CHAPTER 5

INTERNAL CONTROL

INTRODUCTION

This chapter explains the objectives of internal control and discusses some of the reasons why internal control for hospitality operations is more difficult than for some other businesses.

Principles and procedures of internal control, such as implementing controls as preventative procedures, management's having an effective philosophy of control, and monitoring the control system are discussed and illustrated in sufficient detail to clarify their purpose in the following areas:

- establishing written control procedures and employment responsibilities to include selection and training of employees,
- maintaining adequate records and separating record keeping,
- asset control, limiting access to assets, conducting surprise checks, and dividing the responsibility for related transactions,
- rotating jobs, using machines for control, establishing standards, evaluating reports, using forms and reports, bonding of employees, and requiring mandatory vacations,
- using external audits, providing audit trails, numbering all control documents, and ensuring continuous system review,
- control of product inventory purchased for resale and the use of documents to aid in the control of product purchases,
- specific controls required for cash receipts and cash disbursements, including the use of a voucher system, and a bank reconcilitation, as an aspect of the control of cash disbursements,
- setting and evaluating performance standards with actual results are demonstrated with reference to the control over product cost of sales.

The chapter concludes by listing various methods of loss or fraud that could occur in such areas as delivery and receipt of merchandise, cash funds, accounts payable and payroll, food and beverage sales, and in the front office of a hotel or motel.

CHAPTER OBJECTIVES

After studying this chapter, the reader should be able to

1. Define the purpose of internal control.
2. Briefly describe the two basic requirements for good internal control.
3. Briefly discuss some of the basic principles of good internal control, such as defining job responsibilities, separating record keeping from control of assets, and dividing responsibilities for related tasks.
4. Explain how lapping can be used for fraudulent purposes.
5. List and briefly discuss each of the five control documents used to control purchases.
6. List and discuss the proper procedures for product storage and inventory control.
7. Describe how a petty cash fund operates.
8. Explain briefly how control can be established over cash receipts and cash disbursements.
9. List the procedures necessary to control payroll disbursements.
10. Complete a bank reconciliation.
11. Calculate a standard food or beverage cost from given information.

INTERNAL CONTROL

This text discusses management accounting and management control systems. Management uses the information provided by management accounting to make decisions and implement procedures to safeguard assets, control costs, increase sales revenue, and maximize profitability. The information provided must be accurate and current to assist managers in carrying out their responsibilities. Effective and efficient *internal control* policies and procedures apply to all facets of an establishment's operations, from purchases through sales. It

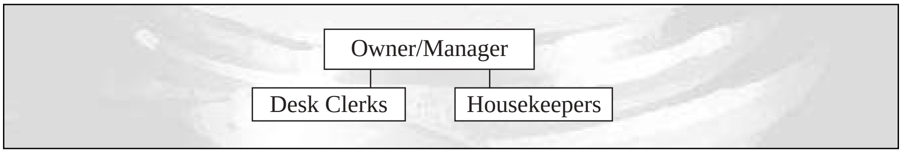

EXHIBIT 5.1

Organization Chart for 50-room Motel.

Source: M. Coltman, 1989. *Cost Control for the Hospitality Industry.* New York: John Wiley & Sons, Inc.

includes control of and accountability for cash receipts, cash disbursements, and the many other assets an organization has to conduct operations.

In a small, owner-operated business, such as an independent restaurant or small motel, very few internal controls are required because the control is carried out by the owner who is often always present and who handles all the cash coming in and the payments going out.

In larger establishments, one-person control is not feasible. In fact, in larger organizations it is necessary to organize operations into various departments and to draw up a plan of the organization, or an organization chart. Indeed, the organization chart itself is the foundation of a good internal control system. It establishes lines of communication and levels of authority and responsibility.

Organization charts for various types and sizes of hospitality establishments are illustrated in Exhibits 5.1 through Exhibit 5.5. In large establishments, as the organization charts show, lines of authority, responsibility, and communication become more complex. Therefore, the internal control system in a large establishment will also be more complex.

