100 Introduction

A Practical Approach

100.1 It is estimated that over 80% of all new restaurants fail or change hands within two years of opening. In addition, countless operations remain open without achieving adequate profitability. While product quality is one of the most important elements of a restaurant's success, operating a successful restaurant and bar requires more than just serving good food and drinks. In the authors' experience, the problems of many struggling restaurants can be traced to their lack of awareness of how to implement controls over operations and their inability to monitor their financial results. *PPC's Guide to Restaurants and Bars* focuses on the unique operational aspects of restaurants and bars and discusses developing simple, yet effective, controls to help restaurant owners/managers improve their operations and monitor their financial results.

Who This *Guide* Is For

100.2 This *Guide* is designed to be used by both CPAs who provide services to restaurant and bar clients and by restaurant owners and managers who are concerned with improving their establishment's operations.

100.3 **CPAs** Many CPA firms find that restaurant and bar clients can be an important part of their practice. Most CPAs have at least one restaurant client. In many cases, the only service provided is an annual income tax return. Some CPAs provide write-up, compilation, payroll and review services. This *Guide* provides the CPA the opportunity to offer the client many more services. The result is happier and more profitable clients. This *Guide* discusses basic services, but goes further to present, in a logical sequence, an extensive discussion of restaurant and bar operations and consulting services frequently provided. This approach allows practitioners to understand the important aspects of restaurant and bar operations and to recommend solutions to the operating problems experienced by their restaurant and bar clients. Helping clients better manage their operation allows CPAs to establish long-term client relationships.

100.4 **Restaurant Owners and Managers** Throughout this *Guide*, the authors provide recommendations on effective restaurant management. This guidance is developed with these important points in mind:

a. Restaurants are in the hospitality industry.

b. Restaurant managers are typically pressed for time.

c. Restaurant managers have both administrative and operational responsibilities.

d. Restaurant managers must have a strong working knowledge of controls and marketing to create sales with controlled costs.

100.5 The restaurant's first priority will be to give its patrons a pleasant dining experience. Any control that intrudes on a patron's enjoyment of the meal risks discouraging that patron's return.

100.6 Managing the day-to-day operations of the kitchen, dining, and bar areas is usually a full time job. Most managers have little time for performing extensive reviews and checks of controls.

100.7 The authors believe that the points outlined in paragraph 100.4 are important considerations in managing a restaurant. Any operating decision, whether it is a decision about choosing a cash register system or a decision about what method to use when setting menu prices, must be made with those points in mind. Consequently, the authors' recommendations contained in this *Guide* are intended to balance the desire for controlling the operation with (a) the requirements of customer satisfaction and (b) the time pressures facing most restaurant managers.

100.8 This *Guide* approaches restaurant management from the standpoint that the factors noted in paragraph 100.4 can be accommodated by establishing a system that allows managers to quickly focus on the critical aspects of the operation. This system is designed to provide critical information without burdening restaurant personnel with excessive recordkeeping or accounting responsibilities. The heart of the system is the weekly profit and loss report. The authors have developed a weekly report format that is simple to prepare and can normally be available to management within 24 hours after the end of the week. Regular review of this report allows managers and owners to identify operating trends, detect potential problems, and initiate corrective measures before minor problems become major ones.

Practice Aids Included in this Chapter

100.9 This chapter contains practice aids tailored to meet the needs of restaurant and bar operations. PPC's *Practice Aids—Restaurants and Bars* are Word and Excel versions of all forms contained in this chapter. They enhance productivity by being editable and including math capabilities. PPC's *Practice Aids—Restaurants and Bars* can be ordered by calling (800) 431-9025.

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101 Overview of Restaurant Operations

101.1 Typically, the word “restaurant” brings to mind an eating establishment where customers wait to be seated (sometimes in a bar area), are seated by a host or hostess, are served by a waiter, and choose from a menu. This *Guide* is written with just such a restaurant in mind. Consequently, it addresses the operations of restaurants that also have bar operations. Two distinctions are important, however. First, the advice in this *Guide* is valuable for virtually any type of food operation, regardless of whether it has a bar operation and regardless of its size or type. Second, although this *Guide* does not specifically refer to stand-alone bar operations such as taverns, much of the information relating to the bar operations of restaurants is also relevant and valuable to stand-alone bar operations. Throughout this *Guide*, the phrase *restaurant and bar* is used interchangeably with the term *restaurant*.

The Restaurant Industry

101.2 The restaurant industry is the segment of the food service industry that prepares and sells food to the general public. According to the National Restaurant Association 2014 Restaurant Industry Forecast, the restaurant industry's sales are projected to be $709.2 billion in 2015. [1] In 2015, there are 1 million locations generating 47% of the total food dollars spent. Restaurants provide employment for approximately 14 million people. Restaurants come in all sizes and varieties, ranging from sidewalk hot dog vendors to elegant five-star restaurants. Despite this variety, most restaurants share certain common features. This section discusses both the factors that are common to most restaurants and the factors that distinguish one restaurant from another.

