

Introduction to a Hotel's Financial Statements for Attorneys

Hospitality Law Conference

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Presenters



- **John Merkin, Principal, JKM Advisory Services**
- John is a 23 year veteran of InterContinental Hotels Group holding senior positions in marketing and franchise operations across seven brands in the Americas region
- John was SVP Brand Management for Holiday Inn Brands in the Americas during the time when the Holiday Inn re-launch was planned and implemented
- John graduated from the Kellogg Graduate School of Management at Northwestern University in Chicago with a MBA in Marketing as well as earning an undergraduate degree in business administration from Southern Illinois University - Carbondale



- **Anthony Campanelli, Senior Manager, Deloitte Financial Advisory Services LLP**
- Anthony is a Certified Public Accountant (CPA) in the States of New York and New Jersey and has earned the credential of Certified in Financial Forensics (CFF) by the American Institute of Certified Public Accountants (AICPA)
- Anthony provides forensic consulting services on a wide range of matters, including securities litigation, fraud and corruption investigations, in several industries with a focus in the tourism, hospitality and leisure sector.
- Anthony has also been quoted in *The New York Times*, *Thomson Reuters*, and *Hotel Interactive* on various fraud, environmental, and compliance issues



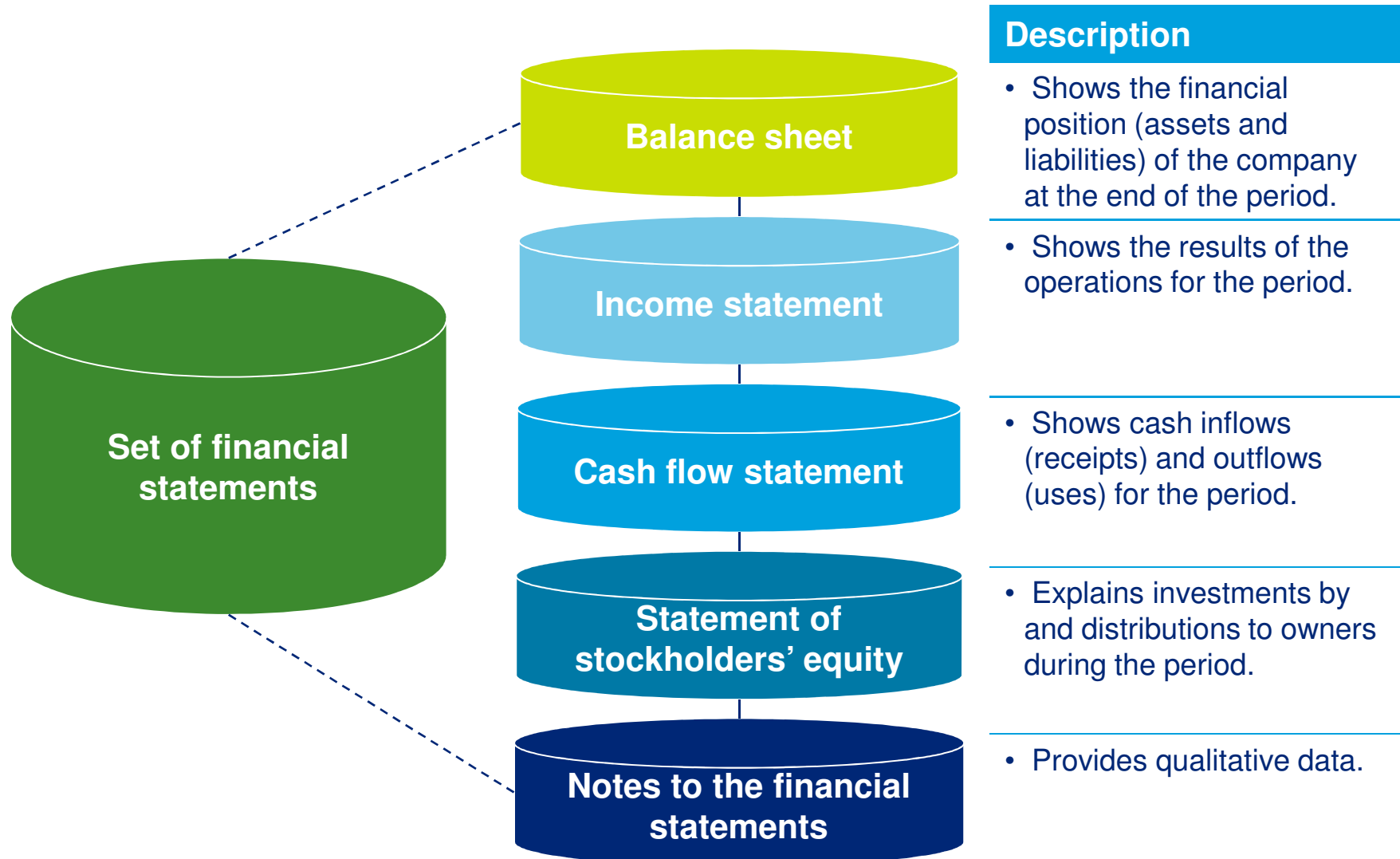
- **Al Gallo, Senior Vice President and Chief Financial Officer for Redstone Companies Hospitality.**
- Al is a Certified Hospitality Accountant Executive with a Bachelor of Science degree in Hotel and Restaurant Management from the University of Houston Conrad N. Hilton College
- Al was named the Houston Business Journal's Chief Financial Officer of The Year for Mid-Cap Private companies in 2009.
- Al has also served as adjunct assistance professor at The University of Houston Graduate School of Hotel and Restaurant Management where he taught Hospitality Financial Planning.



