is therefore:

$$12 \times 60$$
$$= 720$$

The variable costs per occupied room night are $6.75, as calculated in Step 4. Consequently, the total rooms department variable costs are:

$$\$6.50 \times 720$$
$$= \$4,860$$

Step 6. *Calculate the break-even rooms department revenues during the 60-day tour period.*
This is clearly equal to the rooms department total costs - i.e., the sum of the fixed costs and the variable costs. Therefore:

Break-even rooms department revenues during 60-day tour = $7,710 + $4,860

= $12,570

Step 7. *Calculate the break-even average rate per occupied room for the 60-day period.*
This is simply the break-even rooms department revenues divided by the number of room nights. Therefore:

Average rate per occupied room night to break-even during 60-day tour $= \frac{\$12,570}{720}$

= $17.46

Based upon the calculations in Figure 43, it seems that it would be unwise for you to offer a room rate of less than $17.46 a night, the break-even rate. However, with an advertised rate of $21, you could offer the tour operator a 10% discount, so that you would be charging $18.90 per room night. At $18.90, you would be earning a profit of $1.44 beyond your break-even rate.

So should you give the 10% discount? Let's look at your business volumes with and without the tour. We'll assume that you will lose all your normal room business in November and December, because of the presence of the tour group. Here's how your profit would be affected:

	In-Can Inn without tour business	In-Can Inn with tour business at 10% discount
Fixed costs attributable to rooms department for November and December (60 days)	$7,7101	$ 7,710[1]
Variable costs attributable to rooms department for November and December (60 days)	$1,215[2]	$ 4,860[3]
Total costs of rooms department for November and December (60 days)	$8,925[4]	$12,570[4]
Rooms department revenues for November and December (60 days)	$3,780[5]	$13,608[6]
Profit (loss) during November and December	($5,145)7	$ 1,038[7]

1. Calculated in Step 2 of Figure 43.
2. Without the tour group, you normally fill three of your 15 rooms. Variable costs therefore equal $6.75 (from Step 4 of Figure 43) x 3 x 60 days.
3. From Step 5 of Figure 43.
4. Add lines 1 and 2.
5. $21 per night x 3 rooms x 60 nights.
6. $18.90 per night x 12 rooms x 60 nights.
7. Subtract line 3 from line 4.

It is therefore clear that it would be wise to offer the tour operator the 10% discount. This would give you a $1,038 profit during November and December, compared to a $5,145 loss that would otherwise be incurred.

But what would happen if the tour operator insisted on a 20% discount? That would mean you would receive $16.80 per tour group occupied room night - an amount that is below the break-even average rate of $17.46. Should you accept this arrangement? The new situation, with and without the tour group business, is shown below:

	In-Can Inn without tour business	In-Can Inn with tour business at 20% discount
Fixed costs	$7,710	$ 7,710
Variable costs	$1,215	$ 4,860
Total costs	$8,925	$12,570
Room revenues	$3,780	$12,096
Profit (Loss)	($5,145)	($474)

Even with 20% discount, it seems that you would be better off accepting the business. However, as a general rule, you should not sell rooms at below the break-even average rate per occupied room night. There may be occasions, like that of the In-Can Inn, where it appears to make sense. But if you do so, you must remember that by lowering the contribution margin on rooms (ie., the rooms department income percentage), you may be diluting your total rooms department income target for the year. This dilution has to be made up by adjusting rates for the balance of the year.

Returning to the In-Can Inn example, you'll recall that your rooms department income target was $61,047 ($80,483 -$19,436). If you accept the tour operator's business at a 20% discount, you will have to increase your average rate for the rest of the year. The following steps illustrate how you calculate the required increase. (We again assume you have a 70% occupancy percentage.)

Step 1. Calculate room revenues from tour

Room revenues from tour = $16.80 x 720 occupied room nights

= $12,096

Step 2. *Calculate required room revenues for other 305 days.*

Required room revenues for other 305 days = $80,483-$12,096

= $68,387

Step 3. *Calculate required average rate per occupied room night for other 305 days.*

Required average rate per occupied room night for other 305 days = $\frac{\$68{,}387}{(365 \text{ x } 707. \text{ x } 15 \text{ rooms}) - 720 \text{ room nights}}$

$= \frac{\$68{,}387}{3832.5-720}$

$= \frac{\$68{,}387}{3112.5}$

= $21.97

Therefore, you would have to achieve an average rate per occupied room night of $21.97 for the remaining 10 months (January-October) in order to accept the tour operator's business at a 20% discount.

Pricing food and beverages

Setting food and beverage prices tends to be more time-consuming than setting room prices. That's because many prices are involved, not just one. Once more, though, the golden rule is that prices of food and beverages should be established on the basis of costs, not through educated guesses.

Most of the pricing methods used in restaurants and bars in Canada are either *percentage mark-up* or *multiple* pricing methods. These are both cost-based methods, where the cost of the food or beverage is estimated first, and then a mark-up or margin is added to cover other expenses and to provide a profit. The combined material (ie., cost of food or beverage sales) and labour costs are often referred to as the *prime cost.* This is how the menu price breaks down:

Prime cost	Cost of food or beverage	
Prime cost	Plus: Labour cost	Mark-up or margin
	Plus: Other direct expenses	Mark-up or margin
	Plus: Profit	Mark-up or margin
	Equals: Menu price of food or beverage	

Another approach to setting food and beverage prices is to target a food cost percentage or a beverage cost percentage. For example, let's assume that your food cost percentage was 3790 one year and that you'd like to improve your efficiency by achieving a 35% food cost percentage next year. From the discussion on operational ratios (Figure 33), you'll remember that:

$$\text{Food cost percentage} = \frac{\text{Cost of food sold}}{\text{Food revenues}} \times 100$$

The lower the cost of food in relation to the food revenues, the lower the food cost percentage. This is why the food cost percentage declines as the efficiency increases.

If you are aiming for a 35% food efficiency, then the menu price would have to be:

$$\text{Cost of food sold} \times \frac{100}{35}$$

So if we assume that the cost of the food item is, say, \$2.50, then the menu price would have to be:

$$\$2.50 \times \frac{100}{35} = \$7.15$$

As a general rule, menu items are not marked up by the same amount. High food cost items tend to have lower percentage mark-ups than low food cost items. Through experience, you have to find an acceptable compromise between your profit objectives and your customers' perceived value of the items you are selling. When taken together, the various mark-ups should produce an average mark-up, which gives you the food and beverage cost percentages you are aiming for.

The key to effective pricing of food and beverages is the development of standard recipes and standard portion sizes. strongly recommend that you use *standard recipe cards* for all your menu and drinks items. Figures and show examples of these.

In the case of Figure 44, the total cost of the menu item is $2.58. If you were still aiming for a ˘ .˜˘ food efficiency (as mentioned above), then your menu price would have to be:

100

¢2,,58 x = ¢7,,37

If you wanted a food efficiency of then your menu price would have to be:

100

¢2,,58 x g = ¢8,,60

And so on.

FIGURE 44 Standard menu item recipe card

Item		Cost per 28 g	
Amount produced	f sub-total	Portion size	3 24.8
Number of portion(s) 3		Portion cost	$190.78

sk

ggest a financial plan, or method of financing, which would allow you to ild your motel. Also, indicate where you would use short, medium and/or g-term financing. When you have completed your plan, answer the lowing questions:

- With a capital budget total of $190,785, how much debt and how much equity would there be at the highest leverage ratio normally acceptable

Preparation and ice

Method (procedure, time, g $155.785

If you invested $67,074 as equity and borrowed the remaining $123,711, would you be considered under-levered?

FIGURE 45 Standard drink recipe card

DRINK RECIPE				
[tern: Martini				
	Date	Date	Date	Date
	8/21/84			
Drink sales price	$4.00	$	$	$
Drink cost	$1.30	$	$	$
Drink cost percentage	[illegible]		[illegible]	[illegible]

No. 32

Ingredients	Bottle data					[illegible] Size	Drink cost			
	Size	[illegible]	[illegible]	[illegible]	[illegible]					
Dry Gin	ml					56				
Dry Vermouth	ml					ml				
Olive						1	001			
Water (ice)						14 ml				
						18 ml				

Preparation Procedure:

Place ingredients into a mixing glass. Add ice and stir long enough to chill. Strain into a cocktail glass and garnish with an olive.

Glass used:

100 ml lined cocktail

Key points in review

After studying Chapter 5, you should be able to:

- Identify seven unsophisticated pricing methods used by hotel/motels.
- Describe the advantages and disadvantages of these unsophisticated methods.
- Identify and explain two sophisticated pricing methods.
- Calculate a target average rate per occupied room night using the Hubbart formula.
- Differentiate between price cutting and discounting.
- Calculate discount on prices using break-even analysis.
- Explain how food and beverages prices are calculated using percentage mark-up or multiple methods.
- Show how to target a food cost percentage or a beverage cost percentage.
- Define or explain all the key terms that appear in italics.

SELF-TEST QUESTIONS -5

(answers on last page this chapter)

1. Price cutting and discounting are:
   a. Both sophisticated pricing methods.
   b. Exactly the same thing.
   c. Both unsophisticated pricing methods.
   d. Different approaches to pricing.
   e. None of the above.

2. Which of the following is considered to be a sophisticated pricing method?
   a. Intuitive pricing.
   b. Traditional or rule-of-thumb pricing.
   c. pricing.
   d. Follow-the-leader pricing.
   e. Exclusive pricing.

3. The formula is:
   a. A target pricing approach.
   b. A competitive pricing approach.
   c. Used only in discounting.
   d. A trial-and-error pricing approach.
   e. None of the above.

4. Which of the following pricing methods should be avoided?
   a. Price cutting and discounting methods.
   b. Competitive and target methods.
   c. Follow-the-leader and formula methods.
   d. The traditional or rule-of-thumb and intuitive methods.
   e. None of the above.

5. A restaurant's prime costs are equal to:
   a. The costs of purchasing prime ribs.
   b. Labour costs plus cost of food.
   c. Profit less the mark-up.
   d. Labour costs plus cost of food and other direct expenses.
   e. None of the above.

6. Which of the following is a cost-based method of calculating a target average rate per occupied room night?
   a. Competitive pricing.
   b. Price cutting.
   c. formula
   d. Exclusive pricing.
   e. All of the above.

The three principal factors in the profit equation are:
   , a. Volumes, prices and costs.
   b. Competition, value and quality.
   c. Facilities, services and prices.
   d. Prices, costs and staff capabilities.
   e. None of the above.

8. pricing can be effective only if:
   a. There are no competitive facilities.
   b. The owner has no information on operating and other costs.
   c. Other variables such as the weather are noted and recorded.
   d. Calculating the CR formula is too difficult.
   e. All of the above.

9. The use of the formula involves:
   a. much expense for a small hotel/motel.
   b. Preparing forecasts of income and expenses.
   c. Checking out competitive prices.
   d. Using standard recipes for meals and drinks.
   e. All of the above.

10. The discounting pricing method represents an attempt to:
   a. Capture particular types of business or to attract business at particular times of the day, week, month or year.
   b. Undercut competitive prices.
   c. Get suppliers to give price discounts.
   d. Estimate competitive average rates per occupied room night.
   e. None of the above.

11. The use of break-even analysis in pricing is associated with:
   a. The intuitive pricing method.
   b. The price cutting method.
   c. The competitive pricing method.
   d. The discounting method.
   e. All of the above.

12. Percentage mark-up or multiple pricing approaches are:
   a. Cost-based methods used to price food and beverages.

b. Used to develop standard recipes.
c. Cost-based methods used to set room rates.
d. Break-even analysis techniques.
e. None of the above.

13. Effective pricing practices are:
  a. Usually only followed by large hotels.
  b. Always based on a thorough knowledge of competitive prices.
  c. Always based on a sound knowledge of operating costs and the use of one of the sophisticated pricing methods.
  d. Usually only followed by the most experienced owners.
  e. All of the above.

14. Menu prices are usually arrived at by:
  Using the trial-and-error pricing method.
  Using the competitive pricing method.
  Using different mark-ups for various menu items.
  Using the same mark-ups for each menu item.
  None of the above.

15. Competitive pricing is:
  a. A sophisticated pricing method.
  b. Almost as dangerous as intuitive pricing if used on its own.
  c. An unsophisticated pricing method used only by small hotel/motels.
  d. Effective when used together with ——— error pricing.
  e. None of the above.

WORKING EXAMPLE -5

Background

You are thinking of constructing a 10-room motel for a total cost (including land, building, furniture and fixtures) of $200,000. You can obtain a first mortgage from your bank for of the total (at proti per annum, your interest expense will be $18,000 per year). The balance will come from your personal funds. You are looking for a return of 'he n on your investment.

You anticipate a room occupancy percentage each year. There will be no food and beverage facilities. You only other revenues will come from approximately $1,000 of miscellaneous sales.

Operating expenses (general expenses, repairs and maintenance, utilities) are expected to be $10,000 a year. Depreciation is calculated at $10,000 a year. You anticipate room expenses and payroll will be el of room revenues.

Local motels of similar quality and services are advertising room rates of $18.00 (single) and $22.00 (double). In general, the properties experience a double occupancy factor of 1.5.

tax

Using the entirely formula, calculate a target average rate per occupied room night for the proposed motel. As a guideline, you should follow these steps:

- Determine the required revenues from rooms.
- Estimate the number of occupied room nights.
- Calculate the target average rate per occupied room night.

Once you have calculated the required average rate per occupied room night, indicate whether or not you would go ahead and build the motel,

The solution to this example can be found following Chapter 10.

NOTES

answers to self-test questions – 5

1. d	2. c	3. a	4. d	5. b	6. c	7. a	8. c
9. b	10. a	11. d	12. a	13. c	14. c	15. b	

6

OPERATING AND CASH BUDGETS

keeping an eye on the future. . .

A budget is simply a pre-determined financial plan, which is based on your estimate of the future of your business. As such, it can be considered to be a profit plan - ie., a tool, readily available, which you can use to make your hotel/motel more profitable.

There are several kinds of budget, but we will deal only with the three most important ones:

- *Operating budget.* This covers volumes, prices, revenues, expenses and profits.
- *Cash flow budget (or cash budget).* This covers receipts, disbursements, cash shortfalls and cash surpluses.
- *Capital budget.* This covers the costs related to the construction, acquisition, repair and renovation of your hotel/motel's fixed assets.

In this chapter, we will deal with the operating and cash flow budgets. (capital budgets will be discussed in Chapter 9). Our purpose is to show you how you can get the most mileage out of your cash resources by planning and forecasting the flow of cash through your hotel/motel.

Benefits of budgeting

If it is properly set up, a good budgeting system can allow you to:

- Plan the operation of your hotel/motel in advance.
- Set realistic goals and targets.
- Measure your performance.
- Control key aspects of your hotel/motel's operation.
- Make sound pricing decisions.
- Avoid potentially dangerous business situations.
- Choose between alternative courses of action.
- Raise long-term financing from your bank or other lenders.
- Show employees your overall management policy.

Characteristics of a good budget

Most budgets cover a period of one year, but if you run a large hotel/motel, you will need budgets that cover each of the 12 months separately. Either way, though, all good budgets have certain characteristics in common. Good budgets are all:

- Comprehensive - ie., they have taken into account all the activities of your hotel/motel.
- Coordinated - ie., they bring together for comparison purposes all components of your hotel/motel.
- Practical - ie., they indicate where the resources you need will actually come from.
- Realistic.
- Future-oriented.
- Expressed in dollars.

As you can see, good budgets draw on information that comes from all parts of the financial management system.

Most budgets tend to be based only on last year's performance. This makes them easy to prepare. However, the result is generally a poor budget. By using last year's figures, you are simply carrying last year's inefficiencies into this year, next year, and so on. A much better approach is to view each year in isolation, and when planning ahead for, say, one year, build up a budget based only on what you expect to happen during that year. This is called *zero-based budgeting,* because it requires you to start each year from zero. Each year, you are forced to justify all anticipated revenues and expenses; you cannot simply carry forward last year's.

Preparing an operating budget

An operating budget is really a pro-forma, or future, income statement covering your next fiscal year (which may or may not be January l-December 31). You should start preparing your next year's operating budget about three months before the end of your present year.

To do so, you need an understanding of:

- The hotel/motel industry.
- Current and projected economic conditions.
- Your own business and your market.
- Your competition.

Even though most of these factors are outside your control, they must be taken into account when preparing your operating budget, since they greatly affect your hotel/motel's performance. For example, you must consider the inflation rate in your industry when trying to assess your future revenues and expenses.

Here, then, are the steps you should take to prepare and maintain an operating budget.

Step 1. Establish your objectives.
Your objectives should start with your desired rate of return, and be developed from there into revenues and profit targets for the year. You should probably list your objectives and the assumptions you have used when drawing them up.

Step 2. Decide on the division of your budget into planning periods.
Divide your fiscal year into semi-annual, quarterly or monthly periods, depending upon the reporting needs at your hotel/motel.

Step 3. List factors and trends expected to affect your business.
List all of the external forces that affect your hotel/motel and determine what impact they will have during each planning period. In particular, consider the following:

- General growth and trends in the tourist industry.
- Current and projected state of the economy at the local, provincial and national levels.
- Changes in market demand.
- Changes in the number and/or size of competitive properties.

Step 4. Prepare revenues forecasts.
Using the information from Step 3, estimate your projected revenues for each planning period. If possible, calculate the per unit sales (ie., occupied room nights) and the selling prices per unit (ie., average room rates). This is the most critical step in the development of your budget, because the remaining steps are based on its accuracy.

If you have food and beverage and other departments, prepare similar revenues forecasts for them too.

Step 5. Prepare expense forecasts.
Using the information from Steps 3 and 4, calculate your estimated expenses for each planning period. The estimate of expenses should either be based upon a cost per unit of volume activity (eg., laundry expense of $0.50 per occupied room) or expressed as a percentage of revenues (eg., laundry expense of 1% of room revenues).

Some expenses (ie., fixed costs) do not vary with volume, or they are at the discretion of the owner-manager. In these cases, you should estimate the expense based upon your general plan for the upcoming year and known fixed cost increases.

Step 6. Monitor actual performance relative to your budget.
At the end of every planning period, compare the actual results to the budget, and investigate any large variations.

Example of an operating budget

Now let's go through the example of the Towne Motel to see how an annual operating budget is prepared in practice. We will assume that the Towne Motel has 10 rooms; it is open year-round; and it has no food and beverage facilities. Other details of the Towne Motel will be introduced during the course of the example.

Here's what you would do if you were preparing an operating budget for the Towne Motel.

Step 1. Establish your objectives.
We'll assume you would like to achieve a net after-tax income of approximately $3,000 for the year, which is, say, a 10% return on equity of $30,000.

Step 2. Decide on the division of your budget into planning periods.
Here we'll assume that the Towne Motel is located in a summer tourist area, so the planning periods are best defined as May l-October 31 and November l-April 30.

Step 3. List factors and trends expected to affect your business.
The Towne Motel has been in business for 10 years and you have developed a solid relationship with your repeat guests. You do not anticipate any major change in demand by this market. However, a local motor-inn of comparable facilities has just gone out of business. As a result, you feel your annual occupancy should increase by 5%. The local economy is stable. However, you expect a general rise in prices of 8%.

Step 4. Prepare revenues forecasts.
Here, we've made a number of assumptions, which should be self-explanatory.

	Projected	Last Year
Occupied room nights		
May-October	1,370 (75%)	1,278 (70%)
November-April	1,238 (68%)	1,147 (63%)
Double occupancy factor		
May-October	2.0	2.0
November-April	1.3	1.3
Room rates		
Single	$20.00	$18.00
Double	$24.00	$22.00
Room revenues (see below)		
May-October	$32,890	$29,136
November-April	$26,246	$22,022
Total	$59,136	$51,158

The room revenues have not been assumed here; instead, they have been calculated from the other figures shown, using a formula called the *double differential formula.* It is based on the following:

A. Maximum revenues if all rooms are sold as doubles = Double rate x Number of rooms available x Number of days in planning period

B. Maximum revenues if all rooms are sold as singles = Single rate x Number of rooms available x Number of days in planning period

If you subtract the two (ie., subtract B from A), you get a factor called the double differential. The double differential formula for calculating room revenues is then:

$$\text{Room revenues} = \text{Single room rate} \times \text{Number of occupied room nights} + \left[\left(\text{Double occupancy factor} - 1.0 \right) \times \text{Double differential} \times \text{Occupancy percentage} \right]$$

Applying these calculations to the period of May-October, you get:

A. Maximum revenues, doubles = $24 x 10 x 183 = $43,920

B. Maximum revenues, singles = $20 x 10 x 183 = $36,600

Double differential (A-B) = $ 7,320

And applying the double differential formula you get:

Room revenues = $20x 1,370+ [(2.0-1.0)X$7,320X0.75]
= $32,890

The room revenues for November-April are calculated in the same manner.

In addition, we will assume that you estimate telephone revenues at $1.50 per occupied room night and other income at 1.0% of total revenues.

Step 5. Prepare expense forecasts.

The expenses you directly control should be estimated, based on the projected volume. Again, we've made a number of assumptions as follows:

	May-October	November-April
Salaries, wages and employee benefits:		
1 maid @ $11,000	$5,500	$5,500
1 groundsperson (student) @ $4,000	4,000	
Owner's salary	6,000	6,000
Employee benefits @ 8% of salaries and wages	1,240	920
Sub-total	$16,740	$12,420
Other expenses		
Room expenses		
Normally, other room expenses are 6% of room sales at the Towne Motel.	1,973	1,575
Telephone expenses		
Telephone expenses are estimated at 140% of telephone revenues.	2,87'7	2,560
Energy costs		
Energy costs were $3,000 last year. Due to a slight increase in occupancy and an anticipated price increase of 8%, the estimate is $3,400 next year (35% summer and 65% winter).	1,190	2,210
Property operation and maintenance		
If possible, you should cost any planned renovations; in addition, a base amount should be included. We've assumed the figures shown.	1,700	1,300
Marketing		
You budget $650 for marketing in May-October and $850 for November-April.	650	850
Administrative and general		
Expenses are estimated at $700 for May-October and $650 for November-April.	700	650
Financial and other expenses		
The interest expense for the projected year can be obtained from the mortgage company; for the Towne Motel it will be $6,750 for the year.	3,375	3,375
The local insurance agent estimates premiums to be $750 for the year.	375	375
Municipal taxes can be estimated; based on information supplied by the local municipal tax department.	750	750
Sub-total	$13,590	$13,645
Depreciation		
Your project depreciation at $3,000 for the year, based on capital cost allowances and asset values.	1,500	1,500
Income taxes		
Your project that a 28% tax rate will be applied to your income before income taxes (see Figure 46)	970	232
Total expenses	$32,800	$27,797

You are now in a position to draw up your annual operating budget for the Towne Motel. It is shown in Figure 46.

Step 6. Monitor performance relative to budget.
You should complete the operating budget shown in Figure 46 by adding the actual figures as they become available throughout the year. Any major discrepancy between the budgeted figures and the actual figures should be investigated immediately.

FIGURE 46 **Towne** Motel annual operating budget

Period ended April 30_

May 1	October 31		November 1	April 30
Actual	*Budget.*		*Actual*	*Budget*
		Revenues		
$	*$32,890*	Guest rooms	$	*$26,246*
	2,055	Telephone		*$1,857*
	350	Other income		*290*
	35,295	Total		*28,393*
		Operating Expenses		
$	*15,500*	Salaries and wages		*11,500*
	1,240	Employee benefits		*920*
	4,850	Direct operating expenses		*4,135*
	700	Administrative and general		*650*
	650	Marketing		*850*
	1,700	Property operation and maintenance		*1,300*
	1,190	Energy costs		*2,210*
	25,830	Total		*21,565*
	9,465	Income before fixed charges		*6,828*
		Financial and other expenses		
	750	Municipal taxes		*750*
	375	Insurance		*375*
	3,375	Interest		*3,375*
	4,500	Total		*4,500*
	4,965	Income before depreciation		*2,328*
	1,500	Depreciation		*1,500*
	3,465	Income before income taxes		*828*
	970	Income taxes		*232*
$	*$ 2,495*	Net income	$	*596*
	1,830	Available room nights		1,820
	1,370	Occupied room nights		1,238
%	75%	% Occupancy		68%
	2.0	Double occupancy		1.3
$	$24.00	Average rate per occupied room night	$	$21.20

Preparing a cash flow budget

In addition to an annual operating budget, you should prepare a cash flow budget (or a cash budget). As discussed in Chapter 1, cash flow is not the same as net income, since net income includes some non-cash expenses (ie., depreciation) and omits other cash expenses that are not tax-deductible (ie., repayment of principal on mortgages and loans, owners' drawings from the hotel/motel, the cost of any fixed assets that are purchased, and dividends.)

The cash flow budget draws most of its information from the operating budget, so the operating budget is always prepared first. The cash flow budget accounts for all sources and uses of cash in your hotel/motel. Its main benefit is that by estimating your future cash flow, you can plan for debt repayment, fixed asset acquisitions and the investment of any cash surpluses that occur during the year. Proper control and use of cash is essential to ensure the success of any hotel/motel.

Cash flow budgets should normally be prepared for the same planning periods as operating budgets. However, if there is any prospect of a cash deficit occurring during a planning period, you should draw up more detailed cash flow budgets - probably monthly ones. Monthly cash flow budgets will allow you to prepare for the deficit and arrange for any necessary financing.

Here are the steps you should take to prepare a cash flow budget.

Step 1. Determine your opening cash balance.
This is simply the last planning period's closing cash balance.

Step 2. Determine the cash that will be received from revenues.
This is your total revenues, taken from your operating budget.

Step 3. Determine the proceeds from any loans.
This is the amount that you intend to borrow during the planned period.

Step 4. Determine the cash contributions from owners.
This is the amount that the owners intend to invest in their hotel/motel during the planning period.

Step 5. Calculate the total amount of cash that will be received.
This is the sum of Steps 2, 3 and 4.

Step 6. Calculate your total expenses.
These are your total expenses, excluding depreciation. They come from your operating budget.

Step 7. Estimate your purchases of fixed assets.
Your fixed assets would include land, buildings, furniture and fixtures.

Step 8. Determine the cash drawings by the owners.
This is the amount of money the owners will take out of the hotel/motel, which is neither salary nor a loan.

Step 9. Calculate the repayment of debt.
This is the amount you will have to pay out in mortgage and loan payments.

Step 10. Calculate total cash disbursements.
This is the total of all cash expenditures during the planning period -ie. the sum of Steps 6, 7, 8 and 9.

Step 11. Calculate net cash flow.
This is the difference between Step 5 and Step 10.

Step 12. Calculate your cash closing balance.
This is the amount of cash (surplus or deficit) that you expect to have at the end of the planning period. This is the sum of Step 1 and Step 11.

If a cash surplus is anticipated, then you can plan how the excess cash will be used (eg., for renovations, investment in short-term securities, payment of a dividend, etc.). Similarly. if a cash deficit is anticipated, then you can plan how it will be financed (eg., through a bank loan, personal investment by the owner, a delay in fixed asset purchase, etc.). The critical point is that you must be aware of future cash balances, so that you can plan ahead.

