

# **Technical Guide on Audit in Hotel Industry**



**The Institute of Chartered Accountants of India**

*(Set up by an Act of Parliament)*

**New Delhi**

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# FOREWORD

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The Hotel Industry comprises a major part of the Tourism industry. Historically viewed as an industry providing a luxury service valuable to the economy, only as a foreign exchange earner, the hotel industry today contributes directly to employment, employing around 0.15 million people in India, and indirectly facilitates tourism and commerce. The Hotel Industry has grown leaps and bounds after the Asiad games held in India in 1982 and the subsequent partial liberalization of the Indian economy. The Commonwealth Games hosted by India in 2010 have given a greater push to the growth of the hotel industry. The hotel industry has also got a fillip from the entry of low cost airlines and the open skies policy.

With increasing number of hotels in the country and their penetrative reach in each and every part of the country, the responsibility of their effective and timely audit lies with the Chartered Accountants. I am happy to note that the Auditing and Assurance Standards Board of the Institute of Chartered Accountants of India has come out with a Technical Guide on Audit in Hotel Industry, written by an eminent expert. The Technical Guide is designed to help the members and other readers, have a thorough understanding of the peculiarities involved in the operations and audit of hotel industry.

At this juncture, I wish to place on record, the efforts of CA. Abhijit Bandyopadhyay, Chairman, Auditing and Assurance Standards Board for his unstinted endeavours to help the members in their day to day audit assignments through such industry specific audit guides as well as awareness programmes and training workshops on Standards on Audit that were conducted this year.

I am sure that this Technical Guide would be immensely useful and highly appreciated by the members as well as other interested readers.

February 8, 2011  
New Delhi

**CA. Amarjit Chopra**  
President, ICAI

# PREFACE

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The Hotel Industry in India is set to grow at the rate of 15% a year. This figure skyrocketed in 2010, when Commonwealth Games were hosted by Delhi. Already, more than 50 international budget hotel chains have moved into India to stake their turf. Therefore, with opportunities galore, the future scenario of the Indian hotel industry looks brighter than ever before.

In order to sustain the success of an entrepreneurship, timely, relevant and reliable financial information complemented by an independent audit is indispensable, the hotel industry being no exception. The prime objective of the Auditing and Assurance Standards Board in bringing out industry specific audit guides is to help the members understand and address the issues peculiar to the and affecting the audit in a particular industry appropriately.

Accordingly, this Technical Guide on Audit in Hotel Industry provides an insight not only into the general functioning of hotels, but also the risk areas as well as methods of accounting and auditing peculiar to them. It discusses in detail the peculiarities associated with the important items on the financial statements of a hotel, such as, revenue from different streams and activities and receivables, expenditure on aspects such as food and beverage costs, commissions, maintenance costs, rentals, payroll costs, etc., and other issues such as property, plant and equipment, guest royalty reward programmes, etc., The appendices to the Guide contain sample checklists for audit of revenue and a sample audit programmes for the benefit of the members.

At this juncture, I wish to express my heartfelt gratitude to CA. S Narasimhan, Chennai for sparing time out of his pressing professional and personal preoccupations for preparing this Technical Guide. I am also thankful to CA. T. V. Balasubramanian for his assistance in developing the Guide. My sincere thanks are also due to CA. Amarjit Chopra, President, ICAI as well as CA. G

Ramaswamy, Vice President, ICAI whose vision, guidance and support I have been privileged to receive in the activities of the Board.

Many thanks are also due to my Council colleagues at the Board, viz., S/Shri Rajkumar S Adukia, Vice Chairman, Sumantra Guha, P Rajendra Kumar, Jayant P Gokhale, Jaydeep N Shah, Sanjeev Maheshwari, S Santhanakrishnan, J Venkateswaralu, Pankaj Tyagee, Anuj Goyal and the Central Government nominees, Shri Prithvi Haldea and Smt. Usha Shankar and also to the co-opted members at the Board, viz., K. Rajasekhar, Ganesh Balakrishnan, Samir Shah, Harinderjit Singh and T.V. Balasubramanian, for their dedication and support in charting the work plan of the Board and bringing it to fruition. I also wish to place on record my thanks to the special invitees to the Board, viz., Nilesh S. Vikamsey, Sanjay Vasudeva, Bhavani Balasubramanian, Amit Roy, R. Narayanaswamy, Prof. Vipul and Jaideep Bhargava who have taken time out of their far more pressing commitments to devote time to the activities of the Board.

I am confident that this Technical Guide would be well received by the members and other interested readers.

February 8, 2011

Kolkata

**CA. Abhijit Bandyopadhyay**

Chairman

Auditing and Assurance Standards Board

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# PART 1

## FRAMEWORK OF HOTEL INDUSTRY

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### Hotel Industry in India

#### Understanding Hotel Industry

1.1 Hotel industry is foremost among various industries that reflect the economic activity in an economy. It mirrors true social, cultural and economic growth and maturity of a country. The Hotel industry is directly related to the Travel and Tourism industry.

1.2 India is a very vast country with geographical diversity, ranging from snowcapped mountains to deserts to vast coastlines, complemented by rich culture and heritage, fairs and festivals, monumental attractions, etc. For sheer diversity, no other tourist destination probably comes close to India. Therefore, there is a tremendous potential for growth of tourism industry in India.

1.3 The earlier setbacks in global tourism have strengthened the Department of Tourism's resolve to promote India's tourism through aggressive marketing strategies through its campaign 'Incredible India'. The 'marketing mantra' for the Department of Tourism is to position India as a global brand to take advantage of the burgeoning global travel and trade and the vast untapped potential of India as a tourist destination.

1.4 In 2009, the domestic market in India recorded 650 million travellers as compared to only about 5 million international travelers, indicating the dominance of domestic travel in the country. The foreign tourist arrival during the period January-October 2010 was 4.32 million with a growth rate of 9.9 per cent.

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1.5 India is fortunate to have a domestic market that supports the growth of the travel industry even when the world economy is experiencing a downturn. However, domestic travel has probably never been given its due. Even today, it is the statistics on the foreign travellers that garner attention; though, it is the less represented domestic segment that forms the major component of revenue generated by the Indian travel industry.

1.6 The domestic demand for hotels in India has historically been higher than the demand from foreigners. Though a large portion of domestic demand originates from commercial activity, an increasing number of Indians are taking annual holidays, both within the country and overseas. Many States within India such as Kerala, Rajasthan, Goa have started focusing their efforts on the Indian traveller.

1.7 The current count of hotel rooms in India is 130,000, and the country is expected to require an additional 50,000 rooms over the next two to three years, according to World Travel and Tourism Committee (WTCC) estimates.

1.8 The World Travel and Tourism Council (WTTC) has predicted that India has the potential to become the number one tourist destination in the world with the demand growing at 10.1 per cent per annum and will receive 25 million tourists by the year 2015.

1.9 Other than hotels, there are lots of standalone restaurants which are also contributing to economic activity and there are branded chains of restaurants which are claiming prominence across India. Similarly, standalone SPA, medical tourism, etc., are driving the demand and need for expansion of hotel room requirements.

### **Factors affecting Hotel Industry**

1.10 There are various factors which affect the growth of the Hotel industry, viz., economic, political, competition, substitutes, strength of suppliers and of course employees.

## ***Framework of Hotel Industry***

### ***Economic Factors***

1.11 Various key economic factors like interest rates, taxation changes, economic growth, inflation and exchange rates affect the Hotel industry as much as any other business. However, even global recession which has even though not affected India much had major impact in hotels as foreign tourist arrival dropped considerably. Hence, economic circumstances of not only India but global economic factors also affect the industry performance. This phenomenon has been witnessed even in the past like during the 1997 Asian economic crisis.

### ***Political factors***

1.12 Political stability in the country is considered important for the growth of any industry in the country. The political stability is even more necessary for the growth of Hotel industry. In the past Afghan war, Mumbai terror attacks, etc., have forced foreign countries to bring in travel advisories which poorly affected the Hotel industry.

### ***Competition***

1.13 Competition drives both the supply of the rooms and also creates demand for rooms through advertisements by competitors. Whereas competition leads to reduction in prices in the short run, it also leads to improvement in quality of service / product and also bring in healthier impact in the Industry by forcing players to reposition the brand / quality of service in the long run.

### ***Substitutes***

1.14 Of late due, to ever raising room rates especially in five star Hotels category, lots of substitutes have emerged to cater to travellers who spend considerable amounts on Hotel stays. For instance, video conferencing has obviated the need for businessmen to travel long distances, stay in hotels and have face-to-face meetings. Similarly, most corporates have started

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using own guesthouses / shared service apartments resulting in reduction in the Hotel capacity.

### ***Strength of Suppliers***

1.15 The existence of reliable sources that could provide timely and high quality goods and services at competitive rates, is a very important factor for growth of the Hotel industry. The existence of such sources is of even greater necessity for purchase of perishable goods that need to be procured on a daily basis. In the scenario where outsourcing of certain services (like back of the house cleaning services, Kitchen Stewarding) is gaining wider acceptance for the purpose of converting fixed overheads into variable overheads, the strength of suppliers in terms of their ability to provide consistently timely services, assumes great significance.

### ***Employees***

1.16 Employees are always considered as the key asset in a service-oriented industry. The quality and competence of employees, not only of those who interact directly with the guests but also of those who provide support services, are critical to the success of a hotel. Ever increasing employee cost also results in reduction in manpower. Hotels in India in the past had operated with an average of 2, and in some cases, 3 employees per room as compared to the international benchmark of 1.5 or less employees per room.

## ***Peculiar Features of the Hotel Industry***

1.17 There are a number of special features that set the Hotel industry apart from other service industries. These factors are briefly discussed hereinafter.

### ***Fixed Supply of Rooms***

1.18 The number of rooms available in a hotel remains fixed and there is no scope for flexibility in the same. The hotelier cannot increase/decrease the number of rooms available with

## ***Framework of Hotel Industry***

increase/decrease in demand, unlike in a manufacturing industry where a reduction in the production is possible in response to rising / falling demand. Another constraint in case of the hotel industry is that there is very little scope for putting the rooms to alternative use for generating revenue.

### ***Perishability of Hotel services***

1.19 The services of Hotel are immediately perishable as these cannot be stored for future use. For example, if a room remains vacant on a particular day, revenue for that day is lost immediately and it cannot be made up in future. Similarly, if restaurant tables are not occupied it is a lost business opportunity.

### ***Controls on leakage of revenue***

1.20 The existence of appropriate controls for preventing leakage of revenue assumes great significance in case of a hotel for the reason that it generates revenue through a number of operating departments. The existence of appropriate controls is more important in the case of resident guests who have access to virtually all the facilities offered by a hotel. In most of the services, person offering service interacts with a guest and expected to bill for service rendered. It's called *moments of truth*.

1.21 To prevent any possible leakage of revenue, a number of hotels in India are automating their billing systems for telephones, food and beverages that get linked directly to guest ledgers by interfacing point-of-sale billing to Property Management System (PMS). Despite the automation, a hotel is exposed to certain types of leakage of revenue. The control issues in case of a hotel have been more elaborately dealt in subsequent Chapter.

### ***Seasonality Factor***

1.22 The seasonality factor that affects the hotel industry is of more dynamic nature are compared to the other industries. Besides climate and weather factors, hotels have also to contend with the weekdays, weekends as well as monthly 'seasonality' factors. Consequently, a hotel has to devise suitable packages

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and resort to innovative pricing to overcome this problem. (For instance in Goa and Kerala, monsoon packages are offered at cheaper rates to attract local tourist / corporate travellers for conferences, etc.)

#### ***Service Charges***

1.23 The Hotel industry is one of those industries that levy a service charge on the billed amount. These charges are generally levied on food and beverage bills. Service charges are treated differently by different Hotels. While some use it to distribute to the staff as part of labour cost and some for hiring temporary staff for functions, or for breakage of Crockery / Cutlery and Glassware, etc.

#### ***High Fixed Cost***

1.24 The proportion of fixed costs to the total costs is normally higher in case of a hotel. This means that a hotel has to incur certain costs whether or not it has generated any revenue. The need to reduce the proportion of fixed costs has resulted in an increasing trend towards outsourcing. For example, many hotels in India get their laundry done through external agencies. Many of the housekeeping functions, which comprise a chunk of the fixed costs, are also being outsourced. Abroad, sub-letting of bars and restaurants and even the entire food and beverage function is already in vogue.

#### ***Contribution factor on revenue from rooms***

1.25 Revenue from rooms is one of the few revenue streams that have lowest variable costs and, consequently, provide the highest contribution. The incremental costs on letting out of a room are generally the cost of washing the linen and replenishing the guest amenities like toiletries.

## ***Framework of Hotel Industry***

### ***Night / Income Audit***

1.26 The term *night audit* is widely prevalent in the hotel industry. The term refers to the procedure under which various revenues are checked at night, i.e., after the end of the 'normal' business hours. Night audit is a control procedure which is carried out to ensure that revenues for the day, as also cash / credit card collections, have been correctly recorded, so that records are updated and ready by the next morning. As most of the hotels now use PMS, the need for night audit has been shifted to more of income audit done during day time. PMS has ensured that there is an automatic balancing of revenue posting, cashier closing and guest posting. Hence, of late, night date change (for running procedure of posting room revenue in PMS) is done by the front office operating team and income audit is done next day during the day time.

### ***Time sharing arrangements***

1.27 Time-sharing is a relatively new concept that offers the right to use, for a set interval each year, the facilities in a designated hotel/resort, wherein the purchaser pays an initial fixed amount to acquire the timeshare product and then pays an annual contribution known as maintenance or management fee.

### ***High Capital Investment***

1.28 Hotel industry involves high amount of investment in fixed assets, primarily land. Typically, nearly 90% of the net worth of a hotel is invested in fixed assets. Further, the gestation period for hotels is generally longer as compared to other industries.

