

FINANCIAL REPORTING & ANALYSIS

Chapter 1: INTRODUCTION TO FINANCE AND BUSINESS ANALYTICS - Planning the Profitable Restaurant

a) Overview and Scope of Financial Reporting and Business Analytics

Financial reporting and business analytics are two interconnected pillars essential for managing any successful operation, particularly in the dynamic hospitality industry. Financial reporting focuses on providing historical data about a company's performance, position, and cash flows to external and internal users. It is standardized, governed by rules (like GAAP or IFRS), and results in the primary financial statements.

Key Points on Financial Reporting:

- **Standardized Communication:** It provides a common language for stakeholders to understand the economic health of the business.
- **Historical Focus:** It primarily documents past transactions and performance.
- **Compliance:** It ensures the business adheres to legal and regulatory requirements.
- **Core Statements:** It culminates in the Balance Sheet, Income Statement, and Statement of Cash Flows.

Business Analytics, in contrast, uses data, statistical methods, and quantitative analysis to gain insights and drive future decision-making. In a restaurant or hotel, this means analyzing booking patterns, guest satisfaction scores, labor efficiency, and menu profitability to optimize operations and pricing strategies. It moves beyond "what happened" to address "why did it happen" and "what will happen."

Key Points on Business Analytics:

- **Future-Oriented:** It aims to forecast outcomes and optimize processes.
- **Data-Driven Decisions:** It uses various data sources (financial, operational, marketing, etc.).
- **Optimization:** Techniques like Revenue Management are central to applying analytics in hospitality.

b) Users of Accounting Information

Accounting information serves a wide range of users, each with different needs and decision objectives. Categorizing these users helps clarify the purpose and presentation of financial data.

External Users:

- **Investors and Owners:** They need to assess the company's profitability and financial strength to decide whether to buy, hold, or sell ownership shares.
- **Creditors and Lenders:** Banks and suppliers use the information to determine if the company can repay its loans or meet short-term obligations.

- **Government Agencies (e.g., Tax Authorities):** They use the data to compute taxes and ensure compliance with regulatory standards.
- **Customers:** They might evaluate the financial stability of key suppliers or long-term partners, such as hotel chains or convention centers.

Internal Users (Management):

- **Operating Managers (Kitchen, Front Desk):** They use internal reports (cost reports, daily sales sheets, labor schedules) to control costs and manage daily operations.
- **Finance Managers:** They use budget reports and forecasts to manage cash, plan investments, and raise capital.
- **Executive Management (CEO, CFO):** They rely on summarized financial statements and key performance indicators (KPIs) to evaluate overall company performance, make strategic decisions, and set future direction.

c) Accounting Concepts and Conventions

To ensure financial reports are consistent, reliable, and comparable, accountants follow a set of fundamental concepts and conventions.

Core Concepts:

- **Business Entity Concept:** The business is treated as separate and distinct from its owner(s). The owner's personal transactions are kept out of the company's books.
- **Going Concern Concept:** It is assumed that the business will continue to operate indefinitely and will not be liquidated in the foreseeable future. This justifies valuing assets at cost rather than liquidation value.
- **Monetary Unit Concept:** Only transactions that can be expressed in monetary terms are recorded. It also assumes that the value of the currency remains stable over time (ignoring inflation for reporting purposes).
- **Accounting Period Concept:** The continuous life of the business is divided into specific periods (e.g., monthly, quarterly, or annually) to measure and report performance.

Key Conventions:

- **Prudence (Conservatism) Convention:** When faced with uncertainty, revenues and assets should not be overstated, and liabilities and expenses should not be understated. It suggests anticipating losses but only recognizing actual gains.
- **Materiality Convention:** Only transactions and items that are significant enough to influence the decisions of users are included in the financial statements. Minor, immaterial costs can be treated simply (e.g., small equipment expensed immediately).
- **Consistency Convention:** Once an accounting method or principle is adopted, it should be applied uniformly from one period to another to ensure comparability. Any change must be disclosed and justified.
- **Full Disclosure Convention:** Financial statements must report all necessary information to prevent them from being misleading. This often includes explanatory notes and supplementary schedules.

