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Technical Guide on
**ACCOUNTING AND AUDITING IN
HOTEL INDUSTRY**



Research Committee
The Institute of Chartered Accountants of India
NEW DELHI

Technical Guide on Accounting and Auditing in Hotel Industry

The basic draft of this publication was prepared by Shri Arun Gandhi and Shri Vinay D. Balse.



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This publication has been issued by the Research Committee of the Institute. The Publication is of the nature of a study of the various issues involved in the subject. It has been discussed by the Research Committee and has been published to provide an overview of the various aspects of the subject. The publication does not have authoritative status of a Standard or a Guidance Note.

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Foreword

Hotel industry largely mirrors the overall economy of the country. During the hard times faced by the economy, the performance of the industry also deteriorates. On the other hand, if the economy is strong, more travel would be undertaken by business as well as leisure travellers and, consequently, demand for services of the industry would be more. Hotel industry has several peculiar features, including the accounting aspects, that differentiate it from other industries. As a result of these features, the members of the Institute, during the course of discharge of their professional duties, might come across several accounting and auditing issues which are unique to the industry. Therefore, a need was being felt for providing guidance to the members on these issues as well as on technical aspects peculiar to the industry so that they may be able to discharge their professional duties in an effective and efficient manner. It is really heartening to note that the Research Committee, realising the need for guidance, has brought out this 'Technical Guide on Accounting and Auditing in Hotel Industry'.

I am confident that this Guide would be immensely useful to the members as well as to the others concerned.

New Delhi
May 31, 2002

Ashok Chandak
President

Preface

Hotel industry is primarily a tourism related industry and its growth is closely associated with the growth of tourism industry. Realising the role of tourism industry in overall economic development of the country, the government has taken various steps to promote tourism in the country. With the growth of tourism industry, it is expected that hotel industry would also grow at a higher pace. As a result, more and more services of the members of the Institute are expected to be utilised by the industry especially in the areas of accounting and financial control.

The Technical Guide discusses various features that are peculiar to the industry, contains a broad overview of the structure of a hotel and deals with the various technical and operational aspects of the industry. The Technical Guide also discusses various accounting, control and audit aspects of the industry that may be useful in the audit of a hotel. One of the appendices to the Technical Guide contains an audit programme checklist which lays down the procedures that might be gainfully used by the auditor for verification of various items appearing in the financial statements of a hotel.

On behalf of the Research Committee, I place on record my deep appreciation of the efforts put in by Mr. Arun Gandhi and Mr. Vinay D. Balse, eminent members of our profession, for preparing the basic draft of this publication. I also wish to place on record my sincere appreciation of Dr. Avinash Chander, Technical Director, Ms. Anuradha Jain, Secretary, Research Committee, and Mr. Vishal Bansal, Technical Officer of the Institute of Chartered Accountants of India, for their invaluable inputs and for giving this Technical Guide its final shape and form.

I am confident that this publication would be of immense use to the members of the Institute and others concerned.

Mumbai
May 29, 2002

Rajkumar S. Adukia
Chairman
Research Committee

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Introduction

1.1 Industrialisation and modernisation have been the buzzwords in almost every country, in the post-World War period. For achieving rapid industrialisation, advancement in transportation and communication have been major thrust areas. As a result, many new industries including tourism have mushroomed.

1.2 With rapid globalisation, tourism is no more a cultural pilgrimage, rather it is one of the fastest growing industries all over the world. Realising the various socio-economic benefits of tourism, governments of various countries are competing with each other in promoting 'tourism and travel' by highlighting its history, culture, sunshine, snow and sands.

1.3 The tourism industry figures predominantly in the five-yearly plans of our country. In fact there was a time when tourism did not even find a mention in the country's five-yearly plans. Things began to change only with the sixth five-year plan. At present, tourism is the third largest net earner of foreign exchange in India. Being a labour intensive industry, it is also one of the biggest employment generating industries in India. Tourism Industry involves very low foreign exchange spending as compared to its earnings because of the low import content. Recognising the importance of tourism in the economic development, the government has given export house status to the industry.

1.4 India is a very vast country with geographical diversity, rich culture and heritage, fairs and festivals, snow capped mountains, vast coastline, monumental attractions, etc. For sheer diversity, no other destination comes close to India. Therefore, there is a tremendous potential for growth of tourism industry in India.

1.5 Tourism and hotel are related industries. In fact, survival of one without the other might not be possible. Tourists are major customers for

hotels. Although, the persons going on business/office tours are also significant customers for hotels, growth of the hotel industry, to a great extent, depends on the tourism industry.

1.6 The Indian hotel industry is still in its initial stages and has a long way to go. The industry has always been perceived as luxury, and the government continues to tax it heavily. The luxury and expenditure taxes levied on the hotel industry are relatively higher in India. This has become a major hurdle in the growth of the hotel industry in India.

1.7. It is expected that with the growth of tourism industry, the hotel industry will grow at a higher pace. As a result, it is expected that the hotel industry in India would be required to double the capacity available at present to tackle the increase in demand.

SCOPE AND OBJECTIVE OF THE TECHNICAL GUIDE

1.8 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 to the members of the Institute in the conduct of audit of a hotel. Since the size, functioning and nature of business may vary materially from hotel to hotel, the Guide cannot cover all the intricacies that may be involved in all practical situations. The various principles, enunciated in this Guide, might require appropriate modifications/adjustments depending on the size, functioning and nature of the business of the hotel under consideration.

EXTERNAL FACTORS AFFECTING HOTEL INDUSTRY

1.9 The external factors that affect the hotel industry are discussed hereinafter.

ECONOMIC

1.10 The overall health of the economy of the country, to a great extent, affects the flow of tourists and consequently affects the fortunes of the hotel industry. For example, the Asian crisis of late 1997 affected demand for hotel accommodation in this region. Generally, stronger the economy, more is the travel undertaken, both by business and leisure travellers, and consequently, more is the demand for rooms.

POLITICAL

Political Stability

1.11 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 especially for the reason that the flow of tourists into the country gets affected to a great extent by political instability. Further, the growth of other industries also affects the growth of the hotel industry, since a significant portion of hotel revenues comes from business travellers and other programmes organised by various industries.

Minimum Wage Legislation

1.12 Labour cost usually constitutes a major portion of operating cost of any kind of hotel. Accordingly, the existence of any minimum wage legislation is likely to result in increase in labour cost for the industry.

Terrorism

1.13 Acts of terrorism both in the destination country and in the country of origin (of traveller) can seriously affect the flow of tourist traffic. For example, tourism has been badly affected in the state of Jammu & Kashmir due to terrorist activities.

Trade Union Problems

1.14 Unresolved issues of any industry related to tourism with trade unions can have direct impact on the day-to-day operations of a hotel, for example, airlines pilots' strike would affect the travellers' arrival in the country.

COMPETITION

1.15 Competition is one of the major factors affecting the business of various enterprises operating in an industry. Competition affects overall functioning as also the profitability of the enterprise. It may force the enterprise to think in terms of repositioning itself in the market by upgrading its facilities or by adjusting charges.

SUBSTITUTES

1.16 The emergence of cheaper substitutes, such as vocation homes, cheap

guesthouses, etc., is posing an ever-increasing threat to the operations and profitability of hotels. Further, arrangement of small-scale parties on cruise ships is also emerging as a direct threat to the banquet business of hotels. Video conferencing has obviated the need for businessmen to travel long distances, stay in hotels and have face-to-face meetings.

