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

Marriott Conference Center Management Agreement
Cost and Revenue Sharing Audit

August 28, 2023

MCIA-23-4

Highlights

Why MCIA Did this Audit

The Montgomery County Office of Internal Audit (MCIA) conducted an audit of the Cost and Revenue Sharing Agreement and related terms specified in Exhibit F of the Management Agreement (Agreement) between Montgomery County and Marriott Hotel Services, Inc., effective January 29, 2003, as amended.

Montgomery County Government (the County) is the leasehold owner of land where the Montgomery County Conference Center (Conference Center) and Bethesda North Marriott Hotel (Hotel) are located. Both the Hotel and Conference Center are intricately adjoined. The County maintains ownership of the Conference Center while Brookfield Properties (Brookfield), a Real Estate Investment Trust, is the designated owner of the Hotel. Brookfield is also responsible for paying a monthly land lease fee to the County as owner of the Hotel. Marriott International is responsible for managing both the Hotel and Conference Center operations.

The audit was conducted by the accounting firm SC&H Group, Inc., under contract with MCIA.

August 2023

Marriott Conference Center Management Agreement: Cost and Revenue Sharing Audit

What MCIA Found

Marriott's management and oversight of the Agreement includes tasks focused on adhering to contractual terms. However, opportunities exist to improve Marriott's internal processes to help mitigate risks related to noncompliance and inaccurate reporting.

This review identified three opportunities for improvement to strengthen compliance measures in the following areas:

1. Enhanced garage revenue reporting
2. Enhanced event revenue reporting
3. Enhanced cost allocation reporting

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Objectives

This report summarizes an audit of the Cost and Revenue Sharing Agreement and related terms specified in ***Exhibit F*** of the Management Agreement (Agreement) between Montgomery County and Marriott Hotel Services, Inc. (Marriott), effective January 29, 2003, as amended. The audit was performed by SC&H Group, Inc. (SC&H), under contract with the Montgomery County Office of Internal Audit (MCIA).

The audit focused on how and when Marriott records, reports, and wires Conference Center financial data and applicable costs and revenues to the County. The primary objectives of the audit were to determine:

1. If the expenses/costs and revenues are being appropriately allocated in accordance with the terms of ***Exhibit F*** of the Agreement,
2. If there are adequate financial and management processes and reporting in place to provide reasonable assurance of the accuracy of the allocation,
3. If the reports to the County are adequate for the County to have appropriate assurances and insight into the administration of the Conference Center.

Conference Center Background

Montgomery County and Marriott Management Agreement

On January 29, 2003, the County entered into a 20-year Management Agreement (Agreement) with Marriott. With the Agreement, Marriott is responsible for supervising, directing, and controlling the management and operations of both the Hotel and Conference Center. Marriott receives a base management fee of 3% on gross revenues of the Conference Center with an additional incentive management fee of 25% on additional net operating income of the Conference Center when net annual operating profit exceeds $500,000 in a full Fiscal Year. The County's Business Center team (formerly known as the Business Advancement Team) and an established Conference Center Management Committee (Committee) are responsible for monitoring the operational activities of Marriott to ensure they remain compliant with the Agreement.

Exhibit F of the Agreement breaks down the cost and revenue sharing arrangement between the County and Marriott. The Cost and Revenue Sharing Agreement identifies certain cost and revenue items that can be clearly attributable to one or the other of either the Hotel or Conference Center or, alternatively, an allocation of those cost and revenue items that have been agreed upon between the County and Marriott. The following table shows the allocation percentages within ***Exhibit F***, as amended.[1]

Description	Hotel	Conference Center
Rooms	100%	
Telephone	100%	
Gift Shop (Amended)		100%
Restaurant		100%
Lounge		100%
Banquet		100%
Audio Visual		100%
Conference Services		100%

[1] Second Amendment to the Management Agreement, Article 1.04, executed on June 9, 2006.

Description	Hotel	Conference Center
Meeting Room Rental		100%
Business Center (Amended)	30%	70%
Garage/Parking	40%	60%
Transportation	58%	42%
Group Cancellation	58%	42%
Grout Attrition	58%	42%
General & Administrative	50%	50%
Utilities (Unless Separately Metered)	45%	55%
Repairs & Maintenance (Unless Otherwise Agreed)	46%	54%
Central Training & Relocation	46/44/43%	54/56/57%
Sales & Marketing	45%	55%
***At Your Service* Telephone Concierge (Amended)**	50%	50%
Revenue Management Services (Amended)	60%	40%
Investment Factors		
Equipment Rental (Unless Specified for an individual Component)	50%	50%
Permits & Licenses (Unless Specified for an individual Component)	50%	50%
Real Estate Taxes	100%	
Land Rent	100%	
Complete Meeting Package	58%	42%

Additional cost and revenue categories, such as cafeteria, other income, credit cards, accidents, sales & advertising, insurance, management fees, and furniture, fixture, and equipment (FF&E) reserves, may receive unique allocation based on utilization.