101.3 **2015 Update** Based on figures from the Bureau of Labor Statistics, the National Restaurant Association reports that for the 12 months through May 2015, full service restaurant employment increased 3.3%. This figure is greater than gains registered in 2014. Quick service restaurant employment increased 3.7%. Employment through May 2015 in the snack and nonalcoholic beverage (coffee, donuts, ice cream) segment increased 7.4%, placing this segment's employment growth above 5% for the fourth consecutive year. However, the restaurant industry continues to be challenged by rising food costs. According to the U.S. Department of Agriculture, prices on food away from home increased 3% in the 12 months ended June 2015. The greatest increases were due to the price of eggs and beef (21.8% and 10.9%, respectively), while pork prices decreased by 7%.[2]

At the present time, the major concerns for the restaurant industry seem to be the continuing rise in food costs, implementing the Affordable Care Act, credit card fraud, and minimum wage increases. In the last year, more than half the states increased or are planning to increase their minimum wage. The highest state minimum wage is in Washington, D.C., at $10.50. In addition many cities, including Seattle, San Francisco, and Los Angeles, are phasing in the $15.00 minimum wage. Some smaller cities have also increased the minimum wage to $15.00, and in many large cities the $15.00 is pending.

Types of Restaurants

101.4 Although restaurants share many of the same traits, it is often useful to understand the differences between various types of operations. Procedures and controls will often vary depending on the type of restaurant. In addition, the type of restaurant will often dictate inventory levels and staffing needs. Some of the factors that differentiate one type of restaurant from another are:

a. Concept.

b. Level of service.

c. Menu prices and selection.

d. Whether alcoholic beverages are served.

101.5 **Concept** A restaurant's concept, or *theme*, is essentially the image that it wants to convey to the public. Some of the elements that define a concept include:

a. *Menu.* The type and variety of the food to be served (i.e., Mexican, Italian, steak, seafood, etc.) is probably the most important element of a restaurant's concept.

b. *Atmosphere.* A restaurant's ambiance, such as formal or casual, is also an important part of its concept. Atmosphere is reflected throughout the restaurant by its furnishings, dishes, glassware, servers' uniforms, menu, and by the general attitude of the managers and staff.

c. *Prices.* The prices charged by a restaurant are partially dictated by its menu selection and atmosphere. (Lately, the increased cost of wholesale foods has become a significant factor in the prices charged.) Other factors also influence menu prices, though. One of the more influential factors is the prices charged by competitors.

d. *Target Customers.* The target customers (e.g., young professionals, families, or senior citizens) will significantly affect a restaurant's choices of menu, atmosphere, and prices. Different types of customers will have different preferences, and the choices of menu, atmosphere, and prices are generally made with the idea of attracting a particular type of customer.

101.6 In summary, a restaurant's concept defines how the restaurant sees itself and how it wants to be perceived by potential customers. Although concept encompasses more than the menu, most concepts are described in terms of the type of food served (e.g., a Mexican restaurant, a seafood restaurant, or a steak house). It should be noted however that this description is merely a quick way to describe a restaurant operation. Few restaurants limit themselves to their described menu. For example, most steak houses offer a limited choice of other entrees for those patrons who do not care for steak.

101.7 **Level of Service** The level of service provided to diners can vary considerably. Generally, levels of service can be grouped into the following categories:

a. *Full Table Service.* Restaurants in this category employ servers to take and serve the order. Often, additional employees (called bussers) are hired to help the servers clear the tables.

b. *No Table Service.* These restaurants do not employ servers. Customers place their own orders, pick up their own orders, and often bus their own tables. Although seating may be available, some “no table service” restaurants are operated strictly as take-out operations. Fast food restaurants and cafeterias are examples of restaurants that provide no (or limited) table service.

101.8 Also, the level of service is often dictated by the concept. For example, an elegant five-star restaurant concept requires a relatively high level of service. However, many concepts can be successfully established with either of the levels of service previously described.

101.9 **Menu Range** Menu range refers to the variety of menu offerings. A restaurant's menu range will generally fall into one of two categories:

a. *Full Menu.* Restaurants in this category offer a wide variety of menu choices. They typically offer choices of appetizers, entrees, salads, and desserts. Often they will also offer a choice of lighter meals such as salads or sandwiches. In addition, most full menu restaurants serve alcoholic beverages and have full table service.

b. *Limited Menu.* Limited menu establishments restrict their offerings to a fairly narrow selection. Examples are operations that serve only sandwiches or only hamburgers. Restaurants without table service, such as fast food operations, often fall into this category. However, there are also limited menu restaurants that provide full table service.

101.10 **Whether Alcoholic Beverages Are Served** Whether a restaurant serves alcoholic beverages is often determined by the level of service it provides. For example, most patrons expect full table service restaurants to offer alcoholic beverages. Local regulations and zoning laws can also impact this decision.