STRENGTH OF SUPPLIERS

1.17 The existence of reliable sources of goods and services that could provide quality goods and services on time 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 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

1.18 The 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. Outsourcing, referred to in the preceding paragraph, may not be a solution to this problem, since the quality of the employees of the service provider is also equally important.

PECULIAR FEATURES OF THE INDUSTRY

1.19 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

1.20 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 increase/decrease in demand, unlike in a manufacturing industry where a reduction in the purchase of raw materials and in the production can be effected in response to 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

1.21 The services of hotel are immediately perishable as these can not 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.

CONTROLS ON LEAKAGE OF REVENUE

1.22 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.

1.23 To prevent any possible leakage of revenue, a number of hotels in India are automating their billing systems for telephones, food and beverages that are linked directly to guest ledgers which ensure point-of-sale billing. 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 with in a subsequent chapter.

SEASONALITY FACTOR

1.24 The seasonality factor that affects the hotel industry is of more dynamic nature as 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 and resort to innovative pricing to tide over this problem.

SERVICE CHARGES

1.25 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 have been treated differently by different hotels; while some use these to meet the food and beverages labour costs, others distribute a part thereof to the staff.

HIGH FIXED COSTS

1.26 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. 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. 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

1.27 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 toiletries, etc.

NIGHT AUDIT

1.28 The term night audit is widely prevalent in the hotel industry. In case of a hotel, the term refers to the procedure under which checking of various revenues is done 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 collections, have been correctly recorded, so that records are updated and ready by the next morning. However, for city hotels, wherein the check-outs are continuous, the process may be differently organised.

TIME-SHARING

1.29 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

- 1.30 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 long as compared to other industries.

LAWS/STATUTES APPLICABLE TO HOTEL INDUSTRY

1.31 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:

Expenditure Tax Act, 1987	Central Act	For levy of tax on expenditure incurred in certain hotels.
Luxury Tax Act	State Act	For levy of tax on luxury provided in the hotel.
The Prevention of Food Adulteration Act, 1954	Central Act	For maintenance of hygiene and quality of food.
Central Excise Act, 1944	Central Act	Excise duty on pastries and cakes.
State Excise Act	State Act	State excise laws for levy of excise duty on liquor.
Service Tax (levied under the Finance Act, 1994)	Central Act	For levy of tax on Banquet Hall hire – <i>Mandap etc.</i>
Shops and Establishments Act	State Act	For regulating the working of the hotels.
Sales Tax Act	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.

2

Technical Aspects

2.1 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 organisational structure of a hotel and deals with the various technical and operational aspects of the hotel industry.

2.2 The departments of a hotel may be divided into two categories, viz., revenue generating and non-revenue generating. The 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 department and the engineering department where the latter takes care of running the air-conditioning plant, supply of electricity and hot water, etc., besides handling the maintenance of building and equipments. A sample detailed organisational chart of a hotel is given in **Appendix I**. Notwithstanding the departmentalisation, 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 department as also by the food and beverages department and other minor departments, such as health club and leisure facilities.

ARRANGEMENTS FOR OPERATING A HOTEL

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

OWNED HOTELS

2.4 In this type of arrangement, the hotel is owned and managed by the same entity. The land on which the property is 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 (situated in a prime location), and the other party provides finance as well as technical expertise.

MANAGED HOTELS

2.5 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 specialises 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/LICENCED HOTELS

2.6 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 licence 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

2.7 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 programmes. Any such alliance is designed to help both the parties through referrals and cross-selling.

TYPES OF HOTELS

2.8 It would also be useful to briefly deal with the different classifications of hotels so as to get an overview of the cross-section of the business.

CLASSIFICATION BY MARKET SEGMENT

2.9 The hotel industry can be classified into various market segments on the basis of spending ability of the individual traveller and on the basis of entitlement in the case of traveller representing an organisation. The

generally accepted segments, based on the above classification, are following:

- Luxury
- 1st Class
- Mid-Segment, and
- Economy/Budget

CLASSIFICATION BY BRAND

2.10 The analysis of hotels into brands is a relatively new phenomenon. The evolution of the concept of a brand can be attributed to the positioning of a hotel as a niche product, *i.e.*, the product that caters to the needs of a particular class/category of customers. The hotels can be classified into the following categories on this basis:

- Business, and
- Leisure

2.11 Business hotels are normally located at the places which are near the hub of the business activity. On the contrary, leisure hotels are generally located away from civilization and hustle-bustle of life. Such hotels are commonly known as resorts. Providing peace, solitude and privacy to their customers is top priority of such hotels. While the former caters to the business class (including executives of companies), the latter caters largely to the tourists. However, nowadays corporates are also organising their conferences at resorts, which offer an ideal set-up for brainstorming sessions of strategic planning.

TECHNICAL AND OPERATIONAL DETAILS

2.12 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
- (e) Technological Changes

ROOMS

2.13 Rooms generally constitute the biggest source of revenue for a hotel. Approximately, 60% - 62% of the gross revenue of a hotel comes from room rent. Normally, contribution from this source of revenue comes out to be more than 70% due to the low variable costs. The various operations relating to rooms normally are as follows:

- Front Office, including reservations
- Bell-desk
- Housekeeping
- General Administration

Front Office

Reservations

2.14 Normally, a separate person from the front office is made responsible for making all advance bookings/reservations. Reservations may be made based on 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), secretaries of executives and through sales and marketing department. The person responsible for making reservations normally prepares a list of bookings for the next day, *inter alia*, stating room rate to be charged, discount to be allowed on the standard rate, billing instructions, airport pick-up status and expected date and time of departure, etc. The list so prepared is sent to other departments for taking necessary action at their end.

Filling of Registration Card

2.15 Each guest is required to fill-up a registration card at the front office. The registration card normally records the name and address of the guest, the nationality, passport number (in case of a foreign national), the arrival date and time as also the expected departure date and time. The registration card is required to be signed by the guest and a responsible officer of the hotel. After the guest has filled-in and signed the registration card, the room number allotted to the guest as also tariff to be charged is filled-in. The discount allowed to the customer on the standard rate is also recorded on the registration card. The discount granted to the customer can be either

contractual or based on the negotiations made across the counter. The arrival of customer is also recorded in the guest folio of the guest ledger.

Intimation to other operating departments

2.16 At the time a room is sold, the front office intimates the relevant details to the housekeeping and other operating departments. The basic objective of intimation is to inform the other operating departments about the sale of room so that they gear up to provide the required services. While intimating, rooms with scanty baggage, if known, are highlighted.

Reconciliation of Guest Count as per the housekeeping department with Guest Folio

2.17 The housekeeping department, which is responsible for the proper upkeep of the guest areas, more particularly rooms, prepares a guest count report atleast once a day and sends a copy of the same to the Front Office. The Front Office is required to compare the report with the guest folio. The discrepancies noticed, if any, between the two counts are required to be duly reconciled, with a view to ensure that there is no leakage of revenue. For example, an extra bed requisitioned after check-in might get recorded from the housekeeping report.

Report of Guests Checking Out

2.18 It is a practice in most of the medium and large hotels to circulate a report of guest check-outs for the next day to all operating departments. Such a practice is useful in ensuring that all the charges have been posted to the guest folio before raising the final bill on the customer and, therefore, reduces the chances of leakage of revenue.

