Montgomery County, Maryland
Offices of the County Executive
Office of Internal Audit

Audit of Montgomery County Conference Center

March 30, 2015

MCIA -15-10

Highlights

Why MCIA Did this Audit

The Montgomery County Conference Center (the "Center"), which is owned by the County and operates in conjunction with the Bethesda North Marriott Hotel, owned by JBG. The Center began operations in 2004. In 2013, the combined facility had $33 million in sales and the Center alone had $16.2 million. The revenue and cost for the facilities are split in accordance with the agreement terms. The County and JBG engaged Marriott Hotel Services to manage and operate the properties. Marriott has responsibility for ensuring the revenue and cost are allocated to the respective owners in accordance with the agreement terms. Under the agreement the County has the right to audit the financial records of the property.

The Department of Economic Development (DED), which has responsibility for overseeing the County's relationship with Marriott, requested MCIA conduct an audit. DED is designated as the Asset Manager for the management agreement with Marriott and it is the primary recipient of all financial reporting and other information on the Center.

What MCIA Recommends

MCIA is making four recommendations to the DED to improve internal control weaknesses noted. DED concurred with the recommendations.

March 2015

Montgomery County Conference Center

What MCIA Found

Our audit showed that the County's financial interests are being properly safeguarded and reported and that Marriott has complied with the terms and conditions of the management agreement related to the recording and reporting of revenue. We found no errors during our testing of transactions in the revenue cycle, overhead costs, revenue and cost allocations, and financial reporting.

DED has designed and implemented procedures for contract monitoring, but the scope of these procedures is limited. We found weaknesses in the internal controls over contract monitoring and record retention. We identified the following three opportunities for improving the efficiency and effectiveness of contract monitoring where DED should strengthen procedures and controls:

(1) DED currently only reviews one of the twelve monthly financial reports provided by Marriott; (2) DED does not have a formal record archival plan and retention policy for critical documentation received associated with the Conference Center agreement; and (3) at the time of this audit, DED did not have a process in place to address findings and recommendations from prior audits.

We also noted that DED could take additional steps to improve oversight of the Conference Center agreement, such as obtaining and reviewing reports of testing performed over Marriott internal controls prepared by third parties (e.g. Service Organization Control Report).

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Objectives

This report summarizes the work performed by Cherry Bekaert LLP on behalf of Montgomery County Office of Internal Audit (MCIA) in an internal audit of the Montgomery County Conference Center (Center). The scope of this engagement included reviewing the operational and financial reporting policies and procedures of both the Department of Economic Development (DED) and Marriott Hotel Services (Marriott) related to the Conference Center. The objective of the internal audit was to:

> Ensure that the County's financial interests are being properly safeguarded and reported through an assessment of internal controls over the following:
>
> a. Revenue Cycle
> b. Overhead (OH) Charges
> c. Revenue and Cost Allocations
> d. Financial Reporting

This internal audit report was performed in accordance with consulting standards established by the American Institute of Certified Public Accountants (AICPA). Our proposed procedures, developed to meet the objectives stated above, were reviewed and approved in advance by MCIA. Interviews, documentation review, and fieldwork were conducted from July 2014 to November 2014.

Background

General

Montgomery County is the leasehold owner of the parcel of real property where the Center is located. The Conference Center, owned by the County, is a building with approximately thirty-five thousand (35,000) square feet of meeting rooms, conference facilities, and other amenities and related facilities. The Center began operations in November 2004 and operates in combination with the Bethesda North Marriott Hotel (the Hotel), a Marriott-branded hotel owned by The JBG Companies (JBG or Hotel Owner). Marriott (manager) manages both the Center and the Marriott Hotel. A Board of Directors, referred to as the Conference Center Management Committee (CCMC or Board), was established to act as the owner's representative and is the main point of contact with the manager on the owner's behalf. The Board includes representatives from the County (including public and community representation), the Maryland Stadium Authority (MSA), the Conference and Visitors Bureau of Montgomery County (CVB), Marriott, and the Hotel Owner.

Due to the shared nature of the facilities, it is expected that Marriott makes operational decisions with the best interest of both the Hotel and Center as a combined unit.

<u>Management Agreement</u>

In 2003, Montgomery County (the County or Owner) entered into a management agreement (agreement) with Marriott to supervise, direct, and control the management and operation of the Center throughout the terms of the agreement. The agreement stipulates that Marriott will manage the Center and is responsible for reporting financial information to the County and the Hotel Owner.

The County and Hotel Owner entered into an agreement ("Deed of Easement") regarding the reciprocal use of the Hotel and Center and the allocation of certain costs common to both facilities. The Center and Hotel share on-site management and accounting personnel and the combined accounting records for both are maintained in the Marriott accounting system.

The Hotel Owner entered into a separate but related agreement with Marriott to operate the Hotel pursuant to a management agreement hereby known as the "Hotel Management Agreement".

Marriott is responsible for many of the day-to-day operations including, but not limited to:

- The hiring and other personnel decisions of all employees working at the Center
- Setting rates for the various meeting spaces
- The administrative policies and procedures
- Managing Fixed assets
- Public relations and marketing plans
- Inventory and replacement fixed asset procurement
- Preparing financial reports
- Maintenance
- Maintaining documentation on site (licenses etc.)
- Administering the Cost Sharing and Revenue Agreement

Conference Center Revenue and Cost Sharing

<u>Revenue and Cost Sharing</u>

The County, Hotel Owner, and Marriott agreed to specific terms related to the sharing of revenue and cost described in Exhibit F *Cost Sharing and Revenue Agreement*[1] of the management agreement. Table 1 below, summarizes the revenue and cost allocation between the owners. Per the revenue and cost sharing agreement, revenue and cost items are either clearly attributable to the Hotel or Center; or, alternatively, allocated based upon set percentages or use of the revenue and cost items that have been agreed upon between the Hotel Owner, the County and Marriott.