The Agreement has been amended twice.

1. The first amendment included updates to language which allowed the County to have the ability to request and reserve Conference Center space on select days and was executed on December 2, 2004.
2. The second amendment included updates to language surrounding cost and revenue sharing between the County and Marriott and was executed on June 9, 2006.

The Agreement is set to expire on October 15, 2024, with work to renew the agreement beginning in October 2023.

Agreement Ownership and Management

Marriott is responsible for supervising, directing, and controlling the management and operation of the Conference Center throughout the terms of the agreement, including collecting all revenue, paying operating expenses for both the Hotel and Conference Center, and allocating them based upon agreed percentages. Further, each month, Marriott sends the Business Center operating profits (or losses) for the Conference Center and Brookfield's land lease payment to the County. Marriott is also required to hold 5% of total sales in reserve for FF&E replacements and 20% of owner's distributions in reserve for major capital expenses. Both reserves are maintained in separate bank accounts by Marriott on behalf of the County.

Montgomery County Business Center

The Business Center is the County division responsible for monitoring the County's relationship with Marriott. The Business Center falls under the Office of the County Executive and is focused on helping businesses start and grow within the County. Aside from overseeing the Agreement, the Business Center also manages certain funding programs, incubator facilities, and partnerships with other organizations providing resources to businesses in the County. The Business Center team has assigned the Business Center Manager and select Program Managers to perform contract management responsibilities. For the purposes of this audit, only the Business Center's role in overseeing and managing the Agreement between the County and Marriott is documented in detail.

Conference Center Management Committee

The Conference Center Management Committee (the Committee) was established with the Agreement to meet and discuss the operations of the Conference Center, financial projections, reserve account balances, and vote on proposed capital expenditures on a regular basis, often quarterly. The Committee includes representatives from the County, Visit Montgomery (the County's Tourism and marketing organization), Maryland Stadium Authority (MSA), Brookfield, and the Marriott General Manager. A quorum of four must be present and vote for any actionable items to be decisioned. Additional Marriott employees or representatives are free to attend as a non-voting guest for presentation purposes. Once the bonds issued by MSA reach maturity, a representative will no longer be present on the Committee.

Marriott Finance & Accounting

Marriott Hotel's Finance & Accounting team is led by its Director of Finance & Accounting (DFA) (as of November 2022) and overseen by its General Manager (GM). The DFA is the primary and currently only team member responsible for overseeing and leading Marriott's processes to comply with the Agreement.

Marriott Reporting

Monthly Financial Packets & Wires

In order to comply with the requirements of the Agreement, Marriott provides both the Business Center and County's Department of Finance (County Finance) with monthly financial packets.

Marriott's financial packets include the following:

- Bank Statements for the FF&E and 20% reserve accounts
- Profit and loss (P&L) statements
- A summary of the FF&E and 20% reserves with details of projects using these funds
- Statement of operations and rent letter
- Balance sheet summary
- Wire log of payments

Following receipt, County Finance processes the information within the system of record (Oracle ERP). Further, County Finance is copied on communications between Marriott and the Business Center.

Payment of funds are due to the respective owners by the 20th of the following month. If the Conference Center operated at a loss the previous month, Marriot requests the appropriate payment from County Finance, less the Brookfield property lease payment. If the Conference Center had a net profit from the previous month, Marriott wires the appropriate payment to the

County. The wiring of funds is based on a pre-set template where the bank and routing numbers cannot be manipulated.

Annual Budgeting & Financial Reporting

Marriott operates on a calendar fiscal year of January 1st to December 31st while the County's fiscal year is July 1st through June 30th. Prior to the beginning of its fiscal year, Marriott prepares and provides the County with an annual operating budget and financial projection for the upcoming fiscal year. This budget is first prepared as an internal operating budget by the DFA and the GM before being submitted for the Vice President of Finance and Vice President's reviews. The budget is re-submitted until approved and broken out by respective owner, with the Conference Center budget being provided to the County. Once provided, the Business Center and Committee reviews and provides feedback on the budget. The budget is typically submitted around 60 days prior to the start of Marriott's next fiscal year.

