Online Instructor's Manual
to accompany

Accounting and Financial Analysis in the Hospitality Industry

Jonathan Hales
Northern Arizona University

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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 posses to advance to greater responsibilities and senior management. Accounting courses offer the knowledge to understand and apply numbers to operations.*

HIGH PERFORMANCE
ORGANICATIONS

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 posses 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

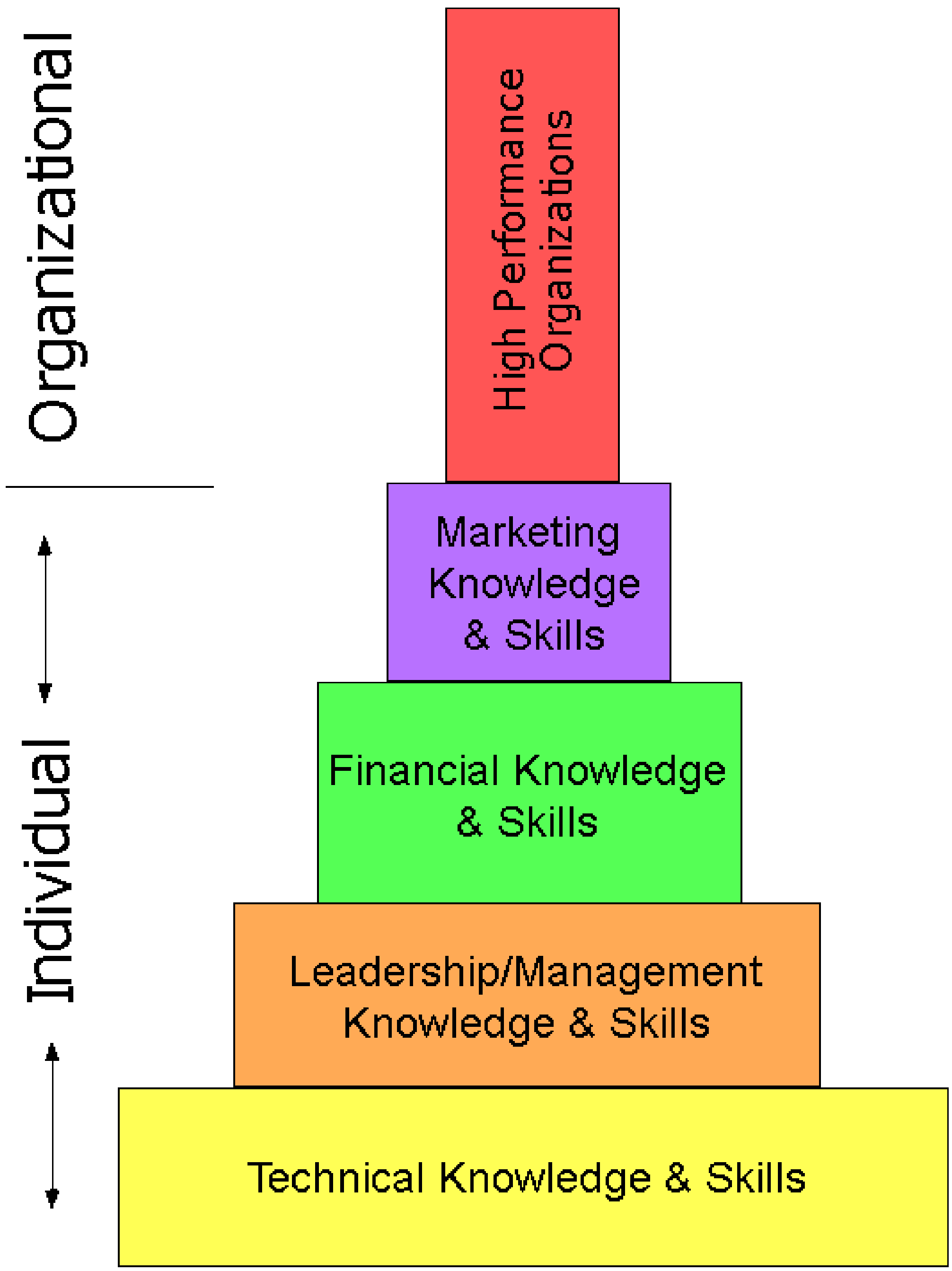
The next step in the Career Success Model is developing Sales and Marketing knowledge and skills which begin by identifying and understanding customers and their expectations. What does a hotel or restaurant do to develop and maintain a competitive advantage over its competitors? Why does a customer 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

   Assets = Liabilities + 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:

_B_Accounts Payable
_A_ Cash
_C_ Equipment
_A_ Inventory
_D_ Bank Loan
_A_ Accounts Receivable
_E_ Retained Earnings
_B_ Taxes Payable
_E_ Initial Capital Accounts
_E_ Common Stock

A. Current Asset
B. Current Liability
C. Long-Term Asset
D. Long-Term Liability
E. Owner Equity

2. Match these equations

_B_ Revenues - Expenses	A. Working Capital
_A_ Current Assets – Current Liabilities	B. Profit Formula
_F_ Revenues - Cost of Sales, Wages, Benefits, and Operating Expenses	C. RevPAR
_D_ Wage Cost / Revenues	D. Cost Percent
_G_ Profit Dollars / Revenue Dollars	E. Retention/Flow-through
_C_ Room Revenues / Total Rooms	F. Department Profit
_E_ Change in Profit Dollars / Change in Revenue Dollars	G. Profit percent

3. Match the financial statement with the description

_B_ Has opening and ending balances	A. P&L
_B_ Is the same as an A&L Statement	B. Balance Sheet
_A Closes out accounts at the end of an accounting cycle	C. Statement of Cash Flows
_C_ Is the same as a Source and Use of FundsStatement	
_A_ Is the same as an Income Statement	
_B Shows the value or net worth of a company	
_A_ Measures the operating success of a company	
_C_ 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

CHAPTER 2
FOUNDATIONS OF FINANCIAL ANALYSIS

Chapter Outline

- Introduction
- Fundamental Methods of Financial Analysis
  - Two important tools
  - The Financial Management Cycle
- Comparing numbers to give them meaning in financial analysis
  - Last Year
  - Budget
  - Forecast
  - Previous Month or Period
  - Proforma
  - Other Goals
- Measuring change to explain performance
- Using Percentages in financial analysis
  - Calculating percentage
  - What percentages measure
- Four Types of Percentages Used in Financial Analysis
  - Cost percentages
  - Profit percentages
  - Mix percentages
  - Percentage change
- Trends in financial analysis
  - Short and long term trends
  - Revenue, expense, and profit trends
  - Company and industry trends
  - General economy trends – National and International
- Summary
- Hospitality Manager Take-Aways
- Key Terms
- Formulas
- Review Questions
- Practice Exercises

Answers to Review Questions

1. What are the two ways numbers are used in financial analysis? Give examples.

To measure financial performance. The three main financial statements – P&L Statement, the Balance Sheet, and the Statement of Cash Flows.
As a management tool. Revenue forecasts, weekly wage schedules, department P&L critiques.

2. Name the four steps in the Financial Management Cycle.

Operations produce the numbers
Accounting prepares the numbers
Operations and accounting analyze the numbers
Operations applies the numbers to improve operations.

3. Name five reports or financial documents the actual financial performance of a business is compared to.

The Operating Budget	The previous month
The most recent forecast	The previous accounting period
Last year's actual results	A Pro Forma
Other established goals	

4. What is the difference between an annual budget and a pro forma?

The Annual Operating Budget is prepared once a year and is the formal one year operating plan for a business. It is based on last years actual performance and builds in any improvements or goals for the next year. The Pro Forma is the first year financial plan for a business and is prepared without any historical operating information. It is used by developers, investors, owners, and management companies to project the first year operations and financial expectations. **The Pro Forma** is replaced in the second year by the Annual Operating Budget.

5. Discuss some of the important components of measuring change in financial analysis.

Measuring change identifies the direction that business operations are going. Change can be both positive or negative. Changes in operations and financial performance are first identified, then the causes of the change identified, and then action to increase or improve operations are made. Change is measured in terms of units, dollars and percentages.

6. Name the four types of percentage used in financial analysis. Give examples.

Profit Percentages identify the relationship between profit dollars and revenue dollars. They tell how much of each revenue dollar remains after all revenues are recorded and all expenses are paid.
Cost or Expense Percentages identify the relationship between expense dollars and revenue dollars. They tell how much of each revenue dollar is spent on costs and expenses to provide the business's products and services to customers.
Mix Percentages identifies how much of your total comes from an individual department or cost center. They can be stated in dollars or units. For example the Rooms Revenue mix by market segment or the Rooms Sold mix by market segment.
Percentage Change identifies the increases or decreases of actual financial performance to previous actual performance or to established measures such as budgets or forecasts.