2.19 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 three hours, provided that the arrival of guest for whom the room has been booked is not expected during that time. Similar concessions are also granted to guests checking in before noon.

2.20 When a guest checks out, *i.e.*, settles the bill, the guest folio is closed and the room is declared vacant. 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 only to the guests having a contractual arrangement with the hotel.

Allowances

2.21 A major part of the price paid to hotel by the guest is for services only, and the guest is normally regarded as the best judge of the quality of services. Furthermore, the relations between the hotel and its guests are such that the hotel has to take the customers' word as granted to a greater extent as compared to other businesses. Consequently, when a guest complains about any service or claims that some minor charges were made to him by mistake, the hotel often grants certain discounts 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, room rate adjustments, adjustments for overcharges, compensation for damage to clothes given to laundry, and adjustments for unsatisfactory service.

Bills on Hold

2.22 Bills on hold refer to the amount that has not been paid by the guest. Such a situation takes place when a guest departs without settling the bills, either in part or in full. These amounts are required to be transferred immediately from guest ledger to the City Ledger, *i.e.*, the ledger of the city of which the guest is a resident, 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.

- (ii) *Skip Accounts* 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.

Bell-desk

2.23 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

2.24 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 realisable value of baggage left behind by such guests, who are known as skippers, is generally very less. The report is prepared on daily basis by the bell desk based on notings 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.

Housekeeping

2.25 The housekeeper supervises cleaning of all guest rooms, public hall and corridors, and reports necessary repairs to the engineering department. The housekeeper is responsible for keeping the Front Office informed about the status of each room and rendering reports of the rooms occupied. The reports on the rooms occupied are based on guest counts carried out by the housekeeping staff. Normally, such counts are carried out thrice a day; once in the morning while cleaning the room, once in the afternoon when the guest is generally not in the room and once in the evening, while making the bed. The purpose of such counts is to ensure that:

- (a) the number of guests actually occupying the room is not more than the number stated on the folio;
- (b) there is no unauthorised letting out of a room by the Front Office; and
- (c) 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.

Inventory of Housekeeping Department

2.26 Linen normally constitutes a major portion of the housekeeping inventory. Many hotels are presently following 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.

General Administration

Pricing of Rooms

2.27 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 in the overall profitability of a hotel, pricing of rooms is required to be done in a manner that overall revenue could be maximised by optimising average room rate and average occupancy. Average room rate and average occupancy are two of the key indicators for measuring the performance of the rooms department. Average room rate 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. Average occupancy is determined by dividing the total room nights sold during a given period by the room nights available during that period.

2.28 Greater care is required to be taken 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.

Night Audit

2.29 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. Under the system, the checking of guests' accounts and preparation of report containing details of the various income and expenditures incurred during the day is the duty of the night auditor, who usually takes charge from the front office billing clerk around midnight. The sales summaries of all departments are brought to the Front Office, so that both the summaries and the vouchers of each department are available to the night auditor.

2.30 The night auditor usually makes the posting of the charges vouchers that had not been posted by the Front Office as also of the further vouchers received before closing the daybook. The vouchers received after close of the daybook are not posted until the work of verifying the accounts is completed. After posting the vouchers, the night auditor verifies the correctness of the postings to the guests' folios from various vouchers. He also checks the cash receipts and the allowance credits. The night auditor also makes 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. The night auditor also ensures that the room rent for the day had also been charged to the guest folios at the rates indicated, posts accumulated local telephone charges for the day, totals the amounts, records the balance, and carries forward the balance to the column representing the next day. In a computerised environment, the process may be organised differently for the reason that in such an environment, charges are normally posted to the guest folio immediately at the point of sale. The night auditor is, consequently, relieved from the burden of manual posting.

2.31 In this regard, it should be noted that normally the role of the night auditor is confined merely to ascertaining that all charges appearing in the departmental sales summary have been charged correctly to the guests' folios. In other words, he usually accepts the departmental records without

any verification, except that he may make corrections for the vouchers sent to the Front Office but omitted from the sales summaries or for entries in the sales summaries for which there may not be any corresponding vouchers.

Cash Float

2.32 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 travellers 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.

Hold Laundry

2.33 Hold laundry refers to the laundry package of the guest which is delivered at the hotel after the departure of the concerned guest. The charges for such laundry are considered as late charges but are usually kept in a separate section of the City Ledger. In such cases, the laundry packages are held as security for such charges and are handed over to the guest only upon receipt of the charges.

Paid-Outs

2.34 Paid-outs refer to the payments made by the Front Office on behalf of guests. Guests, who 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 bringing certain items from market for which payment would be made by the Front Office. Any such payments made on behalf of a guest should be charged immediately to the guest folio so that the risk of late charges might be avoided.

FOOD AND BEVERAGES

2.35 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

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

2.36 Kitchen is the heart of the F&B operation because all the food is prepared 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 the 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 in charge of the kitchen of their respective outlets.

Components of Food Preparation

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

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

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 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

2.38 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 to control the raw material costs are discussed hereinafter.

2.39 *Purchase of Raw Materials - Annual Rate Contracts* Annual rate contracts is 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 finalised 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 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.

2.40 *Ordering for Perishables and Provisions* The Purchase Department places the orders for perishables required on a particular day normally on the afternoon of the previous day. The perishables ordered on the previous day are delivered in the morning. Orders for provisions, on the other hand, are placed on a periodical basis.

2.41 *Basis of Ordering* 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 recognised that the ordering of perishables could affect the cost to a great extent due to the fact that their useful life is very small.

2.42 Receipt, Storage and Issue of Raw Materials 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 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, either 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

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

2.44 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 to be ordered. The hotels generally maintain an elaborate database on popularity 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.

2.45 *Portion Control* The process of determining the standard quantity to be served per dish is known as Portion Control. Such a practice facilitates in optimising 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.

2.46 *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.

2.47 *Wastage Report* At the end of each day, left-over food, which would not be useful on 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

2.48 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 food, sound system, audio visual equipment, decoration, *mandap*, etc., 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 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 hereinafter.

Guaranteed Plates and Expected Plates

2.49 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

2.50 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, becomes a subject matter of dispute, particularly in large functions such as wedding receptions. Hotels have recognised the plate count as a critical control risk area from the point of view of possible revenue leakage, since the possibility 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.

Restaurant

2.51 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, 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

2.52 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 fixes the selling price in such situations.

Cancellation of Bills

2.53 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 unauthorised 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.

Bar

2.54 A bar is an exclusive section of the hotel where wines, spirits and beers 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. The technicalities involved in the operations relating to the bar, are discussed hereinafter.

Maintenance of Excise Records for Alcoholic Beverages

2.55 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 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.

Mixing of Drinks for Cocktails

2.56 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

2.57 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 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.

Room Service

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

Stewarding

2.59 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.

2.60 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 comparisons of physical count are 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.

FOREIGN EXCHANGE COMPLIANCE

2.61 Hotels are generally authorised to deal in foreign exchange as a 'restricted money-changer' specially for accepting foreign currency/traveller's cheques. The authorisation is subject to conditions laid down in this regard and remains valid for a limited period only and the hotel gets it 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 Reserve Bank of India regarding encashment of foreign currency on quarterly basis.

MARKETING DEPARTMENT

2.62 The marketing 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 marketing department, but in a hotel chain, the marketing 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 rates, that do not yield any profits to the hotel or recommend credits that may eventually become doubtful of recovery.