Agenda

- Understand the financial statements and footnotes
- Understand the key things to look for in the financial statements
- Understand the concepts of financial reporting and the accounting framework

A complete set of financial statements for a hotel company



Balance sheet

Balance sheet elements

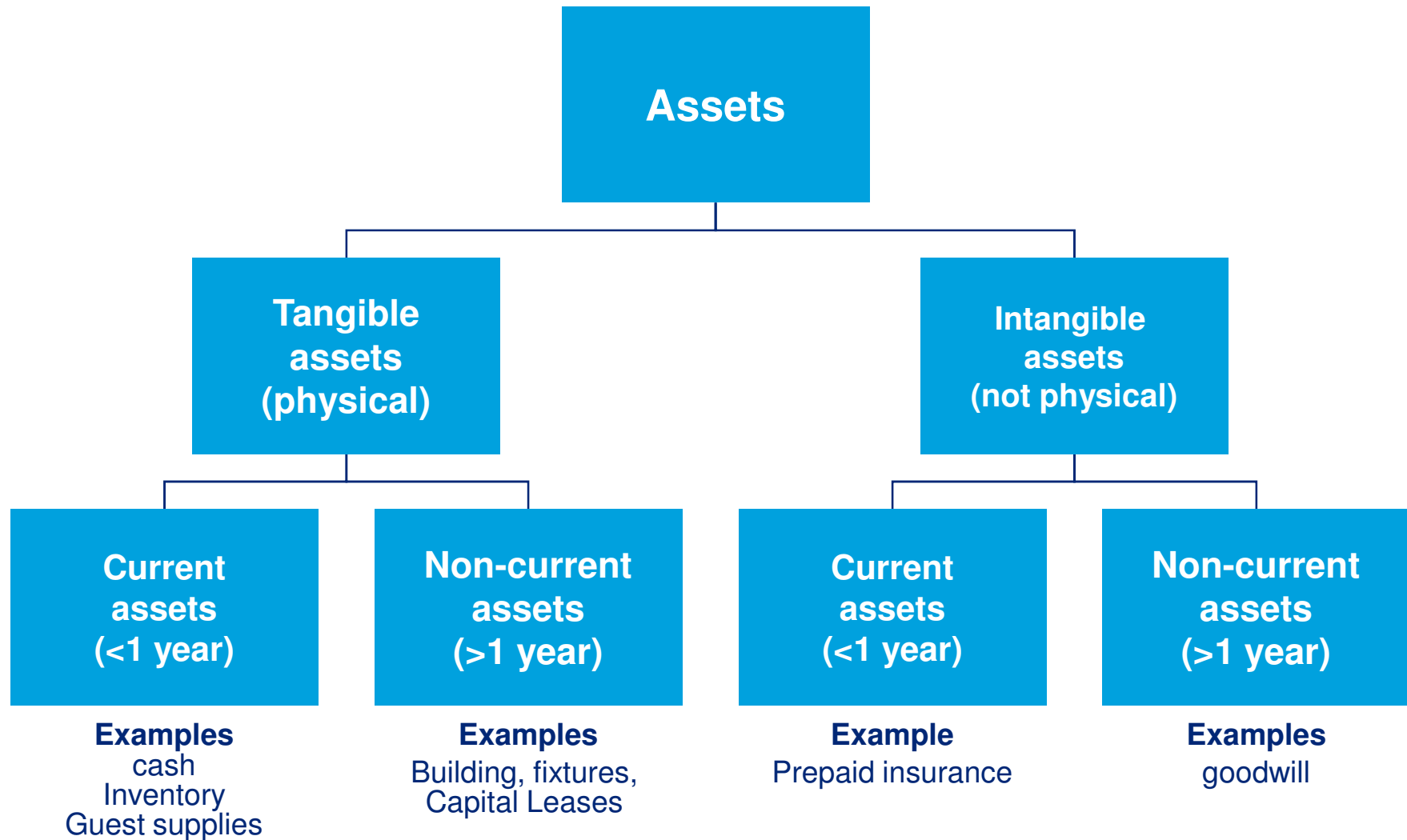
Assets

- Probable future economic benefits obtained or controlled by an entity as the result of past transactions or events.
 - Presented on the balance sheet in order of liquidity (cash first)
 - Commonly presented at historical cost, net of depreciation