Chapter 2: PROCESS OF PREPARATION OF FINANCIAL STATEMENTS - BOOKS OF ACCOUNTS (Journal, Ledger, Cash Book)

The accounting process is a systematic method for recording, classifying, and summarizing financial transactions. It begins with source documents and flows through specialized books of accounts to eventually generate the financial statements.

Books of Accounts

Journal

The Journal, or the book of original entry, is the first place a transaction is recorded. It captures transactions in chronological order using the double-entry system (debit and credit).

- **General Journal:** Used for non-routine transactions that don't fit into a specialized journal, such as correcting entries, adjusting entries, and closing entries.

Specialized Journals for Lodging Operations

Lodging and restaurant operations often use specialized journals to handle the high volume of similar transactions efficiently.

- **Purchases Journal:** Records all purchases of goods or services made on credit.
- **Cash Disbursements Journal:** Records all outflows of cash, regardless of the purpose.
- **Payroll Journal:** Tracks employee earnings, withholdings, and net pay, ensuring compliance and accurate labor cost tracking.

Ledgers

The Ledger is the book of final entry where transactions from the journals are classified and posted to individual accounts.

- **General Ledger:** Contains summary balance sheets for every asset, liability, and equity account, providing a complete record of the business's financial position.
- **Guest Ledgers (or Accounts Receivable Subsidiary Ledger):** Tracks the outstanding balances owed by individual guests or groups who have not yet settled their accounts.

Cash Book and Funds

- **Cash Book:** Serves both as a journal (chronological recording of cash receipts and payments) and a ledger (showing the cash balance).
- **House Funds:** Cash held by the hotel or restaurant for operational purposes, typically including front desk and bar floats.
- **Petty Cash:** A small amount of cash kept on hand for minor, incidental expenses where issuing a check is impractical.
- **Credit Card Accounts:** A record tracking amounts due from credit card companies for charges made by guests.

THE STATEMENT OF CASH FLOWS

The Statement of Cash Flows (SCF) is a key financial statement that reports the cash generated and used by a company over a specific period. It is crucial because profitability (as shown on the Income Statement) does not always equate to cash availability.

Purpose, Format, and Uses

- **Purpose:** To explain the change in the cash balance from the beginning to the end of the accounting period. It bridges the gap between the Income Statement and the Balance Sheet.
- **Format:** The statement is organized into three mandatory categories of activities.
- **Uses:** It helps stakeholders evaluate the company's ability to generate cash, pay its debts, and fund new investments without relying on external financing.

What Information is Reported in the Statement of Cash Flows

The SCF reports the actual inflows (sources) and outflows (uses) of cash during the period, rather than accrual-based revenues and expenses. This is the only primary statement that adheres strictly to the cash basis of accounting.

Three Categories of Cash Flows

1. **Operating Activities (CFO):** Cash flows directly related to the normal revenue-generating activities of the business (selling rooms, serving food).
 - *Examples:* Cash received from customers, cash paid to suppliers and employees.
2. **Investing Activities (CFI):** Cash flows related to the acquisition or disposal of long-term assets (Property, Plant, and Equipment - PP&E).
 - *Examples:* Cash paid to purchase a new oven, cash received from selling an old building.
3. **Financing Activities (CFF):** Cash flows related to transactions involving debt, equity, and dividends.
 - *Examples:* Cash received from issuing stock, cash paid to repay a loan principal, cash paid for owner dividends.

Non-cash Investing and Financing

Certain transactions that affect assets and liabilities but do not involve cash must be disclosed separately, usually in the notes to the financial statements. Examples include the exchange of property for stock or the conversion of debt into equity.

Direct and Indirect Methods

There are two acceptable methods for calculating and presenting the **Operating Activities** section:

1. **Direct Method:** Lists major classes of gross cash receipts and gross cash payments. This is conceptually simpler but more time-consuming for companies to prepare.

2. **Indirect Method:** Starts with Net Income (from the Income Statement) and adjusts it for non-cash items (like depreciation) and changes in current assets and liabilities to arrive at net cash flow from operations. This is the most common method used by companies.

Using Cash Flow Information to Forecast Future Financial Position

The SCF is critical for forecasting. By analyzing historical cash flow trends, management can predict future cash needs and sources. For instance, strong, consistent cash flow from operations (CFO) indicates a sustainable business model capable of generating funds internally, reducing the reliance on borrowing or issuing equity.

