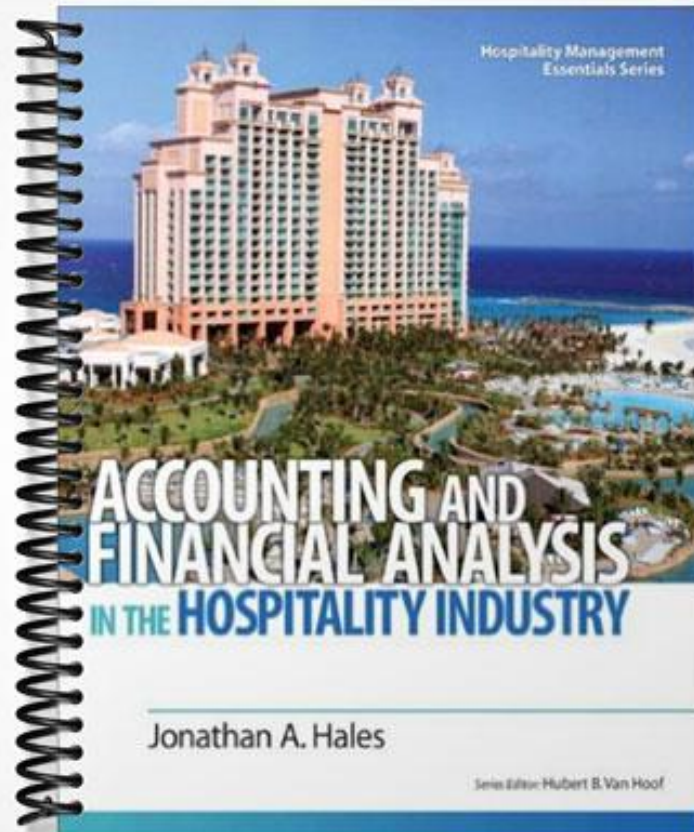


# SOLUTIONS MANUAL



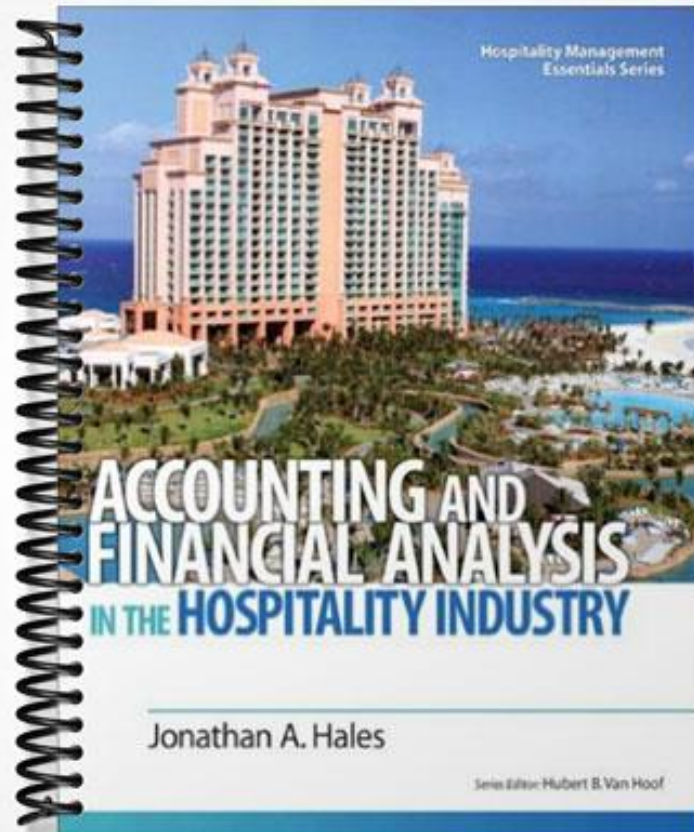
Hospitality Management  
Essentials Series

## ACCOUNTING AND FINANCIAL ANALYSIS IN THE HOSPITALITY INDUSTRY

Jonathan A. Hales

Series Editor: Hubert B. Van Hoof

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**Online Instructor's Manual**  
*to accompany*

# **Accounting and Financial Analysis in the Hospitality Industry**

**Jonathan Hales**  
*Northern Arizona University*

Prentice Hall

Boston Columbus Indianapolis New York San Francisco Upper Saddle River

Amsterdam Cape Town Dubai London Madrid Milan Munich Paris Montreal Toronto

Delhi Mexico City Sao Paulo Sydney Hong Kong Seoul Singapore Taipei Tokyo



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# INTRODUCTION

The purpose of this accounting textbook is to teach accounting to hospitality students in a way that they will understand accounting and be able to use it in their hospitality careers. Traditional accounting courses assume students want to learn the details and complexities of accounting rules and regulations, how to prepare accounting reports and financial statements, and that students understand the accounting language. They teach accounting courses as if all of their students are accounting majors and will take numerous accounting courses.