### ***Laws / Statutes Applicable to Hotel Industry***

1.29 Apart from the common laws that are generally applicable to any business entity, such as the Income-tax Act, 1961, the Companies Act, 1956 (if the entity owning the hotel is a company), and the labour laws, the following statutes require specific mention as being applicable to the hotel industry:

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<b>Details of the Law</b>	<b>Subject</b>	<b>Levy on</b>
Luxury Tax Acts	State Act	For levy of tax on luxury provided in the hotel.
Prevention of Food Adulteration Act, 1954* Food Safety & Standards Act, 2006 Prevention of Food Adulteration Rules, 2010	Central Act	For maintenance of hygiene and quality of food.
Central Excise Act, 1944	Central Act	Excise duty on pastries and cakes.
State Excise Acts	State Act	State Excise laws for levy of excise duty on liquor & regulate sale / service of liquor.
Service Tax (levied under the Finance Act, 1994)	Central Act	For levy of service tax on banquet revenue and various other services like dry cleaning services, etc.
Shops and Establishments Act and the Catering Establishments Act (In few states)	State Act	For regulating the working of the hotels.
Value added Tax Acts	State Act	For levy of tax on sale of food and other goods.
Standards of Weights and Measures Act, 1976	Central Act	To establish standards of weights and measures.
Contract Labour (Regulation & Abolition) Act	Central Act	Controlling & regulating employing contract labour

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\* Getting repealed shortly

## *Framework of Hotel Industry*

### **Key revenue generation activities**

1.30 In a hotel, following are the typical revenue streams

<b>Revenue stream</b>	<b>Basis of revenue&amp; Tax there on</b>
Room Revenue	<ul style="list-style-type: none"> <li>✓ From sales of rooms. Billing is done through PMS.</li> <li>✓ Luxury tax is chargeable on room revenue. In some States it is chargeable on published rack rate and in some States it is on actual room revenue charged to guest.</li> <li>✓ Luxury tax is payable on complimentary rooms as well in most States. Exemptions are given for employees of the hotel who are staying in hotel.</li> </ul>
Retention charges – Due to cancellation / no shows	<ul style="list-style-type: none"> <li>✓ Collected from guest for either cancellation of a reservation or due to no-show (non-arrival upon reservation)</li> <li>✓ It is not equivalent to room revenue as no room is sold but it is collected as a penalty for non-fulfilling the commitment. Hence, it can not be classified with room revenue. However, in some States, Commercial tax authorities have been claiming luxury tax on retention forcing hotels to account it as part of room revenue.</li> </ul>
Food and Beverage (F&B) revenue from Restaurants	<ul style="list-style-type: none"> <li>✓ Food and Beverage sold in restaurants. Billing is done through POS (Point of sales)</li> <li>✓ VAT is charged on F&amp;B sales.</li> <li>✓ Normally F&amp;B income is charged based on food served. But it is also apportioned from a composite</li> </ul>

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Revenue stream	Basis of revenue& Tax there on
	charge through a process called meal plan apportionment. This is explained below.
F&B Revenue from minibar	<ul style="list-style-type: none"> <li>✓ Most hotels keep minibar stocked with liquor, soft drinks, snacks etc.</li> <li>✓ These are normally billed based on self-declaration by the Guest by filling up the form kept in minibar.</li> <li>✓ While replenishing, minibar attendant checks consumption and bills.</li> </ul>
F&B revenue from Banquets	<ul style="list-style-type: none"> <li>✓ Normally, rates offered are per cover basis (cover means per person). Rate is a composite rate for F&amp;B and hall hire.</li> <li>✓ Banquet billing is normally billed on guaranteed covers if actual cover is less than contracted.</li> <li>✓ Banquet income is chargeable with VAT and also service tax, one of the few things which are being subjected to double tax in India.</li> </ul>
Hall hire from Banquets	<ul style="list-style-type: none"> <li>✓ Where rate offered is not composite, then hotels can offer hall hire separately.</li> <li>✓ This will also be subjected to Service tax only.</li> </ul>
Communication revenue (Both Telephone & Internet)	<ul style="list-style-type: none"> <li>✓ Revenue is charged to PMS through interface from EPABX system or internet service provider system</li> <li>✓ For internet alone service tax is charged</li> <li>✓ In some States telephone is included for luxury tax (Like Kerala)</li> </ul>

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Revenue stream	Basis of revenue& Tax there on
Car Hire income	<ul style="list-style-type: none"> <li>✓ Normally car rentals are facilitated by hotel through dedicated travel desk which are normally outsourced to a travel agency.</li> <li>✓ Guest hires car and hire charges are normally posted to guest folio. Hotel gets its commission based on hire charges earned by agency.</li> </ul>
Business centre revenue	<ul style="list-style-type: none"> <li>✓ Business centre services are generally, meeting room, fax service, photocopying services, secretarial services, etc.</li> <li>✓ Revenue assurance is a challenge here as service provided is only manually tracked to billing. If manual tracking through appointment register is missed, billing will be missed.</li> </ul>
Arcade revenues	<ul style="list-style-type: none"> <li>✓ Shopping space is provided at a fixed monthly income at lobby level or in any public area.</li> <li>✓ At time rental is linked to billing done by them. Controls in those cases need to be exercised by ensuring that correct revenue to the Hotel.</li> </ul>
Health club/Spa/Beauty parlour revenues	<ul style="list-style-type: none"> <li>✓ Health club and beauty parlour revenue is booked based on guest serviced. An appointment register is maintained for all guests who seek appointment for service. Upon service, guests are billed in POS.</li> <li>✓ In some hotels, membership fees are received for use of health club (gym) by members. The fees is apportioned over a period of the membership.</li> </ul>

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<b>Revenue stream</b>	<b>Basis of revenue&amp; Tax there on</b>
Laundry revenues	<ul style="list-style-type: none"><li>✓ Laundry is provided to resident guests and employees. At times, in some hotels, outsiders are also allowed to use laundry service through club membership like 'Fabric care club'.</li><li>✓ Billing is done in POS and master data for rates is updated upon rate revision.</li><li>✓ Laundry dry cleaning services are subjected to service tax.</li></ul>
Housekeeping billing	<ul style="list-style-type: none"><li>✓ Housekeeping revenue is generated out of sale of wardrobes, baby-sitting services, etc. These are very rare services.</li></ul>
Disposal of empties / sale of scrap	<ul style="list-style-type: none"><li>✓ Hotels normally sell scrap through annual rate contract process. In case of project scraps, one time seller evaluation will be done considering the volume.</li><li>✓ Scrap is differentiated into wet and dry scrap. Dry scrap of empties comprises empty cans, bottles (liquor, beer and water) and other containers are items, which fetch higher realization.</li></ul>

## **Possible Business Structures**

### **Operating arrangements**

1.31 The arrangements for operating a hotel can be structured in different ways which are discussed hereinafter.

#### ***Owned Hotels***

1.32 In this type of arrangement, the hotel is owned and managed by the same entity. The land on which the property is

## ***Framework of Hotel Industry***

situated can be either owned or leased. There can be certain variations in the manner of ownership of hotels, such as a joint venture where, for example, one of the parties contributes the land and the other party provides finance as well as technical expertise.

### ***Managed Hotel***

1.33 Under such arrangements, there is a clear separation of ownership from its management. The day-to-day operations of the hotel are managed by an enterprise, which specializes in the management of hotels and is not the owner of the hotel. The enterprise generally receives a management fee for management services provided by it.

### ***Leased / Licensed Hotels***

1.34 In such type of arrangements, hotels that are owned by others are taken on lease by an enterprise operating a hotel chain for an annual lease rent or license fee. The rent/fee can be either a lumpsum amount or a combination of minimum guaranteed fees and additional fees paid as a fixed percentage of revenue or profit.

### ***Alliances – Ownership and franchise affiliation***

1.35 Under such arrangements, the owners of hotel make a contract with another enterprise running a chain of well-known hotels for the use of name and reservation system. The hotels may also align with various other partners for services such as, reservation system, on-site car rentals and frequent stay/flier programme. Any such alliances are designed to help both the parties through referrals and cross-selling.

## **Types of Hotels**

1.36 An overview of different classification of hotels are given below:

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### ***Hotel Classification in India***

1.37 With the aim of providing contemporary standards of facilities and services available in the hotels, the Ministry of Tourism, Government of India has formulated a voluntary scheme for classification of operational hotels which will be applicable to the following categories:

- **Star Category Hotels:** - 5 Star Deluxe, 5 Star, 4 Star, 3 Star, 2 Star and 1 Star
- **Heritage Category Hotels:** - Heritage Grand, Heritage Classic and Heritage Basic

1.38 The Hotel and Restaurant Approval and Classification Committee (HRACC) inspects and assesses the hotels based on the facilities and services offered.

### ***Hotel Segments***

1.39 The Hotel industry can be classified into various market segments on the basis of spending ability of the individual traveler and on the basis of entitlement in the case of traveler representing an organization. Market segments are important for better revenue management in a Hotel. It allows the Hotels to target and market to a variety of consumer groups with different behavior with an offer that matches their needs and budget level.

1.40 The Hotel market segmentation helps to identify the purpose of the trip: either business or leisure. The price does not decide the market segmentation. Clear distinction must also be achieved between individual and group business.

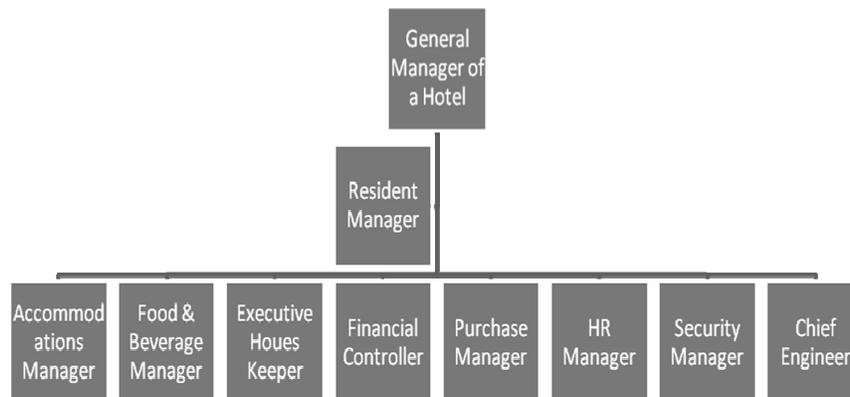
1.41 Major segments practiced in industry are Corporates, leisure, groups, events, conferences, airline crew / layovers, etc.

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### ***Classification of Brand***

1.42 Of late hotels in India is also looking for branding and trying to associate itself with various brands. Branding helps in positioning the hotel in a particular segment and also get revenues in that level. Also, internationally same group may have multiple brands for various segments like Luxury, upper upscale, budget, no-frills hotels,etc.

### ***Hotel Organisation Structure***



### **Scope and Objective of the Technical Guide**

1.43 The main purpose of this Guide is to provide an insight into the general functioning of hotels, the technical aspects peculiar to the industry and its unique accounting methods which would be helpful in the conduct of audit of a hotel.

1.44 Since the size, functioning and nature of business may vary materially from hotel to hotel, the Guide cannot cover all the

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intricacies that may be involved in all practical situations. The various principles, enunciated in this Guide, would, therefore, require appropriate modifications/adjustments depending on the size, functioning and nature of the business of the hotel under consideration. It should also to be noted that only specific aspects which are unique to the Hotel industry are dealt with and normal aspects like audit of the Sundry Creditors / Accounts payable, etc., are not covered in this Technical Guide.

1.45 It needs to be noted that globally, the Hotel industry practices Uniform System of Accounts for Lodging Industry (USALI) which is a uniform chart of accounts owned by Hotel Association of New York City which is part of American Hotel & Lodging Association (AH&LA). This document has, however, not been adopted by the Hotel Industry in India which still follows accounting based on natural head of accounts. (For instances in USALI expenditures are accounted based on revenue department – Salaries & wages are accounted as S&W – rooms division, S&W – F&B, S&W – Sales & Marketing, S&W – Admin, etc.)

# PART 2

## ACCOUNTING FEATURES

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### **Special Features of Hotel Industry**

2.1 The technical and operational aspects of a hotel can be discussed under the following broad heads:

- (a) Rooms
- (b) Food & Beverages (including purchases)
- (c) Foreign Exchange Compliance
- (d) Marketing Department

### **Rooms**

2.2 Rooms generally constitute the biggest source of revenue for a hotel. Approximately, 50 to 65% of the gross revenue of a hotel comes from room rent which of course could vary depending on the city and hotel configuration of banquet business. Normally, contribution from this source of revenue is more than 70% due to the low variable costs. The various operations relating to rooms normally are Reservations including revenue management, Front Office including Concierge, House keeping.

### ***Revenue Management***

#### *Pricing of Rooms*

2.3 Room rent generally makes a major contribution to the overall profitability of the hotel and, therefore, performance statistics of rooms are considered as indicators of the success of the entire hotel business. Keeping in view the importance of the room rent to the overall profitability of a hotel, pricing of the rooms is required to be done in a manner that overall revenue can be

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maximized by optimizing average room rate and average occupancy.

2.4 **Average room rent (ARR)** and average occupancy are two of the key indicators for measuring the performance of the rooms department. Average room rent could be arrived at by dividing the total room revenue for a given period by the number of room nights actually sold during that period. It is also sometimes referred to as Average Daily Rate (ADR). Average occupancy is determined by dividing the total room nights sold during a given period by the room nights available during that period.

2.5 **Revenue Per Available Room (RevPar)** is being used of late to compare the revenue between hotels. RevPar is computed by dividing Room revenue by number of rooms available for sale. RevPar is nothing but ADR multiplied by occupancy percentage.

2.6 Care is exercised while offering discounts on the standard room rate since there are chances that it might create a precedent that may bind the hotel to lower rates in future. While pricing the rooms, rates offered by the competitors are also required to be considered so that misperception about the segment in which hotel is operating may be avoided.

### ***Barter Arrangements***

2.7 Hotels are often presented with offers for goods and services on a barter arrangement. These include “rooms for airline tickets”, “Beverages for the attendant publicity”, “event sponsorship for free invitations” and so on. Whilst many barter arrangements appear extremely attractive and in the hotel’s interest, they have implications from the standpoint of legality, sales tax, income tax, accounting disclosure and the Company’s stated accounting policies. Barter arrangements are also difficult to monitor and keep track of.

2.8 Normally, hotels are expected to get arrangements approved by corporate (where it is a corporate run hotel) for monetary and taxation impact. Ideal accounting system is to

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account both given and taken services to be valued and accounted and taxes like VAT and service tax if any payable must be paid. It may be noted that barter arrangement is as good as normal sale except that consideration is received in kind.

### ***Reservations***

2.9 Normally, in most hotels revenue management and reservations are under same person or in some hotels reservations is an exclusive department either under front office or under Sales department.

2.10 Sources of reservations may be direct inquiries from the guests or through other diverse sources such as travel agents, reservation networks (in the case of an enterprise operating a chain of hotels), Global distribution systems (GDS), etc. Now days, reservations are expected to flow into the hotel along with guest details including positive identity proof. This has become a security requirement to ensure that undesirable elements are identified and appropriately dealt.

2.11 Normally, the reservation department is expected to manage rates as well which are offered in PMS through occupancy maintenance. Various categories of rates that are used are national / global contracted rates, territory sales contracted rates, Airline crew rate, layover rate (use for airline passenger, provided by Airline), best available rate (BAR), etc. Sources of these rates can be decided by various levels of decision making process in an organisation.

### ***Front Office Operations***

#### ***Filling of Registration Card***

2.12 For each guest, a registration card is made at the front office normally printed out from PMS. The registration card generally records the name and address of the guest, the nationality, passport number (in case of a foreign national), rate to be charged, billing instruction, the arrival date and time, as also the expected departure date and time. The registration card is

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required to be signed by the guest and either by duty manager or even Front Office Manager of the hotel (based on company practice). The arrival of customer is also recorded through check-in in the guest folio in PMS.

### ***Unauthorised Occupancy of Room***

2.13 Biggest risk in any hotel is letting room without showing check in into the PMS. Unauthorised occupancy can be detected through two checks, namely room discrepancy report and key checks.

- **Housekeeper's Occupancy Report (HOR):** The reports on the rooms occupied are based on guest counts carried out by the housekeeping staff. Normally, such counts are carried out twice a day; once in the morning while cleaning the room and once in the evening, while making the bed (evening turn down service). HOR is generated at least once a day. In addition to occupancy status, this report will also include number of guests (Single/Double etc.), rooms with scanty Baggage. This report is to ensure that:
  - there is no unauthorized letting out of a room by the Front Office; and
  - the guest has not checked out without settling the bill (for the purpose, due cognisance is taken of the Scanty Baggage Report).
- The housekeeping report, so prepared, is sent to the Front Office where discrepancies, if any, are reconciled. FO ensures that the HOR is cross-checked with front office occupancy data (as per PMS), and a Room Discrepancy Report (RDR) prepared. (This can be done in PMS itself). All discrepancies per the RDR are verified by the Duty Manager, and follow-up action taken to resolve such differences and documented. Hotel's night/day audit procedure verifies that RDR has been prepared, differences resolved, action recorded and reports signed off by the Duty Manager.

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- **Key checks** - Key counting at night by authorized person other than FO personnel for keys in front office for all unoccupied rooms has to be done. Where it is an electronically controlled card (like Ving card) if card making is not integrated with PMS then a dump of keys made as per card system is to be compared with occupancy as per PMS and differences to be investigated and acted upon. Alternatively, authorised person opens unoccupied rooms as per PMS to see whether the room is actually vacant.

### ***Complimentary Rooms / House Use Rooms***

2.14 In the course of conducting its business, hotels often have to give out guest rooms on a complimentary / house use basis. House use rooms are defined as those rooms which are given on a no-charge basis to hotel / company executives when on official tour, as well as no-charge rooms used from time to time by the hotel / company's business associates visiting on the Hotel's official business. Even manager on duty (MOD) is provided with a room for overnight stay as he is officiating at night as Head of the hotel.

2.15 All these have appropriate authorisation as per the corporate policy. What all needs to be given as complimentary is also normally fixed like room, food, soft beverage, local calls, official long distance calls and laundry. Normally, liquor, smokes, long distance calls, spa / beauty club usage are not permitted.

