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# Responsible Accounting in the Hospitality Industry

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## ABSTRACT

Nowadays, due to globalization and intensified market competition, management attention has to be focussed on efforts where they will do the most good. In order to survive, especially in the service industry, Managers in the new business environment need more relevant cost and performance information on the organization's activities, processes, products/services and customers. The task of management accounting is to prepare this accounting information, which has the possibility to indicate what costs, revenues and results should be.

Responsible accounting is an underlying concept of accounting performance measurement systems. The basic idea is that large diversified organizations are difficult, if not impossible to manage as a single segment, thus they must be decentralized or separated into manageable parts. These parts or segments are referred to as responsibility centers that include: revenue centers, cost centers, profit centers and investment centers. This approach allows responsibility to be assigned to the segment managers that have the greatest amount of influence over the key elements to be managed. These elements include revenue for a revenue center, costs for a cost center, a measure of profitability for a profit center and return on investment for an investment center.

**Keywords***:* Responsible Accounting, USALI, Cost Accounting

## Introduction

Responsible accounting assumes the creation of responsibility centers. A responsibility centre can be defined as an organization unit for whose performance a manager is held accountable. Responsible accounting enables accountability for financial results and outcomes to be allocated to individuals throughout the organization. The objective is to measure the result of each responsibility center. It involves accumulating costs and revenues for each responsibility centre so that deviation from performance target (typically the budget) can be attributed to the individual who is accountable for the responsibility centre.

# Responsible Accounting

At the time of industrial revolution more and more companies turned to the mass production, to manage large capacities and to control costs and revenues of this separated business units, responsibility accounting became a widespread concept (Drury, 2006, pp. 5-6).

In the business literature we can find different definitions for responsibility accounting. One of the most general definitions is a system under which managers are given decision-making authority and responsibility for each activity occurring within a specific area of the company. Under this system managers are made responsible for the activities of segments. These segments may be called departments or divisions.

Charles T. Horngren (2011) in his work explains responsibility accounting as a system of accounting that recognizes various responsibility centers throughout the organization and reflects the plans and actions of each of these centers by assigning particular revenue and costs to the one having the pertinent responsibility. It is also called profitability accounting and activity accounting. Eric L. Kohler's dictionary for accountants (Kohler, Cooper, & Ijiri, 1983) defines responsibility accounting as a method of accounting in which costs are identified with persons assumed to be capable of controlling them, rather than with products or functions. It differs from activity accounting, in that it does not in itself require an organizational grouping by activities and sub-activities or provides a systematic criterion of system design. Again John A. Higgins (1952, p. 1-17.) says that by definition it is a system of accounting which is tailored to on organization so that costs are accumulated and reported by levels of responsibility within the organization. Each supervisory area in the organization charged only with the costs for which it is responsible and over which it has control.

Rehana Fowzia (2011, p. 59) cities Robert N. Anthony's words "responsibility accounting as type of management accounting that collects and reports both planned and actual accounting information in terms of responsibility centers". According to the R. N. Anthony's interpretation responsibility accounting can be seen as a linkage between accounting and motivating manager behavior. Responsibility accounting and the related concept of profit centers stress the management aspect and the effect of decision making by managers. This is in contrast with the cost accounting concept of cost centers, which emphasizes the more technical aspect of cost behavior.

As it is seen from above on the one hand, responsibility accounting is able to provide information about the performance of segmented business units of the organization, but on the other hand the concept emphasizes the impact of the human factor for performance. Raymond Cote (2001) in his work stressed that business unit managers have responsibility only for those costs which are controllable by their authority. Therefore managers have the responsibility to ensure the conditions for cost control. According to the concept managers play an important role in the business unit operation. Fay T. Clifford, Richard C. Rhoads and Robert L. Rosenblatt (1981) in their studies expressed that the responsibility reports about business unit performance are primarily tailored to fit the planning, control and decision-making needs of subordinate managers. According to the concept each person in authority is held accountable for attaining planned objectives. This means that there will be monitored action of responsible individuals, transmitted relevant data to those who are responsible for conceiving and executing the company's planning and control functions.