Table 1 – Revenue and Cost Sharing[1]

Description	Assignment[2]	
	Hotel	Conference
Rooms	✓	
Telephone	✓	
Gift Shop	✓	
Restaurant		✓

[1] Management Agreement, Montgomery County, MD-Marriott Hotel Services, January 29, 2003, *Exhibit F Cost Sharing and Revenue Agreement* (as amended June 9, 2006)
[2] Note that the specific allocation percentages of shared items have not been disclosed in this table in this report but can be viewed in the Management Agreement, Montgomery County, MD-Marriott Hotel Services, January 29, 2003.

Description	Assignment[2]	
	Hotel	Conference
Lounge		✓
Banquet		✓
Audio Visual		✓
Cafeteria	✓[3]	✓[3]
Conference Services		✓
Meeting Room Rental		✓
Other Income	✓[4]	✓[4]
Business Center	✓	✓
Garage Parking	✓	✓
Transportation	✓	✓
Group Cancellation	✓	✓
Group Attrition	✓	✓
General & Administration	✓	✓
Credit Cards	✓[5]	✓[5]
Utilities	✓[6]	✓[6]
Repairs & Maintenance	✓[7]	✓[7]
Accidents	✓[8]	✓[8]
Central Training & Relocation	✓	✓
Sales & Marketing	✓	✓
National Sales & Marketing	✓[5]	✓[5]
At Your Service[9]	✓	✓
Revenue Mgmt.	✓	✓
Investment Factors:		
Equipment Rental	✓[10]	✓[10]
Permits and Licenses	✓[10]	✓[10]
Building insurance	✓[7]	✓[7]
Real Estate Taxes	✓	
Base Management Fee	✓[5]	✓[5]
Land Rent	✓	

[3] The total cost of this department will be allocated based on utilization.
[4] Other Income, Rents, Inc., with the exception of those specified herein, are contemplated to be clearly attributable to an individual component.
[5] Allocated on a pro rata basis by dividing the components total revenue by the combined hotel and conference center revenue.
[6] Unless separately metered
[7] Unless otherwise agreed.
[8] If separate insurance is procured, each component will pay its own insurance and accident costs. Otherwise, costs will be allocated based on footnote number 5.
[9] Concierge service.
[10] Unless specified for an individual component.

Description	Assignment[2]	
	Hotel	Conference
Furniture, Fixtures, and Equipment Reserve	✓[11]	✓[10]

Revenue and Cost Allocation Process

Revenues and costs that can be specifically assigned to the Center or Hotel are recorded directly to the respective owner. Revenues and costs that are shared between the owners are allocated based upon agreement terms. Currently, Marriott's financial system does not maintain information on the allocation of shared revenue or cost between the owners. As a result, Marriott staff must manually maintain shared revenue and cost information within an Excel workbook, outside of the financial system. Based on our discussions with the Marriott Director of Finance and Accounting (DFA), it appears that the manual calculation of cost and revenue allocation requires a significant amount of time each month.

Revenues from banquet checks or hotel invoices are recorded at the time an event occurs. Each department is responsible for ensuring the adequacy and validity of costs (e.g., food and beverage purchases, employee wages and benefits, and other operational costs such as guest supplies and linen) which are charged to the department and recorded as they are incurred.

Revenue Cycle

The Center generates revenue from two primary revenue streams, food and beverage, and catering (banquets and audio visual). The Marriott General Ledger (GL or PeopleSoft) is the primary system of record for revenue. All revenue is recorded in the GL via manual entries or through the interface with the Property Management System[12] (PMS), MICROS (i.e., Point of Sale system), or the Consolidated Inventory (CI) sales system.

Catering Revenue

The scheduling of Catering events initiate the revenue cycle when Marriott sales staff persons create a Banquet Event Order (BEO) in CI defining the event details such as the event dates, expected number of attendees, price list and menu. During the event, at the end of each day, Marriott staff creates a banquet check for the catering charges incurred that day for the event.

Nightly, banquet checks post into the CI system. Once the CI system is closed for the day, revenue automatically posts from CI into PMS. The Marriott staff verifies that banquet checks successfully post to the correct PMS accounts. Once catering revenue has been posted into PMS, the revenue is subsequently recorded in PeopleSoft via an automated interface process.

At the end of the catering event, Marriott staff produces a banquet check for the entire event. The banquet check is reviewed by Marriott staff to ensure all prices and services (i.e. food, beverage, audio visual, service charges, etc.) on the final banquet check agree to the prices and

[11] The contractual FF&E percentage for each component will be applied to the individual components total revenue in determining the FF&E Reserve amounts.
[12] PMS is a property-based application system that supports the property's front-end and back-end functions. It stores guest data and records guests' accounting and folio transactions.

services listed on the final BEO signed by the customer. PeopleSoft will automatically generate a customer invoices based on all event charges described above on a daily basis.

