



Hospitality Newsletter

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Implications of COVID-19 on Non-Financial Assets

By: Shaaz Ahamed – Audit Senior Associate
Hisham Shamsudeen – Audit Senior Associate, and
Khaleel Essa – Senior Manager Audit & International Liaison Co-Director

Accounting framework: International Financial Reporting Standards (IFRSs)

Background:

The COVID-19 outbreak developed rapidly during 2020, with a significant number of infections. Measures taken to contain the virus have affected economic activity, which in turn had financial reporting implications.

Measures to reduce the outbreak included restricting travel, temporarily closing businesses and schools, and cancelling events. This had an immediate impact on hospitality, tourism, leisure, transport, retail, and entertainment industries. It has also affected supply chains and the production of goods throughout the world resulting in lower economic activity on account of reduced demand for goods and services.

Reporting professionals have needed to assess the impact of the pandemic on its interim and annual financial statements. Assessments have been subject to several uncertainties due to uncertain duration of business closures, reduced demand for the goods and services and supply-chain disruption.

The implications for financial statements include the assessment and disclosures pertaining to measurement of assets and liabilities and an entity's ability to continue as a going concern, the indirect effects from lower economic activity.

These should be considered by all entities, not just those in the territories most significantly affected.

Most Relevant Indicators to the COVID-19 Pandemic

The most relevant indicators are included below. Given the prevalence of certain of these indicators, we encourage management to consider and document carefully the presence of these factors and the consequences they might have on their financial statements.

External indicators

- Observable indicators of decrease in value.
- Significant changes with an adverse effect on the entity have taken place during the period in the economic environment in which the entity operates or in the market to which an asset is dedicated.
- The carrying amount of the net assets of the entity is more than its market capitalization.

Internal indicators

- Assets becoming idle.
- Evidence that economic performance is worse than expected.
- Plans to dispose of an asset/group of assets.
- Plans to restructure.

Impairment under IAS 36: Impairment of Assets

Many businesses will have to consider the potential impairment of non-financial assets. IAS 36 of the International Financial Reporting Standards (“IFRSs”) requires that assets are tested for indicators of impairment at a minimum every year and other non-financial assets whenever there is an indicator that those assets might be impaired. Temporarily ceasing operations or suffering an immediate decline in demand or prices and profitability are clearly events that might indicate impairment.

Management should consider whether:

- The measures taken to control the outbreak are likely to reduce future cash inflows or increase operating and other costs.
- The assumptions and cash flow forecasts used to test for impairment should be updated to reflect the potential impact of COVID-19.
- Budgets, forecasts and other assumptions from an earlier impairment testing date that were used to determine the recoverable amount of an asset should be revised to reflect the current economic conditions, specifically to address increased risk and uncertainty.
- An expected cash flow approach (multiple probability-weighted scenarios) might be a better way to estimate recoverable amount than a single predicted outcome to capture the increased risk and uncertainty.

- The factors used to determine the discount rate, should be revised to reflect the impact of the outbreak and the measures taken to control it, for example the risk-free rate, country risk and asset risk.