Operating Characteristics of Restaurants

101.11 To effectively manage a restaurant, or to provide consulting advice to a restaurant client, the manager or CPA must have a good understanding of how a restaurant operates. In many ways, the operating characteristics of restaurants are similar to those of most small businesses. However, there are certain things that make restaurants unique, and an understanding of them is important for both the restaurant manager and the CPA. The following are some of the operating characteristics that are common to most restaurants.

a. *High Potential for Theft and Abuse.* Restaurants are essentially cash businesses. Although most operations accept credit cards, a significant portion of the day's receipts are usually in currency. In addition, the operation's inventory is edible and highly portable. These factors, coupled with the fact that restaurant employees tend to be low paid and change jobs frequently, mean that there is a high risk of theft.

b. *Lack of Segregation of Duties.* Ordinarily, a shortage of responsible restaurant employees makes segregation of cash handling and reporting duties difficult. This is especially true in the bar area where the bartender often takes the order, fills the order, and receives payment.

c. *Large Volume of Transactions.* Daily transactions, even in small restaurants, can number in the hundreds. Also, the bulk of these transactions is often concentrated in a relatively short period of time, such as lunch or dinner. The sheer number of these transactions makes any kind of individual monitoring impractical.

d. *Narrow Profit Margins.* Generally, food operations are characterized by low profit margins. For example, in the authors' experience, pretax profit of a full menu, full table service restaurant typically ranges between 4% and 10% of sales. Small profit margins, coupled with the high volume of transactions noted previously, mean that small changes in a restaurant's food, alcoholic beverages, or labor costs can have a material impact on its profitability. To effectively control costs and maintain adequate profit margins, owners and managers need timely and accurate financial information.

e. *Competitive Environment.* Restaurants often face intense competition. This competition can come from well-capitalized national chains, high profile franchises, and/or small local operations.

f. *Perishability of Inventory.* Restaurants deal with perishable inventory. Unlike retail stores, for example, where products that do not sell at full price can be discounted to cost and sold at a break-even price, a restaurant's food inventory not sold within a couple of days must be thrown out. Therefore, careful inventory management is an essential part of effective restaurant operations.

101.12 The combination of these factors highlights the need to develop cost-effective systems and procedures that result in the ability to monitor operating trends and identify problems.

What Is a “Typical” Restaurant?

101.13 The diversity among restaurants makes it difficult to identify a “typical” restaurant. In fact, due to this variety, it is often difficult to make meaningful comparisons between different restaurants. For the purpose of this *Guide*, a “typical” restaurant is assumed to:

a. Be independently owned (i.e., not part of a chain or other multi-unit operation).

b. Have an informal concept designed to cater to families.

c. Offer full table service.

d. Carry a full menu.

e. Serve alcoholic beverages.

f. Have a general manager who oversees day-to-day operations.

101.14 For the most part, the accounting system that would be appropriate for this type of restaurant and the operating problems faced by this type of restaurant would be common to other types of restaurants. However, when warranted, the *Guide* also describes how the operations of other types of restaurants result in different approaches for dealing with various issues.

101.15 The types of restaurants described beginning at paragraph 101.4 are generally referred to as commercial restaurants. Noncommercial restaurant services, often referred to as institutional feeding, are a $53.4 billion industry. Noncommercial restaurant services include food services in hospitals, nursing homes, the military, large company cafeterias, prisons, schools, colleges, and churches. Characteristics of noncommercial restaurant services include preparing large quantities of food to serve at predetermined times. The basic controls discussed in this *Guide* are the same for both commercial restaurants and noncommercial restaurant services. A notable difference is the budgeted prime cost. (Prime costs are discussed in section 303.) For profitable commercial restaurants, prime cost percentages range between 63% and 68%. In noncommercial restaurant operations, the targeted prime cost percentage is approximately 90% to 100% which covers the costs of goods sold, labor, and related labor costs.

Why Restaurants Fail

101.16 The high mortality rate of restaurants is well documented, and in some cases, preventable. The authors have developed a list of the primary reasons for restaurant failure, which is presented on Exhibit 1-1. As can be seen from the exhibit, implementing the controls and methods described in this *Guide* would prevent many of the problems that lead to a restaurant's demise.

Exhibit 1-1

Reasons for Restaurant Failure

1. Lack of equity funding and poor market positioning.

2. Lack of experience in restaurant business.

3. Poor business sense.

4. Excessive purchase price or renovation costs.

5. Lack of daily financial controls.

6. Failure to monitor prime costs (that is, the cost of food, beverages, and labor).

7. Unrealistic lease expense and duration.

8. Inadequate control of food and beverage costs.

9. Ineffective use of menu analysis in determining profitability.

10. Lack of budgeting practices.

11. Lack of portion control.

12. Theft.

13. Misdirected marketing programs.

14. Poor food quality.

15. Poor location.

16. Poor kitchen layout and design requiring additional workers.

17. Excessive, expensive, unusable equipment.

18. Poor service.

19. Lack of cleanliness.

20. Improper pricing of menu.

21. Economic factors.

22. Lack of general business acumen by owners who also do not hire adequate back office support (that is, a knowledgeable accountant and bookkeeper).