Nothing can be further from the truth. Hospitality students want to be hospitality managers with careers in rooms, food and beverage, sales, human resources as well as most other areas of hospitality operations...except accounting! Hospitality students often just hope to survive their accounting classes and hope that minimal damage will be done to their GPA's. Typically they have not done well in introductory accounting classes, often have difficulty understanding and working with numbers especially in an accounting context, generally fear the class or have high anxieties about the class, and in general, have a negative approach or perspective in taking accounting classes.

This accounting textbook approaches accounting in a fundamental way emphasizing what hospitality students have already learned about math and numbers and how basic applying accounting to hospitality operations can be. The only math required is addition, subtraction, multiplication and division. Emphasizing positive aspects of accounting including its value in their career advancement, emphasizing understanding and analyzing accounting statement rather than preparing them, and using real hospitality industry examples can go a long way in building both student confidence and interest.

Therefore this accounting textbook *focuses on the fundamentals of accounting and financial analysis* and how hospitality students use numbers contained in management reports and financial statements in operating their departments. The book is written in English and not accounting. It focuses on using not preparing financial reports. It covers how accounting is used in the daily operations of hotels and restaurants. Directors of Finance from Four Seasons, Hyatt and Marriott have graciously reviewed the material in this textbook to ensure that it is current and correctly presents how accounting is used and applied in actual hospitality operations.

There are several key points and concepts that are used throughout the book and form the framework for the material presented. They are:

1. *There are two main uses of accounting and financial reports in hospitality operations. They are **to measure financial performance and to be used as a management tool.***
2. *The three key measurements of the success of any business are **employee satisfaction, customer satisfaction, and financial profitability and cash flow.***



*This book focuses on the financial aspect of these measurements but it is important to understand that all three of these work together. A problem with one will lead to a problem in all three. That is why it is important to understand accounting.*

3. *It is important to understand how accounting and finance fit into business operations. **The Financial Management Cycle** explains this:
  - A. **Operations produce** the numbers
  - B. **Accounting prepares** the numbers
  - C. **Both operations and accounting analyze** the numbers
  - D. **Operations apply** the numbers back to operations to grow and improve*
4. *The **Career Success Model** shows the important knowledge and skills that any successful manager will need to possess to advance to greater responsibilities and senior management. Accounting courses offer the knowledge to understand and apply numbers to operations.*

*HIGH PERFORMANCE  
ORGANIZATIONS*

*MARKETING KNOWLEDGE  
ACCOUNTING AND FINANCE KNOWLEDGE  
MANAGEMENT AND LEADERSHIP SKILLS  
TECHNICAL SKILLS*

5. ***It's the P&L Baby!!!** Any manager in business will be required to work with P&L Statements...in general terms with a Summary or Consolidated P&L and in very specific terms with their Department P&L. It is essential that hospitality managers understand and are comfortable working with numbers and the financial statements that will help them run their departments. The Balance Sheet and Statement of Cash Flows are important but are primarily taken care of by the Accounting Department.*
6. ***Accounting Concepts and Methods of Financial Analysis** are the terms that describe the important information to know and understand. The accounting concepts will form the foundation of how numbers are organized and used in management reports and financial statements - an accounting process. Financial analysis is how analysis and application are applied to accounting reports and financial statements to give them meaning - a management process.*
7. *This book tries to provide the most current and specific accounting information available, without compromising confidential and proprietary information. Therefore actual reports used in major hospitality companies are presented in this textbook. This should be very helpful to hospitality students to see actual rather than theoretical accounting examples courtesy of **Four Seasons, Hyatt, Host Marriott, Marriott International, and Omni hotel companies** as well as **Red Lobster Restaurants**.*

# ABOUT THE AUTHOR

*Jonathan A. Hales has been associated with the hospitality industry since 1972 with 23 years working in the industry for Marriott International and 15 years teaching in the School of Hotel and Restaurant Management at Northern Arizona University. In an effort to keep current with the hospitality industry growth and development, he has completed many faculty internships with companies in the hospitality industry including:*

