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Accounting Systems for Motels

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Accounting is to the businessman what a scorecard is to a golfer in that it reflects how well he performed this year compared to last year and how he compared with his fellow operators. But accounting is more than a means of keeping score, it is also the means by which the sophisticated operator keeps his hand on the pulse of the business. It permits him to determine the health of his enterprise and provides the controls for its operation. It also indicates when changes in operations are required.

An accounting system need not be complicated to be effective. In fact, the simpler its construction, the more likely it will be to serve its purpose. This paper discusses the purposes and components of an accounting system and the benefits that can be expected from good accounting practice.

PURPOSES OF AN ACCOUNTING SYSTEM

The significance of accounting as an important business tool is a development of comparatively recent years. It was not until about seventy years ago that accounting techniques received much attention, because prior to that time most of this nation's business was done by small, family-owned enterprises. Construction of large production plants and the requirement for increased capital brought about the development of large corporations. In the corporate organization, the owners of the business were not intimately involved in management and it therefore became necessary for management to make an accounting of its activities to the corporate owners. Such accounting required development of accounting systems and reporting techniques. Still, accounting was of real importance only to the large corporate enterprises.

Record-keeping and financial reporting became compulsory with the enactment of income tax laws. Since that time it has been necessary for all businessmen to maintain records of annual income and expenses, and to retain business papers to support income reported

and deductions claimed. Even though this annual accounting to the government has been generally distasteful to all of us, it did have one desirable aspect. It forced the businessman to take a look at the progress of his business. Usually, during the preparation of current income tax returns, the businessman referred frequently to prior returns. He compared current income and expenses with those of prior years and considered the reasons for changes in operating results. Unfortunately this review of business activities took place only once a year, and then usually two months after the year was ended. Such a review of operations is too late to be of maximum benefit.

During the period of intense competition that has existed since 1950, business profits have been dependent on efficient operations. Efficiency doesn't just happen; it must be planned. The planning must be based on adequate and accurate historical information, which, in turn, results only from a sound accounting system. In order for the plan to become a reality, there must be timely comparison of actual operations with planned performance. This desirable purpose is accomplished by the use of financial statements. Such financial statements should be in a form that is useful and should be prepared as soon as possible after each fiscal period. Most businesses find it desirable to prepare financial statements monthly. The basic financial statements are the balance sheet or statement of financial position and the income statement. An understanding of these basic sets of figures is essential to sound business management. The income statement relates the results of operations for a period of time and indicates the revenue for the period and the costs and expenses incurred in producing that revenue. The balance sheet, on the other hand, shows the financial position as of a specific date. It indicates the total assets of the business, the claims against those assets by creditors, and the equity of the owners.

When net profits are decreasing, or when black figures have turned to red, the management of the typical business generally follows two policies: sales are pushed as hard as the organization will permit; and the amount of each expense is scrutinized with the intent of reducing it radically. The emphasis is primarily on increased sales and decreased expenses. It is a natural and logical emphasis but will not in many cases solve the problem.

If the businessman recognized the implications in the relationships between items in the balance sheet as well as he does excessive expenses, he would realize the effect that business policies have upon

financial condition. For example, if investment in property is excessive, the annual depreciation charge will depress profits; if a large mortgage exists, the interest will eat into profits and payments of principal will deplete cash reserves. These conditions become evident from analysis of the statement of financial condition and have a direct bearing on future profits.

As previously stated, the balance sheet is divided into three parts: assets, liabilities, and owner's equity. The assets in turn are usually divided into current assets, property, and deferred charges. Liabilities are divided into current and long-term. Owner's equity in a proprietorship or partnership is usually stated as a single figure. Corporate stockholders' equity is divided between invested capital and equity arising from earnings retained in the business. These divisions are designed to show clearly financial condition. Current assets are those that are available for satisfaction of current liabilities and for working capital. Current assets usually refer to cash and items that will be converted to cash within one year and current liabilities are those that will require payment within one year. Liabilities that mature after one year are considered long-term. Deferred charges include items such as organization expenses, loan costs, etc., that have no value except to a continuing business enterprise.

A single balance sheet is useful in determining the ability of a business to pay its bills if they were presented for payment. It may also suggest trouble spots such as excessive debt in relation to owner's equity. With those exceptions, it is of little value to the businessman. However, two balance sheets as of different dates will help to increase the value of the report. It is for this reason that balance sheets are usually prepared in comparative form, typically as of two dates a year apart. Comparison will indicate changes in financial position. It will indicate whether current position, the ability to pay current bills, is improving or decreasing; whether the owner's equity is improving in relation to claims of creditors. Generally, comparison of balance sheets indicates trend.

