



# HOSPITALITY ACCOUNTING IN ACTION



## THE NAVIGATOR ✓

- Understand *Concepts for Review*
- Read *Feature Story*
- Scan *Study Objectives*
- Read *Preview*
- Read text and answer *Before You Go On*  
p. 7  p. 13
- Review *Summary of Study Objectives*
- Complete *Assignments*

**The Navigator** is a learning system designed to prompt you to use the learning aids in the chapter and set priorities as you study.

## CONCEPTS FOR REVIEW

**Before studying this chapter, you should know or, if necessary, review**

- a. How to use the study aids in this book. (Student Owner's Manual, pages xii–xviii)
- b. The nature of the special student supplements that accompany this textbook. (Student Owner's Manual, page xii)

**Concepts for Review** highlight concepts from your earlier reading that you need to understand before starting the new chapter.



The **Feature Story** helps you picture how the chapter topic relates to the real world of accounting and business. You will find references to the story throughout the chapter.

## F E A T U R E S T O R Y

### Financial Reporting: A Matter of Trust

In recent years the financial press has been full of articles about financial scandals and accounting misdeeds. It started with **Enron**, but then spread to **Xerox**, **Qwest**, **Global Crossing**, and **WorldCom**, among others. Many of the articles expressed concern that as an increasing number of misdeeds came to public attention, a mistrust of financial reporting in general was developing. These articles made clear just how important accounting and financial reporting are to the U.S. and world financial markets and to society as a whole. Without financial reports, managers would not be able to evaluate how well their company is doing or to make decisions about the best way to make their company grow in the future. Without financial reports, investors and lenders could not make informed decisions about how to allocate their funds. There is no doubt that a sound, well-functioning economy depends on accurate and dependable financial reporting—accounting matters!

In order to make financial decisions as either an investor or a

manager, you need to know how to read financial reports. In this book you will learn about financial reporting and some basic tools used to evaluate financial reports. In the first chapter we introduce you to the real financial statements of a company whose products most of you probably are familiar with—**PepsiCo, Inc.** We have chosen the financial statements of PepsiCo because they are a good example from the real world. Appendix A contains the statements in their entirety, and a copy of the PepsiCo, Inc., 2006 Annual Report accompanies this text.

PepsiCo manufactures Pepsi-Cola, the number two soft-drink beverage in the world. PepsiCo also manufactures the number one bottled water (Aquafina), the number one sports drink (Gatorade), the number one ready-to-drink tea (Lipton), and the number one ready-to-drink coffee (Frappuccino). In addition, PepsiCo is the largest manufacturer of snack foods in the



world. Its Frito-Lay chips dominate the U.S. market with 59% of all snack-chip sales and the world market with over 32%. In all, PepsiCo ranks among the world's largest packaged goods and beverage companies, with over \$25 billion in sales, \$23 billion in assets, and 140,000 employees. PepsiCo is not only large; it is also quite profitable, ranking twenty-eighth among all U.S. companies, with \$3.3 billion in net income.

**Chapter-opening vignettes** end with the **Internet address** of the companies cited in the story to help you connect with these real businesses and explore them further.



[www.pepsico.com](http://www.pepsico.com)

## S T U D Y O B J E C T I V E S

After studying this chapter, you should be able to

1. Explain what accounting is.
2. Identify the users and uses of accounting.
3. Understand why ethics is a fundamental business concept.
4. Explain the meaning of generally accepted accounting principles and the cost principle.

**Study Objectives** give you a framework for learning the specific concepts covered in the chapter.

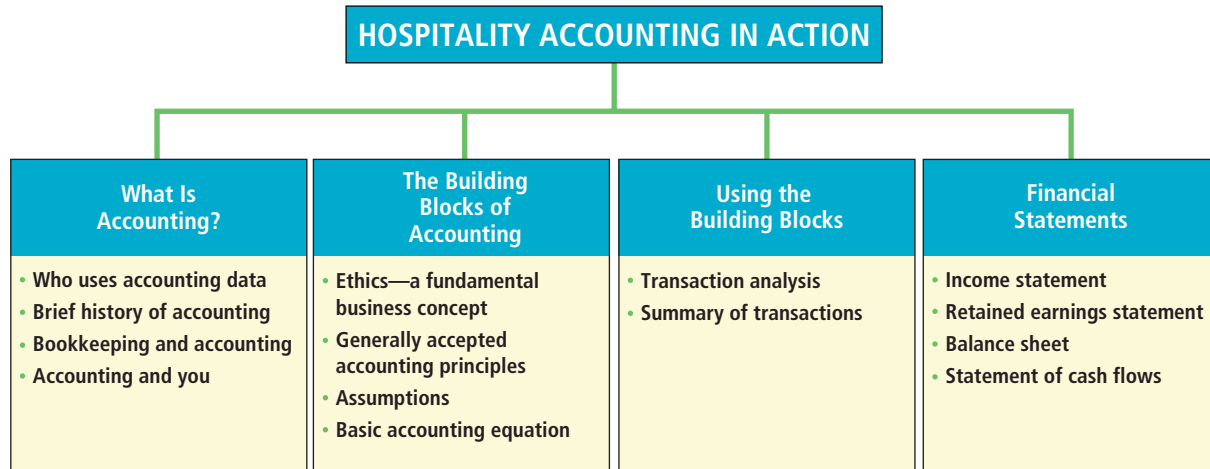


Continued

## PREVIEW OF CHAPTER 1

The opening story about **PepsiCo, Inc.**, highlights the importance of having good financial information to make effective business decisions. Whatever one's pursuits or occupation, the need for financial information is inescapable. You cannot earn a living, spend money, buy on credit, make an investment, or pay taxes without receiving, using, or providing financial information. Good decision making depends on good information.

The purpose of this chapter is to show you that accounting is the system used to provide useful financial information. The content and organization of Chapter 1 are as follows:



The **Preview** describes and outlines the major topics and subtopics you will see in the chapter.

## STUDY OBJECTIVES (CONTINUED)

5. Explain the meaning of the monetary unit assumption and the economic entity assumption.
6. State the basic accounting equation, and explain the meaning of assets, liabilities, and stockholders' equity.
7. Explain the accounting cycle and flow of information.
8. Identify the various systems of accounting procedures used in the hospitality industry.
9. Understand accounting and financial management in a hotel.
10. Understand accounting and financial management in a foodservice operation and a club.

## WHAT IS ACCOUNTING?

### STUDY OBJECTIVE 1

Explain what accounting is.

**Essential terms** are printed in blue when they first appear and are defined in the end-of-chapter glossary.

**Accounting** is an information system that **identifies, records, and communicates** the economic events of an organization to interested users. Let's take a closer look at these three activities.

1. **Identifying** economic events involves selecting the **economic activities relevant to a particular organization**. The sale of goods and services by **PepsiCo, Inc.**, the providing of services by **Disney**, the payment of wages by **The Club Corporation of America**, and the collection of ticket and broadcast money

and the payment of expenses by major league sports teams are examples of economic events.

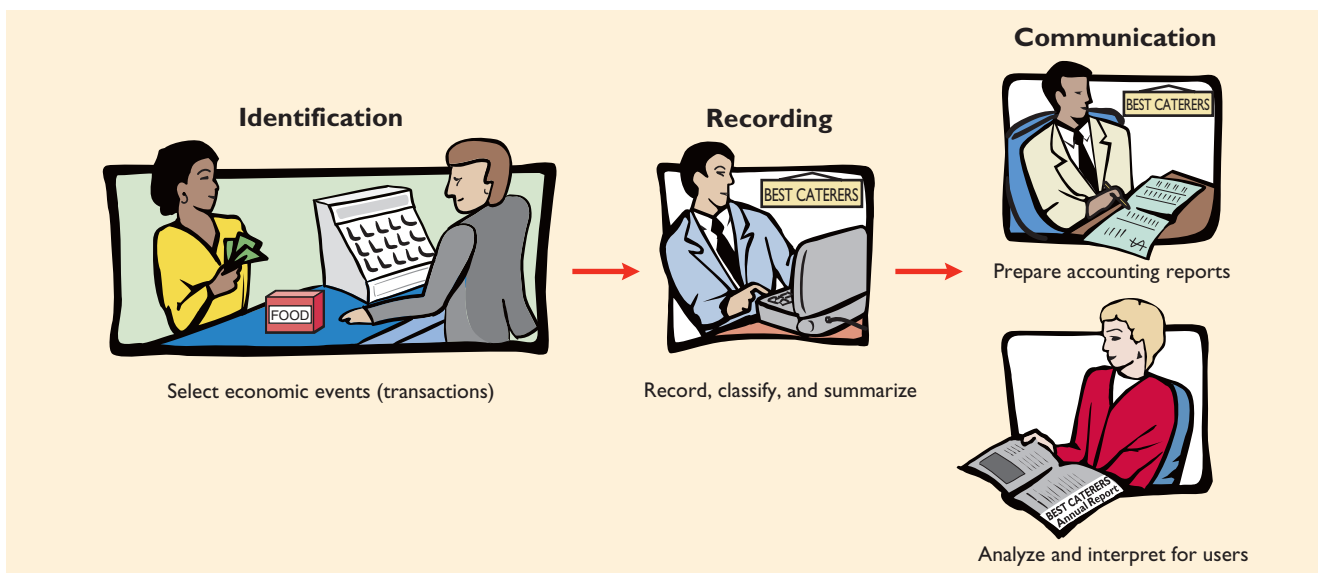
2. Once identified, economic events are **recorded** to provide a history of the organization’s financial activities. Recording consists of keeping a **systematic, chronological diary of events**, measured in dollars and cents. In recording, economic events are also classified and summarized.
3. The identifying and recording activities are of little use unless the information is **communicated** to interested users. Financial information is communicated through **accounting reports**, the most common of which are called **financial statements**. To make the reported financial information meaningful, accountants report the recorded data in a standardized way. Information resulting from similar transactions is accumulated and totaled. For example, all sales transactions of **PepsiCo** are accumulated over a certain period of time and reported as one amount in the company’s financial statements. Such data are said to be reported **in the aggregate**. By presenting the recorded data in the aggregate, the accounting process simplifies a multitude of transactions and makes a series of activities understandable and meaningful.

References throughout the chapter tie the accounting concepts you are learning to the story that opened the chapter.

A vital element in communicating economic events is the accountant’s ability to **analyze** and **interpret** the reported information. Analysis involves the use of ratios, percentages, graphs, and charts to highlight significant financial trends and relationships. Interpretation involves **explaining the uses, meaning, and limitations of reported data**. Appendix A at the end of this textbook illustrates the financial statements and accompanying notes and graphs from **PepsiCo**. We refer to these statements at various places throughout the text. At this point they probably strike you as complex and confusing. By the end of this course, you’ll be surprised at your ability to understand and interpret them.

The accounting process is summarized in Illustration 1-1.

**Illustration 1-1**  
Accounting process



Accounting should consider the needs of the users of financial information. Therefore, you should know who those users are and something about their information needs.

**STUDY OBJECTIVE 2**

Identify the users and uses of accounting.