*Summer 2005 Marriott International*

*Summer 2003 Hyatt Hotels*

*Summer 2003 Red Lobster Restaurants*

*Summer 2002 Four Seasons Hotels*

*Summer 2001 Omni Hotels*

*Professor Hales began his hospitality career in 1972 as an Assistant Controller Trainee for Marriott International at the Twin Bridges Marriott in Washington D.C. After completing his accounting training, he went on to be Assistant Controller at the 1,000 room New Orleans Marriott, the 350 room Camelback Inn in Scottsdale, Arizona, and at the 800 room Philadelphia Marriott. New Orleans and Philadelphia were large convention hotels while Camelback Inn is a resort.*

*His first Controller position was at the 428 room St. Louis Airport Marriott. In August of 1978, he was promoted to the opening Controller of Marriott's Rancho Las Palmas Resort in Palm Springs, California. This 340 room resort was the first resort built by Marriott and included management of Rancho Las Palmas Country Club and its 27 hole golf course, 25 tennis courts, and the Clubs food and beverage operations for 860 condominium owners.*

*After completing Marriott's Executive Training Program, Professor Hales was assigned as Resident Manager for the 400 room Houston Greenspoint Marriott in 1983 and moved up to be the Resident Manager of the 778 room Miami Airport Marriott in 1985. Resident Manager responsibilities included Front Office, Housekeeping, Gift Shop, Security and in Miami, the Tennis Club operations.*

*In 1989 he was named General Manager of the 310 room Tampa Westshore Marriott and returned in 1990 as General Manager of Miami Airport Marriott. During his tenure as General Manager, Professor Hales was on the board of the Hillsborough County Hotel and Motel Association, a member of the Greater Miami Hotel and Motel Association, Chairman of the Marriott Business Council of Miami in 1994, winner of the first annual Alice S. Marriott Community Service Award in 1992 at Miami Airport, and recipient of the Chairman's Award of Excellence for his leadership of the Miami Airport Marriott after Hurricane Andrew in August 1992. In the summer of 1995, the Miami Airport Marriott converted 284 rooms into a Fairfield Inn and 128 rooms into a Courtyard becoming one of the first multi-brand Marriott Properties.*



*In the summer of 1995, Professor Hales relocated to Northern Arizona University in Flagstaff, Arizona as a Marriott Executive on Loan. After 25 years with Marriott, he retired in 1997 to become a faculty member of the School of Hotel and Restaurant Management at Northern Arizona University.*

*Professor Hales has been the Intern Coordinator and Director of Native American Programs for the School of Hotel and Restaurant Management. Currently he is an Associate Professor teaching Hospitality Accounting, Hospitality Corporate Finance, Resort Management and Senior Seminar.*

*He received his BA in Economics and a Certificate in International Relations from the University of Utah, an MBA from Arizona State University, a Masters in Education Leadership at Northern Arizona University, and a Doctorate in Education Leadership at Northern Arizona University. He studied one year in the MBA program at the Darden School of Management at the University of Virginia. After receiving his MBA, Professor Hales spent two years as a Financial Analyst for Motorola Semiconductor Products Division in Phoenix, Arizona and Austin, Texas before returning to Marriott as Assistant Controller in Philadelphia in 1975.*

# ***TEACHING EFFECTIVE ACCOUNTING FOR HOSPITALITY MAJORS***

***Jonathan A. Hales, MBA, EdD***

## **INTRODUCTION AND PREVIOUS LITERATURE**

Most hospitality programs in the United States include several accounting and finance courses in their curriculum. While these accounting classes are important and provide knowledge and skills that every hospitality manager will need, students are generally afraid of, have high anxiety levels, do not like, and do not do well in these classes. Often the result is that they just try and survive the class and do not try to understand and learn the accounting and finance concepts presented in the class that will help them in their hospitality careers.

*Understanding fundamental accounting concepts and methods of financial analysis* are important skills for graduating students to possess as they begin their hospitality careers. They should possess a solid foundation of accounting knowledge and concepts as well as fundamentals of financial analysis that will enable them to quickly learn, understand, and apply the accounting policies and procedures of the hospitality company that they work for. It will often mean the difference between steady career advancement and no advancement at all. The following information discusses the problems and challenges of organizing and structuring accounting classes to be more effective and offers a process that will overcome these problems and result in a more effective class structure and learning environment.

## **WHY CURRENT ACCOUNTING CLASSES ARE NOT AS EFFECTIVE AS THEY NEED TO BE**

There are several reasons why traditional hospitality accounting courses are not as effective as they could be in teaching college students the important concepts and principles of accounting and finance that they will need to know and use in their careers.