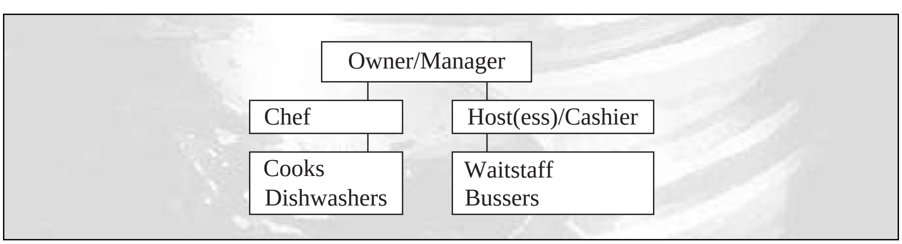

EXHIBIT 5.2

Organization Chart for 120-seat Coffee Shop.

Source: M. Coltman, 1989. *Cost Control for the Hospitality Industry.* New York: John Wiley & Sons, Inc.

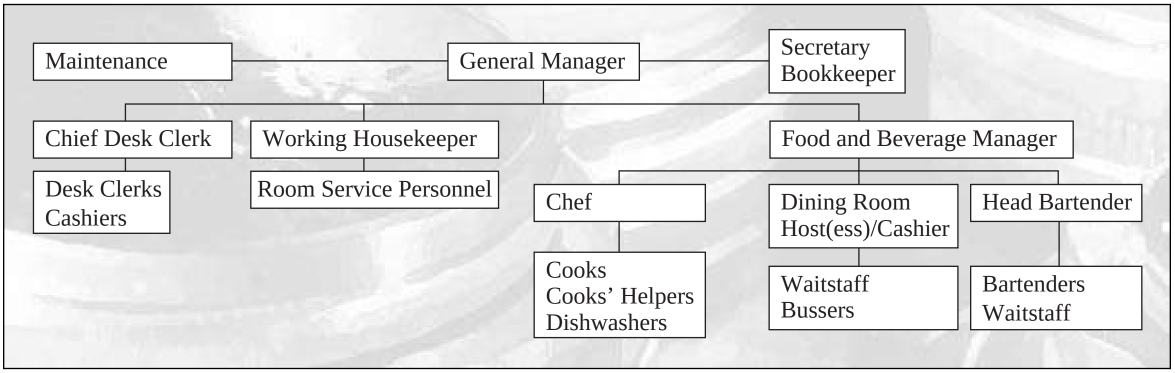

EXHIBIT 5.3

Organization Chart for 150-room Motor Lodge with 100-seat Dining Room and 80-seat Cocktail Lounge

Source: M. Coltman, 1989. *Cost Control for the Hospitality Industry.* New York: John Wiley & Sons, Inc.