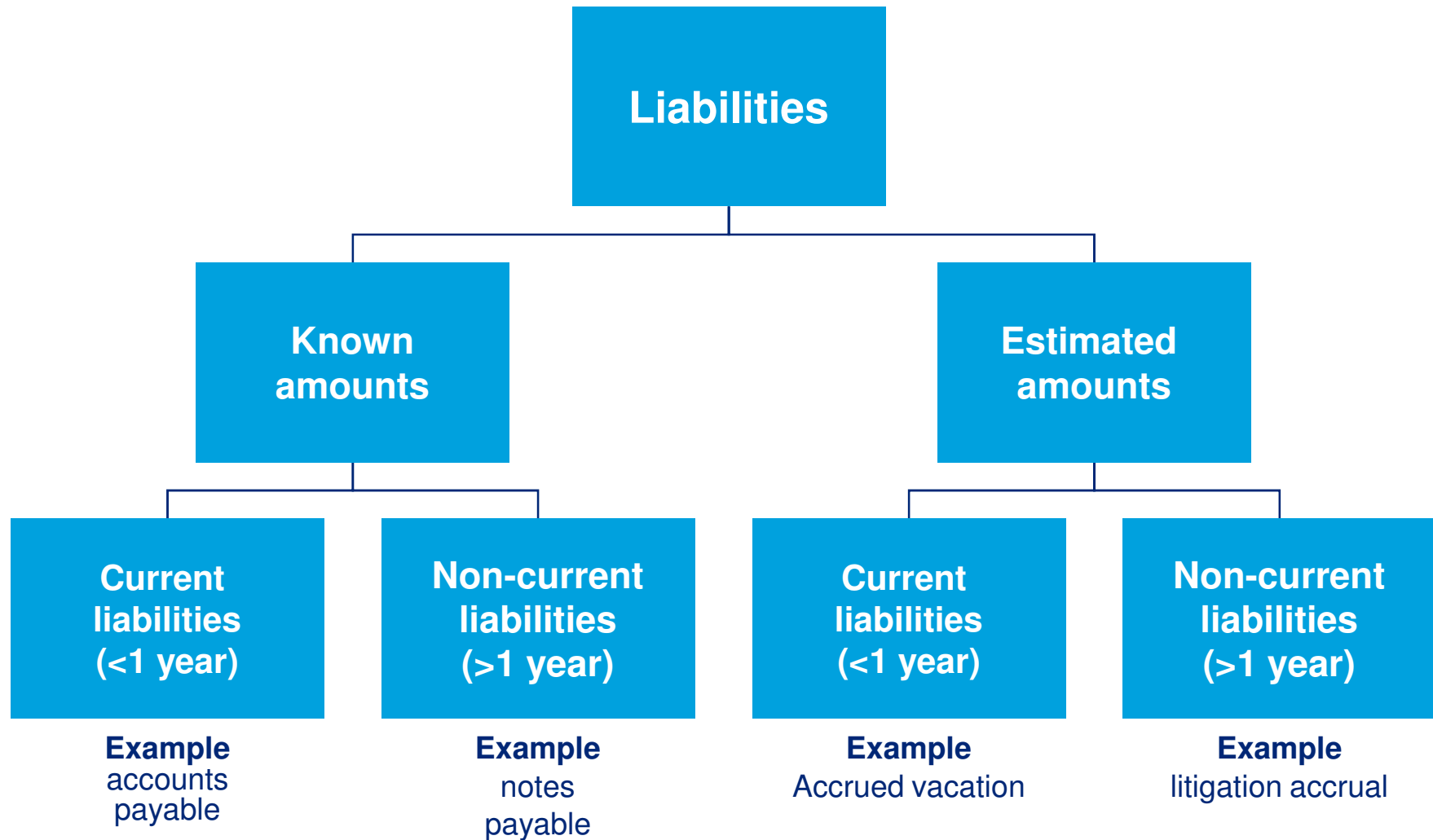
Liabilities

- Probable future sacrifices of economic benefits arising from present obligations to transfer assets or provide services in the future as a result of past transactions or events.

Classification of assets



Classification of liabilities



Key things to look for on the balance sheet

How liquid are the assets?

- Assets are classified and presented in a decreasing order of liquidity (convertibility into cash).

What is the quality of the assets?

- What is the underlying nature of the assets (Current vs. non-current, tangible vs. intangible assets)

How leveraged is the company?

- How much debt is recorded?

Can they meet their current obligations?

- Will the Company be able to pay its debts as they become due, based on their current cash balance and expected cash inflows?

What is the breakdown between short-term and long-term debt?

- Will the company be able to fund its debt?

Income statement

Income statement elements - Revenue

Revenue

- Inflows or other enhancements of assets of an entity or settlements of its liabilities from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations

Gains

- Gains are increases in equity (net assets) from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity except those that result from revenues or investments by owners.

Source: SFAC 6, Elements of Financial Statements

Key Revenue Accounts

The following is a list of potential revenue P&L accounts that may be included in a hotel's trial balance:

- Room Revenue
- Food & Business Revenue – Dining Room
- Food & Business Revenue – Bar
- Catering Revenue
- Business Center
- Gift Shop
- Parking
- Telephone
- Rental & Sundry Income

Income statement elements (cont.)

Expenses

- Outflows or other “using up” of assets or “incurrence” of liabilities from delivering or producing goods, rendering services, or other activities that constitute the entity’s ongoing major or central operations.

Losses

- Losses are decreases in equity (net assets) from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity except those that result from expenses or distributions to owners.