- 1. Traditional accounting classes and textbooks teach to potential accountants, not potential hospitality managers.** The textbooks not only present the basics, but also go into great detail about accounting theory and preparing endless spreadsheets that are important for accountants but not useful for hospitality majors. This ends up confusing and frustrating students and being one more thing that they don't understand. The application of accounting concepts to daily hospitality operations is far more beneficial to hospitality majors.
- 2. The accounting material presented is too complicated and often confusing because it includes too much detail about accounting procedures and**

- information that is only used by accountants.** Problems and case studies get more complex and deal with unusual (but possible) accounting situations. Most of these are far beyond the understanding of hospitality managers and these examples and situations presented will never be used by them in the daily operations of their departments. Problems and case studies should present current material, examples and situations that managers will encounter in daily business operations such as food and wage cost critiques and forecasting and budgeting. Repetition of these kinds of problems will be a great benefit to hospitality managers because they will be encountering these problems in daily operations. Managers will be expected to identify and understand problems and to be able to effectively deal with them.
3. **Typical accounting textbooks are too long, too expensive and too theoretical.** They are usually over 500 pages and often the extensive material will confuse students and result in “information overload” and frustrated students. The real problem is that the accounting material presented in the first part of these chapters is important and could form a solid understanding of accounting concepts and operations. Unfortunately, the chapters then go on and on with more details and complexity that often go beyond what the student needs to understand. Students often get confused and the good done in the first part of the chapter is undone or negated by the complicated and theoretical material presented at the end of the chapter.
  4. **Hospitality students are afraid of accounting classes, don’t like them, are intimidated by them and don’t do well in them.** “Taking a final exam in a math or accounting ranked highest on the anxiety scale. Studying for a math or accounting test ranked second.” Ward and March, p.61 (2002). Student’s approach is to stay awake, survive, and not do too much damage to their GPA. If the organization of the accounting material is fundamental and applicable to their jobs as a hospitality manager, students will then be more open, positive and involved in the class.

## **THE FOCUS FOR AN EFFECTIVE ACCOUNTING CLASS**

It is important to remember that accounting classes are a part of the core curriculum for hospitality managers. These students will graduate with a degree in Hospitality or Hotel and Restaurant Management, not with a degree in Accounting. Therefore, the accounting classes should be viewed as a core course leading to a Hospitality degree, not a core course leading to an Accounting degree. Students need to have a fundamental understanding of using numbers in operating their departments and analyzing their financial statements. An accounting class should present and focus on the following important goals:

1. The class should provide students a solid foundation of fundamental accounting concepts and methods of financial analysis.
2. Students should understand numbers and be able to use numbers in helping them perform their managerial job responsibilities more effectively.
3. Students should understand that using financial analysis in evaluating business operations involves basic arithmetic and fundamental formulas and need not be complicated and overwhelming.
4. Students should understand that numbers resulting from operations are used as a management tool and a means to evaluate financial performance. This includes an understanding of other financial measurement in addition to profits. “Students must be brought to an understanding of the larger picture – the value of the enterprise, measured in cash flows, against the value of firms in the same sector, as well as in comparison to alternative investments.” Beals, p. 76 (2001).
5. Students should be able to apply these concepts and methods in managing their operations, reviewing financial performance and evaluating financial statements.

## **A TEACHING PLAN FOR HOSPITALITY ACCOUNTING AND FINANCE**

A successful curriculum for a hospitality accounting class should include several changes from traditional approaches. These are basic yet very important changes. They are 1) to teach a smaller amount of accounting topics, 2) to teach them thoroughly and clearly, 3) to demonstrate the application of these concepts to current business operations, 4) to establish a solid foundation of accounting and finance knowledge. The accounting and financial material presented should be the concepts students *must know and be able to use* to be a successful hospitality manager. Following are six elements that could be beneficial in designing the course material:

- 1. Eliminate the fear of accounting and working with numbers.**
- 2. Focus on the fundamentals emphasizing arithmetic and basic formulas.**
- 3. Emphasis that accounting concepts and methods of financial analysis go hand in hand.**
- 4. The Financial Management Cycle**
- 5. The Career Success Model**
- 6. The Importance of having a complete understanding of the Profit and Loss Statement (P&L).**
- 7. The importance of understanding other key financial measurements such as cash flow, return on equity, and economic value.**

**1. Eliminate the fear of accounting and working with numbers!** This is so important in creating a positive and open mind set for the students. The instructor should give student’s constant encouragement that they will be able to learn and use accounting information. “Students have confirmed the impact that teachers have on quantitative performance.” Ward and March, p.63. Examples and problems that focus on the basics of

accounting will also build student confidence. The class can then progress to more detail or complexity once the basic understanding is in place.