Naturally, at the end of each planning period, you should compare the budgeted and the actual cash inflows and outflows, and investigate immediately any major variances.

Finally, we have worked out a cash flow budget for the Towne Motel, using numbers that appeared in the Towne Motel's operating budget as well as making certain self-explanatory assumptions. The cash flow budget is shown in Figure 47.

FIGURE 47 Towne Motel cash flow budget

	May-October		November-April		Annual	
	Budget	*Actual*	*Budget*	*Actual*	*Budget*	*Actual*
Cash opening balance (A)	$ 3,000		$ 5,995		$ 3,000	
Cash receipts						
Revenues	$35,295		$28,393		$63,688	
Proceeds of any loans	5,000				5,000	
Cash contributions by owners			2,000		2,000	
Total cash receipts	$40,295		$30,393		$70,688	
Cash disbursements						
Total expenses	30,300		26,065		56,365	
Purchase of fixed assets	2,000		4,000		6,000	
Cash drawings by owners	2,000				2,000	
Repayment on any debt	3,000		3,000		6,000	
Total cash disbursements	$37,300		$33,065		$70,365	
Net cash-flow (B)	2,995		($2,672)		323	
Cash closing balance (A+ B)	$ 5,995		$ 3,323		$ 3,323	

Key points in review

After studying Chapter 6, you should be able to:

- Explain the purposes and benefits of budgeting.
- Identify the characteristics of a good budget.
- Prepare an annual operating budget.
- Prepare a cash flow or cash budget.
- Define or explain all the key terms that appear in italics.

SELF-TEST QUESTIONS -6

(answers on last page this chapter)

1. A budget is:
   a. One of the four principal financial statements.
   b. Something only produced by large hotels.
   c. A pre-determined financial plan.
   d. An estimate of accounts receivable and accounts payable.
   e. None of the above.

2. An operating budget is the same as:
   a. A pro forma balance sheet.
   b. A pro forma income statement.
   c. A pro forma retained earnings statement.
   d. A cash budget.
   e. None of the above.

3. Which of the following factors are not considered in establishing an operating budget?
   a. Current and projected economic conditions.
   b. Capital expenditure program.
   c. Lodging industry prospects and tourism in general.
   d. Your own business and market conditions.
   e. Competition.

4. Which of the following is not a benefit of budgeting?:
   a. Increased credibility at the bank.
   b. Potential problems identified.
   c. Accounting procedures simplified.
   d. Greater motivation provided to employees.
   e. Maintenance of a dynamic operation.

5. An operating budget normally covers the following periods:
   a. A week.
   b. Five years.
   c. One year.
   d. Six months.
   e. None of the above.

6. Which of the following actions should be taken in preparing a budget?
   a. Set your objectives for the budget period.
   b. Review general business and economic conditions.
   c. Review industry and competitive performance.
   d. Review last year's performance.
   e. All of the above.

7. Normally, a cash budget should:
   a. Be prepared with the capital budget.
   b. Be prepared for the same planning period as the operating budget.
   c. Be prepared only for large hotels.
   d. Be prepared only when cash difficulties are expected.
   e. None of the above.

8. Which of the following is not an information source used in budgeting?
   a. Retained earnings statement.
   b. Income statement.
   c. Manager's daily report.
   d. Balance sheet.
   e. Statement of changes in financial position.

9. Another name for a cash budget is:
   a. A cash flow budget.
   b. A capital budget.
   c. A pro forma income statement.
   d. A pro forma balance sheet.
   e. None of the above.

10. Which of the following expenses are not tax-deductible?
    a. Depreciation, interest and purchases of inventories.
    b. Owners' drawings, repayment of principal and fixed asset purchases.
    c. Owners' salaries, purchases of inventories and repayment of principal.
    d. Owners' drawings, interest and repayment of principal.
    e. None of the above.

11. Which of the following is not a reason for preparing a cash budget?
    a. It allows you to plan for the repayment of debt.
    b. It allows you to plan for fixed asset purchases.
    c. It allows you to plan for reservations.
    d. It allows you to plan to invest cash surpluses.
    e. None of the above.

12. If you anticipate a cash deficit, which of the following courses of action should be considered?
    a. Increase short-term bank loan.
    b. Delay an expansion plan.

c. Delay a planned purchase of furniture.
d. Inject a shareholder's loan or more equity.
e. All of the above.

13. An owner's cash drawings from the business are:
    a. Not a salary, dividend or loan.
    b. The same as a loan.
    c. The same as a salary.
    d. The same as a dividend.
    e. None of the above.

14. Budgets should be thought of as:
    a. A snapshot of a business at a given time.
    b. Profit plans.
    c. A necessary evil in business.
    d. Being unnecessary in most small businesses.
    e. None of the above.

15. It is true to say that:
    a. Budgeting only requires information from financial statements.
    b. Budgets need not be compared with actual results.
    c. You can disregard your competition when budgeting.
    d. Budgeting draws information from all parts of the financial management system.
    e. None of the above.

WORKING EXAMPLE -6

Background

As the owner of the Ocean Motel, you have prepared the operating budget shown in Figure 48. In addition, you have drawn up the following information on your finances:

Opening cash balance (May)	$10,500
Bank loan to be taken out (January)	5,000
Planned purchase of new truck (January)	7,000
Owner will draw cash (October)	2,000
Planned purchase of 10 colour TVs (December)	4,500
Payment of principal on mortgage	
May-October	2,500
November-April	3,000

Task

Prepare a cash budget for the Ocean Motel, covering the same periods as the operation budget. Then make a recommendation on your cash planning.

The solution to the example can be found following Chapter 10.

FIGURE 48 Ocean Motel operating budget

	May-October		November-April		Annual	
	Budget	*Actual*	*Budget*	*Actual*	*Budget*	*Actual*
REVENUES						
Room revenues	$33,970		$21,264		$55,234	
Food revenues						
Telephone revenues						
Miscellaneous income						
Total revenues	33,970		21,264		55,234	
EXPENSES						
Wages, salaries and employee benefits	$15,500		$11,500		*$27,000*	
Rooms						
Cleaning supplies and expenses						
Guest supplies						
Laundry						
Linen						
Uniforms						
Miscellaneous						
Total	1,359		851		2,210	

Figure 48 (cont.)

	May-October		November-April		Annual	
	Budget	*Actual*	*Budget*	*Actual*	*Budget*	*Actual*
Cost of food and other items purchased for resale						
Energy costs						
Electricity						
Fuel						
Water						
Miscellaneous						
Total	1,190		2,210		*3,400*	
Property operation and maintenance	1,500		1,500		3,000	
Administrative and general expenses, marketing						
Accounting and legal						
Advertising and sales promotion						
Insurance						
Printing, stationary and postage						
Telephone						
Travel expense						
Miscellaneous						
Total	1,000		500		1,500	
Financial and other expenses						
Mortgage interest						
Municipal taxes						
Total	5,750		5,750		11,500	
Total expenses	26,299		22,311		48,610	
Net income	$ 7,671		$(1,047)		$ 6,624	

NOTES

answers to self-test questions – 6

1. c	2. b	3. b	4. c	5. c	6. e	7. b	8. a
9. a	10. b	11. c	12. e	13. a	14. b	15. d	

7

WORKING CAPITAL MANAGEMENT AND INTERNAL CONTROL

looking after your short-term interests. . .

The operating and cash budgets discussed in Chapter 6 both relate to the future profitability of your hotel/motel. However, before you can be sure of that future, you must first be sure of the present. That's what this chapter is about - ie., it's about looking after the financial resources and obligations that you already have, rather than planning for the ones that lie ahead.

Working capital management

Working capital is a term used to cover both your current assets and your current liabilities, while working capital management is simply the process by which you manage those short-term assets and liabilities.

As we saw in Chapter 1, current assets are cash and other liquid assets (inventories, accounts receivable, marketable securities, etc.), that can be converted to cash in the near future (usually within a 12-month period). Current liabilities are any debts that will be paid in the near future (which, again, is normally within a 12-month period). The cliff erence between your current assets and your current liabilities is called your *net working capital.*

Ordinarily, current assets are linked to current liabilities, because the former pays for the latter. That's because cash (or its equivalent) circulates through a business as follows. Cash is used to buy goods, which are stored in inventory, then converted to accounts receivable that are converted back into cash, In the case of sales that are made directly for cash, the cycle is even shorter - cash to inventory and back to cash. Because of the mark-up of inventory (and of the service that is sometimes sold with the inventory), the amount of cash received from a sale is normally greater than the amount spent on the inventory. Therefore, current assets can be said to pay for current liabilities.

The ability of your hotel/motel to pay its current debts on time depends upon the amount and timing of this cash circulation from one type of current asset to another. If this circulation is fast, compared to the time available for payment of accounts payable, then you will always have enough cash to pay your debts on time, but you will not need to keep a high level of current assets on hand. Under these circumstances, your balance sheet will show a small difference between current assets and current liabilities (ie., a small net working capital). This can be a healthy sign. Indeed, in a business where a high proportion of sales are made for cash, but a high proportion of purchases are made on credit, then current assets may be less than current liabilities giving you a negative net working capital. Nevertheless, most small and medium-size hotel/motels require a positive net working capital, with current assets exceeding current liabilities.

There are three main elements of working capital management:

- *Cash management.* This ensures that any excess cash reserves are used to earn a financial return. Also, it ensures that cash deficits are anticipated and that they are filled in the least costly way.

- *Credit management.* This ensures that suppliers' invoices are paid in time and that maximum advantage is taken of any discounts for prompt payment. It also ensures that accounts receivable are converted into cash within the period of credit granted to your customers.

- *Inventory management.* This ensures that your hotel/motel is neither overstocked nor undersupplied with respect to inventories. In the process, it determines the optimum inventory levels for various items kept in stock.

Determiningg the extent of your net working capital

We've stated that you should probably be aiming for a positive net working capital. But exactly how much do you need? Unfortunately, there is no hard answer to that question. It all depends on your own individual operation. Basically, the best that can be said is that the right amount of net working capital is the amount you need to keep your current assets and current liabilities within a manageable level.

To make an assessment of that manageable level, you should consider the following questions as they apply to your hotel/motel:

- What cash balance do you need to cover your day-to-day needs?
- What are your receivables normally composed of, and what is their likely recovery pattern in relation to monthly sales? How many days' revenues will normally be waiting payment?
- What inventories are required to ensure uninterrupted operations of the expected volume of business?
- What bank credit is required?
- What terms are available from suppliers, and what purchases will be needed at the expected revenue volumes?
- Are there any liabilities that will come due during the next 12 months?

As always, it pays to err on the side of caution, so make sure you have enough net working capital. If you don't, your purchasing power diminishes and your credit reputation will suffer, because you will be unable to pay your bills on time in accordance with the terms available from your suppliers. This sometimes happens with hotel/motels that are experiencing a steady growth in revenues. They need additional net working capital to support the higher revenues, but they haven't made provisions for that extra need.

When considering the net working capital needs of a seasonal hotel/motel in which monthly revenues vary widely during a normal 12-month business year, you should pay most attention to the peak revenue period. That's when your accounts receivable and inventories will be at their highest, and when your need for bank borrowings and support from suppliers will be at their greatest.

Statement of source and use of working capital

This statement shows how your current assets and current liabilities have changed over a specific period of time - ie., it shows how your working capital has changed. As an example, we have drawn up a statement of source of use of working capital for the Four Oaks Motel, presented below. It indicates how the working capital for this motel changed from 1986 to 1987.

Four Oaks Motel
Statement of source and use of working capital

	1987	1986
Current assets		
Cash		$17,600
Accounts receivable	$61,200	34,400
Inventory	11,000	4,200
Total current assets	72,200	56,200
Current liabilities		
Bank loan	15,800	
Accounts payable	25,600	13,400
Total current liabilities	41,400	13,400
Net working capital	$30,800	*$42,800*

As you can see, the statement shows that the net working capital (the difference between current assets and current liabilities) decreased by $12,000 from 1986 to 1987 ($42,800 -$30,800 = $12,000). However, there *is* no indication of where that $12,000 decrease went. That's because the statement of source and use of working capital looks only at current, or short-term, assets and liabilities, and the $12,000 was no doubt used for some long-term purpose - eg., to finance the purchase of a long-term asset or to reduce or eliminate a long-term debt.

It would therefore be better to use a statement that shows not only the short-term changes in assets and liabilities, but also the long-term ones. Such a statement is the statement of changes in financial position, which was briefly discussed in Chapter 1. We suggest you use this statement in place of the statement of source and use of working capital, because it shows net working capital changes - and a lot more besides.

Statement of changes in financial position

This statement (as mentioned in Chapter 1) serves as a link between two consecutive balance sheets. It covers the period between those two balance sheets (usually one year), and its main benefit is that it shows where your money came from during that period, and where it went. In other words, it shows your *sources of funds* (both short-term and long-term) during that period and your uses *of funds* (both short-term and long-term).

Sources of funds can be any of the following:

- Net income from operations.
- Depreciation.
- A decrease in certain fixed asset accounts - eg., the sale of a fixed asset.
- An increase in certain long-term liabilities - eg., an increase in loans or mortgages.
- An increase in shareholders' investment.
- A decrease in net working capital.

Uses of funds, meanwhile can be:

- Net losses from operations.
- An increase in certain fixed asset accounts - eg., the purchase of a fixed asset.
- A decrease in certain long-term liabilities - eg., payment of principal on an outstanding loan or mortgage.
- A decrease in shareholders' investment.
- An increase in net working capital.
- Dividends paid to shareholders.

Example of a statement of changes in financial position

To show how a statement of changes in financial position is drawn up, let's continue looking at the Four Oaks Motel.

As we said, the statement of changes in financial position links two consecutive balance sheets, so to draw one up you need those two balance sheets. However, you also need an income statement and a statement of retained earnings. Figure 49 shows the Four Oaks Motel's balance sheet for 1987, along with comparable figures for 1986. Figure 50 shows the motel's income statement (condensed), and Figure 51 shows the motel's statement of retained earnings. Finally, Figure 52 shows the statement of changes in financial position, which is based on Figures 49, 50 and 51.

FIGURE 49 Balance sheet: Four Oaks Motel example

as at December 31, 1987

ASSETS	1987	1986
Current assets		
Cash		$
Floats		
Operating account		17,600
Bank card account		
Payroll account		
Marketable securities		
Receivables		
Guest ledger	61,200	34,400
City ledger		
Other receivables		
Allowance for doubtful accounts	( )	( )
Inventories	11,000	4,200
Prepaid expenses		
Other current assets		
Total current assets	72,200	56,200
Investments and advances		
Fixed assets		
Land	40,000	40,000
Building	201,200	101.200
Leasehold improvements		
Furniture and equipment		
Accumulated depreciation	(80,000)	(60,000)
China, glass, silver, linen uniforms		
Total fixed assets	161,200	81,200
Other assets		
Total assets	$233,400	$137,400

LIABILITIES	1987	1986
Current liabilities		
Bank loans	$ 15,800	$
Accounts payable	25,600	13,400
Income taxes payable		
Accrued liabilities		
Salaries and wages		
Interest		
Other		
Current portion of long-term debt		
Other current liabilities		
Total current liabilities	41,400	13,400
Long-term debt, less current portion	60,000	
Other non-current liabilities		
Deferred income taxes		
Total liabilities	101,400	13,400
OWNERS' EQUITY		
Capital share	4,000	4,000
Retained earnings	128,000	120,000
Total owners' equity	132,000	124,000
Total liabilities and owners' equity	$233,400	$137,400

FIGURE 50 The Four Oaks Motel income statement (condensed)

as at December 31, 1987

	1987
Revenues	$220,000
Total revenues	220,000
Operating, financial and other income tax expenses	166,400
Depreciation expense	20,000
Total expenses	186,400
Net income	$ 33,600

FIGURE 51 The Four Oaks Motel statement of retained earnings

as at December 31, 1987

Retained earnings (January 1, 1987)	$120,000
Plus: Net income for 1987	33,600
	153,600
Minus: Dividends	25,600
Retained earnings (December 31, 1987)	$128,000

FIGURE 52 Four Oaks Motel statement of changes in financial position 1987

Sources of funds		*Uses of funds*	
Net income	$ 33,600	Fixed assets (buildings)	$100,000
Depreciation	20,000	Payment of dividends	*25,600*
Long-term debt	60,000		
Decrease in net working capital	12,000		
Total sources of funds	$125,600		$125,600

The statement of changes in financial position was drawn up as follows.

First of all, we looked for sources of funds. The place to start here is the income statement (Figure 50); it shows a net income (a source of funds) of $33,600 in 1987. It also shows a depreciation expense of $20,000, and this, too, is a source of funds.

Next we looked at the balance sheets for 1986 and 1987 (Figure 49). They show that long-term debt increased from zero in 1986 to $60,000 in 1987. This increase also represents a source of funds.

In addition, the balance sheets show current assets of $56,200 in 1986 and current liabilities of $13,400 in 1986. The net working capital in 1986 was therefore $42,800 ($56,200 -$13,400). In 1987, current assets were $72,200 and current liabilities were $41,400. Therefore, net working capital in 1987 was $30,800 ($72,200 - $41,400).

This means that net working capital decreased by $12,000 ($42,800 - $30,800) from 1986 to 1987 (as we indicated earlier). This decrease represents the last source of funds to be included in the statement of changes in financial position.

The next items we looked for were the uses of funds. The place to start here is the balance sheets. They show that the value of the Four Oaks Motel's land remained unchanged at $40,000 from 1986 to 1987, but the value of the motel's building increased by $100,000 ($201,200 - $101,200). This represents a use of funds.

Finally, the statement of retained earnings shows that dividend payments in 1987 were $25,600. This represents the last use of funds.

Putting all these numbers together produces the statement of changes in financial position in Figure 52. As we indicated, this statement shows where the Four Oaks Motel's money came from in 1987, and where it went. Naturally, the sources of funds equals the uses of funds.

Internal control

Internal control encompasses the various procedures you should follow to:

- Protect your assets.
- Ensure the accuracy of your financial management data.
- Encourage greater efficiency in your hotel/motel.

It is closely related to working capital management, since the majority of internal control procedures are designed to protect your cash and your inventories.

An internal control system generally incorporates the following elements:

- A system of checks and balances (eg., cash registers, pre-numbered guest folios, pre-numbered guest checks, etc.).
- A system of physical safeguards (eg., locks, safes, etc.).
- A system of record keeping and financial reporting.
- A plan of organization.
- A system of supervision.

In addition, the internal control system must be tailor-made for your hotel/motel (eg., it may be unnecessary to control credit sales if your hotel/motel only sells on a cash basis). Also, it must be cost effective, so that the costs of implementation do not exceed the benefits you will derive. Furthermore, the system must be flexible, so that you can adapt it to any changes in your business policies. And it must be simple, so that all your employees can easily follow it. Finally, all the system's procedures should be written down, so that there is no question about their meaning.

The basics of internal control

There are three basic rules of internal control, which should be reflected in every system. These are:

- All authorizations (eg., ordering food and beverages, cheque writing, etc.) must be kept separate from all bookkeeping functions.
- All authorizations and bookkeeping functions must be kept separate from the handling of assets (eg., the person who orders goods should not be the person in charge of inventory control).
- The entire internal control system should be supervised to ensure that it functions effectively.

Asset control

This aspect of your internal control system is the most important. It consists of four main elements - cash control, inventory control, consumption control and control of furniture, fixtures and equipment - which we will deal with in turn.

Cash control

All cash control systems should have the following objectives:

- They must ensure that you have enough cash to operate.
- They must ensure that all cash receipts are properly accounted for.
- They must ensure that all cash disbursements are authorized before cheques are signed and sent out.
- They must ensure that all disbursements and receipts are supported by some kind of proof.
- They must ensure that cash is protected from theft, fraud and other misappropriations.
- They must ensure that cash is spent only on goods and services that were ordered and received in proper condition.

One of the foundations of a cash control system is the cash budget, discussed in Chapter 6. It is an essential cash-planning and control tool, which enables you to make monthly, quarterly or seasonal comparisons between budgeted and actual cash reserves, and then to take any necessary corrective actions.

The other cash controls are as follows:

General cash controls

- Employees who handle cash should be bonded,
- Receipts should be received for all monies taken from petty cash,
- A bank reconciliation should be completed every month.
- When cash is received, it should be recorded immediate y by an employee who has no further control of cash or bookkeeping.
- All cashiers' change (ie., floats) should be a fixed amount, for which the cashier is held responsible.
- If possible, cash receipts should be deposited on a daily basis at the bank.
- Generally, disbursements should not be made from the daily cash received; petty cash should be used for this purpose.
- Guest folios, restaurant checks, etc. should be pre-numbered and accounted for.
- Finally, you should avoid any cash control system that might tempt an employee to defraud you.

Mail receipts

- Cheques received in the mail should be restrictively endorsed immediately (eg., "For deposit only to the account of . . . ").
- A record of both the person submitting the cash and the amount should be made immediately; for advance deposits, a receipt should be sent to the guest.

Counter receipts

- All "over the counter" receipts should be recorded immediately by means of a cash register, a "paid" guest folio/cheque, etc. A cash register is best,
- At the end of the day (or, if there is a cashier, at the end of his/her shift), the cash received through the cash register should be balanced. Each cashier should then fill in a cashier's report which looks like:

Item	Print register	Adjustments	Net
Sales			
Room			
Food and beverage			
Miscellaneous			
Sales tax			
Total			
Less			
Credit card			
Paid outs			
Cash called for			
Actual deposit			
Cash over (under)			

- Only specified cashiers should be allowed to operate the register.
- If possible, the cashier should place the cash in a drop safe. If not, the cash and the cashier's report should be kept in a safe place, accessible only by the person who will make the bank deposit.

Cash disbursements

- All disbursements of a material nature should be made by cheque.
- Cheques should be signed only if the person signing them is satisfied that the goods/services purchased were received in good order and at the agreed price.
- If possible, cheques should never be pre-signed.
- All cheques should be pre-numbered, and all cheques should be accounted for.
- Cheques spoiled in the course of preparation should be mutilated to prevent their issuance, but they should not be thrown away.
- Invoices should be stamped "paid", with a record of the date and cheque number to guard against double payment. They should also be initialled by the owner, whenever possible.

Inventory control

The control system for inventory should be designed to account for the purchasing, receipt, storage and removal of all goods held for resale. A good inventory control system has the following characteristics:

- Expenses are carefully budgeted.
- Purchasing is done efficiently.
- All purchases are authorized.
- Purchasing as an employee function is separated from bookkeeping.

- Purchasing as an employee function is also separated from receiving and inventory control.
- A reporting system is developed.

Here are the basic types of inventory control you should use.

A perpetual inventory system

It should be used (whenever possible) for all dry goods and beverages. A perpetual inventory system relies on bin cards for each inventory item. All receipts, adjustments and issues of stock are recorded. A bin card looks like this:

Date	Supplier	Receipts	Issues	Balance

Checked goods

Upon receipt, goods should be checked to ensure that they are as they were ordered and that the price is as it was agreed. Inventory should be kept in a locked storeroom, accessible only to the person who is responsible for receiving and issuing stock. If your food and beverage operation is large enough, you should use store requisitions to authorize issues from inventory.

Physical counts

Physical counts should be made to reconcile the inventory with the perpetual records.

Detection

Inventory shortages can be detected by comparing standard cost ratios to actual costs. For example, suppose your pricing policy for beverages is:

Price = 3 x cost

or

Cost of beverage sales = 33%

At the end of each month, you should determine your actual beverage cost and if it significantly exceeds the 33%, then an investigation is warranted.

Cash discounts

These should be taken whenever they are available. In some cases, it may pay to plan around the availability of cash discounts.

Inventory control also requires you to control when, what and how much you buy as well as the cost of purchasing. As a general guideline, you should follow these rules:

- One employee should check all incoming goods for quantities, types and quality. This employee should be told which goods have been ordered and in what quantities.
- Suppliers' delivery slips should be filed alphabetically to compare them with invoices that are mailed afterwards. Both documents should be stapled together before filing.
- If you have a lot of suppliers, you should use an accounts payable sub-ledger. This ledger will give you, in alphabetical order, the amounts you owe to all your suppliers.
- All products should have a specific area in the storeroom. This will avoid purchasing unnecessary goods because you cannot find them.
- One employee should be assigned the storeroom responsibility, and this person should authorize all withdrawals.
- The storeroom should always be locked after business hours.
- Make sure you are never at the mercy of one supplier.
- Never purchase more goods than are needed.
- All suppliers' special offers should be reviewed carefully.
- You should insure all inventory to avoid loss in case of theft or fire.
- You should never tie up too much money in inventory. Always bear in mind that money invested in inventory cannot be used elsewhere.

Even if you manage to establish efficient purchasing, receiving and storing control systems, you may still lose track of your inventory if you don't have a removal policy. This is especially true if many employees have access to your storeroom and can remove whatever goods they think are needed. Quantities taken out may then be higher than those needed; or they may be lost, damaged or stolen. Alternatively, you may end up purchasing items you already have in inventory. Establishing a removal policy is the only way to avoid these kinds of problems.

Your inventories (food, beverage, housekeeping and general supplies) should be located in different storerooms, and each item should be placed in its designated area, from which it can be removed only by the department head (or, in his or her absence, by a designated employee). These employees are the only ones who should have access to the storeroom. Any unused items should be returned to the storeroom.

The bin card system mentioned above should help you control the inflow and outflow of goods from the storerooms. Apart from maintaining up-to-date information on quantities on hand, the system also indicates when supplies must be replenished (usually, when quantities on the bin cards reach a pre-determined minimum).

To make sure the quantities shown on the bin cards equal those on the shelf, you should make regular spot checks, and inquire about any significant discrepancies.

Periodic inventory counts (as indicated above) should also be made. If your hotel/motel has a full-scale food and beverage operation, you will probably need to take inventories of alcoholic beverages at least once a week and of food at least once a month. Small operations with no food and beverage facilities may only need to take inventory on a quarterly or seasonal basis.

Among large hotel/motels, there are some general procedures for taking stock, which will help you speed the process. In the storerooms, you should clear the aisles of all goods, and group all similar items together (perhaps dividing the room into sections, such as A, B, C, and so on, and then drawing a plan of the room and identifying the sections). Then, divide your employees into pairs, one to call out the goods and quantities and the other to list them. Assign each pair a specific section of the room.

You should use inventory count sheets, and total the sheets before beginning the count. List the sheets in numerical order and give them to your employees, taking care to note which sheet has been given to which employee. You should make sure all merchandise has been accounted for (perhaps by asking your employees to place a check mark on the goods as they are counted); and you should make sure you get all the inventory sheets back when they have been completed.