2.16 Complimentary rooms can be classified as under which are normally approved as per corporate policy:

- Given to tour leaders for group and conference bookings as per the terms of the written agreements entered into by the various Sales & Marketing offices directly by FO as per terms.
- Others, including FAM (familiarization) tours, visits by travel writers, business partners, etc.

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2.17 Normally, in some States (like Tamilnadu, Andhra Pradesh, etc.) Luxury tax is payable on complimentary rooms. Hence, there is additional cost while offering complimentary rooms in those States.

### ***Upgrades***

2.18 Normally, rooms are allotted based on category of room for which room is booked. However, higher category of room can be allotted due to various reasons like requested room category not available, guest patronage, profile of the guest, etc. Whenever upgrade is given, it must be authorised by appropriate person as per the corporate policy.

2.19 Luxury Tax has to be applied in cases of room upgrades. In States where Luxury Tax is applicable on published tariff and not on room rates actually charged, the differential of Luxury Tax is normally billed to the guest. However, in case the upgrade takes place because a room of the booked category was not available, and not at the instance of the guest, then such cost has to be borne by the hotel.

### ***Early check in / Late check out***

2.20 In most of the hotels, the check-out time is 12.00 noon and a day is assumed to be complete for charging room rent at 12.00 noon irrespective of the arrival time. In view of this, guests arriving in the hotel in the evening and checking out on the next day morning are charged full day's room rent. Concessions are, however, made for guests checking out after 12.00 noon; usually no extra charge is levied for the first couple of hours based on the corporate policy. Otherwise a fixed percentage of daily rate is charged. Similar concessions are also granted to guests checking in before noon, which is called as early check in. Normally, all late checkout or early check in charges waivers are authorised by appropriate person to ensure that there is no revenue leakage.

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### ***Check out process***

2.21 When a guest checks out, i.e., settles the bill, the guest folio is closed and the room is declared vacant in PMS. Immediately, after closing the guest folio, a message is sent to housekeeping department indicating that the room is vacant. This intimation enables the housekeeping department to take charge of the room, clean and rearrange the room and keep it ready for the next guest. The guest usually settles the bill by making immediate payment and credit is granted, normally, only to the guests having a contractual arrangement with the hotel.

### ***Day use***

2.22 When a guest checks in for few hours' use and not staying over night, such room occupancy is called day use. It is important to keep tab over day use rooms as rate to be charged is much less than rack rate or even BAR. Also, as check out happens before day end (at night time when date change), room rent needs to be manually posted, else day use room may become unbilled.

### ***Allowances***

2.23 When a guest complains about any service or claims that some charges were made to him by mistake, the Hotel may grant certain waivers to the customer for unsatisfactory services or eliminates the charges in question for the satisfaction of the customer. Credits made to guests' account on account of these aspects are called allowances. Most allowances granted to guests are on account of disputed telephone charges, adjustments for overcharges, compensation for damage to clothes given to laundry, and adjustments for unsatisfactory service. These are normally approved through appropriate processes. Billing corrections (for incorrect rate applied) are normally done through adjustments / negative postings as it is not a waiver.

### ***Bills on Hold***

2.24 When a guest leaves the hotel without settling the bills, either in part or in full, front office has no option but to keep the

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Bills on hold. These amounts are required to be transferred immediately from guest ledger to the City Ledger, i.e., Debtors ledger so as to facilitate prompt follow-up action. This situation could arise due to any of the following two reasons:

- (i) **Late Charges:** These are the charges for which details have been received at the Front Office after the relevant guest has departed after settling his other dues. Such charges are not posted to the guest folio, but are posted directly to the City Ledger, if it can be included in the original bills for recovery.
- (ii) **Skip:** Such a situation takes place when a guest, not enjoying credit facilities, has departed without settling his bill. 'Skipping' is invariably a pre-determined act on the part of a guest. Such cases should be transferred immediately from the guest ledger to the City Ledger and handed over to the legal department of the hotel for initiating necessary action for recovery. To avoid such a situation, most of the hotels collect an advance from walk-in guests at the time of reservation.

### ***Concierge (otherwise called as bell desk)***

2.25 The bell-desk is managed by a bell captain supported by bell-boys, porters and elevator operators and doormen. The bell-boys escort the newly arrived guests to their rooms, carry their baggage, deliver mail, faxes and messages, and perform such other services for guests which are not specifically assigned to other employees.

### ***Scanty Baggage Report***

2.26 The Scanty Baggage Report, as the name suggests, is a report meant to keep track of guests having very small baggage. The purpose of this report is to reduce possibility of their checking out without settling the bill. The tendency of checking out without settling the bill and leaving their baggage has been found in the case of walk-in guests, who come to the hotel for the first time. The realizable value of baggage left behind by such guests, who

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are known as skippers, is generally very less. The report is prepared on daily basis by the bell desk based on noting made whilst handling guest baggage. The report is forwarded to the Front Office, which may make relaxations for regular and known guests carrying scanty baggage.

### ***Night Audit***

2.27 The practice of night audit is very widely prevalent in the hotel industry and is normally considered as a major tool in prevention of leakage of revenue. Functions of Night auditors include

- Checking guests' accounts and usually taking charge from the front office billing clerk around midnight.
- Compare vouchers with sales summaries to ensure completeness and tally the same before income accounting.
- Sometimes posting vouchers in guest folios.
- Checking the cash receipts and the allowance credits.
- Making sure that if there has been change in the room of an existing guest, the same has been recorded on the guest folio and that the folio has been transferred in the file to the new room number.
- Checking whether room rent has been charged correctly

2.28 However, need for such activities have been reduced due to integrated computerisation. Most of the hotels have dispensed with night audit and at night time date change in PMS is done by the front office personnel themselves. Charges are normally posted to the guest folio immediately at the point of sale and from POS to PMS. The night auditor is, consequently, relieved from the burden of manual posting. Nevertheless, the role of night audit has become that of day audit as a revenue assurance exercise. A

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detailed checklist which can be adopted for revenue assurance is given in **Appendix 1**.

### ***Cash Float***

2.29 Each cashier, wherever located, generally holds a minimum cash balance, which is normally referred to as cash float or house bank. The largest amount of the float is usually held by the general cashier in the accounts department whereas the next largest amount is usually held by the front office cashier. The front office cashier uses his float for purchasing foreign currencies, including travelers cheques from foreign guests and for making payments on behalf of guests. The front office cashier hands over all cash (as well as cheques and foreign currencies) collections eventually to the general cashier, who in turn deposits the same in the bank.

### ***Paid-Outs***

2.30 Paid-outs refer to the payments made by the Front Office on behalf of guests. Guests, who, for example, may not be carrying ready cash with them, may request the Front Office to make payments on their behalf, such as hire charges of a taxi. Further, the guest may also request for buying certain items from market for which payment would be made by the Front Office. Any such payments made on behalf of a guest is charged immediately to the guest folio so that the risk of late charges might be avoided.

### ***Meal plan apportionment***

2.31 Hotels fix the rates to be charged from resident guests either as per American Plan (AP) or as per European Plan. Under the AP, a composite price, comprising room rent for the day and price of three meals is charged, whereas under the European Plan a separate charge is made for room rent and food. Some other hotels fix their charges on the basis of Modified American Plan which is a variant of the American Plan. Under this plan, hotels charge a composite price for room rent, breakfast and dinner for the day.

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2.32 In case the hotel is following the American Plan or the Modified American Plan (MAP) for fixation of charges, it is required to apportion the composite amount charged, into room rent and charges for food, on equitable and reasonable basis applied consistently. The amount identified as room rent would be treated as income of Rooms Department whereas the amount received for food supplied to the guest would be treated as revenue of food and Beverages Department.

2.33 Most of the hotels follow the practice of issuing food coupons to the guests registered under the AP and the MAP. The guests are expected to present these coupons at the restaurant against which they are served their meals. The coupons presented at the restaurant are handed over to the front office, which identifies the coupons that have expired unutilized. The value of unutilized coupons should be credited to a separate account. However, now days, plan details are entered as package element in PMS that flows into POS as well. In computerised environment, package element can be automated which distributes the income between rooms & F&B.

2.34 There are States like Goa where Luxury Tax (LT) is payable on actual basis and hence, they split F&B and room as per package offered and pay VAT and LT accordingly. However, in States like Tamil Nadu, Delhi, Andhra Pradesh, etc., where LT is payable on Rack Rate, it is difficult to segregate F&B component and pay VAT separately as LT itself is on higher side due to the inability of hotel to sell at rack rate. Hence, in these States many companies do not apportion meal plan. However, in MIS reporting such hotels do account apportioned income.

### ***Arcade Revenue***

2.35 As it is controlled by the front office, normally, arcade revenue is a fixed monthly rental. However, at times it is also linked to revenue billed by such shops. In such cases, the hotel should ensure that adequate control exists to keep track of the shop income.

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### **Food and Beverages**

2.36 Food and Beverages (F&B) are generally considered as the second largest source of revenue for a hotel and generally contributes 30% – 32% of the gross revenue. The F&B department typically comprises the following sections:

- Kitchen
- Banqueting
- Restaurant(s)
- Bar(s)
- Room service
- Stewarding, and
- Stores

2.37 The profitability of the F&B department depends on the combination of two factors, i.e., gross margin (selling price minus cost) and volume. On the one hand, volumes are never fully within the control of the hotel and on the other hand, selling prices are normally fixed in a manner so as to be competitive with the other hotels in the same segment operating in the vicinity. Therefore, profitability of F&B department can be increased mainly by controlling F&B costs. The various technical aspects relating to the F&B department are discussed hereinafter.

#### ***Kitchen***

2.38 Kitchen is the heart of the F&B operation because food is prepared in entirety in the kitchen and supplied to the various outlets. With the increasing emphasis on the control of food costs, it would not be an exaggeration to state that the success or failure of the F&B department is dependent on the kitchen. A hotel may have more than one kitchen, depending on the size of the hotel and number of outlets. The kitchen is under the charge of the head chef, who reports to the F&B Manager. In a large hotel having speciality outlets, the head chef is usually supported by *sous* chefs, who are the second in command after the head chef and / or are in charge of the kitchen of their respective outlets.

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### ***Components of Food Preparation***

2.39 The raw material used for food preparation can be categorized under the following two broad heads:

- (a) Perishables, and
- (b) Provisions

2.40 Perishables are those items that do not have any shelf life; for example, vegetables, fruits, milk, fish and meat. Consequently, such items are required to be purchased on a daily basis. Provisions, on the other hand, have a shelf-life, and can, therefore, be stocked and procured at periodic intervals.

### ***Control over Raw Material Cost***

2.41 As already mentioned, the profitability of the F&B department, to a great extent, depends on the control of the raw material costs, since it is the only major variable cost. Labour cost, which is the next major head of expenditure in the kitchen, is a fixed cost. Perishables constitute a major component of the raw material cost, not only by virtue of the sheer physical composition of the total quantity required, but also because of the tendency for wastage. The key to controlling food costs, therefore, lies in exercising control over the purchase of perishables. The various methods usually employed by hotels to control the raw material costs are discussed hereinafter.

### ***Purchase of Raw Materials – Annual Rate Contracts***

2.42 Annual rate contracts are a typical feature of hotel purchases. Such contracts generally cover all perishable goods and some provisions. Under such arrangements, the supplier agrees to supply raw materials to the hotel at a fixed price. Therefore, the annual rate contracts have the impact of fixing the price at which various items of raw material can be purchased. The annual rate contracts are generally finalized by a Purchase Committee comprising the representatives of the purchase department, accounts department and administration department. The contracts may either specify the rate and the overall quantity

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of a particular item to be purchased during the year, or, alternatively, specify only the rate. In most of the cases, more than one supplier is identified for each item to ensure regular supply of the item. Further, the contracts generally contain a provision to the effect that in the event of any short supply, purchases would be made in the open market and the incremental costs, if any, would be charged to the supplier's account.

### ***Ordering for Perishables and Provisions***

2.43 The perishables (Vegetables, fruits, Meat, Fish & Poultry (MFP) items, Dairy products) are ordered on the previous day of its intended usage. As they are stored in the deep freezers, MFP items at times are procured twice or thrice a week. Orders for provisions, on the other hand, are placed on a periodical basis.

### ***Basis of Ordering***

2.44 The Purchasing Department places the order for perishables/provisions on the basis of requisition received from the head chef. Where a hotel has more than one kitchen, requisitions are sent by the *sous* chefs to the head chef, who consolidates the requisitions and sends a copy of the same to the Purchase Department. The chef generally relies on his past experience and trend while preparing the requisition slip. Many chefs also take into account other factors such as popularity charts, be it for different days of the week, or for particular times of the year while preparing the requisition. Banquet functions and conferences, with their pre-decided menus, generally provide a degree of accuracy to the ordering process. While preparing the requisition, it is recognized that the ordering of perishables could affect the cost to a great extent due to the fact that their shelf life is very limited.

### ***Receipt, Storage and Issue of Raw Materials***

2.45 All perishables received are normally sent directly to the kitchen without routing them through the stores department. The various items of perishables received are inspected by the head chef, or in his absence, by the *sous* chef. Rejections, if any, are

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usually made immediately. After checking, the perishables are sent straightaway to the kitchens requiring them. All perishables purchased on a particular day are normally charged to consumption for that day, whereas provisions are taken into stores and are treated as consumed on the day these are issued for use in the kitchen. All receipts, whether perishables or provisions, are normally recorded in a Daily Receipts Register which becomes the basis for recording of receipt of provisions at the stores and for payment of suppliers' bills.

### ***Food Preparation and Serving of Food***

2.46 The various aspects involved in the preparation and serving of food are discussed hereinafter.

2.47 Menu engineering: Is an interdisciplinary field of study devoted to the deliberate and strategic construction of menus. It is also commonly referred to as Menu Psychology. In general, the term menu engineering is used within the hotel industry. Typically the goal of menu engineering is to maximize a firm's profitability by subconsciously encouraging customers to buy what you want them to buy, and discouraging purchase of items you don't want them to buy.

2.48 Fields of study which contribute most to menu engineering include:

- Psychology (perception, attention, emotion/effect)
- Managerial Accounting (contribution margin and unit cost analysis)
- Marketing & Strategy (pricing, promotion)

2.49 Standard Recipes: Standardisation of recipes is the integral part of menu costing and involves balancing of two delicate and crucial aspects – the taste and the cost. Once the balance has been achieved, it becomes a powerful tool for controlling food costs and even plays a very important part in the determination of the quantity of raw materials to be ordered. The hotels generally maintain an elaborate database on popularity

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charts of various dishes which is often used to estimate the expected business for the next day. The standard recipe, therefore, helps in making better estimate of the raw material requirements on the basis of the expected business.

2.50 Portion Control: The process of determining the standard quantity to be served per dish is known as Portion Control. Such a practice facilitates in optimizing the number of dishes that can be served out of a given quantity of an item and ensuring customer satisfaction. Any arbitrary increase/decrease in the quantity of dish would result in a loss in revenue to the hotel/dissatisfaction to the customer. While determining the standard quantity per dish, due consideration should be given on striking a balance between the price of the dish and the minimum standard quantity that must be served.

2.51 Menu Costing: Menu costing involves determination of the cost of the standard recipes based on current prices. Such costing would also be helpful in ensuring that selling prices of various recipes are arrived at only after including the gross profit at a certain rate.

2.52 Wastage Report: At the end of each day, left-over food, which would not be useful for the next day, is thrown away and known as wastage. The cost of the wastage is determined and included in the Wastage Report. The Wastage Report is usually considered as an indicator of the efficiency of the kitchen in terms of food preparation.