Source: SFAC 6, Elements of Financial Statements

Financial statement reporting: Notes to the financial statements

The following is a list of potential expense P&L accounts that may be included in a hotel's trial balance:

Operating Expenses:

- Rooms
- Food & Beverage
- Business Center
- Catering
- Gift Shop
- Parking
- Telephone

Selling, General, & Administrative:

- Management fees
- Property taxes
- Administrative
- Marketing and sales
- Energy
- Insurance
- Rent

Depreciation/Amortization:

- Depreciation expense
- Amortization expense

Interest, net:

- Interest expense
- Interest income

Taxes

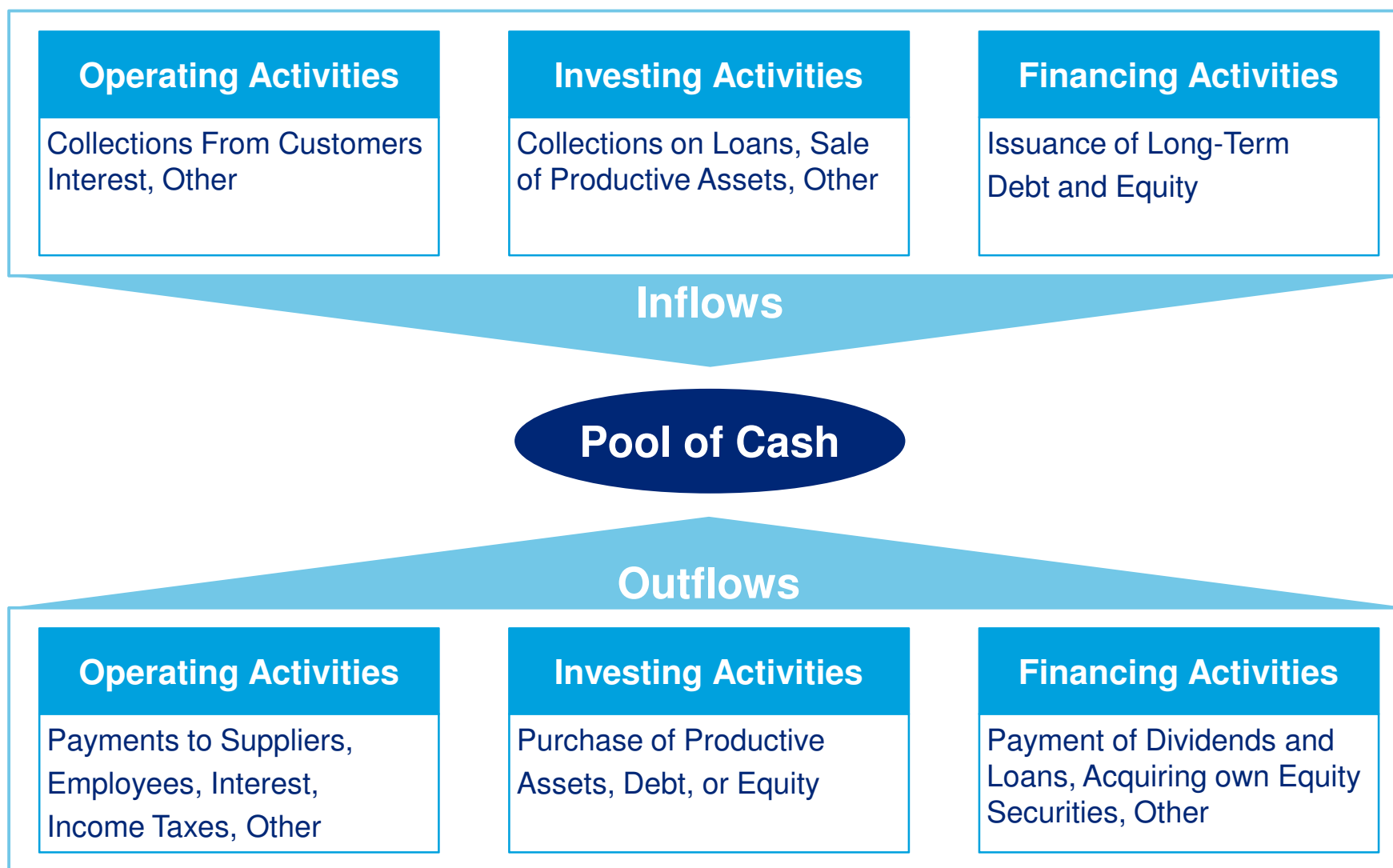
- Income tax provision

Key things to look for on the income statement

- Is the company profitable?
 - Income from Continuing Operations
 - Net Income
- What portion of the income is from non-recurring/non-operating transactions?
 - Were there any one-time occurrences during the year?
- Have any operations been discontinued?
- Which expense items seem out of line?
 - Compare expense items to prior period results
- How do operations and performance results compare to:
 - Previous years (vertical and horizontal analysis)
 - Competitors/Industry

Statement of cash flows

Statement of cash flow ingredients



Key things to look for on the cash flow statement

- Did the company's cash position change significantly?
- How is the company using its cash?
- What were the sources of the company's funds?
- Comparison of Income Statement to Cash Flow Statement:
 - Strong income from continuing operations versus weak cash flow provided by operating activities
- Assess the ability of the company to meet its obligation, pay dividends, need for external financing

Notes to financial statements

Financial statement reporting: Notes to the financial statements

Provides **further explanations** or provides the **only explanations** for significant transactions and contains required disclosures

- Overview of the business
- Significant accounting policies
 - Revenue recognition
 - Principles of consolidation
 - Property, plant and equipment
 - Intangible assets and goodwill
- Discontinued operations

- Business combinations
- Debt offerings and credit risk
 - Income taxes
 - Related party transactions
 - Subsequent events
 - Commitments
 - Contingencies

Other key accounting concepts

Financial statement reporting: limitations on financial statements

- Information often results from **approximate**, rather than exact measures.
 - Example: Estimates include the allowance for doubtful accounts receivable, carrying value of certain intangibles, contingencies, etc.