101.17 The discussion beginning at paragraph 102.23 pulls together the top ten controls or ideas in this *Guide* that can increase a restaurant's profits.

Managing Revenue and Costs during an Economic Slowdown

101.18 During periods of economic slowdown, recessions, or during an adverse part of normal business cycles, many restaurants face reduced revenues as consumers choose to eat out less. Additionally, inventory and supplies costs are increasing further decreasing the restaurant's profits. Restaurateurs must make adjustments or face incurring losses or closure of their restaurant.

101.19 While there are no easy answers or remedies to these problems, certain steps can be taken to preclude failure. The potential solutions will depend on the type of restaurant and its location. Some of the variables that impact the solution include whether the restaurant is located in a distressed area, such as one experiencing high unemployment or closure of key businesses; price range of menu; dining space available for banquets; kitchen space and refrigeration available for catering; availability of part-time help for catering functions; purveyors willingness to accommodate changes; competition; and economic level of patrons within a reasonable radius of the restaurant.

101.20 Keep in mind that what seems to work at one restaurant will not necessarily be successful at another location. This is even true for mini chains within a large city having three or four locations.

The change that may be successful at one location may fail for unknown reasons at another location. When implementing changes, the results should be closely monitored so that additional changes can be implemented if the desired results are not achieved.

101.21 The following are some potential solutions currently being used by restaurant owners and managers. Those solutions could be tested at different locations to increase profits. The potential solutions discussed usually have low implementation costs and are fairly easy to implement. Some of the suggestions are discussed in more detail in other sections of the *Guide*. Restaurant owners and managers should also review the key ideas and controls to increase profits discussed beginning at paragraph 102.23.

Cost Controls

101.22 **Modification of Portions** To increase profits, a restaurant might consider decreasing the portions of higher-cost items and increasing the portions of lower-cost items. (Portion costs are further discussed in Chapter 5.) For example, a restaurant might decrease the portion of fish or meat by one ounce and increase the portion of side dishes by one ounce. Exhibit 1-2 provides an example of how profits could be increased through the modification of portions.

Exhibit 1-2

Increase Profits by Modification of Portions

Assume the example menu item consists of a filet with two side dishes, i.e., vegetable, fries, or cole slaw. The cost of filet is $16.95 per lb or $1.06 per ounce and the side dishes cost an average of $.50 per ounce. The menu price is $23.95.

Item	Size	Cost—Larger Portion of the Filet	Size	Cost—Larger Portion of Side Dishes
Filet	8 ounce	$ 8.48	7 ounce	$ 7.42
Side Dishes	6 ounce	3.00	7 ounce	3.50
Total Cost		$ 11.48		$ 10.92
Food Cost as a Percentage of the Menu Price		47.9%		45.6%

Decreasing the portion of filets and increasing the portion of side dishes reduces the meal cost by 2.3% or $.56. If the restaurant sold 200 of those meals a day at the average reduction of $.56 per meal, the daily cost savings would be $112 or an annual cost savings of $40,880. To further increase profits, the restaurant could decrease only the portion of the filet and not increase the portion of side dishes resulting in a daily and annual cost savings of $212 and $77,380, respectfully. In that situation, the restaurant could use a slightly smaller plate so the customer would not notice the reduced portions.

101.23 **Reduction of the Number of Items on the Menu** Generally, it is more expensive to offer an extensive menu versus a smaller menu. To reduce costs and increase profits, a restaurant could consider decreasing the number of items on its regular menu and increasing the number of daily specials. For example, if the restaurant's present menu has 10-20 entrees with two daily specials, consider reducing entrees to 8-10 and offering 5-6 daily specials. If the menu is printed on location, the restaurant can change the menu frequently to adjust to customer demands and availability of ingredients.

101.24 Advantages of reducing the number of items on the menu and increasing daily specials include—

- Reduction of inventory carrying costs.

- Fresher products due to the reduction in inventory.

- Lower seasonal prices.

- Lower prices when the restaurant is able to take advantage of overstocks (and lower prices) from purveyors.

- Increase in the quality of meals.

- Increased variety to patrons.

101.25 The restaurant should consider leaving the top three to five favorite items on the menu with each change. The Menu Evaluation Form, discussed beginning at paragraph 603.5, can be used to determine menu selection because it assists in quickly identifying those items that are both profitable and popular. In some instances, when monitoring the daily specials by profitability and popularity, the restaurant will find some daily specials that will become *regulars* on new menu changes. Menu selection, pricing, and evaluation is discussed further in Chapter 6.

101.26 Restaurants should use caution when reducing the number of items on the menu—especially if the restaurant has a reputation for a large menu. A large reduction of menu entrees could be detrimental.