**WHO USES ACCOUNTING DATA?**

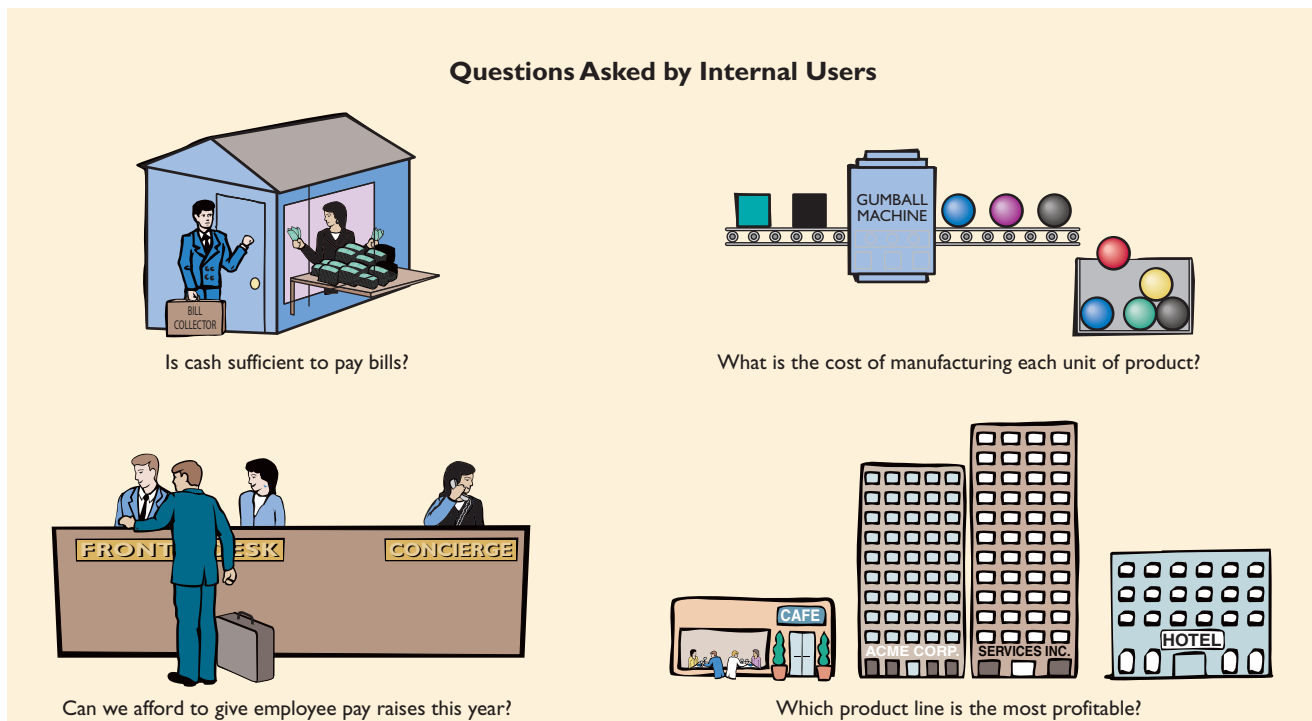
Because it communicates financial information, accounting is often called *the language of business*. The information that a user of financial information needs depends on the kinds of decisions the user makes. The differences in the decisions divide the users of financial information into two broad groups: internal users and external users.

**Internal Users**

**Internal users** of accounting information are managers who plan, organize, and run a business. These include **foodservice managers, housekeeping supervisors, rooms division managers, and others**. In running a business, managers must answer many important questions, as shown in Illustration 1-2.

**Illustration 1-2**

Questions asked by internal users



To answer these and other questions, users need detailed information on a timely basis. For internal users, accounting provides **internal reports**. Examples are financial comparisons of operating alternatives, projections of income from new sales campaigns, and forecasts of cash needs for the next year. In addition, summarized financial information is presented in the form of financial statements.

**External Users**

There are several types of **external users** of accounting information. **Investors** (owners) use accounting information to make decisions to buy, hold, or sell stock. **Creditors** such as suppliers and bankers use accounting information to evaluate the risks of granting credit or lending money. Some questions that may be asked by investors and creditors about a company are shown in Illustration 1-3.

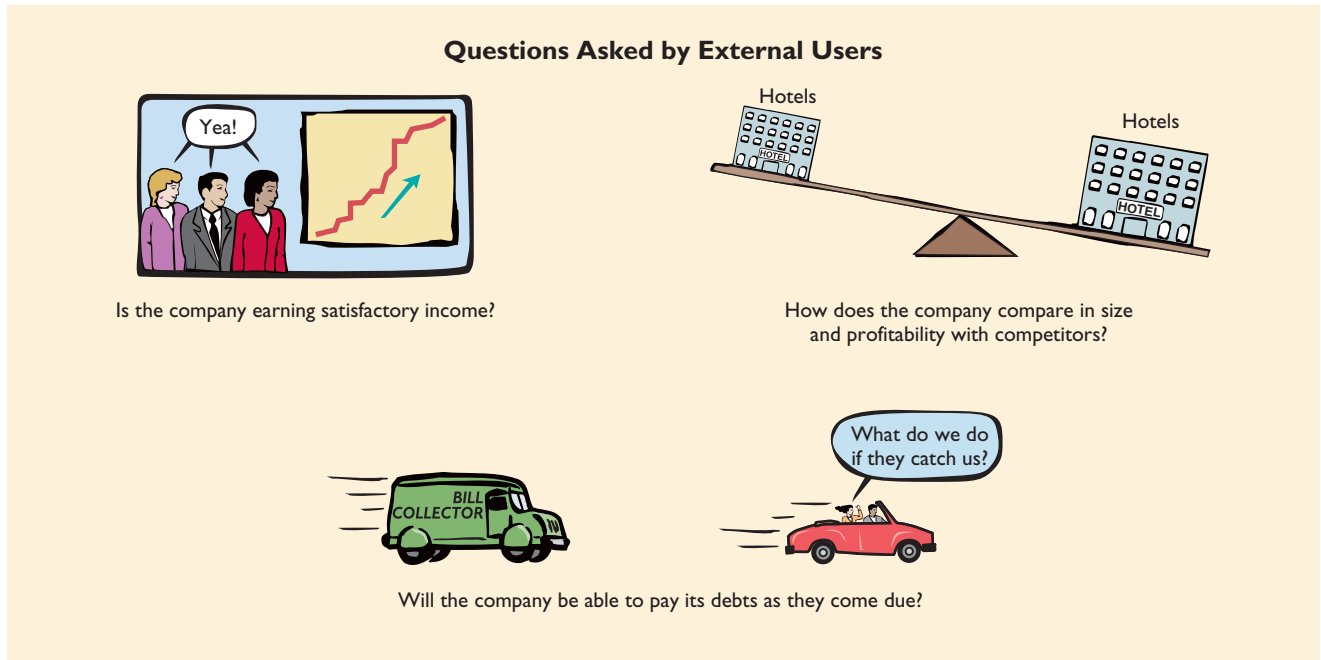
The information needs and questions of other external users vary considerably. **Taxing authorities**, such as the Internal Revenue Service (IRS), want to know whether the company complies with the tax laws. **Regulatory agencies**, such as the Securities and Exchange Commission and the Federal Trade Commission, want to

**HELPFUL HINT**

The IRS requires businesses to retain records that can be audited. Also, the Foreign Corrupt Practices Act requires public companies to keep records.

**Illustration 1-3**

Questions asked by external users



know whether the company is operating within prescribed rules. **Customers** are interested in whether a company will continue to honor product warranties and support its product lines. **Labor unions** want to know whether the owners can pay increased wages and benefits. **Economic planners** use accounting information to forecast economic activity.

**ACCOUNTING IN ACTION** *International Insight*



Concern over the quality and integrity of financial reporting is not limited to the United States. Recently, the Chinese Ministry of Finance reprimanded a large accounting firm for preparing fraudulent financial reports for a number of its publicly traded companies. Afterward, the state-run news agency noted that investors and analysts actually felt that the punishment of the firm was not adequate. In fact, a 2001 survey of investors in China found that fewer than 10% had full confidence in companies' annual reports. As a result of these concerns, the Chinese Institute of Certified Public Accountants vowed to strengthen its policing of its members.



**BRIEF HISTORY OF ACCOUNTING**

The **origins of accounting** are generally attributed to the work of Luca Pacioli, an Italian Renaissance mathematician. Pacioli was a close friend and tutor to Leonardo da Vinci and a contemporary of Christopher Columbus. In his text, *Summa de Arithmetica, Geometria, Proportione et Proportionalite*, Pacioli described a system to ensure that financial information was recorded efficiently and accurately.

With the advent of the **Industrial Age** in the nineteenth century and, later, the emergence of large corporations, a separation of the owners from the managers

**Accounting in Action** examples illustrate important and interesting accounting situations in business.

**E-Business Insights** provide examples of how e-business technology has influenced accounting and financial reporting.

of businesses took place. As a result, the need to report the financial status of the enterprise became more important, to ensure that managers acted in accord with owners' wishes. Also, transactions between businesses became more complex, making it necessary to improve approaches for reporting financial information.

Our economy has now evolved into a postindustrial age—the **information age**—in which many “products” are information services. The computer has been the driver of the information age.

## ACCOUNTING IN ACTION Business Insight



The surge of Internet usage has affected the hotel industry tremendously—so much so that there are new revenue and expense items that hotels did not have before. On the one hand, revenues earned by hotels now include a fee that could either be charged separately or built into the room cost for use of the Internet, business center usage, and banquet facilities, which are associated with convention services and presentations. Other revenues also include rental and installation of equipment, computers, ethernet cards, hubs, patch cables, and even the setup of mini-LAN systems. Expenses, on the other hand, include the cost of leasing lines, Internet provider fees, telephone charges, equipment leases, and wages and salary of hotel and contract personnel, to name a few.

*SOURCE:* Henry A. Weeks, “Internet Revenue and Expense,” *Bottomline* 15(4) (2000): 73–74.

## DISTINGUISHING BETWEEN BOOKKEEPING AND ACCOUNTING

Many individuals mistakenly consider bookkeeping and accounting to be the same. This confusion is understandable because the accounting process **includes the bookkeeping function**. However, accounting also includes much more. **Bookkeeping usually involves only the recording of economic events**. It is therefore just one part of the accounting process. In total, **accounting involves the entire process of identifying, recording, and communicating economic events**.

Accounting may be further divided into financial accounting and managerial accounting. **Financial accounting** is the field of accounting that provides economic and financial information for investors, creditors, and other external users. **Managerial accounting** provides economic and financial information for managers and other internal users. Financial accounting is covered in this textbook.

## ACCOUNTING AND YOU

One question frequently asked by students of accounting is, “How will the study of accounting help me?” It should help you a great deal, because a working knowledge of accounting is desirable for virtually every field of endeavor. Some examples of how accounting is used in other careers include

**General management:** Imagine running a theme park, a major resort, a school, a foodservice facility, a **McDonald's** franchise. All general managers need to understand accounting data in order to make wise business decisions.

**Marketing:** A marketing specialist develops strategies to help the sales force be successful. But making a sale is meaningless unless it is a profitable sale. Marketing people must be sensitive to costs and benefits, which accounting helps them quantify and understand.



**Finance:** Do you want to be a controller, a chief financial officer, a food and beverage controller, a purchasing analyst? These fields rely heavily on accounting. In all of them you will regularly examine and analyze financial statements. In fact, it is difficult to get a good job in a finance function without two or three courses in accounting.

**Real estate:** Have you ever considered hotel properties as real estate? When you decide to buy or sell properties, you will need to understand finance and real estate. Many hospitality programs, especially at the master's degree level, offer courses in real estate. Can the buyer afford to make the payments to the bank? Does the cash flow from an industrial property justify the purchase price? What are the tax benefits of the purchase? All these are questions that need answers.

Accounting is useful even for occupations you might think completely unrelated. If you become a doctor, a lawyer, a social worker, a teacher, an engineer, an architect, or an entrepreneur—you name it—a working knowledge of accounting is relevant. You will need to understand financial reports in any enterprise you are associated with.

## ACCOUNTING IN ACTION *Business Insight*



### *Help Wanted: Forensic CPAs*

Tom Taylor's job at the **FBI** has changed. He used to pack a .357 magnum; now he wields a no. 2 pencil and a notebook computer. Taylor, age 37, for two years an FBI agent, is a forensic accountant, somebody who sniffs through company books to ferret out white-collar crime. Demand for this service has surged in the past few years. In one recent year, a recruiter for San Diego's **Robert Half International**, a head-hunting firm, had requests for more than 1,000 such snoops.