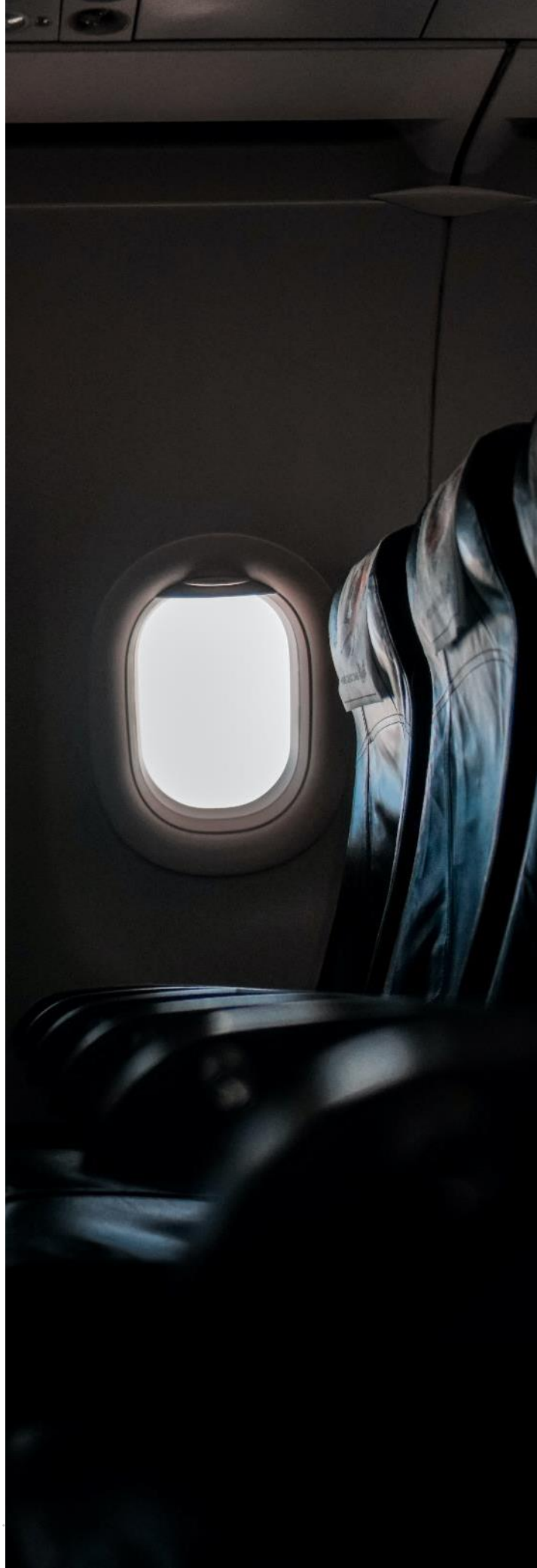
Financial Statements Disclosures Requirements

The uncertainty associated with management’s assumptions about the future is likely to be significant. Therefore, it is critical that management develops robust disclosures to help users understand the sensitivity of recoverable amounts’ estimates to significant changes in key assumptions affected by COVID-19.

Key elements to consider in terms of the disclosures are as follows:

- COVID-19 is likely to give rise to significant judgement and estimation uncertainty, such as the duration of the supply-chain disruptions, reduction in expected demand, and delays in business expansions.
- Management may need to disclose information about the assumptions used to conclude why an impairment test was not triggered if the assessment is subject to significant estimation uncertainty.
- Companies will need to disclose information about the key assumptions used to measure a Cash Generating Unit’s (“CGU’s”) recoverable amount when goodwill or an intangible asset with an indefinite useful life is included in that unit’s carrying amount.

- Management should also consider the need to disclose key assumptions regarding major sources of estimation uncertainty in determining future cash flows or the discount rates that could result in material adjustment to an asset's or CGU's carrying amount.
- IAS 34 - Interim Financial Reporting requires disclosure of the nature and amount of changes in estimates. Impairment losses are examples of events and transactions that require disclosure if they are significant. When an event or transaction is significant to an understanding of the changes in an entity's financial position or performance since the last annual reporting period, as may be the case with material impairment losses recognized in an interim period, the entity's interim financial report should provide an explanation of and an update to the relevant information included in the financial statements of the last annual reporting period.





Repurposing of Hotel Assets – What Information to Obtain From Your Hotel Operators

By: Sajjad Asif – Transformation Advisory Manager
& Syed Aqeel Abbas – Transformation Advisory Consultant

Continuing, the discussion on repurposing the hotel assets by the owners. A significant part of the process is de-flagging the hotel which means, removing the hotel from the management company's name and brand. As the de-flagging process moves towards finalization, hotel owners should be aware of what documentations to receive from the management company as a part of hand over process.