101.27 **Renegotiate Lease Terms** With the economy doing somewhat better, it is getting more difficult to renegotiate lease agreements. However, restaurants may be able to forestall annual rent increases, due in part to a reduced assessed value of property, making for lower property taxes and insurance costs. To determine if this renegotiation is possible, the restaurateur should consider the landlord's position. Some of the factors the landlord will consider include—

- The history of the tenant in meeting his or her obligations, including making rental payments on time and fulfilling other terms of the lease.
- The quality and popularity of the restaurant.
- How the present rental rate compares to similar locations in the area.
- How easily the landlord could find another tenant for the current rental rate and terms.
- Any requirements by other tenants for the landlord to lease space in the vicinity to a restaurant.
- The impact of a decrease in rental rates on the landlord's cash flow and financial obligations.
- The personal relationship between the landlord and the tenant.

101.28 After considering the landlord's position, the restaurateur might considering asking the landlord to—

- Reduce the monthly rent by an amount that would provide a 6% to 8% rental factor based on sales. This could be a temporary or permanent reduction.
- Extend the lease term at the reduced rate.

• Modify the negotiated reduction in rental rate once the economic slowdown has passed.

• Provide rental concessions using a combination of the above items.

101.29 The authors recommend that the restaurateur not provide any additional personal guarantees, agree to a reduction in space that would limit the restaurant's chances for success, limit caps on annual rental adjustment rates, or agree to any concessions regarding concept, menu, pricing, or sales of alcoholic beverages. Additionally, if the original lease permits the restaurant to use the rental space for purposes other than a restaurant, that clause should not be conceded.

101.30 **Reduction of Complimentary Items** Considerable savings can be made by asking the customer if they would like complimentary items, such as rolls and butter, before automatically serving those items. Some patrons who are concerned about their diet do not want to be tempted by having rolls and butter served to them before their entree is served. In the author's experience when using this strategy, the cost for rolls and butter have decreased by approximately 33% with no adverse reaction from the customers.

101.31 **Monitor Times of Sales** Managers should monitor sales by the hour to determine proper opening and closing times for each meal period. Sometimes, opening 30 minutes later or closing 30 minutes earlier will provide substantial labor cost savings with only a minimal reduction in sales.

101.32 **Monitor Employee Meals** In many restaurants, employee meals are provided free to the employee for the convenience of the employer. Restaurant managers should monitor the amount of employee meals that are provided to ensure there is a business purpose for the meal.

101.33 **Customer and Employee Theft** There are two basic kinds of customer theft—leaving without paying the bill and stealing property (such as place settings, ash trays, decorations, or other items from the restaurant). The most effective way to prevent such problems is to ensure that servers are present at their stations as much as possible. It also helps if the restaurant layout is open, allowing observation of customers by all restaurant personnel. Customer theft is discussed beginning at paragraph 409.19 and employee theft is discussed in Chapter 15.

101.34 **Monitor Staffing** Blind staffing is a scheduling method that ignores the restaurant's current staffing levels. Instead, it is designed to determine how many people are actually needed to operate the restaurant, rather than how many people have traditionally been scheduled. The blind staffing scheduling technique can be used to determine whether or not labor reductions can be made. As an example, assume double staffing occurs for one hour per day by an employee with total labor costs of $12.50 per hour. If that double staffing is eliminated, the annual savings to the restaurant is $4,563. Greater savings would occur when applied to higher paid employees such as cooks, sous chefs, etc. Section 801 discusses scheduling in detail.

101.35 **Purchase Inventory and Supplies from Retail Outlets** Some restaurants (usually independents or mini chains) are buying and picking up some of their food and supplies from large retail outlets. There can be considerable savings on produce, paper goods, and cleaning supplies at those outlets versus having them delivered by a restaurant supplier. The savings is greater when the owner does the shopping (versus sending employees who must be paid wages and benefits for this time). However, shopping can take up significant time that might be better spent implementing some of the controls outlined in this *Guide*.

101.36 **Cleanliness and Service** Restaurant managers should continue to emphasize to employees the importance of cleanliness and prompt service. When competitors are cutting costs, they often neglect these two very important areas.

Promotions

101.37 Sales promotions can take a variety of forms, ranging from advertising or public relations efforts that are designed to increase the public's awareness of the restaurant, to promotions such as coupons that provide patrons with a direct financial incentive to dine at the establishment. Regardless of the marketing approach, the restaurant's objective is the same—increasing sales and profits. If properly designed, sales promotions can be an extremely effective way to build restaurant traffic. However, a badly designed program can result in negative financial consequences. Section 1003 discusses sales promotions in detail. Some sales promotions that have been successful include promoting—

• **Take Out.** The number of diners who order take-out is on the rise and is a great way to increase sales. Restaurant managers and servers should also consider encouraging diners to order additional items such as desserts or snacks to be enjoyed later in the evening or the following day at the patron's home.

• **Banquets.** Banquets can be a source of substantial additional sales and profits to a restaurant. Banquets are discussed in detail in section 1002.