Qualifications: A CPA with FBI, IRS, or similar government experience. Interestingly, despite its macho image, the FBI has long hired mostly accountants and lawyers as agents.



## BEFORE YOU GO ON...

### ▶ REVIEW IT

1. What is accounting?
2. What is meant by analysis and interpretation?
3. Who uses accounting information? Identify specific internal and external users of accounting information.
4. To whom are the origins of accounting generally attributed?
5. What is the difference between bookkeeping and accounting?
6. How can you use your accounting knowledge?

**Before You Go On** questions at the end of major text sections offer an opportunity to stop and reexamine the key points you have studied.



# THE BUILDING BLOCKS OF ACCOUNTING

Every profession develops a body of theory consisting of principles, assumptions, and standards. Accounting is no exception. Just as a doctor follows certain standards in treating a patient's illness, an accountant follows certain standards in

reporting financial information. For these standards to work, a fundamental business concept is followed—ethical behavior.

## ETHICS—A FUNDAMENTAL BUSINESS CONCEPT

### STUDY OBJECTIVE 3

Understand why ethics is a fundamental business concept.


Wherever you make your career—whether in accounting, marketing, hotel or food-service management, finance, or elsewhere—your actions will affect other people and organizations. The standards of conduct by which one's actions are judged as right or wrong, honest or dishonest, fair or not fair, are **ethics**. Imagine trying to carry on a business or invest money if you could not depend on the individuals you deal with to be honest. If managers, customers, investors, co-workers, and creditors all consistently lied, effective communication and economic activity would be impossible. Information would have no credibility.

Fortunately, most individuals in business are ethical. Their actions are both legal and responsible, and they consider the organization's interests in their decision making. However, sometimes public officials and business executives act unethically. For example, the **Enron** board waived Enron's code of ethics when an executive created questionable partnerships; a trader with **Salomon Brothers** improperly overbid in auctions of U.S. Treasury bonds; and **WorldCom** continued acquiring companies including MCI, MFS, and UUNET until the 75 acquisitions were unable to function well together.

To sensitize you to ethical situations and to give you practice at solving ethical dilemmas, we have included in this book three types of ethics materials in certain chapters: (1) marginal notes that provide helpful hints for developing ethical sensitivity, (2) Ethics in Accounting boxes that highlight ethics situations and issues, and (3) at the end of the chapter, an ethics case simulating a business situation. In the process of analyzing these ethics cases and your own ethical experiences, you should apply the three steps outlined in Illustration 1-4.

#### Illustration 1-4

Steps in analyzing ethics cases



### Solving an Ethical Dilemma

- 1. Recognize an ethical situation and the ethical issues involved.**  
Use your personal ethics to identify ethical situations and issues. Some businesses and professional organizations provide written codes of ethics for guidance in some business situations.
- 2. Identify and analyze the principal elements in the situation.**  
Identify the *stakeholders*—persons or groups who may be harmed or benefited. Ask the question: What are the responsibilities and obligations of the parties involved?
- 3. Identify the alternatives, and weigh the impact of each alternative on various stakeholders.**  
Select the most ethical alternative, considering all the consequences. Sometimes there will be one right answer. Other situations involve more than one right solution; these situations require an evaluation of each and a selection of the best alternative.

### STUDY OBJECTIVE 4

Explain the meaning of generally accepted accounting principles and the cost principle.

## GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

The accounting profession has developed standards that are generally accepted and universally practiced. This common set of standards is called **generally accepted accounting principles (GAAP)**. These standards indicate how to report economic events.

Two organizations are primarily responsible for establishing generally accepted accounting principles. The first is the **Financial Accounting Standards Board (FASB)**. This private organization establishes broad reporting standards of general applicability as well as specific accounting rules. The second standards-setting group is the **Securities and Exchange Commission (SEC)**. The SEC is a governmental agency that requires companies to file financial reports following gener-

ally accepted accounting principles. In situations where no principles exist, the SEC often mandates that certain guidelines be used. In general, the FASB and the SEC work hand in hand to ensure that timely and useful accounting principles are developed.

One important principle is the **cost principle**, which states that assets should be recorded at their cost. **Cost is the value exchanged at the time something is acquired.** If you buy a house today, the cost is the amount you pay for it, say, \$200,000. If you sell the house in two years for \$230,000, the sales price is its **market value**—the value determined by the market for homes at that time. At the time of acquisition, cost and fair market value are the same. In subsequent periods, cost and fair market value may vary, **but the cost amount continues to be used in the accounting records.**

To see the importance of the cost principle, consider the following example. At one time **Greyhound Corporation** had 128 bus stations nationwide that cost approximately \$200 million. The current market value of the stations is now close to \$1 billion. But, until the bus stations are actually sold, estimates of their market values are subjective—they are informed estimates. So, under the cost principle, the bus stations are recorded and reported at \$200 million, not \$1 billion.

As the Greyhound example indicates, cost has an important advantage over other valuations: Cost is **reliable**. The values exchanged at the time something is acquired generally can be **objectively measured** and can be **verified**. Critics argue that cost is often not relevant and that market values provide more useful information. Despite this shortcoming, cost continues to be used in the financial statements because of its reliability.

## ASSUMPTIONS

In developing generally accepted accounting principles, certain basic assumptions are made. These assumptions provide a foundation for the accounting process. Two main assumptions are the monetary unit assumption and the economic entity assumption.

### Monetary Unit Assumption

The **monetary unit assumption** requires that only transaction data that can be expressed in terms of money be included in the accounting records. This assumption enables accounting to quantify (measure) economic events. The monetary unit assumption is vital to applying the cost principle discussed earlier. This assumption does prevent some relevant information from being included in the accounting records. For example, the health of the owner, the quality of service, and the morale of employees would not be included because they cannot be quantified in terms of money.

**An important part of the monetary unit assumption is the added assumption that the unit of measure remains sufficiently constant over time.** However, the assumption of a stable monetary unit has been challenged because of the significant decline in the purchasing power of the dollar. For example, what used to cost \$1.00 in 1960 cost more than \$4.00 in 2004. In such situations, adding, subtracting, or comparing 1960 dollars with 2004 dollars is highly questionable. The profession has recognized this problem and encourages companies to disclose the effects of changing prices.

### Economic Entity Assumption

**An economic entity can be any organization or unit in society.** It may be a business enterprise (such as **Marriott International, Inc.**), a governmental unit (the state of Ohio), a municipality (Seattle), a school district (St. Louis District 48), or

### INTERNATIONAL NOTE

The standards-setting processes in Canada, Mexico, and the United States are similar in most respects. All three have relatively open deliberations on new rules, and they support efforts to follow international standards. The use of similar accounting principles within North America has implications for the success of the North American Free Trade Agreement (NAFTA).

### ALTERNATIVE TERMINOLOGY

The cost principle is often referred to as the *historical cost principle*.

## STUDY OBJECTIVE 5

Explain the meaning of the monetary unit assumption and the economic entity assumption.

a church (Southern Baptist). The **economic entity assumption** requires that the activities of the entity be kept separate and distinct from the activities of its owner and all other economic entities. To illustrate, Sally Rider, owner of Sally's Boutique, should keep her personal living costs separate from the expenses of the boutique. **Disney's Parks and Resorts** and its Studio Entertainment are segregated into separate economic entities for accounting purposes.

## ACCOUNTING IN ACTION *Ethics Insight*



E-business involves much more than simply selling goods over the Internet. The use of the Internet in hospitality-related areas has expanded from Priceline.com to Orbitz.com, Hotels.com, and many others. According to Lou Gerstner, IBM's CEO, "e-business is all about cycle time, speed, globalization, enhanced productivity, reaching new customers, and sharing knowledge across institutions for competitive advantage." Many accountants are involved in designing and implementing computer system, including systems for e-business. In fact, in recent years e-business consulting has been one of the largest areas of growth for large accounting firms.

We will generally discuss the economic entity assumption in relation to a business enterprise, which may be organized as a proprietorship, partnership, or corporation.

### HELPFUL HINT

Approximately 70 percent of U.S. companies are proprietorships; however, they account for only 6.5 percent of gross revenues. Corporations are approximately 19 percent of all companies but account for 90 percent of the revenues. Obviously, proprietorships, though numerous, tend to be small.

**PROPRIETORSHIP.** A business owned by one person is generally a **proprietorship**. The owner is often the manager/operator of the business. Small service-type businesses (travel agencies, beauty salons, and interior decorators), farms, and small retail stores (cigar specialty shops, ice-cream parlors, and sandwich shops) are often sole proprietorships. **Usually only a relatively small amount of money (capital) is necessary to start in business as a proprietorship. The owner (proprietor) receives any profits, suffers any losses, and is personally liable for all debts of the business.** There is no legal distinction between the business as an economic unit and the owner, but the accounting records of the business activities are kept separate from the personal records and activities of the owner.

**PARTNERSHIP.** A business owned by two or more persons associated as partners is a **partnership**. In most respects a partnership is like a proprietorship except that more than one owner is involved. Typically, a partnership agreement (written or oral) sets forth such terms as initial investment, duties of each partner, division of net income (or net loss), and settlement to be made on death or withdrawal of a partner. Each partner generally has unlimited personal liability for the debts of the partnership. **Like a proprietorship, for accounting purposes the partnership affairs must be kept separate from the personal activities of the partners.** Partnerships are often used to organize retail and service-type businesses, including professional practices (lawyers, architects, and certified public accountants) that work especially with the hospitality industry, providing much-needed services.

**CORPORATION.** A business organized as a separate legal entity under state corporation law and having ownership divided into transferable shares of stock is a **corporation**. The holders of the shares (stockholders) enjoy **limited liability**; that is, they are not personally liable for the debts of the corporate entity. **Stockholders may transfer all or part of their shares to other investors at any time** (i.e., sell their shares). The ease with which ownership can change adds to the attractiveness of investing in a corporation. Because ownership can be transferred without dissolving the corporation, the corporation **enjoys an unlimited life**.

Although the combined number of proprietorships and partnerships in the United States is more than four times the number of corporations, the revenue produced by corporations is nine times greater. Most of the largest hospitality enterprises in the United States—for example, **Hilton Hotels**, **Starwood**, **Marriott**, and the **Walt Disney Company**—are corporations.

## BASIC ACCOUNTING EQUATION

Other essential building blocks of accounting are the categories into which economic events are classified. The two basic elements of a business are what it owns and what it owes. **Assets** are the resources owned by a business. For example, the 2001 year-end figures showed **Marriott** having total assets of approximately \$9,116 million. Liabilities and stockholders' equity are the rights or claims against these resources. Thus a company such as **Marriott** that has \$9,116 million of assets also has \$9,116 million of claims against those assets. Claims of those to whom money is owed (creditors) are called **liabilities**. Claims of owners are called **stockholders' equity**. For example, **Marriott** has liabilities of \$5,629 million and stockholders' equity of \$3,487 million. This relationship of assets, liabilities, and stockholders' equity can be expressed as an equation, as shown in Illustration 1-5.



## STUDY OBJECTIVE 6

State the basic accounting equation, and explain the meaning of assets, liabilities, and stockholders' equity.

### Illustration 1-5

The basic accounting equation

This relationship is referred to as the **basic accounting equation**. Assets must equal the sum of liabilities and stockholders' equity. Because creditors' claims must be paid before ownership claims if a business is liquidated, liabilities are shown before stockholders' equity in the basic accounting equation.

The accounting equation applies to all **economic entities** regardless of size, nature of business, or form of business organization. It applies to a small proprietorship such as a corner delicatessen as well as to a giant corporation such as **Carlson Companies, Inc.**, which owns various hotel brands and also **TGI Friday's**. The equation provides the **underlying framework** for recording and summarizing the economic events of a business enterprise.

Let's look in more detail at the categories in the basic accounting equation.