Chapter 3: REVENUE CYCLES: SALES, RECEIVABLES AND CASH

a) Revenue Recognition

Revenue recognition is the cornerstone of the Income Statement. It determines when revenue is officially recorded (or "recognized") in the financial records. The core principle is that revenue should be recognized when a company satisfies a performance obligation to a customer.

b) When and How Much

- **When:** Revenue is recognized when the control of the goods or services is transferred to the customer. For a hotel room, this is usually when the guest completes the stay. For a restaurant, it's upon service completion and payment.
- **How Much:** The amount recognized is the transaction price expected to be received from the customer.

c) Pressure to Recognize Revenues

In practice, managers often face pressure to increase reported revenue and net income. This can lead to aggressive or premature revenue recognition practices, such as:

- Recognizing revenue before all service obligations are met.
- Shipping goods early (channel stuffing) to meet quarterly targets.
- Ignoring the possibility of sales returns or warranty claims.

d) Timing: Delivery, Percentage of Completion, Installment Methods

The timing of revenue recognition depends on the nature of the transaction:

- **Delivery (Point-in-Time):** The most common method; revenue is recognized when the product is delivered or the service is completed (e.g., selling a meal).
- **Percentage of Completion (Over Time):** Used for long-term projects (like major construction or long-term service contracts) where revenue is recognized based on the proportion of work completed during the period.
- **Installment Methods:** Used when collectability is highly uncertain. Revenue and profit are recognized only as cash is collected, deferring the recognition of sales until payment is received.

e) Amount: Bad Debts, Sales Discounts, Sales returns and Allowances, Warranty Costs

The recognized revenue amount must be net of any costs or expected reductions:

- **Bad Debts:** The estimated portion of credit sales that is expected to be uncollectible. This is an expense (Bad Debt Expense) and reduces the net realizable value of Accounts Receivable.
- **Sales Discounts:** Reductions offered to customers for paying early (e.g., 2/10, n/30).
- **Sales Returns and Allowances:** Estimates for the value of goods expected to be returned or allowances expected to be given for defective goods.
- **Warranty Costs:** Estimated costs the company expects to incur in the future to repair or replace products under warranty.

Revenue Management for Hotels

Revenue management is the strategic process of optimizing price and inventory to maximize revenue, primarily driven by demand forecasting and market segmentation.

a) Establishing Room Rates

Room rates are not static; they depend on:

- **Cost-Plus:** Pricing based on covering costs plus a desired profit margin.
- **Market-Based:** Pricing based on competitors' rates (Comp Set analysis).
- **Demand-Based (Revenue Management):** Pricing that adjusts dynamically based on expected demand, day of the week, season, and lead time.

b) Revenue Management

The goal is to sell the right product to the right customer at the right time for the right price. This involves:

- **Forecasting:** Predicting future demand and occupancy.
- **Segmentation:** Dividing the market into groups (e.g., business, leisure, group) that have different price sensitivities.
- **Inventory Control:** Using techniques like stay restrictions (e.g., minimum length of stay) and managing overbooking levels.

c) Non-Room Revenue, Telephone, and Other Sources of Income

While room revenue is central, hotels generate significant income from other sources:

- **Food and Beverage (F&B):** Restaurants, bars, and catering/banquet operations.
- **Ancillary Services:** Parking fees, business center charges, in-room movies, and Wi-Fi access.

d) Recreational: Golf, Tennis, and Spas. Self-Standing Restaurants and Private Clubs etc.

These segments are often treated as separate profit centers, where revenues and direct costs are meticulously tracked to assess individual profitability. The principles of inventory control and demand-based pricing (yield management) are applied here as well (e.g., dynamic pricing for tee times or spa appointments).

ANALYSIS OF MONETARY ASSETS: Current Ratio, Acid test, Days of receivables etc

Monetary asset analysis focuses on a company's ability to use its most liquid assets (cash and easily convertible items) to meet short-term obligations. This is the study of **Liquidity Ratios**.

- **Current Ratio:** Measures a company's ability to cover its short-term debts with its short-term assets.