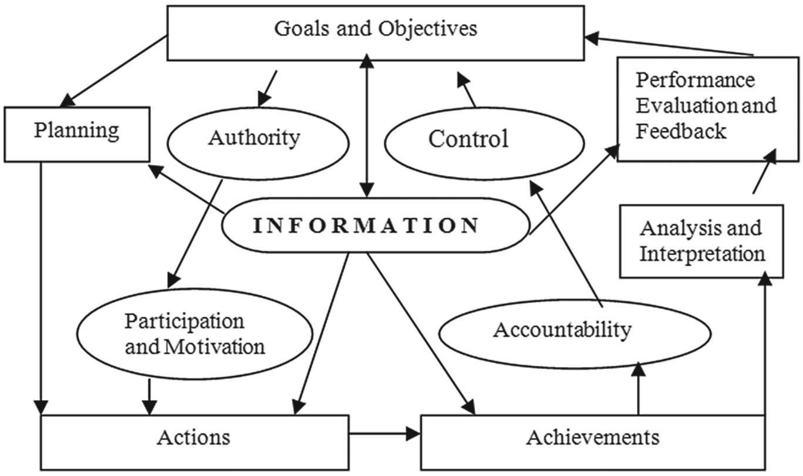


**Fig. 1. Basic structure of responsibility accounting.**
Source: F. T. Clifford, R. C. Rhoads, R. L. Roseblatt, *Managerial Accounting for the Hospitality Service Industries*. Iowa: 1981, p.384.

Well-known experts in the field of accounting agree that the essence of responsibility accounting is to communicate the right information to the right person at the right time. The concept provides a means of control. Responsibility accounting will certainly act as a control device and it will help in improving the overall performance of the business.

In accordance with the above, it could be seen that the term of responsibility centers is used for an organization's sub-unit, which unit is concerned with a particular aspect of an organization's affairs and the unit manager will be responsible for its performance. The responsibility centers are classified and described as follows:

- *Cost centres* - are segments whose financial performance is measured in terms of cost without taking into consideration its attainments in terms of output. The performance of the managers is evaluated by comparing the cost incurred with the budgeted costs. The management focuses on the variances for ensuring proper control. The cost centre does not serve the purpose of measuring the performance of the responsibility centre, since it ignores the output (revenues) measured terms of money.
- *Profit centres* - in a profit centre, both inputs and outputs are measured in terms of money. Profit provides effective appraisal of the manager's performance. The manager of the profit centre is highly motivated in his decision-making relating to inputs and outputs so that profit can be maximized. A profit centre will gain more meaning and significance only when the divisional managers of responsibility centres have empowered adequately in their decision making

relating to quality and quantity of outputs and their relation to costs. If the output of a division is fairly homogenous a profit centre will not prove to be more beneficial than a cost centre.

- *Investment centres* – in the investment centre the manager held is responsible for costs and revenues as well as for the investment in the assets. In an investment centre the performance is measured not by profits alone, but is related to investments effected. The manager of an investment centre is always interested to earn a satisfactory return. Investment centres may be considered as separate entities where the managers are entrusted with the overall responsibility of inputs, outputs and investments.

The results of responsibility accounting are segment reports, which consist of personalizing accounting information, by looking at different types of costs, revenue and results from the personal control standpoint. Nowadays, the importance of segment reporting is appreciated, as it reflects on development stages in accounting standards. The well-known accounting standard institutions are the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB), each of them introduced their own statement of segment reporting. The Financial Accounting Standards Board (FASB) in 1997 issued the SFAS 131: *Disclosures about Segments of an Enterprise and Related Information*, which became effective after 1 January, 1998. The International Accounting Standards Board's (IASB) IFRS 8: *Operating Segments*, came into existence on November 2006 and apply to annual periods beginning on or after 1 January 2009. IFRS 8 defined a reportable segment as an operation segment or aggregations of operation segments. According to global accounting standards (SFAS 131 and FASB 8) segmenting an organization into responsibility centers can be achieved and identified on the basis of operation (e.g. rooms, F&B, swimming pool, conference) or geographical areas (e.g. a region within a country or whole country).

## Responsibility Accounting in the Lodging Industry – Uniform System of Accounts for the Lodging Industry

Francis Kwansa and Raymond Schmidgall (1999) in their work describe the development stages of Uniform System of Accounts for the Lodging Industry, which was established in 1926 by the Hotel Association of New York City. The aim of foundation was to create guidelines for preparing accounting standards and financial reporting practices. As the appearance of document mainly oriented by management needs, it reflects its cost accounting view.