• **Off-location Catering.** Off-location catering requires adequate space, refrigeration, and the ability to retain part-time labor. Adding a promotion for catering on the restaurant's menu is an inexpensive way to advertise this service. Catering is generally very profitable, even more so than banquets, because it is not usually necessary to hire additional labor for small catering functions. The regular labor staff is generally adequate to accommodate the catering function. If a delivery person or set-up personnel are needed at the client's location, the additional labor cost should be reimbursed to the restaurant by the client.

• **Birthday dinners.** Offering a free meal on a customer's birthday may be a way to increase sales.

• **Wine Tasting Parties.** Wine tasting parties need the right type of restaurant to be successful. Often the wine distributors will pay for the cost of the wine.

• **Offering Popular Items at Cost.** The goal of this type of promotion is to sell substantially more alcoholic beverages and offer popular items such as shrimp, oysters, or, occasionally, small lobster at cost.

• **Family Nights.** Some family restaurants bring in inexpensive entertainment one day a week and have found this promotion to be profitable.

• **Healthy Menu.** Almost all of the chains and independent restaurants have added some form of healthy menu items. Additionally, some restaurants are successfully increasing sales by upgrading children's menus to include healthier options.

• **Combo Meals.** Combo meals are combinations of frequently purchased items, such as a hamburger, beverage, and french fries that are sold at a lower price point than the amount charged for the three items individually. Some full service restaurants have implemented a similar concept by charging significantly less for a meal consisting of an appetizer, salad, main course, and a dessert than if the items were ordered a la carte.

• **Smaller Portion Option.** Some restaurants have started offering smaller portions on appetizers, salads, and even main entrees. This gives the customer more price options and also entices the customer who is not looking for a big meal.

• **Social Media Marketing.** Some restaurants have found that using Facebook, Twitter, Groupon, and LivingSocial have been successful in bringing in new customers, especially the younger crowd. See the discussion beginning at paragraph 1003.10.

101.38 **Personal Relationships** Restaurant key personnel can build on their personal relationships to obtain additional business. It is common for restaurants to give coupons for free meals to the managers of sports facilities, golf clubs, and fraternal organizations that don't have their own kitchens (such as Lions Club). Alternatively, these coupons can be coded with the name of the organization to offer a 5% to 10% discount rebate to either themselves or a designated charitable organization.

101.39 The restaurant should consider developing an aggressive marketing program by maintaining a data base for names, addresses, email addresses, and phone numbers of patrons to advise them of special promotions, catering, and the banquet capabilities of the restaurant. Chapter 10 of this *Guide* discusses marketing programs.

101.40 As previously mentioned, restaurant owners and managers must analyze their restaurant's capabilities to determine the most effective way to maintain or increase sales and to decrease costs in a weak economy. No one method of using effective controls or promotions will guarantee success or will have the same results in every restaurant. Owners and managers should monitor financial results and react quickly to decreasing profits to minimize losses.

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[1] For more information, see **www.restaurant.org/research/facts**.

[2] For more information, see **www.ers.usda.gov/data-products**. Another helpful source is **www.restaurant.org/News-Research/Research/Facts-at-a-Glance**.

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102 Overview of This *Guide*

102.1 This *Guide* is organized to provide CPAs and restaurateurs with a logical approach to understanding restaurant operations and improving operational efficiency and profitability. Each chapter includes recommendations, practice aids, and forms designed with those goals in mind. The following paragraphs provide a brief summary by chapter of the topics discussed.

Form of Entity and Other Tax Considerations

102.2 The selection of a form of entity, though it may not affect the day-to-day operations of the restaurant, is a critical aspect of tax planning. The form of entity will determine the tax status of both the restaurant and its owner(s). It will also influence retirement planning strategies for the restaurant owner(s). Most restaurants are established as one of the following types of entities:

a. Proprietorship.

b. General or limited partnership (GP or LP).

c. Limited liability company (LLC).

d. C corporation.

e. S corporation.

102.3 Chapter 2 discusses the various considerations when choosing the form of entity for a restaurant. It also discusses selecting a tax year. The choice of tax year is limited by the tax laws. Both the eligibility requirements and the mechanics of electing a tax year are discussed.

102.4 Also, Chapter 2 discusses the income tax rules dealing with uniform capitalization as they apply to restaurant inventories. This is an area that can be quite complex and time-consuming, and if ignored, can invite IRS scrutiny. The chapter presents a case study and provides a practical method for complying with the uniform capitalization rules. Finally, the chapter discusses income tax credits for employers.

Management Information Systems

102.5 Chapter 3 presents an effective, but practical, system for controlling transactions, accumulating management data, and developing weekly reports that can be used to monitor restaurant operations. This chapter, and the chapters that follow, stress the importance of using a weekly profit and loss report. This report is designed so that information can be posted to the report each day so that the completed report is available to restaurant management within 24 hours after the week ends. The report provides management with a quick picture of weekly results, thus permitting the quick identification and correction of any operational problems. Illustrative weekly reports, presenting different levels of detail, are also provided. Finally, this chapter illustrates a chart of accounts that can be expanded as the restaurant grows.

