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FINANCIAL PERFORMANCE RELATED TO ACCOUNTING TREATMENTS AT HOTELS WITH BREAKFAST INCLUDED: A CASE ANALYSIS

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ABSTRACT

This viewpoint addresses accounting treatments that potentially affect departmental performance evaluation at full-service hotels including breakfast in room rates. The authors contend that important interdepartmental conflicts arising from accounting treatments in such properties could be minimized if handled appropriately.

Introduction

Full-service hotels continue to compete fiercely for business travelers, who continue to expect more for their travel dollars. One of the main difficulties full-service hotels face in increasing the average daily rate (ADR), defined as the total net rooms revenue divided by total paid occupied rooms, is the competition with suite and economy hotels. One of the main competitive elements of suite and economy hotels is that they offer a breakfast with the room (Raleigh & Roginsky, 1995) and include the price of the food in the room rate. In full-service hotels, most accounting treatments for meals included in the price of the room create financial performance evaluation problems and interdepartmental management conflicts. These conflicts arise from how the sale is recorded and the transfer costing procedure used. Unfortunately, the conflict is often resolved based on which manager presents the most eloquent or convincing arguments. In many cases, such arguments are based on self-interest and not necessarily on whether or not the company's objectives are served. This paper examines accounting treatments that will address various financial performance evaluation criteria, including one that resolves all common interdepartmental conflicts.

Both hospitality management accounting texts and general management accounting texts focus on providing accurate information for decision-making within the parameters of generally accepted accounting principles (GAAP). In his widely used text, Schmidgall (2002) explains the differences in statement of income format between retail and manufacturing industries. The main differences are that cost of goods sold includes materials only, and overhead expenses are not allocated to operating or revenue-generating departments. All direct labor and other expenses, however, are included in the department income statements. No specific procedures are recommended for food and room combinations. The *Uniform System of Accounts for the Lodging Industry [USALI]*

(1996) recommends that promotional food and beverage sales be removed from revenues and expensed at cost.

Adding food and beverage promotions to attract room business is primarily a marketing task. At one point, many hotels and inns began including dinner for two with a room to attract weekend and local business (Lanier & Johnson, 1996). More recently, full-service hotels have included a restaurant buffet breakfast to compete with the full breakfast suite hotels or upper-end economy hotels that offer continental breakfasts. As long as the accounting procedure for room and food combinations satisfied GAAP, the accounting treatment was not an issue. Hence, very few hospitality or accounting studies have focused on the accounting treatment's impact on financial performance evaluation criteria or on department manager behavior.

Failure to address the accounting treatment's impact on various financial performance evaluation criteria can cause a hotel to be adversely compared with competitors and same-brand benchmark hotels. Some of the adverse evaluations include a lower ADR, understated breakfast buffet activity, low restaurant average check, and low food productivity. In addition, the failure can lead to adverse manager behavior, such as sales managers being more interested in revenue than profit, and unsupportive room and restaurant managers who feel a lack of recognition for their efforts. Manager conflicts may prevent a hotel from effectively adapting to changing market conditions.

This study exposes a creative accounting treatment that satisfies all financial performance evaluation criteria and reduces departmental conflicts. The data are from an upscale full-service hotel that competes directly with suite and upper-end economy hotels that provide breakfast with the room. Due to confidentiality, the hotel is not identified. The hotel has a three-meal restaurant, dining room, lobby bar, room service, gift shop, and 20,000 square feet of meeting space. A frequent guest program is available, along with all the common amenities of upscale hotels. In this study, the term "breakfast-included" refers to the breakfast buffet offered by the hotel studied to guests with breakfast included in their room rate.

Hotel Environment for Accounting Alternatives

Sales managers of the studied hotel frequently heard from customers that their hotel was the only one that did not include breakfast with the room rate. The sales managers said that they were frequently compared to Embassy Suites, the upscale best practice champion in a study published by the *Cornell Hotel and Restaurant Administration Quarterly,* which had breakfast included in the room rate as a core brand concept (Dubé & Renaghan, 1999). The restaurant managers of the studied hotel were proud of their new breakfast buffet and their labor productivity. These restaurant managers were also highly interested in promoting sales and not allowing their restaurant to be outsourced, as discussed by Hemmington and King (2000). The rooms managers of the studied hotel were intent on improving guest service and were wary of additional administrative burdens in the reservation and check-in process. The bonus plan for the entire executive committee

of the studied hotel included an incentive to raise the hotel's competitive position as measured by revenue per available room (RevPAR).