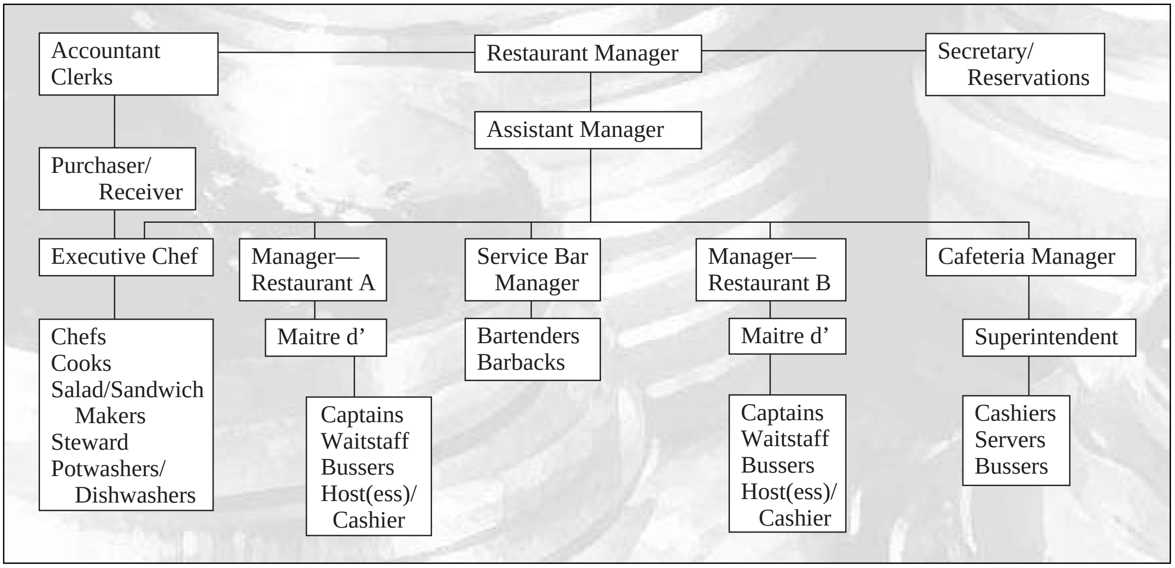

EXHIBIT 5.4

Organization Chart for a Restaurant Complex

Source: M. Coltman, 1989. *Cost Control for the Hospitality Industry.* New York: John Wiley & Sons, Inc.