Analysis of balance sheets is only of limited value without simultaneous analysis of the income statement. The income statement is usually arranged in the following order: operating revenues; costs and expenses that fluctuate directly with revenue; expenses of fixed amount; and costs and expenses not directly related to operations. Such an arrangement permits logical analysis of the statement. For

example, in estimating future profits to be earned as a result of increased sales, we would deduct from such sales a proportionate amount of direct costs and expenses. The difference would normally be the increase in net income. Similarly, if we anticipate a decrease in sales we would have a proportionate decrease in direct costs and expenses, but our fixed expenses would remain comparatively constant.

A single income statement also has limitations because there is nothing to which the revenues and expenses can be compared. Income statements are usually prepared showing operations for the current month and year to date and for the same periods in the prior year. For analysis purposes it would also be helpful to have all amounts expressed as a per cent of sales and, if available, a comparison with percentage averages for the industry. It is then possible to determine how well your business is doing in comparison with the prior year and in comparison with your competitors. If a budget or profit plan is prepared at the beginning of the year, comparison should be made of actual operating results with those that were planned. In all cases the businessman should be asking himself, Why do these differences exist? Why are my expenses higher in proportion to sales than is average for the industry? What can I do to improve the picture?

Profit planning is a practice that currently is receiving considerable emphasis and has long been an established method of controlling operations of large businesses. Unfortunately, small businesses have been reluctant to take the time and effort necessary to benefit from this sound business practice. If the operator has a good accounting system and has prepared monthly financial statements for a year, preparation of a budget for the following year presents few problems. The key to any budget is sales. Once sales are estimated, variable expenses such as utilities, laundry, etc., are determined as a per cent of sales based on prior year's experience. Fixed expenses such as depreciation, property taxes and insurance will be the same as the prior year unless some action has been taken to change them. Planning your operation in advance will prevent impulse spending and should result in improved profits.

Another benefit to be gained from budgeting operations is planning cash requirements. If you anticipate needing new furnishings in the following year, you can determine with some certainty when you will have enough cash for that purpose, or whether borrowing will be required. If borrowing will be necessary you will then have time

to arrange the most favorable terms. Creditors generally, and bankers in particular, react favorably toward businesses that know where they are going financially.

In addition to providing historical information for profit planning and timely reports of current operations and financial position, an effective accounting system must also provide a means of safeguarding business assets. This safeguard of assets is provided by establishment of definite procedure for recording transactions and arrangement of responsibilities in a manner that provides a check on performance of prescribed procedures. Establishment of definite procedures for recording transactions is essential in order that the same transactions will be recorded in the same manner each time they occur. If this were not so, an accumulation of recorded transactions would be of little use in managing the business. Similarly, unless responsibilities are arranged in a way that provides a check on adherence to procedures, the reliability of recorded information is uncertain. The division of responsibility has the additional advantage of minimizing the opportunity for employees to divert business assets to personal use. Even in the smallest operation including only the owner and two employees, some control can be accomplished by an arrangement of responsibilities. For example, assume that a small motel has two employees. One is the night clerk and the other the maid. If the maid records on her time slip the numbers of the rooms cleaned and the number of beds used per room, a check can be made on registrations and collections reported by the clerk. No extra employee time is needed and a useful control is effected.

A further safeguard of assets is made possible by the financial planning discussed earlier. Based on historical information, management can determine when it will be necessary to replace certain wasting assets, such as linen and furnishings. The financial plan would provide for these replacements, and proceeds from current operations would be appropriated for that purpose. An accurate inventory of such assets would be maintained to provide accountability for the assets until their useful life is exhausted.

In summary then, an adequate accounting system provides for:

- An accurate determination of income for tax purposes
- Periodic reporting of operating results and financial position
- A basis for safeguarding business assets

The financial reports, that is, the balance sheet and income statement, are the basic output of an accounting system and as such determine the accounts in which transactions are to be accumulated. Therefore, when the form and content of the financial statements are determined, our chart of bookkeeping accounts is merely the captions taken in sequence from the financial statements. Time can be saved and uniformity maintained by having report forms preprinted as to captions, headings, etc.

In a typical system, a ledger would be set up which would include an account for each item in the chart of accounts and transactions would be posted thereto monthly. The financial reports would then be prepared from the ledger. In many small businesses, the ledger posting step could be eliminated for income and expense accounts by entering transaction totals directly to the current month's portion of the income statement. The monthly reports for a year would then be bound and filed as a permanent record.

The source of entries in the ledger is one or more journals in which transactions are recorded individually and totaled at month end for posting to the ledger. One combined cash journal for recording all receipts and disbursements is adequate for many businesses. The journal would include separate columns for sales, cash receipts, cash disbursements, recurring expenses, and miscellaneous transactions. A memo column for cash balance would also be desirable.