It seemed easy at first. The hotel would enhance its competitive ability by simply raising rates and offering a breakfast and room combination. The property management team felt that the full-service hotel restaurant buffet would certainly be better than the breakfasts offered by suite and limited-service hotels. The guests would have the option of a room with or without breakfast. All other full-service amenities would still be available. The ADR would increase, and guests would be introduced to the hotel restaurant by experiencing the new breakfast buffet. There did not appear to be a downside to the room with a breakfast concept. But as the executive committee stakeholders began to ask questions about how the breakfast would be administered and accounted for, defensive department lines were drawn. The key questions revolved around hotel evaluation criteria and the stakeholders' compensation plans.

Hotel Evaluation Criteria

Understanding performance evaluation criteria is essential to appreciate the accounting treatment differences for the breakfast-included approach. From an investor's perspective, net income, earnings per share, stock price, and dividend payout ratio are important evaluation criteria. However, corporate executives and hotel owners hold property managers accountable by using a few other important evaluation criteria known in the industry as profitability and activity ratios. These evaluation criteria include occupancy, ADR, RevPAR, and gross operating profit (GOP) margin. Occupancy is calculated by dividing the number of paid occupied rooms (not including complimentary occupied rooms) by the total number of available rooms for a given time period. ADR is calculated by dividing total net rooms revenue by total paid occupied rooms. RevPAR is calculated by dividing net rooms revenue by the total number of available rooms for a given time period; this measure is receiving greater focus than occupancy and ADR because it reflects the interaction of both occupancy (productivity) and ADR (profitability) (Douglas, 2000). The GOP margin is calculated by dividing gross operating profit dollars by total hotel net revenues. All ratios discussed above are consistent with those defined in the *USALI* (1996).

Other commonly used evaluation criteria focus on additional detail to determine management effectiveness and efficient utilization of resources. Some of these include department profit margins, average checks for restaurants and banquets (revenues divided by the number of customers), cost of sales percentage, labor productivity (hours worked divided by the number of customers or rooms occupied), energy efficiency, and the percent of sales for various expenses (Coltman & Jagels, 2001). Sales managers may be evaluated on the amount of current revenue as well as future revenue contracted or "booked." Actual performance is compared to budget and the previous year.

In 2001, U.S. full-service hotels experienced a 63.4% occupancy rate with an ADR of $123.21. The average property size in this group was 281 rooms. Room department profits were 76.1%, and food and beverage department margins were 24.3%. The average

GOP margin was 34.4% (Smith Travel Research, 2001). The activity and profitability ratios of the studied hotel were in the general range of these 2001 industry averages.

There is also a competitive evaluation tool available in the marketplace called the Smith Travel Research (STR) Star Report. STR confidentially collects occupancy, revenue, and ADR data from most hotels in all markets across the United States. A given hotel can subscribe to the service and receive competitive information. A hotel manager chooses a group of competing hotels with which he or she wants to be compared. The hotel manager then receives a monthly report comparing the subscribing hotel with the selected competitive set as a group (Smith Travel Research, 2002).

For example, the subscriber hotel may have an occupancy rate of 78% and an ADR of $85 for the month just ended. If the competitive set occupancy is 81% with an ADR of $87 for the same month, this indicates to the subscriber hotel that it is not doing as well as its competitors. Additionally, STR provides a RevPAR comparison for the subscriber hotel among its competitive set. The subscriber hotel's RevPAR is divided by the competitive set's (including the subscriber hotel) REVPAR. A number equal to 100% indicates performance equal to that of the competitors. Hotel managers want to have a score of at least 100%.

Managerial Performance Evaluation and Incentive Plans

Managerial performance evaluations and incentive plans affect accounting treatment decisions. At the studied hotel, managers were evaluated through two means, an annual performance review and a bonus plan. All managers received the annual performance review, but only a few managers were on the bonus plan. The annual performance review was the means of granting salary increases, which were granted according to a predetermined scale that related performance levels to a percentage salary increase. All managers shared some similar performance review criteria, such as hotel profitability, guest satisfaction, and employee motivation/morale.

The managerial positions included in the bonus plan were the executive committee, general manager, food and beverage director, director of sales and marketing, controller, human resources director, director of engineering, and sales managers. The bonus plan consisted of some less-weighted items, including customer satisfaction, employee morale, risk management, and quality assurance, and four more heavily weighted items: RevPAR, GOP, yield, and personal performance. RevPAR and GOP have already been defined. Yield refers to the STR reports that track total room revenues achieved within a competitive set; STR totals actual room revenues of the selected competitive set and assigns a yield percentage, which is a ratio of the actual room revenue achieved by an individual hotel to the room revenue it should have achieved according to its proportion of available rooms in the competitive set. The personal performance item in the bonus plan referred to a corporate initiative and a local goal set between the executive committee member and the general manager.