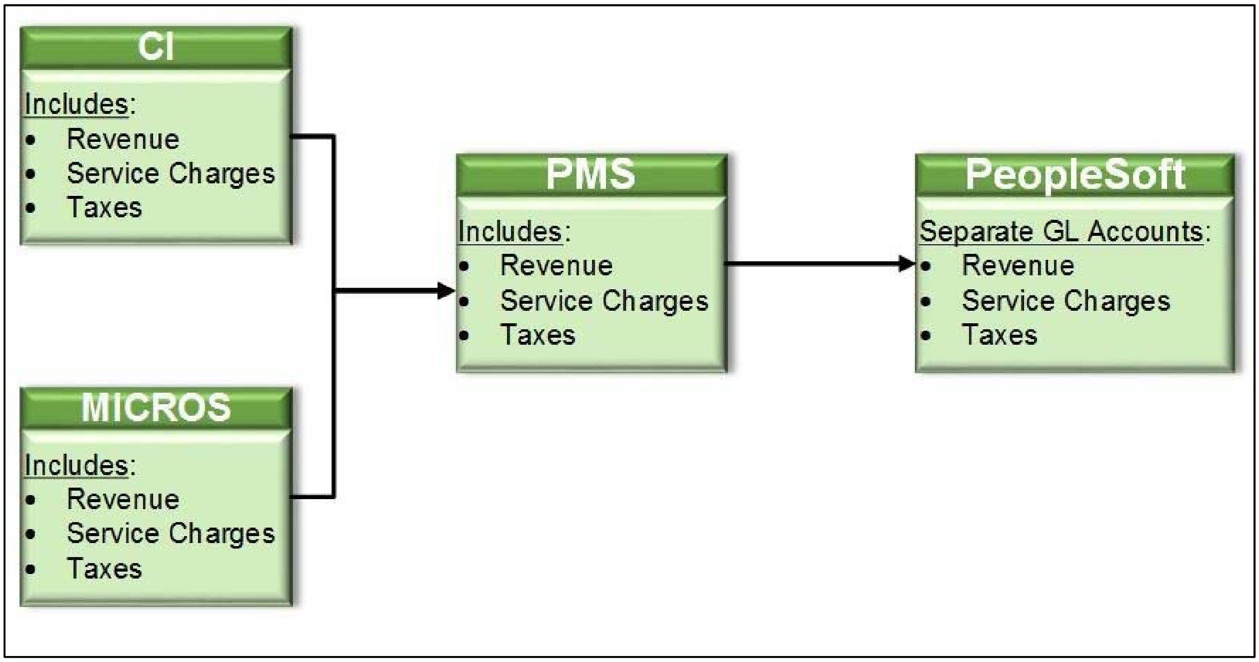
Food and Beverage Revenue

Food and beverage revenue is generated from customer transactions at the Hotel restaurant, lounge, bar, and Starbucks. The revenue cycle for these transactions begins when Marriott staff enters guest orders into MICROS. Marriott staff issues a guest check, produced by MICROS, to each customer after drinks (in lounge/bar) or at the conclusion of a meal (in restaurants).

Nightly, Marriott staff ensures that all guest checks are closed in MICROS. Once the MICROS system is closed, revenue automatically posts into PMS. Once food and beverage revenue is posted into PMS, the revenue is subsequently recorded in PeopleSoft via an automated interface process.

The figure below depicts how transaction information from both revenue streams, food and beverage (MICROS) and catering (CI), flow through the Marriott system applications involved with recording revenue.

Figure 1 - Systems Interface Diagram



Revenue Adjustments

In certain situations, Marriott may need to adjust customer invoices. Such adjustments may occur while the guest account is still active within PMS (PMS adjustments) or after the guest has departed the property and the account is no longer active (BTR adjustments). Hotel/Center staff performs all PMS adjustments; MBS Corporate staff performs all BTR adjustments.

PMS and BTR adjustments are separated into two categories:

i. Charge Adjustments – performed when a guest disputes a charge based on price or service, or when the guest claims they were charged in error. Charge Adjustments also include charges added to invoices subsequent to checkout.
ii. Settlement Adjustments – performed to change the settlement method for a charge. For example, a settlement adjustment is performed when the balance of a guest's charges are settled to the wrong credit card.

Accounts Receivable

Catering events and other property transactions that generate revenue are settled by cash, credit cards, wire transfers, or direct billings. Credit card payments and direct billings give rise to accounts receivable balances.

When customers utilize the direct billing payment method, Marriott is required to perform a customer credit check prior to extending credit to that customer. The DFA is responsible for establishing guidelines to uphold customer credit policies. Credit decisions are the ultimate responsibility of the DFA with recommendations provided by MBS. The credit evaluation process performed by MBS will result in one of three recommendations: Recommend, Warn, or Deny.

Overhead Costs

Overhead costs are indirect costs that are related to the operations of the Center and Hotel but cannot be directly associated with either property. Marriott, as manager of both properties, accumulates overhead costs, or "Support Costs", and allocates them to the owner. The following table summarizes the five types of support costs accumulated and allocated by Marriott. Marriott allocates these costs based on the methods described in table 1.

Table 2 – Overhead (Support) Costs[13]

Overhead Cost	Description
Administrative Expenses	Includes wages and benefits, office supplies, professional fees, and other operational costs.
Utilities Expenses	Includes utilities costs such as gas, electricity, water, sewer, steam, etc.
Repairs and Maintenance	Includes wages and benefits for Engineering, supplies, parts, and miscellaneous repair and maintenance charges such as HVAC system maintenance.
Sales and Marketing	Includes wages and benefits for Sales and Marketing, office supplies, local advertising expense, travel costs for sales associates, etc.
Central Training and Relocation	Includes training and relocation costs provided through Marriott corporate offices.

Escrow Reserve

The management agreement requires that Marriott establish an escrow reserve account[14] to cover the following costs:

[13] See Appendix A for additional information about Overhead Costs.

- Replacements and renewals related to the Furniture, Fixtures, and Equipment (FF&E[15]) at the Center.
- Routine or non-major repairs and maintenance to the Center which are normally capitalized (as opposed to expensed) under generally accepted accounting principles, such as exterior and interior repainting; resurfacing building walls, floors, roofs and parking areas; replacing folding walls, landscaping and the like.
- Proceeds from the sale of FF&E no longer necessary to the operation of the Center shall be added to the Reserve.

Each Conference Center fiscal year[16], in accordance with the agreement, Marriott transfers an amount equal to five percent (5%) of gross revenues into the reserve account. At the end of each Conference Center fiscal year, any amounts remaining in the reserve carry forward to the next Conference Center fiscal year.

Marriott is required to prepare a Capital Expenditure Plan, which includes an estimate of the expenditures necessary for (1) replacements, renewals and disposals to the FF&E of the Center, and (2) routine or non-major repairs and maintenance as described above, during the ensuing Conference Center fiscal year. Marriott must deliver the plan to the County at the same time it submits the Annual Operating Projection described in the financial reporting section below. The Capital Expenditure Plan shall also indicate the estimated time schedule for making such replacements and renewals.