The Revenue Cycle

102.6 Similar to most businesses, accurate and timely recording of sales is a critical function of an effective restaurant management information system. For many restaurants, the cash register is the basis for establishing controls over revenues. Many cash register systems also have the ability to accumulate data that allows detailed analysis of restaurant sales. Chapter 4 discusses procedures found in most restaurants. Those procedures ensure that sales data is recorded accurately and controlled from the point that the order is taken to the deposit of the day's receipts.

Portion Costs and Controls

102.7 Controlling the size of portions that are served is one of the most important aspects of controlling costs in a restaurant. Restaurants must ensure that portion sizes meet customer expectations, but they must also ensure that excessive portions are not served. Controlling and monitoring portions involves two steps. First, a standard portion size for each menu item is established and communicated to the kitchen staff. Second, the cost of each menu item is determined. These costs can then be used to set menu prices, establish target food and beverage costs, and monitor operating results. Chapter 5 provides an overview of some of the considerations that go into establishing standard portions. The chapter then discusses some techniques for establishing costs for menu items and controlling portions. Finally, this chapter addresses some of the unique problems of portion controls in bar operations and buffets.

Menu Selection, Pricing, and Evaluation

102.8 Setting a competitive price for each menu item that covers the restaurant's costs and provides an adequate profit margin is a challenge for all restaurants. Many restaurants reprint menus only once or twice a year. For those restaurants, setting an adequate price is especially important since cost increases can cause profits to suffer until a new menu is printed. Chapter 6 discusses three methods for pricing menu items. This chapter also describes a method for evaluating the profitability and popularity of menu items.

Purchasing and Inventories

102.9 Restaurants that fail to establish effective controls over the purchasing of, and access to, inventories often find that their profits suffer due to inventory losses. Chapter 7 presents a method for setting optimal inventory levels. Procedures that improve controls over purchasing and receiving activities, but do not hamper the kitchen activities, are also described. Finally, this chapter discusses a method for efficiently performing physical inventory counts, as well as ways to monitor and analyze inventory use.

Personnel

102.10 Personnel costs are one of the largest expenses for most restaurants. Failure to properly schedule and monitor employee hours can result in significant unnecessary expenses, including incurring unnecessary overtime expenses. Chapter 8 describes a method for projecting an optimal staff level as the starting point in scheduling and monitoring hours worked.

102.11 Chapter 8 also addresses the relevant aspects of the Fair Labor Standards Act (FLSA), which mandates that certain employees be paid a minimum wage. Some of the topics covered include:

a. Businesses covered by the FLSA.

b. Minimum wages and overtime pay.

c. Reducing the minimum wage paid to servers by taking the tip credit.

d. Child labor laws.

e. Penalties for violating the FLSA.

f. Health Care Reform Acts.

102.12 Chapter 8 also discusses a system for documenting compliance with the Immigration Reform and Control Act of 1986 (as amended), the Family and Medical Leave Act, the new-hire reporting requirements, and employee orientation and incentive programs.

Tip Reporting and Allocation

102.13 One of the most troublesome aspects of personnel management for many restaurateurs is tracking employee tips. The IRS requires that employees report their tips to their employer. If the restaurant is considered a “large food and beverage establishment,” as defined by the IRS, it must allocate tip income to those tipped employees who reported less than a certain level of tip income. Chapter 9 discusses these requirements and the accepted methods of allocating tips to employees. The chapter also discusses IRS efforts to force employers to encourage employee tip reporting. This chapter shows how, by being proactive, the accountant can protect the client even when tip reporting is unrealistic. Additionally, the chapter addresses the provisions of the tax code that permit a tax credit for FICA taxes paid by the employer related to reported tips.

Analyzing Restaurant Operations

102.14 Chapter 10 shows how the information provided by the accounting system can be summarized and utilized for analyzing profitability and identifying trends. This chapter provides guidance on using the weekly profit and loss reports (described in Chapter 3) to analyze operating results. It also describes the ratios that are commonly used to monitor revenue, inventory use, personnel expenses, and other aspects of restaurant operations. The chapter also discusses some of the ways that restaurateurs can evaluate the effectiveness of marketing programs. The appendixes to the chapter include restaurant review forms that restaurateurs or accountants can use to review restaurant operations.

Starting or Acquiring a Restaurant

102.15 Chapter 11 presents a logical approach to evaluating the decision to open a new restaurant or acquire an existing operation. The chapter also addresses evaluating franchise operations and obtaining SBA guaranteed loans.

Financial Statement Presentation

102.16 Chapter 12 discusses some of the accounting and financial statement presentation issues confronting restaurants, including financial statement format and disclosures. The appendixes to this chapter contain sample financial statements for various types of restaurants and a disclosure checklist to be used when income tax basis financial statements are prepared.

Automating Restaurant Operations

102.17 Most of the forms and procedures described in this *Guide* can be successfully used in manual systems. However, the authors believe that most restaurants would benefit from using a sophisticated cash register system (point of sale system). Chapter 13 describes some of the aspects of automating restaurant operations including:

a. Point of sale systems.

b. Timekeeping systems.

c. Bar control systems.

d. Back office computers.

e. Restaurant software.

f. Websites for restaurants.