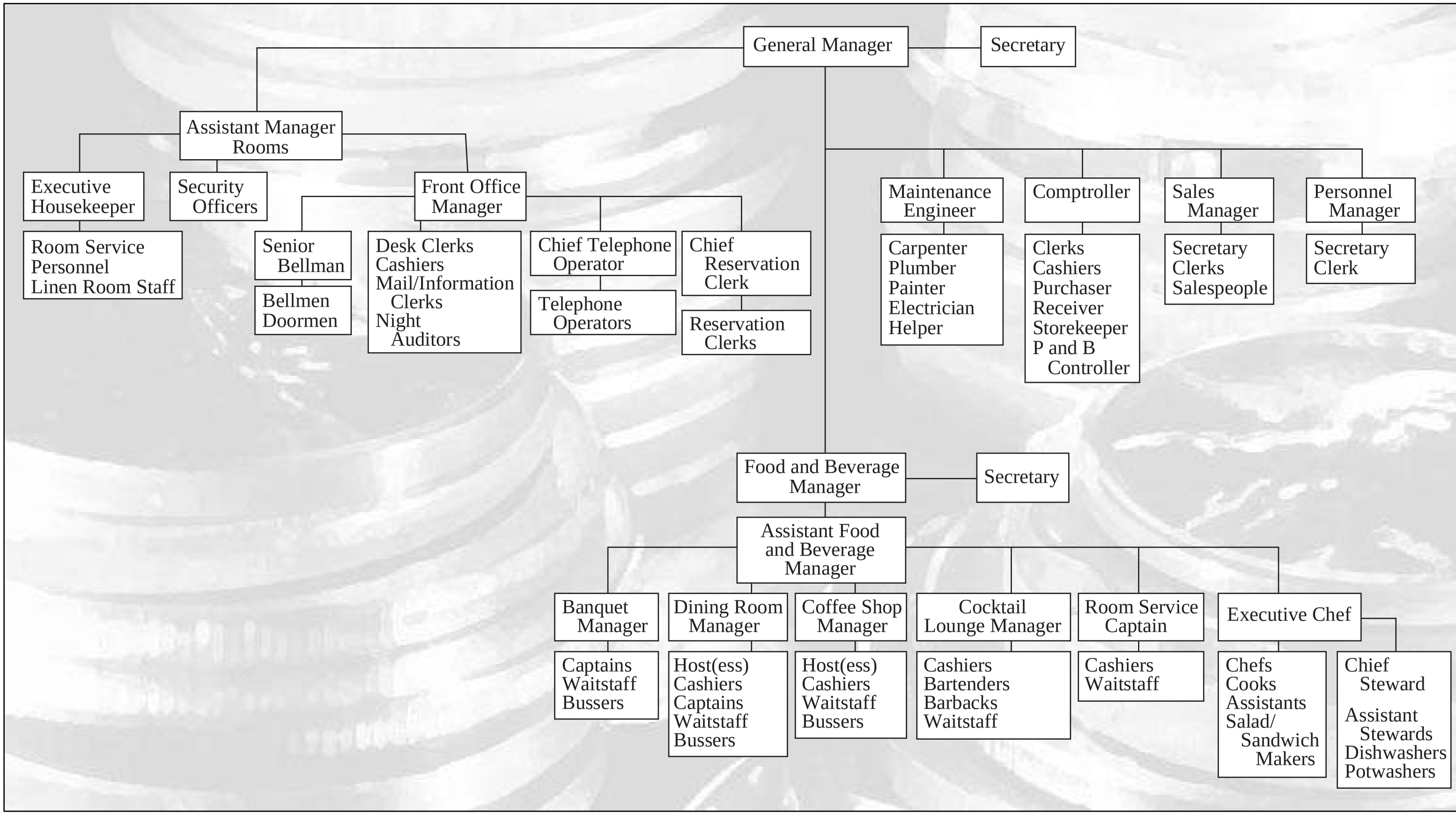

EXHIBIT 5.5

Organization Chart for a Very Large Hotel with Full Facilities

Source: M. Coltman, 1989. *Cost Control for the Hospitality Industry.* New York: John Wiley & Sons, Inc.

A system of internal control encompasses the following two broad requirements:

1. *Methods and procedures for the employees in the various job categories to follow.* Such procedures ensure that employees follow management policies, achieve operational efficiency, and protect assets from waste, theft, or fraud. Assets are defined as cash, accounts receivable, inventory, equipment, buildings, and land. The types of safeguards needed include the use of safes for holding large sums of cash, the use of locked storerooms for inventories of food and beverage, restricted access to locations where cash and products are stored, and maintenance of all equipment in efficient working order.
2. *Reliable forms and reports that will measure employee efficiency and effectiveness and lead to problem identification.* These reports provide information, usually of an accounting or financial nature, that, when analyzed, will identify problem areas. This information must be accurate and timely if it is to be useful. It must also be cost effective; in other words, the benefits (cost savings) of an internal control system must be greater than the cost of its implementation and continuation. Information produced must also be useful. If the information is invalid and cannot be used, then effort and money have been wasted.

It may seem that these two major requirements are in conflict. For example, the procedures used to store and safeguard food products and the paperwork required to obtain those products from storage may be so cumbersome that employees in departments (such as the dining room) that need those products do not bother to replenish depleted stocks. As a result, the operation's efficiency is reduced and sales may be lost. Alternatively, if employees complete all paperwork requirements to ensure they always have sufficient products on hand, the added labor cost may exceed potential losses of products from theft or waste.

Although in this chapter we shall be viewing internal control primarily from an accounting point of view, control is not limited to financial matters. For example, an establishment's personnel policies are part of the system of internal control. A company's policies on such matters as employee skill upgrading and education are important since they are eventually reflected in the company's financial results.

PROBLEMS UNIQUE TO THE HOSPITALITY INDUSTRY

Although most businesses have many shared problems relating to internal control, the hospitality business has some unique problems that often complicate and make more difficult the implementation of total control. This section discusses some of these characteristics.

BUSINESS SIZE

Just about every hospitality operation (even if the individual property is part of a large international chain) can be described as a small business, and it is generally more difficult for a small business to have as comprehensive a control system as a large business.

CASH TRANSACTIONS

Even though many hospitality industry customers today use credit cards to pay for their transactions, many others still pay cash particularly in restaurants and beverage outlets. This means that there is a great deal of cash accumulating in sales departments each day, making it easy for some of this cash to “disappear.” To further complicate cash handling and its control, many hospitality operations have some departments operating around the clock.

INVENTORY PRODUCTS

Even though the assets in inventory for most hospitality operations are only a small proportion of total assets, many individual products in those inventories (such as bottles of quality wine and expensive containers of food products) are valuable to dishonest employees, who might be tempted to remove them from the establishment for personal consumption or even to sell them for personal gain.

HIGH EMPLOYEE TURNOVER

Finally, the industry is characterized by a much higher employee turnover rate than most other businesses. This means that employees often do not receive the training they need because they are often unskilled, nor do they have the same loyalty to the operation that long-time employees often develop.