### ***Banqueting***

2.53 Revenue from the banqueting activities generally constitutes significant component of the total F&B revenue. Banqueting activities include hosting of weddings, parties, seminars, conferences and such other functions. The size of a banquet could vary from as low as 25 people to more than 2000 people. Large hotels generally have a range of banquet halls/rooms that can cater to crowds of varying sizes. The services provided by the banquet departments may include foods, sound system, audio visual equipment, decoration, hall, etc.,

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depending on the requirements of the customer. Nowadays, outdoor catering and letting out of a part of the hotel premises for film shooting has also become a part of the banqueting activity. Generally, the hotel itself supplies food and beverages to the banquet functions whereas, for other services, it may tie-up with the outside parties with a view to reduce fixed overheads. In the banquet function, the major source of revenue is considered to be sale of food and beverages. There are certain typical features of the banqueting activities, which are discussed below. Banquet functions are contracted through a document called *Function Prospectus* which details the services to be provided along with menu for the function. Banquet is one activity which normally attract both VAT and the service tax. Liquor is served in banquets normally by the hotel itself and billed. However, if guest is permitted to bring in liquor, “corkage”, which is a service charge for serving liquor brought by the guest, is charged at nominal rates. Corkage is accounted as income.

### ***Guaranteed PAX (persons) and Expected PAX (Persons)***

2.54 Hotels make charge for the food consumed at a banquet function on the basis of number of plates used. It is a common practice in hotels to require the customer to specify the number of plates expected to be consumed, based on which the customer is also required to guarantee minimum number of plates to be consumed in the function. Such a practice provides basis to the kitchen for food preparation and ensures minimum level of revenue for the hotel, even if the actual plates used are lower than the guaranteed number of plates.

### ***Plate Count***

2.55 As stated earlier, the food cost is charged to a banquet function on the basis of number of plates used and therefore, plate count constitutes a very important aspect of the billing process. The plate count, in some cases, may become a subject matter of dispute, particularly in large functions such as weddings. Hotels have recognized the plate count as a critical control risk area from the point of view of possible revenue leakage, since the possibility

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of understatement of the number of plates used by the banqueting department in connivance with the customer cannot be ruled out. To avoid such a situation, some hotels have instituted a system wherein, if the guaranteed plate level is beyond a specified threshold, representative(s) from the accounts department and/or the F&B Controller's office are required to be present during the function to vouch for the plate count.

### ***Outdoor catering***

2.56 Hotels also serve food for functions to be held outside the hotel. Food is prepared and transported to the location. Billing controls like plate count as indicated in banquets are applicable.

### ***Restaurant***

2.57 Restaurant in a hotel is meant for resident guests (i.e. guests staying in the hotel) as well as for non-resident guests. Large hotels generally also maintain a coffee shop, which is open for 24 hours, as well as speciality restaurants that offer specific types of food; for example, Italian, Japanese, Chinese, Continental, Mediterranean, Thai, Moghlai, etc. The typical procedure in any restaurant is that the guest arrives, places the order, consumes the food and settles the bill. The technicalities involved in the various procedures of the restaurant are discussed hereinafter.

#### ***Pricing of Off-Menu Items (Open food)***

2.58 The regular guests, sometimes, may order a dish that is not listed on the menu card. In order not to disappoint such guests, the requests are usually entertained. In such situations, the restaurant manager, in consultation with the head chef or the *sous* chef of the restaurant, as the case may be, fixes the price to be charged. A similar problem also arises at the bar, where wine, which is normally sold by the bottle, has been requested in the glass or where a particular cocktail drink, which is not normally served at the bar, has been ordered. The manager of the bar

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fixes the selling price in such situations. It may have to be kept in mind that an item which is in menu can also be billed as open food and billed at rates other than that at which it should be billed.

### ***Cancellation of Bills (void bills)***

2.59 Cancellation of bills usually takes place either on account of error in the billing due to the order having been wrongly taken down, or because the customer, on the grounds of quality, rejects the dish. The cancellation of bills represents a control risk in terms of unauthorized or fraudulent cancellation of bills after cash has been collected. To avoid such a situation, the hotels follow a procedure according to which cancellation of bills is required to be approved by the restaurant manager. After cancellation, bills are duly defaced on the bill book and are considered in the serial control of bills. It is also ensured that if food is prepared and then order is cancelled, then chef at the outlet should also approve.

### ***Reprints of Bills***

2.60 At times in POS, reprints become necessary due to bill stationery getting smudged or printer error. It is also possible that credit customers may ask for bill copies at the time of settlement which might be months after the actual bill date. The reprints of cash settled bills are prone to be misused and hence in case of every reprint of checks, copies of the original as well as the reprinted check should be preserved and reasons recorded by the Restaurant in charge.

### ***Bar***

2.61 A bar is an exclusive section of the hotel where wines, spirits, beers and smokes (Cigars) are sold. While wines and beers are generally sold only in bottles, spirits are also sold in pegs. A small peg measures 30 ml and a large peg measures 60 ml. The bar is managed by a barman who is responsible not only for issuing bottles of wine and beer, pouring alcoholic drinks and mixing cocktails, but also for maintaining proper stocks thereof.

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The technicalities involved in the operations relating to the bar, are discussed below.

### ***Maintenance of Excise Records for Alcoholic Beverages***

2.62 The bar stores are required to maintain proper excise records in respect of imported as well as Indian Made Foreign Liquor (IMFL) in order to ensure that only duty paid liquor is sold. An excise officer as nominated by the company should be present at the liquor stores of the hotel at all times and should record receipt and issue of liquor immediately in the stock register maintained at the store. In the stock register, a separate account should be maintained for each brand of liquor. The excise records may also serve as a cross-check for ascertaining the sales tax liability on sale of liquor.

2.63 As a critical liquor control, a hotel normally has a process of reconciliation sales as per POS and consumption arrived as per books. (Opening stock + receipts from stores to outlet – closing physical stock should tally with sales as per POS).

### ***Mixing of Drinks for Cocktails***

2.64 Cocktail refers to the combination of one or more of alcoholic and non-alcoholic beverages in specified measures. The preparation of cocktail involves a great deal of expertise on the part of the person preparing the drinks. Cocktails also give the bartender an opportunity of manipulating the composition of the cocktail by pouring in less quantity of the more expensive drinks and more quantity of the less expensive drinks. The resultant surplus of expensive drinks is called 'overage' and is a benefit to the hotel. However, in such a case, the possibility of the bartender selling surplus liquor, without raising bills and pocketing the cash, cannot be ruled out.

### ***Physical Verification at the Bar***

2.65 Physical Verification at the bar represents one of the prime control mechanisms on bar inventory. Inventory of bar is generally taken by the bartenders at the end of each shift and at

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the beginning of the morning shift. The hotels usually follow a policy of recovering shortages, if any, from the bartender without giving him credit for any excesses.

### **Happy hour billing and Discounts**

2.66 The concept of “Happy hours” is that the hotel identifies few hours of a day during which the drinks are sold at a discounted rate. There can be variations to this concept such as some hotels may have “one for one” offer where in for every bottle sold, there is a complimentary bottle offered. This offer would normally be valid only for consumption of beers.

2.67 The rate master has to be updated with happy hour rate and POS must be configured in such a manner that the happy hour rates are picked only during the designated happy hours. Also in case of “one for one” offer, there needs to be reconciliation between actual bottles sold and offered complimentary so that there is no leakage of revenue.

2.68 Also the hotel may decide to give discounts to a particular class of customers such as “crew” at a fixed percentage. All discounts have to be authorised by the outlet manager and the reasons for the same has to be indicated on the face of the bill and it has to be ensured that such discounts are given only to customers belonging to that category.

2.69 Also, there is a normal practice in bar to provide complimentary soda or snack items. Such complementary items have to be tracked and the cost of it has to be monitored so that there is no pilferage.

### ***Room Service***

2.70 Unlike restaurants and bars within a hotel that cater to resident guests as well as the non-resident guests, room service caters exclusively to the needs of the resident guests. As the name suggests, the department/section is responsible for serving food and beverages to the guests in the room. In large hotels, room service usually remains operative for 24 hours without any

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break. All room service bills are debited to the folio of the guest after obtaining guest signatures on the same.

### ***Minibar income***

2.71 Minibar consists of miniature liquor, beer, soft drinks, juices, snacks, etc., kept in room for consumption of guest. A list along with prices of those items placed in minibar is kept in room. Guests are expected to indicate items consumed to facilitate billing. Also, minibar attendant will visit every room daily to replenish the stocks through which billing is done. At times sale posted is disputed by guest at the time of check out. Most hotels practice waiver if guest disputes any minibar charge.

### ***Stewarding***

2.72 The stewarding department of the hotel is responsible for maintaining stocks of cutlery and crockery of the various outlets and for banquets. Depending on the size of the hotel, the stewarding department could either be common to all outlets or could be dedicated to an outlet or a group of outlets.

2.73 The stock of cutlery and crockery is maintained at the stewarding department on imprest system. Under the system the quantity under circulation is determined and issues are made from the main stores to stewarding department. In this regard, it is important to note that crockery and cutlery are usually accounted for as consumed at the time of their issue from the main stores, notwithstanding the fact that these items may be in use for long durations (particularly in the case of cutlery, including silverware). Proper stock registers are required to be maintained for various items of cutlery and crockery on account of the constant movement of these items between the stewarding department and the various outlets. Periodic physical verification of the stewarding stocks is carried out and comparison of physical count is made with the records so as to calculate shortages, if any. Shortages generally arise on account of breakage, pilferage and due to crockery and cutlery ending-up in the garbage bin. However, first

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time purchase of Crockery & Cutlery in a new hotel is capitalised and amortised over the estimated life.

### ***In circulation inventory - Inventory of Housekeeping Department***

2.74 Linen normally constitutes a major portion of the housekeeping inventory. Many hotels follow a system known as par stocks system for maintaining the inventory of linen. Under this system, four sets of each item of linen are maintained for each room, i.e., one in the room, second at laundry, third in housekeeping store and fourth in main stores. In the normal course, the inventory circulates between room, laundry and housekeeping stores. The items in main stores are being maintained to take care of any possible exigency. The system is considered helpful in monitoring and controlling consumption/use of linen. The accounting treatment is similar to cutlery and crockery stock.

### ***Guest Amenities***

2.75 In guest rooms, amenities like toiletries, guest stationary, water, complimentary beverages like tea, coffee, etc., are placed in the room. Mostly, these are handled through the Housekeeping department. Consumption is accounted once these items are issued from stores to the Housekeeping pantry. There are incirculation inventory kept in guest amenities these are however not valued as value of inventory in room will not be material enough to impact inventory value. Many of the hotels also have the practice of placing fruit baskets/chocolates or wine (For VVIP guests and normally called as "gratis" bar) in the room on complimentary basis. These are issued from the kitchen/stores to the in room service/ housekeeping department and accounted as consumption except that liquor and wine are accounted only on consumption in Gratis bar. However, in the case of Gratis bar, if the guest does not consume the wine / liquor, then it is taken to the main bar for usage. The treatment in excise register has to be carefully seen so that there is not mis-statement in respect of this.

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### **Foreign Exchange Compliance**

2.76 Hotels are generally authorized to deal in foreign exchange as a 'restricted money-changer' especially for accepting foreign currency/ traveller's cheques. The authorization is subject to conditions laid down in this regard and remains valid for a limited period only and the hotel gets in renewed after that period. The hotel is required to issue encashment certificates to the travellers in respect of foreign currency/traveller's cheques purchased and submit a report to the Authorised Dealers regarding encashment of foreign currency on a monthly basis.

### **Sales Department**

2.77 The sales department of a hotel is responsible for selling the hotel services and building its brand image, by the use of innovative strategies. These strategies may include, amongst others, devising off-season packages, holding food festivals, booking of conferences and sponsoring social events. The hotel industry is a seasonal industry in which highs and lows in business volumes during specified periods of the year can be predicted. It is the responsibility of the marketing department to sell the hotel services in a manner that the maximum occupancy is achieved during the off season also to beat the trend. Each hotel usually has its own sales department, but in a hotel chain, the sales departments of various properties complement each other in procuring business. With the constant pressure to perform and achieve targets, the marketing department may, for example, out of desperation, book conferences at ridiculously low rate, that do not yield any profits to the hotel or recommend credits that may eventually become doubtful of recovery.

# PART 3

## AUDIT APPROACH AND PROCEDURES

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### Audit of Hotel Industry

#### Initial Aspects

3.1 While auditing the financial statements of a hotel, an auditor should ensure that all Standards on Auditing (SAs) are adhered to like any other audits.

3.2 Though specific requirements of these Standards on Audit (SAs) have not been articulated in this document as they apply uniformly for all audits, some critical objectives an auditor should adhere are given below.

- Obtain preliminary knowledge of industry, nature of business ownership, management & operations, and decide whether the level of knowledge of business is adequate to perform the audit.
- SA 300, “Planning an Audit of Financial Statements” requires an auditor to establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.
- SA 315, “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment” requires an auditor to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity’s internal control, thereby providing a basis for designing and implementing responses to the

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assessed risks of material misstatement. This will help the auditor to reduce the risk of material misstatement to an acceptably low level.

- SA 330, “The Auditor’s Responses to Assessed Risks” deals with nature, timing and extent of planned further audit procedures at the assertion level.
- Any other planned audit procedures that are required to be carried out so that engagement is in compliance with SAs.
- Audit process has to be divided into risk assessment, risk response and reporting\*.

### **Organisation Structure of a Hotel**

3.3 For determining appropriate accounting and audit procedures to be adopted in case of a hotel, it would be useful to have knowledge of its various operational details. This Chapter contains a broad overview of organizational structure of a hotel and deals with the various technical and operational aspects of the hotel industry.

3.4 The departments of a hotel may be divided into two categories, viz., revenue generating and non-revenue generating. Major revenue generating departments of a hotel include rooms and food and beverages. Minor operating departments include laundry, health club, barber shop, etc. The non-revenue generating departments include the accounts, Purchases, Stores, Housekeeping, Concierge, Security and the Engineering department. Notwithstanding the departmentalization, the departments are required to work in tandem with each other for satisfying the requirements of majority of guests. For example, when a conference is held, the services are provided by the rooms

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\* Attention of the readers is drawn to the Implementation Guide to Risk-based Audit of Financial Statements, published by the Institute.

## ***Audit Approach and Procedures***

department as also by the food and beverages department and other minor departments, such as health club and leisure facilities.

### **Need for Information Technology Experts in Audit**

3.5 It has to be noted that modern day hotel operations are completely computerised with

- Property management softwares (PMS like PMS, Opera, Amadeus, Springer-miller, IDS etc ) for room management,
- Point of sales softwares for F&B and other revenues (POS like Micros, Infogenesis, Shawmanetc) and back office softwares.
- There are hotel industry ERPs like SIMhotel (SAP), Opera, IDS which are integrated, all-encompassing systems which cover from front desk to back office accounting.

3.6 Many interfaced solutions are implemented by various companies. Hence, revenue assurance to cost control needs to be audited through the system than around the system.

3.7 The audit team may therefore need to include IT expert(s) who can understand the data model of applications and application level controls to ensure that any risk in the financial reporting are adequately taken care of in audit planning.

3.8 It is imperative for the auditor to ensure that from the perspective of the financial statements that these systems generate, capture and provide complete, accurate, valid and timely information for financial reporting.

3.9 Generally, IT experts may be called up to work keeping in mind the scope of the financial audit with specific reference to following:

- Information Technology General Controls (ITGC) for identifying key risks in IT, gathering & documenting information about IT systems and controls along with

## ***Technical Guide on Audit in Hotel Industry***

related risks, determining financial reporting significant IT systems and scoping the work over ITGC

- Evaluating and validating automated application controls and also end user computing.
- Testing integrity of the system generated data and reports used in key manual controls.
- Revenue assurance controls / POS controls.
- Data analysis using CAAT for identifying exceptions in controls.

3.10 While planning the audit, involvement of IT experts should be considered keeping in mind:

- The testing plan and resource allocation for ITGC, automated application level controls, automated accounting procedures, revenue assurance controls, etc.
- IT related issues and risks that should be given particular attention.
- Documentation and reporting of control weaknesses identified.

## **Risk Assessment and Internal Controls**

### **Audit Risk**

3.11 Audit Risk consists of two key elements namely:

- Inherent and control risk that the financial statements may contain material misstatement.
- Detection and engagement risk that the auditor will not detect such a misstatement.

3.12 To ensure that audit risk is kept at an acceptably low level and auditor should:

### ***Audit Approach and Procedures***

- Assess the risk of material misstatement; and
- Limit non-detection risk which can be achieved by performing procedures that respond to the assessed risks at the financial statement, class of transaction, account balance, disclosure and assertion level.

