

Case 9

Solution to Walkers Lodge

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I.

(a) Actual Profit and Loss Account for the half year ended 30 Sept 2013

	Guest nights	Rate €	€
Guest income:			
Family guestnights (FI rate)	200	50	10,000
Single walkers (SI rate)	40	35	1,400
Business executives (BI rate)	60	50	3,000
Couples (CI rate)	<u>10</u>	<u>40</u>	<u>400</u>
Total accommodation revenues	<u>310</u>		<u>14,800</u>
Breakfast charges for children €5 × 200			<u>1,000</u>
Total revenue from guests including children	<u>510</u>		<u>15,800</u>
Less: Variable costs:			
Food cost related to no. of guests including children (€3 × 510 guests)		3	1,530
Variable element of energy costs €2 × 510		2	<u>1,020</u>
Total Variable costs		5	<u>2,550</u>

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Contribution	<u>13,250</u>
Less: Fixed costs:	
Marketing costs:	
Fl fee per half year (1500/2)	750
Other marketing costs	<u>2,000</u>
	<u>2,750</u>
Fixed element of energy cost	2,000
Total fixed costs	4,750
Operating income	<u>8,500</u>

Operating Income/Total Revenues % 53.8% (54%)

(b) Interpretive Commentary:

The contribution on rooms is high, being $\text{€}14,800 - (\text{€}3 \times 310) - (\text{€}1,020) = \text{€}12,850$

$C/S \text{ ratio} = 12850/14,800 = 86.8\%$

The cost of cleaning the rooms is not charged as the owners do this work themselves for free.

The contribution margin on breakfasts is also high being:

Children ($\text{€}1,000 - \text{€}3 \times 200 = \text{€}400$) plus contribution from adults paying for breakfast in room charges ($310 \times \text{€}5 (\text{€}1,550) - [\text{cost of food of } \text{€}3 \times 310 (\text{€}930)] = \text{€}620$)

$= \text{€}1,020$

Revenue from breakfast sales of $\text{€}1000 + 310 \times \text{€}5 = \text{€}2,550$

$C/S \text{ on breakfast sales} = \text{€}1,020/\text{€}2,550 = 40\%$

The rooms business is profitable, but the margin varies depending on the type of guest staying.

If we allow a variable cost of $\text{€}5$ per guest, the C/S ratios for each type of guest market segment are:

Families ($50 - 5 = 45/50$ per adult = 90%)

Business executives (same as families = 90%)

Couples ($40 - 5 = 35/40 = 87.5\%$)

Singles ($35 - 5 = 30/35 = 85.7\%$)

Therefore, *the guest mix is critical to profitability*; it is averaging out at 54% roughly, due to the low costs and the free labour provided by John and Mary in cleaning and laundry activities. In particular, families staying at the farmhouse are very contribution rich, but do take a lot of service, due to children staying for free. The Summers may find that they cannot keep up with the demands on their time from the different guest segments, if the guesthouse is full. They may also find difficulties with mixing segments, such as groups of walkers and families and mid-week active retired as well as couples on weekend breaks.

2.

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(a) Walkers Lodge: Three-year Forecast 2014-2016

	Workings See Appendix I (solution)	2014 Six months	2015 Six months	2016 Six months
Revenues:		€	€	€
Non-resident walkers taking breakfast and then attending the briefing by the guide No. of walkers × €5 each	<u>W1</u>	100	150	250
Family room guestnights	<u>W1</u>	11,000	11,000	11,000
Walkers on single occupancy guestnights	<u>W1</u>	350	4,550	2,800
Business executive guestnights	<u>W1</u>	550	–	–
Younger couples weekend break	<u>W1</u>	Nil	2,000	2,000
Early/active retired couples mid-week break	<u>W1</u>	2,500	2,500	7,500
Total Room Revenues (€)		14,400	20,050	23,300
Total Revenues including non-resident sales		14,500	20,200	23,550
Total guestnights		230	350	350
Add: guestnights from children				
Total guests staying		400	400	460
		630	750	810
Variable Costs:				
Food	€3.30 × no. of guests then €4.40 in 2016	2,079	2,475	3,564
Energy	<u>W2</u>	1,386	1,650	1,782
Total Variable costs		3,465	4,125	5,346
Contribution		11,035	16,075	18,204
Fixed Costs:				
Energy	<u>W2</u>	1,800	1,800	1,980
Marketing	<u>W3</u>	2,750	2,750	2,825
Guide	<u>W4</u>	2,400	2,700	2,820
Cleaning/Housekeeping	<u>W5</u>	4,800	4,800	4,800
Total Fixed costs		11,750	12,050	12,425
Operating Income		(715)	4,025	5,779
Operating Income/Total revenues		4.93%	19.93%	24.54%