At the end of its fiscal year, Marriott prepares an Annual Statement of Operations (STOPS) report which provides recipients with a high-level summary of the entity's fiscal year performance. The STOPS report is reviewed and signed off by the Marriott International Vice President and Controller to evidence certification or attestation by Marriott. By the terms of the Agreement, Marriott is required to provide the County with summary-level financial statements within 30 days of fiscal year end.

Scope and Methodology

Scope

The audit was performed in accordance with the Statement on Standards for Consulting Services (SSCS) issued by the American Institute of Certified Public Accountants (AICPA). The audit was conducted from March 2023 to June 2023. The scope focused on the following:

1. Agreements:
    a. Management Agreement, dated January 29, 2003, by and between Montgomery County, Management (Owner) and Marriott Hotel Services, Inc. (Manager); specifically ***Exhibit F*** (Cost and Revenue Sharing Agreement).
    b. Amendment 1 to the Agreement, dated December 2, 2004, if there is impact to item 1a above.
    c. Amendment 2 to the Agreement, dated June 9, 2006, if there is impact to item 1a above.
2. County liaison/group: Office of the County Executive, Business Center
3. Financial and management processes: Marriott Hotel processes surrounding ***Exhibit F*** of the Agreement.
4. Time periods:
    a. Calendar year 2022 (CY22) transactions
    b. Current state of Marriott Hotel operations

In order to achieve the objectives, SC&H performed the following procedures.

Objective 1: Cost and Revenue Sharing Agreement Evaluation

To validate the accuracy of the Cost and Revenue Sharing Agreement as specified in ***Exhibit F***, SC&H reviewed the following within a three-month sample that included July 2022, November 2022, and December 2022:

1. Monthly P&L statements, FF&E funded project schedules, rent letters, balance sheets, wire logs, and bank statements for the FF&E and 20% reserve accounts that were provided by Marriott for calendar year 2022.

2. General ledger (GL) detail supporting the P&L reporting and payroll reporting for hourly and salaried personnel.
3. Supporting documentation such as customer invoices, customer contracts, and daily event revenue check registers to support a sample 10 events held in the Conference Center totaling $1,536,661.
4. System generated Point-of-Sale (POS) reporting to support reported restaurant revenue totaling $404,127.
5. Garage terminal reports supporting garage revenue totaling $55,016.
6. Third party invoices, expense reports, receipts to support expenses reported to the Conference Center for a sample of 68 expenses totaling $366,213.
7. Payroll costs for management salaries, nonexempt management wages, and payroll costs related to three wage codes totaling $921,035 in payroll costs recorded during the three-month sample.
8. Three owner-funded FF&E project costs totaling $134,928 for the month of July 2022.
9. Reviewed payment remittance from Marriott to Montgomery County for profits.
10. Actual expenses and revenues allocated to the Conference Center compared to the allocation percentages specified in ***Exhibit F*** of the Cost and Revenue Sharing Agreement.

Objective 2: Marriott Financial Process Evaluation

SC&H conducted interviews and a walkthrough with Marriott to understand their processes and controls related to the Conference Center operations and associated Agreement. Based on these activities, SC&H developed a process narrative, risks, and controls that were shared with Marriott.

Objective 3: Marriott Reporting Package Evaluation

SC&H requested and reviewed financial packets prepared by Marriott and provided to the Business Center team for each month of calendar year 2022. During interviews conducted in Objective 2, SC&H inquired with the Business Center team to identify areas where the team believed there were shortcomings in the data/reports provided or where they were satisfied with the documentation. Based on these activities, SC&H developed a matrix to analyze each document within the financial packets, resulting in areas compliant with Agreement requirements and opportunities for improvement.

Findings and Recommendations

Results

We appreciate the assistance and cooperation from the County and Marriott teams during this audit. The teams were cooperative throughout the audit procedures, and provided data, information, and responses in a timely manner.

The audit yielded three findings related to noncompliance with the Agreement. These findings and recommendations are presented as follows and intended to help mitigate risks of future noncompliance.