Current Ratio } = Current Assets / Current Liabilities

A ratio of 2:1 is often considered ideal, meaning the company has twice as many liquid assets as short-term debts.

- **Acid-Test Ratio (Quick Ratio):** A more stringent test of liquidity, excluding inventory and prepaid expenses (which are the least liquid current assets).

Acid-Test Ratio = (Cash + Short-Term Investments + Accounts Receivable) / Current Liabilities

A ratio closer to 1:1 or higher is generally considered safe.

- **Days of Receivables (Average Collection Period):** Measures the average number of days it takes for a company to collect its accounts receivable.

Days of Receivables = Average Accounts Receivable / Average Daily Credit Sales

A shorter collection period is preferred, as it indicates efficient credit management and faster cash conversion.

Chapter 4: EARNINGS MANAGEMENT

Earnings management refers to the use of accounting techniques to produce desirable results, often portraying a more favorable picture of the company's financial performance than the underlying economic reality.

a) Factors that Motivate Earnings Management

Managers are often driven by powerful incentives to manage reported earnings.

- **Meet Internal Targets or External Expectations:** Managers may manipulate earnings to achieve bonuses tied to performance goals or to meet forecasts made by stock analysts, preventing a drop in stock price.

- **Income Smoothing:** Companies may try to reduce the volatility of reported earnings by pulling future revenues into the current period during a downturn, or deferring current revenues during a boom. This is done to convey stability and reduce investor risk perception.

b) Common Techniques Used to Manage Earnings

Managers can use several legitimate, yet aggressive, accounting choices to affect earnings:

- **Changing Depreciation Methods:** Switching from accelerated methods to straight-line can lower current depreciation expense and increase net income.
- **Adjusting Reserve Estimates:** Changing the estimated bad debt expense, warranty costs, or returns allowance can immediately impact the income statement.
- **Timing of Expenses:** Deferring or accelerating discretionary expenses like research and development, or advertising.
- **Big Bath Accounting:** Taking large, one-time losses (often when a new CEO arrives or during a bad year) to "clean up" the balance sheet, making future results appear stronger by comparison.

c) Window Dressing for an IPO or Loan

This is a specific, often short-term, form of earnings management.

- **IPO/Loan Motivation:** Before an Initial Public Offering (IPO) or applying for a major loan, a company may engage in "window dressing" to make its financial statements look artificially attractive to potential investors or lenders. This could involve aggressively recognizing revenue, minimizing expenses, or managing the current ratio.

Cost of Goods Sold and Inventory

Inventory is a current asset representing goods held for sale in the ordinary course of business or materials to be consumed in the production of goods or services. Its proper valuation is critical for both the Balance Sheet (Asset) and the Income Statement (Cost of Goods Sold, or COGS).

What is Inventory and Who Owns It?

Inventory is the stock of items a company maintains. Ownership is determined by the terms of sale (e.g., **FOB Shipping Point** means the buyer owns the goods once shipped; **FOB Destination** means the seller retains ownership until delivery). Goods on consignment are still owned by the consignor.

The Type of Companies

1. **Merchandise Companies (e.g., Retailers, Restaurants):** Inventory consists primarily of finished goods purchased for resale (e.g., food ingredients, beverages, gift shop items).
2. **Manufacturing Companies:** Inventory is classified into three stages: Raw Materials, Work in Process, and Finished Goods.

3. **Services Companies (e.g., Many Hotels):** Generally have little to no inventory, but may have consumable supplies (soap, stationery) or minor retail items.

The Cost of Inventory

Inventory cost includes all expenditures necessary to get the goods into a condition and location ready for sale:

- Purchase price less any discounts.
- Freight/shipping costs (Inward freight).
- Insurance and customs duties.

Accounting for Inventory and Cost of Goods Sold

The accounting process must allocate the total cost of goods available for sale between two accounts:

- **Inventory (Balance Sheet):** The cost of goods that are *unsold* at the end of the period.
- **Cost of Goods Sold (Income Statement):** The cost of goods that *were sold* during the period.

Overview of Perpetual and Periodic Inventory Systems

1. Perpetual Inventory System:

- Continuously tracks inventory balances and COGS.
- Every time a sale or purchase occurs, the Inventory and COGS accounts are immediately updated.
- Requires detailed, real-time tracking, often using point-of-sale (POS) systems or barcoding.