### Assets

As noted above, **assets** are resources owned by a business. They are used in carrying out such activities as production, consumption, and exchange. The common characteristic possessed by all assets is the capacity to provide future services or benefits. In a business enterprise, that service potential or future economic benefit eventually results in cash inflows (receipts) to the enterprise.

For example, the enterprise Campus Pizza owns a delivery truck that provides economic benefits from its use in delivering pizzas. Other assets of Campus Pizza are food inventory; furniture fixtures and equipment; such as tables, chairs, jukebox, cash register, oven, mugs, and silverware; and, of course, cash.

### Liabilities

**Liabilities** are claims against assets. That is, **liabilities are existing debts and obligations**. For example, businesses of all sizes usually borrow money and purchase

merchandise on credit. Campus Pizza, for instance, purchases cheese, sausage, flour, and beverages on credit from suppliers. These obligations are called **accounts payable**. Campus Pizza also has a **note payable** to First National Bank for the money borrowed to purchase the delivery truck. Campus Pizza also may have **wages payable** to employees and **sales and real estate taxes payable** to the local government. All these persons or entities to whom Campus Pizza owes money are its **creditors**.

Most claims of creditors attach to the entity's **total assets** rather than to the specific assets provided by the creditor. Creditors may legally force the liquidation of a business that does not pay its debts. In that case, the law requires that creditor claims be paid before ownership claims.

### ***Stockholders' Equity***

The ownership claim on total assets is known as **stockholders' equity**. It is equal to total assets minus total liabilities. Here is why: The assets of a business are supplied or claimed by either creditors or stockholders. To determine what belongs to stockholders, we therefore subtract creditors' claims—the liabilities—from assets. The remainder—stockholders' equity—is the stockholders' claim on the assets of the business. It is often referred to as **residual equity** (i.e., the equity “left over” after creditors' claims are satisfied). The stockholders' equity section of a corporation's balance sheet consists of (1) paid-in (contributed) capital and (2) retained earnings (earned capital).

**PAID-IN CAPITAL.** **Paid-in capital** is the term used to describe the total amount paid in by stockholders. The principal source of paid-in capital is the investment of cash and other assets in the corporation by stockholders in exchange for capital stock. Corporations may issue several classes of stock, but the stock representing ownership interest is common stock.

**RETAINED EARNINGS.** The **retained earnings** section of the balance sheet is determined by three items: revenues, expenses, and dividends.

**Revenues.** **Revenues** are the gross increases in stockholders' equity resulting from business activities entered into for the purpose of earning income. Generally, revenues result from the sale of merchandise, the performance of services, the rental of property, and the lending of money.

Revenues usually result in an increase in an asset. They may arise from different sources and are identified by various names depending on the nature of the business. Campus Pizza, for instance, has two categories of sales revenues—pizza sales and beverage sales. Other titles for and sources of revenue common to many businesses are sales, fees, services, commissions, interest, dividends, royalties, and rent.

**Expenses.** **Expenses** are the decreases in stockholders' equity that result from operating the business. They are the cost of assets consumed or services used in the process of earning revenue. Expenses represent actual or expected cash outflows (payments). Like revenues, expenses take many forms and are identified by various names depending on the type of asset consumed or service used. For example, Campus Pizza recognizes the following types of expenses: cost of ingredients (meat, flour, cheese, tomato paste, mushrooms, etc.), cost of beverages, wages expense, utilities expense (electric, gas, and water expense), telephone expense, delivery expense (gasoline, repairs, licenses, etc.), supplies expense (napkins, detergents, aprons, etc.), rent expense, interest expense, and property tax expense. When revenues exceed expenses, **net income** results. When expenses exceed revenues, a **net loss** results.

#### **HELPFUL HINT**

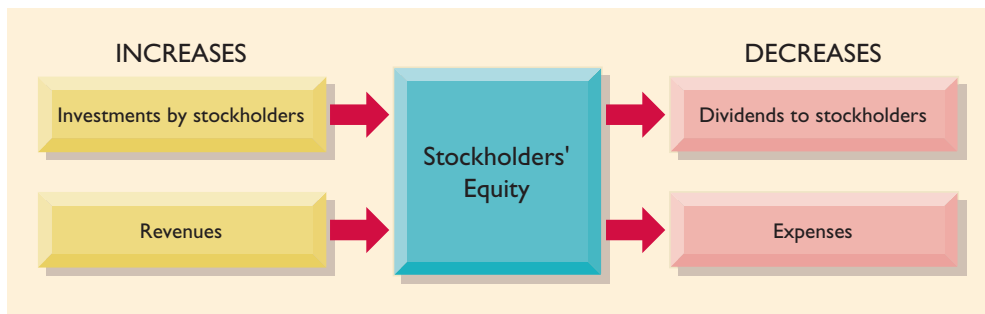
The effect of revenues is positive—an increase in stockholders' equity coupled with an increase in assets or a decrease in liabilities.

#### **HELPFUL HINT**

The effect of expenses is negative—a decrease in stockholders' equity coupled with a decrease in assets or an increase in liabilities.

**Dividends.** When a company is successful, it generates net income. **Net income** represents an increase in net assets, which are then available to distribute to stockholders. The distribution of cash or other assets to stockholders is called a **dividend**. Dividends reduce retained earnings. However, dividends are not an expense of a corporation. A corporation first determines its revenues and expenses and then computes net income or **net loss**. At this point, a corporation may decide to distribute a dividend.

In summary, the principal sources (increases) of stockholders' equity are (1) investments by stockholders and (2) revenues from business operations. In contrast, reductions (decreases) in stockholders' equity are a result of (1) expenses and (2) dividends. These relationships are shown in Illustration 1-6.



**Illustration 1-6**

Increases and decreases in stockholders' equity

## BEFORE YOU GO ON...

### REVIEW IT

1. Why is ethics a fundamental business concept?
2. What are generally accepted accounting principles? Give an example.
3. Explain the monetary unit and the economic entity assumptions.
4. The accounting equation is:  $\text{Assets} = \text{liabilities} + \text{stockholders' equity}$ . Replacing the words in that equation with dollar amounts, what is **PepsiCo's** accounting equation on December 31, 2006?
5. What are assets, liabilities, and stockholders' equity?

### DO IT

Classify the following items as issuance of stock (I), dividends (D), revenues (R), or expenses (E). Then indicate whether the following items increase or decrease stockholders' equity: (1) rent expense, (2) service revenue, (3) dividends, and (4) salaries expense.

### ACTION PLAN

- Review the rules for changes in stockholders' equity: Investments and revenues increase stockholders' equity. Expenses and dividends decrease stockholders' equity.
- Understand the sources of revenue: the sale of merchandise, performance of services, rental of property, and lending of money.
- Understand what causes expenses: the consumption of assets or services.
- Recognize that dividends are distributions of cash or other assets to stockholders.

### SOLUTION

1. Rent expense is classified as an expense (E); it decreases stockholders' equity.
2. Service revenue is classified as revenue (R); it increases stockholders' equity.
3. Dividends is classified as dividends (D); it decreases stockholders' equity.
4. Salaries expense is classified as an expense (E); it decreases stockholders' equity.

**Review It** questions marked with this icon require that you use **PepsiCo's** Annual Report.



**Do It** exercises give you immediate practice of the material just covered.

## THE ACCOUNTING CYCLE AND THE FLOW OF INFORMATION

### STUDY OBJECTIVE 7

Explain the accounting cycle and flow of information.

In financial accounting, there are basically nine steps from beginning to end. Although you will be learning all these steps in detail in the next few chapters, it may be a good time for you to get a sneak preview of what accounting is all about.

All accounting information starts with an economic event that affects the business financially, and therefore, such events will become transactions. Thus the first step in accounting is to **analyze transactions**. This means that you will need to decide what accounts this transaction affects and the amounts that will either increase or decrease the account balances.

Once this is decided, you will need to journalize this entry. This second step is called **journalizing** because you are now putting the information for the first time into the “books” or “journal” of the business. This is also where debits and credits of accounting come into play. Remember that debits and credits can mean both an increase and a decrease in an account. This is dictated by the type of account, whether it is an asset, a liability, revenues, expenses, withdrawal, equity or capital, and the like.

After journalizing comes the third step, **posting**. Posting is the transfer of the accounting information from the journal to the individual accounts, which is called the **ledger**. When this step is complete, all accounts will have a new balance. The debits and credits balances of all the accounts will be added together to form a **trial balance**, the fourth step of an accounting cycle. As the name of the trial balance suggests, this is when the accountant wants to make sure that all debits and credits do match and balance.

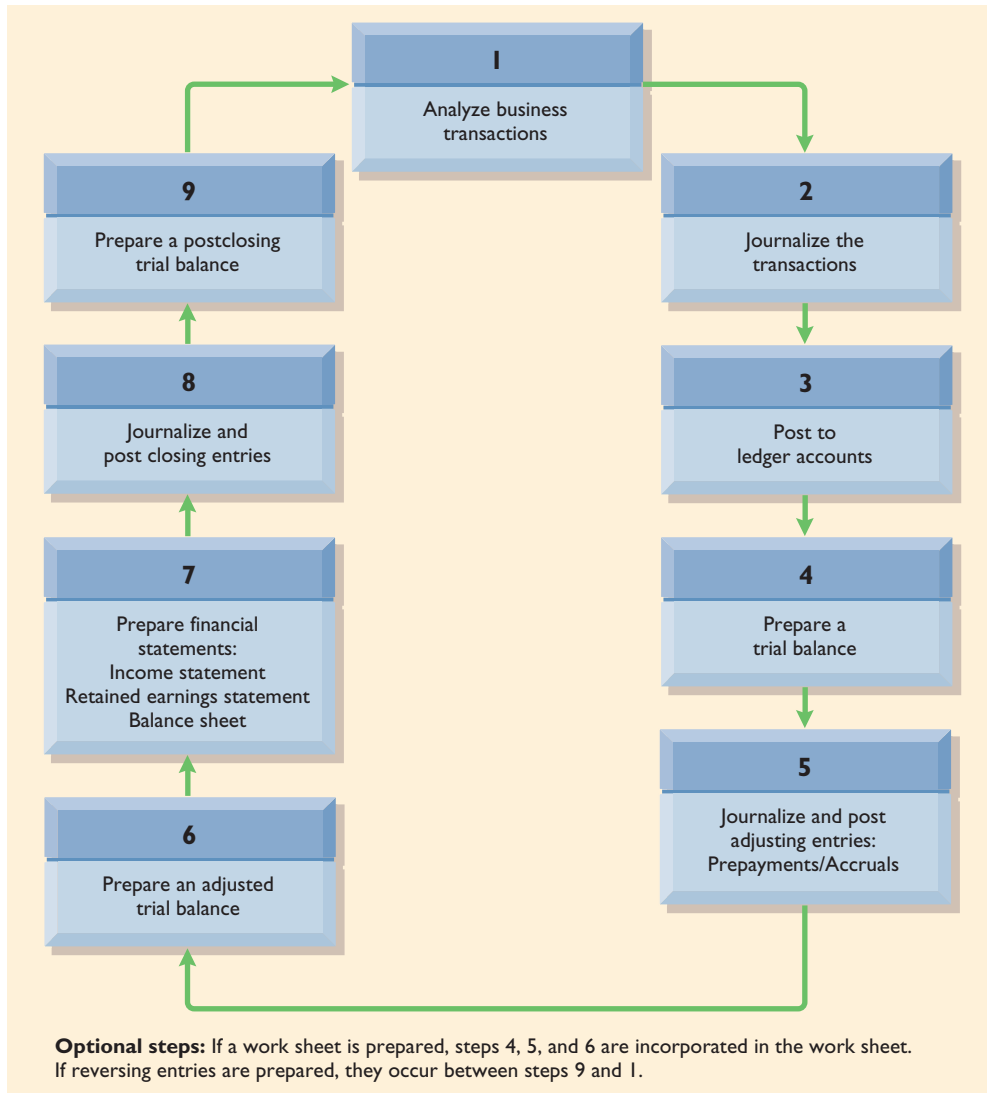
However, life is not always easy, and people do make mistakes; so adjustments are needed. This fifth step is discussed with many illustrations in Chapter 4. Even without mistakes, there are certain type of transactions that are known as **adjustments**, such as depreciation adjustments and recognition of expenses to match revenues; so these are normally made and entered into the journal and the ledger to then result in the sixth step, an **adjusted trial balance**. When the adjusted trial balance is achieved, the balances of the individual accounts now can be used to compile the **financial statements**. In this seventh step, the financial statements will include the income statement, the statement of owner’s equity or retained earnings, the balance sheet, and the statement of cash flows.