This month we are highlighting some of the key information that the owners should expect and request from the management companies during the hand over process.

1. Statement of Accounts due to / from the Management Company

De-flagging is a complex process with special considerations to be placed upon various different kinds of transactions undertaken between the owning company and the management company.

A major issue in this regard is the differences between the owner's books and the operator's books which is often seen as a potential conflict which would take years to resolve if not managed appropriately at the time of hand over.

Therefore, the owning company should request this document at the earliest to resolve and close all the uncleared transactions not just for a smooth handover, but also to maintain good relationship with the operators for future investments.

2. Audited Financial Statements & Books of Accounts

Just explained above, while handing over the books of accounts back to the owner, the operators should prefer validation of the records by an independent auditor. Likewise, the owners should be mindful whether an independent auditor has been appointed to oversee the handover process.

For effective participation, owners can also provide input regarding the appointment of the most independent auditor to ensure integrity and objectivity of the process from all ends.

These auditors not only review the books of accounts, but also oversee the stock counts over food and beverage inventories, other inventories, consumables and physical verification of fixed assets.

3. Legal aspects posing high risks

Owners should be provided with an accurate and most recent account of on-going legal proceedings, cancellation of bank accounts in the hotel's names, credit cards and transfer of employee data , termination of insurance contracts if managed by the operator, from the hotel's name back to the management's company's names in accordance with UAE Labor Laws.

These reports should provide a clear picture of any unresolved matters and whether the owner is responsible to close them.

4. Suppliers and On-going Maintenance Contracts

The management should be communicating the closure of property to all the suppliers; and the owners should be provided the proof of the same.

Any on-going Maintenance Contract along with cancellation notices should also be shared with the owner who can in turn be comfortable that these contractors will not be visiting the premises after the handover, or expecting the owner to make payment in case of breach of contracts.

5. Delisting from Hotel Booking Websites

To minimize the risk of dispute with the departing hotel's clientele, management company should be de-listing the property from primary hotel booking websites like booking.com etc.

For the owner to ensure this, documentation can be requested from the operator showing that the accounts with such websites and travel agents have been closed.



VAT Regulations on the Hospitality Sector

*By: Steve Kitching – Tax Partner , Angela Sharma – Tax Senior Manager
and Mary Grace Bangoy – Tax Assistant Manager*

As COVID -19 created havoc to the World, the hospitality and tourism industry has been severely impacted, with hotel operators across the United Arab Emirates (UAE) trying to safeguard their business establishments from the devastating effects caused by the pandemic.

However, with passing of time and the successful roll-out of the vaccine programme, this has helped to reduce the number of CV 19 cases in the UAE. Also, the hospitality industry has been resilient and adapted to find new ways to boost tourism in the country.

Many hotels are now offering incentive schemes such as 'All-inclusive' packages at a discounted rate. Inbound and outbound tour packages are often offered to travelers along with accommodation, tour guides, plus round-trip airfare for travel during a particular period.

Further, to engage with the guests more, some hotels offer refundable or transferrable bookings while some offer non-refundable bookings for a cheaper price. However, despite this being offered by the business, robustness in the financial position cannot be achieved if the regulatory and compliance requirements are not also fulfilled.

By highlighting this, it is quite right to touch upon the applicability of VAT regulations on the hospitality sector as it applies equally to all other taxable businesses.

VAT compliance is one aspect of the UAE VAT Laws which has been in focus for the past three years due to day-to-day business complexity and activities conducted by the hotels. These include issuing compliant VAT invoices, accounting for deposits, tax points, VAT credit notes, filing of VAT returns and timely VAT payments to the Federal Tax Authority (FTA).

Considering the intricacy revolving around some of the main transactions such as - redemption of loyalty points, exchange of foreign currencies, free supplies of goods and services, benefits provided to the hotel employees, supply of transportation services etc., two important aspects can be often neglected by the hotel operators. These are, firstly to determine the correct VAT liability on the supplies and secondly, to maintain proper detailed records which are required by the FTA during VAT Audits.