Uniform System of Accounting in the Lodging Industry (USALI) requires hotels to prepare detailed financial statements according to their business units. Based on the responsibility accounting, USALI's principle is that each manager should be responsible for revenues and costs that they are able to control.

USALI distinguishes 32 separate business units into investment centers or cost centers. In practice, segments appear as responsibility centers. A hotel can be considered as an investment center. Inside the whole enterprise there can be distinguished profit centers (according to the departments like lodging, food and beverage, and so on) and inside of profit centers there can be identified revenue and cost centers. At the end of the accounting period before preparing the Financial Statement each responsibility center contributes their budget.

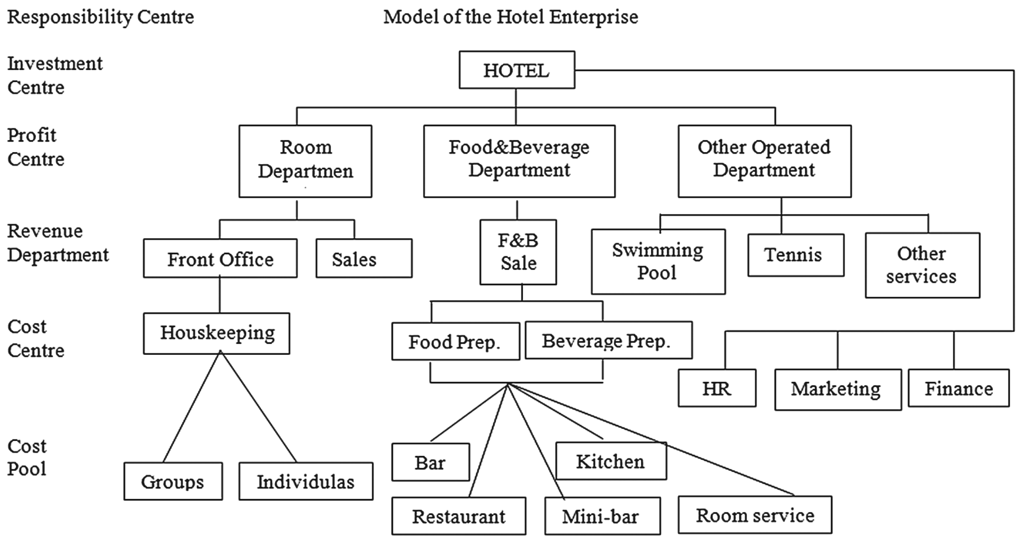


**Fig. 2. Model of the hotel structure as an Investment center.**

Source: Own chart based on: Uniform System of Accounts in the Lodging Industry 1996.

The most important benefits of using USALI is that it emphasizes the determination of departmental income, from which direct and indirect expenses are deducted to arrive at income before taxes. The fundamental principle of responsibility accounting as a subsystem of managerial accounting is that cost are assigned to various hierarchical levels of management which are in charge of their control to make managers responsible for the difference between budgeted and realized (Garrison, & Noreen, 1997).

In accordance with the USALI, departmental managers have an insight into the expenses and revenues that are within their competence. The first level of the internal result is the difference between revenues of those segments costs, that operated their activities directly on the external market and expenses of the same operated departments presented as the profit from operated departments or contribution margin. The variable costs at this level are controllable operation expenses that are deducted from the revenue to establish the gross operating income. If we deduce from the first level profit the part of fixed cost that can be immediately calculated into the particular business operation, we can establish gross operation profit. The manager can not significantly influence the third level of results, the net operating profit. The uncontrollable overheads (rent, property taxes, insurance, interest expense, depreciation and amortization) are compensated on this level. The head manager controls this category of cost, because it is the result of his decision.