7. Name the four types of tends used in financial analysis. Give examples.

Short and Long Term trends – monthly results versus the results from the last six months. A one time result is not a trend, however several months of lower sales or several months of higher sales would be considered trends.
Revenue, Expense and Profit trends – increases in revenue should also result in increases in profit. Decreases in expenses should also result in increases in profit. The trend of these three measurements are critical to identifying successful financial performance.
Company and Industry trends – Is the Chicago Hyatt Hotel's financial performance trending in the same direction as the hospitality industry trend? Is the Miami Airport Marriott Hotel's financial performance trending in the same direction as the other Marriott airport hotels? The financial results of hotels that are going in a different direction than the industry or other similar hotels need to be analyzed to determine why their financial results are different from the predominant trend for like hotels.
General Economic trends/ International or National – a recession will generally have a negative affect on the performance of individual hotels just as an economic expansion or recovery will have a positive affect on the performance of individual hotels.

8. Discuss in two paragraphs, why trends are important and how you would use them to analyze the financial operations of a business.

Trends are important because they show the direction or movement of business operations, industry operations and national and world economies. Understanding the different types of trends and how they affect the operations of a business is an important part of financial analysis.

Trends are used to show if an individual hotel's performance is the same as others in the industry or if it is the same as a result of the general economy. This would indicate that the hotel's performance is the result of other economic or industry conditions. But if the economy is improving, and the hospitality industry is producing increased revenues and a specific hotel is not improving, then management needs to analyze operations to identify why the hotel is not improving when other hotels and the general economy is improving.

Answers to Practice Exercises

January 2010

1. **Following are the financial results for January, 2004 Lumberjack Hotel**:

	Actual	**Budget**	**Last Year**
Room Revenue	**$ 695,000**	**$680,000**	**$650,000**
Room Profit	**$ 500,000**	**$486,000**	**$460,000**
Average Room Rate	**$ 67.50**	**$ 68.00**	**$ 65.66**
Rooms Sold	**10,300**	**10,000**	**9,900**
Occupancy Percent	**83.1%**	**80.1%**	**79.8%**
Restaurant Revenue	**$ 126,000**	**$ 125,000**	**$ 124,000**
Beverage Revenue	**48,000**	**50,000**	**47,000**
Catering Revenue	**240,000**	**250,000**	**245,000**
Total Food & Beverage Revenue	**$ 414,000**	**$ 425,000**	**$ 416,000**
Gift Shop Revenue	**$ 23,000**	**$ 22,000**	**$ 21,000**
Total Revenues	**$ 1,132,000**	**$ 1,127,000**	**$ 1,087,000**

Calculate the following:

A. Dollar change for room revenue, actual to budget and last year.

To Budget + $15,000 To Last Year + $ 45,000

B. Percentage change in room revenue, actual to budget and last year.

To Budget + 2.2% To Last Year + 6.9%

C. Dollar and percentage change for rooms sold, occupancy percent and average rate-actual to budget and last year.

	Rooms Sold		**Occ Percentage**		**Ave Rate**	
Budget	**+ 300**	**+ 3.0 %**	**+ 3.0 pts**	**+ 3.7 .%**	**- $ .50**	**- .7%**
Last Year	**+ 400**	**+ 4.0.%**	**+ 3.3 pts**	**+ 4.1%**	**+ $ 1.84**	**+ 2.8%**

D. Sales mix percentages for room revenues, total food & beverage revenue, and gift shop revenue.

Rooms	**61.4%**
Food & Beverage	**36.6%**
Gift Shop	**2.0%**

E. Sales mix percentages for restaurant, beverage, and catering revenues.

Restaurant	**30.4%**
Beverage	**11.6%**
Catering	**58.0%**

2. The following financial information is from the Darden Restaurants 2003 Annual Report:

	Sales $	Mix %	# Restaurants	Mix %
Red Lobster	$ 2,430,000 000	52.2%	673	53.0%
Olive Garden	$ 1,990,000,000	42.8%	524	41.3%
Bahama Breeze	$ 138,000,000	3.0%	34	2.7%
Smokey Bones	$ 93,000,000	2.0%	39	3.0%
TOTALS	$ 4,651,000,000	100%	1,270	100%

A. What are the total annual sales and how many total restaurants in 2003?
B. Calculate the sales mix percentage for 2003.
C. Calculate the restaurant unit mix percentage for 2003.

3. Following is the Revenue from Continuing Operations from the Marriott International 2003 Annual Report: (in millions)

	2003	Mix %	2002	Mix %	2001	Mix %
Full-Service	$ 5,876	67.4%	$ 5,508	67.0%	$ 5,260	67.7%
Select Service	$ 1,000	11.5%	$ 967	11.8%	$ 864	11.1%
Extended-Stay	$ 557	6.4%	$ 600	7.3%	$ 635	8.2%
Time Share	$ 1,279	14.7%	$ 1,147	13.9%	$ 1,009	13.0%
TOTALS	$ 8,712	100%	$ 8,222	100%	$ 7,768	100%

A. Calculate the sales mix percentage for 2003, 2002, and 2001

B. Calculate the percentage change in revenue for each segment from 2003 to 2002
FS +6.7% SS + 3.4%, ES - 7.2%, TS + 11.5%

C. Calculate the percentage change in revenue for each segment from 2002 to 2001.
FS + 4.7%, SS + 11.9%, ES - 5.5%, TS + 13.7%

D. What is the overall revenue growth (percentage change) from 2002 to 2003 and from 2001 to 2002.
2003 = + 6.0% 2002 = + 5.8%

4. Calculate the cost and profit percentages for General Electric for the 2003 and 2002 years;

	2003 $	2003 %	2002 $	2002 %
Total Revenues	$ 134,187		$ 132,210	
Cost of Goods Sold	37,189	27.7%	38,833	29.4%
Cost of Services Sold	14,017	10.5	14,023	10.6
Interest, financial charges	10,432	7.8	10,216	7.7
Other costs & expenses	52,645	39.2	50,247	38.0
Total Costs	$ 114,283	85.2%	$ 113,319	85.7%
Earning Before Taxes	$ 19,904	14.8%	$ 18,891	14.3%

5. Questions 1-4 represented the second step in the Financial Management Cycle. The following questions represent third step – analyzing the numbers.

A. For the Lumberjack Hotel, discuss the actual January performance including dollar and percentage change. Include comparisons of actual with both the budget and last year and identified operating departments that improved or did not improve.

Answer points:

1. **Actual revenues were slightly over budget.+$3,400 and + .2%**
   And substantially over last year +$84,200 and +6.2%
   Average room rate was under budget but over last year
   Rooms sold was over budget and over last year
2. **Room revenue and profit were under budget but over last year**
3. **Food and Beverage revenue was over budget and over last year**
4. **Gift Shop under budget and last year**

B. For Darden Restaurants, explain what the mix percentages tell about the sales amounts and number of units for each restaurant concept.

Answer points;

1. **Red Lobster has the highest sales and # of restaurants mix %**
2. **Olive Garden has the second highest mix percents**
3. **Olive Garden has highest sales per unit with only 41.3% of total Darden restaurants producing 42.8% of the sales. $3,626,000**
4. **Red Lobster has 53.0% of total Darden restaurants but only produces 52.2% of total Darden sales. $3,611,000**

5. **Bahama Breeze and Smokey Bones are the new growth concepts**

C. For Marriott International, which market segment increased their sales mix percent the most and which if any had a decrease in their mix percent. Use 2003 actual numbers compared with both 2002 and 2001 for your answers.

Answer points:

1. **Full Service and Time Share increase their mix % over 2002**
2. **Select Service and Extended Stay decreased their mix % over 2002**
3. **Select Service and Time Share increased their mix % over 2001**
4. **Full Service and Extended Stay decreased their mix % over 2001**

D. For General Electric, list the cost areas that resulted in productivity improvements and any that resulted in productivity declines for 2003. Comment on all four cost areas and the total costs. Why did the earnings percentage go up? Is that good or bad?

Answer points:

1. **Cost of good sold productivity improved 1.7 % points, 29.4% decreased to 27.7% in 2003.**
2. **Cost of services sold productivity improved .1% to 10.5%**
3. **Total Costs productivity improved .5% from 85.7% to 85.2%**
4. **Other costs and expenses productivity declined as the cost % increased from 38.0% to 39.2% or 1.2% points**
5. **The earnings percent increased .5% points from 14.3% to 14.8% This was because total revenues increased $1,977 billion which was more than the expense increase of $964 million + $1,013 Billion**

Answers to chapter question on the Red Lobster

The average annual sales per Red Lobster restaurant were approximately $3,800,000 in 2007 and $3,900,000 in 2008 and each restaurant will serve 150,000 to 225,000 customers per year. A typical Red Lobster restaurant will include four to five managers and 60 to 100 hourly employees referred to as crew members. Operating departments include Service, Culinary, and Beverage Hospitality. A Red Lobster manager will rotate through each of these departments as they develop their careers. As a Red Lobster manager, you will be responsible for managing between 10 to 20 crew members per shift to serve customers and achieve established sales and profit objectives.