Consumption control

In the lodging business, consumption control focuses on the use of food and beverages. Controls are applied from the time the food and beverage items enter the kitchen or bar from the storeroom, to the time they are recorded on guest checks in the restaurant or lounge. Large lodging facilities usually have elaborate consumption control systems. Smaller hotel/motels may not need them; nevertheless, there are certain procedures that nearly all operators should follow. The main ones involve:

- *Standard recipes and portions.* You should prepare standard menu and drink recipes, and specify all portion sizes. This will reduce unnecessary wastage and over-portioning. (Standard recipe cards were discussed in Chapter 5.)
- *Pre-costing.* Once standard recipes have been developed, each of them should be pre-costed - ie., the actual cost of the dish or drink should be established. The menu items or drinks should then be priced to achieve a desired level of profitability. (This pricing procedure was also discussed in Chapter 5.)
- *Controls on food and beverage service.* The flow of food and beverages from the production area (kitchen or bar) to the service area (restaurant or lounge) must be tightly controlled. The one golden rule here is that no prepared items should be given to service staff without a properly completed guest check.

This is usually accomplished by a duplicate check system, in which the server writes the order on a guest check, at the same time preparing a carbonized duplicate. The duplicate is then submitted to the kitchen or bar staff to obtain the food or beverages listed. Alternatively, you can use a pre-check system, in which the server writes the order on a guest check and registers the correct prices in a machine. The machine produces a tape that is presented to the kitchen or bar staff to obtain the food or drinks listed.

The supply of these guest checks should be carefully controlled, and the checks must be pre-numbered. The service staff must account for all checks issued to them.

- *Pre-control.* A pre-control system is one that documents the sales histories of various menu and drink items. By keeping such "popularity indices", you can estimate the amount of a particular item that should be prepared or stocked.

- *Proper storage methods.* The proper storage of food and alcoholic beverages is essential to an effective consumption control system. It is a technical area that requires specific training, and is not covered in this program.

- *Periodic inventories.* At any given time, your food and beverage inventories will be split between your storerooms and your production areas. Periodic inventories should be taken in these areas.

- *Control through food and beverage cost percentages.* Prices of food and drink items are usually based on a mark-up over cost, and the combination of mark-ups is designed to produce a target level of profit over the entire menu or drink list (see Chapter 5). To ensure that your targets are reached and to pinpoint any control problems, you should compare your actual food and beverage cost percentages against the ones you have budgeted. The process for doing this is as follows:

  - Take a physical inventory at the beginning of a time period and cost it.
  - Add the inventory taken into the kitchen or bar during the period and cost it.
  - Take a physical inventory at the end of the period and cost it.
  - Deduct the closing inventory cost from the total cost of the beginning inventory and the new inventory taken into the kitchen or bar.
  - Calculate the revenues attributable to the kitchen or bar during the period.
  - Calculate the actual food and beverage cost percentages.
  - Compare the actual to the budget and investigate any significant discrepancies.

Control of furniture, fixtures and equipment

As you are no doubt aware, it is difficult to control the loss of, or the damage to, furniture, fixtures and equipment. In smaller establishments, the best procedure may simply be to exert your own personal control. However, you may also find it helpful to use a *fixed asset ledger (* shown below). The fixed asset ledger is self-explanatory; basically it is used to maintain a life-time record of all furniture, fixtures and equipment from purchase to disposal. An additional benefit of the ledger is that it can substantiate any insurance claims.

Description of item:

Date	Supplier	cost	Purchased	Disposed	Balance	Location

Other internal controls

The previous sections outlined specific controls you should use to safeguard your assets. In addition, there are certain other controls (which we briefly touched on) as follows:

- *An effective system of record keeping and financial reporting.* Double-entry bookkeeping gives you an automatic cross-check of your source journals, which ensures that all transactions are recorded accurately. Also, an effective system of record keeping gives you a permanent record of events and transactions for which employees can be held accountable. In addition, a system of financial reporting gives you enough information to detect problems before they become critical. At this stage of our course, it goes without saying that you cannot have effective internal control without an effective system of record keeping and financial reporting.

- *A plan of organization.* Such a plan defines the organizational structure of your business, detailing the various positions and the major duties and responsibilities that each entails. You may not have enough employees to justify a formal plan of organization. Nevertheless, there are a few basic principles that you should apply. For example, the major duties and responsibilities of each employee should be clearly defined. This will ensure a mutual understanding of the employee's responsibilities at the time of hiring and during the term of employment. Also, staff members should be adequately trained and knowledgeable about their positions. In the long run, it will cost you money if you use inexperienced staff for any position with responsibility.
- *A system of supervision.* Some supervision is obviously necessary to ensure that your system of internal control is operating as planned. The time and effort involved in designing and implementing a control system will be wasted unless you review the procedures to ensure that they are being properly carried out.

Check your own internal control

The last section in this chapter gives you an opportunity to check the system of internal control you now have. Simply answer yes or no to the following questions. Then assess your system. The idea is to have as many yes answers as possible. But only you can judge if your existing system is as good as it ought to be.

CASH	Yes	No
1. General		
Are employees who handle cash bonded?	_______	_______
Are receipts received for all monies taken from petty cash?	_______	_______
Is a bank reconciliation completed every month?	_______	_______
When cash is received, is it recorded immediately?	_______	_______
Are cashier change funds kept at a fixed amount?	_______	_______
Is the cashier responsible for the change fund?	_______	_______
Are cash receipts deposited daily?	_______	_______
Are "paid outs" made only from petty cash?	_______	_______
Are guest folios, restaurant cheques, etc., pre-numbered and accounted for?	_______	_______

2. *Mail receipts*	*Yes*	*No*
Are cheques received in the mail restrictively endorsed immediately?		
Is a record of the person submitting the cash (and the amount) recorded immediately?		
3. *Counter receipts*		
Are "over the counter" receipts recorded immediately by means of a cash register, a "paid" guest folio/ cheque, etc? (A cash register is best.)		
At the end of the day (or, if there is a cashier, at the end of his/her shift), is the cash received through the cash register balanced?		
Are only specified cashiers allowed to operate the register?		
Does the cashier place the cash in a "drop" safe (or a safe place, accessible only by the person who will make the bank deposit)?		
4. *Cash disbursements*		
Are disbursements of a material nature made by cheque?		
Are cheques signed only after the person signing them is satisfied that the goods/services purchased were received in good order and at the agreed price?		
Is it a policy to avoid pre-signing cheques?		
Are cheques pre-numbered and accounted for?		
Do you keep cheques spoiled in the course of preparation?		
Are invoices stamped "paid", recording the date and cheque number?		

INVENTORY	Yes	No
Is a perpetual inventory system used for dry goods and beverage?		
Are goods checked on receipt?		
Is inventory kept in a locked storeroom, accessible only to the person who is responsible for receiving and issuing stock?		
, Is inventory counted and reconciled to the perpetual records on a periodic basis?		
Are cash discounts taken when available?		

CONSUMPTION CONTROL	Yes	No
Have you prepared standard recipes for menu items and drinks?		
Have you established standard portion sizes for menu items and drinks?		
Do you pre-cost menu items and drinks?		
Are guest checks in your restaurants or bars pre-numbered?		
Do you assign and record the guest checks used by each service staff member?		
Do you use a duplicate or pre-check system?		
Do you make service staff account for all the checks given to them?		
Do you maintain sales histories for menu and drink items?		
Are you familiar with the correct storage procedures for food and beverages?		
Do you take periodic inventories of food and beverages in storerooms and in production areas?		
Do you use food and beverage cost percentages as a control measure?		

CONTROL OF FURNITURE, FIXTURES AND EQUIPMENT	Yes	No
Are fixed asset ledgers used to maintain a record of all purchases of furniture, fixtures and equipment?		

OTHER INTERNAL CONTROLS	Yes	No
Is a system of double-entry bookkeeping used to record transactions?		
Is there some form of reporting revenues and expenses on a monthly basis?		
Do you review the monthly financial reports and compare financial performance to the budget?		
Is there a job description detailing the major duties and responsibilities of each employee?		
Are the duties of physical custody of assets and the record keeping of assets segregated?		
Are employees adequately trained prior to undertaking any job responsibilities?		
Do you review the procedures and controls on a periodic basis to ensure they are operating as designed?		

Key points in review

After studying Chapter 7, you should be able to:

- Define working capital management and explain its objectives.
- Identify and explain the three main components of working capital management.
- Determine the extent of your net working capital.
- List the major sources and uses of funds.
- Prepare a statement of changes in financial position.
- Define the major objectives of internal control.
- Describe the three basic rules of internal control.
- Identify and explain the four elements of asset control.
- Determine whether your hotel/motel has an effective internal control system.
- Define or explain all the key terms that appear in italics.

SELF-TEST QUESTIONS -7

(answers on last page this chapter)

1. Which of the following is not a use of funds?
   a. The payment of principal on loans and mortgages.
   b. An increase in the value of inventories.
   c. The purchase of fixed assets.
   d. Losses on operations.
   e. Dividends paid to shareholders.

2. A business has cash on hand of $22,000, accounts receivable of $18,000, and inventories valued at S16,000. Its accounts payable equal $25,000, and it has a long-term loan with outstanding principal of $14,000. Its net working capital is therefore:
   a. $31,000.
   b. $17,000.
   c. $10,000.
   d. $42,000.
   e. None of the above.

3. Which of the following is not an element of internal control?
   a. Credit management.
   b. Inventory management.
   c. Cash management.
   d. Personnel management.
   e. None of the above.

4. The amount of net working capital needed in a business is:
   a. Directly related to the size of the business.
   b. Only relevant to large hotels.
   c. The amount needed to meet future cash commitments.
   d. The amount needed to ensure that all current asset and current liability accounts are at a manageable level
   e. All of the above.

5. Which of the following is not a source of working capital?
   a. An increase in value of accounts payable.
   b. A sale of fixed assets.
   c. Profits from operations.
   d. An increase in value of loans and mortgages.
   e. An increase in owners' investment.

6. Which of the following are generally part of an internal control system?
   a. A plan of organization.
   b. A system of physical safeguards.
   c. A system of checks and balances.
   d. A system of record keeping and financial reporting.
   e. All of the above.

7. The four main elements of asset control in the lodging industry are:
   a. Internal control, cash control, consumption control and inventory control.
   b. Inventory control, cash control, consumption control and control of furniture, fixtures and equipment.
   c. Personnel control, internal control, cash control and inventory control.
   d. Personnel control, inventory control, cash control and control of furniture, fixtures and equipment.
   e. None of the above.

8. Four techniques of consumption control used in the lodging industry are:
   a. Bin cards, standard recipes, pre-costing and periodic inventories.
   b. Pre-costing, pre-control, standard recipes and periodic inventories.
   c. Pre-control, food and beverage cost percentages, daily cash reconciliations and standard recipes.
   d. Standard recipes, periodic inventories, bin cards and pre-costing.
   e. All of the above.

9. Which of the following is false?
   a. Those who authorize purchases should also be responsible for bookkeeping.
   b. Those who are responsible for bookkeeping should not be responsible for the storage of inventories.
   c. The owner/manager should supervise the entire internal control system.
   d. Those who order goods should not be responsible for the storage of inventories.
   e. None of the above.

10. Duplicate check and **pre-check** systems are:
    a. Methods that ensure all cash deposits reach a business' bank.
    b. Methods that ensure the guest receives an authorized check for the food and beverages purchased.
    c. Methods that ensure tight control is exercised on the flow of goods from production to service areas.
    d. Useful only in large restaurants.
    e. None of the above.

11. In most hotel/motels it is true that:
    a. Current assets should always equal current liabilities.
    b. Current assets should be twice the value of current liabilities.
    c. Current liabilities should exceed current assets.
    d. Current assets should exceed current liabilities.
    e. None of the above.

12. An internal control system should:
    a. Be tailor-made for a business.
    b. Be more valuable to a full-service hotel/motel than a rooms-only hotel/motel.
    c. Be directly adaptable from one business to another.
    d. Be used only when an employee's motives are suspected.
    e. All of the above.

13. Which of the following is not a purpose of cash control?
    a. To ensure that cash is protected from theft, fraud and other misappropriations.
    b. To ensure that there is sufficient cash to operate.
    c. To ensure that all disbursements and receipts are supported by some kind of proof.
    d. lb ensure that cash is spent only on goods and services that were ordered and received in proper condition.
    e. None of the above.

14. The five elements of inventory control you should follow are:
    a. Bonding employees, counter receipts, physical counts, taking full advantage of suppliers' discounts and bank reconciliations.
    b. Taking full advantage of suppliers' discounts, physical counts, perpetual inventory system, checking goods on receipts and detecting inventory shortages.
    c. Bonding employees, physical counts, food cost percentages, perpetual inventory system and checking goods on receipt.
    d. Physical counts, perpetual inventory system, bonding employees, detecting inventory shortages and checking goods on receipt.
    e. All of the above.

15. Hotel/motels will full-scale food and beverage operations should:
    a. Take inventories of alcoholic beverages at least once a week and of food at least once a month.
    b. Take inventones of alcoholic beverages and food once per season.
    c. Take inventories of food and alcoholic beverages once a day.
    d. Take inventories of alcoholic beverages at least once a month and of food at least once a week.
    e. None of the above.

WORKING EXAMPLE -7

Background

You are the owner of the Twin Elms Hotel, a year-round operation. At the end of 1985, you want to prepare a statement of changes in financial position. You have a balance sheet (Figure 53), a condensed income statement (Figure 54) and a retained earnings statement (also shown in Figure 54).

In addition, you know that the following transactions took place during 1985 (these show up in the balance sheet, Figure 53):

- You purchased an adjacent parcel of land for $10,000.
- You sold a building for $20,000.
- You bought new furniture for $100,000.
- You arranged an additional long-term mortgage of $70,000.

Task

Prepare a statement of changes in financial statement for the Twin Elms Hotel.

The solution to this example can be found following Chapter 10.

FIGURE 53 Twin Elms Hotel balance sheet

as at December 31, 1985

ASSETS	1985	1984	Liabilities	1985	1984
Current assets			Current liabilities		
Cash	$ 30,000	$ 20,000	Bank loan	$ 5,000	$ 50,000
Accounts receivable	$ 45,000	$ 25,000	Accounts payable	$ 15,000	$ 30,000
Inventories	$ 25,000	$ 35,000			
	$100,000	$80,000		$ 20,000	$ 80,000
Fixed assets			Long-term liabilities		
Land	$ 50,000	$ 40,000	Mortgage	$585,000	$515,000
Buildings	$480,000	$500,000	Owners' equity		
Furniture, fixtures and equipment	$375,000	$275,000			
	$905,000	$815,000	Owners' equity	$ 50,000	$ 55,000
			Retained earnings	$ 20,000	(5,000)
Accumulated depreciation	$330,000	$250,000		$ 70,000	$ 50,000
	$575,000	$565,000			
Total assets	$675,000	$645,000	Total liabilities and owners' equity	$675,000	$645,000

FIGURE *54* Twin Elms Hotel condensed income statement

for the year ended December 31, 1985

	1985
Total revenues	$550,000
Operating, financial and other expenses and income tax expenses	$415,000
Depreciation	$ 80,000
Total expenses	$495.000
Net income (loss)	$ 55,000

Retained earnings statement

as at December 31, 1985

Retained earnings (January 1, 1985)	$ 50,000
Plus: Net income for 1985	$ 55,000
	$105,000
Less: Dividends	$ 35,000
Retained earnings (December 31, 1985)	$ 70,000

NOTES

answers to self-test questions - 7

1. b	2. a	3. d	4. d	5. a	6. e	7. b	8. b
9. a	10. c	11. d	12. a	13. e	14. b	15. a	

8

PLANNING FOR GROWTH AND PROFIT

taking the long-term new . . .

Canada's lodging industry has changed a great deal in the past 20 years, but in the next 20 years it's likely to change even more. Here's why: Most of Canada's hotel/motels are small (less than 20 units), and many of them exist because their owners are willing to accept below-average rates of return and salaries. Others exist because the profits they generate are merely supplementary to their owners' other income. However, as profit margins become harder to preserve and as new owners' equity is required to keep these properties going, it is likely that many of them will start to disappear.

Also, a large number of Canada's smaller hotel/motel operators are of retirement age or close to it. For this reason alone, many of them will be selling during the next 10 years or so. Furthermore, many of the smaller hotel/motels change hands at unrealistically high prices, and that, too, will encourage an industry shake-out.

Another reason for change is that many of the smaller hotel/motels are geared to "transient" rather than '(destination" business. As such, they provide little for the visitor to do on-site. Even the destination properties often depend on local attractions to bring them business, and they, too, are likely to find their volumes dropping if they do not add to, or improve, their facilities.

These pressures, together with shifting market demands, mean that major change is inevitable. If you are to survive the future, you are going to have to change too. That's what this chapter is all about. We plan to show you how to make the key decisions that will ensure your hotel/motel's long-term survival.

The decisions you face

Here are the kinds of long-term decisions you will be facing, and the ones we deal with in this chapter:

- Should you expand the size and scope of your operation? If so, what should you add and how much should you spend? We call this expansion planning.
- Should you upgrade, renovate or modernize your operation? If so, what priorities should you set and how much should you spend? We call this renovation planning.
- Should you lease or buy any new equipment you would like to have? We call this lease or buy decisions.
- Should you buy another hotel/motel or a related business? We call this acquisition planning.
- Should you' get out of the lodging industry altogether? We call this exit planning.

From the standpoint of financial management, there is only one place to start when making these types of decisions - your business' bottom line. Therefore, when we talk about planning for the future, we really mean planning for increased profitability. The key question to ask yourself is: Can you earn a higher rate of return investing in the lodging industry than you would get from, say, a bank deposit or certificate? If the answer is no, you shouldn't consider investing in the lodging industry at all. Even if the answer is yes, you still have to ask yourself: Is the rate sufficiently high to justify the risk? Most likely, you will need a before-tax return on investment that is at least three or four percentage points higher than the rate you would earn on a bank certificate, before an investment in the lodging industry becomes worthwhile.

For now, though, we'll assume that you are weighing up the five major kinds of decisions listed above. Let's look at each one in turn.

Expansion planning

The expansion of any small or medium-size hotel/motel requires an increase in capital investment through equity, long-term financing, or a combination of the two. It also requires more time and, most probably, more sophisticated management skills. It's a decision, therefore, that should not be taken lightly.

Knowing when to expand depends on individual market conditions and on your own financial circumstances. It's hard to generalize - especially for seasonally operated hotel/motels - but if you follow the steps outlined below, you should be able to tell when the time is right for you to consider an expansion. The steps - there are seven of them altogether - will not give you a definitive answer. For that, you have to conduct a feasibility study (discussed in detail in Chapter 9). What the seven steps will tell you is whether an expansion is even worth considering.

Step 1. Identify competitive facilities under construction or planned.
To assess your future competition, you should first check your local building department to see if any building permits have been issued to accommodation and/or restaurant developers. Secondly, you should visit local and regional planning departments and provincial/territorial tourism authorities to see if they are aware of any new or planned developments such as highways, visitor attractions and other tourism projects. Thirdly, check with your local press and the trade magazines to see if any developments, especially by the chains, have been announced or are proposed for your area.

Step 2. Assess the availability of land.
If you need additional adjoining land, you need to determine its condition (drainage, grade, soil type, etc.). Also, you have to find out if the present owner will sell and at what price.

Step 3. Check the zoning by-laws.
Will they allow you to expand or will you have to apply for a zoning change? Are there limits on the number of rooms allowed? In addition, you should determine if any by-laws specify the number of parking spaces that must be provided for guests and employees; or if they dictate the proportion of land your buildings are allowed to cover; or if they specify minimum requirements for water supply, sewers, size of yards and floor area: and so on.

Step 4. Determine the site servicing.
Local health authorities will advise you on the adequacy of sewers and water supply, and utility companies will tell you if existing services can accommodate increased loads. Both groups should be consulted.

Step 5. Check the adequacy of support facilities.
Find out if your existing facilities (front desk, public space, restaurant and bar, meeting and banquet rooms, kitchen and storage areas, climate control system, laundry, etc.) will still be adequate, if the expansion is made.

Step 6. Assess the availability of additional staff.
Check your labour analysis records and industry averages to see if your present staff can absorb an increased workload. Be sure to do this before hiring new people. Try to increase the productivity of your existing staff first, even if it means increasing salaries and wages. If it looks as if additional staff will be needed, examine the labour market to see if the people and skills are actually there.

Step 7. Assess the financial impact of an expansion.
Assessing the financial feasibility of any expansion is the most important step, and the key things to look at are as follows:

- Balance sheet considerations:
  How much will the expansion cost?
  How much long-term financing will be needed?
  How much new equity will be needed?
  How will working capital be affected?
- Income statement considerations:
  How much additional revenue will be generated?
  How far will operating expenses rise?
  How will municipal taxes, insurance premiums and interest charges be affected?
  How will profit levels change?
- Cash flow considerations:
  How will your cash flow be affected?

Example of expansion planning

To illustrate how you should assess the financial feasibility of an expansion, let's consider the example of the InTown Motel, We will assume that it is a year-round motel located in a fast-developing community. It has 20 rooms and relies heavily on business-related travelers for the majority of its trade. As the owner/manager of the motel, you have carried out a four-week study of room occupancies, and this indicates that your property enjoys excellent weekday business but has a sharp downturn on the weekends. Here's the pattern of occupancy that your four-week study showed:

	Number of occupied room nights	Number of room nights turned away
Monday	20	9
Tuesday	20	15
Wednesday	20	17
Thursday	20	16
Friday	8	
Saturday	10	
Sunday	14	

Monday	20	8
Tuesday	20	13
Wednesday	20	16
Thursday	20	12
Friday	7	
Saturday	9	
Sundav	12	
Monday	20	9
Tuesday	20	15
Wednesday	20	18
Thursday	20	15
Friday	8	
Saturday	12	
Sunday	14	
Monday	20	7
Tuesday	20	14
Wednesday	20	20
Thursday	20	16
Friday	6	
Saturday	8	
Sunday	12	
Total	440	220

Current occupancy level for 20 rooms =

$$\frac{\text{Total occupied room nights}}{\text{Total available room nights}} = \frac{440}{560} \times 100 = 78.6\%$$

As you can see, the occupancy percentage was 78.6% during the four-week study. We'll assume that this figure is close to your annual average occupancy percentage, so the study is typical of your year-round patterns.

We will now assume that reviewing the pattern of turnaways, you decide that either a 20 or a 10-room addition should be considered. With a 20-room expansion, you would be able to absorb all of the 220 room nights turned away. With 10 rooms, you could accommodate 153 of them. The following procedure shows you how to make a preliminary choice between the two alternatives.

Suppose it will take approximately one year to construct an addition. By that time, the InTown Motel's average rate per occupied room night will be, say, $37.50. Over four weeks, the motel's existing 20 rooms would therefore produce the following revenues:

Room revenues = (78.67. occupancy x 20 rooms x 28 days) x $37.50

= $16,500

Now consider the increased revenues, expenses and profits produced by a 10 and 20-room expansion. These are calculated in Figure 55, using the figures from the four-week study.

FIGURE 55 Measuring the effect of a 10-room and 20-room expansion on income before depreciation

lo-room expansion		20-room expansion	
Additional occupied room nights:			
Week 1 9+10+10+10 =	39	9+15+17+16 =	57
Week 2 8+10+10+10 =	38	8+13+16+12 =	49
Week 3 9+10+10+10 =	39	9+15+18+15 =	57
Week 4 7+10+10+10 =	37	7+14+20+16 =	57
Total	153		220

Additional room revenues:

10-room	20-room
153 occupied room nights x $37.50 = $5,737.50	220 occupied room nights x $37.50 = $8,250.00

Total room revenues:

10-room	20-room
$16,500 + $5,737.50 = $22,237.50	$16,500 + $8,250.00 = $24,750.00

Additional operating expenses:*

	10-room	20-room
Wages, salaries, employee benefits	$ 570.00	$ 820.00
Other direct room expenses	285.00	410.00
Undistributed operating overhead	1,000.00	1,400.00
Total	$1,855.00	$2,630.00

* We've assumed these estimates, based on past performance.

Additional income before fixed charges:

10-room	20-room
$5,737.50-$1,855.00 = $3,882.50	*$8,250.00-$2,630.00 = $5,620.00*

Additional investment required at $25,000 per room:

10-room	20-room
10 X $25,000 = $250,000	20X $25,000 = $500,000

Additional long-term liabilities, assuming you have $75,000 to invest yourself:

10-room	20-room
$250,000-$75,000 = $175,000	*$500,000-$75,000 = $425,000*

Calculation of financing charges, assuming an interest rate of 15% and assuming that mortgage principal is paid off in equal annual installments over 15 years:

Annual interest payments equal

10-room	20-room
0.15 X $175,000 = $26,250	0.15 X $425,000 = $63,750

Annual principal repayments equal

10-room	20-room
$\frac{\$175{,}000}{15 \text{ years}} = \$11{,}667$	$\frac{\$425{,}000}{15 \text{ years}} = \$28{,}333$

Interest payments for four-week period equal

10-room	20-room
$\$26{,}200 \times \frac{4}{52} = \$2{,}019.00$	$\$63{,}750 \times \frac{4}{52} = \$4{,}904.00$

Principal repayments for four-week period equal

10-room	20-room
$\$11{,}667 \times \frac{4}{52} = \$897.50$	$\$28{,}333 \times \frac{4}{52} = \$2{,}179.50$

Additional financial and other expenses:		
Interest	$2,019.00	$4,904.00
Municipal taxes*	350.00	700.00
Insurance*	50.00	100.00
Total	$2,419.00	$5,704.00

* Based upon information supplied by local municipality and insurance agent.

Additional income before depreciation:

Income before fixed charges - financial and other expenses equals
$3,882.50-$2,419.00 = $1,463.50 $5,620.00-$5,704.00 = ($84.00)

From Figure 55, it is clear that you should favour the 10-room expansion over the 20-room expansion, since the former would produce an income before depreciation of $1,463.00 for a four-week period, while the latter would produce a loss of $84.00 for the same period.

If we now look at the cash flow position, the differences between the two alternatives are even more dramatic. Let's assume that $13,000 of the investment per room went into the actual construction of the room itself. This asset is depreciated at 5% per year, we'll say. Furniture, fixtures and equipment costing $5,000 per room are depreciated at 15% per year. And the small business income tax rate is 25%. The cash flow position is shown in Figure 56.

FIGURE 56 Measuring the effect of a 10-room and 20-room expansion on cash flow

10-room expansion		20-room expansion	
Income (loss) before depreciation:			
$1,463.50			($84.00)
Depreciation:			
Buildings depreciation equals $\frac{(\$13,000 \times 10 \times 0.05) \times 4}{52}$	= $500	$\frac{(\$13,000 \times 20 \times 0.05) \times 4}{52}$	= $1,000
Furniture, fixtures and equipment depreciation equals $\frac{(\$5,000 \times 10 \times 0.15) \times 4}{52}$	= $577	$\frac{(\$5,000 \times 20 \times 0.15) \times 4}{52}$	= $1,154
Total depreciation equals	$1,077		$2,154
Income before income taxes:	*$386.50*	*($2,238.00)*	
Income taxes @25%	96.63	0	
Net income (loss)	$ 289.87	($2,238.00)	
Add: Depreciation	$1,077.00	$2,154.00	
	$1,366.87	($84.00)	
Less: Principal repayment	$ 897.50	$2,179.50	
Cash flow	$ 469.37	($2,263.50)	

Figure 56 shows that the 10-room expansion would produce a positive cash flow of $469.37, while the 20-room expansion would produce a negative cash flow of $2,263.50.