The bonus portion for RevPAR and GOP rewarded managers for actual performance against budget. There was a sliding scale that began in the mid-90s percentile of goal

with a maximum bonus achieved at 100% of budget. The yield portion was awarded on a sliding scale as a percent achievement of the yield percent goal set at the beginning of the year. The current year goal was usually an improvement of the yield percent of the prior year. The personal performance portion was awarded based on a percent achievement of the corporate initiative and local goal.

Sales managers were granted bonuses based on rooms revenue, yield, and RevPAR. The rooms revenue section was an 8 to 1 weight ratio to the other two items, which allowed sales managers to double their salary. The sales manager bonus was a sliding scale that started at achieving 100% of budgeted sales and had no upper bounds. Sales managers had no profitability component in their incentive plan. In other words, there were no financial incentives for sales managers to select the most profitable business for the hotel.

Consistent with the explanation of ADR, RevPAR, and yield measurements, the bonus plan highly motivated executive committee members and, to a lesser degree, sales managers to boost the hotel's performance in these measurements. Therefore, any cost accounting process that reduced any of these three measurements would not only be unpopular among managers eligible for the bonus plan, it would also reduce the hotel's ranking among competitors on these three measurements.

Another important key to the organizational structure was that controllers report to general managers. On simple matters such as included-breakfast buffets, the controller has no motivation to explain that room revenue is overstated by the amount of the breakfast buffet. The controller's bonus had the same categories as that of the general manager. Hence, the controller was also motivated to boost ADR, RevPAR, and yield.

There was one other contributing factor to boosting room sales. Most hotel companies are management companies, which earn management fees based on sales with an incentive fee for achieving certain profit levels. This was the case at the studied hotel. Therefore, the higher the sales, the greater were the management company fees.

Accounting Options for Breakfast-Included

USALI (1996) provides the general guidelines for hotel accounting. The hotel studied generally follows these guidelines, but does perform a common modification to the income statement format by comparing actual results to budget and to last year. There are also department statements and a hotel summary statement. The stakeholders' main concerns are for ADR, RevPAR, average restaurant check, restaurant labor productivity, rooms and F&B department margins, and accounting/administrative costs.

Most accounting approaches cause a negative impact on one or more of these ratios or evaluation criteria. If a guest purchases a room with a breakfast included, but no food revenue or food covers are recorded, the restaurant average check and labor productivity are negatively affected (hours of labor are incurred, but there is no recording of revenue or customer counts). Likewise, if there is no transfer cost of materials, food cost of sales is

negatively affected. Food managers contest this approach. If the revenue is recorded as food revenue, and the room revenue is correspondingly reduced, then ADR and RevPAR are negatively affected. All stakeholders are concerned with this approach. Table 1 indicates the impact of four different accounting methods on hotel evaluation criteria. Although additional accounting treatments and combinations of treatments are possible, these four highlight the impact of accounting treatments on the common industry evaluation criteria and ratios.

Table 1
Accounting alternatives and their impact

Alternative		Impact
(A) Record breakfast revenue as room revenue and record no transfer costs.	+	Higher ADR and RevPAR
	+	Higher rooms department margin
	−	Lower restaurant sales & average checks
	−	Higher food cost
	−	Lower labor productivity
	−	Lower food department margin
	−	Food department manager unrecognized work for incentive plan
(B) Record breakfast revenue as room revenue and record transfer of food material and labor costs as an other expense in the rooms department.	+	Higher ADR and RevPAR
	−	Lower labor productivity (food sales and related covers not recorded)
	−	Higher accounting cost
	−	Possible negative impact on rooms department manager incentive plan
(C) Record breakfast revenue as room revenue and reduce room revenue by the amount of transfer food material and labor cost.	+	Higher ADR and RevPAR, but not as high as recording full retail price
	+	Close approximation of breakfast profit effect in rooms department
	−	Worse labor productivity (food sales and related covers not recorded)
	−	Increased accounting/administrative cost
(D) Record breakfast revenue as room revenue, record transfer of food material and labor costs as an other expense in the rooms department, and record food revenues and covers in the food department with use of an allowance account to properly reflect net food sales.	+	Higher ADR and RevPAR
	+	Close approximation of breakfast profit effect in the rooms department
	+	Food sales, average checks, and labor productivity reflect actual volume
	+ / −	Possible boost for all manager incentive plans, but a greater expense to company
	−	Increased accounting/administrative cost