Once the statements are complete, we can close the books so that we can start counting for the next period. This eighth step is known as the **closing**, where closing entries will be performed. All the accounts that are period-based will be closed, whereas others will remain open and carry the new balances forward. This will be discussed in Chapter 5.

Finally, we reached the ninth and the last step, the **postclosing trial balance**. Once more, trial balance is compiled to ensure the accuracy of the data to be carried forward to the next period.

Now how does this translate in the hospitality environment? Well, a waiter rings up on a point-of-sale system a customer’s order; and when the customer pays his or her bill, whether by cash or using a credit card, that is an economic event that has a financial impact on the business and will trigger a transaction analysis. A restaurateur writing a check to pay the produce company for the fruits and vegetables delivered is also an economic event. A hotel guest checks out and the folio is closed on the property management system is another example. A country club member sending a check to pay for his or her monthly dues is another transaction. All the information then is taken to the controller’s office for analysis, journalizing, and posting to create trial balances, adjusted trial balances, and, eventually, financial statements. Illustration 1-7 shows this process.





**Illustration 1-7**  
Steps in the accounting cycle.

## THE UNIFORM SYSTEMS OF ACCOUNTS AND FINANCIAL REPORTING

Although the Financial Accounting Standards Board (FASB) sets the rules by which the accounting profession must abide, the hospitality industry also sets procedures and guidelines for its various segments to ensure comparability, accountability, and meaningful usage of accounting data. For new operators, these systems even act as turnkey accounting systems. This means the system has everything included and is ready to be used in operations. The three most used and well-known systems in the industry are for the lodging, foodservice, and club areas. There is currently one under development for the gaming industry.

Why are such industry-specific systems needed? If every industry follows the FASB's rules, shouldn't each then have the correct accounting information? In theory, yes. However, FASB rules are written for the entire accounting profession. Hospitality has accounts other industries do not, and vice versa. For instance, a restaurant will not have a depletion account for an oil rig, but a restaurant does

### STUDY OBJECTIVE 8

Identify the various systems of accounting procedures used in the hospitality industry.

need an accumulation depreciation account for furniture, fixtures, and equipment. Even within the hospitality industry there are differences. A hotel is different from a club, and a club is different from a theme park. Hotels have room revenues, country clubs have membership dues, and theme parks have admissions fees. There are recommended procedures to categorize certain expenses or naming of accounts. The accounting information provided is more useful not just for the companies themselves but also for investors, creditors, and even employees.

## LODGING INDUSTRY

The **Uniform System of Accounts for the Lodging Industry** is currently in its ninth edition. Of the three systems, this is the oldest. It was first developed by the Hotel Association of New York in 1926 and was known as the Uniform System of Accounts for Hotels. From the 1930s to the 1970s, when most hotels were smaller and motor hotels (motels) were popular, there were actually two systems: the Uniform System of Accounts for Hotels and the Uniform System of Accounts for Smaller Hotels. There was also an expense dictionary where expenditures were categorized under specific accounts so that accountants and controllers could follow the allocation trail.

The ninth edition evolved with industry trends and combines all three books into a seamless system of accounts for the entire lodging industry. The **Hospitality Financial and Technology Professionals (HFTP)** is working with the American Hotel and Lodging Association on the next edition.

## FOODSERVICE INDUSTRY

The **Uniform System of Accounts for Restaurants**, first published in 1927, is currently in its seventh edition. It provides sample statements, analysis blueprints, classification of accounts, and an expense dictionary. The aim of this publication, like that of the lodging and club industries, is to assist operators to interpret financial results in a more meaningful manner.

## CLUB INDUSTRY

The club industry is a self-regulating industry. With its owners also being its members, accountability is of utmost importance. The **Club Managers Association of America (CMAA)** was formed in 1927 and published the Proposed Uniform System of Accounts for City Clubs in 1942. It was not until 1954 that the first Uniform System of Accounts for Clubs was published. The current fifth edition is known as the **Uniform System of Financial Reporting for Clubs**.

Similar to the hotel industry, the club industry has seen tremendous growth, especially in real estate developments. Many new residential developments also include a club, fully equipped with all amenities and services, including one and perhaps two golf courses for its residents.

## SPA INDUSTRY

With the new millennium, where a 40-hour work week is very unusual for managerial and executive positions, the spa industry flourishes by providing comfort and relaxation for many people. In 2003, the International Spa Association and its foundation decided that it is time for the industry to set standards for financial reporting, and thus the **Uniform System of Financial Reporting for Spas** was published in late 2004. Similar to its counterparts, this system is divided into three major sections: financial statements, financial analysis, and financial tools. However, instead of departmental statements such as rooms or telecommunications, the spa industry's has massage, skin care, hair, nail, fitness, and health and wellness, which make the industry and its system distinct from the others.

## GAMING INDUSTRY

You may feel that if any industry needs an accounting system, the casino industry should be the first one to have a set of procedures because there are such large amounts of money involved. However, the first edition of this system is still under development. Two reasons contribute to the late birth. First, both Nevada and New Jersey have strict laws governing the operations of casinos, including how money transactions should be documented. Many states with legalized gaming have adopted the rules of Nevada and New Jersey. In addition, casinos have been using parts of the system from the lodging industry. In the current ninth edition of the system of the lodging industry, there are also sections dedicated to the casino industry, suggesting statement presentation formats and guidelines.

# ACCOUNTING AND FINANCIAL MANAGEMENT IN HOSPITALITY

## HOTEL OPERATIONS

Operating a hotel is like being in charge of a small city. The hotel business is full of exciting moments, surprises, heartwarming stories, and also some tough work-days. If you can imagine a mayor taking care of a city, well, that is what a general manager has to do for his or her hotel. The general manager needs to have the hotel properly staffed, with the right equipment and supplies, so that guests can have a wonderful experience. *Hospitality* is not just the name that encompasses the industry but is also the key word to success.

As seen in the feature story in Chapter 1, whether it is a worldwide hospitality giant supplier like PepsiCo or a small mom-and-pop 40-room motel, planning and controls through prudent and ethical financial management are equally important.

The role of financial management in a hotel is crucial to its success. Reduced to the simplest terms, when the money is not there, the hotel cannot open. The hotel industry really offers a fascinating career. Visit the [American Hotel and Lodging Association \(AH&LA\)](http://www.ahla.com) Web site ([www.ahla.com](http://www.ahla.com)) for more information about the hotel industry from national to local levels.

### Interactions with All Departments

A typical hotel is divided into departments. The bigger the hotel, the more departments it has. Most hotels have a front office that takes care of reservations and registration. There is also a housekeeping department and an engineering and maintenance department. If the hotel is a full-service property, it will have a food and beverage department, which may include restaurant, banquet, and in-room dining. Smaller properties may have their human resources and accounting functions centralized at a regional office. An accounting department at a 1,600-room convention property may have forty to fifty employees. Illustration 1-8 shows a sample organization chart for a full-service hotel.

Regardless of how many departments and how many employees, you can see the big picture. In the hotel business, it takes teamwork to provide the ultimate quality service and product to the guests. Five hundred convention attendees staying with the hotel expect to have their rooms ready for check-in and meeting rooms available for work. They will also expect their coffee and meal breaks served on time and the banquet room decorated with their association's banner and other materials. The group's convention organizer is not going to talk to the housekeeper, the restaurant manager, the banquet captain, or the front office separately regarding their needs. This organizer will have one point of contact with the hotel

## STUDY OBJECTIVE 9

Understand accounting and financial management in a hotel.

sales and catering office, and this hotel manager will need to interact with all departments to communicate the pertinent information. Thus all departments need to interact and make decisions accordingly.

### The General Manager and the Executive Committee

As mentioned, the **general manager** is like the mayor of the city. He or she will work closely with the members of the **executive committee** to manage the hotel. The executive committee is made up of all the department heads. This group comes together for meetings to make decisions and to ensure all information is relayed correctly.

The **controller**, the department head of the accounting department, is a member of the executive committee. Just like the general manager, the controller has to work not only with the employees in the accounting and business office but also with all department heads. At times, while certain department heads may not need to have constant communication with one another, the controller, as the head financial management person, is required to do so.

Controllers need to know how every department performs and whether each department is making or losing money. They can do so from a simple analysis of the departmental income statement. They can then consult with department heads to point out any concerns that are shown on the financial records. This allows departments to take appropriate actions to ensure the success of the hotel. In the career ladder of a hotel, it is highly possible that a controller can one day become the general manager.

### The Casino Hotel

Financial management is important in any hotel. However, it is doubly important in a casino hotel. Think of all the cash that passes through a casino on a daily basis.

#### **Illustration 1-8**

Departmental structure in the hotel and lodging industry: (a) departments of a limited-service hotel; (b) departments of a full-service hotel with fewer than 500 rooms; (c) departments of a full-service hotel with 500 or more rooms.  
 Source: Stutts, *Hotel and Lodging Management: An Introduction*, Second Edition (New York: Wiley, 2006).  
 This material is used by permission of John Wiley & Sons, Inc.