A separate bank account should be maintained for the business and no personal transactions should be processed through it. Receipts would be entered daily in the cash-received column and in the appropriate revenue column such as room rentals, beverage sales, etc. If practicable, bank deposits should be made daily in order to minimize danger of theft or loss and to have a duplicate record of receipts. Each check written would be entered in the cash disbursements column and in the appropriate expense column, such as laundry, or miscellaneous column for such items as principal paid on mortgage. A daily cash balance would be determined by adding receipts and deducting checks and entering the new balance in the memo column.

At the end of the month the bank account would be reconciled with the memo balance and corrections or service charges entered in the journal. Columnar totals would then be posted to the ledger or directly to the financial statements.

This simple set of records will be adequate for good financial accounting as well as for income tax purposes and would require only a few minutes each day.

The accounting system also includes business papers representing the transactions recorded in the journal. Retention of these papers is compulsory for income tax purposes and important for sound business management. Future use of business papers is dependent on a good filing system. Because the journal is a handy, chronological record of transactions, it would seem desirable to file paid bills and registration cards alphabetically by years. They can then be referred to easily when you again have occasion to do business with that supplier or customer.

Subsidiary accounting records usually are required for such items as employee earnings, inventories, furnishings. These are easiest to maintain if they are carried on cards that can be posted easily and replaced when appropriate. As mentioned previously, an inventory of linens and furnishings would be a desirable record for control purposes.

In summary, an accounting system will generally be composed of:

- Periodic financial reports
- Ledger containing an account for each item on the financial reports
- Journal for recording of individual transactions in columns which are totaled for posting to ledger accounts
- Business papers supporting recorded transactions
- Subsidiary ledgers

REASONS FOR CHANGING AN ACCOUNTING SYSTEM

There are three general reasons for changing an accounting system: to improve information provided by the system; to improve accounting control; and to decrease clerical costs. It is not appropriate to approach a systems design without consideration of all three because they are dependent on each other for effectiveness. The purposes of an accounting system were briefly discussed earlier. If the present accounting system does not provide information of a type and form that is useful to management, some revision is certainly indicated. The same can be said for maximum accounting control within the limitations resulting from the size of the business.

Reduction of clerical cost is a most appealing justification for

revision of an accounting system. Cost reductions result from decreased time devoted to this function by employees or service organizations. In small businesses, this can be accomplished by simplifying the system and standardizing procedures so that the bookkeeping can be performed by the manager or owner with a minimum of assistance from a professional accountant. Not only is cost thereby reduced, but the owner or manager is much more familiar with the results of his efforts than would be true if he put all his papers in a box annually and delivered them to his tax adviser.

ADVANTAGES OF UNIFORM CLASSIFICATION OF ACCOUNTS

Numerous trade associations and industry groups have developed and adopted classifications of accounts for use by businesses in that group. Adoption of a uniform classification of accounts is particularly advantageous if it is used by a representative number of firms. An association or independent organization can then obtain financial information from individual businesses, determine averages and statistics, and distribute the combined information to the industry. Such information would be very valuable to individual members for comparison with their own operations. The information would be reasonably comparable because of uniformity of account classifications.

A uniform classification can be adopted easily by individual businesses. Usually little if any change is required in the form of ledgers, journals, or business papers. The uniform classification relieves the businessman of the necessity of developing his own form of financial statements or chart of accounts.

Perhaps the fundamental advantage of a uniform classification of accounts is that it encourages businessmen to practice good accounting. As individual members of an industry improve their management skills, the total industry benefits.

The Uniform Classification of Accounts for Motels prescribed by the American Motor Hotel Association is well designed. The arrangement of accounts is such that statements prepared therefrom present financial information in a logical manner. All accounts have been assigned numbers that are indicative of the type of account. Such a numerical coding simplifies journal posting and identification of business papers because numbers can be substituted for descriptive account titles.

In addition to a complete chart of accounts appropriate for motels,

the uniform classification also has a suggested form of balance sheet and statement of income. The arrangement of these statements is substantially the same as discussed earlier. There is also a description of each account and what generally should be charged thereto. This not only relieves the bookkeeper of deciding where to put an amount but also promotes uniformity in your own system and in the industry. Such uniformity in the industry preserves comparability of statistical information.

The uniform classification does not include information relating to forms of ledgers or journals or to the manner in which the bookkeeping system will be maintained. These factors are not discussed because it is presumed that the classification can be adopted without altering present bookkeeping procedures. This will probably be true in many motels. However, it seem likely that others will be required to make significant changes in bookkeeping practices in order to realize benefit from the system. Unless the bookkeeping system is well designed, the advantages of the uniform system and financial reports will be lost because of the extra time consumed in recording transactions.

SUMMARY

The businessman who is interested in obtaining maximum profits realizes the importance of periodic financial reports. Such reports are only available if a good accounting system is being currently maintained. If this association adopts the proposed system of accounts, it should benefit all members, but only if they are prepared to adopt good accounting methods.