### ***Components of Audit Risk***

- **Inherent Risk** – This refers to susceptibility of an assertion to a misstatement that could be material. (Both individually and aggregate with other misstatements). It is assessed both at financial statement level and at assertion level. These are business and other risks that arise in entities objectives, nature of operations, industry, and regulatory environment in which it operates and its size and complexities. Risk of material misstatement may vary based on nature of account balance or class of transactions
- **Control Risk** - It's a risk that the entity's internal control system does not prevent, or detect and correct on timely basis, a misstatement that could material. (Both individually and aggregate with other misstatements). Entity should identify and assess its business & other risks and respond by designing and implementing proper internal controls. Entity level controls are for all assertions but activity level control is for specific assertion. Some control risks always exist and accepted by entity but auditors are expected to understand the entity's internal control and perform audit procedures to assess risks of material misstatement at assertion level.
- **Detection Risk** - This refers to auditor's inability to detect a misstatement that exists in an assertion that could be material (both individually and aggregate). Acceptable level of detection risk for a given level of audit risk bears an inverse relationship to the risk of material misstatements at the assertion level. Hence, auditor should focus on the

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audit procedure on those areas where risk of misstatements is high.

3.13 The audit team can optimize the time to be spent in an audit by focusing on risk assessment which might reduce or eliminate audit work in low risk areas.

3.14 Effective risk assessment process requires all members of the engagement team be involved and team to meet regularly and talk (between hotels as well if a company has multiple hotels) to share insights such as to:

- discuss and decide over all audit strategy, detailed audit plan, audit procedures to be designed & employed to detect any fraud (Team planning meetings).
- discuss implication of findings, discuss fraud risk and need for further audit procedure requirement (Team debriefing meetings).

## **Risk Assessment**

### ***Need for risk assessment***

3.15 The auditor should record risks relevant to assertions as well as the related control activities which respond to the risk. The auditor must test controls where the risk is such wherefor the substantive procedures alone will not provide sufficient assurance or where the risk assessment includes an expectation that the control is operating. In addition, if the auditor wishes to test controls to reduce substantive testing for efficiency purposes then the auditor must test controls.

3.16 Audit procedures should be responsive to the risks identified. Risk assessment and control may be documented as below.

- A brief summary of risk and related controls including whether risk is significant or one where substantive procedures alone are insufficient.

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- These are documented for assertion risk indicating.
- Existence/ occurrence, rights / obligations, completeness, accuracy, valuation and presentation and disclosure.
- Also assessing risks for its magnitude of risk and likelihood of risk to occur.
- Whether control testing is required or not? Cross reference to control activities evaluation and testing form.
- Control testing conclusion and impact on substantive audit procedures.(consider need to revise planned substantive procedures if testing unsatisfactory)
- Substantive audit procedure number if any carried out.

3.17 The substantive procedures program should contain tests which reduce the risk of material misstatement of the financial statements to an acceptable level taking into account the risks and the controls testing as documented above.

3.18 Substantive procedures should be performed for all material areas and risks identified as significant. Tests should be designed such as are responsive to the assessed level of risk.

3.19 When the approach to significant risks consists only of substantive procedures these may be tests of detail only or a combination of tests of detail and substantive analytical procedures.

3.20 When substantive procedures are performed at an interim date the auditor may perform further substantive procedures or substantive procedures combined with tests of control to cover the remaining period so that there is a reasonable basis for extending the audit conclusions from the interim date to the period date.

3.21 When auditing accounting estimates, the auditor may use one or more of the following procedures to conclude on the reasonableness of the estimate:

- Review and test the process used by management to develop the estimate

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- Use an independent estimate for comparison with that prepared by management
- Review of subsequent events which provide audit evidence of the reasonableness of the estimate made

3.22 In Hotel industry, following are an illustrative list of key risks which persists and may require greater audit focus.

#### ***Revenue related risks***

3.23 These include:

- Non-recognition of room revenue by providing unauthorized occupancy of rooms without showing check-in in PMS.
- Incorrect rate charged / package used due to which revenue is short collected in case of rooms / in POS.
- Providing room on complimentary or as house use when rooms are not to be provided so but charged.
- Unauthorised waiver of a fully or portion of charges leading to loss of revenue in any name (like discounts / voids / allowances, etc.)
- Incorrect revenue accounting in General Ledger due to interface issues from PMS to Financial accounting systems.
- Non recognition of actual cash settlement made by accounting it as a settlement by other mode thereby leading to fraud risk.

#### ***Expenditure related risks***

3.24 The risks related to expenditure include:

- Non- recognition of provision for cost incurred but bills not received (for services or good received for which vendor bills not received).

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- Non-recognition of time period cost especially like municipal property taxes, liquor licenses cost, license fee for hotel premises in a managed hotel, etc.
- Incorrect recognition license fees payable to owners or management fees payable to managing company.
- Possibility of mismatch between the expenditure incurred and the payment made may be due to non-adherence to bill wise payment accounting.

### ***Fixed assets related risks***

3.25 Following are some examples of fixed assets related risks:

- Incorrect capitalisation of refurbishment or renovation expenditure without decapitalizing original asset from books.
- Capital item wrongly charged to revenue or otherwise.
- Incorrect classification of asset leading to incorrect depreciation as well.
- Delay in capitalisation / incorrect date of capitalisation.

### **Information Technology Application Level Controls**

3.26 ITGC review is generally performed to obtain audit comfort over the financial statement assertions in the financial statements. Since the comfort is required on financial statements assertions, greater audit focus is needed on the financially significant applications.

3.27 In the hotel industry PMS, POS, Back office systems including financial books are significant applications.

3.28 The audit should document the link between key ITGC and key automated application controls and interfaces, key automated accounting procedure and system generated reports used in key manual controls or in generating journal entries. ITGC has to be conducted over computer operations, access to programs and data, change management and program development.

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3.29 Control weaknesses in ITGC would impact the financial statement assertions. In view of such weaknesses it would be difficult for the auditor to place reliance on the automated application controls. However each and every weakness observed should be discussed in terms of its potential impact on audit, the materiality of the exception, the compensating controls and mitigating factors, if any and further audit procedures required in that area. All these should be clearly documented in audit work papers.

### **Financial Reporting Controls (Including end user computing)**

3.30 A critical check that is required for financial reporting control is to ensure that all income from subsystems viz., PMS or POS are flowing to financial reporting system (back office systems). Most of the hotels have interfaced or even integrated system to facilitate free flow of revenue information. However, the auditor has to ensure that there exists a process to ensure completeness of income accounted.

3.31 Similarly, hotel should ideally ensure that accounting of all transactions other than revenue is done on real time and there is an inventory module integrated with the financial module. Alternatively, there must be a process to match GL system with subsystems at all levels.

3.32 Most hotels generate financial reporting pack through spread sheet softwares. Hence, there must be adequate control over end user computing of generation of financial statements. End user computing control should include version controls, integrity check for last trial balance and maintenance of log of changes.

### **Revenue Assurance Controls**

3.33 Primarily, in a hotel revenue assurance controls happen in both Room Revenue & F&B Revenue. Revenue assurance controls gets ensured on a daily basis by night / day audit

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process. A detailed checklist as given in **Appendix 1** ensures that revenue assurance risks are covered.

3.34 As part of control evolution, auditors may use sample document given in **Appendix 1** with modification based on the features and automated controls exist in PMS, POS and General Ledger.

#### **Audit plan for Control evaluation**

3.35 The auditor would need to develop a detailed audit plan indicating the control objective, various activities and validation procedure to test controls. The results of the validation procedure should be documented and observations if any should be discussed with the management to obtain their comments as well as identify any mitigating controls that the auditor would need to test to obtain comfort over the area. An indicative audit program is given in **Appendix 3**. An illustrative audit plan indicating control objective, activities performed and validation procedure is given below:

3.36 In Room revenue, Front office allowancing and adjustments

Risk	Classifi- cation (High / Medium / Low)	Control	Control classifi- cation (Critica l/ essenti al/ desirab le)
Allowances may be passed which are <ul style="list-style-type: none"> <li>• Unauthorised</li> <li>• Not posted appropriately</li> </ul>	H	<ul style="list-style-type: none"> <li>• All allowances are directly posted in the PMS.</li> </ul>	E
		<ul style="list-style-type: none"> <li>• Allowances for crew are based on the contracted all</li> </ul>	E

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in PMS		inclusive rates.	
		<ul style="list-style-type: none"> <li>Balance transfers to other rooms are done manually, i.e. credit in one room folio and debit in another.</li> </ul>	E
		<ul style="list-style-type: none"> <li>Guest disputes less than INR 1,000 can be allowed by the Front Office Staff, however Allowances greater than INR 1,000 need the Duty Manager's approval.</li> </ul>	E
		<ul style="list-style-type: none"> <li>'Posting adjustment report' is generated at the end of each day, which is reviewed by the Duty Manager.</li> </ul>	C
		<ul style="list-style-type: none"> <li>This report is cross checked by the FOM next morning and sent back to finance.</li> </ul>	C

**Data Analysis**

3.37 Data analysis is done using CAAT tools to facilitate evaluation of controls. Most of the revenue assurance checks can be done using data extracted from PMS / POS and GL. Audit through CAAT will help in identifying the exceptions better with root cause for exceptions. This will ensure that any systemic pattern for exception is established and can be rectified. Typically,

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following reports are useful for running CAAT based exceptions identification.

3.38 From PMS:

- Journal by department code report (consist of daily postings)
- Guest in house report (list of guest who are in house at the end of the day)
- Departures of the day report
- User log which consist of all user activity.

3.39 From POS:

- KOT - Billing reconciliation report
- Voids report
- Discounts report
- Complimentary report (including non-chargeable KOT – NCKOT)
- Item sales summary
- Bill print audit to check on delay in settlement

### **Fraud Risk Control**

3.40 Hotels have potential fraud risk which needs to be extensively covered by the auditor for fraud risk management policies of the hotel. An illustrative checklist is given in **Appendix 4**.

## **Audit of Revenue and Receivable**

### **Background of Revenue and Receivable**

3.41 As seen in the previous Chapter, revenue stream in a hotel is primarily from Rooms and F&B. All others are minor revenue streams. Normally, more than 50% of the business is done either on cash or credit card. Credit customers are from airline, travel agents, corporates, Government departments and very rarely

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individuals. Hence, credit offering in hotels itself is a specific activity treated as not ordinary. Hotels have a list of credit customers for whom credit is offered. If any other guest requires credit, an ad hoc credit authorization process has to be adhered. Usually the credit department is responsible for collections, but may also take help of the Sales and the front office. If there are any dispute with the guest at later stage due to some billing errors etc, credit department will do a back office allowance. (Similar to front office allowance but done post check out of the guest) However, if it is anything other than billing errors, then normally doubtful debts provisioning norms of the company should be adopted.

3.42 Credit department is also responsible for credit card reconciliation for ensuring that daily batch closing and credit received from bank for credit card collections are same (after adjusting for credit card commission).

### **Various Streams of Revenue, Its Controls and Audit Considerations**

#### ***Room Revenue***

3.43 Hotels use property management software to maintain, allot, bill guests for room related services. Rooms are sold based on reservation that flows into the hotel either directly or through reservations networks. Critical internal control relating to rooms that must exist are given below:

- Rates that are updated in the PMS are either done centrally by Central reservation network or if done in PMS are reviewed and signed off by the Reservation Manager.
- All ad hoc rates / discounts offered on contracted rate or on BAR based reservations are being reviewed by reservations of the day report and signed off by Revenue Manager.
- For all guest checked in, the Duty Manager, at the end of the shift, should ensure that registration card duly filled up with all required fields are made and signed off by guest.

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- Rates offered are reviewed and signed off by FOM through rate variance report.
- Duty manager reviews rooms occupied at the time of night date change and ensures that all rooms have been charged.
- All manual postings are reviewed and signed off by the Duty Manager.
- All allowances made are signed off with reasons at the end of the shift by Duty Manager. FOM generates a report on daily basis and signs off after reviewing the allowances with reasons.
- All negative postings and adjustments of the day are reviewed and signed off by FOM.
- Upgrades of the day report is generated and approvals as per corporate policy is ensured and signed off by FOM and GM.
- Paid outs are reviewed to ensure that all paid outs have been acknowledged by guest and also signed off by the Duty Manager.
- Review splits and transfers between folio to ensure that these have been done only between related guests (of same company or group).
- Income audit ensures that cash receipts, EDC batch closing and city ledger settlements are tallying with daily PMS trial balance of guest ledgers.
- Complimentary and house use rooms are listed and reviewed for authorization on a daily basis.
- All waivers of retention for cancellations / no shows /charges for late check outs / early check ins are all documented and signed off.
- Income audit ensures that income as per PMS flows into GL and accounting happens correctly.

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### ***Food and Beverage Revenue (Including Banquet Revenue)***

- Finance through F&B Control department ensures that menu rates are appropriately approved as per levels of authority of the hotel.
- Menu approved are updated in menu master of the POS and there are no mistakes.
- F&B Manager reviews open food items (off menu items) along with item modified report and ensures price offered is reasonable and in line with policy and comparable with similar item.
- F&B Manager ensures that POS level exceptions are reviewed and signed off like void KOTs, void bills, NCKOT (complimentary food), entertainment bills, discounts and missing KOTs if any.
- Where due to some POS system failure, manual KOTs are used, serial continuity of KOTs and its link to billing should be ensured at the end of the shift.
- F&B Manager ensures that daily reprint reports are taken and reprinted checks are enclosed along with reasons documented.
- F&B Manager ensure that guest tracking sheets are maintained for coffee shop where buffet is offered and guests are escorted to table and marked in tracking sheets. These sheets are mapped to bills generated at the end of every shift.
- F&B Manager also reviews delay in opening tables, settlement of bills in POS and ensure that outlet incharge documents reasons for such delays.
- F&B controls ensure that liquor sold and NCKOTs (including happy hour billing and gratis bar consumed) are reconciled with consumption arrived by opening stock, plus receipts from stores adjusted for physical closing stock.
- F&B control ensures that liquor is stored and sold only in earmarked areas and keep a tab on excess liquor if any gets generated due to overage.

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- Similar reconciliation and controls are exercised in minibar as well.
- Cash turn in procedure of ensuring cash collected and credit card EDC batch closing summary are tallied with chance sheet (summary from POS) and deposited in front office or to accounts.

In case of banquets:

- There is a process to ensure that all functions are backed by function prospectus (FP) and a contract.
- Advance is collected for all functions as per corporate policy and any deviations are documented and approved by appropriate authority in FP itself.
- On function date, F&B service shall ensure that banquet challan is prepared documenting all services offered and signed off by guest.
- Banquet billing is done based on banquet challan to ensure that there is no dispute on billing at later date.
- Liquor drawn from main stores for a function is tracked and unsold is returned and balance is matched with sales as per banquet challan.

#### ***Other revenues like Laundry, Telephone, Internet etc.***

- Finance through income audit ensures that menu rates are appropriately approved as per levels of authority of the company.
- Menu approved are updated in menu master of the POS and there are no mistakes.
- All POS controls to the extent applicable for F&B will be applied.

#### **Accounting Considerations (special natures)**

3.44 Only special feature one needs to keep in mind when auditing hotels are meal plan accounting. All other aspects are normal. In case of guest staying in on last day of financial period,

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room revenue is accrued in the books till last night and is kept as guest ledger balance. Guest ledger balance is transferred to city ledger or settled by cash or credit card upon check out.

### **Audit of Expenditures (special emphasis on Hotel Industry Specific)**

#### **Room Related Expenditures including Travel Agent Commission**

3.45 Room related expenditures are primarily travel agent commission, upselling commission, complimentary airport transfer cost, guest amenities, TV channel subscriptions, new paper and magazines, florist. Some rare expenses like guest damage and book out cost could also be incurred.