From the above information, calculate the following assuming 365 days per year:

1. Average sales per day

   $10,411 per day in 2007 and $10,685 in 2008 a 2.6% increase over 2007.

2. Average customers served per day

   411 customers served per day at 150,000 per year and 616 customers served per day at 225,000 per year.

3. What is the percentage increase in average sales per restaurant from 2007 to 2008?

   2.6% increase in 2008 over 2007.

CHAPTER 3
ACCOUNTING DEPARTMENT ORGANIZATION AND OPERATIONS

<u>Chapter Outline</u>

- Introduction
- Organization Charts
  - Full service hotels
  - Accounting departments
  - Smaller or select service hotels
- Accounting operations in full service hotels
  - Accounting department operations
  - Hotel department operations and relationships with accounting
  - Monthly preparation of financial reports
- Accounting operations in smaller hotels and chain restaurants
  - Financial Statement Preparation
  - Purchasing and Inventories
  - Wage and Cost Controls
- Summary
- Hospitality Manager Take-Aways
- Key Terms
- Formulas
- Review Questions
- Practice Exercises

Answers to Review Questions

1. Name the two operating departments and the four staff departments in a full service hotel.

Operating Departments	Staff Departments
Rooms and Related	Accounting
Food and Beverage	Engineering
	Sales and Marketing
	Human Resources

2. Identify three areas of the accounting office and describe what their duties and responsibilities include.

Income Area – records income in the income journal, pays invoices in accounts payable, prepares daily bank deposits and change orders in the general cashier, processes payroll, assists the Assistant Controller in other accounting functions as requested.

Accounts Receivable Area – processes all direct billing applications and final invoice for group accounts, processes and reconciles all credit card activities, monitors the accounts receivable ageing for timely collections, prepares information for write-off meetings, assists the Assistant Controller or Credit Manager in other accounting functions as requested.
Night/Day Audit Area – records and balances the days revenue transactions, closes out the previous day's financial and operational transactions and opens the next day for all financial and operational transactions, prepares daily management reports, and performs all front desk functions for the all-night shift.

3. What management position is responsible for delivering products and services every day to the guests?

Line or shift managers that manage the a.m. shift from 7:00 to 3:00, the p.m. shift from 3:00 to 11:00, and the night sift from 11:00 p.m. to 7:00 a.m. These manages can be in the Rooms, Food & Beverage, Gift Shop, Spa, or Golf departments.

4. What management position is responsible for all of the operations of a hotel?

The General Manager

5. Describe the operations and responsibilities of a Corporate Accounting Office.

The Corporate Accounting Office communicates daily with individual hotels or restaurants in providing financial support for their operations. Operating and financial information is transmitted at the end of each day to the corporate accounting office and they process the information, prepare the necessary financial reports, and return it the next morning to the hotel or restaurant. It is efficient for one location to provide the financial support for many individual hotels or restaurants that are not large enough to have their own accounting staff. Questions can be discussed or problems answered through discussions between the operating units and the corporate accounting office.

6. Identify three types of operating/financial information that a corporate accounting office returns daily to a restaurant for its review and use

Daily financial report preparation including daily and month to date revenue reports, purchasing and inventory management including purchase order forms and inventory status reports, wage and cost controls including employee schedules and wage productivities.

7. What is the most important financial report for hotel department managers that is prepared monthly or each period by the accounting department?

The Profit & Loss Statement because it measures the financial performance of the hotel or restaurant and it is a financial report that is affected by the ability of hotel managers to efficiently manage their departments. This includes maximizing revenues and minimizing expenses that result in maximum profits.

8. Explain the differences, advantages, and disadvantages of monthly P&L's when compared to 28-day accounting period P&L's.

Monthly P&L's – Advantages include traditionally using the 12 months of the year for measuring operations and financial performance, the ease of comparing one month to the same month for the last year, 12 months add up to 365 days, and the fiscal year always ends on December 31. Disadvantages include not having the same number of days in each month, for example January has 31 days, February has 28 days, and April has 30 days, each month can begin on a different day of the week which make comparisons more difficult.

Accounting Period P&L's – Advantages include always having 28 days in the accounting period, always starting each week or accounting period on the same day of the week, always having four weeks in each accounting period, easy to compare to the previous period or the same period from last year because they all have 28 days. Disadvantages include having 13 accounting periods in a fiscal year that is not as common as 12 months in a fiscal year, the 13 accounting periods only add up to 264 days so every five to seven years their needs to be a fifth week in the 13th period to get the year end date back around December 31.

Practice Exercises

1. Based on the examples provided, draw an organization chart for a 100 room select service hotel. To help you in this exercise, identify the different operations in a hotel of this size and then draw the organization chart based on these operations or departments.

General Manager

Assistant General Manager

Front Desk Manager	**Housekeeping Supervisor**	**Restaurant Supervisor**	**Engineering Supervisor**

2. Assume that you are going to open your own 100 seat restaurant and bar. Draw the organization chart that you would use to set up your restaurant. Be sure to identify specific departments, the different levels of management that would be responsible for these departments, and who they would report to.

General Manager

Restaurant Manager	**Restaurant Manager**	**Restaurant Manager**
Dining Room	**Admin/Purchasing**	**Kitchen**

3. What are the main differences in the organization chart for a 600 room full service hotel compared to a 100 room select service hotel?

600 room hotel

- **Executive Committee level**
- **Department Head level**
- **Support Departments – Accounting, Engineering, Human Resources, Sales and Marketing**
- **Line managers running shifts**

100 room select service hotel

- **No Executive Committee or Department Head level**
- **No Support Departments**
- **Supervisors replace line managers for many departments**
- **Positions are combined, i.e. Human Resources and Admin**

Answers to chapter question on the Otesaga Hotel and Resort

1. Draw the organization chart for the Otesaga Resort Hotel, including the Executive Committee that reports to the General Manager and the different department heads that report to the Executive Committee members.

General Manager

Operations | Staff

Director of Rooms Operations
- Front Office Mgr
- Housekeeping Mgr
- Director of Golf
- Gift Shop Manager
- Security

Director of Food & Beverage
- Restaurant Manager BLD
- Specialty Restaurant Manager
- Lounge Manager
- Director of Catering
- Executive Chef

Director of Finance

Director of Sales & Marketing

Director of Engineering

Director of Human Resources

Bold positions report to the General Manager

2. With 135 rooms, would you recommend one Director of Operations or would you distribute those responsibilities between the Director of Rooms Operations and the Director of Food and Beverage? Why?

If the student answers one Director of Operations, the explanation should include that it is a smaller hotel and with strong department heads, the Director of Operations should be able to oversee all operations effectively.
If the student answers that separate positions for the Director of Rooms Operations and the Food & Beverage Director, the explanation should include comments such as high paying group business would need to ensure that the rooms operations is effectively run and that the complicated nature of catering at a resort and the specialty restaurants and lounges would require someone with food operational expertise such as a Food & Beverage Director.

3. To whom would you have the Director of Golf reporting to and why?

The Director of Golf could report to the General Manager if the General Manager has an interest in golf and would be helpful in selling group business because of his knowledge and involvement in the golf operations. This would also free either the Director of Operations or the Director of Rooms Operations to concentrate on the front office and housekeeping operations.

The Director of Gold could also report to the Director of Operations or the Director of Rooms Operations. Since each of these positions is focused on front of the house operations, including golf would be a natural fit.

4. What management positions do you think are for 12 months and what positions

Twelve month positions at a seasonal resort that closes for several months during the winter would include the General Manager, Executive Committee, Sales and Marketing, Engineering, Human Resources and Director of Finance. These positions would be involved in the selling and maintenance of the resort and other administrative tasks. Most of the line managers would be seasonal as there would not be much for them to do when the resort is closed and no customers. During the off season, a great deal of maintenance is performed as well as the planning and budgeting for the next year.