102.18 Restaurateurs frequently wonder which general ledger software can be most efficiently and effectively used. Many have selected QuickBooks® because of its low selling price and perceived ease of use. Once a restaurateur begins to use QuickBooks®, questions often arise as to how to make it more efficient. *PPC's QuickBooks® Solutions: A Problem-solving Guide for Accounting Professionals* provides guidance on general QuickBooks® issues. It can be ordered by calling (800) 431-9025 or online at **tax.thomsonreuters.com**. Chapter 13 discusses some special issues when using QuickBooks® in a restaurant.

Consulting Services for a Restaurant

102.19 Chapter 14 includes guidance regarding consulting services an accountant might provide restaurant clients. It also discusses the professional standards applicable to consulting services.

Theft

102.20 As noted in Exhibit 1-1, employee theft is a reason many restaurants fail. Chapter 15 provides an overview of the common ways employees steal from a restaurant or bar and methods restaurants and bars can put in place to reduce the amount of employee theft.

Compilation and Review of Financial Statements

102.21 Chapter 16 discusses the CPA's responsibilities when compiling or reviewing restaurant or bar financial statements. Example engagement letters, a representation letter, and compilation and review reports are provided in the appendixes to the chapter.

Restaurant Operations Review Forms

102.22 The appendixes to Chapters 3-9 each include a Restaurant Operations Review Form. Each form consists of a list of questions that addresses the points covered in the applicable chapter. The purpose of these forms is to allow the manager or the CPA to review a particular area and identify ways to (a) better control and monitor the restaurant's operations and (b) improve the restaurant's profitability. The forms are designed so that each question is answered "Yes" or "No." "Yes" answers indicate that the restaurant's procedures follow the recommendations of this *Guide*. "No" answers indicate an area where improvements may be possible. In addition, a Preliminary Restaurant Assessment Form is provided in the appendix to Chapter 10. This form lists questions regarding each of the areas covered in Chapters 3-9. Responses to these questions can be evaluated and used to identify particular areas where the restaurant's operations can be improved. Once those areas are identified, the applicable Restaurant Operations Review Form(s) can be completed.

Key Ideas or Controls to Increase Profits in a Restaurant or Bar

102.23 This *Guide* focuses on the unique operational control aspects of restaurants and bars and discusses numerous simple, yet effective, ideas or controls to help restaurant owners and managers improve their operations and financial results. The discussion beginning at paragraph 101.18 addresses managing revenue and costs during an economic slowdown. Exhibit 1-3 pulls together the top 10 ideas and controls, references where in the *Guide* they are discussed, and provides a brief discussion of their benefits. In the authors' experience, implementing these ideas or key controls can potentially increase the restaurant's profits by 1%-10% of sales. Key controls are fully discussed in various parts of the *Guide*. These areas provide excellent opportunities for value-added consulting services and management recommendations.

Exhibit 1-3

Key Ideas or Controls to Increase Profits

Idea or Control	Reference in *Guide*	Benefit of Idea or Control
		Reviewing monthly financial statements allows dangerous trends to be detected more quickly than

		waiting for annual statements. Monthly statements verify that the weekly profit and loss statements are accurate. Individual departmental percentages, such as alcoholic beverage cost, can quickly identify trends such as employee theft.
1. Prepare monthly financial statements with comparison to prior month, prior year, and budget.	Section 1201	
2. Prepare weekly profit and loss statements on location by restaurant staff in a summarized format.	Section 303	Weekly statements make management instantly aware of problem areas so corrective action can be taken immediately. This financial knowledge motivates the staff to participate in adjustments and activities that create higher profits.
3. Cost the menu.	Chapter 5	When the cost of a menu item is known, an appropriate price can be established and consistent portion controls can be implemented.
4. Monitor and evaluate menu items.	Section 603	Menu engineering increases profits because a restaurant is able to look at its menu objectively, remove items that are not selling, and promote items with a higher profit margin.
5. Implement weekly inventory controls.	Section 705	With a weekly inventory process, slow-selling items and high-priced items are easier to track, employees are more honest when they see inventory taken, and weekly profit and loss statements are more accurate.
		Reviewing staffing needs,

6. Schedule labor efficiently.	Section 801	comparing those needs to sales, and determining optimal staffing levels all contribute to increased profits.
7. Implement controls in bars.	Section 505	Due to a lack of segregation of duties and a high volume of transactions, bars require unique controls in order to reduce theft and create a substantial profit center.
8. Establish employee incentive programs.	Section 808	Incentive programs can help improve employee commitment to efficient operations and result in increased profits.
9. Establish effective inventory purchasing and receiving.	Sections 701-703	Obtaining optimal inventory levels and implementing purchasing controls can increase a restaurant's profits.
10. Implement a point-of-sale system.	Chapter 13	Integrated point-of-sale systems help managers obtain needed information more quickly and accurately, thus contributing to more informed decision-making.

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