(b) *Interpretive Commentary on Three-year Forecast:*

Cost Control:

Energy and Marketing and Cleaning Costs: The forecast shows a loss for the first year, due to the increase in costs of energy and marketing, and also the need to employ the guide and cleaning staff. The costs of FI subscription need to be reviewed to see if they could be reduced by developing a web presence for Walkers Lodge. The energy cost per person is highly significant and consideration needs to be given to rationing the showers to certain times or to charging for the washer/dryer facility. The solar panels should eventually reduce the costs of heating the house and the water in the next few years after 2016.

Cost of Guide: The guide(s) may need to be employed on a per-hour basis (i.e., that it behaves as a variable cost – say €50 per half-day of three hours walking and €100 for a full day's walking of six hours) and not be paid a flat fee for the month, as they may not get bookings for every day. The cleaning staff also should be charged on a per-hour basis and flexed to the occupancy of the guesthouse.

Rates and Profitability by Market Segment:

Discounted Packages: There is a need to examine the discounted prices on the packages as they are not sufficiently profitable. The rate charged for breakfast for non-residents could be raised say to €7 to provide some contribution towards the cost of the guide and the use of the meeting room free of charge.

Profitability of the Families and Children Segment: The rates seem to be insufficient for the cost of providing the service. Families should be charged something for children and a charge for afternoon tea should be bundled into the charge for breakfast, bringing it up to about €8 inclusive, especially for families who will wander around the farm and the walking trails, returning to the lounge in the afternoon, thus requiring some staff to be present during the day. The Summers need to review the profitability of the family guest segment.

Mid-week and Weekend Break Segments: The rates being charged for the packages seem low, given the service they have to provide to these guests. They should be kept under review to establish volume of bookings and whether in time, the price could be increased to compensate for extra service consumed by these guests.

Walkers – Individual and Groups: The groups of walkers are going to be out all day and perhaps some calculation of the cost of the guide (say €50 per half-day) should be done and a contribution requested at time of booking the groups. The bigger the group, the less the charge (to each person in the group) for the guide. Individual walkers would be required to pay a set contribution for the use of the guide. However the room rates for individual and groups of walkers should be the same, with no single supplement for twin rooms occupied by one person.

Additional Revenue Opportunities Through Adding Value:

Farm Walks, Education in Cheese-Making and Packed Lunches Using Farm Produce: The Summers might consider having farm walks and education classes in cheese-making for the children staying with their parents and they could charge for this. Also, packed lunches for walking groups could be profitable if the cost of preparing them is not too high and produce from the farm is used.

Commissions for Referrals to Local Restaurants: It might be possible to get commission from local restaurants for referrals for dinner in the evening.

(c) Management Accounting Templates That May be Useful:

A *costing sheet* for the cost of serving the guest segments showing the rates charged and the food cost and energy cost and other costs of serving per guest segment staying. This would help the Summers to see the *profitability* of the guest segments. This may need ABC analysis of the indirect costs. See suggested outline below.

Guest Segment Profitability Template

	Guest segment: Mid-week breaks	Guest segment: Weekend couples	Guest segment: Families	Guest segment: Single walkers	Guest segment: Groups of walkers	Non-resident sales segment: Morning briefing meetings for non-resident walkers	Cheese-making classes and other revenue streams
Revenue: rooms							
Revenue: breakfast							
Revenue: Packed lunches							
Revenue from cheese-making classes							
Other commission income – restaurant referrals							
Less: Costs							
Direct food							
Direct drink							
Booking engine commission							
Contribution margin							
Indirect costs: see diagram below for ABC analysis							
Light and heat							
Food and beverage overheads							

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Housekeeping costs							
Security and grounds							
Instructor costs							
Marketing costs							
Net profit per customer segment							