CHAPTER 4
THE PROFIT AND LOSS (P&L) STATEMENT

Chapter Outline

- Introduction
- Hotel Consolidated P&L Statements
  - Revenue Centers and Profit Centers
  - Expense Centers and Support Costs
  - Fixed costs, fees, and Other Deductions
  - Hotel Profit Levels
- Formats for Consolidated P&L Statements
  - Titles
  - Horizontal Headings
  - Vertical Headings
  - Examples of Consolidated P&L Statements
- Department P&L Statements
  - The Four Major Cost Categories
  - Revenue and Profit Department P&Ls
  - Expense Center Department P&Ls
  - Fixed Cost Departments P&Ls
  - Analyzing Department P&L Statements
- Summary
- Hospitality Manager Takeaways
- Key Terms
- Review Questions
- Practice Exercises

Answers to Review Questions

1. Define and name the four main classifications of accounting information contained in a Consolidated P&L.

Revenue Centers – Operating departments that record revenues by providing products and services to customers.
Profit Centers – Operating departments that record revenues and the expenses associated with those revenues in providing products and services to customers. Department profits are what remain after all department revenues and expenses have been recorded. The term profit center is interchangeable with revenue center – one records only revenues for a department and one records revenues, expenses and profits for a department.
Expense Centers – Staff departments that only include expenses – wages, benefits and direct operating expenses.
Fixed Expenses – Direct expenses associated with a specific hotel that do not change from month to month and are not associated with volume levels. These expenses are

based on contracts and must be paid regardless if the hotel is open or closed, profitable or not profitable.

2. Define and name the five main revenue and expense categories contained in a Department P&L.

Department Revenue – records the revenue for the department over a specified time period

Cost of Sales – records all cost of sales expenses associated with producing products and services that are sold over the same time period as the revenues

Wage Cost – records all management, hourly, and overtime wage costs over the same time period as the revenues

Benefit Cost – records all the benefit costs associated with the wage cost incurred over the same time period as the revenues

Direct Operating Costs – records all other direct costs associated in the department with producing the products and services sold over the same time period as the revenues.

Department Profit – The dollar amount of sales that is remaining after all the above expenses have been paid.

3. Name and describe four different profit levels and what they measure.

Department Profit – Describes the total profit for a specific operating department or revenue/profit center. Formula is department revenue minus department expense equals department profit.

Total Department Profit – The total of all the individual operating department profits. Formula is adding up all individual department profits.

House Profit/Gross Operating Profit – The profit level that identifies management's ability to maximize profits. The hotel managers can control and affect the revenues and expenses that result in House Profit. Formula is Total Department Profits minus Total Expense Center costs.

Net House Profit/Adjusted Gross Operating Profit – The profit level that identifies the final financial profit for a specific hotel. It includes all revenues and all expenses incurred in operating that hotel. It is the best measure of the financial performance of a hotel. Formula is House Profit/Gross Operating Profit minus Fixed Expenses.

4. Name the three sections for the format for a P&L.

Title – Name of hotel or restaurant, name of financial report, time period covered.

Horizontal Headings – Current month or accounting period and year-to-date (YTD)
Actual, Budget and Last Year for current month/period
Actual, Budget, Last Year for year-to-date
The dollars, units or percentages for each heading

Vertical Headings – Consolidated P&L
Revenue Centers
Profit Centers
Total Department Profits
Expense Centers
House Profit/Gross Operating Profit
Fixed Expenses
Net House Profit/Adjusted Gross Operating Profit

5. Explain the differences between a Profit Center and Expense Center. Give examples.

A profit center records revenues, cost of sales, wages, benefits, and direct operating expenses. The remaining balance will be department profit if revenues were greater than expenses or will be department loss if expenses are greater than revenues. Profit centers provide products and services to external paying customers in the form of sales or revenues.
An expense center does not record any revenues and therefore have no cost of sales. Their expenses include wages, benefits and direct operating expenses. Expense centers have internal customers in the form of other employees in the hotel or restaurant.

6. What is a line account and why is it important in financial analysis?

A line account is a specific accounting code or category that collects and records all revenues or expenses classified within the description of the line account. For example the rooms guest supply line account will include all purchases and expenses for guest supply items provided in the guest rooms such as soap, shampoo, conditioner, toilet paper, Kleenex, shoe shine mitts, and sewing kits.

7. Refer to the hotel organization chart in Chapter 3. Identify at least one hotel department that each Executive Committee Member is responsible for.

Resident Manager – Rooms, Gift Shop, Recreation, Security
Food & Beverage Director – Restaurants, Kitchen, Lounge, Catering/Banquets
Director of Finance – Accounting
Director of Engineering – Repairs and Maintenance, Utilities
Director of Sales and Marketing – Sales, Advertising
Director of Human Resources – Personnel, Accidents, Training

8. Why do you think this is the most important chapter in this book?

The Profit & Loss Statement is the main financial statement that shows the operational and financial performance of a hotel in general and for each department. Hotel managers can make decisions and operate their departments to maximize revenues and minimize expenses that will determine department and hotel profits. Hotel managers must be able to understand their Department P&L and use it as a management tool to operate their department in the most efficient, most profitable manner possible. They will be expected to analyze their monthly performance and write P&L critiques that explain variations in operational and financial goals and measurements.

Practice Exercises

1. Match the line account or classification to the appropriate P&L.

A. __2__	Hourly wage cost	1.	Consolidated P&L
B. __2__	Linen expense	2.	Department P&L
C. __1__	Revenue centers		
D. __2__	Food cost		
E. __1__	Fixed costs		
F. __1__	House profit		
G. __2__	Overtime		
H. __1__	Total department profits		

2. Draw the format for a Consolidated P&L using the three sectons in review question 4.

Hotel Name
Hotel Report
Date

	Current Month/Period			Year-to-Date		
	Actual	Budget	Last Year	Actual	Budget	Last Year
Revenue Centers		$, %, #			$, %, #	
Total Revenue						
Profit Centers						
Total Department Profits						
Expense Centers						
House Profit/Gross Operating Profit						
Fixed Expenses						
Net House Profit/Adjusted Gross Operating Profit						
Taxes						
Profit After Taxes						

3. Draw the format for a Department P&L using the three sections in review questions 4.

Hotel Name
Hotel Report
Date

	Current Month/Period			Year-to-Date		
	Actual	Budget	Last Year	Actual	Budget	Last Year
Department Revenue	$, %, #			$, %, #		
Cost of Sales						
Wages						
Benefits						
Other Direct Operating Expenses						
Total Department Profit						

Answers to chapter questions on the Springhill Suites and Residence Inn

These two properties complement each other by providing different experiences for travelers. Visit www.chicagorivernorthhotel.com to view more information on these new properties. Answer the following questions from the perspective of White Lodging.

1. Which property quoted the highest room rates?

According to the 2008 Marriott International Annual Report, the Residence Inn brand had a higher average rate of $126.06 compared to the Spring Hill Suite brand average rate of $109. This is because the Residence Inn brand is an extended stay hotel with larger guest rooms including a small kitchen and more amenities for guests staying from three days to three weeks or more. The Spring Hill Suite advertises an upper-moderate lifestyle experience for their guests. It would be reasonable to expect that both of these Chicago properties would have higher average rates than the brand average because of being located in a large metropolitan city such as Chicago.

2. Which property do you think would have the highest room profit margin? Why? a

Generally the property with the highest average room rate will have the highest room profit margin. However, it would be interesting to examine and compare the amenities that the Residence Inn brand offers compared to the amenities that the Spring Hill Suite offers to see which has the highest amenity costs. Higher amenity costs would result in lower room profit margins.

3. What criteria would you use to put together the competitive set for each property?

Competitive set criteria for each property would include properties that are also extended stay or suites, similar number of rooms, similar rate structure, generally a geographic location close to your property, and any competitor that you lose group and transient business to. Age and condition of competitive hotels should also be considered.

CHAPTER 5
THE BALANCE SHEET (A&L) AND STATEMENT OF CASH FLOWS

Chapter Outline

- Introduction
- The Balance Sheet or Asset & Liability Statement (A&L)
  - Definition
  - Working Capital
  - Capitalization
- The Relationship between the Balance Sheet and P&L Statement
  - Manager's use of Balance Sheet accounts in daily operations
  - Business Operating Cycle
  - Similarities and Differences between the Balance Sheet and the P&L
- The Statement of Cash Flows
  - Definition
  - Cash Flow and Liquidity
  - Classifications of Cash Flow
  - Source and Use of Funds Statement
- Summary
- Hospitality Manager Take-Aways
- Key Terms
- Review Questions
- Practice Exercises

Answers to Review Questions

1. Explain the financial information contained in a Balance Sheet and explain how it is used.

The Balance Sheet measures the value or net worth of a company at a specific date and time. It includes assets that are owned by the company (current and long term), the liabilities that are owed by the company (current and long term), and the owners of the company or who owns and has equity in the company. There are individual accounts in each one of these categories that have balances representing the financial value or amount in each account. The Fundamental Accounting Equation defines the format of a Balance Sheet and is: Assets = Liabilities + Owner Equity

2. Describe working capital and capitalization, and explain what each is used for. Include the Balance Sheet accounts that are used in each process.

Working Capital is the dollar amount provided for the daily operations of a business. It is the money or financial resources generated and used in the daily operations of a company. It includes recording sales and paying expenses that involve the P&L

Statement, and using current assets (cash, inventory, accounts receivable) and current liabilities (accounts payable, wages payable) contained in the Balance Sheet. **Capitalization** identifies the way a business obtains and uses money to start or expand the business. Capitalization involves the use of long-term debt or owner equity as a way of obtaining the necessary funds or money to start, expand or renovate a business. This capitalization is primarily used to purchase long term assets such as property, plant and equipment.