Capitalization rate

As indicated earlier, it is particularly hard to generalize about the merits of expanding a seasonally operated hotel/motel. The rooms or cottages/cabins have a lower revenue generating potential than do year-round ones, so they tend to yield a lower return on owners' equity. That makes it difficult to justify their expansion. However, if you are turning away many high-season bookings, an expansion maybe worthwhile.

One quick way of assessing the potential for expansion is a method of evaluation that relies on the *capitalization rate.* The method is easy to follow and relatively accurate; but it is not thorough enough to help you obtain financing. It basically tells you if you should proceed with a more comprehensive feasibility study (to be discussed in Chapter 9).

The capitalization rate method is appropriate for seasonally operated properties. However, it can be used by year-round properties too. The method works by telling you the maximum amount that you should consider investing in an expansion. This maximum is then compared to the estimated capital investment to see if the expansion is really worthwhile.

To use the capitalization rate method, you need to estimate four things:

- The capital budget - ie., the total cost of the project.
- The revenues the project might generate.
- The income before fixed charges.
- The capitalization rate.

Let's suppose you have estimated these four as follows:

Capital budget. We'll assume you are planning 10 new cottage units for a total cost of $100,000, divided like this:

$70,000 for construction
$15,000 furniture, fixtures and equipment
$10,000 for site preparation and servicing
$5,000 for other items

Revenues. From a market study, you have established:

Number of days in season	140
Number of units	10
Rate per day	$35
Occupancy	85%

Therefore, revenues = Number of days in season x Number of units x Rate per day x Occupancy percentage
= 140 X 10 X $35 X 0.85
= $41,650

Income before fixed charges. You have estimated operating expenses of $16,660 for a 140-day season, or 40% of total revenues.

Total revenues	$41,650.00
Operating expenses	$16,660.00
Income before fixed charges	$24,990.00

Capitalization rate. The capitalization rate varies from development to development depending on the following fixed costs:

Municipal taxes.
Insurance premiums on buildings and contents.
Interest rate on loans and mortgages.
Depreciation.
Owners' expected return on equity.

Now let's get to the method itself. As mentioned above, the method begins by calculating the maximum investment (or the total investment justified). The capitalization rate is the actual cost expressed as a percentage of this maximum amount.

In our example, we'll assume you have gathered the following information:

- You will invest $40,000 in the project and borrow the other $60,000 at a rate of 11.590 per year.
- Depreciation will be calculated at 10% per year on the construction cost of $70,000.
- Depreciation will be calculated at 12.59. per year on the furniture, fixtures and equipment costing $15,000.
- The assessment office of the local township has advised you that the mill rate on the project, including both property tax and business tax, will be 40 mills. This assessment will apply only to the cost of buildings, site preparation and improvements and site servicing. These three capital budget items total $80,000.
- Your insurance agent has indicated that yearly premiums on buildings will equal 0.25% of the cost of constructing each unit.
- If you invested your $40,000 in bank certificates, you would earn 9% per year before tax. To this rate, you add three percentage points as a risk factor, bringing your desired rate of return on the expansion to 12% before tax.

You would then calculate the capitalization rate as follows:

Expense items	Relationship to total investment	Calculation	Percentage of total investment
Interest	Borrowed 60% of total investment at 11.5%	$\frac{60 \times 11.5}{100}$	6.9
Depreciation - building	Building construction cost is 70% of total investment; depreciated 10% per year	$\frac{70 \times 10}{100}$	7.0
Depreciation- furniture, fixtures, and equipment	FFE was 15% of total investment; depreciated at 12.5% per year	$\frac{15 \times 12.5}{100}$	1.875
Municipal taxes	Mill rate of 40 mills (or $40 on every $1,000 of assessment) on 80% of total investment	$\frac{80 \times 40}{1{,}000}$	3.2
Insurance premiums	At 0.25% on the building construction cost; which equals 7090 of the total investment	$\frac{70 \times 0.25}{100}$	0.175
Return on owners' equity (before tax)	12% return expected on 40% of total investment	$\frac{40 \times 12}{100}$	4.8
Total			23.95

This total - 23.95% -is your capitalization rate. (For most hotel/motels, the capitalization rate is between 18% and 257..)

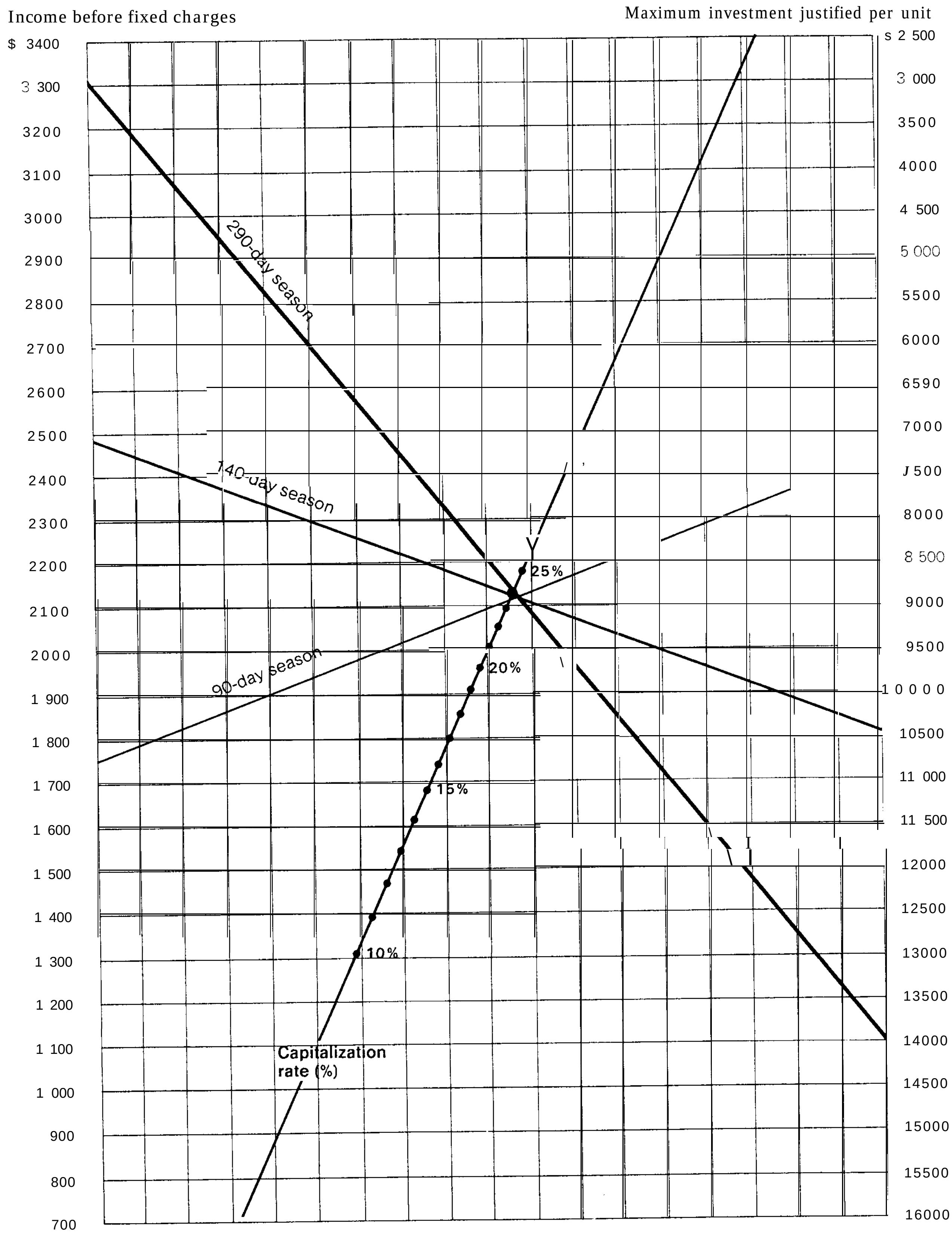
The next step is to take your income before fixed charges ($24,990 or $2,499 per unit in our example) and the capitalization rate (23.95%) and introduce them into the graph shown in Figure 57. This graph, known as a *nomograph*, can be used by any hotel/motel operator. A nomograph is simply a visual way of determining how much investment per unit is justified, if both the income before fixed charges per unit and the capitalization rate are known.

In our example, insert the income before fixed charges of $2,499 per unit on the left hand side of the graph. On the slanting line, mark the capitalization rate of 23.95%. Then draw a straight line from the income before fixed charges to the capitalization rate - and extend it to intersect the right side of the graph, which indicates the maximum justifiable investment per unit. In our example, the intersection occurs at $10,350.

Your estimated capital cost was $100,000, or $10,000 per unit. This is less than your maximum justifiable investment per unit, so it would be worthwhile proceeding with a more detailed feasibility study.

One other point worth noting: With the nomograph, there should be a tolerance factor of 5%. In other words, even if the total capital budget exceeds the justifiable total investment by up to 5%, the expansion still warrants further analysis. In our example, you should still proceed with further analysis even if the capital budget added up to $108,675 ($103,500 x 10570).

FIGURE 57 Nomograph



The effect of the length of your season

Generally speaking, the longer the season, the greater the amount of investment that can be justified. Similarly, the shorter the season, the lesser the amount. We can illustrate this, continuing with our example above.

Suppose that the season is reduced to 90 days (mid-June to mid-September) and that the occupancy level is increased to 90%. Your total revenues would then be:

90 days x 10 rooms x $35 x 0.90 = $28,350

Because of the higher occupancies, your income before fixed charges percentage would probably be higher at, say, 62% of total revenues. The income before fixed charges would therefore be:

0.62 X $28,350 = $17,577, or $1,758 per unit

Because your capitalization rate does not change, you can use the $1,758 income before fixed charges per unit and the 23.95% capitalization rate in the nomograph to determine the maximum justifiable investment per unit, You will find the maximum investment per unit is $7,340, or $73,400 for all 10 units (see Figure 57). Therefore, with a capital budget estimated at $100,000 ($10,000 per unit), you would have to conclude that it would not be feasible to build the 10 units - not for a 90-day season. (If you were still determined to build the cottage units, you would have to decrease the capitalization rate, perhaps by acquiring some kind of direct financial assistance or by lowering the rate of return expected on your investment.)

Suppose, now, that you could extend the period of operation to, say, 290 days (early June to mid-March). Your occupancy factor might drop to, say, 65%, and you may have to reduce the average rate charged per unit to, say, $32 per night. At the same time, your capital budget might have to increase by $10,000 (to winterize the units), giving a total of $110,000 for the development. Revenues would then be:

290 days x 10 rooms x $32 x 0.65 = $60,320

Because of the winterizing, your income before fixed charges may be somewhat lower - let's say 55% of total revenues. Your income before fixed charges would then be:

0.55 X $60,320 = $33,176, or $3,318 per unit

Using the nomograph, a 23.95% capitalization rate and an income before fixed charges of $3,318 per unit, you will find that an investment of approximately $13,850 per unit (or $138,500 in total) is justifiable. Since this is in excess of the capital budget figure of $110,000 (or $11,000 per unit), you can confidently proceed with a more detailed analysis of the expansion's feasibility.

Renovation planning

Decisions on renovation are usually not as clear-cut as decisions on expansion. When expanding, you increase the number of units of production (ie., additional guest rooms, additional restaurant seats, etc.) and thus your revenues and (you hope) your profits. It is the increased profits that justify the required investment.

When renovating (eg., upgrading existing guest rooms), the required investment has to be justified by price increases or demand increases, or by a combination of the two. These are hard to predict and measure.

The best way to renovate your hotel/motel is to plan ahead. Draw up a plan of the renovation (and/or replacement) of your buildings, furniture, fixtures and equipment, etc., and then set aside a certain amount of cash each year to pay for the eventual cost. The amount to be set aside should be tied to the expected lifetime of each fixed asset. A few generally accepted rules-of -thuumb for this type of scheduling are set out in Figure 58.

FIGURE 58 Accepted lifetimes of major hotel/motel assets

Item	Lifetime (in years)
Carpets for restaurant, perimeter, lounge, stairs and linking hallways	4
Drapes for perimeter, restaurant and lounge	4
Furniture in public areas	4
Pool furniture	4
Carpets in rooms, corridors, suites and adjoining rooms, assembly area and ballroom	5
Drapes in suites and adjoining bedrooms	5
Pool bubble (or cover)	6
Drapes, lamps, lounge chairs, mattresses and box springs in rooms	8
Furnishings and decor items in restaurant, coffee shop and lounge	8
Ice machines	8
Equipment and furnishings in office	10
Furniture in rooms	10
Equipment in kitchens	10
Furniture in ballroom	10

While this approach will help you plan ahead, the question remains: How much should you spend on renovations? Here, the answer simply is to spend just enough to produce a rate of return that is acceptable to you. However, we have to be a little more specific than that, so the first thing to realize is that a renovation project will normally add to your fixed costs of operation. The problem, therefore, becomes one of determining if volumes (eg., occupied room nights, covers served, etc.) and prices (eg., average rate per occupied room night, average check, etc.) can be adjusted to justify the increased fixed costs.

This is a problem best tackled by break-even analysis, and best demonstrated by an example. Let's assume that in the year prior to a renovation project, you record the following statistics:

Average rate per occupied room night	$ 24.00
Variable cost per occupied room night	$ 8.00
Contribution margin per occupied room night	$ 16.00
Fixed costs	$35,000.00
Total room revenues	$72,000.00
Occupied room nights	3,000
Net income	$13,000.00

Suppose your renovation project would cost $24,000, and suppose it would add $5,000 per year to your fixed costs (bringing the annual total to $40,000). If the number of occupied room nights remains the same (ie., 3,000), and if you hope to increase your net income to $16,000 from $13,000, then your average rate per occupied room night would have to increase to $26.67, as shown below:

$$\text{Target average rate per occupied room night} = \frac{\text{Total required revenues}}{\text{Number of occupied room nights}}$$

$$= \frac{\text{Fixed costs + Desired net income + (Number of occupied room nights x Variable costs)}}{\text{Number of occupied room nights}}$$

$$= \frac{\$40{,}000 + \$16{,}000 + (3{,}000\text{X } \$8)}{3{,}000}$$

$$= \frac{\$80{,}000}{3{,}000}$$

$$= \$26.67$$

However, if you felt that the contribution margin on rooms would remain the same (ie., $16.00, instead of the $18.67 it would be with an average rate per occupied room of $26.67), then the investment in renovations would have to be justified entirely by increased volumes (ie., more occupied room nights). In fact, an additional 500 occupied room nights would be needed, as shown below:

$$\text{Target unit sales volume} = \frac{\text{Fixed costs + Desired net income}}{\text{Contribution margin}}$$

$$= \frac{\text{Fixed costs + Desired net income}}{\text{Average rate per occupied room night - Variable cost per occupied room night}}$$

$$= \frac{\$40{,}000 + \$16{,}000}{\$24 - \$8}$$

$$= \frac{\$56{,}000}{\$16}$$

$$= 3{,}500 \text{ occupied room nights}$$

In this case, then, you would have to decide if you can reasonably expect to achieve room revenues of $80,000, through an increased average rate per occupied room night of $26.67, or an increased volume of business of 3,500 occupied room nights, or by some intermediate combination of two - eg., 3,200 occupied room nights and an average rate of $25. If you decide that these are reasonable forecasts, then you should proceed with a more detailed feasibility study of the renovation project.

Lease or buy decisions

Leasing is simply a form of financing that can allow you to furnish, refurnish or equip your hotel/motel without having to invest and/or borrow significant amounts of money. The advantages of leasing can be summarized as follows:

- Leasing is a kind of financing that enables businesses with limited capital to obtain furniture, fixtures, equipment, etc.
- Leasing usually conserves existing sources of credit, and generally it does not restrict a business' future borrowing capacity.
- Leasing provides 100% financing for the asset or assets. Banks and other lenders normally require a downpayrnent (ie., owners' equity) of 10% -2070.
- Leasing costs are 100% deductible from income before income taxes (although you cannot take advantage of both leasing costs deductions and depreciation at the same time).
- Leasing enables you to try out furniture, fixtures, etc., before you commit to buying them.
- Leases are quoted at fixed rates for the duration of the lease. This helps you avoid the risk of having to refinance at higher rates.
- Leasing protects you from the costs involved when the equipment becomes obsolete (although you lose the benefit of any resale value).
- Leasing is a quick and flexible way of acquiring assets.

In short, the key variables in making a lease-or-buy decision are depreciation, obsolescence, operating/maintenance charges, salvage/resale value and income tax implications.

There are four types of leases generally available to the lodging industry:

- *Operating lease* - an agreement that can be cancelled by the lessee or lessor once notice has been given by the other party. Operating leases usually have an indefinite term, and apply to items such as vehicles, computers, word processors, photocopying equipment, etc.

- *Financial lease* - an agreement whereby the lessee makes payments to the lessor over a specified period of time in exchange for the use of the leased asset. The life of the lease is usually set at half the expected life of the asset. These types of leases are associated with office equipment and furniture, as well as photocopying equipment, computers, word processors, etc.
- *Sale and leaseback* - an agreement under which you sell an asset you now own and lease it back from the purchaser.
- *Maintenance lease* - an agreement in which the lessor provides maintenance service for the leased asset.

To illustrate the way you decide between leasing and buying, let's assume that you would like to acquire equipment costing $20,000, including sales taxes, and that you have two options available:

- Obtain a bank loan of $16,000 and use $4,000 of your own money,
- Lease the equipment over a 10-year period.

The financial implications of these alternatives are shown in Figure 59. Certain other assumptions were made in compiling this figure, as follows:

- The operating life of the equipment is 10 years.
- Annual lease installments are $4,770,
- Bank loan carries a rate of 18% per year, to be repaid in equal annual amortization payments of $4,450.
- The small business tax rate is 25%.
- The equipment is depreciated at 15% on a declining balance basis.

In this case, ownership is better than leasing, since leasing would cost you $1,414 more than owning over the 10 years. But note that the ownership option requires you to invest $4,000 of your own money in the equipment - and we have not considered the return you would have earned on this money, had you invested it elsewhere. Also, we have not considered the residual/salvage value of the equipment at the end of 10 years of ownership.

FIGURE 59 The cost of owning versus leasing*

	OWNING						LEASING			DIFFERENCE
Year	*Repayment of loan principal*	*Interest on loan @ 18%*	*Depreciation @ 15% declining balance*	*Tax deductible expenses*	*Tax saving @ 25%*	*Net cost of owning*	*Lease cost*	*Tax saving @ 25%*	*Net cost of leasing*	*Difference (net cost of leasing - net cost of owning)*
1	$ 850	$ 3,600	$ 3,000	$ 6,600	$ 1,650	$ 2,800	$ 4,770	$ 1,192.50	$ 3,577.50	$ *777.50*
2	1,003	3,447	2,550	5,997	1,499	2,951	4,770	1,192.50	3,577.50	*626.50*
3	1,184	3,266	2,168	5,434	1,358	3,092	4,770	1,192.50	3,577.50	*485.50*
4	1,397	3,053	1,842	4,895	1,223	3,227	4,770	1,192.50	3,577.50	*350.50*
5	1,649	2,801	1,566	4,367	1,092	3,358	4,770	1,192.50	3,577.50	219.50
6	1,945	2,505	1,331	3,836	959	3,491	4,770	1,192.50	3,577.50	*86.50*
7	2,292	2,158	1,131	3,289	822	3,628	4,770	1,192.50	3,577.50	(50.50)
8	2,695	1,755	962	2,717	679	3,771	4,770	1,192.50	3,577.50	(193.50)
9	3,180	1,270	818	2,088	522	3,928	4,770	1,192.50	3,577.50	*(350.50)*
10	3,805	645	695	1,340	335	4,115	4,770	1,192.50	3,577.50	*(537.50)*
	$20,000	$24,500	$16,063	$40,563	$10,139	$34,361	$47,700	$11,925.00	$35,775.00	*$1,414.00*
Column number	1	2	3	4	5	6	7	8	9	10
Method of calculation				Col 2 + Col 3		(Col 1 + Col 2) Col 5			Col 7 Col 8	Col 8 Col 6

* Does not consider the present value of either owning or leasing.

Acquisition planning and exit planning

One of the key challenges of acquiring a business or of selling one is establishing a purchase/sale price. The process of doing this is known as *valuation*, and its purpose is to determine a *fair market value.* The accepted definition of fair market value is the highest price available in an open and unrestricted market between informed, prudent parties who are under no compulsion to act, and who act at arms' length (ie., they have no pre-established common interests between them).

This definition contains a number of conditions:

- The fair market value is the highest price available.
- The property is exposed in the open market for a reasonable time.
- Both parties are well-informed, and each one is acting in his or her own best interests.

There are two major approaches used to determine the fair market value of a hotel/motel, and they are described below.

Cost approach

The cost approach assumes that the fair market value of a hotel/motel is equal to the value of its assets. As such, it is based upon three types of value.

- *The replacement value new.* This is the current cost to replace a new, but otherwise identical, item. It is normally determined by qualified real property and equipment appraisers. For example, the replacement value new of a 10-unit motel would be the current cost to replace the land, building and equipment used to operate the business. This value does not recognize the decrease in value due to obsolescence and/or wear and tear.

- *The depreciated replacement value.* This applies an amount of accumulated depreciation to the current cost of a property. For example, if an item of equipment - which originally cost, say, $1,000 but now costs $2,500- is 50% worn out, then the depreciated

The cost approach is normally used:

- For new hotel/motels that are entering the market for the first time (the fair market value under these circumstances would be the depreciated replacement value).
- For existing properties about to go out of business (here, the fair market value would be the liquidation value).
- To compare with the second major approach to determining fair market value, which is the going concern approach.

Going concern approach

The going concern approach is based on a principle of investment analysis, which converts anticipated future income into current fair market value. Often, a quick method based on the *income before fixed charges multiple* is used. This is really the reverse of the capitalization rate approach described earlier, which means that it is also a preliminary method of establishing a fair market value.

The following steps are used in the income before fixed charges multiple approach.

Step 1. Calculate the historic average income before fixed charges.
The historic average income before fixed charges is the actual average income before fixed charges for five or more previous years of operation.

Step 2. *Estimate the future maintainable income before fixed charges.*
The historic average income before fixed charges should be adjusted for any known changes in local market conditions or in the economy in general - eg., the closing of a local competitor or a sudden acceleration in the inflation rate. This is basically an exercise in preparing an operating budget for several years, and then averaging the income before fixed charges earned during the forecast period. This average is known as the *future maintainable income before fixed charges.*

Step 3. *Calculate an appropriate income before fixed charges multiple.*
This multiple is a factor that is used to convert the future maintainable income before fixed charges into the estimated market value of the business. It is based on current interest rates and on the element of risk associated with the business, as well as other financial and other expenses.

For example, suppose you were planning to buy a 20-unit motel with a mortgage for 70% of the purchase cost at a rate of 15% per year. The remaining 30% would come from your personal funds. You could invest your funds in term deposits, which are low-risk, and obtain a return of, say, 14%; so you feel you should get 20% from the much higher-risk motel. Also, the motel involves certain costs, such as depreciation, municipal taxes and insurance premiums, and these have to be taken into account.

You could draw up the following table to calculate the income before fixed charges multiple (as indicated earlier, this is the same process as the one used to calculate a capitalization rate).

Expense items	Relationship to total investment	Calculation	Percentage of total investment
Interest	Borrowed 70% of total investment at an interest rate of 15%	$\frac{70 \times 15}{100}$	10.5
Depreciation - building	Assume building construction cost is 7090 of total investment; depreciated at 5% per year	$\frac{70X5}{100}$	3.5
Depreciation - furniture, fixtures and equipment	Assume FFE is 15% of total investment; depreciated at 1590 per year	$\frac{15 \times 15}{100}$	2.25
Property and business taxes	Assume mill rate of 40 mills (or $40 on every $1,000 of assessment) on 80% of total investment	$\frac{80 X 40}{1000}$	0.175
Insurance premiums	Assume 0.25% on the building construction costs, which equal 7090 of the total investment	$\frac{70 X 0.25}{100}$	0.175
Return on owners' investment (before tax)	2090 return expected on 30% of total investment	$\frac{30 \times 20}{100}$	6.0
Capitalization rate			25.62570
Income before fixed charges multiple		$\frac{100}{25.625}$	3.9

As you can see, the income before fixed charges multiple is calculated by dividing the capitalization rate into 100.

Step 4. Determine the fair market value.
The fair market value is simply the future maintainable income before fixed charges multiplied by the income before fixed charges multiple.

If, for example, the future maintainable income before fixed charges was $200,000, then the fair market value in our example would be:

$200,000 X 3.9 = $780,000

This fair market value covers the net operating assets only - ie., those assets normally required to operate the business. Any non-operating assets (eg., investments, excess land, etc.) should be added to this value.

Finally, you should realize that this is simply the starting point for negotiating the sale price between the purchaser and the seller. It's an approximate figure only. If you are really serious about buying or selling a hotel/motel, you should first seek professional advice.

Key points in review

After studying Chapter 8, you should be able to:

- Decide when and by how much a hotel/motel should expand.
- Use the capitalization rate method to determine if an expansion is worth considering.
- Determine the impact of changing the length of your season.
- Use break-even analysis to determine how much you should spend on renovations.
- Indicate the normal lifetime of various fixed assets used in hotel/motels.
- Determine whether you should lease or buy.
- Describe the different types of available leases.
- Determine the fair market value of a hotel/motel using the cost approach and the going concern approach.
- Define or explain all the key terms that appear in italics.

SELF-TEST QUESTIONS -8

(answers on last page this chapter)

1. The capitalization rate method is:
   a. A method used in preparing a cash budget.
   b. A detailed feasibility test used in valuations.
   c. A method used to capitalize on market opportunities.
   d. A quick feasibility test used in expansion planning.
   e. None of the above.

2. The two approaches used to establish the fair market value of a business are:
   a. The income before fixed charges multiple and replacement value new approaches.
   b. The liquidation value and replacement value new approaches.
   c. The cost and going concern approaches.
   d. The capitalization rate and going concern approaches.
   e. None of the above.

3. The income before fixed charges multiple is:
   a. A quick feasibility test used in expansion planning.
   b. A detailed feasibility test used in valuations.
   c. A preliminary method for placing a value on a lease.
   d. The reverse of the capitalization rate.
   e. All of the above.

4. The fair market value of a business is:
   a. The price that the buyer and seller consider fair.
   b. The price a business would command in a restricted market.
   c. The price a business would command in an open and unrestricted market.
   d. The price Revenue Canada considers fair.
   e. None of the above.

5. The five types of long-term decisions, which most hotel/motel operators will have to consider, relate to:
   a. Expansion planning, internal control, working capital management, renovation planning and acquisition planning.
   b. Lease or buy decisions, expansion planning, exit planning, acquisition planning and renovation planning.
   c. Expansion planning, renovation planning, physical planning, lease or buy decisions and internal control.
   d. Renovation planning, entrance planning, lease or buy decisions, working capital management and expansion planning.
   e. None of the above.