Further, consideration needs to be carefully decided on the VAT treatment of each transaction conducted in the hotels where different VAT rates may apply. For example – an 'All - inclusive' packages, usually include accommodation, international and local transportation, and unlimited food and beverages.

Furthermore, with unpredictability on the travel industry, there are a number of no-show, cancellations, and deposits being forfeited on which the supply concept may have been overlooked and therefore, may result to some complexities in the filing and unreconciled financials against the VAT returns.

Each supply mentioned as part of this package may have different VAT liabilities depending on whether it is provided by a single supplier or multiple suppliers. The way it is reflected on the VAT invoice may have an impact on how to treat the supply of goods or services for VAT purposes. It is also important to note that the FTA has issued various Public Clarifications and VAT Guides to help hotels in determining the correct VAT treatment for certain transactions conducted by the hotels. Nonetheless, the hotel operators may still require careful interpretation and application of the VAT Laws based on the facts of each case. Private clarifications have been sought by various hotels already however, the decision issued only applies to each specific case for which the clarification was filed.

It has been quite some time since VAT was implemented in the UAE and the FTA Audits are going in full swing. One of the requisites of an FTA audit is information related to VAT returns along with supporting documents, contracts, policies, reconciliation of VAT returns and books of accounts etc. In terms of the VAT Laws, the businesses are required to furnish the documents within five working days from the date when the request is made.

The UAE VAT Laws provide that the FTA can impose excessive penalties up to a maximum of 300% of the taxable amount in case of VAT evasion or presence of malicious intention to avoid and reduce the VAT amount payable to the FTA.

Generally, this can occur due to lack of understanding of the VAT Laws or the ambiguous nature of transactions in the industry.

Nevertheless, the FTA has recently issued Cabinet Decision No. 49 of 2021 declaring substantially reduced penalties for taxpayers who are willing to voluntarily disclose errors and settle any pending VAT liabilities and 30% of unpaid penalties by 31st December 2021. Additionally, the Cabinet Decision effective from 28th of June 2021 has also redefined and reduced the penalties for other administrative errors which is good news for all taxpayers in the UAE.

Thus, it is now essential that the hotel operators are fully acquainted with the VAT Laws, as if once FTA Audit is initiated it will be difficult to 'adopt' all the VAT rules at one go. The hotels should be mindful of the fact that slight changes in the business transactions can lead to varying VAT outcomes.

Moreover, given the business complexity and the volume of business transactions, it takes a substantial amount of time to evaluate every single transaction and determine the appropriate VAT treatments. Therefore, it is advisable to initiate a VAT Health Check which would help to discover and rectify any errors, to prevent imposition of penalties in the future. Undoubtedly, this good practice will help to strike an equilibrium between the financial position of the hospitality industry in the UAE as well as economy of the UAE as a whole.



How Has the UAE Hotel Market Performed in the Past Year?

By: Armen Biberian - Director, Audit, GT Sharjah

The UAE has proven to be one of the leading countries in the world to cope with the Covid-19 pandemic repercussions and impact on the travel and tourism sector. It came as no surprise that the UAE tourism sector was among the least affected and fastest to recover around the world.

According to a recent article in Zawya, “the UAE suffered the least in terms of tourist traffic in 2020, where activity fell by just 45% which was the lowest drop in the world”. In fact, the UAE recorded the 2nd highest occupancy rate in the world in the year 2020, at 55% and sitting right after China. The Global rate dropped to a 37% low due to the pandemic.

With the variety of offerings that the hospitality industry had created, the UAE was well equipped to attract the local residents to travel within the country rather than to hassle with the travel abroad. Besides, the strict measures taken by the UAE to prevent the spread of the virus has allowed it to open up its borders relatively early, and became a safe destination for markets that were still struggling with lockdowns.