2. Periodic Inventory System:

- Inventory records are updated only at the end of the accounting period.
- COGS is calculated by taking a physical count of the ending inventory and using the formula:

$COGS = \text{Beginning Inventory} + \text{Purchases} - \text{Ending Inventory}$

2. Commonly used by small businesses or for high-volume, low-cost items.

Inventory Costing Methods

When inventory items are purchased at different prices, a method must be chosen to assign a cost to the goods sold (COGS) and the goods remaining (Ending Inventory).

a) Specific Identification Method, First in, First out method, Last in First out Method, Average Cost Method

- **Specific Identification Method:** Used when items are unique and distinguishable (e.g., expensive wine bottles). The actual cost of the specific unit sold is tracked to COGS.

- **First-In, First-Out (FIFO) Method:** Assumes the oldest inventory items purchased are the first ones sold.
 - *Result:* Ending Inventory is valued close to current (latest) costs, and COGS uses older, cheaper costs (resulting in higher Net Income during inflation).
- **Last-In, First-Out (LIFO) Method:** Assumes the newest inventory items purchased are the first ones sold.
 - *Result:* Ending Inventory uses older costs, and COGS uses newer, more expensive costs (resulting in lower Net Income during inflation). (Note: LIFO is not permitted under IFRS).
- **Average Cost Method:** Calculates the weighted-average cost of all goods available for sale and applies this average cost to both COGS and Ending Inventory.

b) Lower of Cost or Market (LCM)

The conservatism principle dictates that inventory must be reported at the *Lower of Cost or Market* value. If the current replacement cost (Market) of the inventory is lower than its historical cost, the inventory must be written down to the market value. This prevents overstating assets and profits.

c) Analysis Of Inventory

Analysis focuses on how efficiently a company manages its stock.

- **Inventory Turnover:** Measures how many times inventory is sold and replaced during a period. A higher turnover indicates efficient inventory management.

Inventory Turnover = Cost of Goods Sold / Average Inventory

- **Gross Margin (Gross Profit Percentage):** Measures the percentage of sales revenue remaining after deducting the cost of goods sold. A high margin suggests either lower input costs or effective pricing strategies.

Gross Margin = (Net Sales - Cost of Goods Sold) / Net Sales

Chapter 5: UNDERSTANDING ANNUAL REPORTS AND FINANCIAL STATEMENT ANALYSIS

Financial statement analysis is the process of evaluating the relationships among the figures in the financial statements to assess the economic health and performance of the business.

a) Analysis of Financial Statements

The primary purpose is to transform raw data into useful information for decision-making. Analysis focuses on key areas like profitability, liquidity, solvency, and operating efficiency.

b) Horizontal Analysis, Vertical Analysis

These are foundational techniques for analyzing trends and relationships within the statements.

- **Horizontal Analysis (Trend Analysis):** Compares figures over a period of time (e.g., comparing revenue this year to last year) to determine the percentage change. This highlights growth or decline.
- **Vertical Analysis (Common-Size Analysis):** Expresses each line item on the statement as a percentage of a base amount.
 - *Income Statement:* Every line item is expressed as a percentage of Total Revenue/Sales.
 - *Balance Sheet:* Every line item is expressed as a percentage of Total Assets.
 - This is useful for comparing companies of different sizes or for identifying efficiency changes (e.g., how much of each dollar of revenue is consumed by labor cost).

c) Trend Analysis, Ratio Analysis

- **Trend Analysis (Long-Term Horizontal):** Extends horizontal analysis over many periods (e.g., five or ten years) to identify long-term patterns, allowing analysts to forecast future performance.
- **Ratio Analysis:** Involves calculating specific metrics by dividing one financial statement item by another to capture key relationships.

d) Ratio Standards

Ratios are most meaningful when compared against standards:

- **Industry Averages:** Comparing a company's ratios to the average of its peers in the hospitality sector.
- **Competitor Performance:** Benchmarking against key rivals.
- **Past Performance (Historical):** Comparing current ratios to the company's own historical ratios to identify improvement or deterioration.