Contract Monitoring

DED is the County department with the responsibility for overseeing the County's relationship with Marriott. The County has assigned DED staff to perform contract administration activities for the management agreement contract with Marriott, as such, DED is the primary recipient of all financial reporting and operational information associated with the Center's business operations.

Audits

The management agreement includes provisions that establish the County's right to audit the operations of the Center. Per the agreement,

> "[the County] *shall have a continuing right to audit or examine all of the books and records of the Conference Center including all of the books and records supporting revenue and cost allocations related to operations of the Conference Center at any time upon prior reasonable notice, provided that such audit or examination is conducted without unreasonable interference with the operation of the Conference Center."*

The County also has the right to perform financial audits, at its own cost, of the books and records of the Center. Such an audit may be performed at any time during the three (3) year

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[14] Source: Management Agreement, section 5.02 *Repairs, Maintenance and Equipment Replacements to be Paid from Reserve*

[15] Per agreement, "FF&E" shall mean furniture, furnishings, fixtures, kitchen appliances, vehicles, carpeting and equipment, including front desk and back-of-the house computer equipment, but shall not include Fixed Asset Supplies or any computer software of any type (including upgrades and replacements) owned by Manager, Marriott, an Affiliate of Manager of Marriott, or the licensor of any of them.

[16]The term "fiscal year" (or FY) refers to the fiscal year defined in the management agreement (January 1st – December 31st)

period following the publication date of the County's Comprehensive Annual Financial Report (CAFR) for the applicable Conference Center fiscal year.

Prior to this audit, the last audit of the Center performed on behalf of the County occurred during 2008. See Appendix B for additional information about the prior audit report, *Independent Accountant's Report on Applying Agreed-Upon Procedures for Montgomery County Conference Center* (dated February 6, 2008).

Financial Reporting

The terms of the management agreement include requirements related to monthly and annual reporting of both historical and future financial information. The Conference Center fiscal year is on a calendar year basis (January 1st – December 31st), while the County fiscal year is July 1st to June 30th. In accordance with the management agreement, on a monthly basis, Marriott provides the County (i.e., DED and Finance Department) with financial reports showing Gross Revenues, Deductions, and Operating Profit. The following financial statements are provided:

- Balance sheet
- Income statement
- Cash flow statement
- Cash flow forecasts for the remainder of the year

Similarly, after the end of each Conference Center fiscal year, Marriott delivers to the County a statement summarizing the operations of the Center for the preceding Conference Center fiscal year, and a certificate from Manager's Chief Accounting Officer certifying that such year-end statement is true and correct.

Marriott submits a preliminary draft of the Annual Operating Projection and Business Plan (the "Annual Operating Projection") to the County prior to the beginning of each Conference Center fiscal year. This projection includes estimated financial results of the operation of the Center during the next Conference Center fiscal year for the County's review and comment. The final version of the Annual Operating Projection is due to the County no later than fifteen (15) days after the beginning of each Conference Center fiscal year.

Marriott is also required to provide the County, within thirty (30) days after the end of the County fiscal year, summary level financial statements that include accruals; vendor accounts; sales and catering bonuses.

To aid in the County's budgeting process Marriott prepares and submits a detailed five-year plan ("Five Year Plan") to the County, no later than June 1st of each year. The Five Year Plan consists of financial projections of occupancy, rate, revenue, department profit, costs, investment factors and net house profit, together with such additional information as the County may reasonably request.

Per discussion with both DED personnel and the Marriott DFA, we noted that Board meetings occur every other month, in which there is a review of monthly financials, updates on needed repairs and other relevant operational information. Prior to the start of a new Conference Center fiscal year, the Board will meet to discuss the proposed Annual Operating Projection (i.e. basis of annual budget) and Business Plan. The Board is responsible for the final review and approval of the Center's annual budget for the upcoming Conference Center fiscal year.

Service Organization Control (SOC) Report

Since MBS provides financial accounting services (e.g., processing accounts payable, billing, accounts receivable transactions, and cash management) for numerous Marriott properties across the North American region, Marriott periodically hires an independent public accounting firm to prepare SOC reports related to MBS activities. The purpose of a SOC report is for service organizations (i.e. organizations that operate information systems and provide information system services to other entities) to provide its customers information that describe their systems, associated internal controls, and independent auditor procedures to validate those controls. MBS SOC reports are available to the County upon a request to Marriott

Scope and Methodology

We reviewed Center transactions that occurred during the period of June 1, 2012 to December 31, 2013. This review period includes transactions from both FY 2012 and 2013. We reviewed the original Management Agreement, dated January 2003, and Amendment 2, dated June 2009, which describe the terms and conditions under which Marriott manages the Center and is responsible for reporting financial information to the County and the Hotel Owner. Marriott accounting staff provided examples of the periodic financial reporting provided to the County.

Procedures performed included interviewing key Marriott staff involved with managing the Center to obtain an understanding of the revenue cycle, overhead charges, revenue and cost allocations and financial reporting. We interviewed the County's Asset Manager from DED to gain an understanding of the financial reporting process and contract monitoring and other department oversight activities for the Center.

<u>General Sample Selection</u>

As part of our sample testing, we selected specific accounting periods that would provide coverage for both Conference Center fiscal years and include a period at quarter-end. The table below summarizes the accounting periods included in our samples for the testing areas listed.

Table 3 – Months Included in Sample

Testing Area	November 2012	June 2013	September 2013
Overhead	✓	✓	✓
Conference Center Rev/Cost Allocation	✓	✓	✓
Escrow Reserve	✓	✓	✓
Financial Reporting	✓	✓	✓

Revenue Cycle Sample Selection

We requested Marriott staff provide us a listing of the top 39 customers' events for calendar year 2013. Using the report, generated from the CI System, we selected a sample of 10 customers for testing. The sample of customers included events utilizing different payment types (e.g. cash, credit card, direct bill, etc.) We obtained the following supporting documentation, if applicable, for each customer event in the sample: (1) BEOs; (2) banquet checks; (3) PMS invoice and (4) evidence of the credit review process performed by MBS.