6. An operator calculates a capitalization rate of 24% and an income before fixed charges of $8,400 per room for a 20-room expansion. The maximum investment justified per room is therefore:
   a. $35,000.
   b. $7,000.
   C. $8,400.
   d. $24,000.
   e. $28,000.

7. The operator in question 6 above prepares a capital budget for the 20-room expansion and finds that it totals $650,000. He should therefore:
   a. Abandon the expansion project because it is not feasible.
   b. Reduce the scale of the expansion.
   c. Carry out a more detailed feasibility study because the expansion appears feasible.
   d. Carry out a more detailed feasibility study because the project falls within the 5% tolerance factor.
   e. None of the above.

8. A company is interested in purchasing a hotel with 40 rooms. The company's executives determine that the hotel's future maintainable income before fixed charges is $325,000. Also, they estimate that a capitalization rate of 20% would be appropriate for the property. Based on the income before fixed charges multiple, how much should they pay for the hotel?
   a. $3,250,000.
   b. $1,300,000.
   c. $6,500,000.
   d. $1,500,000.
   e. $1,625,000.

9. The four types of leases generally available to the lodging industry are:
   a. Building leases, non-financial leases, land leases and maintenance leases.
   b. Sale and leaseback, operating leases, maintenance leases and financial leases.
   c. Non-financial leases, financial leases, maintenance leases and operating leases.

d. Sale and leaseback, non-financial leases, building leases and operating leases.
e. None of the above.

10. One of the disadvantages of leasing is that:
   a. You are never able to own the asset you are leasing.
   b. The leasing company will not maintain the asset you are leasing.
   c. You cannot deduct the lease payments from taxable income.
   d. You cannot deduct the depreciation on the asset you are leasing.
   e. All of the above.

11. One of the advantages of leasing is that:
   a. The lease payments provide a greater tax advantage than depreciation.
   b. You can claim depreciation on the asset you are leasing.
   c. All assets are obsolete by the time the lease expires.
   d. The lease payments are always less than the ownership costs.
   e. None of the above.

12. The going concern approach to valuation is:
   a. Another name for replacement value new.
   b. Used only for businesses that have been in operation for at least five years.
   c. A way of converting anticipated future income into an estimate of fair market value.
   d. Used only in the lodging industry.
   e. None of the above.

13. Which of the following is used in planning renovations?
   a. Working capital management.
   b. Ratio analysis.
   c. Operational analysis.
   d. Break-even analysis.
   e. None of the above.

14. One of the key operational ratios considered in expansion planning is:
   a. The current ratio.
   b. The food cost percentage.
   c. The occupancy percentage.
   d. The number of times interest earned.
   e. None of the above.

15. A nomograph is:
   a. The same as a break-even chart.
   b. Used in conjunction with the capitalization rate.
   c. Used in conjunction with the income before fixed charges multiple.
   d. Used to prepare a capital budget.
   e. None of the above.

WORKING EXAMPLE -8

Background

The Green Gables Motel is a 20-room property that you are interested in buying. Having done some basic research, you have developed the following table:

Expense items	Relationship to total investment
Interest	You plan to borrow 60% of total investment at an interest rate of 12% per year
Depreciation - building	Building construction cost is 75% of total investment, depreciated at 5% per year
Depreciation - furniture, fixtures and equipment	FFE is 20% of total investment, depreciated at 2090 per year
Property and business taxes	Mill rate of 35 mills (or $35 on every $1,000 of assessment) on 80% of the total investment
Insurance premiums	At 0.25% on the building construction cost
Return on owners' investment	25% return expected

In addition, you estimate the future income before fixed charges for the Green Gables Motel to be:

Year 1	$65,000
Year 2	$70,000
Year 3	$72,000
Year 4	$76,000
Year 5	$80,000

Task

Using the income before fixed charges multiple, calculate the fair market value of the Green Gables Motel.

The solution to this example can be found following Chapter 10.

NOTES

answers to self-test questions -8

1. d	2. c	3. d	4. c	5. b	6. a	7. c	8. e
9. b	10. d	11. a	12. c	13. d	14. c	15. b	

9

DEVELOPING A BUSINESS PLAN

or raising the necessary funds . . .

In Chapter 8, a number of long-term decisions were reviewed - expansions, renovations, equipment leases and purchases, acquisitions, sales, and so on. All these decisions have one thing in common: They need financing to carry them out. This chapter therefore deals with your financing requirements, and it does so by describing the business plan. It is the key to securing the kind of financing you need. In addition, the chapter reviews capital budgeting and feasibility studies, since they provide vital information that must be included in your business plan.

When you have read and absorbed this chapter, you should be in a position to raise new financing for any sound project you have in mind.

The type of financing to look for

The first step in securing financing is to decide the type of financing you need in your particular situation. Here, there, is one golden rule that you should follow: If you have a long-term use for money, draw on a long-term source of funds; if you have a medium-term use, draw on a medium-term source of funds; and if you have a short-term use, draw on a short-term source of funds.

Although opinions vary, long-term normally refers to a period of 10-25 years, medium-term to a period of 5-10 years, and short-term to a period of five years or less.

The types of financing that should be used in different situations are as follows:

Situation	Use	Type of financing
Setting up a new business or buying an existing one	Long-term	Long-term loan or mortgage Equity Grants
Refinancing an existing business	Long-term	Long-term loan or mortgage
Expanding an existing establishment	Medium to long-term	Medium- to long-term loan or mortgage Grants
Renovating an existing establishment	Short to medium-term	Short- to medium-term loan or mortgage Equipment lease Grants
Covering operating costs	Short-term	Working capital loan Line of credit

The next step is to decide how much money you need to carry your project through. The best way to decide this is to draw up a capital budget, like the one shown in Figure 60. It will help you identify and cost all the expenditures you will encounter. Be sure to add a contingency factor to cover any unforeseen cost overruns.

Next, you should decide how much you want to put into the project yourself, and how much you want to borrow from outside sources. Lenders will usually want to be assured that your share (or your equity) is roughly 25%-40% of the capital budget total. Usually, the higher your equity, the more secure the lenders will feel. However, it may not be in your interests. to have a high equity. It all depends on *financial leverage* and the way you use it.

Financial leverage

The term financial leverage refers to the ratio of borrowed funds (loans, mortgages, etc.) to owners' equity.

When you start a business, the leverage is at its highest - eg., 3:1, if you have borrowed 75% of the total investment and supplied 25% yourself. The leverage is at its highest at this time, because as you repay the amount borrowed, your equity increases, so your leverage decreases. When all borrowed funds have been repaid, there is no leverage at all, since you now own the business outright. It therefore follows that as your leverage decreases, your ability to borrow increases. This can be of great importance if you want to undertake a major renovation or expansion.

FIGURE 60 Capital budget

	Amount ($)
Land cost	$ ________
Site preparation and improvements	
Clearing, levelling and grading	________
Landscaping	________
Roads and paths	________
Rock excavation	________
Other	________
Site servicing	
Sewage disposal system	________
Wells or other water supply	________
Hydro	________
Telephone service	________
Other	________
Building construction costs	
Building materials	________
Building contractor's charges	________
Electrical sub-trade (materials and labour)	________
Plumbing sub-trade (materials and labour)	________
Costs of permits, site plan approvals, etc.	________
Other	________
Furniture fixtures and equipment	
Furniture	________
Drapes, carpets, etc.	________
Cutlery, plates, cookware, etc.	________
Linens	________
Other	________
Professional fees	
Legal, etc.	________
Cost of interim financing	________
Working capital	________
Pre-opening expenses	________
Sub-total	________
Contingency (1 OYO-25TO of sub-total)	________
Capital budget total	$ ________

The following example demonstrates how leverage can be used to raise additional financing. We'll assume that five years ago you started a business for a total cost of $100,000. You put up $25,000 in equity and borrowed $75,000 from a bank, repayable in eight equal installments of $9,375 per year. At the end of your fifth year of operation, you contemplate a major renovation and expansion, but you have little available cash to finance the project personally. So would you be able to borrow the funds you need? Let's look at how your leverage has changed over the past five years, making certain assumptions as we go along.

At start of business:

Owners' equity	=	$25,000
Debt	=	$75,000
Leverage	=	$75,000 : $25,000
		3: 1

During first five years of operation, your net income was:

Year 1	$ 1,000
Year 2	$ 5,000
Year 3	$10,000
Year 4	$15,000
Year 5	$15,000
Total	$46,000

Also, during first five years, your owners' drawings were:

Year 1	Nil
Year 2	Nil
Year 3	$ 5,000
Year 4	$10,000
Year 5	$10,000
Total	$25,000

At end of fifth year of operation:

Owners' equity	=	Beginning equity + (Total net income - Total drawings)
	=	$25,000 + ($46,000 - $25,000)
	=	$25,000 + $21,000
	=	$46,000
Debt	=	Beginning loan principal - (5 years x $9,375)
	=	$75,000-$46,875
	=	$28,125
Leverage	=	$28,125 : $46,000
	=	1 : 1.64

Under these circumstances, you could probably approach your bank (or another source of finance) and borrow enough funds to take your leverage ratio back to 3:1. This amount would be calculated as follows:

Equity (end of year 5)	=	$46,000
Total debt possible (end of year 5)	=	$46,000 X 3
	=	$138,000

Additional financing possible (end of year 5) = Total debt possible - Existing debt
= \$138,000-\$28,125
= \$109,875

Effect of leverage on your return

Leverage is also important since it affects the rate of return you receive on your equity. In the example above, you had a net income of \$15,000 at the end of the fourth year of operation, so your return on equity was:

$$\text{Return on equity (end of year 4)} = \frac{\text{Net income} \times 100\%}{\text{Owners' equity}}$$

$$= \frac{\text{Net income} \times 100\%}{\text{Beginning equity} + (\text{Net income to year 4} - \text{Total drawings to year 4})}$$

$$= \frac{\$15{,}000 \times 100\%}{\$25{,}000 + (\$31{,}000 - \$15{,}000)}$$

$$= \frac{\$15{,}000 \times 100\%}{\$41{,}000}$$

$$= 36.6\%$$

At the end of the fifth year, your net income was again \$15,000. However, by that time, your equity had increased, so the return on your equity had decreased:

$$\text{Return on equity (end of year 5)} = \frac{\$15{,}000}{\$25{,}000 + (\$46{,}000 - \$25{,}000)} \times 100\%$$

$$= \frac{\$15{,}000 \times 100\%}{\$46{,}000}$$

$$= 32.6\%$$

What does this mean to you? Very simply, it means that as your leverage decreases and your net income increases or remains the same, then your rate of return on equity decreases. To maintain the rate of return at the highest possible level, you should keep your leverage as high as possible (normally 3:1).

Two further expressions that you should be familiar with are *under-levered* and *over-levered.* In the above example, where your leverage was 1:1.64 at the end of year 5, your business would have been viewed as under-levered. However, if for some reason your leverage was greater than 3:1, then your business would be considered to be over-levered. From the discussion above, it is clear that your rate of return improves if you are over-levered as opposed to under-levered. However, if you go too far and have too much leverage, your repayment commitments may be too large in relation to your cash flow - and that could spell serious trouble.

Sources of funds in Canada

When looking for new financing, you can turn to government sources or to private sources. Here are the main places to go.

- *The Federal Business Development Bank (FBDB).* The FBDB is a federal institution specializing in assisting small business. It can provide capital assistance to people who are having difficulty securing financing from other sources. If the FBDB approves your application for a loan, it will tailor a repayment schedule to your ability to repay (although terms are usually less than 10 years). The loan is usually in the form of a first mortgage on the fixed assets of a hotel/motel. In some cases, a personal guarantee may also be required from the owner.

- *Small business loans.* The federal Small Business Loans Act helps small businesses get loans for capital improvements from the chartered banks. The loans are guaranteed by the federal government. Interest rates fluctuate with market rates. The loans' repayment terms are up to 10 years. Loans are restricted to businesses with total revenues of $1.5 million or less during the fiscal year in which the loan is made. The maximum amount of any loan is $100,000.

- *Other government sources.* These include various provincial assistance programs involving various terms and conditions. The types of assistance normally available are grants, low-interest loans and deferrals of interest payments in the initial years of operation. Among provincial organizations offering assistance are the British Columbia Development Corporation, the Alberta Opportunity Company, the Saskatchewan Economic Development Corporation, the Manitoba Development Corporation, the Ontario Development Corporation, the New Brunswick Department of Tourism, the Nova Scotia Resources Development Board, PEI Industrial Enterprises Inc. and the Newfoundland and Labrador Development Corporation.

  These organizations are interested in helping hotel/motels in a way that will have a positive impact on the local economy. Inquiries should be directed to your provincial/territorial government tourism agency.

- *Chartered banks.* In the private sector, banks are usually the leading source of funds for both short-term and long-term uses. However, the terms and conditions attached to their loans are frequently too strict for many hotel/motels. No special considerations are given to the lodging industry; lending is judged solely on the degree of risk to the bank. Banks prefer to lend to hotel/motels that are already established and producing a profit rather than to those that are still in the development stage. An important factor in getting financing from a bank is any special relationship that you have developed with that bank.

- *Trust companies.* Trust companies follow the same lending policies as the banks, but they tend to be more interested in your projected profitability. Consequently, they are more flexible than the banks.

- *Insurance companies.* The insurance companies tend to invest in large-scale hotel/motels (chains or franchises), but they may also be interested in a carefully researched and presented proposal. They, too, are more flexible than the banks.
- *Finance companies.* Their requirements are similar to those of the banks and trust companies. Your personal worth, hotel/motel experience and the attractiveness of your proposal all play important roles in your ability to raise funds. Personal guarantees will most likely be required.
- *Mortgage brokers.* They have up-to-date information on all sources of real estate financing, including institutional lenders and venture capitalists. Also, they can help you choose the best kind of financing, depending on your needs.
- *Venture capital companies.* These companies are prepared to take bigger risks than the ones mentioned above, and they are more interested in the future profitability y of new ventures. The Department of Industry Trade and Commerce in Ottawa has published a book entitled "Sources of Venture Capital in Canada". It provides an excellent outline of venture capital proposals, as well as a list of most of the venture capital sources in Canada.

The five Cs of credit

No matter where you go to raise new financing, you will find that lenders are mainly concerned about the following questions:

- Will your profits be sufficient to repay the loan?
- What is the desired term of the loan?
- Are there any personal guarantees already attached to your business?
- Do you have sufficient management skills?
- Do you have sufficient equity in your hotel/motel?
- Has there been a certified appraisal of the value of the hotel/motel?
- Will valid financial statements be produced?
- Will the uniform system of accounts be followed?
- What is the extent of the risk involved?
- What is the past performance of the hotel/motel?
- What will the future performance be?

These main concerns of lenders have been summarized as the five Cs of credit, listed below.

- *Character.* This refers to your track record in business, together with your integrity and proven ability to meet financial commitments.
- *Collateral.* This offers the lender some insurance in case your hotel/motel fails and the assets are liquidated. It is basically a pledge offered in exchange for the funds.

- *Capacity.* This refers to your hotel/motel's ability to produce the cash flow required to cover the repayment of principal and interest charges. It is usually demonstrated by a feasibility study (to be discussed later in this chapter).
- *Cap it al.* This refers to the amount of equity you have in your hotel/motel, compared to the funds you have borrowed. The debt-equity ratio is a key indicator in this respect.
- *Conditions.* This refers to the status of the lodging industry in your market area, including trends in demand, prices, competition, profitability and government regulations.

The feasibility study

The feasibility study is a major element of any business plan. As we saw in Chapter 8, there are a few quick tests of feasibility (such as the capitalization rate), but these only tell you if a full feasibility y study is worth doing. If a full study is worth doing, you would normally get a hospitality management consultant to prepare the study for you. However, there's no reason why you can't do a lot of the digging yourself.

The purpose of a feasibility study is to reveal the true potential of a given project. That means it requires a *site evaluation,* a *market study,* a *pro forma income statement* and a *capital budget.* Let's look at each one in turn.

Site evaluation

If you own land, or if you are considering buying land, or if you are searching for a site, then you should use Figure 61 as a guide for site evaluation. It will give you some idea of the land's suitability for hotel/motel development. It does not examine the site in relation to markets - that comes later. It examines only the site's physical characteristics.

Market study

This study examines a hotel/motel's location in terms of the economic environment, proximity to events and attractions that could generate business, and the current and future supply of, and the demand for, rooms. It produces the data you need to determine if a proposed hotel/motel (or an expansion) has market potential, and, if so, what size it should be. Figure 62 gives an idea of the kind of information your market study should contain.

FIGURE 61 Site evaluation guidelines

	WHAT YOU SHOULD LOOK FOR	
Components	Hotel/motels	Resorts
Size and shape	Check the scenic value and potential need for guest facilities. Is the site big enough for future expansion? Does it have the required frontages? Collect information on drainage, soil depth, source of water, pollution control and services.	Give prime consideration to the recreational potential. There should be space for pool, tennis courts, etc. Scenic value, lake frontage and general topography should be checked. Evaluate for expansion and ease of construction. Soil depth, water sources, etc. should be measured. Site investigation should be made by contractors, architects and engineers.
Zoning and anticipated real estate development	Research the site's zoning classification and that of surrounding properties. Establish what chances there are for objectionable construction - eg., body shops and other noise producers. Examine height restrictions that could limit expansion. Investigate business-producing potential of industrial/commercial developments.	Regional or municipal governments will provide current building restrictions and future expansion capability. Check private cottage associations to see if there is resistance to your proposal.
Access	Check ease of access from highway. Site should be on right-hand side of highway prior to major destination. Is there a median on the highway or is one proposed? If site is on wrong side of highway, can access be gained by an exit close to site? Transient attractions should be accessible. Can visitors re-enter traffic from hotel/motel without danger or difficulty, or without a long wait?	Proper maintenance and snow removal on roads to resort, to communities and to attractions should be assured. Snow removal is particularly important for ski resort or business-oriented year-round resort. Examine complexity of roads for possible problems in reaching resort. How far is resort from major transportation terminals? This is an important consideration for group business.

Figure 61 (cont.)

Visibility	Allow travelers 400 metres to assess your property and to exit. Is exit well marked? A rise on the site or a long highway approach will improve visibility. Check to see if bridges or highrise construction will hamper visibility now or in the future.	As long as your project presents a pleasant visual impact from the road or water, visibility is not too important. Visibility might even be a negative factor. Signs should guide the traveller.
Rules-of-thumb (should be used only as very general guide)	Site size: Single storey, 93 square metres per unit or 0.4 hectares for 45-50 units. Two storey, 65 square metres per unit. Site costs: For large properties, land should not be more than 50% of the cost of buildings.	Rules-of-thumb do not apply to resorts. Costs reflect type of resort and the extent of seasonality.

FIGURE 62 Market study guidelines

	WHAT YOU SHOULD LOOK FOR	
Components	Hotel/motels	Resorts
Present economy and growth potential	Location should be near a community with a growing economy. Use population trends, growth of income per capita and industrial growth as indicators of economic prospects.	Resorts rely on business from the nearest urban centre. Study its economy and isolate markets. Examine specialty market trends by sales of equipment - eg., skiis, snowmobiles, canoes, etc. Regional planning reports may help assess future potential.
Major attractions	Industrial attractions create demand for rooms by salesmen, executives, trainees and industrial tours. Assess present and future demand. Tourist attractions include recreational facilities, historic sites and local scenery. List all events and attractions. Establish where the people come from, how long they stay and how many there are to estimate "drawing power" of attractions.	Industrial attractions produce business meetings, seminars and banquets. They can turn a seasonal resort into a year-round business. Successful resorts generally identify and attract specific markets, according to local resources and attractions. Appraise hunting, fishing, skiing, boating and other recreational facilities. Tailor resort to resources.

Figure 62 (cont.)

Major attractions	General location should be close to town or city where restaurants, car service, shopping and entertainment are located. Proximity to major highway and airports is important. Obtain traffic statistics and purposes of travel to ascertain traffic patterns and tourist usage. Find out about future highway developments.	Isolated location is generally desirable. Transportation facilities suitable to the target market must be available. Assess effect of seasonality on tourism, spending characteristics, length of stay and tourism growth expectation for both hotel/motels and resorts.
Competitive activity	Existing and proposed competition will give the present and future supply of rooms. Establish number and size of properties, quality of amenities offered, occupancy levels, rates, sources of business. Tourism demand tends to be seasonal. Commercial/business demand is more year-round. Convention travel is generally part-tourist and part-business in nature. Check with local building departments for building permits applied for or issued in the last 12 months, and with local hotel/motel associations to find out what facilities are planned or are under construction.	Resort operators have a more thorough knowledge of their guests than do hotel/motel owners, due to longer duration of stay. Interview resort operators. Study peak period occupancy levels, rates, sizes and types of resorts, and quality of service. Local building departments, provincial/territorial tourism offices, resort associations, banks, etc., will know what future developments are proposed. Research the type of market you hope to attract and the specialized facilities required. Remember that your competition will be wide-spread. It could be all the resorts in your province/territory, or even some international properties.
Future demand	Data collected can be used to establish mix and quality of rooms and related facilities. Use recent trends to make growth projections for all sources of demand.	Hard facts are needed. They are available from government tourism departments, hotel/motel associations, resorts groups, etc. Facts on special interest groups are required - eg., skiers, fishermen, etc. Trend data can be projected to give growth potential. For group business demand, interview local convention bureaus and industry representatives.

Pro forma income statement

This gives you an indication of expected revenues and expenses. It can also be called an operating budget (as we saw in Chapter 6). For example, suppose you propose to build a 15-room motel, which we will call Motel C, for a total capital investment of $297,000. The following steps should be taken to draw up a pro forma income statement.

Step 1. Determine the supply of rooms.
Suppose that your proposed property has a highway location and that it will have heavy tourist demand with some industrial support. An analysis of competitive facilities with similar amenities and location reveals that there are two existing year-round motels in the area, Motel A and Motel B. Motel A has 20 rooms and Motel B has 25, for a total of 45.

With this information, the total number of room nights available in the area can be easily calculated. This is an expression of present supply and is equal to the total rooms available multiplied by the time period (expressed in number of days) that competitive motels are open for business. In this case, the two motels are open year-round. Therefore:

$$\text{Present supply} = 45 \text{ rooms} \times 365 \text{ nights}$$
$$= 16{,}425 \text{ room nights}$$

Step 2. Calculate the average room rate for the area.
The average room rate for a property is arrived at by dividing total room revenues by the total number of occupied room nights over a given period. Let's assume present room occupancy is 65% in Motel A and total room revenues for the year are $66,430. Therefore:

$$\text{Total occupied room nights (Motel A)} = \text{Total number of rooms in Motel A} \times \text{Average annual Occupancy} \times 365$$
$$= 20 \times 0.65 \times 365$$
$$= 4{,}745 \text{ occupied room nights}$$

Motel A's average room rate is therefore:

$$\text{Average room rate (Motel A)} = \frac{\text{Total room revenues}}{\text{Total occupied room nights}}$$
$$= \frac{\$66{,}430}{4{,}745}$$
$$= \$14$$

A similar calculation can be done for the 25-room Motel B, which is assumed to have a 60% occupancy and total annual room revenues of $93,075. The average room rate for Motel B turns out to be $17.

The average room rate for all competitive properties is then obtained by multiplying the total number of rooms available by the average room rate for each property. The average room rates are then added and the sum is divided by the total number of rooms in the area to calculate the average rate for the area as a whole:

Motel	Size		Average room rate		Factor for rate average
A	20	x	$14	=	$280
B	25	x	$17	=	$425
	45				$705

Average rate for area $= \dfrac{\$705}{45} = \$15.67$

Step 3. *Calculate the average area occupancy.*
The annual occupancy levels for the competitive properties are multiplied by the number of rooms and by the number of days of operation to arrive at the number of occupied room nights sold for the year. In our example:

Motel	Size		Occupancy percentage		Days in year		Demand for occupied room nights
A	20	x	65%	x	365	=	4,745
B	25	x	60%	x	365	=	5,475
							10,220

By comparing demand and supply (expressed in terms of the number of room nights at present occupied and available), you can get an estimate of the average room occupancy for the area. This is simply the number of occupied room nights expressed as a percentage of the total room nights available:

$$\text{Area average occupancy} = \frac{\text{Occupied room nights (demand)} \times 100\%}{\text{Available room nights (supply)}}$$

$$= \frac{10{,}220 \times 100\%}{16{,}425}$$

$$= 62.2\%$$

Step 4. *Determine the composition and growth of demand for rooms.*
Demand was expressed earlier as the total number of occupied room nights at present. However, to forecast future demand for rooms in the area, you have to break down the composition of the present market by major sources of demand. Consultants normally make such estimates on the basis of interviews they carry out in competitive lodging properties and other businesses in the area. Alternatively, estimates of visitor arrivals can be obtained from local chambers of commerce and tourism offices. For our purposes, such a breakdown is assumed to be:

	Market composition
Tourists	7590
Business travelers	2070
Meeting/convention delegates	5%
	10090

To make an accurate estimate of growth in demand, you must calculate a composite growth rate from the growth rates of each source of demand. Again, in a hospitality management consultant's study, these growth rates would have been estimated for you. Other sources for such estimates might be provincial or local records of growth in tourism and industry. Either way, your projections must be based on several years' data. We will assume the following annual growth rates for each source of demand:

	Annual growth rate
Tourists	14%
Business travelers	8%
Meeting/convention delegates	4?fo

We will also assume for the sake of simplicity that your planned motel will attract these three types of guests in the same proportion as the area in general. The composite growth rate is then calculated as follows:

	Weighting factor (proportion of total visitors)		Anticipated annual growth rate		Composite growth rate
Tourists	0.75	x	14%	=	10.5?70
Business travelers	0.20	x	8%	=	1.6%
Meeting/convention delegates	0.05	x	4%	=	0.2%
	1.00				12.3%

Next, by applying this composite growth rate of 12.3% per year (assuming no fundamental changes in the composition of demand), you can calculate total room night demand in occupied room nights for the next five years:

Year 1

10,220 occupied room nights in previous year + (10,220 occupied room nights in previous year x composite growth rate)
= 10,220 + (10,220 X 0.123)
= 11,477 room nights

Year 2

11,477 + (11,477 X 0.123)
= 12,889 room nights

Year 3

12,889 + (12,889 X 0.123)
= 14,474 room nights

Year 4

14,474 + (14,474 X 0.123)
= 16,254 room nights

Year 5
16,254 + (16,254 X 0.123) = 18,254 room nights

Step 5. Calculate the future demand for rooms in the area.
On the basis of the above forecasts of room night demand, the following number of rooms could be supported in the area at these average annual occupancy levels:

	Year 1	Year 2	Year 3	Year 4	Year 5
Total room night demand	11,477	12,889	14,474	16,254	18,254
@ 60% occupancy"	52	59	66	74	83
@ 62.29o occupancy	51	57	64	72	80
@ 65% occupancy	48	54	61	69	77

* The number of rooms supported at given occupancy level is equal to:

$$\frac{\text{Total room night demand for the year}}{\text{Occupancy x 365 days}}$$

For example, for year 1 @ 60% occupancy, the rooms supported at given occupancy level = $\frac{\text{11,477 rooms}}{0.60 \times 365}$

= 52 rooms

From the table above, it is apparent that at all three occupancy levels, additional hotel/motel rooms could be supported in the immediate area. That's because there are now only 45 rooms. Of course, if no new rooms were provided in the area in the next five years, increasing demand would be reflected in higher occupancies at two existing motels (A and B). Therefore, consideration must now be given to the growth in the supply of hotel/motel rooms.

