How to audit hotel accounts

W*HAT special steps will you take into consideration in auditing the accounts of a hotel?*

The general considerations for audit of a hotel are:

i) Study the constitution. That is, whether it is a public or a private limited company. (certain income-tax benefits to the hotel establishments are available only if it is a public limited company.)

ii) Examine if the hotel is affiliated to any chain of hotels, whether national or international.

Read the terms of affiliation and ensure compliance. These hotels may be awarded star status depending on the facilities provided.

Ensure that the facilities are provided as per the star category requirement. (Often an auditor is asked to issue a certificate to this effect.)

iii) Examine if the hotel has a reciprocal arrangement with another hotel. Understand the significant accounting and other policies of the hotel, especially with reference to checkout time of the guests, discount structure, corporate clientele benefits, appropriation and allocation of overheads into various departments or profit centres, and so on.

iv) Understand the various profit centres identified by the hotel, such as coffee shop, bar, restaurant, conference halls, banquets, outside catering, and so on.

v) Study the internal control procedures of the hotel with particular reference to

a) purchase of edibles, stores and kitchen, b) consumables such as soaps, shampoos, guest toiletries, c) occupancy of rooms of the hotel, and so on.

vi) Carry out audit of profit centres independently and confirm the profit or loss at each profit centre — coffee shop, restaurant, or bar.

vii) Examine the internal control procedures for taking orders, serving food and collection of bills.

viii) Examine internal control for serving the food with reference to quantity or quality. Income from this centre would be sale of food, liquor, and so on.

Check the internal control systems for recording the sales. Test-check the bills and their entry. Match the direct expenditure on this centre consisting of consumption of edibles, condiments, provisions, vegetables, non-vegetarian items, and so on, and salaries of, among others, the serving staff, cooks, waiters, cleaners, stewards and cashier.

ix) Arrive at the gross profit for the profit centre and analyse the same with that of the industry as well as figures of the previous year to satisfy about the reliability.

x) Check the charging of overheads such as depreciation of furniture, kitchen equipment, and so on, to this profit centre.

Guest rooms: a) Understand the classification of guestrooms as air-conditioned, non air-conditioned, suites, and so on.

b) Study the internal control procedures for registration of guests, recording of checking in time, checking out time, number of persons, adults, children, and so on.

It is possible in the case of guest rooms to have a revenue more than hundred per cent of installed capacity as guests are charged for a full day even if the room is occupied for a part of a day. If a guest, for instance, occupies a room in the evening and checks out early next morning, the same room may be allotted to another guest immediately. Both the guests will be charged full day's tariff.

c) Study the internal control for serving food to the guests inside the rooms.

d) Apportionment of food expenditure to the guestrooms is normally made, depending upon the management policies of the hotel.

e) Study procedures of the hotel for collection through credit cards.

d) Vouch expenditure and income related to guestrooms. Direct expenditure would be salaries of room service boys, upkeep and maintenance of guestrooms, depreciation on furniture in guestrooms, washing and cleaning of linen, cost of air conditioning, and so on. Allocation of indirect expenditure such as salaries of receptionists, telephone operators, housekeeping department, and so on, should be done on a consistent basis as per management policies.

Conference halls, banquets, and so on: Evaluate the internal control systems for booking of conference hall. Examine the authority for allowing of discounts and concessions for booking of conference hall.

Income from conference hall would be booking charges in general. Cancellation charges of the conference hall also form a substantial income of a hotel. Examine the procedure for refund of booking charges and ensure that a competent person authorises the refund.

Direct expenditure on a conference hall shall be the public address systems, salaries of sound technicians, electricians, and so on.

Electricity charges, depreciation on equipment and furniture should be directly charged off to the conference hall.

Other points: Hotels also operate certain smaller facilities such as conversion of foreign exchange, travel desk, shopping area, Beauty parlours, gym, swimming pools, and so on. Study the arrangement with the hotel for profit sharing and internal controls.

Hotels organise food festivals. See if a separate account is maintained for such special events and surplus is transferred to the general profit and loss account. Surplus arising out of different profit centres should be transferred to the general income and expenditure account.

Depreciation on utility buildings, general furniture, interest on loans, debentures and auditor's fees should be charged off to the general revenue account to arrive at the net profit or loss.

Hotels are long gestation projects and, therefore, payment of interest out of capital is permissible for these projects. In such a case, ensure that the requirements of Section 208 are complied with.

Particular attention is to be paid to the assets of the hotel, such as kitchen equipment, air-conditioning plants, sound systems, cutlery and crockery, linen, and so on. Section 227 (4) (A) requires the auditor to state whether there is a system of periodic verification of fixed assets and the treatment of material deviations observed during the course of such verifications.

Obtain management representation for the verification of miscellaneous assets such as cutlery and crockery.

Hotels periodically discard the furniture and cutlery. Examine the policy of the hotel and internal controls for such transactions.

Vouching and verification

H*OW do you vouch/verify the following:*

Advertisement expenses: The auditor should understand the norms for a particular industry, such as FMCG, and acquire sufficient knowledge of the norms (AAS 20).

The auditor should call for the advertisement policy of the entity and satisfy himself about complying with the norms.

The auditor should examine the agreements with the advertising agencies, if any, to ensure the rates for advertising. At random, check the proof copy of the particular media where the advertisement has appeared. If an ad campaign was launched, say for the launch of a new product, the expenditure should be considered as deferred revenue expenditure.

In this case, the basis on which the period over which it is proposed to be written off would constitute a complex estimate (AAS 18) and the auditor should examine it carefully and be satisfied with its justification.

The auditor should examine the budget for advertisement expenditure and allocation for each media such as press, TV, and so on.

Vouch entries in the cashbook with the relevant receipts issued by the advertising agency or the media in which it is issued.

The advertisement should be properly classified as marketing, recruitment of staff, legal requirements, such as quarterly results, and disclosed accordingly as staff costs, and so on.

Obtain a management representation justifying the expenditure.

b) Goodwill: Goodwill is the monetary value of the reputation enjoyed by an entity. The auditor should adopt following procedure to verify goodwill:

- Check the method of valuation of goodwill.
- If goodwill arises due to admission or retirement of a partner, check the valuation of goodwill.
- Ensure that goodwill is either brought in or paid out in cash by the partner/s.
- Obtain management representation about the value of goodwill.
- Vouch entries in the books with the receipts issued for the amount of goodwill paid.
- If goodwill is paid in a scheme of amalgamation, the auditor should study the court orders, if any, to substantiate goodwill.
- Verify the minutes books for the necessary resolutions passed in this regard.
- Ensure compliance with AS 10 and AS 26. AS 10 does not permit goodwill to be recorded in the books unless it has been paid for in cash. Goodwill should be amortised within a reasonable period in accordance with requirements of AS 26.
- Verify minutes of the meeting of the board of directors where it was decided to amortise goodwill.