3. What accounts on the Balance Sheet will hospitality managers generally use in the daily operations of their departments?

Hospitality managers will primarily use working capital accounts which involves the cash, accounts receivable, inventory and accounts payable accounts. They use the cash account to purchase inventories and supplies, the accounts receivable accounts to generate sales, and the accounts payable to pay supply invoices and employee wages.

4. List five characteristics of the Balance Sheet.

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

   Assets = Liabilities + Owner Equity
3. It is made up of accounts organized by assets, liabilities, and owner equity.
4. These accounts are divided in to 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 account on the Balance Sheet

5. Compare and contrast liquidity with profitability.

Liquidity is the amount of cash or cash equivalents that a company has to cover its daily operating expenses and that it maintains in its cash or cash equivalent accounts on the Balance Sheet. It measures a company's ability to pay all of its operating expenses. A liquid company will always have enough cash to pay their expenses as well as maintain a comfortable, non committed cash balance.
Profitability is the amount of revenue remaining after all expenses have been paid. It is a key account on the P&L Statement. The formula for profits is revenue minus expenses. A company can show a profit year after year, but if the money is tied up in inventory or accounts receivable and not available in the cash account to pay expenses, the company is not liquid and will not be able to pay their expenses and stay in business.

6. List five characteristics of the Statement of Cash Flow.

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

7. Name the three classifications of cash flows

Operating **Financing** **Investing**

8. Name three changes in Balance Sheet accounts that area source of funds and three that are a use of funds.

Sources – decrease in assets, increase in liabilities and owner equity
Uses – increase in assets, decrease in liabilities and owner equity.

Practice Exercises

1. Which of the following accounts are part of working capital and which are a part of capitalization?

A. _2_ Accounts payable
B. _1_ Line of credit
C. _1_ Laundry washer and dryer
D. _2_ Inventory
E. _2_ Cash
F. _1_ Paid in capital

1. Capitalization
2. Working capital

2. Following is the Balance Sheet in $ for the GTO Hotel: Answer the following:

$210,000 What is the working capital amount?

$2,660,000 What is the total capitalization amount?

33.8% What is the Liabilities capitalization percent?

66.2% What is the Owner Equity capitalization percent?

Balance Sheet

Cash	$ 250,000	Accounts Payable	$ 175,000
Accounts Receivable	125,000	Wages Payable	145,000
Inventory	235,000	Taxes Payable	80,000
Total Current Assets	$ 610,000	Total Current Liabilities	$ 400,000
Equipment	800,000	Bank Loan	500,000
Property	$ 1,250,000		
Total Long Term Assets	$ 2,050,000	**Total Liabilities**	**$ 900,000**
		Paid-In-Capital	1,000,000
		Retained Earnings	760,000
		Total Owner Equity	**$ 1,760,000**
Total Assets	**$ 2,660,000**	**Total Liabilities and O.E.**	**$ 2,660,000**

Answers to chapter questions on the Pappadeaux Seafood Kitchen

Imagine you were a Pappadeaux manager and think about the following questions relating to your Balance Sheet and Statement of Cash Flows:

1. How is building and opening a 400+ seat Pappadeaux restaurant different from building a 150-seat Chili's or Olive Garden? Which Balance Sheet accounts would be most affected—current or long term? Explain why.

A 400+ seat Pappadeaux compared to a 150 seat casual dining restaurant would require a much larger infrastructure including the size of the kitchen, dining room, and public space. Support equipment needs to be either larger or more of them such as dishwashing machine, freezers, coolers and other kitchen equipment. The dining room will require three times more tables and chairs and the china, glass, silver, and linens to furnish the tables. While the cost of building a larger building might not be that significant because of efficiency, the actual furnishing of equipment and supplies will be directly larger according to the number of seats.

The Balance Sheet accounts most affected would generally be long term assets including PP&E. However the initial working capital account would also be larger because of the higher inventory and cash levels necessary to support a 400 seat restaurant.

2. From a cash flow perspective, what are the main invoices and expenses that a Pappadeaux manager will need to plan for and pay daily, weekly, and monthly? Give some thought to this answer especially when you consider the purchasing of fresh food.

Because a Pappadeaux restaurant features fresh seafood and fish, the daily ordering of these menu items requires a great deal of attention to provide the freshness and quality that the Pappadeaux brand delivers to its customers. Deliver costs will generally be higher as many menu items are flown in daily to maintain freshness. If the vendor expects same day payment, there would need to be higher balances in the cash account to cover these payments. A 400 seat restaurant will require higher inventory levels and higher cash levels on the balance sheet.

Weekly and monthly expenses are generally more stable with wage costs and other operating supplies being more regular in nature. It is a priority of any business manager to make sure that there is enough cash in the cash account each week to cover weekly payroll costs. Managing the cash flow of a business requires attention to the amount of cash necessary to cover daily operating expenses, meet weekly payment responsibilities such as payroll, and cover monthly fixed expenses such as bank loans, mortgage payments, lease expenses, insurance and any other monthly expenses.

3. What do you think the two busiest and two slowest days of the week are for Pappadeaux sales? Explain your answer and tell how that affects cash inflows and outflows.

Fridays, Saturdays, and possibly Sundays are generally the busiest days in any restaurant as customers have the weekend with more leisure time to enjoy dining out. Monday and Tuesday are generally the slowest days of the week.

From a cash flow perspective, it is good to have busy days on the weekend because you will have three days of sales going to the bank on Monday to be deposited. If payday is Friday, most pay checks will clear the bank on the following Monday when the deposit is generally the largest.

CHAPTER 6
HOTEL MANAGEMENT REPORTS

Chapter Outline

Answers to Review Questions

1. Compare the format of a P&L Statement with a Daily Revenue Report. What is the same and what is different?

The formats of both reports are very similar. For example:

	P&L Statement	Daily Revenue Report
Time period	Monthly and YTD	Daily and month to date
Information	Revenues and expenses	Revenues and statistics
Comparisons	Budget and last year	Budget and last year
Format	By departments	Sections by dollars and statistics

2. What information does the Daily Revenue Report contain and how does a hospitality manager use it?

The Daily Revenue Report contains the actual revenues for each revenue center in a hotel. For the restaurants, it includes the meal periods – breakfast, lunch and dinner – organized by revenue, customer counts and average checks. For the rooms department, it has market segments organized by revenue, rooms sold, and average room rate. This

report gives immediate results for the previous days operations. The actual results are compared to budgets, forecasts, previous month, or last years results to determine if sales are increasing or decreasing.
Some daily reports also contain wage costs and relate the wage expenses to revenue levels in wage productivity sections of the Daily Revenue Report. Wage costs can then be compared with budgets and last year to ensure that wage productivities are maintained.

3. Explain how fixed and variable wage expenses are used to maintain labor productivity standards.

Fixed wages are difficult to adjust to different business levels. Therefore they are constant and rarely change in relation to business volumes.
Variable wage costs can be scheduled and controlled based on business levels. Historical ratios and formulas are used to schedule the proper amount of employees and wage manhours to provide the expected products and services to guests and also maintain expected productivities.

4. How are weekly revenue forecast used to plan expenses for the upcoming week?

Weekly revenue forecasts identify the expected business levels for the next week. They are based on historical averages, current events, and consider the current trends in customer activity. Weekly revenue forecasts begin with projecting the expected volume each day for the next week. This means forecasting daily rooms sold by market segment and daily customers by meal periods for the restaurants. Once these volumes are known, operations managers can schedule the appropriate wages for each day based on current formulas and ratios.

5. Define retention and flow through. Why are they important?

Retention and flow through are two terms that are used to measure and describe how much profit dollars go up or down as a percentage of the change in revenues. Formulas and guidelines are established that determine how much profits should go up given an increase in revenues and how much profit should go down given a decrease in revenues. Retention standards or formulas are established for each revenue center or operating department and then calculated to determine the expected retention or flow thru for the total hotel.

6. How do department managers use retention and flow through to manage their departments?

Retention and flow thru guidelines and formulas help managers determine appropriate wages to schedule and levels of other expenses to use. While it is obvious that expenses are expected to decrease if sales are down, retention and flow thru formulas and guidelines provide a way to calculate and plan appropriate expense levels that will maintain established and expected productivities and profits.

7. Define incremental. How is it used in financial analysis?

Incremental is an increase, something gained or added. In financial analysis, it describes additional revenues, expenses or profits beyond what was expected. Incremental is also associated with retention and flow thru. For example, if there are incremental increases in sales, what will be the expected incremental increases in profit?