**2. Focus on the fundamentals emphasizing arithmetic and basic formulas.** The sooner students understand and use basic arithmetic in analyzing business operations, the sooner they will be comfortable and confident in learning fundamental accounting concepts. After all, average room rates are calculated by dividing room revenue by rooms sold. Occupancy percent is calculated by dividing rooms sold by total rooms. Food cost and wage cost percentages are calculated by dividing food expenses by food sales and wage expenses by food sales. Basic arithmetic! REVPAR, probably the most important statistic in maximizing room revenues is calculated by multiplying average room rate by occupancy percentage. Again, basic arithmetic!

**3. Accounting concepts and methods of financial analysis go hand in hand.** This means that an understanding of fundamental accounting concepts is necessary to be able to use and understand methods of financial analysis. Hospitality managers need to understand accounting to be able to use and apply the information in operating their business. The **first step is understanding** accounting concepts and the **second step is applying** methods of financial analysis in evaluating current business operations.

**4. The Financial Management Cycle.** It is important to understand this concept that demonstrates how numbers and accounting are generated and used in business operations. This concept deals with the flow and use of numbers in business operations.

**First, Operations produce the numbers.** All the activities involved in the daily operations of a business produce the numbers that measure performance. In a hotel, the daily operations provide products and services to guests including the rooms department, food and beverage outlets, gift shop and other departments that involve a sales transaction with the guest. Numbers used in financial analysis have to come from somewhere and that is the daily operations of the business.

**Second, Accounting prepares the numbers and provides financial reports and statements.** At the end of the day, week, or month, all operations and activities are collected, summarized and reported in financial reports prepared by the accounting department. These reports describe the business operations and activities and are distributed to the appropriate managers for their review and use.

**Third, Accounting and Operations analyze the numbers.** Operations management and accounting management work together to review and analyze the reports. They look for changes, the cause of the change, and the result of the change to understand operations and determine ways to correct and improve them. Together they have operational and financial analysis experience and can identify the changes or improvements that need to be made to ensure that productive operations continue.

**Fourth, Operations applies the numbers back to the business.** After reviews and discussions, it is the operations managers that make any necessary changes to

operations to correct or improve them. The ability to analyze quickly and accurately and then to make any necessary changes is an important part of any business operation. It enables the business to constantly improve by being more productive, creating more value in the products and services that they provide, or identifying new processes and procedures.

## **5. The Career Success Model**

There are certain skills and abilities that are required for any manager to have that result in a successful business career. Stephen R. Covey talks about three of these in his book The Seven Habits of Highly Effective People, (1989) Covey defines skill as “how to do”, knowledge as “what to do” and attitude as “want to do.” p. 47 The use of these three abilities determines how successful a manager can be.

The Career Success Model (Exhibit 1) identifies four individual skills and one organizational skill that are very helpful in enabling managers to successfully manage departments or businesses and advance with a company. It is very important that managers continue to grow and to learn, and this includes expanding their knowledge to new and challenging areas that will broaden their skills and abilities.

### **Technical Skills**

These are the day to day operational skills and knowledge required to get a specific job done and to operate a specific department. Entry level managers in the hospitality industry will start out as Assistant Desk Managers, Assistant Housekeeping Managers, Assistant Restaurant Managers and so forth. The job description defines what they are expected to know and to be able to do to accomplish all the required tasks and responsibilities necessary in operating their department. New managers spend the first year learning and doing. That should be their focus – to learn all the aspects of their job. This includes knowing and being able to perform the jobs of all the employees that report to them. For example, Assistant Desk Managers will be checking guests in and out, managing room inventories, handling group business, staffing the concierge level, running fronts for the bellman etc. Assistant Restaurant Managers will be seating customers, bussing tables, and expediting food orders. Understanding these technical aspects of daily operations is essential to the department’s success and to establishing a solid foundation for personal career growth for the manager.

### **Management/Leadership Skills**

The first promotion provides a manager with more opportunities to manage others in getting the job done. The additional knowledge and skills needed include working with other managers as well as hourly employees. This step involves the progression



from managing – we manage things, to leading – we lead people Covey, (1989). A manager is now paid to get other people to do the job. This includes the typical management responsibilities of planning and control but has now progressed to the leadership responsibilities of motivating, challenging, engaging, supporting and recognizing employees. The real definition of a leader is the ability to teach and inspire the people they work with that will result in higher job performance and higher job satisfaction.

Leaders also have the responsibility to allocate company resources. This includes allocating time, money, labor and ideas to the most productive or profitable projects and departments. They do this by listening to employees and customers and then prioritizing projects or job responsibilities, and then supporting them with sufficient resources.