Finding 1: Underreported Garage Revenue
<u>Background</u> Based on feedback from Marriott the following items were included in garage revenue: *"Parking Revenues for the complex are generated through the following buckets:*

- *Front Office PMS system on the guest folio – 0080 - Brookfield*
- *3C revenues – these are revenues recorded at the pay station. With the exceptions of [terminal] 12A- those are all Moco [Montgomery County]*
- *CI/TY - Instead of the individual attendee paying out of pocket for the group these are banquet checks that included parking for the groups' attendees.; these revenues are 100% Moco"*

SC&H reviewed P&L reporting provided for the months of July 2022, November 2022, and December 2022. SC&H reviewed 3C reporting for July 2022, November 2022, and December 2022 against the reported P&L revenue. SC&H also reviewed parking revenue associated with a sample of 10 events.

Findings
The November 3C garage pay station report included $11,160 in revenue which was not reported for the Conference Center P&L. This issue appears to have only occurred in November 2022 which is the month the prior to when the Marriott DFA transitioned to the current DFA. The other months reviewed did not include this error; as such, this appears to be a unique occurrence.

Marriot Response
The finding and amount were confirmed as errors by Marriott.

Risks
1. Contracted parties do not report financial results timely, accurately, or in compliance with the established Agreement.

Recommendation 1
1. Marriott should process a prior period adjustment to the revenue account to correct the under-reported garage revenue.
2. Marriott should include additional reporting in the P&L to include a breakdown of garage revenue. The current P&L includes only one revenue category noted as "other" to the garage department. For example, Marriott could break out garage revenue into the following categories: 1) pay station revenue and 2) banquet garage revenue. This would allow for more transparency in the P&L. It would also allow for the County to review month-to-month trends and, if needed, validate support for 3C terminal sales and event banquet check revenue more easily.

Finding 2: Underreported Banquet Event Revenue

Background
Marriott provided a Property Detail and Summary Report which included a list of event names, dates, event type (group vs. local), and quoted revenue amounts for both Hotel and Function amounts. SC&H requested event contracts, invoices, receipts, banquet check support, GL event posting data, and transaction data to validate the actual revenue received by Marriott equaled the reported revenue to the Conference Center for a sample of 10 events totaling $1,536,661.

Findings
Two (2) out of the 10 sampled events included an underreported revenue totaling $129,534. The two errors are included below in more detail.

IEEE Military Communication

Event Date	Catering Amount Billed to Client	Event Revenue Reported in ePL	Difference Between Client Invoiced Amount and Revenue Reported to Conference Center
11/29/2022	$ 114,347.93	$ 95,667.38	$ 18,680.55
11/30/2022	90,964.07	90,964.07	-
12/01/2022	33,413.30	33,413.30	-
12/02/2022	8,149.68	8,149.68	-
Total	**$ 246,874.98**	**$ 228,194.43**	**$ 18,680.55**

Government Contract Management Symposium

Event Date	Catering Amount Billed to Client	Event Revenue Reported in ePL	Difference Between Client Invoiced Amount and Revenue Reported to Conference Center
12/03/2022	$ 3,728.73	$ 3,728.73	$ -
12/04/2022	21,078.09	21,078.09	-
12/05/2022	12,799.20	12,799.20	-
12/06/2022	193,072.09	82,218.88	110,853.21
12/07/2022	4,608.02	4,608.02	-
12/10/2022	3,472.76	3,472.76	-
Total	**$ 238,758.89**	**$ 127,905.68**	**$ 110,853.21**

Marriott Response
Marriott agrees with the finding.

Marriott provided the following feedback in response to the variance: *"Looks like these variances were not captured in our GL for those days from CI/TY. On November 30, the hotel changed from 25% service fee to 26% service fees. In order to complete this update we had to void and re-post event checks that were created prior to the system's automatic update. The event checks created for December 6th for the GCM event were voided, updated with the correct service charge and re-posted. Due to a program error, the re-posted checks were not captured by CI/TY to be recorded as revenue to the GL and instead treated the voided checks to be netted out from the gross revenue in the day. The corrected event checks were available for invoicing to the client and accurate invoicing and review of the charges for the event as a whole did occur and was found to be accurate by both client and property. The client paid in full and to the accuracy of the invoice."*

Additionally, the Property Detail and Summary Report did not reflect actual invoiced amounts. There does not appear to be a report that includes all events and amounts invoiced by Marriott for the County to review.

Risks
Marriott does not report financial results timely, accurately, or in compliance with the established Agreement.

Recommendation 2

1. Marriott should process a prior period adjustment to the revenue account to correct the under-reported event revenue totaling $129,534.
2. Marriott should include a schedule of events and their respective revenue totals for the Hotel and Conference Center as part of the monthly financial packages. This will allow

for easier review of banquet revenue by the County. Additionally, it will allow for the County to select events, as necessary, to review supporting documentation to validate reported revenue.