8. List three formulas for calculating labor productivities and three for calculating wage cost percentages.

Manhours per occupied room = manhours divided by occupied rooms
Manhours per customer or cover = manhours divided by customer counts or covers
Rooms cleaned per shift or room credits per shift

Wage cost as a percentage of sales = department wage dollar expense divided by department revenue

  Front Office wage cost dollars divided by Room Revenue
  Housekeeping wage cost dollars divided by Room Revenue
  Restaurant wage cost dollars divided by Restaurant Revenues
  Gift Shop wage cost dollars divided by Gift Shop Revenues

Wage cost per room sold = department wage dollar cost divide by number of rooms sold

Practice Exercises

1. Calculate the actual and budget department profit margins (remember profit margins are percentages) for the following hotel departments:

	Actual		Budget	
Room Revenues	$ 1,250,000		$ 1,200,000	
Restaurant Revenues	215,000		225,000	
Beverage Revenues	75,000		80,000	
Catering Revenues	480,000		450,000	
Total Hotel Revenues	$ 2,020,000		$ 1,955,000	
		%		%
Room Profit	$ 960,000	76.8%	$ 910,000	75.8%
Restaurant Profit	18,000	8.4%	20,000	8.9%
Beverage Profit	22,000	29.3%	25,000	31.2%
Catering Profit	170,000	35.4%	160,000	35.6%
Total Hotel Profit	$ 1,170,000	57.9%	$ 1,115,000	57.0%

2. Calculate the actual retention/flow through in dollars and percent

Actual retention/flow through dollars $ 55,000
The difference between actual and budget profit dollars
$ 1,170,000 minus $ 1,115,000
Actual retention/flow through percent 84.6%
The change in profit dollars divided by the change in revenue dollars
$ 55,000 divided by $ 65,000

Answers to chapter questions on the Four Seasons Scottsdale Resort

1. How many Revenue Departments do you think are included in the Daily? Revenue Report? Name them.
Probably 10 or more

Rooms Department	BLD Restaurant
Gift Shop	Specialty Restaurant
Spa	Casita 24 hour dining (room service)
Golf	Pool casual dining restaurant and lounge
Recreation	Banquets and Catering

2. List the departments that prepare weekly wage forecasts that the Director of Rooms Operations is responsible for and also the departments that the Director of Food and Beverage is responsible for.

Director of Rooms Operations forecasts – rooms sold and room revenue, gift shop, golf, spa
Director of Food & Beverage forecasts – restaurants, beverage, catering.

3. Which revenue center (rooms, restaurants, or banquets) do you think generates the highest sales? Explain why.

Generally the rooms department generates the highest sales because of higher average room rates than restaurant or catering average checks and more guest rooms than seats in a restaurant. In a convention hotel or resort, the banquet department can also generate significant revenues especially if there is a large amount of meeting space both indoors and outdoors.

CHAPTER 7
REVENUE MANAGEMENT

Chapter Outline

- Introduction
- RevPAR – Revenue Per Available Room
  - Definition
  - Why it is important
  - How it is used
- Rate Structures and Market Segments
  - Definition
  - Establishing rate structures
- Revenue Management
  - Definition
  - Seven Core Concepts of Revenue Management
  - Yield Systems
  - How Yields Systems Work
  - Using Revenue Management in Different Types of Hotels
- Selling Strategies
  - Definition
  - The Selling Strategy Process
  - Revenue Management Critiques
- Summary
- Hospitality Manager Take-Aways
- Key Terms
- Review Questions
- Practice Exercises

Answers to Review Questions

1. What are the two formulas for RevPAR?

Total Room Revenue divided by Total Number of Rooms in a Hotel or
Total Average Room Rate times Actual Occupancy Percentage

2. Why is understanding and using RevPAR information so important to maximizing total room revenue?

REVPAR measures both the ability to sell the most rooms and the ability to achieve the highest average room rate. It includes two financial measures and identifies how the hotel is combining the two strategies of maximizing rooms sold and maximizing average room rates to generate the highest amount of room revenue. This means that revenue managers will look at policies and procedures that will balance maximizing room rates but at the same time attracting as many customers as possible who are willing to pay the established rates.

3. Explain the relationship between room rates and market segments.

Market segments define customer expectations, preferences, behaviors, and buying patterns. Room rates are established for each market segment based on how the market segment is defined. Business travelers who have their expenses paid by their company will generally stay in very different places than when they are traveling on leisure and pay out of their own pocket. This is seen in the lower weekend rate structures of most hotels to attract leisure customers compared to the higher weekday rates.

4. What is DOA and why is it such an important part of yield management?

DOA stands for Day of Arrival and is the central point in collecting all the historical information regarding room reservations. The current years booking pace is compared to historical reservation booking information and the appropriate selling strategy is determined and implemented to maximize room revenues for each day of arrival. A revenue manager will look at each day of the week to review the status and activity and then decide on the selling strategy.

5. How is the booking pace used with the historical average in yield management?

The Booking Pace identifies the amount and type of room reservations that have been received for a specific day of arrival. The Booking Pace is then compared to the Historical Average to see if the hotel is expected to have more or less reservations than the historical average. Revenue Managers will look at a specific day of arrival one week, two weeks, or one month or any other time period to see how reservations are being received for a specific DOA and to implement the appropriate selling strategy to maximize total rooms sold and total room revenues.

6. Who is on a hotel's selling strategy team? Which one is the most important?

The General Manager, Resident Manger or Director of Rooms Operations, Director of Sales and Marketing, Director of Finance, Front Office Manger and Revenue Manger. The **Revenue Manger** is the most important because that person is the expert on reading and understanding the technical information presented by the Revenue Management system and can make good recommendations to the selling strategy team. Decisions should be made by the team after discussion and analysis.

7. What selling strategy should a hotel implement when the booking pace is under the historical average?

When the booking pace is under the historical average, it means that not as many reservations are being made than in the past. Therefore, the selling strategy should be to open up all discounted rates and make sure that there are no length of stay or arrival restrictions. In this situation, you want to encourage more reservations by making the lowest rates available.

8. What selling strategy should a hotel implement when the booking pace is over the historical average pace?

When the booking pace is over the historical average, it means that more reservations are being made than in the past. Therefore, the selling strategy should be to close all lower rated discount rates and force remaining reservations to be made at higher room rates. Also length of stay or arrival date restrictions can be implemented to assist in maximizing room revenues. In this situation, you want reservations to be made at higher room rates and are willing to turn down business that is only willing to pay the lower discounted rates.

Practice Exercises

1. The corporate rate at a 600 room downtown east coast hotel is currently $199. The owner would like to see a small increase in the room rates for next year. Put together a room rate structure with at least six different rates. Your corporate rate should show a slight increase and the other rate categories should have a logical relationship to the corporate rate.

Concierge Rate	$ 239
Regular or Rack Rate	$ 219
Corporate Rate	$ 209
Special Corporate Rates	
Small number of annual rooms	$ 195
Large number of annual rooms	$ 175
Discounts	
Super Saver Rate	$ 179
Week end Rate	$ 139
Government and Military Rate	$ 99
Holiday rate	$ 109

3. For this same hotel and the rate structure that you developed in question 1, answer the following questions:

A. What days of the week do you think demand would be the strongest?

Tuesday and Wednesday because they are the busiest meeting days for business travelers. This would be followed by Monday and Thursday which are also fairly busy business days. Fridays, Saturdays, and Sundays would be the slowest days because business travelers are generally not traveling during the weekend.

B. For those dates, give examples of a day when your selling strategy would be (1) to close either one or all of the discounted rates, (2) when you would try and shift the day of arrival, (3) when you would require a two day minimum length of stay. Be specific on which days you would do what strategies. For example, which day should a minimum length of stay be appropriate and which days would shifting the day of arrival be appropriate?

1. Generally close discounted rates on Tuesday and Wednesday
2. For a discounted rate, shift the day of arrival to Monday or Thursday when possible because of traditionally lower demand on those days.
3. A two day minimum could be required for Tuesday and Wednesday reservations. A special event such as Super Bowl or the NCAA Final Four might require a three or four day minimum.

3. Discuss at least three Revenue Management terms that would be used primarily in a 1,000 room convention hotel and three Revenue Management terms that would be used primarily in a 400 room airport corporate hotel.

1,000 room convention hotel

Group room block
Peak night
Shoulder nights
Slippage
Pick up
Cut off date

400 room corporate hotel

Day of arrival
Historical average
Booking pace
Selling strategies
Opening and closing discounts

Answers to chapter questions on the Fairmont Maui Resort

1. What and why do you think the two biggest market segments are for this resort?

Group and Transient Leisure. Group because it is a 450 room Hawaii destination resort with over 30,000 square feet of meeting space. Transient because it is a premier resort destination with not only the favorable climate, but also the culture and history of the Hawaiian Islands.