Revenue Cycle Testing

The purpose of the revenue cycle testing procedures was to determine if the customer and event information is setup correctly in CI and to ensure the proper recording of revenue into PeopleSoft through the PMS interface.

We obtained the original management agreement, dated January 2003, and Amendment 2, dated June 2009, and reviewed the specific terms and conditions related to the Montgomery County Conference Center Booking Policy (January 20, 1998). Table 4 summarizes the attributes tested as part of this area:

Table 4 – Attributes Tested for Revenue Cycle

Attribute	Description
A	Event information from Banquet Event Order (BEO) is setup in CI system
B	If applicable, evidence of credit review and approval process being performed by MBS
C	Banquet check agrees to catering and food & beverage revenue to ensure proper recording of revenue
D	Revenue was accurately and timely recorded
E	If applicable, accounts receivable (AR) was timely collected (within 60 days)

Overhead Sample Selection and Testing

We judgmentally selected three (3) months, summarized in table 3 above, from FY 2012-2013. From these months, we selected three (3) support cost pools out of five (5) shown in the P&L Statement. The support cost pools selected are Administrative (includes Accounting), Repairs & Maintenance, and Sales & Marketing. The sample included one cost pool for each of the three allocation methods (i.e. 50/50 split defined percentage or based on budget/utilization). For each overhead cost pool tested, we obtained Monthly Department P&L statements and Rent Letters.

The purpose of the overhead testing procedure was to determine if costs accumulated in the OH cost pools were reasonable and if the allocation to the owners was in accordance with the agreement. We obtained the original Management Agreement, dated January 2003, and Amendment 2, dated June 2009, and reviewed the specific terms and conditions related to the Cost and Revenue Sharing Agreement.

Conference Center Revenue and Cost Sharing Sample Selection and Testing

We judgmentally selected three (3) months, summarized in table 3 above, from FY 2012-2013.

The purpose of the conference allocation testing procedure was to determine if revenue/cost was properly reviewed and allocated respectively within ownership groups (Hotel/Convention Center). We recalculated and/or re-performed the revenue and costs allocation respectively within ownership groups to agree revenue and costs from PeopleSoft P&L to the manual split schedule (Rent Letter) prepared by Marriott for accuracy. We reconciled month-to-date revenue from CI system to the revenue recorded in the PeopleSoft P&L. For each month tested, we obtained Monthly Department P&L statements, Rent Letters and CI reports.

We obtained the original Management Agreement, dated January 2003, and Amendment 2, dated June 2009, and reviewed the specific terms and conditions related to the Cost and Revenue Sharing Agreement. Table 5 summarizes the attributes tested as part of this area:

Table 5 – Attributes Tested for Revenue and Cost Sharing

Attribute	Description
A	Determine accuracy of revenue allocation respectively within ownership group
B	Determine accuracy of cost allocation respectively within ownership group
C	Determine if calculation had proper and reasonable level of review and approval
D	Determine if the MTD Revenue from the CI system to the PeopleSoft system is accurate for the selected months
E	Determine if revenue and costs were allocated in accordance with percentage defined in the Cost and Revenue Sharing Agreement.

Escrow Reserve Sample Selection and Testing

We judgmentally selected a sample of three months, summarized in table 3 above, to test the FF&E schedule. For each month selected, we obtained the applicable documentation to support the contributions and withdrawals from the reserve account. This supporting documentation included FF&E schedules, vendor invoices for FF&E replacements, ACH wire logs, monthly rent letters, approved capital expenditure schedules, Project Authorization Requests (PAR) if required, and monthly PeopleSoft Profit/Loss reports.

The purpose of the escrow testing procedures was to determine if the Center FF&E[14] Reserve schedule was accurate and contained appropriate information to support the escrow funding calculations and if Marriott properly funded the Center escrow account per terms of the management agreement. We obtained the original Management Agreement, dated January 2003, and Amendment 2, dated June 2009, and reviewed the specific terms and conditions related to funding and using an escrow reserve account for repairs, maintenance and equipment replacements. Table 6 summarizes the attributes tested as part of this procedure:

Table 6 – Attributes Tested for Escrow Reserve

Attribute	Description
A	Revenue per FF&E Schedule agreed to revenue for Conference Center in specific month's Rent Letter file
B	Total Revenue per Rent Letter file agreed to revenue recorded in PeopleSoft Profit/Loss
C	Contributions and Redemptions per FF&E Schedule agreed to ACH Wire Log
D	Conference Center Escrow Account funded in accordance with Management Agreement and contribution calculation was clerically accurate
E	Repair costs were supported by adequate documentation and agreed to amounts reported on FF&E schedule
F	Repair cost was properly authorized in budget per CapEx Schedule
G	If PAR required, the PAR was properly approved

Contract Monitoring Testing

The purpose of this procedure was to determine if the County performed adequate contract monitoring activities over the Center during the review period based on the terms of the management agreement. We obtained the original Management Agreement, dated January 2003, and Amendment 2, dated June 2009, which describe the terms and conditions under which Marriott manages the Center and is responsible for reporting financial information to the County and the Hotel Owner. During meetings with DED, we inquired about the contract monitoring activities performed during review period and any issues noted. We obtained meeting minutes of the CCMC meetings held during the period of June 1, 2012 to December 31, 2013.

Prior Audit Report

We reviewed the *Independent Accountant's Report on Applying Agreed-Upon Procedures for Montgomery County Conference Center* (dated February 6, 2008) and evaluated whether the County had taken any corrective action through inquiry of DED or based results of testing performed during current audit. Refer to Appendix B for additional details related to the prior audit.

Financial Reporting Testing

The objective of this testing was to determine if the County's financial interests are being properly safeguarded and reported through review of internal controls over financial reporting. We obtained the original Management Agreement, dated January 2003, and Amendment 2, dated June 2009, and reviewed the agreement to identify the applicable terms and conditions related to reporting financial information to the County. We met with the Marriott DFA who is responsible for management of the Center in order to obtain an understanding of the current processes and procedures in place related to financial reporting. We obtained Marriott internal control process narratives[17] related to the procedures and controls in place over financial reporting. We requested documentation that provided evidence that key controls were being performed.