The last method in Table 1 would appear to be the most desirable alternative, as it offers numerous benefits. With the use of the allowance account: (1) ADR is increased when a guest buys a breakfast with the room; (2) restaurant average check is properly reflected when someone eats a buffet breakfast; (3) restaurant productivity is properly reflected for serving a guest eating a buffet breakfast; and (4) total sales are properly reflected—the room sale was not duplicated as a food sale. This approach also has the least impact on manager performance evaluations and incentive plans.

However, while this method offers numerous advantages, it should be noted that one disadvantage is the additional cost to the company for incentive expenses and accounting/administrative costs. As with other important decisions, a cost/benefit analysis would aid in the decision process in helping to determine the best available alternative.

Administration and Accounting Procedures

At the studied hotel, the executive chef calculates the cost per breakfast buffet by computing the total food cost of 100 meals and dividing the total food cost by 100. The software "CostGuard" does this calculation for the chef to arrive at the standard transfer cost.

The accounting process at the studied hotel starts with the ten-day room occupancy and guest forecast. The director of food and beverage receives the room and guest forecasts and makes a ten-day restaurant cover and revenue forecast. The F&B director uses historical data and his or her own knowledge and experience to make these projections. The executive chef receives the forecast from the F&B director, and orders/purchases food accordingly. The chef prepares a daily breakfast buffet according to the forecasted covers. The revenue from breakfasts included in the room rate is included but not segregated in the F&B director's forecast of food revenue.

Table 2 illustrates the incremental impact of accounting entries for a 500-room hotel during a 30-day period in which a 70% occupancy rate was hypothetically achieved and 2,500 rooms were hypothetically sold with breakfast included. The entries are labeled 1 through 5. The room rate is $90 without breakfast, and $100 with breakfast. Room revenue is recorded in the normal fashion, as would be the case regardless of the accounting treatment option for the breakfast (1). Guests with breakfast included are flagged and given identification to present in the restaurant for the buffet. The restaurant records or posts in the point-of-sale system breakfast buffet sales only if the room guest with breakfast included consumes a breakfast (2), but flags the sales from guests with breakfast included for later treatment by the night audit.

Table 2
Accounting entries for 500 rooms with breakfast

Accounting Entry	Debit Amount	Debit Account	Credit Amount	Credit Account
(1) Cash room sales for 2,500 rooms w/Bfst	250,000	Cash	250,000	Room revenue
(1) 2,500 Room Nights	2,500	Room statistics	2,500	Room statistics contra account
(2) 2,500 Breakfast Buffets @ $10	25,000	Accounts Receivable	25,000	Breakfast buffet revenue
(2) 2,500 Food Covers	2,500	Restaurant statistics	2,500	Restaurant statistics contra account
(3) Adjust Duplicate Restaurant Revenue	25,000	Restaurant Revenue Allowance	25,000	Accounts receivable
(4) Transfer Food Cost @ 30%	7,500	Rooms Dept. Comp Guest Services	7,500	Food dept. cost of sales
(5) Transfer Labor Cost @ 30% with benefits 30% of wages	7,500	Rooms Dept. Comp Guest Services	5,385 1,615	Food labor other Benefits other

This point-of-sale restaurant posting is essentially a debit to accounts receivable and a credit to restaurant sales. These breakfast-included charges are then adjusted off at the end of each day by night audit, which essentially reduces the net restaurant sales to an amount before breakfast included revenues (3). This is done through a promotion account in the property management system that allows the restaurant to post and segregate included buffet charges. The accounting department accumulates the daily night audit adjustments for a month-end entry to the general ledger. In essence, room sales are recorded (together with included breakfasts), restaurant sales are recorded for all consumed buffets, and total restaurant sales are reduced by the amount of included breakfasts via an allowance account. Next, the accounting department credits the food department cost of goods sold (food cost) for the standard direct material costs of consumed included breakfasts (4). The same amount is debited to the rooms department guest services account. Hence, the direct material cost of included breakfasts at the standard cost rate is transferred from the food department to the rooms department. A standard labor cost for breakfast buffet kitchen and restaurant labor is credited to the food labor "other" wage account and debited to the rooms department guest services account (5).[1] Wages and hours by wage category are not affected with this approach to maintain wage

[1] The studied hotel was considering the transfer of labor costs at the time of the study. The researchers recommended the mentioned procedure.

productivity ratios. A standard benefit percent of labor is credited to the benefit other account.