2. What effects will each of your market segments have on maximizing total resort? revenue? Give at least one example for each of your main market segments.

The Group market segment will have a major impact on banquet revenues because of both meeting room revenue and banquet meal revenues. Often these group meetings are recognition or achievement meetings where the meals feature very high average checks and specialty themes. Groups can also generate significant revenues for the golf and spa operations where they book golf tournaments are provide spa treatments for attendees and their spouses.

3. Do you think average room rate or occupancy will have the greatest effect on RevPAR? Explain why.

The higher average room rate of a resort will generally have the greatest impact on RevPAR for a resort. Remember, many people attending group meetings at resorts are coming from cold, snowy and dreary climates so they are willing to pay a higher room rate to get away from it all and relax in the sunshine, enjoy recreational amenities, and participate in cultural or historical activites.

CHAPTER 8
COMPARISON REPORTS AND FINANCIAL ANALYSIS

Chapter Outline

Introduction
Profitability – The Best Measure of Financial Performance
- Definition
- The Difference between Analyzing Profits and Analyzing Revenues
- The Impact of Department Profits on Total Hotel Profits
- Maximizing and Measuring Total Hotel Profitability

Chapter 2 Review: Foundations of Financial Analysis
- Comparing Numbers/Results to Give Them Meaning
- Measuring and Evaluating Change in Financial Analysis
- Percentages as a Tool in Financial Analysis
- The Importance of Trends in Financial Analysis

Variation Analysis
- Definition
- Formulas and Ratios Used in Variation Analysis
- Key Hotel Ratios that Measure Hotel Financial Performance

STAR Market Reports
- Definition
- Different Types of STAR Market Reports
- How STAR Reports Are Used

Summary
Hospitality Manager Take-Aways
Key Terms
Review Questions
Practice Exercises

Answers to Review Questions

1. Name two important variables for maximizing revenues.

Rate and Volume, specifically market segment average room rates and market segment rooms sold. In restaurants it is average guest check and customer counts.

2. Name two important variables for controlling expenses.

Average wage rate and total manhours for hourly wage costs. Also food costs in restaurants.

3. What is the impact of different department profit percentages on total hotel profits?

Each revenue center has a specific cost structure that determines how much of a revenue dollar is spent on expenses and how much will be left over as profit. For example the most profitable to least profitable revenue or profit centers in a full service hotel are:

1. Rooms Department	65-75%
2. Lounge or Bar Department	30-40%
3. Banquet/Catering Department	25-35%
3. Full Service Restaurant	0-10%

4. Define variation analysis, and tell why it is an important tool in financial analysis.

Variation analysis involves identifying the difference between actual operating performance and established standards. Variation can be positive or negative reflecting improved or declining performance. It is important because it identifies and examines the causes of changes in operations. It is used to describe the results in revenues, expenses, or profit accounts compared to standards or expectations.

5. Name one important ratio from each of the five ratio classifications and tell why you think it is important in financial analysis. (These are examples, students can choose any ratio as long as they explain it clearly).

Activity ratios – Total Occupancy Percentage because it tells how many rooms in a hotel are sold or occupied and therefore generating room revenue. Average Occupancy Per Room tells how many guests are staying in a room and the total hotel.

Operating ratios – Average Room Rate identifies the average room rate for all rooms occupied in a hotel. REVPAR identifies how average rate and occupancy strategies are used to maximize total room revenue.

Profitability ratios – Profit Margin identifies the percentage of revenue dollars that remain as profit after all expenses are paid. Earnings Per Share identifies the relationship between earnings or profits and the number of common stock shares outstanding. Return on Assets identifies how effectively assets are used to generate profits or earnings.

Liquidity rations – Current Ratio identifies the relationship of current assets to current liabilities and how effectively they are used as working capital. Accounts Receivable Turnover identifies how quickly accounts receivable are collected in relationship to total revenues.

Solvency ratios – Solvency Ratio measures the relationship between total assets and total liabilities. Debt/Equity Ratio measures the relationship between total liabilities and total owner equity.

6. Discuss the relationship of the four elements that make up the foundation of financial analysis and why they are an important part of variation analysis.

The four elements that make up the Foundations of Financial Analysis are first, comparing numbers to give them meaning, second, measuring and evaluating change in operations, third, using percentages as a tool in financial analysis, and fourth, the importance of trends in financial analysis. They are important in variation analysis because they give meaning to the numbers or financial results produced by department operations. They relate or compare these results to other measures that indicate whether operations are improving or not.

7. What key information is provided in the STAR market Report?

Key information provided in the STAR Market Report are Average Room Rates, Average Occupancy Percent and REVPAR for a specific hotel and for that hotel's competitive set. Comparisons are made to identify where the specific hotel is doing better or doing worse than the competitive set. Trends are also identified that will help identify the performance of the specific hotel to other hotels or the hospitality industry. It also identifies how well a specific hotel is capturing market share compared to it's competitive set.

8. How is the STAR used in the operation of and financial analysis of a hotel?

The STAR Market Report is used to compare and analyze a specific hotel's operations and financial results compared to its competitive set. The competitive set includes hotels that are primary competition. Therefore, the STAR Market Report offers an external comparison of a hotel's operations in addition to the internal comparisons of last year, the budget and the forecast.

Practice Exercises

1. Calculate the following rations from the following information sheet and balance sheet.

Flagstaff Marriott Hotel – 600 Rooms
June 30, 2008
Operating Information

1. Total Rooms 18,000 = 600 X 30 days in June
2. Total out of order and complimentary rooms = 75
3. Total Rooms Sold in June = 15,300
4. Total Guests = 18,360
5. Total Room Revenue = $ 1,185,000
6. Total Restaurant Customers = 11,000
7. Total Restaurant Revenue = $125,000
8. Total Food Cost = $35,500
9. Total Hotel Profit (Net Profit) = $ 550,000
10. Number common shares outstanding = 1,000,000
11. Stock Price = $12.00
12. Total Hotel Revenue = $ 1,575,000

Flagstaff Hotel
Balance Sheet
June 30, 2008
(000)

ASSETS		**LIABILITIES**	
Current		**Current**	
Cash	$ 75	Accounts Payable	$ 60
Accounts Receivable	40	Wages Payable	40
Inventories	90	Taxes Payable	25
Total Current Assets	$205	Total Current Liabilities	$ 125
Long Term		**Long Term**	
Property	$ 125	Bank Loans	$ 150
Plant	200	Line of Credit	50
Equipment	250	Lease Obligations	25
Less Deprecation	(50)	Other Long Term Obligations	0
Total Long Term Assets	$ 525	Total Long Term Liabilities	$ 225
Total Assets	**$ 730**	**Total Liabilities**	**$ 350**
		OWNER EQUITY	
		Paid In Capital	$ 200
		Capital Stock	100
		Retained Earnings	80
		Total Owner Equity	**$ 380**
Total Assets	**$ 730**	**Total Liabilities and Owner Equity**	**$ 730**

Answers

2 points each unless noted otherwise

Activity ratios

__85.0%____ Total Occupancy %
__89.4%____ Available Occupancy %
__1.2_______ Average Guests per Room

Operating ratios

_$77.45__ Average Room Rate
_$11.36__ Average Food Check
_$65.83__ RevPAR
_28.4%__ Food Cost % 1 point

Liquidity ratios

_1.64__ Current Ratio 1 point
_39.4__ Accounts Receivable Turnover 1 point

Profitability Ratios

_34.9%__ Profit Margin %
_75.3%__ Return on Assets(use the balance for June 30) 1 point
_1.45%__ Return on Owner Equity (use the balance for June 30) 1 point
_ $_.55_ Earnings per Share 1 point
__21.8__ Price/Earnings Ratio (PE Ratio) 1 point

Solvency ratios

_2.09__ Solvency Ratio
__.92__ Debt Equity Ratio

Answers to chapter questions on the Hyatt Regency Scottsdale

1. Name five resorts that you would include as the competitive set for the Hyatt and explain why.

The Hyatt Regency Scottsdale competitive set might include any of the following resorts: Arizona Biltmore, The Phoenician, The Fairmont Scottsdale, Camelback Inn, Desert Ridge, and the Westin Kierland. Most of these Arizona resorts are similar in size, room rate structure, amenities offered, recreation offered such as gold and spa, and meeting space available. They might also include a similar resort in Palm Springs to broaden the information on competitors.

2. How do you think the location of the Hyatt in expensive Scottsdale affects the wage costs for the operating departments? Give examples.

Because Scottsdale has a higher cost of living index, resorts in Scottsdale might have to pay higher hourly wages to their employees. Also transportation becomes an issue if employees have to travel a greater distance to get to the resort or if there is limited or no access to public transportation.