- Information is based upon **historical** data and does not measure or discuss management's plans for the future.
 - Example: The benefits of a company's restructuring plan might not benefit the company until several years after the plan is announced/implemented.
- Information is **generally recorded at cost** and may not reflect the current market value.
 - Example: Generally, fixed assets are accounted for at a cost, and not at their fair market value (FMV). For example, a hotel built in the 1950s will be recorded at the amount for which it was constructed and not at its FMV in 2010.

Auditors responsibility on the financial statements

- Financial statements are the **responsibility of company's management**
- **Auditor's responsibility** is to **express an opinion** on the financial statements as a whole based on an audit
- An audit:
 - is designed to obtain **reasonable assurance** about whether the financial statements are **free of material misstatement**
 - includes examining, on a **test basis** evidence supporting the **amounts and disclosures** in the financial statements
 - assessing the principles and estimates used by management
 - evaluating the overall financial statement presentation
 - **DOES NOT** evaluate every transaction

Non-GAAP measures

Public companies are required to disclose or release certain financial information that is calculated and presented on the basis of methodologies other than GAAP to present:

- Most directly comparable GAAP financial measure
- A reconciliation of the disclosed Non-GAAP measure to the most directly comparable GAAP measure

Examples of non-GAAP Measures:

- EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization)
- RevPar (Revenue per Available Room)
- ADR (Average Daily Rate)

Pro forma vs. Historical financial statements

Pro Forma — provides information about the continuing impact of a particular transaction by showing how it might have affected historical financial statements if a transaction (acquisition or disposition) had been consummated at an earlier time.

- **Example:**

- For a business combination, the financial statements shall include certain pro forma information, such as the “results of operations for the current period as though the business combination(s) had been completed at the beginning of the period”

Historical — measure income or present a financial position for past events. The information as reported in historical financial statements is a summarized presentation of the operations of the business during a specific period of time.

Source, SFAS 141, Business Combinations

Questions and answers

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