Step 6. Determine the growth in the supply of rooms.
Future demand has been expressed in terms of number of rooms; now it must be matched to the supply of rooms. This is the next key factor in determining the size of the property under consideration.

Information collected during the market study will reveal:

- Hotel/motel properties under construction.
- Extensions being made to existing properties.
- Planned or rumoured hotel/motel construction.

All new hotel/motel development proposals and expansion/renovation plans must be approved by local or municipal building departments, so it is relatively easy to acquire this information. For the sake of our example, let's assume that your enquiry at the local building department shows that a building permit has been issued to Motel A to add five guest rooms. Otherwise, there is no planned or rumoured hotel/motel construction.

Step 7. Compare the growth of supply and demand.
By comparing your rooms forecast at the three levels of occupancy with your information on supply, you can see that supply falls short of demand (remember that this shortfall could still be reflected in higher occupanices at Motels A and B if no new rooms were provided). Construction has just begun on Motel A's addition and the rooms will be ready for use in the early part of year 2. If a new 15-room motel (Motel C) were built and ready for operation in the early part of year 3, and the new and existing motels were to each maintain the 62.2% average occupancy that now prevails in the area, then the supply/demand situation would be near balance in year 3:

	Year 1	Year 2	Year 3	Year 4	Year 5
Demand (rooms)					
@62.2% occupancy	51	57	64	72	80
Supply (rooms)					
Rooms available per day in January	45	45	50	65	65
Rooms added		5	15		
Rooms removed					
Rooms available per day in December	45	50	65	65	65
Over (under) supply	(6)	(7)	1	(7)	(15)

It would therefore seem reasonable that your 15-room motel (Motel C) could come into operation in year 3 and attain a 62.2% occupancy (the occupancy that now prevails in the area). The actual occupancy for Motel C could only be estimated if substantial research were conducted to estimate the property's penetration of the three types of demand mentioned earlier - ie., tourist, business and convention.

Step 8. Estimate room revenues.
We have forecast an opening occupancy level of 62. 2% for Motel C, so we can now calculate a rate structure. We will assume that Motel C can afford to charge a slight premium over its competitors' prices, once it opens in year 3. The average rate you can charge will then be:

Average competitive rate now	$15.67
Growth factor at 5% inflation per year over two years (1.05 x 1.05)	1.1025
Anticipated competitive rate in year 3 ($15.67 x 1.1025)	$17.28
Quality factor in new Motel C at 5% above anticipated rate ($17.28 X 5%)	$ 0.86
Average anticipated rate for new Motel C ($17.28 + $0.86)	$18.14

The anticipated room revenues for the first full year of operation (year 3) are the occupancy level multiplied by the average rate per occupied room, multiplied by the number of rooms, multiplied by the number of days per year:

62.2%x $18.14 x 15 rooms x 365 = $61,775

(The use of a double occupancy factor for more than one person per occupied room has been ignored so far in this example. We've assumed its effect is included in the average room rate.)

Step 9. *Estimate food and beverage revenues.*
These calculations are based on estimated seat turnovers and anticipated check averages for the various meal periods. The estimates are based on competitive analysis, demand and price growth, and previous experience of similar operations. An example of a typical food revenues calculation is shown below. We have assumed that Motel C is to be constructed with a coffee shop of 30 seats plus a small bar.

Breakfast. We will assume from historical evidence of comparable operations that 80% of your guests will eat breakfast in your coffee shop and that the occupancy level for a representative year is 62.2%. Also, we will assume that the average number of guests per rented room is 1.5. The calculation of sales volume is then:

Number of annual breakfast covers served	= Number of rooms x Number of days in year x Double occupany factor x Occupancy level x Breakfast use factor
	= 15 X 365 X 1.5 X 62.2% X 80%
	= 4,087 covers

The next step is to estimate the average check. It is usually based on market study results. We will assume that it is $1.50 per cover. Therefore:

Total breakfast revenues	= $1.50 X 4,087
	= $6,132

Lunch. The lunch revenues calculation is based on anticipated seat turnover. In our example, we'll say the estimate is 1.2 times. The estimate of the average check (based on market study results) is $2.00. Therefore:

Total lunch revenues	= Number of days x Number of seats x Turnover x Average check
	= 365X 30 X 1.2 X $2.00
	= $26,280

Dinner. The dinner turnover will probably be lower for this type of motel, so we'll assume it is 0.8. The average check will, however, be slightly higher at $3.00 (based upon market study results). Therefore:

Total dinner revenues	= Number of days x Number of seats x Turnover x Average check
	= 365 X 30 X 0.8 X $3.00
	= $26,280

Adding the breakfast, lunch and dinner revenues, we get:

Total food revenues	= $6,132 + $26,280 + $26,280
	= $58,692

Beverage revenues from the bar we'll assume are 11% of year 3 gross revenues $139,267). Therefore:

Total food and beverage revenues	= $58,692 + ($139,267 X 0.11)
	= $74,011

Step 10. Estimate telephone revenues.
We'll assume they are 2.5% of year 3 gross revenues ($139,267), or $3,481.

Step 11. Determine gross revenues and income before fixed charges (year 3).
The gross revenues figure is simply the sum of the rooms, food and beverage and telephone revenues:

Rooms	$ 61,775
Food and beverage	74,011
Telephone	3,481
	$139,267

The gross revenues figure is then reduced by departmental expenses and undistributed operating expenses to arrive at an income before fixed charges for the first year of operation. Departmental expenses are calculated as a percentage of departmental revenues, while undistributed operating expenses are calculated as a percentage of gross revenues. The two sets of percentages are directly available from annually published trends and ratios, which can be obtained from trade associations, hospitality management consultants and textbooks.

Care must be taken in three respects with regard to the use of these cost percentage rules-of-thumb. Firstly, they are usually based on industry averages, so they can vary from situation to situation. In estimating costs, therefore, you should double-check the figures by comparing them with the proposed number and cost of staff for each of your departments.

Secondly, care must be taken to include all expense items and to determine which of those items are fixed and which are variable.

Thirdly, since pro forma income statements should cover at least the first three years of operation, you must project the revenues/cost relationships over that period of time. Many costs do not remain in the same proportion to revenues, because they do not vary directly with changes in revenues. For example, expenditures on marketing are normally higher relative to gross revenues in the first years of operation than in later years.

In our example, Motel C would begin operations in January of year 3. Pro forma income statements for its first five years of operation (years 3-7) are shown in Figure 63. From the income before fixed charges figures, the financial and other expenses are deducted. For Motel C, the pro forma income statement was extended for a further five years (ie., to year 12), and then the financial and other expenses and depreciation were deducted (Figure 64). With the information contained in Figure 64, you are now in a position to analyze the rate of return on the Motel C project.

Capital budgeting

At this stage in the feasibility study, capital budgeting techniques should be applied. (Capital budgeting is also referred to as financial analysis Or economic feasibility analysis.) A few of the simplest techniques are discussed below, again using Motel C as an example.

FIGURE 63 Motel C, pro forma income statement, years 3-7

	Year 3		Year 4		Year 5		Year 6		Year 7	
	$	%	$	%	$	%	$	%	$	%
Occupancy		62.2		64.0		67.0		70.0		73.0
Average rate per occupied room	$18.14		$19.05		$20.00		$21.00		$22.05	
Revenues										
Rooms	$61,775	44.4	$66,751	44.7	$73,365	45.1	$80,483	45.5	$88,128	46.0
Food	58,691	42.1	62,682	41.9	67,697	41.6	73,113	41.4	78,962	41.1
Beverages	15,323	11.0	16,365	11.0	17,674	10.9	19,088	10.8	20,615	10.7
Telephone	3,478	2.5	3,650	2.4	3,820	2.4	4,010	2.3	4,210	2.2
Total	139,267	100.0	149,448	100.0	162,556	100.0	176,694	100.0	191,915	100.0
Departmental expenses										
Rooms	17,297	12.4	17,934	12.0	18,694	11.5	19,436	11.0	20,343	10.6
Food	51,648	37.1	54,698	36.6	58,683	36.1	62,726	35.5	67,170	35.0
Beverages	8.887	6.4	9,509	6.3	10,175	6.3	10,887	6.2	11,649	6.1
Telephone	4,521	3.2	4,633	3.1	4,714	2.9	4,770	2.7	4,9o4	2.6
Total	82,353	59.1	86,774	58.0	92,266	56.8	97,819	55.4	104,066	54.3
Departmental income	56,914	40.9	62,674	42.0	70,290	43.2	78,875	44.6	87,849	45.7
Undistributed operating expenses										
Administrative and general	10,445	7.5	11,059	7.4	11,704	7.2	12,545	7.1	13,434	7.0
Marketing	4,874	3.5	5,230	3.5	5,364	3.3	5,478	3.1	5,757	3.0
Energy cost	4,178	3.0	4,334	2.9	4,552	2.8	4,947	2.8	5,374	2.8
Property operation and maintenance	2,646	1.9	3,000	2.0	3,375	2.1	3,900	2.2	4,500	2.3
Total	22,143	15.9	23,623	15.8	24,995	15.4	26,870	15.2	29,065	15.1
Income before fixed charges	34,771	25.0	39,051	26.2	45,295	27.8	52,005	29.4	58,784	30.6

FIGURE 64 Motel C, pro forma statement of income before income taxes, years 3-12

	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12
Income before fixed charges	$34,771	$39,051	$45,295	$52,005	$58,784	$65,000	$70,000	$74,000	$78,000	$82,000
Insurance	4,000	4,000	4.000	4,000	4,000	4,000	4,000	4,000	4,000	4,000
Municipal taxes	8,000	8,000	8,000	8,000	8,000	8.000	8.000	8,000	8,000	8,000
Interest	26,730	26,529	26,305	26,053	25,772	25,456	25,103	24,696	24,252	23,754
Depreciation	13,500	13,500	13,500	13,500	13,500	13,500	13,500	13.500	13,500	13,500
	$52,230	52,029	51,805	51,553	51,272	50,956	50,603	50,196	49,752	49,254
Income (loss) before income taxes	ıterım ı	($12,978)	($ 6,51O)	$ 452	$ 7,512	$14,044	$19,397	$23,804	$28,248	$32,746

Calculated on a blended payment system.
Calculated on a straight line basis.

Return on owners' equity

This is by far the simplest technique. It relates owners' equity to various levels of profit over a number of years of operation. The return can then be compared with prevailing rates of return for less risky ventures. It can also be used to rank different hotel/motels in terms of investment potential.

illustrate this point, let's assume you have the following three alternatives open to you:

- Invest $74,250 in a savings accounts at a local bank at 9.257..
- Invest $74,250 in a mortgage loan at
- Invest $74,250 in Motel C (the equity portion of a total capital investment of $297,000., assuming a leverage ratio of 3:1).

The average rate of return on these investments equals the average annual income divided by the original equity invested. In other words:

$$\text{Average rate of return} = \frac{\text{Average annual income before taxes}}{\text{Original equity invested}}$$

Having completed our pro forma statements, we find that Motel C's income before income taxes (Figure 64) averages $8,926 per year for the 10-year period (years 3-12). This is calculated as follows:

$$\text{Average annual income before income taxes} = \frac{(\$17{,}459) + (\$12{,}978) + (\$6{,}510) + \$452 + \$7{,}512 + \$14{,}044 + \$19{,}397 + \$23{,}804 + \$28{,}248 + \$32{,}746}{10}$$

$$= \frac{(\$36{,}947) + \$126{,}203}{10}$$

$$= \frac{\$89{,}256}{10}$$

$$= \$8{,}926$$

Theaverage rates of return before taxes)onthethree alternatives are therefore:

Savings account		12.60
Mortgage loan		*13.0070*
Motel C	$\frac{\$8{,}926 \times 100}{\$74{,}250}$	*1,0270*

In this case, it seems that the mortgage loan is the best investment. But what would happen if the rate of return on Motel C were You would then have to decide if the higher return was worth the greater risk.

Payback method

The payback method is again fairly simple to calculate, although it introduces the concept of cash flow into the calculations. The payback period is calculated by dividing the original equity invested by the annual cash flow. It is expressed in terms of a number of years. In essence, it tells you the number of years it takes to recover your initial investment.

Continuing with our example of Motel C, the annual cash flows are calculated in Figure 65. They are based on the following assumptions:

- Your total capital investment of $297,000 is composed of:

$210,000	for buildings
30,000	for furniture, fixtures and equipment
20,000	for land
10,000	for working capital
27,000	for contingencies
$297,000	

- Your financing of $297,000 is composed of:

' 74,250	equity
222,750	mortgage
$297,000	

- Your mortgage has an interest rate of and an amortization period of 25 years, and it is repayable on a blended payment basis (one payment per year).
- Depreciation is calculated on a straight line basis - ie., buildings, $10,500 per year for 20 years; furniture, fixtures and equipment, $3,000 per year for 10 years.

FIGURE 65 Calculation of cash flow - Motel C example

	Year 3*	Year	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12
Income (loss) before taxes	($17,459)	($12,978)	d 6,510)	$ 452	›ı 7,512	$14,044	$19,397	$23,804	$28,248	$32,746
Income taxes paid							1,204	6,427	7,627	8,841
Net income (loss)	(17,459)	(12,978)	(6,510)	452	7,512	14,044	18,193	17,377	20,621	23,905
Add : Depreciation	13,500	13,500	13,500	13,500	13,500	13,500	13,500	13,500	13,500	13,500
	(3,959)	522	6,990	13,952	21,012	27,544	31,693	30,877	34,121	37,405
Less: Principal repayment	1,671	1,872	2,096	2,348	2,629	2,945	3,388	3,705	4,149	4,647
Cash flow	($ [illegible]	($ 1,350)	$ 4,894	$11,604	$18,383	$24,599	$28,305	$27,172	$29,972	$32,758

* Year 3 refers to the first year of operation of Motel C.

In the first six years of operation (years 3-8), cash flow from the business totals $52,500:

Year	Cash flow
3	($ 5,630)
[illegible]	(1,350)
5	4,894
6	11,604
7	18,383
8	24,599
be at	$52,500

This means that at some point in year 9 (cash flow $28,305), the original $74,250 invested will be recovered. [illegible] find out the exact number of years required to pay back the $74,250, you have to make the following calculation:

$$\text{Payback period} = 6 \text{ years} + \frac{(\$74{,}250 - \$52{,}500)}{\$28{,}305}$$

$$= 6 + \quad \text{years}$$

$$= 6.76 \text{ years}$$

This is the time it takes to earn your money back.

Normally, if you are considering more than one investment project, the one with the shortest payback period is best. If you are considering only one project, and the payback period is less than some maximum acceptable period, then the project should be abandoned.

Internal rate of return and net present value methods

These two methods are considered superior to both the average rate of return and the payback methods. That's because they are based on the concept of *present value.* The basic principle behind present value is that money has an inherent cost - ie., a dollar received today is more valuable than a dollar received next year or the year after, simply because the money received today can be put to work immediately to earn profits or interest. As a result, it is the project that returns the greatest amount in the earlier years of its life that is generally considered to be the best investment.

Usually, it is necessary to have a hospitality management consultant determine these returns for you, since the calculations are more complex than they are in either the average rate of return or the payback methods.

The business plan

You are now in a position to put together a business plan, which is the key to success in raising new financing. The business plan will tell prospective lenders all they need to know about your proposal. But it will also be of considerable help to you, in a number of different ways. Here are the main benefits of a business plan.

From the lender's point of view, a business plan:

- Provides a solid base on which to judge your proposal.
- Assures the lender that you, the owner, are aware of both the opportunities and the potential problems.
- Indicates the owner's ability to maintain and repay debt or provide a satisfactory return on equity.
- Identifies all of the components of the business' operations, internal and external.
- Forecasts the timing and nature of future cash requirements.
- Enables the lender to assess the owners' ability to plan and manage.
- Indicates how much funding is needed and when it will be required.

From your point of view as the owner, the main benefits are that a business plan:

- Shows how you plan to achieve the results you are aiming for.
- Forces you to assess the project realistically.
- Ensures that you will consider every aspect of your operation.
- Provides continuing measurable results, which you can use to measure your progress.
- Helps you use all your resources.

Now let's look at the actual structure of a business plan. Earlier in this chapter, we listed the major concerns of all lenders (ie., the five Cs of credit). Your business plan must address each of these concerns. It must therefore contain the following components, which should appear in the order shown.

Background information. This describes you and your hotel/motel and the professional people who advise you. List information on your education, your experience (especially in the lodging industry) and your accomplishments. If your business is a partnership, state the name and interests of all partners; if a corporation, the name and shareholdings of each shareholder. In addition, provide the name and branch of your bank, as well as the name of your accountant and lawyer.

General statement of the purpose for the loan. Indicate whether the loan you are seeking is to be used to expand/renovate an existing hotel/motel or to build a new one. Include information on:

- The site and its location.
- The facilities to be provided.
- The type of clientele anticipated.
- The methods of operation and policies to be implemented.

Wherever possible, this information should be visually portrayed, with preliminary building and floor plans, site photographs, representative scale models, etc.

Opening balance sheet. Show the capital costs and the proposed financing. This is sometimes called a pro forma (or projected) balance sheet. For the Motel C example discussed earlier, it would look like this:

Pro forma balance sheet for Motel C - year 3

Estimated project costs (assets)	
Land	$ 20,000
Building construction	210,000
Furniture, fixtures and equipment	30,000
Working capital	10,000
Provision for contingencies	27,000
Total	$297,000
Financing (debt and equity)	
Loan	$222,750
Owners' equity	74,250
Total	$297,000

Note that any pre-opening expenses not accounted for in the projected costs should be shown as a cost item. Remember in all cases that the total project costs must equal total financing (since total assets equal total liabilities plus equity).

In addition, the following supplementary information must accompany the balance sheet:

- There must be a clear indication of which costs are firm and which are based on your estimates only. For example, lenders often require a firm agreement among you (the owner), the developer and the general contractor. Only if the general contractor has given you a figure for the total construction cost, and has put his signature to it, will the cost be considered a firm one.

- For each cost item shown on the opening balance sheet, provide more detailed information - eg., the area, location and legal description of the land to be purchased, preliminary architectural plans of the development, etc.
- the lender about other sources of financing you plan to use. This would include your equity, as well as other loans you may already have lined up.

Feasibility study. Present the research you have done on the site and the market, as described earlier. Don't be surprised if the lender asks that your feasibility study be repeated by an independent third party, such as a hospitality management consultant.

Pro forma income statement. convince the lender that you will be able to repay the loan, include your pro forma income statement. This statement should show expected occupancies, average room rates, revenues, departmental expenses and undistributed operating expenses. As discussed earlier, it should cover the first five years of operation. Your accountant and/or hospitality management consultant will advise you on the financial expenses and taxes to be deducted from the income before fixed charges to arrive at net income. In some cases, the lending institution will calculate these for you. In doing so, it will estimate the cash flow for your business. Ease of repayment will depend on this flow.

Your plan for repaying the loan. As a general rule, you should develop a separate repayment plan, based on the cash revenues to be generated by the borrowed funds. Don't place the onus on the lender to suggest a repayment plan. Develop your own.

Loan security Be prepared to discuss how the lender might minimize his risk. If your loan application is a borderline case, you may sway the decision in your favour by providing collateral security or a personal guarantee. List your personal assets such as marketable securities, bonds, etc. Decide in advance just how much you are willing to offer as security for the loan.

These, then, are the seven elements that make up a business plan. Armed with these, and your own conviction that your proposed hotel/motel investment really is a sound one, you should experience little difficulty in raising the funds you need.

Key points in review

After studying Chapter 9, you should be able to:

- List long-term, medium-term and short-term uses and sources of financing.
- Explain the concept of financial leverage.
- Identify the main sources of funds in Canada.
- Explain the meaning of the five Cs of credit.
- Prepare a feasibility study.
- Explain the main capital budgeting techniques and prepare an itemized capital budget.
- Explain the benefits of a business plan to both lenders and owners.
- Outline the contents of a business plan.
- Prepare a business plan.
- Define or explain all the key terms that appear in italics.

SELF-TEST QUESTIONS -9

(answers on last page this chapter)

1. As a general rule in financing, it's true that:
   a. A long-term source of funds should be used for long-term uses of money, and short-term sources of funds for short-term uses.
   b. A medium-term source of funds should be used for short-term uses of money, and short-term sources of funds for long-term uses.
   c. A long-term source of funds should be used for short-term uses of money, and short-term sources of funds for long-term uses.
   d. A short-term source of funds should be used for long-term uses of money, and medium-term sources of funds for medium-term uses.
   e. None of the above.

2. For which of the following would you not use a long-term mortgage?
   a. Refinancing an existing business.
   b. Buying an existing business.
   c. Covering periodic shortages of working capital.
   d. Expanding an existing business.
   e. All of the above.

3. Short-term, medium-term and long-term usually mean respectively:
   a. One year or less, 1-5 years, 5-25 years.
   b. Two years or less, 2-5 years, 5-25 years.
   c. Five years or less, 5-10 10-25
   d. Five capit or less, 5-15)tal o: 15-25 years.
   e. None of the above.

4. A hotel has owners' equity of $25,000 and a long-term mortgage of $ . . What is its equity ratio and is it under-levered, normally levered or over-levered?
   a. 1:5 and under-levered.
   b. 3:1 and normally levered.
   c. 1:3 and normally levered.
   d. 5:1 and over-levered.
   e. None of the above.

5. Four capital methods are:
   a. Income before fixed charges multiple, capitalization rate, return on owners' equity and payback.
   b. Net present value, internal rate of return, payback and return on owners' equity.
   c. Net return on assets, income before fixed charges multiple, internal rate of return and net present value.
   d. Internal control, net income, return on owners' equity and capitalization rate.
   e. None of the above.

6. Lenders normally expect to supply:
   a. of the project costs in equity.
   b. of the project costs in equity.
   c. of the project costs in equity.
   d. of the project costs in equity.
   e. None of the above.

7. A business shows a net income of $52,000. Its operating expenses are $200,000, depreciation is interest charges are S40,000 and repayment of principal is $18,000. Its cash flow is therefore:
   a. $234,000.
   b. $118,000.
   c. $34,000.
   d. $74,000.
   e. $78,000.

8. An owner invests S500,000 in a hotel. For the first seven years the hotel's income before income taxes is S20,000, $74,000, $128,000, S178,000, S200,000, S220.000 and S240,000. The payback period is therefore:
   a. 4.5 years.
   b. 7.0 years.
   c. 6.5 years.
   d. 6.0 years.
   e. 5.5 years.

9. Which of the following is a public sector source of financing?:
   a. The chartered banks.
   b. The Federal Business Development Bank.
   c. Mortgage brokers.
   d. Trust companies.
   e. All of the above.

10. The five of credit are:
   a. Control, character, capital, conditions and collateral.
   b. Currency, charisma, capitalization, cash and conditions.
   c. Character, cash, currency, collateral and capacity.
   d. Character, capacity, capital, conditions and collateral.
   e. None of the above.

11. The two main elements of a feasibility study are:
    a. Capitalization rate and nomograph.
    b. Net present value and internal rate of return.
    c. Site evaluation and market study.
    d. Break-even analysis and capital budgeting.
    e. None of the above.

12. Net present value and internal rate of return are:
    a. Break-even analysis techniques.
    b. Present value techniques.
    c. Internal control techniques.
    d. Cost valuation techniques.
    e. None of the above.

13. You should use a bank line of credit for:
    a. Expanding your business.
    b. Covering operating expenses when they exceed the cash available from operations.
    c. Refinancing your business.
    d. Buying another business.
    e. None of the above.

14. Financial leverage is important to small- and medium-size hotel/motels because:
    a. As leverage decreases, the ability to borrow increases.
    b. As leverage increases, the ability to borrow increases.
    c. As leverage decreases, the ability to borrow decreases.
    d. It shows how profitable a business has been.
    e. None of the above.

15. Grants and low-interest loans are normally received from:
    a. Chartered banks.
    b. The Federal Business Development Bank.
    c. Provincial government development corporations and tourism departments.
    d. Trust companies.
    e. All of the above.

WORKING EXAMPLE -9

Background

The New Motel is a proposed 10-room motel you would like to build. You have drawn up the following capital budget so that you can decide on a financial plan (ie., a way of financing your project).

Capital budget

	Amount
Land	$ 12,600
Site preparation and improvements	7,500
Site servicing	3,600
Building construction costs	102,000
Furniture, fixtures and equipment	21,600
Professional fees	10,000
Cost of interim financing	3,700
Working capital	2,500
Pre-opening expenses	2,400
Sub-total	$165,900
Contingency (of 15% of sub-total)	24,885
Capital budget total	$190,785

Task

Suggest a financial plan, or method of financing, which would allow you to build your motel. Also, indicate where you would use short, medium and/or long-term financing. When you have completed your plan, answer the following questions:

- With a capital budget total of $190,785, how much debt and how much equity would there be at the highest leverage ratio normally acceptable to lenders?
- If you had $35,000 to invest as equity, do you think you would be able to borrow the remaining $155,785?
- If you invested $67,074 as equity and borrowed the remaining $123,711, would you be considered under-levered?

The solution to this example can be found following Chapter 10.

NOTES

answers to self-test questions -9

a	2. c	3. c	4. d	5. b	6. a	b	8. a
9. b	10. d	11. c	12. b	13. b	14. a	15. c	

ɔartnership?
ılimited liability.
se in raising new capital.
eak-up and reorganization is simple.
:cisions can be made quickly.
ɔne of the above.

ı an individual receives a capital gain:
is taxed at 49% upon receipt, but a 32%
'und can later be claimed.
ıe half of the capital gain is included in
:ome and taxed at the individual's personal
x rate.
l of the capital gain is included in income and

14.

d. It is taxed at 25%.
e. None of the above.

13. Five types of income are:
a. Business income, dividend income, investment

a. Buildings.
b. Furniture.
c. Equipment.
d. Land.

AND BUSINESS

holding onto what you've . .

In this last chapter, we offer some general background information, which may help you with your hotel/motel in areas that are slightly different from those contained in the first nine chapters. Specifically, we look at the different ways a business such as a hotel/motel can be legally formed in Canada; and we discuss the different types of income that can be produced and the way these different types of income are taxed.

The main problem we face here is that the tax laws in Canada are constantly changing, Nearly every federal and provincial budget introduces a number of proposals that affect the way money is taxed, so any detailed information we gave would quickly go out of date.

Also, not all the levels of tax are standard across Canada. For example, some provinces levy sales taxes; others do not. At the municipal level, taxes are based on an assessment formula, an assessed value of your fixed assets and on a pre-determined mill rate (ie., the amount of tax paid for every $1,000 of assessed value). These formulae, assessments and mill rates vary widely, so again it is impossible for us to give specific advice that would be widely applicable.