3. Which revenue department would you like to manage? List three important factors

Rooms Department – This answer might include the group and transient market segments, determining an appropriate rate structure that would maximize revenues but still provide a good customer value, and balancing rate times volume.
F&B Departments – This answer might include the challenge of managing multiple food outlets with specialty themes and operations that take advantage of the favorable resort climate and cultural themes. For banquets, the challenge of having outdoor venues for unique meal functions could also be an attraction.
Golf or Spa Departments – This answer might include the challenge of a non-traditional hotel revenue department. It would require a great deal of specialty knowledge to operate either a golf or spa department.

CHAPTER 9
BUDGETS

Chapter Outline

Answers to Review Questions

1. Why is the annual operating budget one of the most important financial reports a hospitality manager should know, understand and use?

The annual operating budget contains the details and specifics of the financial operations of a business or department for one fiscal year. It is important because it is a guide as well as a measurement of how well a department performs month to month and over a fiscal year. It is a plan that outlines the financial results planned for based on daily operations.

2. Name five characteristics of an annual operating budget.

1. It is a plan for the next fiscal year, therefore it is the plan for future operations.
2. It is for one fiscal year.
3. It is based on the previous year's actual financial results.

4. It includes growth and financial improvements over the previous year.
5. It includes dollar amounts, percentages, and units or statistics.
6. The budget column is included on monthly profit and loss statements and provides a comparison for actual financial results.
7. It includes the hotel's current marketing plan.

3. Why is a capital expenditure budget important, and how do hospitality managers use it in operating their departments?

Capital Expenditure Budgets identify the needs for replacing long-term assets of a business, for renovating a business, and for expanding a business. Since these assets will last longer than one year, it is important to plan for their replacement before they become inefficient, outdated, or present safety concerns. Replacement projects can be very expensive and can include replacing a single piece of equipment or a project that includes many components such as rooms softgoods redos including new carpets, bedspreads, paint, vinyl, and pictures.

4. Name five characteristics of a capital expenditure budget.

Five characteristics of a capital expenditure budget are:
1. It identifies purchases of specific pieces of equipment such as a laundry machine, airport van, kitchen oven or mechanical motor.
2. It identifies projects that involve many pieces of equipment or activities, such as rooms soft-goods redo, restaurant renovation, or expansion.
3. Budget items must have a useful life of more than one year.
4. Budget items must have a minimum cost.
5. Projects must contain the details of all expenditures necessary to complete the project.
6. Expenditures have different approval levels. For example, items costing less than $5,000 can be approved by the General Manager whereas items or projects costing more than $5,000 might need corporate approval.
7. Small expenditures can be included in one list, totaled and approved.
8. Large expenditures are itemized and approved one by one.

5. What is the difference between a consolidated hotel budget and a department operating budget?

The Consolidated Budget is a summary budget and only contains the total revenue, total profit, or total expense amounts for specific departments. It is a true summary of the main operating and financial results. The Department Budget contains the details of revenues and expenditures by individual line accounts. An operations manager uses the department budget as a management tool in operating his department to meet expected operational and financial goals.

6. Name five ways to budget direct operating expenses.

Five ways to budget direct operating expenses are:
1. Historical average amounts.
2. Historical average plus inflation.
3. As a percentage of sales for the department.
4. As a cost per occupied room or cost per customer for the department.
5. Specific formulas that can be used to identify budget amounts.
6. Allocation percentages that determine what part of a particular department cost that should be assigned to another department.
7. Annual contracts.

7. Name and describe the three main ways to prepare an operating budget.

The three main ways to prepare an operating budget are 1) **zero based** which prepares a budget bottom up and line by line, 2) **historical** which prepares a budget based on last years actual or averages of several years, and 3) **goal based** which prepares a budget based on a pre-determined goal or amount.

8. How is a budget used to evaluate actual financial performance?

A budget is used to evaluate actual financial performance by setting specific financial amounts and goals that business operations are expected to achieve. The budget will generally include an improvement or growth in operations and financial results from year-to-year. Actual financial results are compared to the budget to determine if business operations are meeting desired and established goals or levels.

Practice Exercises

There are two budget problems to complete. The first is to calculate amounts to use in budgeting based on actual information and formulas. The second is to prepare an annual budget based on that information. Following is information for the Rooms Department for the Flagstaff Hotel for the first ***six periods*** of the year:

Room Revenue				$ 8,713,000
Transient Rooms Sold	83,730			
Group Rooms Sold	16,270			
Total Rooms Sold	100,000			
Operating Expenses				
Linen			$ 31,100	
Cleaning Supplies			24,000	
Guest Supplies			104,800	
Outside Services			24,000	
Laundry			80,500	
Concierge Expense			60,000	
Office Supplies			19,200	
Reservation Expense				
Reservation Department		$ 150,000		
Fixed Res Center Cost		180,000		
Variable Res Center Cost				
At $6 per transient reservation		251,200		
Total Reservation Expense			581,200	
All Other Expense			120,000	
Total Operating Expenses				$ 1,044,800
Total Operating Expense Percentage				12.0%

Problem 1

Use the following formulas to calculate each one of the line items: They will be used to prepare the annual budget for next year. Round the average cost per period to whole dollars, round the cost per occupied room to whole cents, round the cost per occupied room to whole cents, and round the percentage of sales to four decimals. Use the laundry and reservation information as supplied.

1. Linen - Calculate the average cost per period
   $5,183 per period

2. Cleaning Supplies – Calculate the average cost per occupied room
   .24 cents per occupied room

3. Guest Supplies – Calculate the average cost per occupied room
   $1.05 per occupied room

4. Outside Services – Calculate the average cost per period
   $2,000 per period

5. Laundry – Calculate at 70% of total laundry department expense per period
   Laundry department expense at $115,000 for six periods
   $13,416 per period

6. Concierge Level Expense – Calculate as a percentage of total room sales
   .69% of sales

7. Office Supplies – Calculate as a percentage of total room sales
   .22% of sales

8. Reservation Cost

   A. Reservation Department average cost per period
      $25,000 per period

   B. Fixed expense at $50 per total number of rooms in hotel per period
      $30,000 or 600 rooms x $50

   C. Variable expense at $6 per reservation. Calculate the reservations As 50% of Transient Rooms Sold.
      $41,865 or 83,730 reservations x 50% x $6 per reservation x 6 periods

9. All other expense at $20,000 per period
   $20,000 per period

Problem 2

Prepare the annual operating expense budget for the next year using the formulas from problem #1 and the following assumptions: Remember there are 13 accounting periods in a fiscal year, each with four weeks and 28 days.

Room Revenue		$ 19,184,000
Transient Rooms Sold	184,000	
Group Rooms Sold	34,000	
Total Rooms Sold	218,000	

Operating Expense Annual Budget

Linen $5,183 average cost per period x 13 periods		$ 67,379
Cleaning Supplies .24 cents x 218,000 rooms sold		52,320
Guest Supplies $1.05 per room x 218,000		228,900
Laundry $250,000 x 70% Annual laundry department budget of $250,000		175,000
Concierge Expense .69% x $19,184,000		132,370
Office Supplies .22% x $19,184,000		42,211
Reservation Expense		
Reservation Department Cost $25,000 x 13 periods	$ 325,000	
Fixed Res Center Cost 600 rooms x 13 periods x $50	390,000	
Variable Res Center Cost 184,000 transient rooms x 50% x $6	552,000	
Total Reservation Expense		$ 1,267,000
All Other Expense $20,000 x 13 periods		260,000
Total Operating Expenses $		$ 2,225,180
Total Operating Expense %		11.6%

Answers to chapter questions on the Radisson Fort McDowell Resort

1. From the above information and the Web site, list the revenue department budgets that you think the Radisson Resort Fort McDowell reviews each year. Be specific.

Rooms, Restaurants, Bar, Banquets or Catering, gift shop, golf and spa.

2. Make a list of at least five pieces of equipment that might be on a typical capital expenditure list for the Radisson Resort and five pieces of equipment for the Wekopa Golf Course. Remember the golf course is divided into golf shop, food and beverage, and golf course maintenance departments.

Capital expenditures for the resort might include vacuums, maid carts, and laundry washer and dryer for the rooms department. Kitchen equipment such as stoves, ovens, steamers, coolers, and refrigeration units for the restaurant department. Recreation might include new pool lounge chairs,
Capital expenditures for the Wekopa golf course might include fairway mowers, fertilizing equipment, irrigation equipment, golf carts, beverage carts, and kitchen equipment for the restaurant.

3. Name what you think might be the three biggest expense accounts for each of the following departments:

A. Rooms operations – wages, benefits, reservation costs, linen, guest supplies, and laundry expense.
B. Food and beverage operations, including banquets – wages, benefits, food cost, china-glass-silver costs, linen, and laundry.
C. Golf clubhouse – wages, benefits, cost of sales, paper supplies, freight.
D. Golf course maintenance. – wages, benefits, fuel, equipment repair, water or irrigation, fertilizer, flowers, seed.