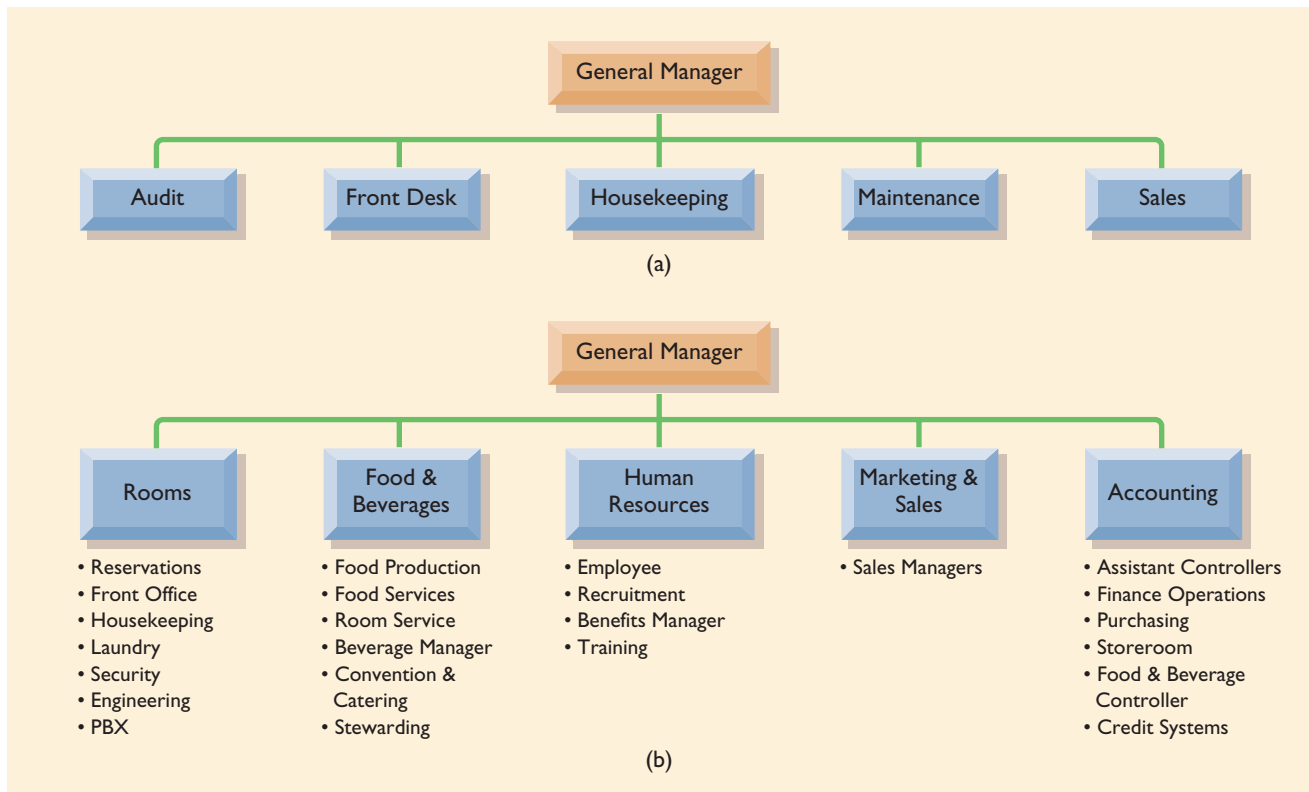
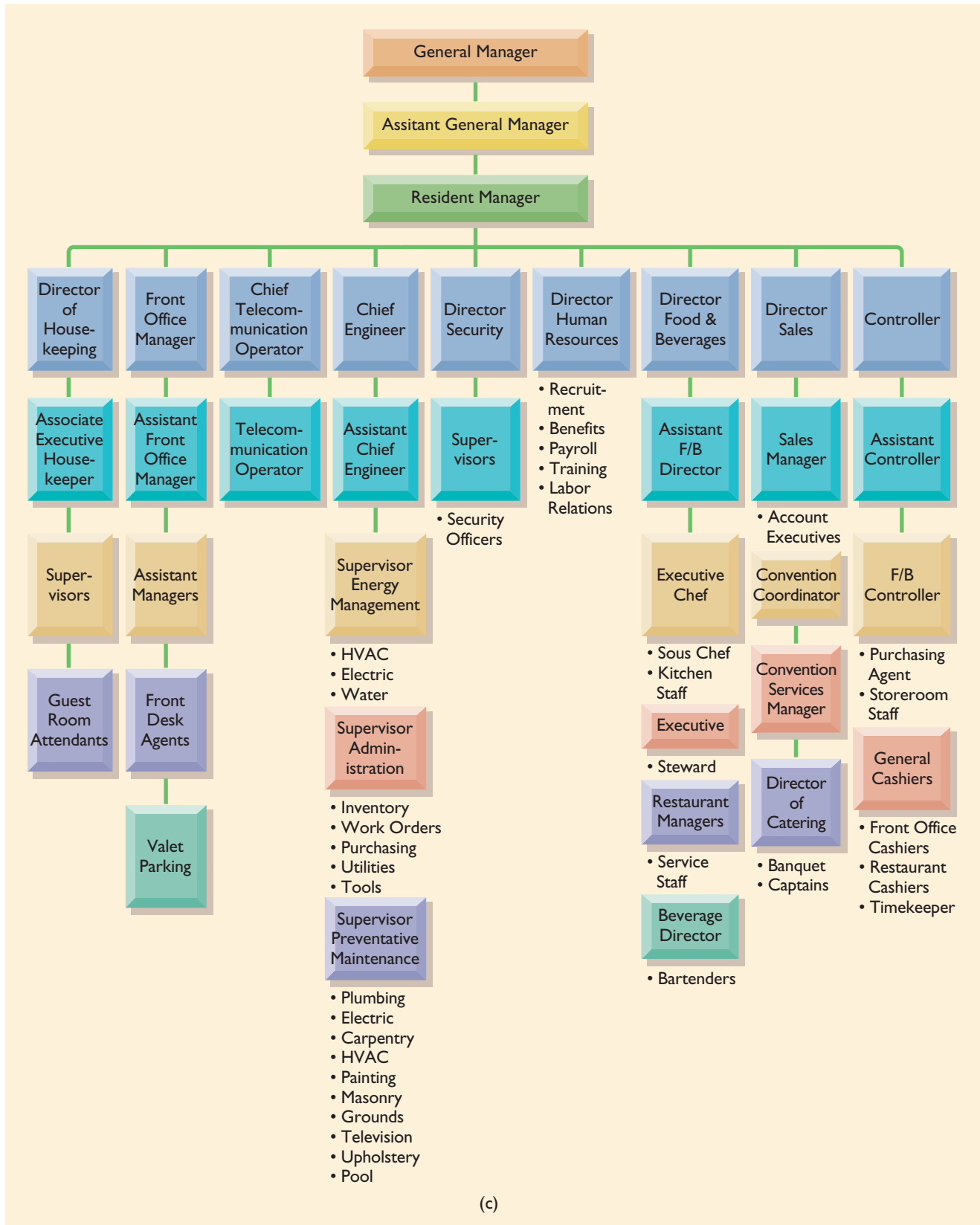


Illustration 1-8

Continued

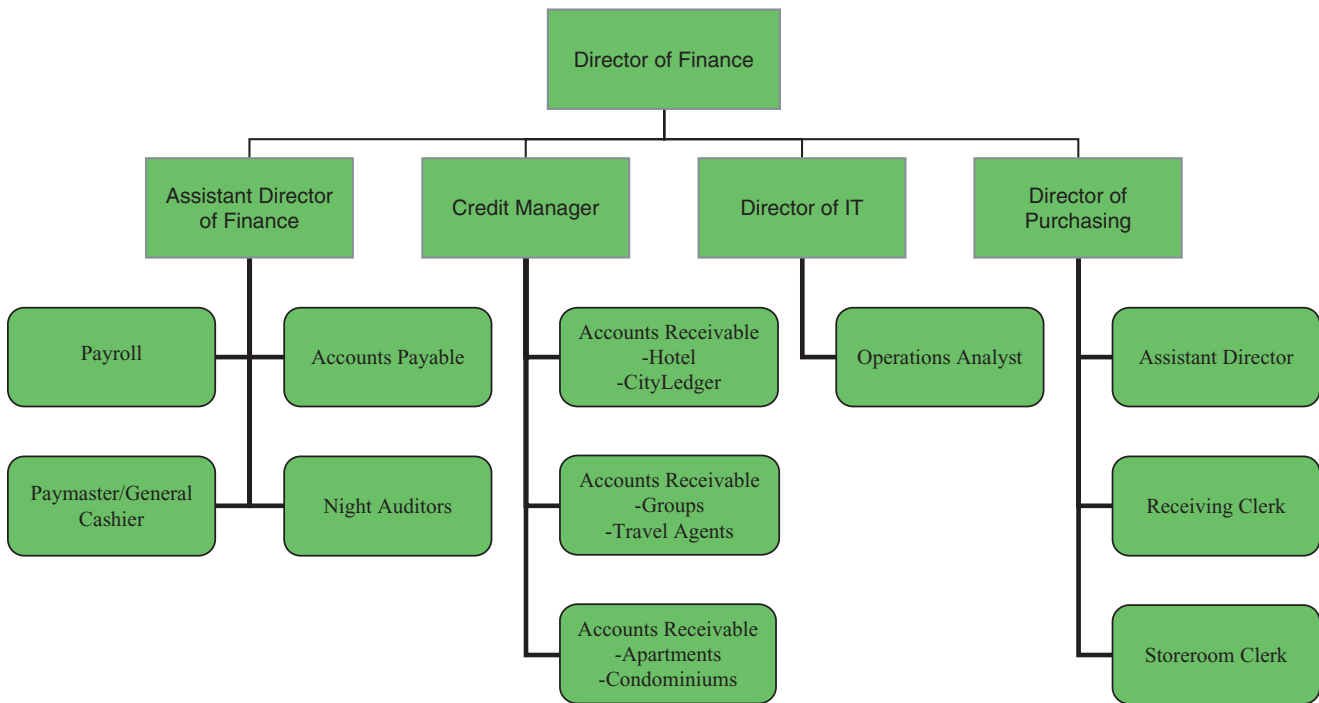


We are talking about thousands to millions of dollars. The exchange of cash for playing chips, the emptying of cash at slot machines and the table games, the issuing of credit to guests, and even the counting of coins and paper money have set procedures regulated by the hotels and by the law. Therefore, besides taking care of all the billing, cash, and payables of a regular hotel, the accounting functions in a casino hotel include managing all other revenue centers from all the games. This makes a controller’s function more interesting and challenging.

### HOTEL ACCOUNTING DEPARTMENT ORGANIZATION

There are many users of accounting and financial information. It takes quite a bit of work to make sure that records are kept properly for all parties. Illustration 1-9 is an organizational chart of a full-service hotel. Some hotels may have a director of finance, whereas others may have a controller; some of the other functions may not exist in a hotel, such as a food and beverage department. For most limited-service hotels, the general manager may assume the function of the controller, or that function will be centralized at a district or regional office. Following is a short description of some of the accounting functions in a hotel.

**Illustration 1-9**  
Accounting department organizational chart



#### **Director of Finance**

For some hotels, the position of controller has been elevated to director of finance, who is then also responsible not just for the accounting and purchasing functions but also for information technology. This individual sits on the executive committee of the hotel and works with the general manager and other executive committee members to make decisions for the operation.

#### **Assistant Director of Finance**

This is similar to the assistant controller. In a big hotel you may see one or a few assistant controllers. In smaller hotels, there may not be any. The controller divides the various functions to be performed so that the workload will be even. For ex-

ample, one assistant might be responsible for daily transactions, whereas another works on special projects, budgets, and the like.

### **Payroll**

Payroll employees calculate the pay rate with the hours worked to generate the payroll register so that paychecks are released on time. Payroll functions also include filing all payroll taxes and tip credits for tipped employees, as well as keeping track of vacation pay, sick pay, and other payroll-related deductions.

### **Accounts Payable**

A key area in accounting, accounts payable ensures that all bills are paid on time and that all discounts are taken, minimizing the costs of the hotel. Accounts payable clerks work closely with the purchasing department to verify that all invoices to be paid are indeed invoices of the hotel.

### **Paymaster/General Cashier**

Pause for a minute and think how many cash banks there are in a large hotel: a few at the front office, at least one in each of the restaurant outlets, at least one in the gift shop, and so on. The general cashier, or the paymaster, is the person who is in charge of all the cash banks in the hotel. He or she also makes all deposits of checks and credit-card receipts.

### **Night Audits/Day Audits**

Night auditors get their title because of the hours they work. At the end of the day, after most hotel guests have retired, these auditors begin recording charges to guests' accounts and verifying the revenue for the hotel. However, with computers and various technologies, the hotel industry can post charges instantaneously. Some hotels actually have changed night auditors to day auditors.

### **Credit Manager**

A big hotel may have its own credit manager, whose function is to check and grant credit. In today's business world, many transactions are done on credit rather than cash or cashier checks. It is therefore the credit manager's responsibility to conduct investigations to ensure that a person or a company is creditworthy.

### **Accounts Receivable**

Working under the credit manager are the accounts receivable (or A/R) clerks. Some A/R clerks are responsible for the guest ledger that is associated with the guests staying at the hotel, whereas other A/R clerks work with the city ledger, which contains all other billings. It is important that the accounting department have a person in accounts receivable working with the city ledger so that the hotel is able to bill and collect revenues due on a timely basis. Some hotels have a collection policy that states that for bills over a certain amount, for example, \$25,000, the invoice will be sent via express mail. In today's hotel industry, where mixed-used hotel development is becoming more common, there may be A/R clerks who work with the apartments and/or condominiums that are owned by the hotel.