TECHNOLOGICAL CHANGES

2.63 Technological changes have affected all facets of the hotel business ranging from reservations and day-to-day operations to marketing and distribution. For instance, hotel systems such as reservations and property management are becoming more and more sophisticated due to recent technological innovations. The average traveller, be it a business or a leisure traveller, is becoming more and more conscious of the time factor and has no time to wait. Under such circumstances, a hotel, which keeps pace with the technological developments, will demonstrate a powerful advantage over those that do not. The recent technological changes have affected the functioning of hotels in more than one way. Some of the effects may be discussed as follows:

- The Internet has facilitated direct reservations by customers and thereby has reduced, to an extent, the need for having travel agents. As a result, the hotels have been able in effecting savings of travel agents' commission.
- Yield management has received a tremendous boost since it is has become possible to both obtain real time room inventory information and adjust rates in a real time environment based on projected usage by linking the property management system to the central reservation system.
- Services to the guests have seen a dramatic improvement with the following facilities now being made available:
 - ☆ 'in' room technology such as Internet access and PC based facilities;
 - ☆ prompt generation of bill at the time of check-out;
 - ☆ using guest history from the database to know the likes and dislikes of repeat guests and cater to them accordingly;
 - ☆ use of electronic swipe cards (in lieu of keys) for access to rooms; and
 - ☆ electronic combination locks for safes in hotel rooms.

- Real time updation of guest folios has virtually eliminated the risk of late charges.
- The facility of updating/ascertaining the status of availability of each room through the system has substantially enhanced the efficiency of not only the housekeeping department, but also of the front office reception, particularly during the peak season rush hours.

3

Accounting and Control Aspects

3.1 The services to the resident guests are provided by more than one operating department of the hotel. For example, a resident guest may use the telephone and valet service, have meals, send fax messages and purchase cigarettes within a short span of time after checking-in in the hotel. The guests usually make payment for all these services at the Front Office while checking-out. In view of this, all the operating departments are required to inform the Front Office about the services provided by them so that it may record these charges in the guest folio. This process should be completed in a manner that the account of the guest remains updated, since he may ask for his bill at any moment, settle the bill and leave the hotel.

3.2 Like most of the industries, the accounting principles and practices for hotel industry in India are governed by, *inter alia*, the Accounting Standards, Guidance Notes, etc., issued by the Institute of Chartered Accountants of India. The requirements of the applicable statute(s) also affect the accounting principles and practices to be followed by the hotel industry. For example, the requirements of the Companies Act, 1956, would be applicable to the hotels run by enterprises registered under the Act.

LIST OF BOOKS OF ACCOUNT NORMALLY MAINTAINED BY A HOTEL

3.3 A hotel maintains the following books of account which are similar to those maintained by any other service providing organisation or a business entity:

- (a) General ledger.

- (b) Day books such as cash book, bank book, purchases and expenses register.
- (c) Journal.
- (d) Debtors ledger (generally referred to as 'City Ledger' in the hotel industry).
- (e) Creditors' ledger.
- (f) Stock ledger (Stock register).
- (g) Payroll summaries.
- (h) Fixed assets register.

In addition to the above, other books of account maintained, which are peculiar to the hotel industry, are the following:

- (a) Sales summaries of operating departments (*i.e.*, restaurants, beauty parlour, petrol station, health club, etc.).
- (b) Allowance register.
- (c) Lodger's register (where the records are maintained on a manual basis).
- (d) Guest ledger containing guest folios.

FINANCIAL ACCOUNTING ASPECTS PECULIAR TO HOTEL INDUSTRY

RECOGNITION OF ROOM REVENUE

3.4 Revenue arising from room rent should be recognised in the books of account on accrual basis. In the normal course, revenue from room rent is recognised either upon the guest checking out or upon passage of check-out time, whichever is earlier.

CLASSIFICATION OF FIXED ASSETS

3.5 Classification of fixed assets in case of hotels is generally similar to other industries. However, there are certain peculiarities, *e.g.*, bathroom fittings and plumbing, in the case of hotel, are considered as part of plant and machinery.

CUTLERY AND CROCKERY

3.6 Cutlery and crockery could be used again and again over a long period of time. These items are issued from stores to the stewarding department, which in turn makes them available to the outlets for use. Cutlery, comprising steelware and silverware, normally enjoys a significantly longer life than crockery. Notwithstanding the difference in the life of cutlery and crockery and the fact that the actual issue from the stewarding department to the outlets may happen at a later date, these items are charged off to revenue at the time of issue to the stewarding department. A memorandum record of inventory of these items is maintained for control purposes.

ALLOWANCES

3.7 Generally, two types of allowances are granted to a guest, *viz.*, front office allowances and back office allowances. The front office allowances are granted at the time of preparation of bill, whereas the back office allowances are granted in the accounts department after preparation of bill. Such allowances generally arise either due to an error in billing or due to guest complaint. In arriving at the amount of turnover, the allowances granted to the customers on account of any of the above two reasons should not be included.

BILLS ON HOLD

3.8 As discussed earlier, bills on hold usually take place either in case of late charge or in case of skipping. In the case of skipping, the chances of recovery are very remote and accordingly, it is assumed that the revenue has been lost immediately. In the case of a late charge, there might be chances of recovery but still a large part of the receivables could progressively degenerate into bad debts. Accordingly, at the year-end, a provision for bad debts against receivables outstanding for late charges should be created on estimated basis. In order to minimise the chances of revenue loss arising from these two factors, the following control measures should be ensured:

- (a) prompt posting of charges to the guest folio; and
- (b) proper monitoring of guest movements to prevent skipping – such as preparation of scanty baggage reports and guest count by housekeeping department at specified intervals during the day.

WAITERS' TIPS

3.9 The guests usually pay an amount in addition to the billed amount which represents a tip to the waiter serving the guest. Most of the hotels permit the cashiers to disburse the tips at once to the concerned waiter after making a paid-out voucher thereby eliminating the need to maintain further records whereas some hotels may follow the system of settling the amounts subsequently after carrying out due audit.

BAR INVENTORY

3.10 All the hotels generally follow a system of taking inventories of all the stock kept at the bar, including partly filled bottles, on daily basis. The physical verification generally takes place at the beginning of the day. Some hotels have the practice of having an inventory count at the time of change of shifts of bartenders. The system helps in identifying shortages or overages to a particular bartender. Any shortage noticed while taking physical inventory is generally charged to the concerned bartender without giving him any credit for surplus. Most of the hotels follow a system of destroying empty bottles immediately so as to avoid any possible misuse of the same by the bartender.

INTERNAL CONTROL ASPECTS

3.11 Paragraph 8 of the Statement on Standard Auditing Practices (SAP) 6, *Risk Assessments and Internal Control* (revised June, 2002), issued by the Institute of Chartered Accountants of India, states the following:

“8. “Internal Control System” means all the policies and procedures (internal controls) adopted by the management of an entity to assist in achieving management’s objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, the

prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information. The internal audit function constitutes a separate component of internal control with the objective of determining whether other internal controls are well designed and properly operated.”

3.12 As per the above, the management of a hotel is responsible for designing and incorporating various internal control procedures which are appropriate to the size and nature of the business. One of the basic principles of internal control is that various systems/procedures are designed in a manner that no person in the organisation is able to control any activity from beginning to end. On the contrary, the work of one employee is made complementary to that of another in a way that work of one gets verified automatically by that of another. The control aspects having a direct bearing on the leakage of revenue and on the safeguarding of assets are discussed hereinafter.