ABC DIAGRAM

ILLUSTRATING THE OVERHEAD ALLOCATION FROM COST CENTRES TO ACTIVITY CENTRES AND THEN ON TO THE GUEST SEGMENTS

COST CENTRES: MARKETING, ADMINISTRATION AND GENERAL AND OCCUPANCY

FIRST-STAGE COST DRIVERS

(e.g. time spent rate, estimated usage of resources) to charge overhead to



ACTIVITY CENTRES: CHECK IN/CHECK-OUT/ HOUSEKEEPING/ ROOMS/ FOOD AND BEVERAGE/ADMINISTRATION

SECOND-STAGE COST DRIVERS

(e.g., no. of bed/room nights, no. stays, no. covers, % revenue) to drive overhead from the activity centres to



GUEST SEGMENTS

An *analysis of the costs of marketing* by *digital* methods would help cut costs, since the mail-shot is too expensive. Using Twitter and other social media should be much less expensive. Also the Summers should try to be part of the Fáilte Ireland website special offers, to ensure that the special offers they offer at the Lodge are seen by overseas tourists and the domestic market.

[AU: Is Owner-Manager Learning Networks:

there some text missing from here?] Financial management research on small firms mentions that management decisions of owner-managers in small firms are based on a rationality, that is, they are grounded in the particular contextual environment in which they operate, and *entrepreneurial learning* is an important part of the process of change (for example using the templates suggested here). Some financial

management practices of OMs have been characterised as fire-fighting: dealing with problems as they arise on a day-to-day basis. Consideration of these OM practices over a prolonged period, however, would reveal that behaviour occurs in a more evolutionary fashion, with the role of critical events in small firms being important for determining the learning of OMs.

The losses forecasted for 2014 may force a re-think by the Summers of their strategy and make them consult Ted Toner for business advice (non-compliance services). Relationships between OMs and external advisors whether accountants, bank managers or other professionals are very important, especially in the early stage development of a business, reducing the isolation and self-dependency of the OM during the early years of trading. The embeddedness of the OM in *networks* involving advisors was concluded by research to be an important factor that influences financial management practices.

Ted Toner should encourage the Summers to join a network of local B&B owners and agritourism businesses to share experiences and learn through transfer of knowledge. Barriers to learning opportunities have been noted as one of the key reasons for early failure of small tourism businesses and specifically it led to the development of Tourism and Learning Networks (TLNs), because research had shown that cost efficiencies are not sufficient for small tourism businesses to survive, but these businesses must enter into co-operative bonds with their competition. These businesses must exploit the learning from these co-operative networks. Irish research has reported on the set-up of a TLN in order to cluster small tourism business owners and managers in the hopes of nurturing future collaborative activity and effective learning. Small business may struggle to find the type of training they want and lack the chance to take time out of the business to attend accredited courses, such as those provided by third-level institutes. Peer-to-peer contact on an individual basis is helpful in TLNs, where an OM, due to confidentiality or inhibition, presents difficulties within the learning sets in the TLN. Learning can be transferred between more progressive experienced operators within the TLN and those less experienced OM's whose business is not as well developed. There are some critical things that need to be present to make the TLN function effectively and they are: an efficient secretariat or administrative support, experienced facilitators with skills suited to the particular needs of the learning set, an active extranet or follow-up web community when the TLN meetings finish as well as facilitated local learning sets (comprising say 12 entrepreneurs meeting eight times a year) and the active involvement of local policy-making agencies.

Note: Students should summarise some recent research and continue the ideas from the “cut and paste exercise” but should also indicate some additional professional accountancy body *urls* to ensure Ted can quickly access more research as he needs it.

3. Memorandum to Ted Toner

Memo

To: Ted

From: E. G. Beaver, assistant accountant

Subject: Research into the Role of the Accountant in helping small owner-managed businesses with particular reference to the need to offer non-compliance services

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The reluctance of the owner-manager clients to seek external advice and support is because research found that OMs had a “fortress enterprise” mentality and tended to want to “go it alone”, rather than expose their problems to the outside world, as well as cost. The reasons for this were based on the psychology of the OMs, a need to “stand on their own two feet” and avoid showing weaknesses, and the opportunity cost and financial cost of taking on advice and the often held view that the quality of the advice that was available was irrelevant or poor. However, because of the absence of in-house expertise, there is an *a priori* case that SMEs require external support and advice. There has been a spectacular growth in the market for advice and support for small business, both from private and public sector agencies.

Recent Irish research (already discussed over coffee with you) that is very relevant in the area shows an overall satisfaction rating of 67%, with the services of accountants. However the main services availed of are compliance/statutory, with business advice, tax consultancy and financing advice being the top three non-compliance services. However, the lack of industry knowledge of the accountant was the factor that most weakened the satisfaction rating of the accountant in an advisory capacity (with only a 60% satisfaction rating).