### **Director of Information Technology**

This position is still evolving in the hotel industry. While some information technology (IT) directors report to the director of finance, some report directly to the

general manager. They are in charge of all the property management systems and point-of-sales systems and their integration with call accounting or any other automated systems used in the hotel. Their scope of responsibility has grown in the past decade at the property level as the use of technology has become more prevalent. Especially in the past few years, when identity theft and data theft have crippled hotels in their operations and compromised the security of guests, the responsibility and importance of the IT directors also have increased. In smaller hotels, the controller or an assistant controller may take on this responsibility. Normally, this position is found at a district, regional, or corporate level.

### **Operations Analyst**

This is a nice position to have in a hotel. An operations analyst performs analyses to help managers operate the hotel more effectively. From guests' statistics to revenue trends, the operations analyst does it all. However, not all hotels are able to afford an analyst on the payroll. If this is the case, an assistant controller often performs these duties. For smaller hotels that do not have an accounting office on the property, this function is done at the district or regional level.

### **Director of Purchasing**

This person is often also known as the purchaser or the purchasing agent. He or she negotiates for and buys everything the hotel needs. Although on a daily basis it appears that all a hotel needs are food and beverage items, the fact is that there are many other items that need to be purchased new or replenished and replaced, from office supplies, to kitchen equipment, to bedding, furniture, decorative art items, and many more.

### **Receiving Clerk**

When any purchased items come in, they should be delivered to the back dock area where the receiving clerks can check the delivered goods against the purchasing orders to ensure that only the proper items will be received and accounted for. More details of this function will be discussed in Chapters 9 and 10.

### **Storeroom Clerk**

Once any goods are received, they are delivered either to the proper departments or to the storeroom to be kept until they are requisitioned by the departments. The storeroom clerk will ensure that the stock is being rotated. This is especially crucial for food items so that current products will be consumed first, before any new products that have just arrived.

## **FOODSERVICE OPERATIONS**

The controller of an independent restaurant or a foodservice operation is similar to that of a food and beverage controller at a hotel. The difference is that the foodservice controller concentrates on only the food and beverage side, whereas a hotel controller oversees various departments of a hotel. Therefore, besides labor cost and overhead items, accounting and financial management in the foodservice business are focused on yield analysis, food and beverage cost control, and the purchasing function.

### **Purchasing and Yield Analysis**

Foodservice operations purchase food, beverages, and other items on a day-to-day basis. In the case of food and beverage, because products are perishable, buying the

### **STUDY OBJECTIVE 10**

Understand accounting and financial management in a foodservice operation and a club.



right amount of food, at the right quality, at the right time reduces the amount of cash tied in inventory. The extra cash then provides more liquidity to the business.

When buying food and beverage, yield is important. A good-quality piece of beef may have fewer trimmings, yielding the foodservice operation more meat products to be sold. A can of tomatoes may just look like another can. But if the controller performs a “can cutting” and compares the two brands, he or she might discover that one is better than the other, and the cost difference might work to the advantage of the operation.

### ***Food and Beverage Cost Analysis***

In general, for a restaurant or an operation that sells alcoholic beverages (liquor, beer, and wine), it is not unusual to have 15 to 30 percent of its total sales derived from beverages. This means that 70 to 85 percent of the sales are made from food items. For smaller restaurants and quick-service operations that do not sell alcoholic beverages, all revenue comes from food sales. Therefore, the accounting department spends a lot of time tracking food costs. This is especially important because foodservice operations use products where prices often fluctuate.

Restaurants and operations that sell alcoholic beverages also will track beverage costs and perform various analyses. Do not think for a minute that because beverage sales are only 15 percent of total sales they are not important. First, the restaurant business is a “penny” business. One needs to watch for any penny that is earned or spent; otherwise, the profit margin can easily disappear if the business is not managed wisely. More important, the markup of beverages is very high. A bottle of wine that can be purchased retail for \$15 can be sold at the restaurant for \$40 to \$60 depending on the type of restaurant.

Thus careful cost analysis provides foodservice operators with useful information for product purchasing and pricing to maximize profits while offering guests the products they prefer and enjoy. For those who are interested in the restaurant segment, please visit the [National Restaurant Association](http://www.restaurant.org) Web site at [www.restaurant.org](http://www.restaurant.org).

## **CLUB OPERATIONS**

The club segment of the hospitality industry in North America is substantial. In every major city there are many country clubs. But clubs are not just country clubs. They also include city clubs, yacht clubs, racquet clubs, tennis clubs, other athletic clubs, military clubs, and university clubs. These private clubs are membership-only operations. In 2003, The Club Managers Association of America reported gross revenues of \$10.16 billion, employing over 260,000 people with a \$4 billion payroll. Since these clubs are restrictive of clientele, the way business is carried out, and thus the way accounting is performed, is quite different from the foodservice and hotel segments of the hospitality industry.

### ***Membership Accounting***

While hotels have rooms, food, beverage, and other miscellaneous revenues, and restaurants have food, beverage, and other revenues, clubs have all these and a unique revenue category—membership dues. Membership dues from country clubs often make up to 50 percent of a club’s revenue, whereas food and beverage percentage is about 35 percent, with other revenues of 15 percent or so rounding up the 100 percent. These other revenues can include athletic fees for guests, golf greens fees for guests, and sales of merchandise in pro shops and gift stores. In city clubs, food and beverage revenues often exceed that of membership, since golf membership is normally not provided in a city club environment. Membership revenues are the main source of funds needed for a club to run its operations.

## ***Golf, Tennis, and Spas***

Golf, tennis, and spas are three of the major athletic packages included in many club dues. Depending on the type of club, the initiation fees can run from \$10,000 to easily more than \$100,000. In certain clubs you need to be invited and sponsored by existing members before you are put on a waiting list to join. There are also various levels of membership. A full membership will entitle the member to play golf and tennis and use the athletic and spa facilities, whereas a social membership will permit the member to use only the food and beverage outlets.

The club accounting department needs to treat each of these outlets as a cost center, just like a gift shop or a restaurant in a hotel, determining the profit and loss of each area. This gives management the needed information to make sound operating decisions.

## **SUMMARY OF STUDY OBJECTIVES**

**1. Explain what accounting is.** Accounting is an information system that identifies, records, and communicates the economic events of an organization to interested users.

**2. Identify the users and uses of accounting.** (a) Management uses accounting information in planning, controlling, and evaluating business operations. (b) Investors (owners) decide whether to buy, hold, or sell their financial interests on the basis of accounting data. (c) Creditors (suppliers and bankers) evaluate the risks of granting credit or lending money on the basis of accounting information. Other groups that use accounting information are taxing authorities, regulatory agencies, customers, labor unions, and economic planners.

**3. Understand why ethics is a fundamental business concept.** Ethics is the standards of conduct by which actions are judged as right or wrong. If you cannot depend on the honesty of the individuals you deal with, effective communication and economic activity would be impossible, and information would have no credibility.

**4. Explain the meaning of generally accepted accounting principles and the cost principle.** Generally accepted accounting principles are a common set of standards used by accountants. The cost principle states that assets should be recorded at their cost.

**5. Explain the meaning of the monetary unit assumption and the economic entity assumption.** The monetary unit assumption requires that only transaction data capable of being expressed in terms of money be included in the accounting records. The economic entity assumption requires that the activities of each economic entity be kept separate from the activities of its owners and other economic entities.

**6. State the basic accounting equation; and explain the meaning of assets, liabilities, and stockholders' equity.** The basic accounting equation is:

$$\text{Assets} = \text{liabilities} + \text{stockholders' equity}$$

Assets are resources owned by a business. Liabilities are creditorship claims on total assets. Stockholders' equity is the ownership claim on total assets.

**7. Explain the accounting cycle and flow of information.** The nine steps of the accounting cycle are transaction analysis, journalizing, posting, trial balance, adjustments, adjusted trial balance, closing, postclosing trial balance, and financial statements. Information flows from both the front and the back of the house, through point-of-sales systems, property management systems, and other means, to the accounting office.

**8. Identify the various systems of accounting procedures used in the hospitality industry.** There are currently three systems: The Uniform System of Accounts for the Lodging Industry, The Uniform System of Accounts for Restaurants, and The Uniform System of Financial Reporting for Clubs. Each has a long history, and their purpose is to provide users of financial information with comparable data and meaningful analyses.

**9. Understand accounting and financial management in a hotel.** Proper accounting and financial management of a hotel is crucial to its success. The chief accounting officer is known as the controller. The controller is part of the hotel's executive committee, which includes the general manager and all department heads. The controller interacts with all the department heads, assisting and consulting with them on all financial matters so each department head makes sound decisions.

**10. Understand accounting and financial management in a foodservice operation and a club.** The controller of a foodservice operation focuses on food, beverage, and labor costs. Food and beverage cost analyses are of particular importance due to the amount of money spent and the perishable nature of the products. The club industry is unique in that its customers are all members of the club. Members pay dues to the club and in return have a decision-making role in club operations. Members also spend money on food and beverage, merchandising, and other amenities. Therefore, a club controller must account for revenues by looking at different cost centers such as golf, tennis, spa, and food and beverages to provide solid information for management.



## GLOSSARY

- Accounting** The information system that identifies, records, and communicates the economic events of an organization to interested users (p. 2).
- American Hotel and Lodging Association (AH&LA)** A trade association whose members are mostly hotels and lodging properties in the United States (p. 17).
- Assets** Resources owned by a business (p. 11).
- Basic accounting equation**  $\text{Assets} = \text{liabilities} + \text{stockholders' equity}$  (p. 11).
- Bookkeeping** A part of accounting that involves only the recording of economic events (p. 6).
- Club Managers Association of America (CMAA)** A trade association whose members are mostly club managers in the United States (p. 16).
- Controller** The department head of the accounting department who has to work not only with the employees in the accounting and business office, but with all department heads (p. 18).
- Corporation** A business organized as a separate legal entity under state corporation law having ownership divided into transferable shares of stock (p. 10).
- Cost principle** An accounting principle that states that assets should be recorded at their cost (p. 9).
- Dividend** A distribution by a corporation to its stockholders on a pro rata (equal) basis (p. 13).
- Economic entity assumption** An assumption that requires that the activities of the entity be kept separate and distinct from the activities of its owners and all other economic entities (p. 10).
- Ethics** The standards of conduct by which one's actions are judged as right or wrong, honest or dishonest, fair or not fair (p. 8).
- Executive committee** The executive committee is made up of all the department heads of a hotel. This group comes together for meetings to make decisions and ensure all information is relayed correctly (p. 18).
- Expenses** The cost of assets consumed or services used in the process of earning revenue (p. 12).
- Financial accounting** The field of accounting that provides economic and financial information for investors, creditors, and other external users (p. 6).
- Financial Accounting Standards Board (FASB)** A private organization that establishes generally accepted accounting principles (p. 8).
- Generally accepted accounting principles (GAAP)** Common standards that indicate how to report economic events (p. 8).
- General manager** This person is the manager of the entire hotel. He or she manages the hotel through the various department heads (p. 18).
- Hospitality Financial and Technology Professionals (HFTP)** A membership-based organization for financial and technology professionals. Its aim is to provide continuing education, resources, certifications, information sharing, and networking opportunities for its membership. It also produces the HITEC trade show, the largest technology trade show for the hospitality industry worldwide (p. 16).
- Liabilities** Creditorship claims on total assets (p. 11).
- Managerial accounting** The field of accounting that provides economic and financial information for managers and other internal users (p. 6).
- Monetary unit assumption** An assumption stating that only transaction data that can be expressed in terms of money be included in the accounting records (p. 9).
- National Restaurant Association (NRA)** A trade association whose members are mostly restaurateurs and restaurant corporations in the United States (p. 23).
- Net income** The amount by which revenues exceed expenses (p. 13).
- Net loss** The amount by which expenses exceed revenues (p. 13).
- Partnership** An association of two or more persons to carry on as co-owners of a business for profit (p. 10).
- Proprietorship** A business owned by one person (p. 10).
- Revenues** The gross increase in stockholders' equity resulting from business activities entered into for the purpose of earning income (p. 12).
- Securities and Exchange Commission (SEC)** A governmental agency that requires companies to file financial reports in accordance with generally accepted accounting principles (p. 8).
- Stockholders' equity** The ownership claim on total assets of a corporation (p. 12).
- The Uniform System of Accounts for the Lodging Industry** A system of accounting guidelines and procedures developed for the use of hotel and lodging properties (p. 16).
- The Uniform System of Accounts for Restaurants** A system of accounting guidelines and procedures developed for the use of hotel and lodging properties (p. 16).
- The Uniform System of Financial Reporting for Clubs** A system of accounting guidelines and procedures developed for the use of various types of clubs (p. 16).

