2 Review of hospitality and tourism financial statements

The key financial statements produced from accounting systems which are relevant to hospitality and tourism managers are the:

- Profit and loss statement
- Balance sheet
- Cash flow statement

These statements are fundamental to the profit planning and control of business operations and are the basis om which to measure, analyse and interpret operating results in financial terms.

Profit and loss statements

The profit and loss statement is the primary financial report for managing routine operations at the property (unit) level. It summarizes trading operations in relation to revenues generated and expenses incurred during a particular financial period, indicating the resulting profit or loss.

Basic profit and loss statements

The structure of the traditional profit and loss statement has evolved over time through the development of business and commercial activities. In its basic form the profit and loss statement appears as shown in Figure 2.1.

	£
Sales revenue	300,000
Less: cost of sales	90,000
Gross profit	210,000
Less: expenses	150,000
Net profit	£ 60,000

Figure 2.1: Basic profit and loss statement

Referring to Figure 2.1, the preparation of a profit and loss statement is based on a number of fundamental accounting principles and conventions, the most important of which is the *matching* principle, also known as the *accrual* principle. This principle requires all revenues generated and the expenses incurred (in the generation of the revenues) during a financial period are matched (accrued) in the profit and loss statement, regardless of when the cash was received or paid.

The matching principle is crucial determining the true profit or loss position for a given financial period. By expanding the basic profit and loss statement with a little more detail in Figure 2.2, we can consider examples of the matching principle involving revenue and expenses in determining profit, as follows:

♦ ***Revenue example:*** Referring to Figure 2.2, if £5,000 of the £300,000 sales revenue was not received by the end of the period, the amount owing will reduce the cash position by £5,000, but will not affect the £300,000 revenue itself.

	£	£
Sales revenue		300,000
Less: cost of sales:		
Opening stock	10,000	
Purchases	100,000	
110,000		
Closing stock	20,000	90,000
Gross profit		210,000
Less: operating expenses		150,000
Net Profit		£ 60,000

Figure 2.2: Basic profit and loss statement illustrating the matching principle

♦ ***Expense example:*** Referring to Figure 2,2, the cost of sales of £90,000 has been analysed to reveal £100,000 worth of stock purchases (items bought for resale) were acquired during the period. From the stocks on hand at the beginning (£10,000) and at the end (£20,000) of the period we can determine that £90,000 worth of stock (cost of sales) was actually consumed in generating the revenue of £300,000.

We can see that gross profit results from sales revenue less the cost of sales and not, as is sometimes thought, sales revenue less the cost of purchases.

Service industry profit and loss statements

Figures 2.1 and 2.2 outline a basic profit and loss statement applicable to almost any business undertaking. However, in order to provide relevant information for reporting results the structure and content should reflect the type of business involved.

The basic structure of a service industry profit and loss statement is shown in Figure 2.3. Closer inspection of the statement reveals:

	£
Sales revenues	300,000
Less: direct expenses	140,000
Departmental profit	160,000
Less: indirect expenses	100,000
Net profit	£ 60,000

Figure 2.3: Basic structure of a service industry profit and loss statement

- Operating activities of service industry organisations, such as hospitality and tourism undertakings, are normally carried out within departments rather than performed on production lines found in manufacturing firms.
- Revenues are grouped (classified) by departments applicable to the nature of the products and/or services offered by the particular undertaking.

Operating expenses are divided into two main groups, *direct expenses* and *indirect expenses* (also known as overhead):

- Direct expenses (costs directly related to specific revenue producing departments) are normally allocated to the respective departments and in some cases, can be related with individual units of products and/or services.
- Indirect expenses (costs which benefit the business as a whole) cannot be directly related to particular revenue producing departments or products and services and, therefore, remain unallocated.

Hotel profit and loss statements

The operating activities and industry characteristics of the hotel sector referred to in Chapter 1 are taken into account in the Uniform System of Accounts for the Lodging Industry (USALI), an all inclusive format comprising the main sources of revenue and expenses encountered in hotel undertakings. Figure 2.4 broadly follows the layout recommended for the USALI profit and loss statement for internal management use:

- The structure and presentation of the revenue and expense sections of the profit and loss statement make it possible to present and measure the major activities of a hotel property.
- Indirect expenses (overhead) are sub-divided into two groups termed *undistributed operating expenses* (controllable) and *fixed charges* (non-controllable).