e) Purposes of Ratio Analysis

- **Profitability Assessment:** Determining the company's earning power.
- **Liquidity Assessment:** Evaluating short-term debt-paying ability.
- **Solvency Assessment:** Evaluating long-term debt-paying ability and financial structure risk.
- **Efficiency (Activity) Assessment:** Measuring how effectively the company uses its assets.

f) Average versus Ending Value

When calculating ratios, especially those that mix Income Statement (period) figures with Balance Sheet (point-in-time) figures (like Inventory Turnover), it is generally more accurate to use the **average** of the beginning and ending Balance Sheet values in the denominator. This better represents the amount of asset employed *throughout* the period.

Classes of Ratios

Financial ratios are typically grouped into categories based on the financial characteristic they are designed to measure.

Liquidity Ratios

Measure a company's ability to meet its short-term obligations (those due within one year).

- **Current Ratio:** Already detailed in Chapter 3.
- **Acid-Test Ratio (Quick Ratio):** Already detailed in Chapter 3.
- **Operating Cash Flows to Current Liabilities Ratio:** Focuses on the ability to pay short-term debt using actual cash generated from operations, providing a more reliable measure than static current assets.

Operating Cash Flow to Current Liabilities } = Cash Flow from Operating Activities /
Average Current Liabilities

- **Accounts Receivable Turnover:** Measures how quickly receivables are converted into cash.

Accounts Receivable Turnover = Net Credit Sales / Average Accounts Receivable } }\$

- **Average Collection Period (Days of Receivables):** Already detailed in Chapter 3.

Solvency Ratios

Measure a company's ability to meet its long-term obligations and the extent of its financial leverage.

- **Debt-Equity Ratio:** Measures the proportion of debt financing relative to equity financing. A higher ratio indicates higher risk.

Debt-Equity Ratio = Total Liabilities / Total Owners' Equity

- **Long-Term Debt to Total Capitalization Ratio:** Measures the long-term debt as a percentage of the total funds invested in the business (debt plus equity).
- **Debt Service Coverage Ratio:** Crucial for lending decisions; measures the company's ability to generate cash flow to cover its debt payments.
- **Number of Times Interest Earned Ratio (TIE):** Measures the company's ability to meet its periodic interest payments.

TIE = Earnings Before Interest and Taxes (EBIT) / Interest Expense

- **Fixed Charge Coverage Ratio:** A broader measure than TIE, including other fixed obligations like lease payments along with interest.
- **Operating Cash Flows to Total Liabilities Ratio:** Measures the total liability coverage using cash from operations (similar to the liquidity version but covers all liabilities).

Activity Ratio

Measure how effectively a company is utilizing its assets and resources.

- **Inventory Turnover:** Already detailed in Chapter 4.

- **Property and Equipment Turnover:** Measures how effectively the company uses its fixed assets (PP&E) to generate sales.

PP&E Turnover = Net Sales / Average Net Property and Equipment

- **Asset Turnover:** Measures the overall efficiency of asset use, indicating how many dollars of sales are generated for every dollar of assets.

Asset Turnover = Net Sales / Average Total Assets

Hospitality-Specific Activity Measures:

- **Paid Occupancy Percentage:** The proportion of available rooms sold to paying guests.
- **Seat Turnover:** In a restaurant, the average number of times a seat is occupied during a specific period (e.g., lunch service).
- **Complimentary Occupancy:** Rooms given away (e.g., for promotion, staff) that do not generate revenue.
- **Occupancy Percentage:** The total number of rooms sold divided by the total number of rooms available.
- **Average Occupancy per Room:** The average number of guests occupying each room sold.
- **Multiple Occupancy:** Measures the percentage of rooms occupied by more than one person, useful for forecasting F&B and other per-person amenity usage.

Profitability Ratios

Measure the company's success in generating profits from its operations.

- **Profit Margin (Net Profit Margin):** Measures the percentage of sales left over after all expenses, including taxes and interest, have been deducted.