Some interesting research from the ACCA website revealed that three general types of accountants emerged, based on the content of their advice.

The first and most numerous grouping among the respondents were the Strategists(39%), who believed that small OMs need to take a moment to make robust plans for the future and, more than other members, they tended to advise their clients to seek out opportunities as markets begin to recover, to invest and to explore niche or new markets. Alongside capital investment, they emphasise the value of retaining key people and developing their skills and they encourage small business clients to innovate and be as flexible as they can. The second type of accountant among the respondents were the Competitives (26%), who believed that the downturn offered a rare opportunity for smart businesses to build a strong competitive advantage. They advised on competitive pricing, achieved by cutting costs or building more efficient operations as well as on maintaining and improving quality and customer service. The Defenders (36%) tended to be accountants in the Western Europe region and typically advise their small business clients to be cautious, to prepare psychologically for tough years ahead and to focus on survival. They were advising clients to maintain strong cash flow, improve financial controls and reduce reliance on other organisations, including lenders. Defenders are also more likely to direct their small clients to government assistance agencies.

Finally, international research from IFAC on the role of SME Accountancy Practices (SMAPs) in providing business support to SME enterprises is very informative. There would appear to be three reasons why SMEs use accountants as business advisors (i.e., for non-compliance work) and these are competency, trust and proximity and responsiveness. Regarding competency, it was a demonstration of technical competency rather than a paper qualification. The evidence suggests that if the external accountant shows competency in compliance work, they are more likely to be asked by the OM to give non-compliance advice and support. The accountant will also be competing with other providers of these non-compliance services, like bank managers and MBA consultants. The larger accountancy practices also may have a lot of expertise in HRM, succession planning and marketing for small businesses and also actively innovate their range of services and then target these OMs as new clients. Secondly, trust in the relationship is a major reason why small businesses draw on their accountant for advice and finally, proximity of the local

accountant who can arrange face-to-face meetings with the OM places small local accountants (like our practice) in a stronger position than regional offices of larger accountancy practices. Also, small businesses know that the local accountant will respond speedily to their demands for help. This plays a critical role in maintaining the OM-accountant relationship.

To break into the market for non-compliance services to OMs, small accountancy practices need to market themselves and avoid the practice of waiting for referrals. They also need to change their education and training to encompass soft skills such as people management and communication abilities. The type of professional training we receive as accountants will enable our capabilities and hopefully widen them to encompass non-value-added services like valuations, due diligence, tax planning and advice, strategic business advice, computer audit/IT, Mergers and Acquisitions, Company Law and Pensions. A problem in the area would appear to be that some of this work tends to take a lot of time, but may be less lucrative financially than compliance advice services.

Summary of the Key Points from the Research:

The key points going forward to note is that *changing regulation* (such as the removal of the statutory audit) will drive the demand for non-compliance services and *growing competition from new providers* of such services and the *capability* of small accountancy practices to provide specialist services (compared to the larger firms). The *relationship* between the small accountancy practice and the OM is crucial. Our role will use *softer skills* to act as coach, mentor and advisor, working with our small tourism clients rather than being mere one-stop shops. We need to create space for discussion opportunities that can help us *unpack our client's thinking* and we must develop empathy with the OM to become an *effective coach*. We also should focus on a *specific sector*, like tourism, to allow us to develop specialisms in this area, like we would do for the music industry or the environmental waste industry. Our *accountancy bodies will also play a role in pointing out the future trends* that we need to be aware of and which will affect the way the profession will develop (see for example below some guidance regarding where to find useful and recent references). *Finally, we need to be part of a high-quality referral network*, where we are referred by other small practices and we also in turn, provide referrals to other firms. This means that between us as a *network of small local accountancy practices*, we can satisfy the emerging breadth of demands from small businesses in tourism and other sectors.

Where to find useful references from the professional accountancy bodies:

If you consult the CA Ireland, ICAEW, CIMA and ACCA websites, you will find a host of references on small businesses and on how local accountants can best serve their owner-manager clients in the area of non-compliance services.