What does this have to do with accounting and finance? *Everything! Specifically, the more knowledgeable and comfortable that a manager is in working with numbers and completing the accounting and financial analysis part of their job, the more time they will have to spend with their customers and employees – their top priorities!*

Unfortunately, the careers of many managers slow down or stop at this point. They do not have the interest, knowledge, or ability to learn the next skills that will help them to do a better and more complete job, and to advance taking on more and wider areas of responsibility. It is just not enough to have management/leadership and technical skills to advance to higher positions within a company. These positions require the knowledge and ability to understand accounting and marketing concepts in the daily operations of their company.

### **Financial Skills**

Financial knowledge and skills begin with 1) understanding numbers, 2) having the ability to communicate or teach what the numbers mean, and 3) having the ability to apply what is learned from numbers to improve the operations of the business. Specifically, it is the ability to interpret and discuss the information contained in financial reports with all levels of management. A manager must be as comfortable talking about the financial aspects of their department as the operational aspects of their department with the hotel controller, general manager, or regional managers. Explaining revenues, profits, and expenses, comparing actual results to budgets and forecasts, and making recommendations and adjustments to improve operations are all important financial skills for any manager to possess.

It is important to understand that every hospitality manager must have a fundamental understanding of accounting and finance to grow and advance within a company. They do not have to be Certified Public Accountants or Directors of Finance. But they must be able to intelligently discuss both the operational and financial performance of their departments with them and senior management. This should be the primary objective of a Hospitality Accounting class at the college level – teach hospitality students to understand, analyze and communicate financial performance.

## **Marketing Skills**

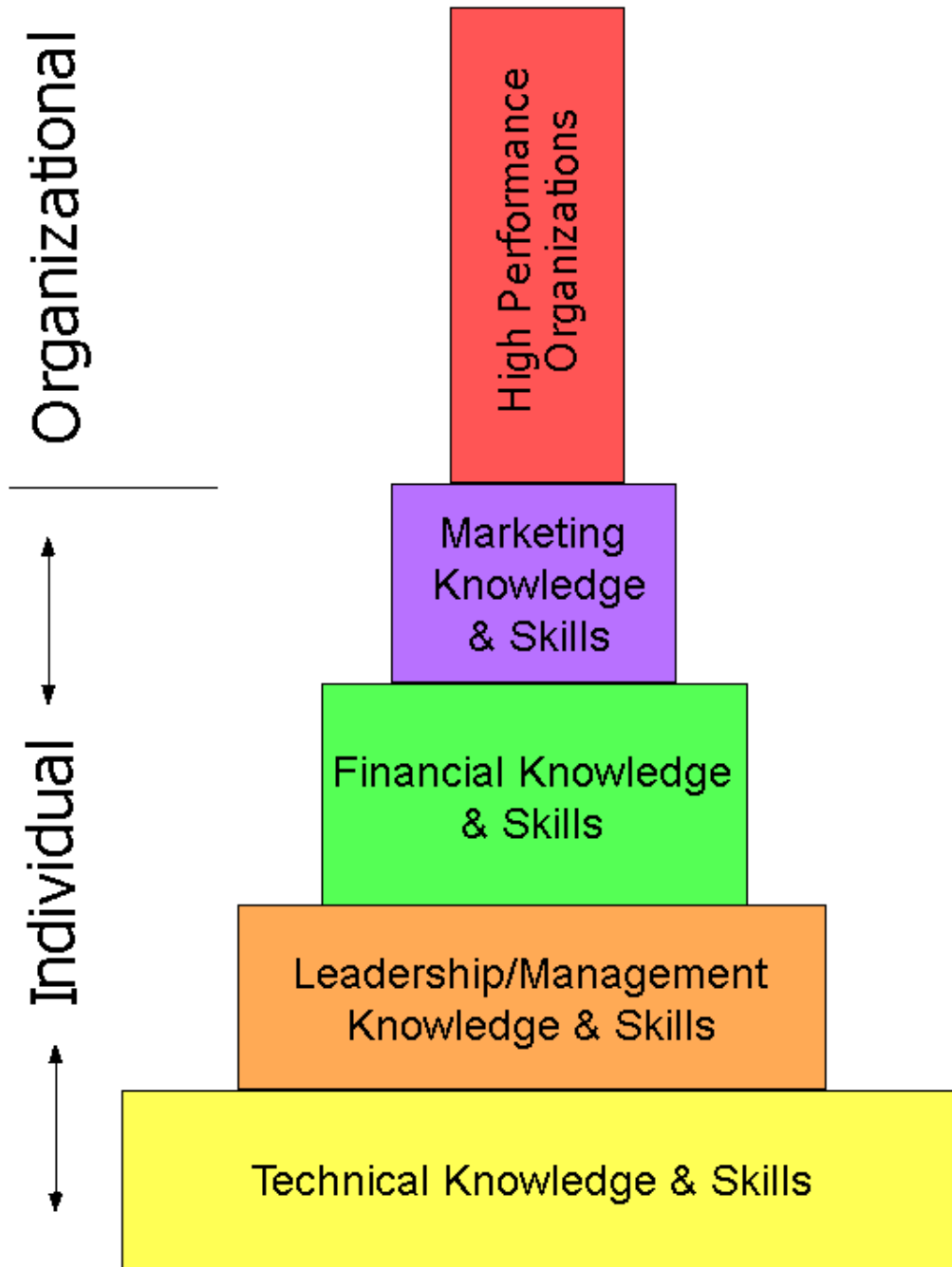
The next step in the Career Success Model is developing Sales and Marketing knowledge and skills which begin by identifying and understanding customers and their expectations. What does a hotel or restaurant do to develop and maintain a competitive advantage over its competitors? Why does a customer choose to stay in a particular hotel or eat in a particular restaurant? The Marketing Department is responsible for identifying customer preferences, expectations, buying patterns, and behavior patterns. This customer information is then classified into different market segments. A hotel or restaurant identifies which market segments that it wants to and can successfully compete in by meeting customer expectations.