SALES

3.13 The key control aspects of sales in case of a hotel are discussed hereinafter.

Granting of discount to guests

3.14 A discount has a direct impact on the room revenue and should, therefore, be granted very discreetly and judiciously. All non-contractual discounts granted to the guest should be duly approved. In small and medium sized hotels, which do not have formalised systems, it is even more important that the management has fixed standard room rent and has laid down a clear policy for allowing discounts. In the absence of such a policy, the person authorised to fix room rent/allow discount may misuse a part of the money received from the guests.

Granting complimentary rooms

3.15 A room should be given on complimentary basis only in exceptional circumstances since it does not generate any revenue to the hotel. However, in certain situations, granting of a room on complimentary basis becomes inevitable, for example, when a senior executive from the corporate office visits the hotel. In such situations, a room may be granted on complimentary

basis only after getting prior approval of the General Manager or any other authorised official.

Permitting occupancy of a room beyond the normal hours

3.16 Most of the hotels permit their guests to make early check-in and late check-out. The extra charges made for such early check-in/late check-out are either nil or are very less. Such a practice is followed by the hotels for the purpose of building guest loyalty. In order to prevent any possible misuse of this facility, it is imperative to have appropriate guidelines for waiver of early check-in and late check-out charges.

Granting of Allowances

3.17 The allowances, which are granted for reasons other than rectification of errors in billings, result in a direct reduction in the revenue earned. The authority to grant allowances should be vested in an officer at the appropriate level. However, in certain circumstances, this approval cannot be obtained before crediting allowance to the guest's account. It is, therefore, important to ensure that all such allowances have been got duly approved from the relevant authority on the basis of allowance vouchers that are serially numbered and properly controlled.

Guest Billing

3.18 In most of the hotels, sale is effected from several outlets such as restaurants, banquets, health-club, discotheque, etc. The resident guests make payment for all the services utilised by them at the Front Office at the time of check-out. It is, therefore, essential to ensure that charges for all the services utilised have been duly charged to the guest folio before the guest checks out. Non-resident guests generally make payments for use of the hotel's facilities at the point of sale itself. Accordingly, in such cases, it has to be ensured that the charges for use of facilities have been charged at the counter of outlet providing services.

Restaurant and Bar

3.19 At the restaurant and bar, certain elementary checks are mandatory and cannot be ignored. For instance, if two stewards and two cashiers are employed at an outlet, their working hours should be arranged in a manner that the same two, steward and cashier, are not always on duty during the

same hours. In large hotels, stewards and cashiers should be transferred frequently from one outlet to another. Where cash registers are in use, these should be sealed so that no one can clear them at any time. Where billing is computerised, access to the master computerised file containing price of each item should be restricted to authorised persons only.

3.20 Control over billings for food served in the restaurant in of utmost importance. For this purpose, kitchen copy of the Kitchen Order Ticket (KOT) should be matched with the F&B Controller's copy of the bill to verify the correctness of the billings. In order to facilitate this, the chef is required to drop the kitchen copy of the KOT along with the copy of the bill (preferably stapled together) in a sealed box after the order has been served. The kitchen copy of the KOT contains the details about the quantity of actual food served by the kitchen as against, for instance, the accounts copy of the KOT which contains details about the ordered quantity. Although, in most cases, there would not be any discrepancy between the accounts copy and the kitchen copy of the KOT, the system acts as a deterrent against any intentional errors.

Banqueting

Control on Revenue – Ensuring Completeness

3.21 Serial number control on the form (which is a part of the Function Prospectus) being filled by the client for the booking of the function, is one of the important mechanisms for ensuring control on billing for banquets. The Venue Register, which records the bookings in respect of various banquet locations, would be very useful for cross checking and for monitoring the banquet revenue.

Collection of Advances

3.22 Banquets department usually collects an advance at the time of confirming booking of parties that do not enjoy credit facilities, in order to prevent the risk of any last minute cancellations or more importantly to reduce the risk of bad debts.

Levying of Rates and Granting of Discounts

3.23 The rates for various combinations of banquets should be standardised and authority levels for granting of discounts, if any, should also be well

defined. Such a practice will substantially mitigate the risk of indiscriminate discounts being granted and the resultant loss in revenue.

Plate Count – Ensuring Correctness of Billing

3.24 A system of taking plate counts by a representative other than from the banquets department should be instituted in cases where the guaranteed plate count exceeds a particular threshold. This will minimise the possibility of billing for a lower plate count through collusion between the banquets department and the client.

PURCHASES

3.25 Various control procedures adopted in the area of purchase should primarily aim at minimising risk of leakage of revenue that may take place due to entering into contracts at rates that are not competitive, or making purchases inspite of existing stocks being adequate, or receiving goods that are not up to the specifications. The basic requirements of a good internal control system in the area of purchases are discussed hereinafter.

Annual rate contracts

3.26 The following aspects should be kept in mind with regard to internal control on annual rate contracts entered into by the hotel 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 with shortlisted 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

3.27 There should be a formalised 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 serial numbering of indents should be maintained.

Monitoring of Stock Levels

3.28 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 and clearly prescribed for each item of inventory.
- Stock records should be maintained properly and updated on regular basis.

Receipt of Materials

3.29 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 control should be maintained thereon.

CASH

Cash Receipts

3.30 Cash is generally considered highly prone to misappropriation, misapplication and other forms of fraud. The risk of misappropriation of cash in case of a hotel is even more due to the fact that a hotel operates through a number of outlets such as restaurant, bar, coffee shop, health club, book shop, cigarette counter, etc. Most of these outlets remain open for more than one shift. In order to minimise the risk of misappropriation of cash receipts, the following measures should be taken by the hotel:

- At the end of the shift, the cashier should be required to submit a summary of cash receipts made by him, in addition to the detailed record of cash receipts.
- At the end of the shift, cash should be counted in the presence of incoming and outgoing cashiers and discrepancy, if any, should be properly documented and reconciled.
- The person responsible for maintaining the books should not be allowed to handle cash even if the records are audited on regular basis.
- The duties of cashiers should be rotated on regular basis.
- The chief accountant should receive a summary report of cash receipts made during the day from the head cashier.

Cash Payments

3.31 In order to avoid the risk of excessive cash payments, it is suggested that a hotel should take the following measures:

- The vouchers should be preprinted and proper serial number control should be maintained over these vouchers.
- Payments should be made only against the vouchers that are duly authorised and the authority level for authorising various payments should be clearly defined.

- The document supporting the payment should be defaced immediately by a stamp, so that these may not be presented again for payment at a later date.

Cash and Bank Balances

3.32 The cash-on-hand should be reconciled with the balance as per the books on daily basis. The cash balance should be counted frequently at irregular intervals by the general cashier and chief accountant. For counting purposes, all the outlets of a hotel must be required to produce the cash at same place at the same time so that the risk of cash shortage of one outlet being made good from cash of another outlet might be minimised.

3.33 The bank balance as per the cash book should be tallied with the balance as per the pass book/bank statement at least on monthly basis. The difference, if any, between the two balances should be properly analysed and duly reconciled. The banks should be instructed to deliver the copy of the bank statements and cancelled cheques to the chief accountant only. The cheque books should be kept under safe custody. There should be procedure, to the extent possible, of joint signatories to cheques of more than a particular amount.

