

# Managerial Accounting & Finance

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# Income Statement

## Chapter 3

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# Role of Financial Reporting

- Stewardship – financial statements provide feedback to management and shareholders on management performance.
- Predictive – the statements provide information about the future profitability of the business.

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## Role of Financial Reporting (cont.)

- Accountability – through the reporting of statements management is able to highlight and showcase the successes and explain the failures in an operating year.

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## Role of Financial Reporting (cont.)

- Confirmatory – the statements provide information to external users, such as policing agencies, to verify the true financial condition of the business.

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## Uniform System of Accounts for the Lodging Industry

- Idea first introduced by New York Hotel Association in 1925.
- 1969, AH&MA commissioned the NAA (now IMA) to create a formal system of accounts for hotels.

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Uniform System of Accounts for the Lodging Industry (cont.)

- Financial Management Committee of AH&MA has since been responsible for revisions and interpretations of USALI. Ninth Edition is the most current.

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Uniform System of Accounts for the Lodging Industry (cont.)

- There is also a Uniform System of Accounts for Restaurants originally created by Laventhol and Horwath for the National Restaurant Association.

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Uniform System of Accounts for the Lodging Industry (cont.)

- USALI was designed for hotels to classify, organize and present financial information in a uniform manner. By limiting the degree of variation in preparing statements, investors and others could better compare lodging operations.

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### Uniform System of Accounts for the Lodging Industry (cont.)

- One benefit of USALI is it enables organizations to collect local, regional and national information from similar properties and publish results in average statistics (eg. PKF, Smith Travel, PwC, HVS etc.)
- System is underpinned by responsibility accounting.

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### Major Changes in USALI's 9<sup>th</sup> Edition

- **China, Glassware, Silver, Linen, and Uniforms:** recommended capitalizing initial complement of stock and depreciating over 3 years, while expensing replacements as they are purchased. Reserve stock, however, to be added to inventory and expensed immediately when put in use.

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### Major Changes in USALI's 9<sup>th</sup> Edition (cont.)

- **Pre-opening expenses:** eliminated as Other Fixed Asset, expense as incurred.
- **Food and Beverage:** were traditionally reported in a combined manner, now they are separated.

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## Major Changes in USALI's 9<sup>th</sup> Edition (cont.)

- **Banquet service charges (Gratuities):** now recognized as Other Income (under Revenues) and recorded as wages & salaries expense to banquet staff when they are paid.

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## Major Changes in USALI's 9<sup>th</sup> Edition (cont.)

- **Contract Services:** representing maintenance contracts, service contracts, and other outsourced services, previously charged as overhead cost to Property and Maintenance, is now charged directly to department receiving the services.

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## Major Changes in USALI's 9<sup>th</sup> Edition (cont.)

- **Revenues and expenses from internet access connections:** recommendations made about their treatment, including web-page design costs.

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## Income Statement

Also known as: statement of earnings, P&L statement, statement of operations. Income statement most popular usage.

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## What is it?

Summary of revenues and expenses over a specified period of time – summary of operating results. These operating results reflect transactions in which the hotel or restaurant's personnel have been engaged over the accounting period, for which documentary evidence exists.

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## Why is it important?

- This statement helps us to predict cash flows and future growth prospects of the business.
- It helps us to evaluate management's performance.

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## Similarity to Photography

Using a camcorder a photographer captures series of still pictures of hotel employees engaged in specific actions on behalf of the hotel. These still pictures are woven into a flow so that at the end of the day when we replay the tape we have a motion picture showing specific actions that are relevant only to the events of the day.

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## Similarity to Photography (cont.)

When we have repeated this motion picture over several days and we attempt to edit and summarize all of the individual events from the beginning to the end of the period for the purpose of telling the story, then we have a movie.

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## Similarity to Photography (cont.)

The income statement represents the movie of the hotel or restaurant for a given day, week, month, quarter, or year, and the hotel accountant serves as the director of this movie.

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## Things to note

- The income statement presents results over a period of time.
- There may be events that occur during this period that may impact on the business for several years to come but we only concentrate on the parts of the transaction relevant to the story of the day, week, month etc. in which we are interested.

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## Things to note (cont.)

- Matching principle - the income statement summarizes the results of operations through the matching of revenue earned in that period against the expenses incurred to earn that revenue.

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## Major Elements of the Income Statement

- 1. REVENUES** - sources generally include room sales, food and beverage sales, interest and dividend from investments, and rent received from tenants/lessees of retail space. These represent inflow of assets.

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## Major Elements of the Income Statement (cont.)

**2. EXPENSES** - represent outflow of assets. Generally includes: cost of goods sold (eg. food and beverage cost), labor cost, utilities, depreciation cost etc.

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## Major Elements of the Income Statement (cont.)

**3. GAINS** - these are benefits received from transactions that are not part of the daily operations of the hotel/restaurant eg. Sale of delivery vehicle that earns a profit above the net book value of the vehicle.

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## Major Elements of the Income Statement (cont.)

**4. LOSSES** - losses from transactions that are not part of the daily operations of the hotel/restaurant (same as above) incidental transactions eg. Selling the delivery vehicle for less than the net book value will create a loss. This would also include a loss from a natural disaster (less reimbursement amount from insurer).

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## Uniform System of Accounts

In the Uniform System of Accounts, gains and losses are not included in revenues and expenses on the income statement, they are generally located toward the bottom of the statement.

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## Connection between the Balance Sheet and Income Statement?

The bottom-line performance of the operation (net income less dividends) from the income statement shows up on the balance sheet as part of the Retained Earnings account.

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## Management

Management generally requires more information from the income statement so the statement tends to be more detailed while an income state prepared for the benefit of shareholders and outsiders is typically condensed.

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## Responsible Accounting

Full-service hotel business is departmentalized so the income statement is also presented reflecting each department's contribution to the hotel's operations – this termed responsibility accounting.

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## Restaurant Income Statement

- Revenue sources - food and beverage
- Other income - merchandise, videogames, jukebox etc.
- Controllable expenses - operating expenses: wages & salaries, employee benefits, utilities, marketing, administrative and general etc.

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## Restaurant Income Statement (cont.)

- Income before occupancy costs - end of GM's responsibility.
- Occupancy costs - insurance expense, property taxes, rent.

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## Notes on Hotel Income Statement

- Limited service hotels or motels have a simplified income statement that lists Revenues at the top and operating expenses below.

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