Each of these market segments are defined by specific customer expectations and behavior patterns. For a manager to continue to advance, they must understand the marketing of their hotel or restaurant. What are the strengths and competitive advantages of a property? What are the expectations and preferences of your customers? A manager must be able to discuss their customers with the Director of Sales or Marketing and understand the marketing plan and positioning of their hotel or restaurant.

*When a manager is knowledgeable and comfortable with these four individual skills, they have the potential to be a part of a “high performance organization.” A manager with strong individual skills and knowledge, and with a positive attitude can then create or be a part of an organization that not only meets but exceeds the expectations and goals it has established.*

## **HIGH PERFORMANCE ORGANIZATIONS**

It is the ultimate goal of any hotel or restaurant or department within a hotel or restaurant, to achieve outstanding financial results and performance. This requires a team effort by all involved in the operation. The greater the degree of knowledge and skill in these four areas, the greater the contribution a manager can make to the performance of his team or department. Only when a manager can translate excellence of individual performance into excellence of team performance, can they truly excel and achieve outstanding performance.



## **CAREER SUCCESS MODEL**

The Career Success Model outlines the knowledge, skills and abilities that are required to be successful in business and to advance to senior management positions. The goal of a Hospitality Accounting class should be to provide students with the accounting and financial knowledge, skills and abilities necessary to be successful in the careers that they choose.

**6. The importance of having a complete understanding of the Profit and Loss Statement (P&L).** Of the three main financial statements – Profit and Loss Statement, Balance Sheet, and Statement of Cash Flows – the P&L Statement is the one that hospitality managers will be required to work with in operating their departments. Their daily activities and decisions in operating their departments will impact the results contained in their Department P&L. Therefore, they must have a solid understanding of the relationship of department operations to Profit and Loss Statements.

Following is a list of knowledge and skills that a hospitality manager will be expected to understand and use in their hospitality career.

1. A thorough knowledge of Department and Consolidated P&L Statements
  - A. the information required to prepare a P&L Statement
  - B. the P&L format that presents the financial information
  - C. the ability to analyze and critique a P&L Statement
  - D. the ability to understand productivities and profit margins
2. A working knowledge of financial and productivity management reports
  - A. Daily Revenue Report
  - B. Labor scheduling and productivity reports
3. A working knowledge of forecasting
  - A. Weekly and monthly revenue forecasts
  - B. Weekly wage schedules
4. Purchasing, inventories, and accruals

The P&L Statement is the main financial report that hospitality managers will be expected to use and understand in the daily operations of their departments. The actions that they take, the tools that they use and the decisions that they make will all show up at the end of the month in the financial results contained in their Department P&L Statement. These will also be recorded on the Consolidated P&L. Managers need to understand how their daily actions and decisions impact both P&L Statements and be able to analyze and critique them to explain how the numbers were produced and what they mean.

It might be useful at this time to review the four steps in the Financial Management Cycle and understand that the daily operations of a department or business produce the numbers reported in financial documents. This is the first step in the Financial Management Cycle. Managers must then be able to understand and analyze these numbers, the third step, and to make any necessary changes or improvements to their operations, the fourth step.