SOC Report

We obtained the SOC 1 report related to MBS, *Description of Marriott Business Services', operated by Marriott International, Incorporated, System of Financial Services and related IT Support Services*, for the period November 3, 2012 through October 31, 2013 with Independent Service Auditor's Report. The public accounting firm Ernst and Young LLP prepared the report (dated December 18, 2013.) We reviewed the SOC report to determine if there were any significant control weaknesses or other relevant deviations.

Results

Revenue Cycle

We performed testing over the revenue cycle, including customer credit review, Food/Beverage and Catering revenue and accounts receivable, to ensure Marriott properly recorded revenue and that funds due to the Center were collected timely.

Customer Credit Review

Five of the 10 customers selected for testing utilized a payment method (e.g. direct bill) that required the performance of a customer credit check, by MBS, prior to credit being extended to that customer. We found that Marriott properly initiated customer credit checks for all five customers as required. Based on the credit recommendation provided by MBS, all five of the customers were approved for credit.

Food/Beverage and Catering Revenue

We determined that Marriott properly calculated the Food/Beverage and Catering (i.e. banquet and audio/visual) revenue applicable to the Center for all sample items based on a comparison of BEOs, customer/event setup in CI system and final banquet checks/invoices.

During our comparison of final banquet checks/invoices to the revenue recorded in CI, we noted that the revenue from three invoices did not agree to customer revenue listed on the *Actual Function Revenue per CI Customers* report provided by Accounting Department. The variances we observed range from $442 to $100. Based on discussion with DFA, we noted that the differences resulted from adjustments made subsequent to initial recording in CI and based on our understanding of the Marriott revenue adjustment process certain minor variances are expected and not considered true discrepancies. Adjustments to revenue that can occur between the various systems[18] in the revenue cycle can lead to inherent differences between revenue amounts at different stages of the recording process (e.g., if adjustments are made in

[17] Marriott Internal control/process narrative "FINANCIAL REPORTING- FULL SERVICE PROPERTY NARRATIVE" (Revised May 2014)
[18] See figure 1 in the Background section for details about the various systems involved in recording revenue.

PMS at the end of the process, they would not flow back to CI the original system, creating a variance).

Ultimately, we found that revenue recorded in PMS was accurate based on review of final banquet checks/invoices and the revenue was recorded timely and no internal control weaknesses were noted.

Accounts Receivable Collection

Of the 10 sample items tested, six of the customers utilized a payment method (e.g. direct bill or credit card) that resulted in the establishment of an accounts receivable balance. Based on the documentation reviewed, we confirmed that Marriott collected the accounts receivable for all six items within 60 days.

Conference Center Revenue and Cost Sharing

We confirmed that month-to-date revenue from the PMS system agreed to PeopleSoft for the months tested, without exception. For all three periods (months) tested, we determined that the allocation of revenue and costs between the Hotel and Center was in accordance with the terms of the management agreement.

We tested the reasonableness and accuracy of the revenue and cost allocated to the Hotel and Center and assessed the level of compliance with terms of the management agreement.

During our testing, we found that the allocation of revenue and cost between the owners is a manual process. Each month, Marriott accounting staff spends a significant amount of time preparing Excel spreadsheets to allocate balance sheet accounts. This allocation is calculated and maintained on Excel schedules outside any integrated financial system. We noted that there is limited supervisory review and approval of the information derived from the calculations in the Excel spreadsheets prior to the submission of financial reporting (i.e. Rent Letter) to the County. Due to the manual nature of the allocation and the lack of a formal review, there is the risk of input and calculation errors in the financial reporting provided to the County.

Overhead Costs

For all three periods (months) tested, we reviewed descriptions of specific costs charged to the OH departments selected for testing and determined that the goods and/or services were reasonable and represented costs appropriately charged to the OH pool. For all three periods (months) tested, we determined that the allocation of overhead cost pools to the Hotel and Center was in accordance with the terms of the management agreement.

Escrow Reserve

We tested the use of funds from the escrow account and the funding of the escrow account to determine if Marriott used and funded the account in accordance with the terms of the management agreement.

We tested the FF&E Reserve schedules and the associated supporting documentation for each month in the sample. For each month tested, we agreed revenue stated on the FF&E schedule to revenue split between Hotel and Center per monthly Rent Letter and ultimately to the revenue recorded in the PeopleSoft P/L. We verified that repair costs on the FF&E schedule related to the repair or replacement of FF&E as defined in the agreement, that the costs were supported by adequate documentation, and that the costs had proper approval prior to being incurred (i.e. via Capital Expenditure schedule or County approval). We confirmed that all contribution and redemption amounts per the FF&E schedule agreed to the monthly ACH Wire Log and that the escrow reserve account was funded in accordance with the management agreement.

Contract Monitoring

After reviewing the management agreement to gain an understanding of the terms and requirements related to contract monitoring, we conducted an interview with DED staff to review contract monitoring tasks being performed. During the interview on July 8, 2014, we inquired and observed the following:

- Due to funding constraints, the County has not performed an audit of the Center as frequently as the agreement allows for. The most recent audit performed was in 2008. DED staff stated that they were not aware of any follow-up procedures performed to review corrective actions from the prior audit that was completed before the current DED Asset Manager assumed the position. DED indicated that they plan on tracking and resolving any findings from this current audit.

- Prior to the meeting with DED, we requested examples of the monthly reports listed above in order to gain an understanding of the information included in the periodic reporting sent by Marriott. However, DED was unable to locate several reports requested as examples for the period under review. Our expectation was that DED could provide all requested documents.