The following rooms and food department income statements illustrate the impact of the four different accounting treatments on the rooms and food departments.

Rooms Department Income Statement

Accounting Method	(A)	(B)	(C)	(D)
ADR*	$ 92.38	$ 92.38	$ 90.95	$ 92.38
RevPAR*	$ 64.67	$ 64.67	$ 63.67	$ 64.67
Revenue	$ 25,000	$ 25,000	$ 10,000	$ 25,000
Allowances				
Net Revenue				
Expenses				
Salaries and Wages				
Employee Benefits				
Total Payroll & Related				
Other Expenses				
Cable TV				
Commissions				
Comp Guest Services	$ 0	$ 15,000	$ 0	$ 15,000
Contract Services				
Guest Relocation				
Guest Transportation				
Laundry & Dry Cleaning				
Linen				
Operating Supplies				
Reservations				
Telecommunications				
Training				
Uniforms				
Other				
Total Other Expenses	$ 0	$ 15,000	$ 0	$ 15,000
Department Profit/(Loss)	$ 25,000	$ 10,000	$ 10,000	$ 10,000

*ADR and RevPAR represent the hotel monthly totals. All other revenue and expenses shown are incremental revenue and expenses for rooms with breakfast

Food Department Income Statement

Accounting Method	(A)	(B)	(C)	(D)
Average Check*	$ 9.50	$ 9.50	$ 9.50	$ 9.60
Labor Productivity*	.392	.392	.392	.317
Revenue				$ 25,000
Allowances				($25,000)
Total Net Food Revenue	$ 0	$ 0	$ 0	$ 0
Other Income				
Total Revenue	$ 0	$ 0	$ 0	$ 0
Cost of Sales	$ 7,500	$ 0	$ 0	$ 0
Payroll Expenses				
Salaries and Wages	$ 5,770	$ 5,770	$ 5,770	$ 5,770
Salaries other		($5,770)	($5,770)	($5,770)
Employee Benefits	$ 1,730	$ 1,730	$ 1,730	$ 1,730
Other Benefits		($1,730)	($1,730)	($1,730)
Total Payrll and Related Exp	$ 7,500	$ 0	$ 0	$ 0
Other Expenses				
China, Glass, Silver, Linen				
Contract Services				
Laundry & Dry Cleaning				
Licenses				
Misc Banquet Expense				
Music & Entertainment				
Operating Supplies				
Telecommunications				
Training				
Uniforms				
Other				
Total Other Expenses				
Department Profit/(Loss)	$15,000	$ 0	$ 0	$ 0

*Shows total average check and labor productivity assuming 100,000 covers with a $9.50 average check and a manhours per cover ratio of .333 before the incremental 2,500 covers for guests assumed to be single occupancy with room and breakfast.

Conclusion

The studied hotel creatively accounts for rooms with breakfast included. Its approach maximizes important hotel financial ratios and minimizes interdepartmental conflicts caused by accounting treatments. The implication is that all full-service hotels

could maximize their activity and profitability ratios while minimizing interdepartmental conflicts. The ADR and RevPAR are higher with breakfast included as a part of room revenue. This approach makes full-service hotel ADR and RevPAR more comparable to suite and economy hotels that provide breakfast with the room and include the food price in the room rate. The trade-off between restaurant average check and labor productivity is avoided by recording the revenue, covers, and labor dollars and hours in the usual accounts. The revenue is reduced by using the allowance account, which does not affect the calculations of average check. The use of a labor "other" account to transfer labor costs from the food department to the rooms department maintains the correct labor productivity calculations. The appropriate food and labor costs are transferred from the food department to the rooms department, where the revenue is recorded. The daily revenue is also accurately reported through the daily night audit rebates of breakfast-included buffets from the restaurant.

The underlying hotel's accounting measurement is consistent with *USALI*. Its incentive plan achievement and performance evaluation criteria are kept intact. Administrative and accounting processing costs are increasing, but are not excessive. Certain operational steps are necessary to limit the food department exposure to exceeding the standard transfer cost. Without the mechanism of the allowance account, the stakeholders may not be able to agree on which evaluation criteria to sacrifice. The result could be that the hotel misses out on adapting to a market shift. Not only could additional revenue be missed, but existing revenue bases could decline.

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