The Balance Sheet and Statement of Cash Flows are also important financial reports to understand when evaluating the operational and financial performance of a business. However, these reports are mainly used by the accounting managers in the performance

of their job responsibilities. Accountants are expected to understand and analyze what these reports mean and make the necessary changes or improvements. Rarely does an operations manager get involved with the analysis of these reports.

**8. The importance of understanding other key financial measurements such as cash flow, return on equity and economic value.** These accounting concepts are also very important in successfully operating and analyzing business operations. A positive cash flow and liquidity are essential to maintain daily operations. A business is expected to generate sufficient operating revenues to pay operating expenses. “The truly conscientious instructor should begin the process of orienting the student to the financial realities of the hospitality industry from the very first financial accounting course. Teach not only the operating cycle and the elegance of the matching principle, but also the cash-to-cash cycle. Introduce capital flows and differentiate them from operating flows from the beginning, instead of leaving them for the end of the course.”

Beals, p.76. These additional financial concepts should be a natural extension of understanding P&L Statements. Because they are an important financial component of evaluating business operations, they should be included in a hospitality accounting class.

Understanding the basic accounting concepts of return on owner equity and return on investment are essential if students are to learn and be able to use accounting concepts and measurements that are actually used in the hospitality industry. Teaching should go beyond the mere calculating of ratios to understanding the business and financial concept behind them and why they are so important in understanding and evaluating business operations.

## *SUMMARY*

Traditional hospitality accounting classes generally do not connect with hospitality students. This is because the focus of the course is on presenting accounting information for accountants not hospitality students. This is a major problem because hospitality students need to know, understand and be able to use accounting information and financial analysis in performing their jobs and operating their departments. Hospitality Accounting course content should therefore focus on the important fundamental accounting concepts and not focus on complicated accounting procedures used by accountants. Those details and procedures are rarely used by hospitality managers in department operations. This information more often confuses or discourages or students.

Part of the process of designing a balanced accounting course is to build confidence in the students in their ability to be able to understand and use accounting as a hospitality manager. The first step is to realize that most of the accounting that they will be using involves fundamental arithmetic and not complicated formulas, college algebra, or complex accounting. To create a strong foundation of accounting knowledge, the focus should be on accounting fundamentals and how they are applied to successfully and profitably operating a hospitality operation.

Some or all of the following concepts can help to make a hospitality accounting class more effective and understandable for the students. 1) Eliminate student's fear of accounting and working with numbers, 2) Focus on accounting fundamentals emphasizing arithmetic and key formulas, 3) Understand that accounting concepts and methods of financial analysis go hand in hand, 4) Introduce the Financial Management Cycle, 5) Explain the Career Success Model, 6) Spend the most time on the P&L Statement, the financial report that they need to know and understand as hospitality managers, 7) Present and discuss other key financial measurements of business operations such as cash flow, return on equity, and economic value.

There are three reasons to focus on accounting fundamentals. **First**, this will create a strong accounting foundation for the student and enable them to learn and to grow into more detailed or complicated accounting and financial analysis. **Second**, students will not be able to understand and use the more detailed and complicated accounting if they do not understand the fundamentals. **Third**, confidence is an important ingredient in learning, and by starting off with the key fundamentals, the student can build the confidence necessary to expand their accounting knowledge and progress to other useful methods of financial analysis that will enable them to be more effective and successful as a hospitality manager.



# ACCOUNTING AND FINANCIAL ANALYSIS IN THE HOSPITALITY INDUSTRY

## INSTRUCTORS MANUAL

### CHAPTER 1 INTRODUCTION TO NUMBERS, ACCOUNTING AND FINANCIAL ANALYSIS

#### Chapter Outline

- Introduction
- Numbers – the lifeblood of business
  - Definitions and Formulas
  - Customers, Associates, and Profitability
- Career Success Model
  - Technical Skills
  - Management/Leadership Skills
  - Financial Skills
  - Marketing Skills
  - High Performance Organizations
- Financial Statements
  - The Profit & Loss Statement
  - The Balance Sheet
  - The Statement of Cash Flows
  - The Statement of Stockholders Equity
- Revenues – The Beginning of Financial Performance
  - Formulas
  - Market Segments
  - The Customer
- Profit – The Ultimate Measure of Financial Performance
  - Department Profit
  - House Profit
  - Net House Profit
  - Profit before and after taxes
- Summary
- Hospitality Manager Take-Aways
- Key Terms
- Formulas
- Review Questions
- Practice Exercises

## 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

- |                                                                               |                           |
|-------------------------------------------------------------------------------|---------------------------|
| <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,<br>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

- |                                                                |                            |
|----------------------------------------------------------------|----------------------------|
| <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