According to the World Travel and Tourism Council, the direct contribution of travel and tourism to the Middle East’s GDP was predicted to reach USD133.6 billion by 2028.

While this number could be argued to be too high, there is no doubt that the markets that will recover first and reopen their borders are the ones that will benefit the most, and the UAE is well on the right track. Indeed, the UAE was one of the best performing countries in hospitality and the Middle East was regarded as a “top performer globally”. In terms of average daily rates of hotels, Ras Al Khaimah alone recorded a 7% increase and Fujairah a 1% increase in its ADRs.

New year’s celebrations allowed hotels across Dubai to run average occupancy of around 76%. This is further proof that the UAE is also looking to diversify the various locations within the country and not only focus on Dubai and Abu Dhabi as the main hot spots.

According to reuters.com, as of May 2021, “The UAE has administered approx. 11 million doses of COVID vaccines which means it has vaccinated around 55% of the Country’s population”. UAE is now also taking further measures to ensure that it will be one of the first country’s in the world to reach 100% vaccination of the entire population.

If the UAE, with all its tourism offerings, proper management of the pandemic and fast vaccination rollout will not be one of the top performer of hospitality once travel returns back to normal, I doubt anyone else can.



Emerging Issues in Hotels

By: Sajjad Asif – Transformation Advisory Manager

& Syed Aqeel Abbas – Transformation Advisory Consultant

We take a closer look on some of the emerging issues the hotel industry is facing and what can be done to potentially deal with them. In this article we discuss the issues of:

1. Costing of Food & Beverage Items
2. Breakfast Packages
3. Menu Engineering
4. Workforce reduction due to pandemic
5. Payment Guarantees and Debt Recovery

Controlling Food & Beverage Costs

With costs of input materials i.e. ingredients on the rise, when the customers are looking to get value for money, it is important that whilst prices of menus are affordable to the guests, the operations still remain profitable to the hotel. A strong and comprehensive food costing exercise is necessary to ensure this. Our recent reviews have indicated that while top level management recognizes the issues, the detailed costing at operations levels is still not being carried out frequently. This has resulted in F&B Outlets being unable to adhere to their food cost ratio and thus, are facing losses or significantly reduced profits. Hotels could also benefit from carrying out a periodic profitability analysis on individual menu items sold.

Breakfast package Classification

Due to the pandemic, guests have been unwilling to physically visiting the restaurant specially for buffets. Consequently, significant number of guests do not visit the hotels' breakfast buffet despite it being included in the room price as a package. We have observed that hotels do not bifurcate their consumed and unconsumed package revenue.

While it's convenient to record all the package revenue as F&B Revenue irrespective of whether the service was actually received or not, it does not portray a fair picture. As per the guidance provided by Uniform System of Accounts for Lodging Industry (USALI), revenue pertaining to breakfast packages which are not consumed by the guests should be classified under Miscellaneous Income.

High amount of unconsumed revenue might be indicator of reduction in room revenue in the future as guests would not want a room with a higher rate due to breakfast package that they know they do not want to consume. To keep an eye out for such emerging risks, it is important to have some differentiate reporting of consumed and unconsumed package.

Lack of Menu Engineering

Increase in costs and price-sensitive customer base requires drastic measures for the restaurants to maintain or increase their profitability. One of the most important tools in Food & Beverages is Menu Engineering, exercise which helps restaurants to identify each menu item's profitability and popularity, as well as form a strategy to enhance and improve the overall success and sales of the F&B outlet.

Despite the importance, in recent engagements we have seen that medium sized restaurants are not conducting the Menu Engineering exercise at all or frequently enough. Revenue in the Food & Beverages segment is projected to reach US\$271m in 2021 as per the recently published report by Statista. It is very important for the F&B department to work on engineering their menus in such a way that it maximizes profitability by promoting their most profitable menu items.

Workforce Reduction Due to Pandemic

As things get back to normal and the hotels start to see the customers returning, there is a need to optimize the utilization of workforce which was reduced due to layoffs during the COVID19-related lockdowns.