- The DED Asset Manager indicated that when reviewing the package of 12 monthly reports provided by Marriott the primary focus is on the forecast report. When reviewing the forecast report DED considers:
    - Variances from month to month
    - Review and compare against budgeted annual revenue
    - Comparison of actual results to forecast to evaluate forecast accuracy
    - Comparison of Hotel/Center results to national industry averages

  Other than the review considerations listed above, it appears that the County is relying on Marriott to provide accurate reports, which are prepared in accordance with the agreement. The County does not retest revenue or cost splits contained in the Rent Letter to make sure Marriott has applied the split percentage correctly.

- We reviewed minutes of CCMC meetings, described in background section, held during the review period and observed that these meetings included discussions of monthly and year–to-date financial results, major facility repairs, pertinent operational activities and other information to be communicated to County and Hotel Owner.

Our audit determined that DED, has been an active participant in the periodic CCMC meetings and each month DED reviews the Forecast schedule, which is the primary financial performance report tracking results on a monthly and annual basis. Our audit identified minor internal control weaknesses in the performance of contract monitoring activities including record retention and supervisory review of all monthly financial reports. We also identified opportunities for DED to improve internal control procedures over contract monitoring.

Financial Reporting

We reviewed the management agreement and process narratives to gain an understanding of the terms and requirements related to financial reporting. In addition, we conducted an interview with the Marriott DFA to discuss the financial reporting process. During the interview on July 7, 2014, we inquired and observed the following:

- Based on our review of the Marriott internal control process narrative[19], we identified a key control over financial reporting: "The DFA and GM are required to submit a balance sheet certification on a quarterly basis stating the condition of accounts and an explanation for material items noted. The certification is submitted to and reviewed by the regional office."

- We requested documentation to evidence the performance of this internal control. However, the DFA indicated that documentation we requested related to controls over financial reporting at the Hotel and Center were proprietary to Marriott and could not be shared with County personnel or their auditors. Therefore, we were not able to obtain documentation of the signed quarterly balance sheet certifications (i.e. evidence of the control described above). We were able to obtain the statements summarizing the annual operations of the Center certified by Marriott to be true and correct.

- Each month, the Marriott DFA prepares several reports and schedules as part of the periodic reporting required by the management agreement. The reporting package is submitted to the County by the 20th of the following month and includes the following reports:

    - Forecast
    - Advance Deposit Split Period
    - A/R Aging
    - Bethesda North Cash Flow Statement
    - Center (CC) Split Period
    - Rent Letter
    - Final Balance Sheet
    - Guest Ledger Split
    - Non-CC Split
    - A/P Split
    - Wire Log
    - Department Profit/Loss Statements

Our audit determined that Marriott has procedures in place to satisfy the management agreement requirements related to financial reporting. For the period reviewed, we confirmed that Marriott properly submitted all monthly financial reports.

[19] Marriott Financial Reporting process narrative, May 2014

SOC Report

Based on our review of the SOC report related to MBS, there were no significant control weaknesses or other relevant deviations noted.

Recommendations

We are making four recommendations to improve internal control weaknesses at the Center. MCIA recommends that the Director of DED:

1. Coordinate with Finance department to ensure periodic reviews of all monthly financial reports provided by Marriott are performed to verify accuracy and reasonableness.

2. Develop and implement a record archival plan and retention policy that ensures record retention and easy accessibility of critical documentation received for the Conference Center agreement (such as Rent Letter and other reports that support information contained in Forecast). The retention plan should be in accordance with the terms of the management agreement and should comply with requirements of the County record retention policy.

3. Develop and implement a process to ensure DED is made aware of any County reviews or audits performed over the Center. Implement policies and procedures for tracking audit findings and recommendations, including a process for subsequently assessing the implementation status of recommendations.

4. Develop and implement procedures to periodically obtain a copy of the SOC report related to MBS from Marriott. DED staff then evaluate the auditor's opinion in report section I, the system description in report section III, the control objectives and control activities specified in section IV, the description of subservice organizations in report sections III and IV, and any findings relevant to the Center. If any findings are noted, DED should follow up with Marriott.

Comments and MCIA Evaluation

We provided DED and Marriott with a draft of this report for formal review and comment on March 12, 2015. Marriott responded on March 13, 2015 and DED responded on March 26, 2015. Marriott's response and subsequent conversation with the Marriott's point of contact indicated Marriott had no disagreement with the report. DED stated it agreed with the report's recommendations and was implementing corrective actions. (See Appendix C and D for Marriott and DED responses).

Appendix A

Overhead (Support) Costs[20]

Overhead Cost	Description
Administrative Expenses	Includes wages and benefits for Executive Office, Human Resources, Loss Prevention, and Accounting, credit card discounts, office supplies, recruiting fees, audit fees, professional fees, dues, maintenance of property systems, and other operational costs. Also included are corporate reimbursable costs for Computer, Payroll, and Accounting services provided through the corporate offices, which are allocated to each Hotel as a percentage of total sales for the Hotel.
Utilities Expenses	Includes utilities costs such as gas, electricity, water, sewer, steam, etc.
Repairs and Maintenance	Includes wages and benefits for Engineering, supplies, parts, and miscellaneous repair and maintenance charges such as ground maintenance, HVAC system maintenance and supplies, fire alarm system, electrical, plumbing, etc.
Sales and Marketing	Includes wages and benefits for Sales and Marketing, office supplies, local advertising expense, travel costs for sales associates, etc. Also included are corporate reimbursable costs for National Sales and Advertising services provided through the corporate offices, which are allocated to each Hotel as a percentage of total sales for the Hotel.
Central Training and Relocation	Includes training and relocation costs provided through Marriott corporate offices, which are allocated on a pro-rata basis per the number of managers at each hotel.