3.46 Travel agent's commission is normally accounted on accrual basis based on agent profile attached with reservation. Hotels needs to put in process to check whether the profiles attached are proper and process of accrual based on guest check ins. Auditor must ensure that there is a process to ensure that:

- Commission is not being paid to a non-existent / dummy travel agent.
- Commission is not being paid to travel agents who are not eligible to receive them.
- Claims made by the travel agent for commission for bookings not materialised are not paid.
- Commission paid to the agent not as per the company defined rates structure or non-commissionable rates are identified.
- Unauthorised higher commission is not paid.
- Erroneous calculation being made at the time of commission payment is corrected.

3.47 *Upselling Commission*: "Upselling" is an activity by which the guests are persuaded to book for higher category room than what they have actually booked for. This can happen at the time of

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reservation or at the time when the guest actually arrives. The former is normally very difficult to track as there cannot be any documentary proof to suggest that the potential guest asked for a lower category of room and he was persuaded to take a higher category of room unless the reservation is confirmed through email correspondence. But the latter case of the upselling by the front office personnel can be easily identified by the seeing the difference in room category at the time of reservation and at the time of check in. The reservation and front office personnel are encouraged to upsell by giving an incentive in the form of commission as a percentage of the differential revenue earned on account of such upsell. However, the auditor should ensure that , all “upsells” are being authorized so that it is not misused. The difference between an upgrade and upsell is that in case of upgrade cost is borne by the company and in upsell additional revenue is earned.

3.48 *Complimentary airport transfers* – Hotels provide complimentary transfers for certain category of the guest rooms. In those cases, hotels may hire cars from external service providers which need to be accounted as expenditure. An auditor should ensure that there is a process to map front office check in's to travels bills for car hire. Hotels should ensure that this is done before payment.

3.49 *Guest Amenities* – Auditor should ensure that the hotel has a process for accounting guest amenities consumption based on issues from stores to housekeeping. A comparison of cost of amenities per occupied room indicates average cost over a period.

All other expenses are time period based on supply of goods / services. Like any other audit, an auditor shall ensure that they are accrued properly and processes exist for the same.

3.50 *Guest Damage* compensation occurs very rarely but is even based. Hence, chances of omitting to accrue in the books are high. Auditor can review the system of review of guest complaint system by the hotel and see whether any of them will

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result in possible damage claim and evaluate need for provisioning.

3.51 *Book out cost*- Book out cost is the cost incurred in accommodating a guest in another hotel. This situation may arise due to over booking, which at times is practiced by hotels to manage last minute cancellations and ensure full occupancy. In these cases, auditor should ensure that there is a process to ensure certification of such expenditure and accrual process exists.

### **Food and Beverage Cost and Its Controls**

3.52 Food and beverage cost primarily consist of perishables, groceries, crockery/cutlery/glassware / silverware (CGS), kitchen requisites (incl cleaning supplies), fuel (cooking / natural gas) and banquet sundry expenses including audio / video hire.

3.53 Almost all expenses other than banquet sundry expenses are normally controlled through material management system.

3.54 Primarily, normal audit checks that are required to be done for material issues are to be carried out in case of hotel also. In hotels, daily food cost report is prepared considering direct material issued (perishables and groceries). Ideally, audit should also ensure that there is a process of reconciling daily cost report to monthly financials.

3.55 In case of CGS, as explained elsewhere before issues of these items from stores are normally accounted as consumption. Stock in Kitchen Stewarding is considered as a memorandum record for monitoring breakage / loss of CGS. Auditor also needs to check whether breakage is as per the norms established by the hotel.

### ***Purchase***

3.56 Various control procedures are adopted in the area of purchase should primarily aim at minimizing risk of incurring excess expenditure that may take place due to entering into

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contracts at rates that are not competitive or making purchases in spite of existing stock being adequate or receiving goods that are not upto the specifications. The basic requirements of a good internal control system in the area of purchases are discussed herein after.

### *Annual rate contracts*

3.57 The following aspects should be kept in mind with regard to internal control on annual rate contracts entered into by the hotels for purchase of various items:

- Such contracts should be entered into by the Purchase Committee having Purchase Manager, Chief Accountant and Administration Manager as its members.
- There should be proper documentation of the minutes of negotiations and short listed parties based on the comparative chart.
- In case the contract has been awarded to the vendor whose quote is not the lowest, the reasons for doing the same should be properly documented.
- A list of approved suppliers should be maintained and periodic review thereof should be made.
- Level of authority for raising and approval of purchase orders should be predetermined.
- Proper control over serial numbering of purchase orders should be maintained.

### *Formalised Indenting System*

3.58 There should be a formalized indenting system having the following features:

- Authority level for raising indent on the stores department should be clearly defined in the user department.
- Proper control over the serial numbering of indents should be maintained.

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### *Monitoring of stock levels*

3.59 For ensuring proper monitoring of stock levels and avoiding purchase of excessive stocks, the following measures are required to be taken:

- Reorder level, maximum order quantity and maximum and minimum stock levels should be defined clearly prescribed for each item of inventory.
- Stock records should be maintained properly and updated on regular basis.

### *Receipts of materials*

3.60 The following precautions are required to be taken at the time of receipt of materials in store/kitchen:

- Proper inspection of the material received should be done by a responsible person at the time of receipt
- Proper control should be exercised on preparation of goods received note and serial number should be maintained thereon.

3.61 *Cooking Gas* – Auditor should ensure that there is a process of controlling gas cylinders receipt / consumption / return of empties. In case of pipeline supplies, hotel should have process of monitoring meters used to keep track of consumption.

3.62 *Banquet Sundries* – Banquet Sundries consist of cost incurred on decoration, seating arrangements, stage, audio / video arrangements, public address system, floral arrangement, etc. Normally, all these are identified with a particular function and are linked to Function Prospectus. Hence, the auditor needs to ensure that all expenses for a function is accrued and accounted based on Function Prospectus.

### **Other Maintenance Costs and Its Controls**

3.63 Engineering department controls all maintenance costs. An audit of these costs should ensure that there is a process to

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ensure that all services rendered have been provided for in the books whether bills for such services are received or not. Typically, in a hotel, utilities like electricity bills, diesel / furnace oil used for genset, boiler (for generating steam / hot water) are all monitored and maintained by engineering department. These bills are also certified by engineering department. The auditor must ensure that all these are accounted based on processes establish to ensure that time period based billings are accrued and where services are received, it is accrued upon receipt of service.

### **Rentals**

3.64 Rental expenses payable by hotel for the owners of the hotel are governed by the agreements. Audit should ensure that all the terms and conditions of the agreement have been complied and rent provision is made in books as per the same. Care should be taken if the rent payable is a percentage of gross revenue or gross operating profit as all items to be considered for payment has been considered correctly.

### **Payroll Costs**

3.65 Like any other audit, payroll cost should be audited to check whether there adequate processes exist to ensure that time period costs are accrued in the books and there is no risk of any misstatement of account balances and class of transactions.

### **Incirculation Inventory**

3.66 As explained elsewhere, incirculation inventory of linen, CGS etc, should be audited to ensure that all those items which are issued from stores have been accounted as consumption. There are risks of some hotels taking some stock as 'To be returned' and use some CGS items for some functions and return. Such practices should be prohibited and consumption should be accounted once it is issued from stores.

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### **Audit of Other Aspects**

#### **Audit of Property, Plant and Equipment**

3.67 Audit of fixed assets should be done as in any other industry. However, as hotel requires renovation / refurbishment every 4-5 years, there is major cost incurred for maintaining the quality. This amount is mostly capitalised by identifying the earlier cost and de-capitalising the same. Also, typically hotel fixed assets are broadly categorized as:

Land
Lease hold Land
Building
Owned Building Hotel
Plant & Machinery and Electrical installation
P&M General
P&M Less than Rs. 5000
P&M HVAC
P&M refrigeration
P&M electrical Equipment
P&M Sanitary & Plumbing
P&M Elevators & Escalators
P&M AV equipment
P&M Generators & Boilers
P&M Water Systems
P&M EDP & Computers
P&M Kitchen equipment
P&M House keeping equipment
P&M Special equipment
P&M Fire fighting equipments

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P&M sports & fitness equipment
Electrical fittings & Installation
<b>Furniture, fixtures and office equipments</b>
F&F Hotels
F&F Decorations & Artefacts
F&F Hotel Carpets
F&F Offices
F&F lower than 5000
office equipment

3.68 Normally all tangible assets are depreciated based on useful life. However, most hotel companies adopt depreciation rates as per Schedule XIV of the Companies Act, 1956.

3.69 Attention is drawn to a head called F&F decorations & artefacts. All painting & artefacts purchased should be capitalised as furniture and fixtures. Key controls in terms of these items are given below:

- The paintings and artefacts classified under the head 'furniture and fittings' are separately identified and memorandum account (a separate logbook is maintained which gives details of all paintings purchased, the date of acquisition, the name of the artists and the value at which it was purchased) is maintained for review of such artefacts.
- MIS tracking is done for paintings having high values, to determine its actual realizable value.
- In case of sale / disposal of paintings, revaluation is done in order to arrive at the realizable value.
- Unit reviews on a periodic basis to verify the paintings and art works.

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- Any differences on such verification are reported to the General Manger with a copy to Financial Controller for necessary action.
- The Financial Controller reviews the discrepancy report, and the follow up action is taken.
- The conditions of the paintings are regularly monitored, especially, where the values are proportionately higher.
- The paintings and artefacts are codified giving details of name of painter and date of acquisition.
- Special locks and hooks are used to secure the paintings.
- The unit adequately insures paintings and art works.

3.70 Other intangible assets would include scientific or technical knowledge, design and implementation of new processes or systems, licenses, intellectual property, patents, copyrights, customer lists, mortgage servicing rights, fishing licenses, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights or any other asset which qualifies for recognition as an intangible asset as per the provisions stated in AS – 26 stated above. The cost of the intangible asset is recognized in Balance Sheet and amortised.

3.71 Software to be capitalized are large application level software like PMS / POS etc., or operating systems like Oracle. All generalized software like windows OS, MS Office tools, etc., should be charged off in the year of purchase. Amortization should be based on estimated user life. Such estimation is, therefore, made on a prudent basis. Accordingly, it is considered appropriate to amortize software over a period not exceeding six years. However, audit committee of respective company can decide on the amortization policy.

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### **Audit of Guest Loyalty Reward Programme/ Redemptions**

3.72 Hotels introduce their own loyalty program to attract guest and encourage them to earn points so that they can redeem the same against their free stay or some gift items. Points accrue based on the amount spent by the guest. Normally, points at the financial closing date are accrued in the books of the various entities based on accrual pattern. Value of accrual is determined based past trend of redemption and value of redemption per point.

3.73 Hitherto, the cost of such royalty programs are accrued in the books at period end based on number of points outstanding in member's account at redeemable cost. However, based on Ind AS / IFRS such royalty program points should be accrued and adjusted against sales and not accrued as expenditure separately.

3.74 International Financial Reporting Interpretations Committee (IFRIC) 13 discusses Customer Loyalty Programmes. According to Para 5 of IFRIC 13, the consideration received or receivable is to be allocated between award credits and other components of sale. Para 6 states that consideration to be allocated to award credits will be based on their fair value. This fair value as stated in Para 6 is to be recognized as a liability until the awards credits are redeemed in exchange for awards.

3.75 When the award credits are redeemed the following amount is to be recognized as revenue:

$$\frac{\text{Total award credits redeemed}}{\text{Total number expected to be redeemed}} \times \text{previously recognized liability}$$

3.76 As auditors one has ensure that accrual and redemption processes are robust to ensure that there are no unauthorized accrual and also unauthorized redemption. There are fraud risks if the program is not closely monitored and controls are in place.

## Appendix 1

### Revenue Assurance Checklist

Risk No.	Risk Description	Control Framework / Checks to be carried out
1.	<b>ROOM REVENUE</b>	
1.1.	<b>Room charge not charged but rooms let out</b>	<p>Check whether room revenue has been charged for all rooms occupied during the day. This check is to be carried out by checking the spool report “Journal for the day” from PMS. The check should specifically cover the following:</p> <ul style="list-style-type: none"> <li>• All the Guest In House at the time of night audit</li> <li>• All the guests who have checked out during the day</li> </ul>
1.2.	<b>Room charge not charged but rooms let out – special cases</b>	<p>Wherever the room revenue has not been charged for occupied rooms, check whether they fall in the following category</p> <ul style="list-style-type: none"> <li>• Complimentary</li> <li>• House Guest</li> <li>• Late Check-out</li> <li>• Early Check-In</li> <li>• Day use guest</li> <li>• In the case of <b>complimentary and house guest rooms</b> check whether necessary approvals in accordance with Corporate circular exist and they appear in the Complimentary report printed and circulated to GM / FOM.</li> <li>• In the case of <b>Late checkouts</b> <ul style="list-style-type: none"> <li>○ Whether half day / full day charge</li> </ul> </li> </ul>

**Appendix**

Risk No.	Risk Description	Control Framework / Checks to be carried out
		<p>levied is in accordance with the late check-out policy of the Hotel</p> <ul style="list-style-type: none"> <li>○ Whether the waiver of half day / full day charges is in accordance with the late check-out policy of the Hotel</li> <li>○ If it is not in accordance with the policy, check whether the same has been duly documented and approved in accordance with corporate Circular.</li> </ul> <ul style="list-style-type: none"> <li>● In the case of early check-ins (after the night audit and before noon) <ul style="list-style-type: none"> <li>○ Whether half day / full day charge levied is in accordance with the policy of the Hotel.</li> <li>○ Whether the waiver of half day / full day charge is in accordance with the early check-in policy of the Hotel.</li> <li>○ If it is not in accordance with the policy, check whether the same has been duly documented and approved.</li> </ul> </li> <li>● In the case of <b>Day use guest</b> <ul style="list-style-type: none"> <li>○ Check whether room revenue has been charged for all day use guests</li> <li>○ Whether the waiver of half day / full day charges has been duly documented and approved.</li> </ul> </li> </ul>
1.3.	<b>Check-in without reg.</b>	<ul style="list-style-type: none"> <li>● Review Registration cards for their completeness</li> </ul>

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<b>Risk No.</b>	<b>Risk Description</b>	<b>Control Framework / Checks to be carried out</b>
	<b>Card or improper reg. Card – control over unauthorised use of rooms.</b>	<ul style="list-style-type: none"> <li>• Check whether Room Discrepancy Report has been prepared and documentation for resolving the discrepancies.</li> <li>• Check whether Key checks have been carried out by the authorised person and documented.</li> </ul>
1.4.	<b>Incorrect rates charged leading to loss of revenue</b>	<ul style="list-style-type: none"> <li>• Rate Variance Report – Approvals in accordance with Corporate circulars for adhoc rates</li> <li>• Check the rates charged, especially adhoc rates / rates based on BAR with appropriate approvals.</li> <li>• Upgrade report – Approvals in accordance with Corporate circulars.</li> </ul>
1.5.	<b>Check outs not billed and not settled</b>	<p>For all check-outs during the day, check whether bills have been raised and duly settled in PMS either as</p> <ul style="list-style-type: none"> <li>• Credit card settlement</li> <li>• City Ledger settlement</li> <li>• Cash settlement</li> </ul>
1.6.	<b>Credit card settlement not properly done</b>	<p><b>Credit card settlements</b></p> <ul style="list-style-type: none"> <li>▪ For all bills settled by Credit card as per PMS, availability of credit card charge slips should be verified.</li> <li>▪ For all bills settled by Credit card as per POS Chance sheet, availability of credit card charge slips should be verified.</li> <li>▪ Credit card charge slips should also be matched with the EDC</li> </ul>