SUNDRY DEBTORS (ACCOUNTS RECEIVABLE)

3.34 Debtors represent the amounts due from the customers who have not settled their bills for cash at the time of check-out. The guests normally check-out only after making payment and check-out without settlement of bills is allowed only to those customers who are authorised to use credit facilities. The sundry debtors also include the amount due from skippers and the amount due for the late charges. Chances of receipts from debtors representing skippers and late charges are normally less and, therefore, it is necessary to follow-up such customers regularly. Balances in various sundry debtors accounts should be confirmed with the concerned person at regular intervals. The credit limits of various customers should be monitored regularly and reviewed on periodical basis.

UPDATION OF PRICE MASTERS IN RESTAURANTS

3.35 Hotels using computerised billing machines at the restaurant usually create master file containing the price of each dish which is usually referred to as the 'price master'. At the time of any revision in the menu prices, the

price masters are also required to be duly updated. These are required to be protected from unauthorised changes, therefore, control on the access to the price masters assumes great significance. Accordingly, it is suggested that access to price masters should be restricted and any modification should be allowed to be made only by the specified person after obtaining due approval from the top management authorised to effect changes in prices.

MANAGEMENT CONTROL SYSTEMS ASPECTS

3.36 It is recommended that all hotel enterprises should uniformly follow a system of accounting under which each operating department is treated as a profit centre. This would be achieved by introducing an elaborate system of coding of department-specific account heads. This system provides relevant information about the performance of each of the departments and serves as an important tool for controlling their respective operations.

3.37 For determining and controlling profitability of operating departments, it is useful to prepare profit and loss account for each operating department. In departmental profit and loss account, all the expenses that are attributable to and/or controlled by the operating department should be allocated against revenues of that department to arrive at departmental operating profit. The operating departments treated as profit centres under the system would be the departments that are actively engaged in revenue generating activities, such as rooms, food and beverages, telephones, health club, laundry, etc. The expenses relating to the departments that provide support to the operating departments, such as housekeeping, accounts, engineering, security, marketing, etc., are allocated to the operating departments on a systematic and rational basis. The expenses that can not be allocated to operating departments are charged to general profit and loss account. **Appendices II and III** to this Guide contain illustrative formats of the Statement of Profit and Loss for the Rooms Department and Summary Statement of Profit and Loss.

3.38 For preparation and presentation of the departmental profit and loss account, hotel enterprises would be required to devise a system of accounting wherein the required departmental information could be obtained immediately without any waste of time and effort. Some important aspects of such a system peculiar to hotel industry are dealt with hereinafter.

SPLIT OF REVENUE UNDER THE AMERICAN PLAN

3.39 Hotels may fix the rates to be charged from resident guests either as per American Plan or as per European Plan. Under the American Plan, 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.

3.40 In case the hotel is following the American Plan or the Modified American Plan 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 the Rooms Department whereas the amount received for food supplied to the guest would be treated as revenue of Food and Beverages Department.

3.41 Most of the hotels follow the practice of issuing food coupons to the guests registered under the American Plan and the Modified American Plan. 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 unutilised. The value of unutilised coupons should be credited to a separate account.

COMPOSITION OF DIRECT FOOD COST

3.42 Only raw material costs are included in direct food cost. Direct labour and other costs are not usually considered for the purpose of arriving at direct food cost. The reason for the same is that due to the operating conditions prevalent in restaurants, it is extremely difficult to allocate these costs to various items. The cost of developing and maintaining any system of allocation of these costs would exceed the expected benefits.

DAILY SUMMARY COST REPORT

3.43 Daily Summary Cost Report, usually backed by detailed analysis sheets, is prepared to calculate the cost and sales of each group of similar items selected as a unit of control. The report usually is not absolutely

accurate due to the fact that it is based on issues from store and direct purchases only. While preparing the report no adjustments are made for the differences between the inventories at the beginning and at the end of the day. The daily cost reports also state the cumulative costs and sales for the month. On the cumulative basis, the difference between the inventories, at any given point of time, would be the difference between the balance at the beginning of the month and the balance on the day on which the report is made. However, in some cases, the report, prepared without considering inventories, might give a totally distorting picture, for example, in case of hotels where items of raw materials are delivered directly into the kitchen and purchases of few days' requirement is made at a time. In such cases, it might be necessary to consider inventories of important items while preparing Daily Summary Cost Report.

COSTING OF MEALS IN RESPECT OF ADMINISTRATIVE AND GENERAL (A&G) BILLS

3.44 In most of the hotels, the heads of departments (HODs) are generally granted access to all the restaurants at the hotel for having their meals, for providing entertainment to the guests for official purposes, etc. In respect of orders placed by the HODs, special A&G bills are prepared on which the concerned HOD is required to sign. At the end of the month, these bills are sorted department-wise. The cost of meals is determined by applying a rate arrived at by reducing the profit margin from the menu card price. The computation of profit margin is generally based on historical data. The cost of food provided to the HODs is charged to the expenses of the concerned department by giving a credit for the same to the food and beverages department.

GROSS OPERATING PROFIT

3.45 Gross Operating Profit is the sum of all operating revenues less all direct and indirect operating expenses such as administrative and general expenses, marketing expenses, property operations and maintenance expenses and utility costs (See Appendix III). In other words, it is the profit before reducing depreciation, interest and other finance costs, insurance, property taxes and income tax. Gross Operating Profit is usually used as a benchmark for determining the profitability of hotels and also for determining the incentive fee payable to management companies.

4

Audit Aspects

APPOINTMENT OF AUDITORS

4.1 The owners of the enterprise owning/managing a hotel usually appoint auditors for the audit of hotel. Such audits are usually conducted by chartered accountants. The provisions of the law/statute governing the enterprise are also required to be followed for the appointment of auditors, e.g., the appointment of auditors of hotel run by a company established under the Companies Act, 1956, would be made as per the provisions of the Act.

OBJECTIVE OF AUDIT

4.2 With regard to the objective of audit, paragraphs 2 and 3 of the Statement on Standard Auditing Practices (SAP) 2, *Objective and Scope of Audit of Financial Statements*, issued by the Institute of Chartered Accountants of India, provide the following:

- “2. The objective of an audit of financial statements, prepared within a framework of recognised accounting policies and practices and relevant statutory requirements, if any, is to enable an auditor to express an opinion on such financial statements.
3. The auditor’s opinion helps determination of the true and fair view of the financial position and operating results of an enterprise. The user, however, should not assume that the auditor’s opinion is an assurance as to the future viability of the enterprise or the efficiency or effectiveness with which management has conducted the affairs of the enterprise.”

On the basis of the above, it is clear that the prime objective of a statutory audit is to enable the auditor to express an opinion on the financial statements

of the enterprise owning and running the hotel. Such an opinion provides assurance to the users of the financial statements that these reflect a true and fair view of the financial position and operating results of the enterprise.

PLANNING THE AUDIT

4.3 With regard to audit planning, paragraphs 12, 13 and 14 of the Statement on Standard Auditing Practices (SAP) 1, *Basic Principles Governing an Audit*, issued by the Institute of Chartered Accountants of India, provide the following:

“12. The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client’s business.

13. Plans should be made to cover, among other things:

- (a) acquiring knowledge of the client’s accounting system, policies and internal control procedures;
- (b) establishing the expected degree of reliance to be placed on internal control;
- (c) determining and programming the nature, timing, and extent of the audit procedures to be performed; and
- (d) coordinating the work to be performed.