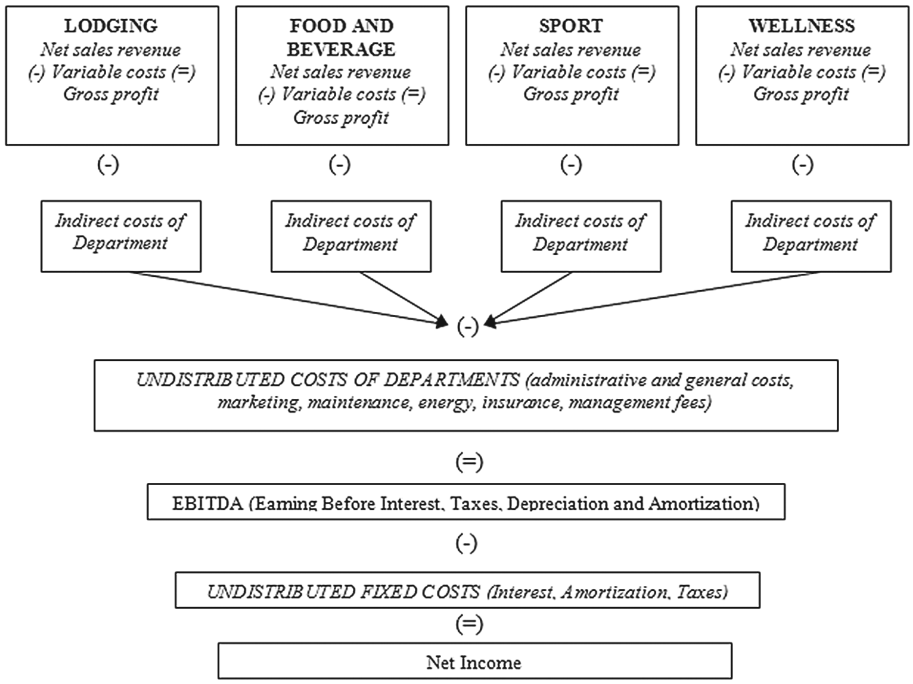


**Fig. 3. Calculation of business result according to USALI.**
Source: Own chart.

Based on standard cost accounting, USALI distinguishes variable and fixed costs. In fact, while the variable costs are flexible (rise and fall) during changing level of capacity utilization (the department manager of lower hierarchical levels with their decision can directly affect them), fixed costs in the short term will remain unchanged but all significant efforts to increase the level of capacity utilization, since with rise the degree of capacity utilization total weight of fixed costs shifted to a larger number of impacts (products or services) and their relative participation in unit performance decreases, which is related to decisions about assortment offers and target markets.

According to partial costing method, fixed costs do not divide directly to the product or services. The application of partial cost calculation method give managers possibilities for revenue management (yield management), in order to increase departmental revenue managers have to consider to reduce the sales price of product or services, but not below the average variable cost per unit of output. Furthermore, this calculation provides information and basic decisions as to whether an activity performed within the framework of their own performing system (e.g. laundry, cleaning the rooms, etc.) or with third parties that better anchor the environment, depending on the amount of variable costs and available capacity, as the need to divide fixed costs on the optimum number of effects.

The USALI's framework give a chance to better understand the manager's motivation background into the concept of responsibility accounting. As installed capacities in a hotel enterprise (or departments) are limited, managers need to bring important business decisions to achieve a higher level of capacity utilization in order to operate profitably their expensive capacity. To do so, managers should start with increasing coordination of internal work processes, it is necessary to ensure the shortest possible lead time from procurement process, through the production process until the process of implementation. The emphasis is on making such decisions that will contribute to improving the range and quality of supply, the introduction of the organizational structure, implementing innovative solutions and other improvements, finding new sales channels and target segments, the introduction of measures of cost reduction, increased revenue (e.g. yield management) etc. With this action managers expert its view to strategic accounting.

## Conclusions

The aim of this paper was to bring attention to the responsibility accounting in the hospitality Industry. Today, due to globalization and intensified market competition, managers face the need of personal information about companies operation. Responsibility accounting provides information to management about the performance of a sub-unit of the organization. It is also a view of an accounting system, which emphasizes the human element and its effects on operations and stresses the control or influence that managers can exert within the segment of the organization for which they are responsible. To do so, USALI should expand its view to modern cost accounting methods. One of solution should be the activity-based costing (ABC). Activity-based costing (ABC) method provides insight into how management is presently serving its customers, and how to better serve them in the future. It is defined as a methodology that measures cost and performance of activities, resources and cost objects. Resources are assigned to activities, then activities are assigned to cost objects based on their use. ABC recognizes the causal relationship of cost drivers to activities.

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