**Appendix**

Risk No.	Risk Description	Control Framework / Checks to be carried out
		summary sheet for the day
1.7.	<b>City ledger settlement without billing instruction.</b>	<b>City Ledger settlements</b> <ul style="list-style-type: none"> <li>• Check whether for all bill settlement to city ledger, there is billing instruction or the party is a credit listed party</li> <li>• Check for guest signature in the case of Credit customers.</li> <li>• Ensure that all City ledger settlements have been duly posted to CITY LEDGER and the control totals matched.</li> </ul>
1.8.	<b>Cash Settlement not accounted in cash book or paid outs not charged</b>	<ul style="list-style-type: none"> <li>• Tally the cash settlements with the cash summary and the cash book / scroll</li> <li>• Check all Paid Outs as per PMS report with the Paid out slips and check for guest acknowledgement and Duty Manager approval.</li> </ul>
1.9.	<b>Forex Settlements – wrong rates applied for charging / settlement</b>	<ul style="list-style-type: none"> <li>• Check whether correct foreign exchange rates have been updated in the system and check whether TT rates are applied for billing and TC / CN rates are applied for settlement.</li> <li>• Verify all Foreign exchange encashment certificates. Ensure serial continuity, filling up of all relevant details and signature of the guest and authorised signatory.</li> </ul>
1.10.	<b>Checkouts without settlement of bills but keeping bills</b>	<ul style="list-style-type: none"> <li>• Ensure that all the bills received from Front desk are final bills and not Information bills</li> <li>• Review payment masters (PM) with reasons, ensure that they are properly</li> </ul>

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Risk No.	Risk Description	Control Framework / Checks to be carried out
	<b>open</b>	<p>approved by Front office Management and are not kept pending.</p> <ul style="list-style-type: none"> <li>• Review bills on hold and ensure that they are transferred as per corporate policy to city ledger</li> <li>• Check bills are periodically (not later than a fortnight) raised for long stayers</li> <li>• Review Guest In House balances and High Balances Report. Specifically look for abnormal balances and amounts pending in PM accounts.</li> </ul>
1.11.	<b>Charges being unauthorised allowed</b>	<ul style="list-style-type: none"> <li>• Check Front office allowances are as per PMS report with its base documents, reasons and the approval of the same.</li> <li>• In case of Diplomats where taxes are not charged, check with the relevant supporting documents applicable to the respective state laws.</li> <li>• Review and confirm the correctness of Manual Postings in PMS.</li> <li>• Review Lost postings account and take corrective action to identify the correct guest name.</li> </ul>
1.12.	<b>User using software options to not charging or billing the guest.</b>	<p>Review User logs to identify exceptional and unusual events logged by the system. Special emphasis to be given to the usage of the following options:</p> <ul style="list-style-type: none"> <li>• Deletions,</li> <li>• Transfers,</li> <li>• Moves,</li> <li>• Modifications and</li> </ul>

**Appendix**

<b>Risk No.</b>	<b>Risk Description</b>	<b>Control Framework / Checks to be carried out</b>
		<ul style="list-style-type: none"> <li>• Splits</li> </ul>
1.13.	<b>Over all revenue control and tally</b>	<ul style="list-style-type: none"> <li>• Review PMS Trial Balance and ensure it tallies</li> <li>• Review and ensure the correctness of Daily Business Report</li> </ul>
1.14.	Room Rate Master Maintenance – Rate codes wrongly updated	Master Maintenance audit <ul style="list-style-type: none"> <li>• Check all rate code amendments in the rate master.</li> <li>• Check creation of new department codes in PMS, necessary approvals for such creation and the correctness of the flow of data from the new department code in PMS to ARCL.</li> </ul>

<b>Risk No.</b>	<b>Risk Description</b>	<b>Control Framework / Checks to be carried out</b>
2.	FRONT OFFICE CASH	
2.1.	IOUs controls – not approved / not settled	<ul style="list-style-type: none"> <li>• Check IOU's with vouchers and approval by FOM / DM.</li> <li>• Ideally IOUs should be discouraged.</li> </ul>
2.2.	Cash Turn not receipted	<ul style="list-style-type: none"> <li>• Check cash turn in procedure and tally cash receipts from all the outlets with cash settlement reports from POS, PMS and Front Office cashbook,</li> <li>• Check all cash Receipts with PMS and Manual cash book.</li> <li>• Check for serial continuity of receipts.</li> </ul>

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<b>Risk No.</b>	<b>Risk Description</b>	<b>Control Framework / Checks to be carried out</b>
		Cancelled receipts should have the reason for cancellation and approval by FOM / DM.
2.3.	Physical cash not verified	<ul style="list-style-type: none"> <li>• Physically verify cash and tally with book balance and document denominations and fact of verification done.</li> <li>• Physically verify Foreign Exchange with Forex encashment certificates and TC/Cash with PMS and manual / PMS cashbook.</li> <li>• Check whether there is process of physical verification of cash / forex at the time of shift change and denominations are recorded in the cash book / shift handover book.</li> </ul>

<b>Risk No.</b>	<b>Risk Description</b>	<b>Control Framework / Checks to be carried out</b>
3.	OTHER REVENUE CONTROLS	
3.1.	Non-charging / non-billing services provided.	<ul style="list-style-type: none"> <li>• Check all the bills with the sales summaries received from the outlets (Pastry shops, Beauty Parlour, Laundry, Business Centre, Boat Income, etc.)</li> <li>• Check all settlement modes and cross check with respective controls Viz., <ul style="list-style-type: none"> <li>○ Batch slip for EDC machine in case of credit card,</li> </ul> </li> </ul>

**Appendix**

Risk No.	Risk Description	Control Framework / Checks to be carried out
		<ul style="list-style-type: none"> <li>○ Billing instruction for city ledger and</li> <li>○ Cash summary for cash sales.</li> <li>● In the case of Manual bills ensure serial number continuity of bills and ensure it is duly posted in PMS.</li> <li>● Check telephone charges as per telephone system matches with the charge in PMS</li> </ul>

Risk No.	Risk Description	Control Framework / Checks to be carried out
4.	F&B REVENUE	
4.1.	POS controls – serial continuity of the bills settled.	<ul style="list-style-type: none"> <li>● Check whether sales as per Chance Sheet from Point Of Sales tallies with entries posted in PMS.</li> <li>● Check whether all bills have been received from all the outlets for the sales made during the day.</li> <li>● Check the void bills report and ensure that the original void bills are physically available and the same have been approved by the Restaurant Manager / F&amp;B Manager and counter Chef.</li> <li>● Check the Reprint bills report and ensure that the original bill and the reprinted bill are physically available and the same has been approved by the Restaurant Manager / F&amp;B Manager</li> </ul>

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<b>Risk No.</b>	<b>Risk Description</b>	<b>Control Framework / Checks to be carried out</b>
		<ul style="list-style-type: none"> <li>• Check whether there are any open bills, if yes, approval and the reasons for the same.</li> </ul>
4.2.	POS controls – non-billing of food and beverage served or short billing.	<ul style="list-style-type: none"> <li>• Check whether duly approved entertainment slips as per corporate policy are available for the complimentaries / entertainments</li> <li>• Check whether all EDM bills have been appropriately approved.</li> <li>• Check whether Gift vouchers / share holders coupon attached to the food bills are duly defaced</li> <li>• Check F&amp;B discounts and its authorisation. Check whether discount coupons are defaced</li> </ul>
4.3.	Wrong appropriation of income between F&B / room revenue	<ul style="list-style-type: none"> <li>• Check whether Meal plan credits and taxes have been correctly given in all cases as per corporate circular.</li> </ul>
4.4.	Rate master wrong updation	<ul style="list-style-type: none"> <li>• Check restaurant rate code amendments with menu card and edit list from system.</li> </ul>

<b>Risk No.</b>	<b>Risk Description</b>	<b>Control Framework / Checks to be carried out</b>
5.	BANQUET REVENUE	

**Appendix**

<b>Risk No.</b>	<b>Risk Description</b>	<b>Control Framework / Checks to be carried out</b>
5.1.	Rates – unauthorised discounts / terms	<ul style="list-style-type: none"> <li>• Check whether banquet contract as envisaged in Corporate Circular is entered into.</li> <li>• Check whether the rates fixed are as per Corporate Circular on optimising revenue and necessary approvals have been taken with regard to discounts.</li> <li>• Check whether the contract terms on advances, credit extensions have been adhered.</li> <li>• Check whether the PAN number has been obtained for all bills over Rs.25000 if settlement is going to be in cash.</li> </ul>
5.2.	Billing for quantity less than what has been guaranteed	<ul style="list-style-type: none"> <li>• Cross check the Function Prospectus (FP) with the Banquet challans and check the correctness of billing.</li> <li>• Check whether all corrections / modifications in the FP / Banquet challans have been duly approved by the Banquet supervisor and the guest.</li> <li>• Any changes in Guaranteed Pax (covers) have been duly approved by Banquet Sales Manager and F&amp;B Manager.</li> </ul>
5.3.	Incomplete billing	<ul style="list-style-type: none"> <li>• Check whether bills have been raised for all the banquets for the day and they are supported by Banquet challans duly signed by the guests.</li> </ul>

## Appendix 2

### F&B Cost Related Risks and Controls

Risk	Control
Non verification of liquor stock on daily basis	Item to item reconciliation is conducted by the F&B Cost Controller on a daily basis for entire liquor inventory of outlet and minibar.
	F&B Cost Controller reconciles sales as per POS with the consumption arrived at from the liquor inventory (Opening stock plus requests less closing stock) for all outlets and minibar. Discrepancies are reported to the Outlet Manager.
	Excess liquor found is booked in the Liquor inventory by the F&B Controller.
	For shortage in liquor, reasons for the same are obtained from the Outlet Manager.
	In case of shortage of liquor from spoilage or breakage, spoilage / breakage report duly signed by the Outlet Manager and F&B Manager is obtained. In case of breakage, the broken bottle neck is obtained from the outlet.
	In case of shortage, if the reasons cannot be clarified by the Outlet Manager, the shortage is debited to Outlet at Sale price of the liquor.
	F&B Controller compares the physical stock with book stock as per FLR register on daily basis.
	Random density checks are carried out by F&B Controller to ensure that the liquor is not diluted.

**Appendix**

Monthly physical verification of stores inventory not conducted.	Month end verification done by F&B Controller for entire food and liquor inventory in stores and is compared with the MMS. Discrepancies are reconciled with the Storekeeper.
	In case the discrepancy cannot be reconciled, the report is sent to the Finance Controller (FC).
	Expired stocks and non / slow moving stocks are also identified in such monthly verifications.
	Stores initiates action on such expired / slow moving / non moving stocks.
Cost consumption report not generated / monitored	Food consumption- Food cost is debited to the outlet based on the requisition raised by outlet and food issued by the kitchen to outlet on daily basis.
	- Daily food cost report is generated by F&B Cost Controller for review by the Financial Controller.
	Liquor / tobacco consumption - Liquor cost is treated as circulating inventory and is charged based on the consumption of the outlet (arrived at as Opening stock plus requisition less closing stock) on monthly basis.
	The cost of consumption less the Non-chargeable KOT (at cost) equals the Net cost, which is compared with Sales posted in FIDELIO to arrive at Cost percentage.
No system of reporting on costs	Following reports are generated on a monthly basis by the Cost Controller for MIS and review by GM / F&B Manager / FC:
	<ul style="list-style-type: none"> <li>• RM Cost to F&amp;B Sales (%) ( Excl complimentary)</li> </ul>

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	<ul style="list-style-type: none"> <li>• Food Cost % to Food Sales ( Excl Complimentary )</li> </ul>
	<ul style="list-style-type: none"> <li>• 'Soft Drink Cost % to Soft Drink Sales ( Excl Complimentary)</li> </ul>
	<ul style="list-style-type: none"> <li>• Liquor Cost % to Liquor Sales ( Excl Complimentary)</li> </ul>
	<ul style="list-style-type: none"> <li>• 'Smoke Cost % to Smoke Sales ( Excl Complimentary)</li> </ul>
	<ul style="list-style-type: none"> <li>• Complimentary Cost (Guest+ Staff) % to F&amp;B sale</li> </ul>
	<ul style="list-style-type: none"> <li>• Complimentary Cost (Guest) % to F&amp;B sale</li> </ul>
	<ul style="list-style-type: none"> <li>• Complimentary Cost (Staff) % to F&amp;B sale</li> </ul>
	<ul style="list-style-type: none"> <li>• Average Cover per day</li> </ul>
	<ul style="list-style-type: none"> <li>• Average Check per cover</li> </ul>
	<ul style="list-style-type: none"> <li>• Outlet wise</li> </ul>
	<ul style="list-style-type: none"> <li>○ Income</li> </ul>
	<ul style="list-style-type: none"> <li>○ Resident, Non-resident and Total covers</li> </ul>
	<ul style="list-style-type: none"> <li>○ Covers per day</li> </ul>
	<ul style="list-style-type: none"> <li>○ Average check</li> </ul>

**Liquor Inventory Controls**

<b>Risk</b>	<b>Control</b>
Purchases of Non Moving Liquor brands	There may be a need to stock all the brands even if they are non-moving. However, the stock levels for the same need to be prescribed and monitored. Reorder levels also need to be fixed at minimum for non moving brands.
	Fresh orders to be placed after considering the existing inventory levels.
	In case of non-moving and slow moving, the ageing needs to be regularly reviewed.
Purchase of imported liquor by paying duty and not under the EXIM policy as per the Hotel's policy	Procedure for import of liquor is communicated by corporate purchase to all the units.
	Foreign liquor for all the units under the luxury division is imported under a single license. Corporate purchase forwards the license copy to unit purchase.
	P.O is authorised by the FC and GM of the unit.
	In case due to certain emergencies imported liquor has to be purchased by payment of duty, approval of GM and Materials Head needs to be taken before placing the order.
Issue of liquor from the main store to the	Outlets raise requisition duly authorised by outlet managers to Foreign Liquor (FL) store room for their imported liquor requirement.

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<b>Risk</b>	<b>Control</b>
outlet without valid approvals leading to contravention of excise laws and misappropriation of liquor.	All issues from the FL store room are supported with FL 9 form duly authorised by the excise inspector.
No independent, appropriate inventory counts being carried out	Physical verification of Liquor inventory in the liquor store is done on a monthly basis with the stock as per excise register.
	Liquor inventory stock count is done in the presence of F&B cost controller

## Appendix 3

### Sample Audit Programme Checklist

Client : \_\_\_\_\_ Schedule No: \_\_\_\_\_

Audit Period : \_\_\_\_\_ Date: \_\_\_\_\_

#### **Audit of Fixed Assets**

##### ***Audit objectives***

1. Fixed assets recorded in books are actually in existence owned by the entity and are used in operations,
2. No unrecorded fixed asset is in existence.
3. Fixed assets sold, abandoned, or otherwise disposed off have been eliminated from the financial statements. Fixed assets, retired from active use and held for disposal, have been stated at the lower of their net book value and net realisable value are shown separately in the financial statements.
4. Subsequent amounts spent on existing fixed assets have been capitalized only in a case where it increases the future benefits in the asset beyond its previously assessed standard of performance, for example, where it increases the capacity.
5. Valuation of fixed assets is appropriate keeping in view the generally accepted accounting principles and these principles have been consistently applied.
6. All the assets obtained on finance lease, on or after 1<sup>st</sup> April 2000 are recognized as assets in the financial statements as per accounting standard 19, leases, issued by the ICAI. Operating lease rentals have been appropriately charged as an expense over the life of the lease.
7. Any impairment in the value of fixed assets has been appropriately recognised in the financial statements.

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### ***Audit Procedures***

1. Trace and verify opening balances of fixed assets from previous year audited financial statements.
2. Review significant expenditure related to fixed assets incurred during the year to ensure that the expenditure resulting in increase in capacity of existing fixed assets as also expenditure incurred on purchase of new fixed assets have been properly capitalized.
3. Obtain a list of fixed assets disposed off during the period and verify computation of profits/loss, if any, on the same on sample basis.
4. Verify the items of fixed assets, retired from active use and held for disposal, have been stated at the lower of their net book value and net realisable value and are shown separately in the financial statements. Also verify that any expected loss has been recognized immediately in the statement of profit and loss.
5. Ensure that depreciation on fixed assets has been charged at the rates which are not lower than the rates prescribed and applicable statute, if any, to the enterprise, Eg: Rates prescribed in schedule XIV to the Companies Act, 1956, would be relevant to the companies registered under the Act.
6. In case depreciation on fixed assets has been charged at rates higher than those prescribed in the applicable statute on the grounds of lower useful life, the report of the technical expert must be verified.
7. Perform analytical review procedures on computation of depreciation on major fixed assets as also on useful life of the assets.
8. Verify that the fixed assets register has been duly maintained and updated on regular basis. Further, various balances appearing in the fixed asset register should be reconciled with the books of accounts.