3. Marriott should prepare an annual event schedule including all events and total invoiced to clients for both Hotel and Conference Center so annual revenue can be validated for accuracy.

Finding 3: Expense Allocations Do Not Comply with Exhibit F to the Agreement

Background

Exhibit F to the Agreement includes a Cost and Revenue Sharing Agreement with agreed split of different revenue and cost categories between the Hotel and Conference Center. SC&H reviewed the GL detail provided by Marriott to confirm the revenue and costs for the Hotel and Conference Center which were subject to allocation were calculated in line with the Agreement.

Findings

1. There were differences in the Repair and Maintenance cost category allocation related to kitchen expenses. Marriott allocated 100% of kitchen expenses such as "hood cleaning", "kitchen equipment repair", and "lightbulbs" to the Conference Center instead of the agreed 54% for Repairs and Maintenance. The total difference was $5,808 for the months of July, November and December 2022.
2. Marriott applied the "grounds maintenance" charges at an allocation of 80% to the Conference Center and 20% to the Hotel. Contract includes Repairs & Maintenance at 54% to the Conference Center. The total difference in July, November and December 2022 was $1,216.
3. Expenses related to Information & Telecom Systems do not have a defined allocation percentage within ***Exhibit F*** or Amendment 1 or 2.
4. No documentation has been provided establishing a different allocation than what is specified in ***Exhibit F*** for these expenses.

Marriott Response

Marriott agrees that the allocation of repair / maintenance costs was not in line with the percentages in the contract. Additionally, Marriott could not find any documentation to substantiate a different allocation percentage which is permitted by ***Exhibit F*** for this expense category subject to the County's approval.

Risks

1. Marriott does not allocate shared expenses and revenue to the Conference Center and Hotel in line with the Agreement.
2. Exceptions from the contract agreed to by Parties are not approved by appropriate stakeholders.
3. Changes to the contract are not commemorated in the Agreement.

Recommendation 3

1. Marriott and the County should amend the Agreement if changes to the allocation percentages are agreed to by the County and Brookfield.
2. The County should establish a process which defines the approval process and required documentation to authorize a different allocation percentage than what is specified in the Agreement. The Repairs and Maintenance expense allocation percentages in ***Exhibit F*** of the Agreement contains a footnote which states "Unless

otherwise agreed"; however, the current Agreement does not specify the agreement process between the parties.

3. Marriott and the County should amend the Agreement to include the terms of the Information & Telecom Systems expense allocation between the Hotel and Conference Center.

Comments and MCIA Evaluation

As noted above, SC&H shared the findings with Marriott; Marriott agreed with the three findings and has agreed to address the findings. The total cost and revenue amount from 2022 identified for reimbursement to the County was $147,718. Based on communications received from Marriott on July 11, 2023, and July 19, 2023, Marriott has communicated the reimbursement owed to its technology support team (CI/TY), which will process the backdated entries. These entries will then flow down into the general ledger accordingly. Marriott anticipates these entries and the corresponding updated profit-sharing amounts being processed and sent to the County by the end of the third quarter of 2023 (September 30, 2023).

The draft final report was shared with the County's Business Center for its review and comment. The Business Center responded on August 23, 2023, stating that it had received a repayment plan from Marriott to address the shortfalls identified in the report; and that the Business Center and Marriott were working in partnership to strengthen internal controls and review of the monthly financial documents moving forward. The Business Center's response is included in this report at Appendix A.

APPENDIX A – Department Comments

OFFICE OF THE COUNTY EXECUTIVE

Marc Elrich
County Executive

Richard S. Madaleno
Chief Administrative Officer

MEMORANDUM

August 23, 2023

TO:	William Broglie, Manager Office of Internal Audit
FROM:	Gene Smith, Manager Gene Smith Business Center, Office of the County Executive
SUBJECT:	Formal Comments for the Marriott Conference Center Management Agreement Cost and Revenue Sharing Audit

Thank you for the opportunity to comment on Marriott Conference Center Management Agreement Cost and Revenue Sharing Audit.

We appreciate the work and effort conducted by your office, SC&H, and Marriott during this audit. The County acknowledges the findings and has received a repayment plan from Marriott to address the shortfalls identified in the report. The County's Business Center and Marriott are also working in partnership to strengthen our internal controls and review of the monthly financial documents moving forward. We look forward to working with you again in the future.

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