

ACCOUNTING AND FINANCIAL ANALYSIS IN THE HOSPITALITY INDUSTRY

INSTRUCTORS MANUAL

CHAPTER 1 INTRODUCTION TO NUMBERS, ACCOUNTING AND FINANCIAL ANALYSIS

Chapter Outline

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Answers to Review Questions

1. Name and describe the three main financial statement of a business. Include the characteristics of each financial statement.

The Profit & Loss Statement, The Balance Sheet, and the Statement of Cash Flows.

P&L Characteristics

1. It covers a specific time period, for example month, accounting period, year.
2. It reports the actual financial results for a business for the specific time period.
3. It compares the actual financial performance to other measures such as budget, the previous year, the previous month or previous accounting period.
4. It includes a Summary or Consolidated P&L statement and supporting Department P&L statements
5. A new P&L statement is started each month or accounting period and records information for the current month/accounting period and year to date (YTD).
6. Managers are expected to analyze or critique their monthly P&L Statements to explain variations – both positive and negative - from the budget or from the previous year.

Balance Sheet Characteristics

1. It measures the value or net worth of a company at a specific point in time.
2. The fundamental accounting equation describes the Balance Sheet
$$\text{Assets} = \text{Liabilities} + \text{Owner Equity}$$
3. It is made up of accounts organized by assets, liabilities, and owner equity.
4. These accounts are divided into current accounts under one year and long term accounts over one year.
5. Each account has a beginning balance, monthly activity, and an ending balance. The ending balance for one month becomes the beginning balance for the next month.
6. Operations managers are not expected to provide monthly Balance Sheet critiques.
7. Accounting managers balance monthly the accounts on the Balance Sheet

Statement of Cash Flows Characteristics

1. It involves the cash account of the Balance Sheet
2. It has beginning and ending balances.
3. It shows how money is used in the daily operations of the business.
4. It measures liquidity.
5. It is a fundamental component of working capital.
6. It reflects the increases and decreases in Balance Sheet accounts.
7. There are three classifications of Cash Flow:
 - Operating activities
 - Financial activities
 - Investment activities.

2. Define REVPAR and explain why it is so important as a revenue measurement for room revenues as well as total hotel financial performance.

REVPAR is an important measure of a hotel's ability to generate room revenue by measuring average rate and occupancy percentage in maximizing total room revenue. It is calculated in two ways, Total Room Revenue divided by Total Rooms, or Average Room Rate times Room Occupancy Percentage. REVPAR shows how well the hotel management is managing both average room rates and total rooms sold. It is important because room departments in a hotel have the highest department profit margins, are generally the largest revenue departments, and maximizing total room revenue will often have the greatest impact on maximizing total hotel profits.

3. Name and describe the four profit levels in a hotel.

Department Profit measures the profit generated by each individual revenue/profit department in the hotel.

Total Department Profits measure the total profitability of all the revenue/profit departments in the hotel.

House Profit/Gross Operating Profit measures the hotel profit remaining after the cost of expense centers have been deducted from Total Department Profits. It measures management's ability to manage all the hotel resources to maximize House Profit.

Net House Profit/Adjusted Gross Operating Profit measures the total hotels financial performance after fixed expenses are deducted from House Profit.

***Profit After Taxes** measures the remaining profit after all expenses and taxes have been paid. It is often distributed between the owners, management companies, franchise companies, or any other organizations that have a financial interest in the hotel.

4. What is the difference between capitalization and working capital? What is each used for in business operations?

Capitalization involves the start up, expansion or renovation of a business and generally involves the long term assets, long term liabilities and owner equity accounts.

Working Capital involves the day-to-day operations of a company and generally involves the short term asset and short term liability accounts. It includes revenues and the managing of daily cash flows in the business.

5. Why is understanding accounting concepts and methods of financial analysis important to a hospitality manager?

Accounting Concepts form the foundation for working with numbers in measuring financial performance. They are rules, policies and procedures that ensure that the numbers are prepared and presented accurately for anyone that reads or uses financial reports.