The an result is that we can offer general guidelines only. ue, can point out the principles involved, and this might help you get started in the right direction; but we cannot fill in the details. For that, you have to seek professional advice from a qualified accountant or lawyer.

Developing a tax plan

The purpose of a tax plan is to arrange your affairs so that you minimize the taxes that the federal, provincial and municipal governments levy on your business and personal incomes, on the assessed value of your land and other fixed assets, on your capital gains, and so on. In many instances, there is not a lot that you can do about these taxes. For example, you cannot plan to minimize your sales taxes (where they apply), except by minimizing your sales. Also, the only way to minimize your municipal taxes is to compare your municipal tax bills with those of your colleagues in hotel/motels similar to yours, and appeal your assessment if you find that your bills seem unreasonably high.

In other areas, however, you can take steps to arrange your affairs so that your taxes are minimized, especially in the area of income taxes. That's what this final chapter is primarily about.

The amount of income tax you pay depends on the type of taxpayer you are and the type of income you earn. Essentially, there are two types of taxpayer:

- Business.
- Individual.

And there are three types of income:

- Business income.
- Investment income.
- Income from employment.

planning is really the process of determining which combination of type of taxpayer and type of income results in the lowest amount of tax being paid. (It is not the understating of revenues or the padding of expenses; that is tax evasion, and it is illegal.) As we indicated, developing a tax plan for your hotel/motel really requires professional help. However, there are some general guidelines that you should consider in developing such a plan (or in assessing your present tax position). Here are the main ones.

Your business as a taxpayer

The type of business organization you choose for your hotel/motel has an impact that goes well beyond the amount of tax you pay. will touch on some of these other ramifications as we go through the legal forms of business organization, but our emphasis will be on saving tax.

In Canada, there are three main legal forms of business organization —

proprietorship (or sole proprietorship), partnership and corporation. Let's look at each one in turn.

Proprietorship (or sole proprietorship)

This is the easiest and least costly way of setting up a business. Your only legal obligation is to register the proprietorship with your province by paying a small registration fee. However, a proprietorship has no legal status with respect to debt, lawsuits and income taxes. The legal responsibility of the business is borne entirely by you, the proprietor. Also, any net income earned by your business must be reported as personal income, which in turn means that your business income is taxed at your personal rate.

Partnership

A partnership is an ownership structure similar to a proprietorship. The major difference is that the business is owned by more than one person. Each reports his or her share of the net income as personal income.

Corporation

A corporation is an entity separate from the owners. It has a legal status with respect to debt, lawsuits and taxation. That means, for example, that if a corporation is unable to pay its debts and enters into bankruptcy, the unpaid creditors are not entitled to demand payment from the owners. A corporation therefore offers the benefit of *limited liability.*

Two main types of corporation can be legally formed in Canada – private corporations and public corporations. In a *corporation,* the shares are held privately and are not offered for sale to the general public. In a *public corporation,* shares are generally available to anyone who wants to buy them. For this reason, financial reporting requirements are far more onerous for public than for private corporations.

There is also an entity called the *Canadian-controlled private corporation* that should be mentioned. It qualifies for a special low income tax rate, commonly known as the *small business rate (currently* 2590). For this low rate to apply, the corporation must be private (less than shareholders), and it must be at least controlled by Canadian residents.

The main disadvantage of incorporating a business is the relatively high set-up costs for such things as incorporation fees and professional services (ie., lawyers and accountants), and the continuing costs of fulfilling certain legal requirements (eg., holding annual shareholders' meetings, maintaining minutes of these meetings, submitting annual financial statements, etc.).

Figure 66 summarizes the three principal business forms, and their main advantages and disadvantages.

It is not possible to say exactly when (from a tax point of view) it is better for you to receive income through a corporation than it is to receive it personally (through either a proprietorship or a partnership). because the cut-off point depends almost entirely upon your own situation.

However, Canadian-controlled private corporations are taxed at that low (flat) rate of of their first $200,000 of active business income per year (UP to a cumulative total of million); and this rate is lower than the marginal rate at which most people are taxed personally. (Active business income is the income you earn from your hotel/motel, excluding investment income.) Against this tax advantage, you have to balance the higher costs of incorporation and the possibility that, in some years, your personal marginal rate may fall below the your corporation would have to pay in any event.

FIGURE 66 The three main legal forms of business organization in Canada

Form	Characteristics	Advantages	Disadvantages
Proprietorship (or sole proprietorship)	Sole ownership without partners. If business is to be conducted under a company name or name other than your own, you must register with the appropriate provincial/ municipal government. As the proprietor, you are bound by general legal statutes and personal tax laws.	·ate control. Full financial rewards. May have more flexibility in terms of decision-making. Does not have to consider the opinions of partners or other business associates. Low start-up costs. Greater freedom from regulation. All profits to owner. Minimal working capital requirements.	If bankruptcy occurs, no distinction is made between business and personal assets. (However, creditors cannot seize property belonging to spouse.) At certain levels of business income, it presents tax problems. Reduced opportunities to raise capital and secure loans compared to forms with broader-based financial resources.
Partnership	An arrangement by which two or more persons combine resources, talent and efforts, with profits being shared.	Debt financing more accessible. Larger total capital contributions of the members. advantages over sole proprietorship. Ease of formation. Low start-up costs. Limited outside regulation.	Difficult to dismiss a partner lacking skills or integrity. More difficult to make quick decisions, because of divided authority. Break-up and re-organization very complex, especially if death is the cause. Unlimited liability. Difficulty in raising additional capital.
Corporation	A legal entity in its own right, which is separate from its owners. Corporations may be privately or publicly owned.	Limits liability, since owners are not liable for debts beyond their investment or share in the corporation. Broadens ownership base giving faster growth through easier financing and improved credit rating. Diversity of ownership. Stock (or shares) facilitate ownership transfer. Canadian-controlled private corporations qualify for low income tax rate.	Relatively high costs for incorporation, disbursements and legal fees. Decision-making can be a lengthy process if there are many shareholders so if owner-operated). Dilution of control and profit if many shareholders exist. Closely regulated. Extensive record keeping necessary.

However, as a general rule, if your income before income tax (also called taxable income) is more than about $20,000, then you should look into the possibility of incorporation.

The different types of income

As we've indicated, the type of income you earn also has an effect on the amount of tax you pay (and when you have to pay it). That's because business income, investment income and employment income attract different rates of tax.

Figure 67 shows how these types of income are taxed. (Once again, we stress that before you act on this information, you should check that the details are still valid.)

FIGURE 67 Tax treatment of different income types

	Type of taxpayer	
Type of income	Corporation	Individual
Business income	Reported on a corporate tax return as active business income (net income from the operation, excluding investment income). Income up to $200,000 is taxed at a rate of 25% to a cumulative total of $1 million.	Reported on a personal income tax return as business income (net income from your business). The business income is taxed at your personal tax rate.
Investment income — dividends	Dividend income received from non-controlled taxable Canadian corporations is taxed at 25% upon receipt. However, the tax paid is potentially refundable when the corporation itself pays dividends to its shareholders.	Dividend income received from taxable Canadian corporations is taxed at an effective rate, which is less than your personal rate due to dividend tax credits. The actual rate depends on the amount of your other income and the amount of the dividend income. The first $1,000 of dividend and investment income is not taxed.
Investment income — other than dividends	Investment income is taxed at 49% upon receipt. However, private corporations can obtain a refund of 32% of the tax paid when they pay a certain amount of dividends to shareholders.	Investment income is taxed at your personal rate of tax. The first $1,000 of dividend and investment income is not taxed.
Capital gains	One-half of the actual capital gain is taxed at 49%. However, private corporations can obtain a refund of 32% of the tax paid when they pay a certain amount of dividends.	One-half of the actual capital gain is included in income and taxed at your personal rate of tax.
Employment income	Not applicable	Employment income is taxed at your personal tax rate.

Ideally, you should structure your income sources so that the lowest tax rate applies. Unfortunately, this is easier said than done, because most small and medium-sized hotel/motel owners have only one investment (their property), which generates only one kind of income.

However, you will always have some degree of leeway, especially if you bear in mind these main tax points:

- The first $1,000 of investment income (dividends, interest and taxable capital gains from Canadian sources) can be received personally without any tax being due. You should try to take advantage of this exemption.
- Contributions (up to a specified maximum) that you make to a registered retirement savings plan (RRSP) are tax deductible. Similarly, certain contributions made to a registered home ownership savings plan (RHOSP) are sometimes tax deductible.
- Dividends are taxed less harshly than most other sources of income, because of the *dividend tax credit.*
- A number of tax breaks can be doubled in value if you split income with your spouse.
- If you operate your hotel/motel as a corporation, and if your net income is less than $200,000 per year, you will probably attract the lowest rate of tax if you receive your income as a mix of employment income (ie., salary) and investment income (in the form of dividends).

Buying and selling a hotel/motel

Although the tax aspects of owning a hotel/motel are extremely important, they are perhaps not as important as the tax aspects of buying or selling a hotel/motel. In these latter two instances, the tax aspects can often make the difference between profit and loss, success and failure.

When you buy a property (regardless of whether it is a proprietorship, a partnership or a corporation), you do not incur any income tax liability, because (as yet) you have not earned any income. However, it is vital that you allocate the purchase price among the various assets you are buying, in a way that is most beneficial to you from a tax point of view.

The reason for this is that certain assets can be depreciated at higher rates than others; and the more you allocate the purchase price to those assets that can be depreciated most rapidly, the better it is for you. In particular, you should realize that land cannot be depreciated for tax purposes, so you should try to allocate to land as little of the purchase price as possible.

Unfortunately, for tax reasons of his own, the vendor will be trying to allocate the purchase price (or, from his point of view, the sale price) in a different way from you. The allocation of the price therefore becomes a subject for negotiation, involving lawyers and accountants for both parties.

Of course, you cannot allocate any price you like to the various assets. As a rule, the allocation must be based on the fair market value of the assets involved. But as you can imagine, there is still a lot of room in which to ,, Break.. when, for example, you are trying to determine how much of the price should be allocated to buildings and how much should be allocated to the fixtures contained in those buildings.

When you sell a hotel/motel, you almost always face immediate tax consequences, depending on the price at which you sell, the price at which you bought, and so on. However, for tax purposes, you can be considered to have sold, or disposed of, your hotel/motel even when you do not actually sell it. For example, you are "deemed to have disposed of" your hotel/motel when:

- You become a non-resident of Canada.
- You change the use of your hotel/motel (eg., you convert a resort into privately owned cottages).
- You give the hotel/motel to someone else.

The tax ramifications of the purchase and sale of a hotel/motel are extremely complicated. You need to have a tax plan drawn up specifically for you and for the situation in which you are in. That is why we are unable to generalize further, and why we suggest that you seek qualified professional advice.

Key terms in

After studying Chapter 10, you should be able to:

- Identify the different types of taxpayer and the different types of income.
- Define and explain the advantages and disadvantages of the three main forms of business organization in Canada.
- Differentiate between a private and a public corporation.
- Explain the key attributes of a Canadian-controlled private corporation.
- Explain how different types of income are taxed.
- List some of the tax implications of buying and selling a hotel/motel.
- Define and explain all the key terms that appear in italics.

SELF-TEST QUESTIONS -10

(answers on last page this chapter)

1. The three main forms of business organization in Canada are:
   a. Canadian-controlled public corporations, limited partnerships and private corporations.
   b. Partnerships, corporations and proprietorships.
   c. Private corporations, public corporations and proprietorships.
   d. Franchises, referral groups and corporations.
   e. None of the above.

2. A Canadian-controlled private corporation must have:
   a. of its shares owned by Canadians.
   b. of its shares owned by non-residents.
   c. At least of its shares owned by Canadians.
   d. or less of its shares owned by non-residents.
   e. None of the above.

3. A Canadian-controlled private corporation can deduct income taxes on the first $200,000 of its active business income at a rate of:
   a.
   b.
   c.
   d.
   e. None of the above.

4. Which of the following is not an advantage of incorporation?
   a. Limited liability.
   b. Low start-up costs.
   c. Diversity of ownership.
   d. Continuous existence.
   e. None of the above.

5. Unlimited liability is characteristic of:
   a. Corporations and partnerships.
   b. Corporations and proprietorships.
   c. Proprietorships and partnerships.
   d. Private and public corporations.
   e. All of the above.

6. How much investment income can be received tax-free in Canada?
   a. None.
   b. $5,000.
   c. $1,000.
   d. $2,000.
   e. $500.

7. In most cases, incorporation should be considered if the earnings from a business exceed:
   a. $20,000.
   b. $10,000.
   C. $8,000.
   d. $11,000.
   e. None of the above.

8. Which of the following is not an advantage of a proprietorship?
   a. Easier debt financing.
   b. Minimal working capital requirements.
   c. Full financial rewards.
   d. Greater freedom from regulation.
   e. control.

9. The major disadvantage of incorporating is:
   a. Unlimited liability.
   b. High start-up costs.
   c. Close regulation.
   d. Dilution of control.
   e. None of the above.

10. Which of the following is false?
    a. A proprietorship means sole ownership without partners.
    b. One of the main disadvantages of proprietorship is unlimited liability.
    c. A proprietor is bound general legal statutes and personal tax laws.
    d. In all cases, a proprietorship need not be registered with provincial/municipal governments.
    e. None of the above.

11. Which of the following is an advantage of setting up a partnership?
    a. Unlimited liability.
    b. Ease in raising new capital.
    c. Break-up and reorganization is simple.
    d. Decisions can be made quickly.
    e. None of the above.

12. When an individual receives a capital gain:
    a. It is taxed at 49% upon receipt, but a 3290 refund can later be claimed.
    b. One half of the capital gain is included in income and taxed at the individual's personal tax rate.
    c. All of the capital gain is included in income and taxed at the individual's personal tax rate.
    d. It is taxed at 25%.
    e. None of the above.

13. Five types of income are:
    a. Business income, dividend income, investment income, capital gains and employment income.
    b. Revenues, dividend income, investment income, capital gains, and employment income.
    c. Wages, salaries, CPP, UIC and Workmen's Compensation.
    d. Revenues, wages, salaries, dividends and capital gains.
    e. None of the above.

14. An owner/manager of a corporation can be paid in:
    a. Capital gains and net income.
    b. Capital gains and salary.
    c. Salary and dividends.
    d. Dividends and capital gains.
    e. None of the above.

15. Which of the following types of assets cannot be depreciated for tax purposes?
    a. Buildings.
    b. Furniture.
    c. Equipment.
    d. Land.
    e. None of the above.

WORKING EXAMPLE -10

Background

You are planning to buy a motel, which you expect to generate an income before tax of $30,000 next year.

Last year, you earned $30,000 in income from employment, and after personal exemptions of $4,000 you paid $8,400 in tax. You expect that if you were to earn $30,000 personally again this year, your tax situation would be just as it was last year.

Suggest the best business structure you should apply to your planned purchase of the motel. In particular, consider whether you should setup a proprietorship or a corporation.

The solution to this example can be found following this chapter.

NOTES

answers to self-test questions -10

b	2.	3. d	b	5. c	6. C	7. a	8. a
9. b	10. d	11. e	12. b	13. a	14. c	15. d	

SOLUTIONS TO WORKING EXAMPLES

Solutions to working examples -1

Example 1

The completed balance sheet looks like this:

Assets		Liabilities	
Current assets	$	Current liabilities	$ 27,000
Fixed assets		Long-term liabilities	
Land	150,000	Mortgage payable	368,000
Buildings	250,000	_____ liabilities	395,000
Furniture	120,000	Owners' equity	160,000
Sub-total	520,000		
_____ assets	$555,000	_____ liabilities and owners' equity	$555,000

Example 2

The income before fixed charges and the cash flow of the Motel can be calculated as follows:

	_____	$1,800,000
Minus:	Operating expenses	1,404,000
Equals:	Income before fixed charges	396,000
Minus:	Fixed charges	247,000
Minus:	Depreciation	105,000
Equals:	Income before income taxes	44,000
Minus:	Income taxes	11,000
Equals:	Net income	33,000
Plus:	Depreciation	105,000
Equals:		138,000
Minus:	Principal repayment	69,000
Equals:	Cash flow	$ 69,000

Solution to working example -2

Registration card and guest folio

ROOM NO	NAME	GUESTS
3	CHE(:UES W.'ITTEN CO	2

ACCOUNT No. 170

NAME FURNITURE AND EQUIPMENT

CITY TORONTO

OF CAR	LICENSE NO.	PROVINCE OR STATE
	376	ONTARIO

DATE	CHARGES: ROOMS	TAX	OTHER	RECEIPTS: CASH	No. CARD	OTHER	BALANCE
ADD 3		47					47
DA	2/ 00	47					
	o. 1 0300						

THIS AMOUNT WILL BE
CASH ❑

CHARGED TO
COMPANY
PERSONAL ❑

VISA
AMERICAN EXPRESS ❑

MASTERCARD

CARD
NO

Registration card and guest folio

ROOM NO	NAME	GUESTS
9	RUES IKITTEN	1

W/NIV/

MAKE OF CAR	LICENSE NO.	PROVINCE OR STATE
	523	
	4	5

DATE	CHARGES: ROOMS	TAX					OTHER	RECEIPTS: CASH	CARD	OTHER	BALANCE
IESS 4		26									— 26
	3( )										

THIS AMOUNT WILL BE , CHARGED TO

CASH O — COMPANY ❑ PERSONAL ❑ — VISA ❑ AMERICAN EXPRESS — MASTERCARD 0 — NO. ______

card and guest folio

ROOM NO	NAME	GUESTS
1 0	MRS.	

NAME F JRNITURE AND I QUIPME

ADDRESS

MAKE OF CAR	LICENSE NO	PROVINCE OR STATE

4 5

OATE	CHARGES						RECEIPTS			BALANCE
	ROOMS	TAX				OTHER	CASH	CARO	OTHER	
4			7 00							
	0	46								

THIS AMOUNT WILL BE

CASH

CHARGED TO

COMPANY ❑

PERSONAL ❑

VISA ❑

AMERICAN EXPRESS ❑

MASTERCARD ❑

CARO

NO.

Daily transcript: record of charges and receipts

OUNT No. 101 SHEET No.
ME BANK OPERATING ACCOUNT TERMS
DRESS RATING

DATE	DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE
'OV. 30	CASH DEPOSITS	CR	701 86			DR	701 86
'OV. 30	CHEQUES WRITTEN	CD					

OUNT No. 170 SHEET No.
ME FURNITURE AND EQUIPMENT TERMS
DRESS RATING

DATE	DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE
'OV. 30	TOWNE FURNITURE	CD	120 00			DR	120 00

OUNT No. 253 SHEET No.
ME SALES TAX COLLECTED TERMS
DRESS RATING

	DATE		EXPLANATION		STATISTICS		BANK		ACCT CASH	
					Rooms occ.	No. of guests	OP. Acct. 101	B. Card 102	Receiv 110	Short (ov.) 625
1	Nov.	5	DAILY TRANSCRIPT		3	5	102 66			
2	Nov.	7	DAILY TRANSCRIPT				74 90			
3	Nov.	10	DAILY TRANSCRIPT				21 40			
4	Nov.	13	DAILY TRANSCRIPT				42 80			
5	Nov.	15	DAILY TRANSCRIPT				128 40			
6	Nov.	18	DAILY TRANSCRIPT				64 20			
7	Nov.	20	DAILY TRANSCRIPT				32 10			
8	Nov.	23	DAILY TRANSCRIPT				117 70			
9	Nov.	30	DAILY TRANSCRIPT				117 70			
10										
11			TOTAL				701 86			
12										
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35										

TING ACCOUNT

SHEET No.
TERMS
RATING

SCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE
TS	CR	701 86			DR	701 86
'RITTEN	CD					

AND EQUIPMENT

SHEET No.
TERMS
RATING

SCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE
NITURE	CD	120 00			DR	120 0(

COLLECTED

SHEET No.
TERMS
RATING

SCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE
COLLECTED	CR				CR	45 3(

GUEST ROOMS

SHEET No.
TERMS
RATING

SCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE
REVENUES (NOV.)	CR				CR	541 0(

TELEPHONE CALLS

SHEET No.
TERMS
RATING

ESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE
ALL REVENUES (NOV.)	CR				CR	107 0.

GIFT SHOP

SHEET No.
TERMS
RATING

ESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE
AND CONFECTIONARY	CR				CR	8 5.

General ledger

ACCOUNT No. 101 | SHEET NO.
NAME BANK OPERATING ACCOUNT | TERMS
ADDRESS | RATING

DATE		DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE
Nov.	30	CASH DEPOSITS	CR	701 86			DR	701 86
Nov.	30	CHEQUES WRITTEN	CD					

ACCOUNT No. 170 | SHEET No.
NAME FURNITURE AND EQUIPMENT | TERMS
ADDRESS | RATING

DATE		DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE
Nov.	30	TOWNE FURNITURE	CD	120 00			DR	120 00

ACCOUNT No. 253 | SHEET No.
NAME SALES TAX COLLECTED | TERMS
ADDRESS | RATING

DATE		DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE
Nov.	30	SALES TAX COLLECTED	CR				CR	45 36

ACCOUNT No. R 300 | SHEET No.
NAME REVENUE - GUEST ROOMS | TERMS
ADDRESS | RATING

DATE		DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE
Nov.	30	GUEST ROOM REVENUES (NOV.)	CR				CR	541 00

ACCOUNT No. T-300 | SHEET No.
NAME REVENUE - TELEPHONE CALLS | TERMS
ADDRESS | RATING

DATE		DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE
Nov.	30	TELEPHONE CALL REVENUES (NOV.)	CR				CR	107 00

ACCOUNT No. G 300 | SHEET No.
NAME REVENUE - GIFT SHOP | TERMS
ADDRESS | RATING

DATE		DESCRIPTION	FOLIO	DEBIT	✓	CREDIT	DR OR CR	BALANCE
Nov.	30	NEWSPAPER AND CONFECTIONARY	CR				CR	8 50

General ledger

ACCOUNT No. 7 - -
NAME of
ADDRESS
SHEET No.
TERMS
RATING

		DESCRIPTION	FOLIO			OR OR CR	
			·	50 00			5'0 00

ACCOUNT NO.
NAME - SA
ADDRESS
Building construction cost is 75% 75 x 5
SHEET No.
TERMS
RATING 3.75

						OR OR	
Nov.							86 50
				17			I 4 30

ACCOUNT No. 530
v and business taxes Mill rate of 35 mills (or $35 on every 35 x 80
ADDRESS $1,000 of assessment) on 80% of the 1,000
SHEET No.
TERMS 2.8
RATING

		DESCRIPTION			CREDIT	OR CR	
rem	im	At 25% on the		7 00			5 00

ACCOUNT No 6 4 0
NAME I
ADDRESS
SHEET No
TERMS
RATING

DATE			FOLIO	DEBIT	CREDIT		
re fi	30	harges		0 0			0 0 0

ACCOUNT
NAME Second, the average income before fixed charges for
ADDRESS $72,600, calculated as follows:
SHEET
TERMS
RATING

DATE		(10 + 5)	FOLIO	DEBIT	CREDIT	CR	BALANCE
	30			3			35
		= $72,600					

The fa
NAME
ADDRESS
SHEET No.
TERMS
RATING

DATE							BALANCE
				0 0			5 00

NOVEMBER 30, 19__

	No.	ACCOUNT			TRIAL BALANCE DEBIT	TRIAL BALANCE CREDIT
1	101	BANK OPERATING ACCOUNT			52 56	
2	170	FURNITURE AND EQUIPMENT			120 00	
3	253	SALES TAX COLLECTED				45 3
4	R-300	REVENUE - GUEST ROOMS				541 0
5	T-300	REVENUE - TELEPHONE CALLS				107 0
6	G-300	REVENUE - GIFT SHOP				8 5
7	T-400	COST OF TELEPHONE CALLS			50 00	
8	R-500	ROOMS - SALARIES AND WAGES			104 30	
9	R-530	ROOMS - CLEANING SUPPLIES AND E[illegible]SES			25 00	
10	690	ADVERTISING			200 00	
11	778	PROPERTY OPERATION AND MAINT. - [illegible] PLIES			35 00	
12	792	ENERGY COSTS - FUEL			115 00	
13						
14					$701 86	$701 8
15		INCOME				
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35						

Solutions to working examples -3

Example 1

Beach balance sheet

Assets		Liabilities	
Current assets		Current liabilities	
Cash	$ 5,000	Bank loan	$ 5,000
Fixed assets		Long-term liabilities	
Land	80,000	Mortgage payable	145,000
Building	80,000	Owners' equity	50,000
Furniture and fixtures	35,000		
—— assets	$200,000	—— liabilities and owners' equity	$200,000

Example 2

Should you be satisfied with your investment?

Profitability ratios (expressed as percentages)

			1985	1984
Return on owners' equity	=	Net income x 100 / Owners' equity	$991 x 100 / $35,000 = ——	$3,543 x 100 / $35,000 — 10.1%
Return on total assets	=	Income before interest and income taxes x 100 / assets	($1,322 + $16,000) x 100 / $140,000 = 12.4%	($4,724 + $16,250) x / $155,500 = 13.570
Net return on total assets		Net income x 100 /)00 + assets	$991 x 100 / $140,000 = 0.790	$3,543 x 100 / $155,500 = 2.3%
Profit margin	=	Net income x 100 / revenues	$991 x 100 / $87,780 1.1%	$3,543 x 100 / $91,336 =

All the profitability ratios point to the fact that the Frontier Resort was less profitable in 1985 than in 1984. Your return on investment has dropped quite sharply. Therefore, should not be satisfied with your investment in 1985.

Would a creditor extend credit to the Frontier Resort?

Liquidity ratio

		1985	1984
Current ratio	Current assets / Current liabilities	$10,000 / $18,000	$18,000 / $18,000
		= 0.56	= 1.0

Leverage ratios

		1985	1984
assets ratio	liabilities / E assets	$105,000 / $140,000	$120,500 / $155,500
		0.75	= 0.78
Debt-equity ratio	long-term liabilities / owner's equity	$87,000 / $35,000	$102,500 / $35,000
		= 2.49	= 2.93
Times interest earned	= Income before income taxes and interest / Interest expenses	$1,322 + $16,000 / $16,000	$4,724 + $16,250 / $16,250
		= 1.08	= 1.29

These ratios show that, in 1985, the Frontier Resort was a high credit risk since its current ratio was far less than 1.0. Thus, if suppliers (ie., creditors) were to demand payment immediately, the Frontier Resort would be short by $8,000 (current liabilities of $18,000 minus cash of $10,000). The Frontier ——— does have an acceptable debt-to-equity ratio; nevertheless, a creditor should be very unwilling to extend short-term credit, since the resort could have severe difficulties in repaying even its existing current liabilities.