14. Plans should be further developed and revised as necessary during the course of the audit.”

4.4 The working of the hotel industry is unique in many ways and knowledge of working of other industries would not be of much help in understanding the intricacies involved in the working of hotel industry. In view of this, prior to accepting an engagement, it is imperative for the auditor to obtain preliminary knowledge of the industry and of the nature of ownership, management and operations of the entity to be audited and to ensure that the required knowledge of business can be obtained. More detailed information on the subject would be collected subsequent to the acceptance of the audit at various stages. The knowledge of the business

obtained at various stages would be very useful in performing various audit procedures. For detailed guidance on the subject, reference may be made to the Statement on Standard Auditing Practices (SAP) 8, *Audit Planning*, and SAP 20, *Knowledge of the Business*, issued by the Institute of Chartered Accountants of India.

EVALUATION OF THE ACCOUNTING SYSTEM AND RELATED INTERNAL CONTROL

4.5 Paragraph 7 of the Statement on Standard Auditing Practices (SAP) 2, *Objective and Scope of the Audit of Financial Statements*, issued by the Institute of Chartered Accountants of India, states as below:

- “7. The auditor assesses the reliability and sufficiency of the information contained in the underlying accounting records and other source data by:
- (a) making a study and evaluation of accounting systems and internal controls on which he wishes to rely and testing those internal controls to determine the nature, extent and timing of other auditing procedures; and
 - (b) carrying out such other tests, enquiries and other verification procedures of accounting transactions and account balances as he considers appropriate in the particular circumstances.”

4.6 As per the above, the auditor is required to study and evaluate the accounting system and related controls for the purpose of determining reliability and sufficiency of information contained in accounting records and other sources of data. The Statement on Standard Auditing Practices (SAP) 6, *Risk Assessments and Internal Control* (revised June, 2002), issued by the Institute of Chartered Accountants of India, should be referred to for this purpose.

4.7 Many of the frauds and misappropriations in hotels are the result of collusion and are very carefully planned. Therefore, proper understanding of the practical way in which controls operate in a hotel assumes greater significance for the auditor. This will enable the auditor to:

- (a) understand how the organisation is structured and managed;
- (b) design a tailor-made audit approach for each hotel;

- (c) gauge the effectiveness or otherwise of a systems-based audit; and
- (d) identify weaknesses in the system that may be reported to the management.

4.8 The auditor should hold formal discussions with the staff of various departments for gathering information about the functioning of the departments, various processes involved, levels of authority for carrying out various transactions and the various documents prepared. The information gathered as a result of discussions should be properly documented.

4.9 The auditor should carry out confirmatory tests on the information collected to confirm his understanding of the system and to identify the controls upon which reliance can be placed.

AUDIT PROCEDURES RELATING TO SPECIFIC AREAS

4.10 A Sample Audit Programme Checklist for the audit of certain important items of the financial statements of the enterprise owning/running a hotel is given in **Appendix IV**. The various checklists provided in the said Appendix are only illustrative and are not meant for the purpose of laying standard auditing principles and procedures. The check-list is only indicative and should be modified depending upon the size and nature of the hotel. The auditing aspects that are peculiar to hotel industry are discussed hereinafter.

ROOM REVENUE

4.11 As stated earlier, rooms are the largest source of revenue for a hotel both in terms of gross revenue and in terms of contribution. The method of checking/analysing room revenue, therefore, assumes greater significance.

4.12 Letting out of room is usually recorded in more than one record, for example in the guest folio, housekeeping department report, etc. Normally, more than one person is involved in the preparation of these records. In view of this, the possibility of manipulating room sales is normally less since in order to omit a sale from the records it would be necessary to omit

the entry of the guest from all records. In large hotels, many persons are involved in maintenance of records relating to room sales and, therefore, intentional omissions become practically impossible, and unintentional errors or omissions can be detected quickly.

4.13 If control procedures explained above, are actually in existence and have worked properly to the satisfaction of the auditor, he might not carry out various detailed checks for the audit of room revenue during the course of the year. In such a case, the auditor should apply various analytical review procedures for verification of overall revenue from room rent. While applying analytical review procedures, it should be noted that rent of rooms might vary depending upon the configuration and location of the room. The room rent charged for the same room may also differ from customer to customer and from season to season. Accordingly, it is felt that proper understanding of the product mix of the hotel would enable the auditor to fine-tune the analytical review procedures. For carrying out an analytical review of room revenue, the following procedures might be applied gainfully by the auditor:

- (a) Comparison of actual room rent revenue with industry norms; and
- (b) Using the information gathered on the product mix to independently arrive at the room rent revenue and comparing the same with actual room rent.

FOOD AND BEVERAGES INCOME

4.14 Food and beverages income generally moves in tandem with room rent revenue, since the resident guests usually consume food and/or take drinks at the restaurant/bar of the hotel during their stay. For instance, a large proportion of resident guests have their breakfast at the hotel. This relationship between room rent revenue and food and beverages income would be stronger in case of resorts that are situated at places away from the city. City based hotels normally also try to attract customers who are not staying at the hotel for food and beverages. Thus, the relationship between food and beverages income and room rent revenue may vary depending upon the type of the hotel.

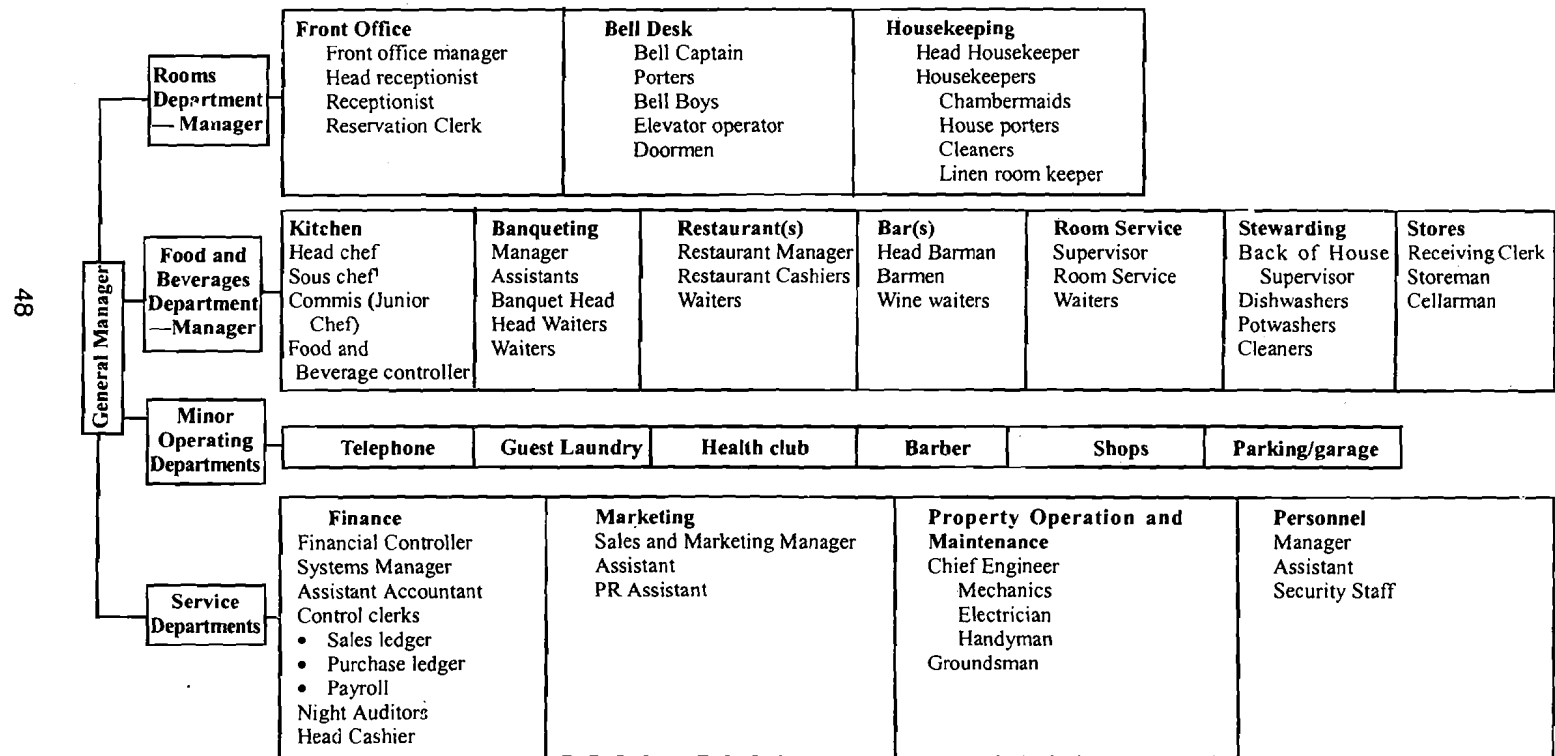
4.15 The most important aspect of verification of food and beverages income would be the examination of serial control on paid and unused bills. Control on cash bills can be exercised through review of the cash