Methods of Financial Analysis are ways to use the financial numbers produced by operations to evaluate the success or lack of success of the business. It involves analyzing and comparing numbers to guidelines such as the budget or last years actual

performance. Financial analysis brings the numbers to life in describing the results of business operations.

6. What are the three key measurements of the performance of a business?

Associates - Customers - Financial Performance (profitability and cash flow).

7. Why is the P&L Statement the most important financial statement for a hospitality manager to understand?

The P&L Statement is the most important financial statement for operations managers to know and understand because these managers work with and can affect revenues and they can control and manage most costs associated with operations. Their daily activities in operating the business produce the numbers reported on the P&L. They need to understand how the numbers resulted, how to analyze the numbers, and how to make improvement to operations as a result of what the numbers tell them about hotel operations.

8. What are the formulas for?

Room revenue	Room rate x rooms sold
Occupancy %	Rooms sold / total rooms
RevPAR	Room Revenue / total rooms
Profits	Revenues - expenses
Retention/Flow through	Change in profit \$ / change in revenue \$

Practice Exercises

1. Match the following types of accounts to their balance sheet classification:

<u>B</u> Accounts Payable	A. Current Asset
<u>A</u> Cash	B. Current Liability
<u>C</u> Equipment	C. Long-Term Asset
<u>A</u> Inventory	D. Long-Term Liability
<u>D</u> Bank Loan	E. Owner Equity
<u>A</u> Accounts Receivable	
<u>E</u> Retained Earnings	
<u>B</u> Taxes Payable	
<u>E</u> Initial Capital Accounts	
<u>E</u> Common Stock	

2. Match these equations

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|---|---------------------------|
| <u>B</u> Revenues - Expenses | A. Working Capital |
| <u>A</u> Current Assets – Current Liabilities | B. Profit Formula |
| <u>F</u> Revenues - Cost of Sales, Wages, Benefits,
and Operating Expenses | C. RevPAR |
| <u>D</u> Wage Cost / Revenues | D. Cost Percent |
| <u>G</u> Profit Dollars / Revenue Dollars | E. Retention/Flow-through |
| <u>C</u> Room Revenues / Total Rooms | F. Department Profit |
| <u>E</u> Change in Profit Dollars / Change in Revenue Dollars | G. Profit percent |

3. Match the financial statement with the description

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|--|----------------------------|
| <u>B</u> Has opening and ending balances | A. P&L |
| <u>B</u> Is the same as an A&L Statement | B. Balance Sheet |
| <u>A</u> Closes out accounts at the end of an accounting cycle | C. Statement of Cash Flows |
| <u>C</u> Is the same as a Source and Use of Funds Statement | |
| <u>A</u> Is the same as an Income Statement | |
| <u>B</u> Shows the value or net worth of a company | |
| <u>A</u> Measures the operating success of a company | |
| <u>C</u> Shows the liquidity of a company | |

Answers to chapter questions on the J.W. Marriott Desert Ridge

1. Group is the largest market segment because of the size of the resort, the large amount of meeting space, and all the different food and beverage and recreational opportunities.
2. The rooms department generates the most revenues because of the large number of rooms and the high average room rate. The banquet department also generates significant revenues because of the large amount of indoor and outdoor meeting space. The restaurant operations in a resort can also generate high revenues because of the many specialty restaurants typical of resorts. For example a steak house, Chinese restaurant, Italian restaurant, golf club restaurant, pool bar, etc.
3. The departments with the highest profits will generally be:
First – Rooms because of high profit margins and average room rates
Second – Banquets because of large amount of meeting space, high average checks, and other revenue generators such as meeting rooms and A/V
Third – Beverage because of low cost of sales and low labor costs
Fourth – Spa and Golf because of relatively high treatment revenues and greens fees
Fifth – Restaurants are generally the lowest because of high food and labor costs