Profit Margin = Net Income / Net Sales

- **Gross Operating Profit Margin Ratio (GOP Margin):** Measures the profitability of the core, non-allocated operations before non-operating income, expenses, and management fees.
- **Gross Operating Profit per Available Room (GOPPAR):** A key hotel metric combining revenue and cost control efficiency.
- **EBITDA Margin Ratio:** Earnings Before Interest, Taxes, Depreciation, and Amortization as a percentage of revenue. Useful for comparing companies globally by removing non-operating and non-cash items.
- **Return on Assets (ROA):** Measures how effectively a company uses its total assets to generate profits.

ROA = Net Income / Average Total Assets

- **Return on Owners' Equity (ROE):** Measures the return generated for the shareholders' investment.

ROE = Net Income / Average Owners' Equity

- **Earnings per Share (EPS):** The portion of a company's profit allocated to each share of common stock.
- **Price Earnings Ratio (P/E Ratio):** The ratio of a company's share price to its earnings per share. A high P/E suggests investors expect higher future earnings growth.

Viewpoints Regarding Profitability Ratios

Profitability ratios are often viewed from different perspectives:

- **Management:** Concerned with ratios like GOP Margin and GOPPAR for operational efficiency.
- **Shareholders:** Focus on ROE and EPS as measures of return on their investment.
- **Creditors:** Interested in TIE and Debt Service Coverage, indirectly affected by profitability.

Operating Ratios

Ratios specific to the operational performance of hospitality entities, focused on daily efficiency and pricing.

- **Mix of Sales:** The relative proportions of different revenue streams (e.g., the percentage of total sales derived from room vs. food vs. beverage).
- **Average Daily Rate (ADR):** The average rental revenue earned for an occupied room per day.

ADR = Total Room Revenue / Total Rooms Sold

- **Revenue per Available Room (RevPAR):** A crucial metric combining occupancy and ADR, showing revenue generated per available room regardless of whether it was occupied.

RevPAR = ADR * Occupancy Percentage

- **Average Food Service Check:** The average amount spent by a customer or party in the food service area.
- **Food Cost Percentage:** The cost of food ingredients as a percentage of food sales. A lower percentage is generally better.
- **Beverage Cost Percentage:** The cost of beverages as a percentage of beverage sales.
- **Labor Cost Percentage:** Total payroll and benefits as a percentage of total revenue. A key measure of operating efficiency.

Important questions for full subject:

[Chapter 1: INTRODUCTION TO FINANCE AND BUSINESS ANALYTICS](#)

Conceptual Understanding

1. Differentiate clearly between the primary scope and focus of **Financial Reporting** versus **Business Analytics**. Provide an example of how each is used in managing a profitable restaurant.
2. Explain the difference in informational needs between **External Users** (specifically creditors) and **Internal Users** (specifically operating managers) of accounting data.
3. Define the **Business Entity Concept** and the **Going Concern Concept**. How does adhering to these concepts ensure the reliability of a hospitality company's Balance Sheet?
4. Describe the **Prudence (Conservatism) Convention** and the **Materiality Convention**. Provide a scenario where a manager must apply one of these conventions in recording a transaction.
5. Why is **Consistency** a vital accounting convention? What must a company do if it decides to change its accounting method for inventory valuation?

Chapter 2: PROCESS OF PREPARATION OF FINANCIAL STATEMENTS

Books of Accounts

1. Explain the primary purpose of the **General Journal** versus a **Specialized Journal** like the Purchases Journal. When would a manager use the General Journal?
2. Define the **Guest Ledger** and explain its relationship to the General Ledger. Why is the Guest Ledger critical for credit control in a lodging operation?
3. Describe the function of **Petty Cash** and **House Funds** in daily hotel operations. How does the accounting for these funds differ?

The Statement of Cash Flows (SCF)

4. What is the main **purpose** of the Statement of Cash Flows, and why is it essential even if the Income Statement shows a high Net Income?
5. Define and provide two examples for each of the three major categories of cash flows: **Operating Activities (CFO)**, **Investing Activities (CFI)**, and **Financing Activities (CFF)**.
6. Explain the fundamental difference between the **Direct Method** and the **Indirect Method** for calculating cash flow from operating activities. Which method is most commonly used, and why?
7. How is information from the SCF used to **forecast future financial position**? What does a strong, consistent CFO indicate about a business?
8. Provide an example of a **non-cash investing and financing activity** and explain why it must be disclosed separately from the main sections of the SCF.