PRINCIPLES OF INTERNAL CONTROL

Some of the basic principles that provide a solid foundation for a good internal control system are discussed in this section.

ESTABLISH PREVENTATIVE PROCEDURES

Internal control procedures need to be preventative. In other words, they should be established so that they minimize and/or prevent theft. This is much more effective than suffering losses from theft or fraud and having a system that detects the culprits only after the event.

ESTABLISH MANAGEMENT SUPERVISION

The majority of employees are honest by nature, but—because of a poor internal control system, or, worse still, the complete absence of any controls—some employees will yield to temptation and become dishonest. If management does not care, why should the employees?

Control systems, by themselves, do not solve all problems. The implementation of a control system does not remove from management the necessity to observe constantly the effectiveness of the system using supervision. A control system does not prevent fraud or theft; but the system may point out that it is happening. Also, some forms of fraud or theft may never be discovered, even with an excellent control system. **Collusion** (two or more employees working together for dishonest purposes) may go undetected for long periods. The important fact to remember is that no system of control can be perfect. An effective manager will always be alert to this fact.

MONITOR CONTROL SYSTEMS

Any system of control must also be monitored to ensure that it is continuing to provide the desired information. The system must therefore be flexible enough to be changed to suit different needs. If a reporting form needs to be changed, then it should be changed. If a form becomes redundant, then it should be scrapped entirely or replaced by one that is more suitable. To have employees complete forms that no one subsequently looks at is a costly exercise, and employees quickly become disillusioned when there seems to be no purpose to what they are asked to do. As well, employees may take advantage of management's disinterest and steal from the operation.

INSTITUTE EMPLOYEE SELECTION AND TRAINING SYSTEM

Important aspects of effective internal control are employee competence, trustworthiness, and training. This means having a good system of screening job applicants, selecting employees, and providing employee orientation, on-the-job training, and periodic evaluation. Supervisory personnel must also be competent, with skills in maintaining the operation's standards, motivating the employees they supervise, preparing staffing schedules, maintaining employee morale (to reduce the cost of employee turnover), and implementing procedures to control labor and other costs. A poor supervisor will fail to extract the full potential from employees and will thus add to the operation's cost.

ESTABLISH RESPONSIBILITIES

One of the prerequisites for good internal control is to clearly define the responsibilities for tasks. This goes beyond designing an organization chart. For example, in the case of deliveries of food to a hotel, who will do the receiving?

Will it be the chef, the storekeeper, a person whose sole function is to be the receiver, or anybody who happens to be close to the receiving door when a delivery is made? Once the designated person is established, that person must be given a list of receiving procedures, preferably in writing, so if errors or discrepancies arise, that person can be held accountable.

PREPARE WRITTEN PROCEDURES

As mentioned, once procedures have been established for each area and for each job category where control is needed, these procedures should be put into writing. In this way employees will know what the policy and procedures are. Written procedures are particularly important in the hospitality industry, where turnover of employees is relatively high and continuous employee training to support the system of internal control is necessary.

It is impossible in this chapter to establish procedures that will fit every possible situation in the hospitality industry because of the wide variety of types, sizes, and styles of operation. Even in two establishments of similar nature and size, the procedures for any specific control area may differ due to management policy, type of customer, layout of the establishment, or numerous other reasons. However, for illustrative purposes only, the following might be the way a written set of procedures could be prepared for the receiver in a food operation:

1. Count each item that can be counted (number of cases or number of individual items).
2. Weigh each item that is delivered by weight (such as meat).
3. Check the count or weight figure against the count or weight figure on the invoice accompanying the delivery.
4. Check that the items are of the quality desired.
5. If specifications were prepared and sent to the supplier, check the quality against these specifications.
6. Spot check case goods to ensure that they are full and that all items in the case are of the same quality.
7. Check prices on the invoice against prices quoted on the market quotation sheet.
8. If goods were delivered without an invoice, prepare a memorandum invoice listing name of supplier, date of delivery, count or weight of items, and, from the market quotation sheet, price of the items.
9. If goods are short-shipped or if quality is unacceptable, prepare a credit memorandum invoice listing items missing or returned and obtain the delivery driver's signature acknowledging the driver is returning with the noted items or that they were short-shipped; staple the credit memorandum to the original invoice.
10. Store all items in the proper storage locations as soon after delivery as possible.