CA Ireland Accountancy Resources:

Publications can be sourced and purchased online:

<https://www.charteredaccountants.ie/en/General/Shop/Publications1/>

Here are some useful resources for Accountancy Practices:

<https://www.charteredaccountants.ie/en/General/Shop/BooksListings/Practice-Management/>

ICAEW Resources:

Technical Library at ICAEW:

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<http://www.icaew.com/en/technical>

Resources on Financial Management:

<http://www.icaew.com/en/technical/business-and-financial-management>

<http://www.icaew.com/en/technical/business-and-financial-management/financial-management>

Also, here is an interesting set of articles on marketing our practice to our clients:

<http://www.icaew.com/en/library/subject-gateways/practice-management/marketing-your-practice>

Technical Library at ACCA:

<http://www.accaglobal.com/en/technical-activities/technical-library.html>

Finance transformation notions:

<http://www.accaglobal.com/en/research-insights/finance-transformation.html>

<http://www.accaglobal.com/en/technical-activities/technical-library/finance-transformation.html>

Research on small business:

<http://www.accaglobal.com/en/technical-activities/technical-library/small-business.html>

Technical Resources at CIMA:

For research on financial management systems in small firms:

<http://www.cimaglobal.com/en-gb/Thought-leadership/Research-topics/Management-and-financial-accounting/Barriers-and-catalysts-to-sound-financial-systems-in-small-sized-enterprises1/>

For ideas about management accounting techniques that are innovative:

<http://www.cimaglobal.com/en-gb/Thought-leadership/Research-topics/Management-and-financial-accounting/Dont-blame-the-tools-the-adoption-and-implementation-of-managerial-innovations/>

For ideas about adding value to businesses:

<http://www.cimaglobal.com/Employers/Supporting-growing-businesses/>

IFAC: SME Sector reports

<http://www.ifac.org/publications-resources?publication-type = &source = &issues = 43&language = 87&tag = &keyword = Search + Publications&x = 71&y = 14&sort = date>

I trust this is helpful. Please do not hesitate to contact me, should you have any questions.

Kind Regards,

E. Beaver.

APPENDIX I

Workings for Case*WI: Revenues: Non-resident breakfast sales***2014:** $20 \times \text{€}5 = \text{€}100$ **2015:** $30 \times \text{€}5 = \text{€}150$ **2016:** $50 \times \text{€}50 = \text{€}250$ *Guestnights at various rates*

Rate charged		Guestnights	Rooms Revenue	No. of children with families	Total no. of guests consuming food and energy costs
<u>FI rate</u>	No. of families				
2014	100 × 2 adults	200	200 × €55 = €11,000	200	400
2015	100 × 2 adults	200	200 × €55 = €11,000	200	400
2016	115 × 2 adults	230	200 × €55 = €11,000	230	460
<u>SI rate</u>	No. of walkers/ backpackers either on their own or in a group				
2014		10	10 × €35 = €350		10
2015		130	130 × €35 = €4,550		130
2016		80	80 × €35 = €2,800		80
<u>BI rate</u>	No. of business executives all assumed to be on their own				
2014		10	10 × €55 = €550		10
2015			N/A		
2016			N/A		
<u>WI rate</u>	No. of weekend couples				
2014		0	Nil × €200 = €0		0
2015		10	10 × €200 = €2,000		10
2016		10	10 × €200 = €2,000		10

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<u>W2 rate</u>	No of mid-week couples		
2014	10	10 × €250 = €2,500	10
2015	10	10 × €250 = €2,500	10
2016	30	30 × €250 = €7,500	30

W2: Energy costs

[AU: Edit
ok here?]

2014: Fixed costs: $2000 \times 90\% = €1,800$

Add: Variable costs $€2 \times 1.10 = 2.20$ per guest staying $\times x = 630 = €1,386$ Total Energy costs = €3,186

2015: $€1,800 + €2.20 \times x = 750 = €1,650 =$ Total €3,450

2016: $€1800 \times 1.10 = €1,980 + [€2.20 \times x = 810 = €1,782] =$ Total €3,762

W3: Marketing costs

2014: Advertising cost per half year = €2,000

2014: Half year of FI subscription:

$1500/2 = 750$

2014: € 2,750

2015: € 2,750

2016:

As per 2015 2,750

Add: 10% increase in FI sub:

$750 \times 10\% = 75$

Total cost €2,825

W4: Guide costs

2014: $400 \times 6 = €2,400$

2015: $450 \times 6 = €2,700$

2016: $470 \times 6 = €2,820$

W5: Cleaning costs:

2014: $€800 \times 6 = €4,800$

2015: $€800 \times 6 = €4,800$

2016: $€800 \times 6 = €4,800$