## CHAPTER 1 APPENDIX *The Accounting Profession*

What would you do if you join the accounting profession? You probably would work in one of three major fields—public accounting, private accounting, or not-for-profit accounting.

## PUBLIC ACCOUNTING

### STUDY OBJECTIVE 11

Identify the three major fields of the accounting profession and potential accounting careers.

In **public accounting**, you would offer expert service to the general public in much the same way that a doctor serves patients and a lawyer serves clients. A major portion of public accounting practice involves **auditing**. In this area, a **certified public accountant (CPA)** examines the financial statements of companies and expresses an opinion as to the fairness of presentation. When the presentation is fair, users consider the statements to be **reliable**. For example, **PepsiCo** investors and creditors would demand audited financial statements before extending it financing.

**Taxation** is another major area of public accounting. The work performed by tax specialists includes tax advice and planning, preparing tax returns, and representing clients before governmental agencies such as the Internal Revenue Service.

A third area in public accounting is **management consulting**. It ranges from installing basic accounting systems to helping companies determine whether they should use the space shuttle for high-tech research and development projects.

## PRIVATE ACCOUNTING

Instead of working in public accounting, you might choose to be an employee of a business enterprise. In **private (or managerial) accounting**, you would be involved in one of the following activities.

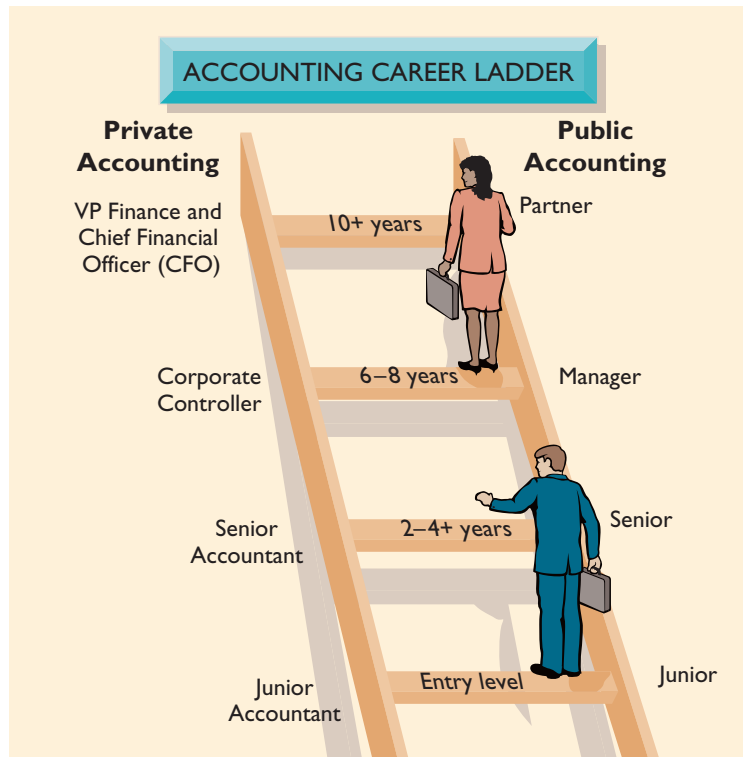
1. **General accounting**—recording daily transactions and preparing financial statements and related information.
2. **Cost accounting**—determining the cost of producing specific products.
3. **Budgeting**—assisting management in quantifying goals concerning revenues, costs of goods sold, and operating expenses.
4. **Accounting information systems**—designing both manual and computerized data processing systems.
5. **Tax accounting**—preparing tax returns and engaging in tax planning for the company.
6. **Internal auditing**—reviewing the company's operations to determine compliance with management policies and evaluating the efficiency of operations.

You can see that within a specific company, private accountants perform as wide a variety of duties as the public accountant.

Illustration 1A-1 presents the general career paths in public and private accounting.

## NOT-FOR-PROFIT ACCOUNTING

Like businesses that exist to make a profit, not-for-profit organizations also need sound financial reporting and control. Donors to such organizations as the **Coca-Cola Foundation**, the **Conrad N. Hilton Foundation**, and the **Red Cross** want information about how well the organization has met its objectives and whether continued support is justified. Hospitals, colleges, and universities must make decisions about the allocation of funds. Local, state, and federal governmental units provide financial information to legislators, citizens, employees, and creditors. At the federal level, the largest employers of accountants are the **Internal Revenue Service**, the **General Accounting Office**, the **Federal Bureau of Investigation**, and the **Securities and Exchange Commission**.



**Illustration 1A-1**

Career paths in public and private accounting

## SUMMARY OF STUDY OBJECTIVE FOR APPENDIX

**11. Identify the three major fields of the accounting profession and potential accounting careers.** The accounting profession comprises three major fields: public accounting, private accounting, and not-for-profit accounting. In public accounting one may pursue a career in auditing, taxation, or management consulting. In private or managerial accounting,

one may pursue a career in cost accounting, budgeting, general accounting, accounting information systems, tax accounting, or internal auditing. In not-for-profit accounting one may pursue a career at hospitals, universities, and foundations or in local, state, and federal governmental units.

## GLOSSARY FOR APPENDIX

**Auditing** The examination of financial statements by a certified public accountant in order to express an opinion as to the fairness of presentation (p. 26).

**Management consulting** An area of public accounting involving financial planning and control and the development of accounting and computer systems (p. 26).

**Private (or managerial) accounting** An area of accounting within a company that involves such activities as cost

accounting, budgeting, and accounting information systems (p. 26).

**Public accounting** An area of accounting in which the accountant offers expert service to the general public (p. 26).

**Taxation** An area of public accounting involving tax advice, tax planning, and preparation of tax returns (p. 26).

## EXERCISES

**1-1** Presented below is the basic accounting equation. Determine the missing amounts.

Use basic accounting equation.  
(SO 6)

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
(a)	\$120,000		\$50,000		?
(b)	?		\$45,000		\$126,000
(c)	\$100,000		?		\$58,000

Use basic accounting equation. (SO 6)

- 1-2** Given the accounting equation, answer each of the following questions.
- The liabilities of Frank's Smoothies are \$120,000, and the stockholders' equity is \$325,000. What is the amount of Frank's total assets?
  - The total assets of Gina Pizza are \$360,000, and its stockholders' equity is \$210,000. What is the amount of its total liabilities?
  - The total assets of Ralph Salads Co. are \$700,000, and its liabilities are equal to one-half its total assets. What is the amount of Ralph Salads' stockholders' equity?

Use basic accounting equation. (SO 6)

- 1-3** At the beginning of the year, Rita Pasta Company had total assets of \$780,000 and total liabilities of \$400,000. Answer the following questions.
- If total assets increased \$125,000 during the year and total liabilities decreased \$50,000, what is the amount of stockholders' equity at the end of the year?
  - During the year, total liabilities increased \$100,000, and stockholders' equity decreased \$50,000. What is the amount of total assets at the end of the year?
  - If total assets decreased \$90,000 and stockholders' equity increased \$130,000 during the year, what is the amount of total liabilities at the end of the year?

Determine effect of transactions on basic accounting equation. (SO 7)

- 1-4** Classify each of the following items as asset (A), liability (L), revenue (R), or expense (E).
- |                                    |                          |
|------------------------------------|--------------------------|
| ___ (a) Food inventory             | ___ (e) Taxes payable    |
| ___ (b) Rooms revenue              | ___ (f) Rent expense     |
| ___ (c) Salaries and wages expense | ___ (g) Beverage revenue |
| ___ (d) Property management system | ___ (h) Cash             |

Classify various items. (SO 6, 7)

- 1-5** Sunny's Noodles has the following balance sheet items.
- |                   |                     |
|-------------------|---------------------|
| Accounts payable  | Accounts receivable |
| Insurance expense | Taxes payable       |
| Wages expense     | Food inventory      |
| Cash              | Kitchen equipment   |

**Instructions**

Classify each item as an asset, liability, or stockholders' equity.

List the steps of an accounting cycle. (SO 7)

- 1-6** From 1 to 9, arrange the following steps of the accounting cycle in order:
- \_\_\_ Posting
  - \_\_\_ Financial statements
  - \_\_\_ Transaction analysis
  - \_\_\_ Closing entries
  - \_\_\_ Postclosing trial balance
  - \_\_\_ Trial balance
  - \_\_\_ Adjusted trial balance
  - \_\_\_ Journalizing
  - \_\_\_ Adjustments

Understand the steps of an accounting cycle. (SO 7)

- 1-7** In which step of the accounting cycle will one compile the income statement, the retained earnings statement, and the balance sheet?

Understand the Uniform Systems of Accounts. (SO 8)

- 1-8** Indicate whether each of the following statements is true (T) or false (F).
- \_\_\_ The Uniform System of Accounts for the Gaming Industry is a joint effort of the Nevada and New Jersey governments.
  - \_\_\_ The Hospitality Financial and Technology Professionals is the sponsor for the first edition of the Uniform System of Financial Reporting for Spas.
  - \_\_\_ The Hospitality Financial and Technology Professionals is also the sponsor for the latest edition (10th) of the Uniform System of Accounts for the Lodging Industry.

Understand the organizational structure of a hotel accounting department. (SO 9)

- 1-9** Indicate whether each of the following statements is true (T) or false (F) in a hotel accounting department.
- \_\_\_ The night auditors get their name because of the long hours they work.
  - \_\_\_ There is no difference between a city ledger and a guest ledger.

\_\_\_\_\_ Smaller hotels may not have a credit manager on staff because that function may be at a district, regional, or even corporate level.

**1-10** Indicate whether each of the following statements is true (T) or false (F) in the foodservice or club environment.

\_\_\_\_\_ Purchasing and yield analysis are the two most important items for a foodservice operations that are related to accounting.

\_\_\_\_\_ It is important to track food cost and beverage cost separately.

\_\_\_\_\_ In 2003, CMAA reported that the club industry employed over 260,000 employees.

*Understand account classifications in the foodservice and club businesses. (SO 10)*

### FINANCIAL REPORTING PROBLEM: PepsiCo

**1-11** The actual financial statements of **PepsiCo**, as presented in the company's 2006 Annual Report, are contained in Appendix A (at the back of the textbook).

#### Instructions

Refer to PepsiCo's financial statements and answer the following questions:

- What were PepsiCo's total assets on December 30, 2006? On December 31, 2005?
- How much cash (and cash equivalents) did PepsiCo have on December 30, 2006?
- What amount of accounts payable and other current liabilities did PepsiCo report on December 30, 2006? On December 31, 2005?
- What were PepsiCo net sales in 2004? In 2005? In 2006?
- What is the amount of the change in PepsiCo's net income from 2005 to 2006?



### EXPLORING THE WEB

**1-12** This exercise will familiarize you with skill requirements, job descriptions, and salaries for accounting careers.

**Address:** [www.careers-in-accounting.com](http://www.careers-in-accounting.com)

#### Instructions

Go to the site shown above. Answer the following questions:

- What are the three broad areas of accounting (from "Skills and Talents")?
- List eight skills required in accounting.
- How do the three accounting areas differ in terms of these eight required skills?
- Explain one of the key job functions in accounting.
- Based on the *Smart Money* survey, what is the salary range for a junior staff accountant with Deloitte & Touche?



Remember to go back to the Navigator box on the chapter-opening page and check off your completed work.