11. Send all invoices and credit memoranda to the accounting office so that extensions and totals can be checked and then be recorded.

As another example, the following could be a set of procedures for front office staff of a hotel or motel for the handling of credit cards:

1. When the guest checks in, ask whether payment will be by credit card or some other method.
2. If it is to be by credit card, ask to see the card.
3. Verify that the card is one acceptable to this hotel (such as Visa, Master Card, American Express).
4. If acceptable, check the date on the card to make sure it has not expired.
5. Scan the credit card number for approval.
6. As you return the card, remind the guest to see the front office cashier before departing to verify the accuracy of the account and sign the credit card voucher for the charge.
7. Before filing the folio with the cashier, check the credit card number to make sure it is not on the credit card company's cancellation list. If it is, advise the front office manager of the situation.
8. Initial the credit card number on the folio to show that the card has been checked against the cancellation list and is not listed.

When the guest checks out:

9. Check the guest account to ensure that the credit card number has been initialed.
10. If it has not been, check the cancellation list and advise the front office manager if it is listed. Do not return the card to the guest.
11. If not listed, complete the appropriate credit card company voucher, using the imprinter.
12. Have the guest sign the voucher. Check the voucher signature against the credit card signature.
13. Return the credit card to the guest with his/her copy of the voucher.

MAINTAIN ADEQUATE RECORDS

Another important consideration for good internal control is to have good written records. For example, for food deliveries there should be, at the very least, a written record on a daily order sheet of what is to be delivered, from which suppliers, and at what prices. In this way, the designated receiver can check invoices (which accompany the delivered goods) both against the actual goods and against the order form. The larger the establishment, the more written records might be necessary. For example, a market quotation sheet could be used so a responsible person can be designated to obtain quotes from two or more suppliers before any orders are placed. Without good records, employees will be less concerned about doing a good job. The forms, reports, and other records that are part of the internal control system will depend entirely on the size and type of establishment.

SEPARATE RECORD KEEPING AND CONTROL OF ASSETS

One of the most important principles of good internal control is to separate the functions of recording information about assets and the actual control of the assets. Consider the accounts of the guests who have left a hotel and have charged their accounts to a credit card or company account. Such accounts are an asset—accounts receivable—and in some hotels are left in the front office until payment is made. These accounts are known as city ledger accounts. Checks received in payment are given to the front office cashier, who then records the payments on the accounts. These checks, along with other cash and checks received from departing guests, are turned in as part of the total remittance at the end of the cashier's shift. As long as the cashier is honest, there is nothing wrong with this procedure!

A dishonest cashier could, however, practice a procedure known as **lapping.** Mr. X left the hotel, and his account for $175 is one of the accounts receivable. When he receives his statement at month's end, he sends in his check for $175. The cashier does not record the payment on Mr. X's account. Instead, the check is simply put in the cash drawer and the cashier removes $175 for personal use. The cashier's remittance at the end of the shift will balance, but Mr. X's account will still show an outstanding balance of $175. When Mr. Y, who has an account in the city ledger for $285, sends in his payment, the cashier records $175 as a payment on Mr. X's account, puts the $285 check in the cash drawer, and removes a further $110 in cash for personal use. A few days later, Mr. Z's payment of $350 on his city ledger account is received. The cashier records $285 on Mr. Y's account, puts the $350 check in the cash drawer and takes out $65 more in cash. This lapping of accounts will eventually snowball to the point where the cashier can no longer cover a particular account and the fraud will be discovered. However, the outstanding account may be so large that the misappropriated cash cannot be recovered from the dishonest cashier.