We have seen hotels struggling to effectively use their workforce due to lack of detailed employee utilization plans which account for the employees' working hours, planned leaves and experience in areas other than their current positions. All these elements coupled with high expectations from guests upon their return to hotels has impacted the guest satisfaction as well as increased the stress level for existing employees in recent months.

Payment Guarantee & Debt Recovery Issues

After enduring a significant loss of business in the last 18 months, hotels seem to have taken an aggressive approach to gain more business using exceedingly flexible credit terms and payment guarantee related controls. It has been noted that in order to secure business or to cater the recurring guests, a lot of check-ins are made without securing payment guarantee for the entire stay or to cover extras. This approach poses a threat of having high amount of irrecoverable, unguaranteed debts in the hotels' financial statements. Consequently, the outstanding balances hike up which might need to eventually be written off in the future. The impact of this practice on the cashflows may be significant to the going concern of the hotels in some cases.





We caught up with HE Marwan Jassim Al Sarkal on a video call to discuss the secret to success, future of Sharjah's Tourism and the beauty of travel. Marwan Jasim Al Sarkal is the Executive Chairman of Sharjah Investment and Development Authority, also known as Shurooq and they have big plans for the future!

By:

Noelle Homsy – Associate Director, Hospitality Industry Lead

The Shurooq Development and Properties have performed amazingly well in the past year. What are the secrets behind the success?

When we talk about Shurooq and its investment strategy and portfolio, we manage to look at different sectors and to find the sector that really needs investments. So the diversity of creating a portfolio of real estate, tourism, logistics, transportation, and waste management has made the Shurooq portfolio one of the best. Even when we look at tourism related; we try to look at what makes Sharjah so special. So we have looked at the eco-tourism, we looked at heritage tourism, archeological tourism, and then how unique we want to be and create instead of making any sort of hotel, looking at the boutique hotel, looking at nudges rather than just the Massawa that everybody is looking at. And then when we looked at recycling, we looked at the recycling waste management. Then when we looked at real estate, looking at creating a housing project that looked at sustainability as a key.

So, whenever we looked at an investment opportunity, we looked at what was differentiated, what is the unique selling point in it and how can we be different than the norm.

What have you learned from the pandemic? How will these learnings affect your plans Sharjah's for future?

So, the pandemic accelerated many things, especially in technology. Technology is one of the drivers that made us overcome this economic crisis, I would say. So, for a lot of countries, it was a crisis because they were not prepared for it. And I think the United Arab Emirates managed to overcome it because they were way much prepared. Even the people living in the Emirates were prepared for this. And they were prepared in a way to adapt. And when we see how the education sector have moved from classroom to virtual classroom instantly without anybody interfering, it was a smooth flow. And I think this is one of the main reasons why the Emirates is so dynamic.

So, with every challenge you find, you find opportunities. And with those opportunities, if you act fast and you are ready for it, then you win the battle. And I think this is one of the things that we felt that in the United Arab Emirates, we managed to do it. But also, in Shurooq, when the pandemic hit, the whole tourism sector was affected and was impacted dramatically.

People were not able to travel, people were trapped in their homes. But with our unique properties having this exclusive offering, whether it's the Kingfisher Retreat or whether the boutique hotel, The Chedi, where the privacy is very important but also exclusivity. You're exclusive in that place, you're the only one in twenty tenants, you're only one of five rooms, then you can overcome anything when it comes to being at safe distance, for example. That's what Shurooq looks at. As long as you create the differentiation, you will always be better when it comes to any challenge.

That's what Shurooq looks at. As long as you create the differentiation, you will always be better when it comes to any challenge.

We know that traveling is one of your hobbies. How have your extensive travels around the world shaped who you are today and your contribution to Sharjah's positioning as a tourism destination?