Chapter 3: REVENUE CYCLES: SALES, RECEIVABLES AND CASH

Revenue Recognition and Timing

1. What is the core **principle of revenue recognition**? When is revenue typically recognized for a hotel's room stay versus a catered banquet event?
2. Discuss the **pressure to recognize revenues** and list three aggressive techniques managers might use to prematurely recognize sales.
3. Compare the **Delivery (Point-in-Time)** method of revenue recognition with the **Percentage of Completion (Over Time)** method. For what type of business or contract is each method appropriate?
4. Explain the need to account for **Bad Debts** and **Warranty Costs** immediately, even if the actual uncollectible amount or repair cost is not yet known.

Revenue Management and Monetary Assets

5. Define **Revenue Management** in the context of a hotel. What three core elements (e.g., forecasting) are essential to a successful revenue management strategy?
6. Why is tracking **Non-Room Revenue** (like F&B or spa services) essential for a hotel? How does the pricing strategy for these services often relate to demand management?
7. Calculate the **Current Ratio** and **Acid-Test Ratio** for a company with Current Assets of \$100,000, Inventory of \$30,000, and Current Liabilities of \$50,000. Interpret the result of each ratio.
8. If a restaurant has an Average Collection Period (Days of Receivables) of 45 days, what does this indicate about its credit policy and operational efficiency?

Chapter 4: EARNINGS MANAGEMENT, COGS, and INVENTORY

Earnings Management

1. Explain two primary factors that **motivate** a manager to engage in earnings management, such as meeting external expectations or income smoothing.
2. Describe three **common techniques** used to manage earnings (e.g., adjusting depreciation, changing estimates).
3. What is "**window dressing**," and why would a company be motivated to engage in it specifically before seeking a major bank loan or launching an IPO?

Inventory and COGS

4. Differentiate between the three types of companies based on their inventory (Merchandise, Manufacturing, Services). Provide a hospitality-related example for each.

5. Explain the key operational difference between the **Perpetual Inventory System** and the **Periodic Inventory System**. Which system is generally preferred by large hospitality chains, and why?

6. Assume a period of inflation. Compare the impact of the **FIFO** and **LIFO** inventory costing methods on (a) reported Net Income and (b) the valuation of Ending Inventory.

7. Define the **Lower of Cost or Market (LCM)** rule. If a restaurant purchased a consignment of specialty beef for \$5,000, but its current replacement cost (market) has dropped to \$4,200, what amount must be reported on the Balance Sheet, and why?

8. If Company A has an **Inventory Turnover** of 12 and Company B has a turnover of 6, what does this suggest about the efficiency of inventory management at the two companies?

Chapter 5: UNDERSTANDING ANNUAL REPORTS AND FINANCIAL STATEMENT ANALYSIS

Analysis Techniques

1. Explain the methodology and purpose of **Vertical Analysis** as applied to a hotel's Income Statement. What benchmark is used for all line items?

2. Compare and contrast **Horizontal Analysis** and **Trend Analysis**. How do these techniques assist analysts in forecasting future performance?

3. List the five main **purposes of ratio analysis** (e.g., Liquidity Assessment).

4. Explain why it is generally more accurate to use the **average** of a Balance Sheet account (like Total Assets) rather than the ending value when calculating a ratio that uses an Income Statement figure (like Net Income).

Ratio Application and Interpretation

5. A hotel has an **EBITDA** of \$5 million, Interest Expense of \$500,000, and Lease Payments of \$300,000. Calculate the **Number of Times Interest Earned Ratio (TIE)**. What does the result indicate?

6. Explain the difference in focus between the **Current Ratio** (a liquidity measure) and the **Debt–Equity Ratio** (a solvency measure).

7. Define and explain the significance of **GOPPAR (Gross Operating Profit per Available Room)**. How is this ratio a more comprehensive measure than simple RevPAR?

8. Explain why **Return on Assets (ROA)** is important to management, while **Return on Owners' Equity (ROE)** is the primary concern for shareholders.

9. A restaurant has a **Food Cost Percentage** of 30% and a **Labor Cost Percentage** of 35%. Explain what these figures mean to management and how they would use them to control operating efficiency.