Solutions to working examples -4

Example 1

Rooms

		1985	1984
Occupancy percentage	$\frac{\text{Occupied room nights} \times 100}{\text{Available room nights}}$	$\frac{2{,}642 \times 100}{3{,}682}$	$\frac{2{,}694 \times 100}{3{,}682}$
		= [illegible]	=
Double occupancy factor	$\frac{\text{Number of guests}}{\text{Occupied room nights}}$	$\frac{5{,}890}{2{,}642}$	$\frac{6{,}073}{2{,}694}$
		= 2.23	= 2.25
Average rate per occupied room night	= $\frac{\text{Room revenues}}{\text{Occupied room nights}}$	$\frac{\$57{,}880}{2{,}642}$	$\frac{\$60{,}282}{2{,}694}$
		= $21.91	= $22.38

Food department

		1985	1984
Ratio of food revenues to room revenues (as a percentage)	= $\frac{\text{Food revenues} \times 100}{\text{Room revenues}}$	$\frac{\$26{,}750 \times 100}{\$57{,}880}$	$\frac{\$28{,}087 \times 100}{\$60{,}282}$
		= [illegible]	= 46.690
Revenues per seat	$\frac{\text{Food revenues}}{\text{Number of seats}}$	$\frac{\$26{,}750}{40}$	$\frac{\$28{,}087}{40}$
		= $668.75	= $702.18

The following conclusions can be reached from a review of these ratios:

- A combination of a decrease in the number of occupied room nights in 1985 and a lower average room rate resulted in a fall in room revenues.
- Although the ratio of food revenues to room revenues did not change significantly, the decrease in occupied room nights in 1985 caused a fall in coffee shop revenues.
- The increased expenses and lower revenues in 1985 resulted in a significant deterioration in the Frontier Resort's operating performance.

The end result is that, as the owner-manager, should find ways to reduce expenses and to attract more guests at a higher room rate.

Example 2

determine the break-even, you would make the following calculation:

Break-even in unit sales	$= \dfrac{\text{Fixed costs per year}}{\text{Contribution margin per occupied room night}}$
Fixed costs	
Property operation and maintenance	$ 3,000
Administrative and general	750
Marketing	750
Financial and other expenses	11,500
Depre fixed costs	$16,000
Contribution margin per occupied room night	Selling price per unit - Variable cost per unit
Selling price per unit (average room rate)	$\dfrac{\text{room revenues}}{\text{rooms sold}} = \dfrac{\$63,228}{2,373}$
Variable cost per unit	$\dfrac{\text{variable costs}}{\text{35 on rooms sold}} = \dfrac{\$32,927}{2,373}$
Contribution margin per occupied room night	$12.76
Break-even	$\dfrac{\$16,000}{\$12.76}$ = 1,253 occupied room nights

For an income of $20,000 before depreciation, you would make the following calculation:

Break-even in unit sales when income before depreciation is $20,000	$\dfrac{\text{Fixed costs + Desired income}}{\text{Contribution margin per occupied room night}}$
	$= \dfrac{\$16,000 + \$20,000}{\$12.76}$
	= 2,821 occupied room nights

Solution to working example -5

determine the required revenues from rooms, you would make the following calculation:

Add :

Return on owners' equity (157. x x $200,000)	$ 7,500
Depreciation	$10,000
Financing and other charges	$18,000
Operating expenses	$10,000
	$45,500

Subtract:

Miscellaneous income	$ 1,000

Equals:

Required departmental income from rooms		$44,500
Required revenues from rooms	$44,500	$63,571

The estimate of the number of occupied room nights would be made as follows: Occupancy is estimated to be .., .. At the number of occupied room nights equals:

60%x 10 x 365
= 2,190

At the number of occupied room nights equals:

taliz X 10 X 365
= 2,373

Here's how you would calculate the target average rate per occupied room night.

Average daily rate at occupancy equals:

$$\frac{\text{Room revenues}}{\text{Occupied room nights}} = \frac{\$63,571}{2,190}$$

$$= \$29.02$$

Average daily rate at occupancy equals:

$$\frac{\text{Room revenues}}{\text{Occupied room nights}} = \frac{\$63,571}{2,373}$$

$$= \$26.79$$

Cost-based prices are therefore $26.79 and $29.02 (average room rate) at and occupancy respectively.

Competitive prices in the area are $18.00 (single) and $22.00 (double). If you are to cover your expenses and earn a reasonable return on your investment, ɲ1 must generate an average room rate of $26.79-$29.02. Assuming a double occupancy factor of 1.5, your advertised rates would have to be approximately $26.00(single) and $30.00 (double).

These rates are not competitive. Therefore, based upon the cost structure given, the planned investment would not be successful. You should either investigate ways to reduce your construction costs or you should abandon the idea of building this motel.

Solution to working example -6

Cash budget

	May - October		November - April		Annual	
	Budget	*Actual*	*Budget*	*Actual*	*Budget*	*Actual*
Cash opening balance (A)	$10,500		$13,671		$10,500	
Cash receipts:						
Revenues	33,970		21,264		55,234	
Proceeds of any loans			5,000		5,000	
Cash contributions by owners						
— cash receipts	33,970		26,264		60,234	
Cash disbursements:						
—— expenses	26,299		22,311		48,610	
Purchases of fixed assets			7,000		7,000	
			4,500		4,500	
Cash drawings by owners	2,000				2,000	
Repayment on any debt	2,500		3,000		5,500	
cash disbursements	30,799		36,811		67,610	
Net cash-flow (B)	3,171		(10,547)		(7,376)	
Cash closing balance)	$13,671		$ 3,124		$ 3,124	

For the period May to October, the motel has a cash surplus of $10,OOO, which should be invested in short-term notes.

Solution to working example -7

From balance sheet (Figure 53),

1985 net working capital	= Current assets - Current liabilities
	= $100,000-$20,000 = $80,000
1984 net working capital	$ 80,000-$80,000 = O
Change in net working capital	= $80,000-0 = $80,000

This increase in net working capital represents a use of funds. The statement of changes in financial position can now be drawn up.

Twin Elms Hotel
Statement of changes in financial position
for the year ended December 31, 1985

Sources	
Net income	$ 55,000
Depreciation	$ 80,000
Mortgage	1 70,000
Sale of building	$ 20,000
nent	$225,000
Uses	
Purchase of land	$ 10,000
Purchase of furniture	$100,000
Declaration and payment of dividends	$ 35,000
Increase in net working capital	$ 80,000
	$225,000

Solution to working example -8

First, you should calculate the income before fixed charges multiple as follows:

Expense items	Relationship to total investment	Calculation	Percentage of total investment
Interest	Borrowed 60% of total investment at an interest rate of 12% per year	60 X 12 / 100	7.2
Depreciation - building	Building construction cost is 75% of total investment; depreciated at 5% per year	75 x 5 / 100	3.75
Depreciation - furniture, fixtures and equipment	FFE is 2090 of total investment; depreciated at 20% per year	20 x 20 / 100	4.0
Property and business taxes	Mill rate of 35 mills (or $35 on every $1,000 of assessment) on 80% of the total investment	35 x 80 / 1,000	2.8
Insurance premiums	At 0.25% on the building construction cost	75 X 0.25 / 100	0.1875
Return on owners' investment	259o return expected	40 X 25 / 100	10.0
Total capitalization rate			27.9375
Income before fixed charges multiple $\frac{100}{27.9375}$			3.58

Second, the average income before fixed charges forecast is found to be $72,600, calculated as follows:

$$\frac{[\$65{,}000 + \$70{,}000 + \$72{,}000 + \$76{,}000 + \$80{,}000]}{5}$$

$= \$72{,}600$

The fair market value of the Green Gables Motel is therefore:

$3.58 \times \$72{,}600$

$= \$259{,}908$

Solution to working ur Reservati An adv -9

You could finance your project in the following way. (Please note that this is just one way; many others are also possible.)

First mortgage for fixed assets (long-term financing)
You should shop around among various mortgage brokers to obtain the best terms and rates of interest for a first mortgage. You should be able to get a first mortgage for of the real property, so the size of your mortgage (and equity) would be calculated as follows:

Land	$ 12,600
Site preparation and improvements	7,500
Site servicing	3,600
Building construction costs	102,000
Sub-total	125,700
Contingency (of of sub-total)	$ 18.855
Total	144.555
Mortgage at ıotel of total	108,416
Owners' equity required	$ 36,139

Bank loan for furniture, fixtures and equipment (medium-term riginal entr
You could obtain a medium-term loan (5-10 year repayment period) to finance a portion of the furniture, fixtures and equipment. These assets would provide the lender with security in case of a default. Alternatively, you could lease some of the items. We'll assume here that you could obtain a loan for 50% of the value of the items:

Furniture, fixtures and equipment	$21,600
Contingency of 15T0	3,240
	$24,840
Bank loan for	$12,420
Owners' equity required	$12,420

Short-term loan (short-term financing)
You probably finance your working capital through a short-term loan from a bank.

Working capital	$2,500
Contingency of hen	375
name	$2,875
Short-term loan for	2,875
Owners' equity required	

Owners' equity for other items (long-term financing)

Your own funds would be required to finance the following:

Professional fees	$10,000
Interim financing	3,700
Pre-opening expenses	2,400
Sub-total	$16,100
Contingency of 15%	2,415
Owners' equity required	$18,515

In summary, the financial structure would be as follows:

	a you f. term	term	Long-term	Owners' equity	Total
Land, site preparation and servicing, building costs	perat	$ -	$108,416	$ 36,139	$144,555
Furniture, fixtures and equipment	-	$ 12,420	-	$ 12,420	$ 24,840
Professional fees, interim financing, pre-opening expenses	-			$ 18,515	$ 18,515
Working capital	$ 2,875	-			2,875
	2,875	$ 12,420	$108,416	$ 67,074	$190,785

Now for the three questions:

- The highest leverage ratio normally acceptable to lending institutions is 3:1, or 75% debt to ... . equity. Given a capital budget total of $190,785, then the debt would be approximately $143,089 ($190,785 x 0.75) and the equity approximately $47,696 ($190,785 x 0.25).
- At a debt to equity ratio of Smal business rate it is not likely that lenders will provide the remaining $155,785.
- If you invested $67,074 and borrowed $123,711, the leverage (or debt to equity ratio) would be 1.84:1. Since this is less than 3:1, you would be under-levered. You might therefore decide to lower your level of equity and increase the amount of your debt.

Solution to working example -10

If you were to set up a proprietorship, you would be taxed on the motel's income before income tax as if you had earned the money personally. Assuming your tax situation remains unchanged from last year, you would pay fit mar in tax.

If, instead, you were to set up a corporation that owned the motel, your $30,000 of income before income tax would be taxed at a rate of ome le ie., you would pay $7,500 in tax.

It would therefore be better to incorporate, since this would save you $900 in tax. The only other points to consider are:

- How much would the $900 saving be reduced by the higher costs of incorporation?
- Will the level of income before income taxes generated by the motel be maintained in future years?

Glossary

Account classification
The grouping of account titles under standard headings and definitions. It allows meaningful comparisons to be made among hotels/motels.

Accounting
The process of preparing financial statements that record, classify and summarize a business' financial transactions.

Accounts payable
Short-term obligations owed to a business' creditors - ie., amounts to be paid within one year's time.

Accounts receivable
Amounts due to the business from guests, customers, credit card companies and similar sources.

Accrual basis
One of the two alternative approaches to recording financial transactions in bookkeeping journals. Under this approach, transactions based on both cash and non-cash are recorded - ie., this approach records accounts payable and accounts receivable, as well as cash transactions.

Accumulated depreciation
The cumulative total of periodic depreciation expenses deducted from the value of a particular fixed asset.

Acid test ratio
Also known as the quick ratio, this is the relationship of cash, accounts receivable and marketable securities to current liabilities.

Activity ratios
Ratios that show how effectively a business is using its assets.

Administrative and general
A category of undistributed operating expenses, which includes office expenses, legal and other professional fees and similar items not charged to the various operating departments.

American Plan
A type of room rate that includes the price of the room, breakfast, lunch and dinner; commonly abbreviated to [illegible]

Amortization
Annual, or installment charges to pay off a loan or mortgage.

Assets
The tangible and intangible items of value owned by a business.

Available room nights
The number of rooms available for rental in a hotel/motel during a specific period of time.

Balance sheet
A financial statement that shows the relationships between a business' assets, liabilities and owners' equity at a particular point in time.

Bank card
A credit card issued by a chartered bank. Bank card payments are usually deposited directly into a bank account, so they are not treated as accounts receivable.

Bin cards
Cards used in a perpetual inventory system to record all receipts, adjustments and issues of individual items in the inventory.

Bookkeeping
The process of collecting, classifying, recording and summarizing a business' financial transactions in what are known as books of original entry.

Book of final entry
Another name for the general ledger. It draws on information contained in the books of original entry.

Books of original entry
The bookkeeping journals maintained [illegible] a business in which all financial transactions are initially recorded. These are maintained according to the double-entry system. They include the cash receipts journal, sales journal. cash disbursements journal, purchases journal, payroll journal, general journal and monthly journal.

Break-even analysis
A technique that examines the relationships between revenues, expenses and profits. It is used to establish prices and to enhance the profitability of a business.

Break-even chart
A graph that shows the relationships between a business' revenues, expenses. profits and volumes.

Break-even point
The point at which total revenues equal the combined value of fixed and variable costs. The break-even point can either be expressed in unit sales (ie., occupied room nights) or in dollars.

Budget
A pre-determined financial plan based on an owner's estimate of the future performance of a business. The most common types of budget are the cash budget, operating budget and capital budget.

Business plan
A comprehensive document that supports an application for financing.

Canadian-controlled private corporation
A private company (less than 51 shareholders), at least . controlled by Canadian residents. It qualifies for a special low rate of income tax, currently [illegible]

Capacity
The ability to produce the cash flow required to cover the repayment of principal and interest charges.

Capital budget
An itemized forecast of the costs of an expansion, renovation, acquisition or construction of a hotel/motel.

Capital budgeting
The planning of capital expenditures to produce the most favorable long-range returns. The techniques of capital budgeting measure the rates of return on investment projects. Capital budgeting is often called financial analysis or economic feasibility analysis.

Capital cost allowance
A tax deduction that Canadian tax laws allow you to claim for the loss in value of fixed assets due to wear and tear and/or obsolescence (depreciation).

Capital gain
The profit realized when certain assets, such as real estate and shares of a public or private company, are sold for proceeds in excess of cost. One-half of a capital gain is taken into taxable income when proceeds are received. This is called a taxable capital gain.

Capitalization rate
A technique used as a quick test of assessing the potential of a capital expenditure project. It tells you if you should proceed with a more comprehensive feasibility study.

Cash basis
One of the two alternative approaches to recording financial transactions in the bookkeeping journals. Under this approach, you record only those transactions in which cash has either been received or paid out - ie., you do not record accounts payable and accounts receivable.

Cash budget
This projects all sources and uses of cash in a business for a given period of time (usually a year). It is basically a forecast or pro forma source and use of cash statement.

Cash disbursements journal
A book of original entry in which all payments in cash or by cheque are recorded.

Cash flow
The actual cash profit (or loss) made by a business during a given period of time. It is calculated by adding depreciation costs to your net income, and then subtracting the amount of principal repaid during that period of time on any long-term loans and mortgages.

Cash management
It ensures that excess cash reserves are used to earn a financial return.

Cash receipts journal
A book of original entry in which all the transactions involving the receipt of cash, whether in the form of cash, personal cheques or credit card payments, are recorded.

Character
A term lenders use to refer to your track record in business, your integrity and your proven ability to meet financial commitments.

Chart of accounts
A numbered schedule of accounts containing the account classifications recommended under the uniform system of accounts. It follows the sequence of the balance sheet and income statement.

City ledger
The ledger that records all accounts receivable of guests who are no longer registered in your hotel/motel.

Collateral
Buildings, equipment, real estate, stocks, bonds and other items of value that can be pledged as security for a loan. A lender has the right to sell collateral in the event of a borrower's default.

Competitive pricing method
A pricing method based on research into competitive price levels, but not into operational costs or market expectations.

Conditions
A term used by lenders to refer to the status of the lodging industry in your market area, including trends in demand, prices, competition, profitability and government regulations.

Contribution margin
The difference between total revenues per room and variable costs per room. It is used in break-even analysis.

Corporation
A business venture by one or more persons creating a legal entity that is in itself considered to be a legal person.

Cost approach
An approach to placing a fair market value on a lodging facility. Itassumes that themarket value of the business is equal to the value of its assets.

Cost of sales
The cost of goods or services sold to guests to produce revenues.

Cover
A unit of food service provided to a customer. This is not synonymous with meal, because a food cover [illegible] co ffeeora bowl of soup.

Credit
An entry on the right hand side of an account recording an increase in liabilities, owners' equity or revenues, or a decrease in assets or expenses.

Credit management
It ensures that suppliers' invoices are paid in time to take advantage of any discounts for prompt payment.

Current assets
Items that are either cash now, or that are expected to be turned into cash within one year's time.

Current liability
A financial obligation that will have to be paid within one year's time.

Current ratio
The ratio of current assets to current liabilities. It is a measure of a business' liquidity.

Daily transcripts
The daily records of all outstanding charges and settled receipts made during the past 24 hours.

Debit
An entry on the left hand side of an account recording an increase in assets or expenses, or a decrease in liabilities, owners' equity or revenues.

Debt
The total long-term liabilities of a business.

Debt-equity ratio
The ratio of long-term liabilities to owners' equity.

Departmental expenses
Expenses incurred directly by a hotel/motel in running the various departments.

Departmental income
The difference between total revenues and the combined value of the total cost of sales and total departmental expenses.

Departmentalization
The allocation of revenues and expenses to the various operating departments in a hotel/motel.

Depreciation
The loss in the value of fixed assets due to wear and tear and/or obsolescence. It is an accounting expense made with the intention of apportioning the cost of the asset over its useful life.

Disbursements
Amounts paid out in cash or cheque or other cash equivalent.

Discounting
A pricing method used to capture particular types of business or to attract business at particular times of the day, week, month or year. It uses break-even analysis. It is not the same as price cutting.

Dividends
The amounts paid out of net income to a hotel/motel's shareholders.

Dividend tax credit
A preferential way of treating dividend income received from taxable Canadian corporations. The actual amount ıd the credit depends on your province of residence. The federal dividend tax credit is equal to 34y0 of the dividend received. The provincial tax credit is a percentage of the federal dividend tax credit in all provinces except Quebec.

Double differential formula
A formula used for calculating room revenues.

Double-entry system
The basic procedure followed in bookkeeping, which dictates that for every debit there must be a credit (and vice versa) and that total debits must always equal total credits.

Double occupancy factor
A factor measuring the average number of persons occupying rooms in a hotel/motel. It is calculated by dividing the number of occupied room nights into the total number of room guests during a given period of time.

Drawings
The cash taken from a business by the owner, which is not in the form of a dividend. salary or bonus.

Efficiency ratios (or efficiency percentages)
Ratios that measure the performance of the various operating departments in a hotel/motel.

Energy costs
A category of undistributed operating expenses including all utility-related costs incurred by the hotel/motel - eg., electricity, fuel, water, etc.

Equity
The funds in a business that have been invested by the owners. On a balance sheet, owners' equity equals total assets minus total liabilities.

European plan
A room rate that covers the price of the room only; commonly abbreviated to EP.

Exclusive pricing method
A method that sets prices significantly above those of a business' competitors.

Expense dictionary
A reference book designed to assist in expense classifications. It follows the uniform system of accounts.

Fair market value
The highest price available in an open and unrestricted market, which is reached between informed, prudent parties who are under no compulsion to act and who act at arm's length.

Feasibility study
A special study carried out on a property expansion, renovation or construction project to see if a satisfactory return can be earned by would-be investors.

Financial and other expenses
An income statement expense that includes rent, municipal taxes, insurance on buildings and contents and interest charges.

Financial lease
An agreement whereby the lessee makes payments to the lessor over a specified period of time in exchange for the use of a leased asset.

Financial leverage (or leverage)
The ratio of borrowed funds (loans, mortgages and other long-term liabilities) to owners' equity.

Financial management
It shows you how to deploy your financial resources to get the maximum return. It has four components: bookkeeping, accounting, analysis and sed as ra making and action-taking.

Fixed assets
Permanent items that are used by a business over a number of accounting periods - eg., land, buildings, furniture, fixtures and equipment.

Fixed assets ledger
A ledger used to maintain a life-time record of all fixed assets from their purchase to their disposal. It can be used to substantiate any insurance claims you might have.

Fixed costs
Expenses that do not change even if sales volumes change - eg., municipal taxes, interest, depreciation and insurance premiums. These costs are used in break-even analysis.

Folio
The name given to a card or sheet used in the front office of a hotel/motel to register guests and to record guest charges.

Follow-the-leader pricing method
A variation on competitive pricing where prices are made to follow those of the largest or most successful hotel/motel. An unsophisticated method, which is not recommended.

Food and beverage control
The term applied to the system of internal control over food and beverage merchandise and revenues derived from its sale.

Food cost percentage
An approach to pricing food items that is based on setting food prices at a pre-determined percentage of food costs to food revenues.

Food and beverage cost percentage control
A checking process to ensure the target profit levels you have budgeted are being met.

Food and beverage daily report
A daily management report that contains information on one day's food and beverage sales and cost of sales. This report is used as an information source for operational analysis.

Food and beverage department ratios
Ratios used in operational analysis.

Front office
The office located in the front lobby of a hotel/motel, which controls and sells guest rooms, off ers guests key, mail and information services, keeps guest accounts, bills and receives payments from guests and provides information to other departments.

Future maintainable income before fixed charges
Established by preparing an operating budget for several years, and then averaging the income before fixed charges earned during the forecast period. It is one step in the income before fixed charges multiple approach to valuation of a hotel/motel.

General journal
A book of original entry that records all transactions that do not fit into the cash receipts journal, sales journal, cash disbursements journal, purchases journal or payroll journal.

Operating expenses
All expenses normally incurred to operate your hotel/motel on a day-to-day basis. They include two distinct types of expenses - departmental expenses and undistributed operating overhead expenses.

Operating lease
An agreement that can be by the lessee or lessor once notice has been given by either party.

Operating ledger
The section of the general ledger, which contains the revenues and expenses accounts.

Operational analysis
A technique that uses the financial statements and other information sources (eg., management information reports) to evaluate efficiency, productivity and profitability.

Other departmental ratios
Ratios from departments other than rooms and food and beverage, which are used in operational analysis.

Other income
Miscellaneous sources of revenue earned by a hotel/motel, such as cash discounts, salvage values, etc.

Over-levered
When a business' ratio of borrowed funds to owners' equity is greater than 3:1.

Owners' equity
The portion of the business that belongs to the owners. It is equal to the assets minus the liabilities, as shown in the balance sheet.

Partnership
A business arrangement by which two or more people combine resources, talent and efforts, and share profits.

Payroll earnings record
A form that records an employee's history of earnings.

Payroll journal
A book of original entry that records all payments made to, or on behalf of, employees (including salaries and wages, income tax deductions, Canada Pension, Unemployment Insurance, Workmen's Compensation, etc.).

Percentage mark-up pricing method
A cost-based pricing method used for food and beverage items. The cost of the food or beverage is estimated first, and then a margin is added to cover other expenses and to provide a profit.

Periodic inventories
A check to account for food and beverage inventories held in both your storerooms and production areas.

Perpetual inventory system
A method of inventory control used in storerooms for food, beverages and other items. Bin cards are used for each item in inventory (or a stores ledger).

Personal history form
A form used to record information about anyone you have interviewed for a job.

Pre-control
A system that documents the sales histories of various menu and drink items in order to estimate the amount of a particular item that should be prepared or stocked.

Pre-costing
The process of establishing the actual cost of menu items or drinks.

Pre-register
A method of registering guests before they check-in at your hotel/motel. It reduces delays at the registration desk.

Present value
A concept of capital budgeting, which states that a dollar received today is worth more than a dollar received in the future.

Pricing
The use of techniques such as break-even analysis and other cost-based methods to determine room rates, menu prices and other charges.

Price cutting
The lowering of rates or prices below competitive levels to gain a bigger market share.

Prime cost
A term used in food service operations; it equals the combined cost of [illegible] and food or beverage sales.

Principal
The outstanding amount to be repaid on a long-term liability such as a loan or mortgage.

Principal repayment
The periodic payment of an amount owing on a long-term liability such as a loan or mortgage.

Private company
A company with ownership limited to less than people. It does not offer its shares to the public.

Profit
The amount by which revenues exceed expenses or by which cash receipts are greater than cash disbursements. Commonly known as income.

Profitability ratios
A method of measuring the profitability of your hotel/motel. The ratios show whether or not you are earning an equitable return on your investment.

Profit and loss statement
A traditional name for the income statement.

Profit margin
The relationship of net income to total revenues expressed as a percentage.

Pro forma
A term meaning forecast or future. Pro forma financial statements, for example, are forecast or budgeted statements.

Pro forma income statement
A financial statement in which you forecast expected revenues and expenses. It can also be called an operating budget.

Property operation and maintenance
A category of undistributed operating expenses, which includes all the repairs and maintenance costs in a hotel/motel.

Proprietorship (or sole proprietorship)
A type of business organization that has no legal status with respect to debt, lawsuits and income taxes. The legal responsibility of the business is borne entirely by the proprietor.

Public company
A company whose shares are offered to the general public. The number of shareholders is not limited, and the ability to transfer shares from one person to another is unrestricted.

Purchases journal
A book of original entry in which all purchases made on credit are recorded.

Quick ratio
Also known as the acid test ratio. This is the relationship of cash, accounts receivable and marketable securities to current liabilities.

Ratio analysis
Calculation of the relationships, expressed as ratios, between figures found in the financial statements.

Registration card
A form used when guests arrive to record their names, addresses, room number, rate and length of stay.

Replacement value (or market replacement value)
The current cost of replacing an existing fixed asset with a new, but otherwise identical item for a given fixed asset. This is one of the cost approaches to placing a fair market value on a hotel/motel.

Reservation deposit
An advance payment to obtain a confirmed room or reservation.

Retained earnings
The net income left after deducting dividends and owners' drawings from a business.

Return on equity
A rate expressed as a percentage that relates the profit/income level to owners' equity.

Revenues
The money earned from the sales of rooms. food, beverages, telephone and other services.

Rooms department ratios
A ratio used in operational analysis to measure the operational efficiency of your rooms department.

Rule-of-thumb
An average or "norm" frequently used in the hotel/motel business.

Sale and leaseback
An agreement under which you sell an asset you own and lease it back from the purchaser.

Sales journal
A book of original entry in which all of the sales made on credit are recorded.

Shares
Shares of ownership of a corporation normally issued as certificates to the owners. Preferred shareholders receive dividends first and common shareholders receive them last.

Site evaluation
An examination of a site's physical characteristics to check if it is suitable for hotel/motel development.

Small business rate
A special tax incentive available to Canadian-controlled private corporations. The first $200,000 of income before taxes is taxed at approximately 25% until $1 million is earned cumulatively.

Solvency
The ability of a business to meet its financial obligations when they become due.

Sources of funds
One of the items that appears on the statement of changes in financial position. It shows where your hotel/motel received funds from during a given period of time.

Standard recipe cards
An internal control and pricing technique used for food and beverage items. Standard recipe cards show standard portions, ingredients and preparation methods for menu and drinks items.