summary sheets containing details of the sales for a particular day/shift. The auditor could also apply surprise on-line checks on the serial control. The said check might be applied either during the day or while carrying out audit on the sale of the day that does not fall within the audit period.

4.16 Under the analytical review procedures, the auditor should review the relationship between room rent revenue and food and beverages revenue on monthly basis. The reasons for any exceptional relationship between the two should be determined and properly analysed. In some cases, there might be some valid reasons for change in relationship, for example, a disproportionate increase in the food and beverages revenue in the month of December could be attributed to Christmas and New Year celebrations.

Appendix I

SAMPLE DETAILED ORGANISATION CHART OF A HOTEL



¹ Sous Chef – Chef in charge of the kitchen of a specific outlet

Appendix II

STATEMENT OF PROFIT AND LOSS FOR THE ROOMS DEPARTMENT

Particulars	Amount (in Rs.)
REVENUE	
Room Rent	6,124,991
Less: Allowances	54,635
Net Revenue (A)	6,070,356
EXPENDITURE	
<i>Payroll and Related Expenses</i>	
Salaries and Wages	855,919
Employee Benefits	212,464
Total Payroll and Related Expenses (I)	1,068,383
<i>Other Expenses</i>	
Cable/Satellite Television	20,100
Commissions	66,775
Complimentary Guest Services	2,420
Contract Services	30,874
Guest Relocation	1,241
Guest Transportation	48,565
Laundry and Dry Cleaning	42,495
Linen	12,140
Operating Supplies	122,600
Reservations	40,908
Telecommunications	12,442
Training	7,122
Uniforms	60,705
Other	5,100
Total Other Expenses (II)	473,487
Total Expenditure (B = I + II)	1,541,870
Departmental Income (A - B)	4,528,486

Appendix III

SUMMARY STATEMENT OF PROFIT AND LOSS

Particulars	Operating Departments					Total Amount
	Rooms	Food	Beverages	Telecommunications	Other Income	
Net Revenues (A)	6,070,356	2,017,928	778,971	213,744	188,092	9,269,091
Expenditure						
Cost of Sales	—	733,057	162,258	167,298	—	1,062,613
Payroll and Related Expenses	1,068,383	617,705	205,897	31,421	—	1,923,406
Other Expenses	473,487	168,794	78,783	17,309	—	738,373
Total Expenditure (B)	1,541,870	1,519,556	446,938	216,028	—	3,724,392
Income (Loss) (A – B)	4,528,486	498,372	332,033	-2,284	188,092	5,544,699
Less: Unallocated Operating Expenses						
Administrative and General					559,181	
Marketing					538,296	
Property Operation and Maintenance					368,449	
Utility Costs					546,331	2,012,257
Profit after Unallocated Operating Expenses (Gross Operating Profit)						3,532,442
Less: Rent, Property Taxes, and Insurance						641,029
Profit before Interest, Depreciation, Amortization, and Income Taxes						2,891,413
Less: Interest Expense						461,347
Profit before Depreciation, Amortization and Income Tax						2,430,066
Less: Depreciation and Amortization						552,401
Add: Profit on Sale of Fixed Assets						1,574
Profit Before Tax						1,879,239
Less: Provision for Tax						469,810
Net Income						1,409,429

Appendix IV

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 of 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 and are shown separately in the financial statements.
4. Subsequent amount spent on existing fixed assets have been capitalised only in a case where it increases the future benefits from the asset beyond its previously assessed standard of performance, e.g., 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 1st April, 2000, are recognised as assets in the financial statements as per Accounting Standard (AS) 19, Leases, issued by the Institute of the Chartered Accountants of India. Operating lease rentals have been appropriately charged as an expense over the life of lease.

7. Any impairment in the value of fixed assets has been appropriately recognised in the financial statements.

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 has been properly capitalised.
3. Obtain a list of fixed assets disposed of during the period and verify computation of profit/loss, if any, on the same on sample basis.
4. Verify that 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 recognised 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 in applicable statute, if any, to the enterprise, e.g., rates prescribed in Schedule XIV to the Companies Act, 1956, would be relevant for 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 account.
9. Physical verification of various fixed assets should be carried out and discrepancies noticed, if any, should be properly analysed 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 uncollectable portion of debtors and the individual items have been charged off on becoming uncollectable.
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 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

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

Analytical Review of Individual Items

9. Compare monthly room rent revenue with the budgeted amount and with the revenue for the corresponding month of the previous year/period.
10. Compare monthly room rent revenue with the revenue computed on the basis of industry trends and occupancy rates for the month.
11. 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.
12. 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.
13. Compare and analyse monthly relationship of food and beverages revenue with room rent revenue besides comparing actual food and beverage revenue with budgeted revenue and revenue for the corresponding month in previous year.
14. 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.

15. Assess reasonableness of interest received and interest paid by comparing the same with the interest computed on the basis of 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 costs including health care, pension and other post-retirement benefit costs are appropriate keeping in view various pronouncements of the Institute of the 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 the accounting principles have been appropriately disclosed in the notes to the financial statements.

Audit Procedures

Accounting System and Internal Control

1. Perform walk-through test to examine accounting system and internal control with regard to payroll.
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 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 within 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 cost with the budgeted cost as also with the cost for the previous year.
8. Apply trend analysis on payroll cost 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 the prior years as also with the industry standards.
10. Obtain necessary information and explanations from the management for major variances, if any, noticed at steps 7 to 9 and ensure that all information and explanations for variances are consistent with the relevant available information.
11. Check relevant documents relating to fresh appointments and for resignations.
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 explanations 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 benefits 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 noticed, 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.
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 realisable 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.

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 realisations 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.
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.