I think we did a lot when we travel. We get to know a lot of cultures. We get to meet of people, whether it be travel for the sake of business, whether it's a conference or whether it's an exhibition or whether it's a road show, or if you even follow the pleasure of travel, you learn a lot from people. And as long as you're open to meeting people, to understand their needs, to understand how they think, the more international you become. I think one of the issues of the pandemic is inability to travel, but because of the super technology that we're using today, with this conference being online, we feel that we are still connected.

And I think this is one of the main reasons. But I can't wait to travel again to explore different countries, different places, different cuisines around the world and meeting different people. And that's the beauty of life is getting to know different cultures.

Now that travel is coming back to life, you're going to start attracting investors again to Sharjah. What you promise these potential investors who are interested to invest in developments in Sharjah?

One of the most important things about the United Arab Emirates, it's a safe haven. It's a place where people can actually come invest, enjoy their life and raise their kids here. The wife might find a job. The man can open a factory or open his business. It's a place that you can really feel at home. And the diversity of the Emirates having more than 200 nationalities makes it one of the unique places to actually come and live, invest, build and grow. And I think we're so proud to see the new laws that have been implemented in the Emirates that encourages people to come, whether you're a citizen that's been here for a long time, or whether you're coming new to the place, you will always be welcome.

In Sharjah, we have a lot of opportunities where we encourage investors to come and invest in logistics. We have three seaports in Sharjah. We encourage investors to come and look at the agricultural business, the aquaculture business, the tourism sector, the environment sector, whether it's recycling or energy or the education sector.

So, we encourage investors to look at sectors that has huge potential and there's still ways to develop them. And as I say, with the new laws, we are much more open to attract investors to come and invest in the United Arab Emirates.



How is Sharjah planning to compete or complement other destinations around the GCC when it comes to logistics?

Sharjah is the educational hub of the Emirates, it is the cultural hub of the Emirates. We have the museums. We have the universities. We are the SME hub of the region; I would say with many small and medium sized companies. We are the startup hub of the region. We're now focusing on research and technology and development where we're trying to take Sharjah to the next level. We want to be the research hub of the region.

We're also focusing on media, with the Sharjah Media City being one of the fastest growing media Freezones in the region. But I would say Sharjah is so unique as it has many cities, it has Khorfakkan, which next to the mountains.

You have Kalba sitting next to Oman on the Indian Ocean. You have Sharjah as the main emirate, but you also have the central region, and all of those cities within the Emirate of Sharjah have a huge potential for growth. Opportunities are there, try to find the right partners with you, come to Shurooq, come to the Sharjah FBI office and we will guide you. We will support you and make sure that your journey to invest in Sharjah is second to none.

Thank you Marwan Jasim Al Sarkal for your valuable time and insights on the exciting future for Sharjah Tourism. We are very much looking forward to visit!



Grant Thornton UAE aims to provide you with updates regarding the latest developments in the Hospitality industry within country.

For more details with respect to this alert or queries on other Hospitality issues, please contact the Hospitality Industry experts, whose details are given below.



George Stoyanov



Partner
Head of Advisory & Tax

 +971 4 388 9925
 george.stoyanov@ae.gt.com



Sajjad Asif

Manager,
Transformation Advisory

 +971 56 623 4899
 sajjad.asif@ae.gt.com

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Dubai

Rolex Tower, 23 Floor
Sheikh Zayed Road
PO Box 1620
Dubai, UAE

T +971 4 388 9925
F +971 4 388 9915

Abu Dhabi

Al Kamala Tower
Office 1101, 11 Floor
Zayed the 1st Street
Abu Dhabi, UAE

T +971 2 666 9750
F +971 2 666 9816

Abu Dhabi

Office 3414, 34 Floor
Al Maqam Tower
ADGM Square
Al Maryah Island
Abu Dhabi, UAE

F +971 2 666 9816

Sharjah

Al Bakr Tower
Office 305
7/9 Al Khan Street
Sharjah, UAE

T +971 6 525 9691
F +971 6 525 9690