[20] Source: Marriott Expenditures Property Narrative, May 2014

Appendix B

Status of Prior Audit Recommendations[21]

Finding	Recommendation	Original County Response in 2008	Comments from Current Audit
1	• The Hotel should develop and implement specific procedures for the amount and collection of advance deposits.	The County agrees that it should review advance deposit procedures with Marriott, and consider including the potential institution of multiple, periodic deposits and tying the amount of the deposits to the potential profits lost.	*Current audit*: we performed testing over the revenue cycle, including transactions with advance deposits.
2	• The Hotel should evaluate the current policy of extending credit to regular customers. • Consideration should be given to revising the current credit policies. • In addition, regular customers should be required to pay a significant portion of the event cost prior to the date of the event, to cover the cash flow requirements of the event.	The County agrees that the practice of Marriott extending credit to its regular customers should be reviewed. This discussion should include information on which regular customers are habitual late-payers.	*Current audit*: we performed testing over the revenue cycle, including transactions that required a customer credit check.

[21] Source: *Independent Accountant's Report on Applying Agreed-Upon Procedures for Montgomery County Conference Center*, February 6, 2008

Finding	Recommendation	Original County Response in 2008	Comments from Current Audit
3	• Consideration should be given to using an estimate based on a percentage of total receivables, each month, with a more detailed allocation at the County's year end. • Alternatively, consideration should be given to evaluating the staffing levels at the Bethesda North Marriott, as the accounting requirements of the combined project appear to exceed the requirements at other typical Marriott hotels due to the dual ownership and independent management.	The County agrees that the recommendation is worthy of discussion with Marriott. Streamlining the allocation method during the year and working towards a year-end reconciliation makes sense. Both the County and the Hotel owner have discussed staffing with Marriott, but have not yet made recommendations.	*Current audit*: we performed testing over the allocation of revenue and cost to the Center.
4	• Montgomery County personnel should request to review all of the policies and procedures related to the operation of the Center, to determine that policies and procedures agree to the terms of the Management Agreement and properly reflect the best interests of the Center and County. • We also recommend the County consider revising or clarifying if necessary, certain policies and procedures to strengthen the operating controls related to the accounts receivable and advance deposit processes.	The County agrees that Marriott's policies should comport with the Management Agreement. The County will determine how to seek review of these policies.	*Current audit*: we obtained and reviewed Marriott internal control narratives, including a narrative related to accounts receivable. We also obtained and reviewed a SOC 1 report related to MBS activities.
5	• We recommend the County require that MBS increase the number of calls to customers with balances less than $1,000 and that the Bethesda North Marriott Management develop procedures to regularly contact all customers with outstanding balances. • Montgomery County should review the Aged Receivables report received from the Bethesda North Marriott at the end of each period to monitor the collection process. • In addition, the County should obtain summaries from the Bethesda North Marriott and Center of all balances over 60 days old, with explanations of collection efforts and status of the account.	The County agrees that the collection process for aged receivables appears to be less rigorous than warranted, and that more County involvement in the process would be useful. The County will pursue the recommendation with Marriott.	*Current audit*: we performed testing over the revenue cycle, including transactions that resulted in creating accounts receivable. Noted that there were no significantly aged accounts receivable at the time fieldwork was performed.

Finding	Recommendation	Original County Response in 2008	Comments from Current Audit
6	• We recommend the County require that the Bethesda North Marriott improve procedures to calculate the allocation of receivables according to the projected revenue for the event.	The County agrees that Marriott should improve its procedures for calculating the allocation of receivables at the site, any discussion of which should include the relative advantages and disadvantages of instituting a system that is less accurate but far less time-consuming.	*Current audit*: we performed testing over the allocation of revenue and cost to the Center.
7	• We recommend the County require that the Bethesda North Marriott identify the amount of all advance deposits and the related due date(s) in the contracts. • We also recommend the County and the Bethesda North Marriott develop a new policy for advance deposit requirements.	The County agrees that the advanced deposit policy currently in effect may need amending. The County will discuss changes in the policy while seeking to balance the needs of the manager regarding the flexibility of the policy.	*Current audit*: we performed testing over the revenue cycle, including transactions with advance deposits.
8	• We recommend that the County require the Bethesda North Marriott to establish procedures to have the accounting department review the allocations and compare amounts to the related contracts.	The County agrees that Marriott should improve its procedures for calculating the allocation of advance deposits at the site, any discussion of which should include the relative advantages and disadvantages of instituting a system that is less accurate but far less time-consuming.	*Current audit*: we performed testing over the revenue cycle, including transactions with advance deposits.

Finding	Recommendation	Original County Response in 2008	Comments from Current Audit
9	• We recommend the Bethesda North Marriott Hotel and Center require that all advance deposits negotiated with customers comply with the established policy and that the contracts reflect the arrangements negotiated with customers.	The County agrees with this recommendation.	*Current audit*: we performed testing over the revenue cycle, including transactions with advance deposits.

Appendix C

MARRIOTT

March 13, 2015

Mr. Larry Dyckman
Manager, Office of Internal Audit
Montgomery County Government
101 Monroe Street
Rockville, MD 20850

Ms. Deidre Bland
Cherry Bekaert, LLP
1934 Gallows Road
Suite 400
Tysons Corner, VA 22182

Dear Mr. Dyckman and Ms. Bland:

The hotel would like to thank you for all the time and effort you and your teams put into this audit. We know it is not easy to audit an entity that you are not familiar with and we appreciate your desire to really understand the conference center business. We look forward to working with you again in the future.

Thank you,

Jessica Kleiman
Director of Finance

Bethesda North Marriott Hotel and Conference Center
5701 Marinelli Road, North Bethesda MD 20852
Telephone (301) 822 9200 Facsimile (301) 822 9201

Appendix D

DEPARTMENT OF ECONOMIC DEVELOPMENT

Isiah Leggett
County Executive

Sally Sternbach
Director

Memorandum

March 26, 2015

TO: Larry Dyckman, Manager
Office of Internal Audit

FROM: Tina Benjamin, Director of Special Projects
Department of Economic Development

SUBJECT: Montgomery County Conference Center Audit

Thank you for the opportunity to respond to the recommendations listed in the Montgomery County Conference Center Audit Report. We agree with the recommendations and are already working to implement some of them internally. In addition we will work with the County's Finance Office to implement the remaining recommendations. Please contact me if you have any questions.

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