## ***Appendix***

9. Physical Verification of various fixed assets should be carried out and discrepancies noticed, if any, should be properly analyzed and reconciled.

### **Profit and Loss Account**

#### ***Audit Objectives***

1. All the items of revenue and expenses have been properly recorded and recognised.
2. Proper adjustments have been made for expenses accrued/outstanding at the year end and for the prepaid expenses.
3. Proper adjustments have been made for income accrued at the year end and for the income received in advance.
4. Adequate provision has been created for expected uncollectible portion of debtors and the individual items have been charged off on becoming uncollectible.
5. Recognition, measurement and disclosure requirements laid down in various pronouncements of the Institute of the Chartered Accountants of India have been duly complied with.

#### ***Audit Procedures***

##### ***Sales and Purchase Accounting***

1. Perform walk-through tests to examine the system of accounting and internal control with regard to sales and purchases.
2. Identify and test controls on which reliance is to be placed.
3. In case accounting and/or internal control system has undergone a change during the year, re-perform tests as stated in (1) and (2) above to the extent required and document the same.
4. Apply necessary tests on the systems and controls, designed to prevent errors and frauds, to obtain the desired level of confidence. In case the desired level of

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confidence cannot be obtained by applying these tests, its impact on the accounts and audit must be ascertained and the auditor should consider applying the additional tests.

#### ***Analytical Review of Profit & Loss Account***

1. Determine significant variances for major heads of revenue and expenditure *vis-à-vis* the budget figures and the corresponding figures for the previous year.
2. Identify unusual items of revenue and expenditure in the profit and loss account.
3. Ascertain/obtain reasons from the management for such variances and unusual items and these reasons should be properly documented.
4. Obtain corroborative evidence for management's explanations of significant matters.

#### ***Analytical Review of Individual Items***

1. Compare monthly room rent revenue with the budgeted amount and with the revenue for the corresponding month of the previous year/period.
2. Compare monthly room rent revenue with the revenue computed on the basis of industry trends and occupancy rates for the month.
3. Carry out a global check on the room rent revenue by considering industry occupancy rates (particularly in that market segment) and the room rates charged by the hotel.
4. Obtain necessary information and explanations from the management for major variances, if any, and ensure that all information and explanations for variances are consistent with the relevant available information.
5. Compare and analyse monthly relationship of food and beverages revenue with room rent revenue besides comparing actual food and beverage revenue with

## ***Appendix***

budgeted revenue and revenue for the corresponding month in previous year.

6. Verify reasonableness of banqueting income by comparing the same with the income for the corresponding previous period and the budgeted income. Any material variances should be properly analysed and investigated.
7. Assess reasonableness of interest received and interest paid by comparing the same with interest computed on the average balance outstanding and applicable rates of interest. Further, ensure on test basis that interest has been received and paid at rates contracted and computation of interest should also be checked on sample basis.

## **Payroll**

### ***Audit Objectives***

1. Amounts outstanding at the year-end as also the amounts paid in advance have been recorded and properly adjusted in the financial statements for the period.
2. Amounts recorded as payroll expenses accurately represent the value of services received by the entity.
3. Allocation of various expenses to assets, expenses and other accounts has been done correctly on reasonable and equitable basis and applied consistently.
4. Accounting principles applied to various employee benefit cost including health care, pension and other post retirement benefit costs are appropriate keeping in view various pronouncements of the Institute of Chartered Accountants of India such as Accounting Standard (AS-15), Accounting for Retirement Benefits in the financial statements of the employers. It should also be ensured that accounting principles have been appropriately disclosed in the notes to the financial statements.

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### ***Audit Procedures***

#### ***Accounting system and Internal Control***

1. Perform walk-through test to examine the accounting system and internal control with regard to payroll.
2. Identify and test controls on which reliance is to be placed.
3. In case of accounting and/or internal control system has undergone a change during the year, re-perform tests as stated in (1) and (2) above to the extent required and document the same.
4. Apply necessary tests on the systems and controls, designed to prevent errors and frauds, to obtain the desired level of confidence. In case desired level of confidence cannot be obtained by applying these tests, the impact on the accounts and audit must be ascertained and the auditor should consider applying the additional tests.
5. Examine and review the segregation of duties with in the payroll department and the EDP department.
6. Carry out analytical review of payroll costs using key performance indicators.
7. Make comparison of current year payroll costs with the budgeted costs as also with the cost for the previous year.
8. Apply trend analysis on payroll costs incurred and benefit received by the department.
9. Compute a ratio of profit as a percentage of payroll costs for each department and compare the same with prior years as also with industry standards.
10. Obtain necessary information and explanation from the management for major variances, if any, noticed at steps 7 to 9 and ensure that all the information and explanations for variances are consistent with the relevant available information.
11. Check the relevant documents relating to fresh appointments and for resignations.

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12. Review payroll sheets to identify unusual items and significant variances and obtain explanations from the management for such unusual items and variances.
13. Analyse relationship between casual labour cost and monthly occupancy rate, compare the same with previous year figures and industry standards and obtain explanation from management for significant variances.
14. Verify that timely payment of payroll related statutory dues such as tax deducted at source, provident fund, ESIC, etc., has been made.
15. Review the correctness of various calculations done by actuaries with regard to retirement benefit and ascertain reasonableness of assumptions used.
16. Examine the following documents for their relevance to the period under audit:
  - Contracts with unions
  - Other employment contracts
  - Employee benefit plans
  - Post retirement benefits

### ***Stock Verification***

1. Obtain a copy of the stocktaking instructions to ensure that these instructions are adequate from the control viewpoint and also ensure that these instructions have been duly complied with.
2. Identify all stock locations to ensure the coverage of all locations in the stocktaking process.
3. Identify important items from the stock sheets and physically verify them. Discrepancies notice, if any, should be properly documented.
4. Select certain items of inventory on random basis and ensure that these appear properly in the stock sheets.
5. Identify important items of inventory from the stock ledger and confirm their balances in the stock sheets.

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6. Select certain items of inventory from the stock sheets (other than those covered referred in 5 above) and trace their balances in the stock ledger.
7. Ensure that the stock sheets are referenced/numbered in a manner which ensures their completeness.
8. Obtain details of cut-off procedures used on inventories from all documents pertaining to movement of stocks.
9. Identify any damaged or slow/non-moving stock, as also stocks in excess of current requirements.

#### ***Stock Valuation***

1. Ensure that the principles relating to valuation of inventories stated in Accounting Standard (AS) 2, Valuation of Inventories, issued by the Institute of the Chartered Accountants of India, have been duly complied with.
2. Verify that the principles relating to valuation of inventories have been followed consistently from year to year, i.e., the valuation principles followed in the current year are the same as those followed in previous year.
3. Independently determine lower of net realizable value and cost for certain important items of inventory and ensure that their valuation is correct.
4. Carry out an analytical review on the value of stock by comparing the same with the budgeted value as also with the value of inventories at the end of the previous year.
5. In case significant variances are found in the valuation of inventories, category-wise analytical review must be carried out and reasons for variances in value of each category must be ascertained from the management and properly documented.
6. Verify that appropriate provision has been created on damaged or slow/non-moving stock, as also on stocks in excess of current requirements.

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### ***Debtors***

1. Examine the relevant records to ensure validity, accuracy and recoverability of debtor balances.
2. The balances of debtors shown in the schedules must be tallied with those shown in the ledger accounts. Further, the total of schedules must be tallied with the control account of debtors as appearing in the ledger accounts. Any differences in this regard should be clearly examined and analysed.
3. In case of significant debtors, the correspondence and other documentary evidence must also be verified to ensure their validity and accuracy.
4. For larger balances, subsequent realizations might also be verified.
5. Bad debts written off or excessive discounts or unusual allowances should be verified from the relevant correspondence.
6. Review city ledger and front office reconciliation for the year and investigate any unusual or significant items in the reconciliation.
7. Ensure that year-end charges made to guests have been adjusted for credit notes/allowances given in the next accounting year.
8. Examine credit balances in Sundry Debtors Account and after verifying correctness thereof ensure that these are grouped under creditors.
9. Obtain explanations from the management with regard to doubtful debts and verify the same with the corroborative evidence available. Further, it should be ensured that provision for doubtful debts is adequate.
10. Obtain an aging analysis of guest balances to identify old debts in respect of which provision has not been made, check all correspondence in relation thereto, and obtain explanations from the management before deciding upon whether a provision ought to be made

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11. Assess the effectiveness of credit control; the measures taken to ensure credit-worthiness of the significant debtor groups such as corporates, travel agents and long-staying guests before extending credits.

#### **Creditors**

1. Ensure that all perishables / other stocks received till last day of the financial period have been accrued in the books for materials received for which bills not received.
2. Such cut off procedure should ensure that physical verification is done after taking last document references.

## Appendix 4

### Fraud Risk Checklist

Fraudulent Financial Reporting	
<b>Tone at the Top</b> Pertains to management's abilities, pressures, style and attitude relating to internal control and the financial reporting process.	<b>1. Pressures</b> <ul style="list-style-type: none"><li>• Bonuses A significant portion of management or staff's compensation is represented by bonuses (or other incentives), the value of which is contingent upon the entity achieving unduly aggressive targets for operating results, financial position, or cash flow.</li><li>• Forecasts Management commits to financial institutions, creditors and other third parties to achieving what appear to be unduly aggressive or clearly unrealistic forecasts.</li><li>• Tax reduction Management has an interest in pursuing inappropriate means to minimize reported earnings for tax-motivated reasons.</li></ul>

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	<p><b>2. Opportunities</b></p> <ul style="list-style-type: none"><li>• Management's attitudes</li></ul> <p>Failure by management to display/communicate an appropriate attitude regarding internal control and the financial reporting process such as:</p> <ul style="list-style-type: none"><li>○ Management does not effectively communicate and support the entity's values or ethics or Management communicates inappropriate values or ethics;</li><li>○ Management is dominated by a single person or a small group without the compensating internal control such as effective oversight by those charged with governance;</li><li>○ Management does not monitor significant internal control procedures adequately;</li></ul>
	<ul style="list-style-type: none"><li>○ Management fails to correct known material weaknesses in internal control on a timely basis;</li><li>○ Management sets unduly aggressive financial targets and expectations for operating personnel;</li><li>○ Management displays a significant disregard for regulatory authorities; and</li><li>○ Management continues to employ ineffective accounting and/or information technology staff.</li></ul> <ul style="list-style-type: none"><li>• Turnover</li></ul> <p>There is a high turnover of management, legal counsel or board members.</p>

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	<ul style="list-style-type: none"> <li>• Management/auditor relationships There is a strained relationship between management and the current/ predecessor auditor such as: <ul style="list-style-type: none"> <li>○ Frequent disputes on accounting, auditing, or reporting matters;</li> <li>○ Unreasonable demands on the auditor, including unreasonable time constraints regarding the completion of the audit or the issuance of the auditor’s report;</li> <li>○ Formal or informal restrictions on the auditor that inappropriately limit the auditor’s access to people or information or limit the auditor’s ability to communicate effectively with those charged with governance; and</li> <li>○ Domineering management behaviour in dealing with the auditor, especially involving attempts to influence the scope of the auditor’s work.</li> </ul> </li> <li>• Corporate governance structure The corporate governance structure is weak or ineffective as evidenced by inexperience or lacking members, members who are not independent of management or where little attention is being paid to financial reporting matters and accounting and internal control systems.</li> </ul>
<p><b>Industry Conditions</b></p> <p>Pertains to the</p>	<ul style="list-style-type: none"> <li>• New compliance requirements New accounting, statutory, or regulatory requirements that could impair the financial stability or profitability of the entity.</li> </ul>

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<p>economic and regulatory environment in which the entity operates.</p>	<ul style="list-style-type: none"> <li>• Operational challenges           <ul style="list-style-type: none"> <li>A high degree of competition or market saturation, accompanied by declining margins.</li> </ul> </li> <li>• Industry trends           <ul style="list-style-type: none"> <li>○ A declining industry with increasing business failures and significant declines in customer demand; and</li> <li>○ Rapid changes in the industry, such as high vulnerability to rapidly changing technology or rapid product obsolescence.</li> </ul> </li> </ul>
<p><b>Operating Characteristics and Financial Stability</b></p> <p>Pertains to the nature and complexity of the entity and its transactions, the entity's financial condition, and its profitability.</p>	<ul style="list-style-type: none"> <li>• Cash flows           <ul style="list-style-type: none"> <li>○ Inability to generate cash flows from operations while reporting earnings and earnings growth; and</li> <li>○ Significant pressure to obtain additional capital necessary to stay competitive, considering the financial position of the entity (including a need for funds to finance major research and development or capital expenditures).</li> </ul> </li> <li>• Estimates           <ul style="list-style-type: none"> <li>○ Assets, liabilities, revenues or expenses based on significant estimates that involve unusually subjective judgments or uncertainties; and</li> <li>○ Estimates subject to significant change in the near term that may have a financially disruptive effect on the entity (such as collectibility of accounts receivable, valuation of inventory, timing of revenue recognition. or a</li> </ul> </li> </ul>

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	<p>significant deferral of costs).</p> <ul style="list-style-type: none"><li>• Related parties<ul style="list-style-type: none"><li>○ Significant related-party transactions which are not in the ordinary course of business; and</li><li>○ Significant related-party transactions which are not audited or are audited by another firm.</li></ul></li><li>• Complexity<ul style="list-style-type: none"><li>○ Significant, unusual or highly complex transactions (especially those close to year end) that pose difficult questions concerning substance over form;</li><li>○ Significant bank accounts or subsidiary operations in tax-haven jurisdictions for which there appears to be no clear business justification;</li></ul></li></ul>
	<p><b>Reporting</b></p> <ul style="list-style-type: none"><li>○ An overly complex organizational structure involving numerous or unusual legal entities, managerial lines of authority; or contractual arrangements without apparent business purpose; and</li><li>○ Difficulty in determining the organization or person (or persons) controlling the entity.</li><li>• Growth/profitability Unusually rapid growth or profitability, especially compared with that of other companies in the same industry.</li><li>• Dependencies/vulnerabilities</li></ul>

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	<ul style="list-style-type: none"> <li>○ Especially vulnerable to changes in interest rates;</li> <li>○ Unusually high dependence on debt, a marginal ability to meet debt repayment requirements, or debt covenants that are difficult to maintain;</li> <li>○ Unrealistically aggressive sales or profitability incentive programs;</li> <li>○ A threat of imminent bankruptcy, foreclosure; or hostile takeover;</li> <li>○ Adverse consequences on significant pending transactions (such as a business combination or contract award) if poor financial results are reported; and</li> <li>○ A poor or deteriorating financial position when management has personally guaranteed significant debts of the entity.</li> </ul>
<b>Misappropriation of Assets</b>	
<b>Susceptibility of Assets to Theft</b>	<ul style="list-style-type: none"> <li>• Large amounts of cash on hand or processed;</li> <li>• Inventory characteristics, such as small size combined with high value and high demand;</li> <li>• Easily convertible assets, such as bearer bonds, diamonds, or computer chips; and</li> <li>• Fixed asset characteristics, such as small size combined with marketability and lack of ownership identification.</li> </ul>
<b>Absence of Internal Control</b>	<ul style="list-style-type: none"> <li>• Lack of appropriate management oversight (for example, inadequate supervision or inadequate monitoring of remote</li> </ul>

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	<p>locations);</p> <ul style="list-style-type: none"><li>• Lack of procedures to screen job applicants for positions where employees have access to assets susceptible to misappropriation;</li><li>• Inadequate record keeping for assets susceptible to misappropriation;</li><li>• Lack of an appropriate segregation of duties or independent checks;</li><li>• Lack of an appropriate system of authorization and approval of transactions (for example, in purchasing);</li><li>• Poor physical safeguards over cash, investments, inventory or fixed assets;</li><li>• Lack of timely and appropriate documentation for transactions (for example, credits for merchandise returns); and</li><li>• Lack of mandatory vacations for employees performing key internal control functions.</li></ul>
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