To aid in preventing this type of loss, the separation of cash receiving and recording on accounts should be instituted. Checks or cash received in the mail in payment for city ledger accounts could be kept in the accounting office for direct deposit to the bank. The front office cashier is simply given a list of account names and amounts received, and the appropriate accounts can be credited without the cashier handling any money. This procedure may not, however, prevent collusion between the person in the accounting office and the cashier.

The separation of asset control and asset recording does not pertain only to cash. For example, food and beverage inventories maintained in a storeroom may be controlled (received and issued) by a storekeeper, but it is often a good idea to have the records of what is in the storeroom (e.g., perpetual inventory cards) maintained by some other person.

LIMIT ACCESS TO ASSETS

The number of employees who have access to assets such as cash and inventory should be limited. The larger the number of employees with access, the greater is the potential for loss from theft or fraud. In the same way, the amount of cash and inventory should be kept to a minimum. This requires a balancing act, because cashiers need to have enough cash to make change and the store's departments need sufficient inventory so that they are not continually running out of products and are unable to satisfy customer demand. Also, control procedures for access to those assets should not be so cumbersome that they severely restrict efficient operations.

CONDUCT SURPRISE CHECKS

Surprise checks (such as counting cash or taking inventory) should be carried out at unusual times. Two principles are involved here: First, the person conducting surprise checks should always be independent of the part of the operation being checked. In other words, the person who normally takes the month-end storeroom inventory should not be the person who makes the surprise check. Second, such surprise checks should be carried out frequently enough that they become routine, but not scheduled in a predictable pattern.

DIVIDE THE RESPONSIBILITY FOR RELATED TRANSACTIONS

Responsibility for related transactions should be separated so the work of one person is verified by the work of another. This is not to suggest duplication of work—that would be costly—but to have two tasks that must be carried out for control reasons done by two separate employees. This procedure keeps one person from having too much control over assets and may prevent their theft.

For example, many restaurants record items sold and their prices on handwritten sales checks. These checks, when the customers pay, are then inserted in a cash register that prints the total amount paid on the sales check, and on a continuous audit tape. At the end of the shift or the day the machine is cleared, the total sales are printed on the audit tape, which is then removed by the accounting department. The total cash turned in should agree with the total sales on the audit tape. But even if there is agreement, there is no guarantee that the audit tape figure is correct. Over-rings or under-rings could occur, or a sales check might have been rung up more than once or not rung up at all, or might have been rung up without being inserted in the register. If the same transaction was rung up twice, the cash would be short and the over-ring would identify the cash shortage. However, if a cash transaction is not rung up, a cash overage would exist, which could be stolen by the cashier.

Because of all these possibilities, further control over sales checks is needed. First, the prices, extensions, and additions of all sales checks should be verified (if time does not allow this daily, then it should be done on a spot-check basis). Then the sequence of numbers of sales checks turned in should be verified to make sure there are no missing sales checks. Finally, an adding machine listing of sales checks should be made. Assuming no errors were made on this adding machine listing, the total on this listing should be reconciled against the cash turned in. If no cashier errors were made, the register audit tape will also agree with the adding machine listing.

A person other than the cashier should verify the sales checks for prices, extensions, additions, and other changes to ensure that there are no missing sales checks. This person should also prepare the adding machine tape. In this way the responsibility for sales control is divided, and one person verifies the work of another. The cost of the second person's time conducting the verification will normally be more than recovered in increased net income as a result of reduction of losses from undiscovered errors.

EXPLAIN THE REASONS

Employees who carry out internal control functions should have the reasons they are asked to perform these tasks explained to them. For example, in the previous section it was suggested a second person verify the work of the cashier. The losses that can occur from servers making errors in pricing items on sales checks, in multiplying prices by quantities, and in totaling sales checks could add up to many dollars. So could losses from missing sales checks where cash was received from the customer, but a dishonest server or cashier kept the cash and destroyed the sales check. The importance of minimizing these losses should be explained to the employee doing the task.

ROTATE JOBS

Wherever possible, jobs should be rotated. This may be difficult to do in a small establishment with few employees. In a larger operation, cashiers could be moved from one department to another from time to time, or accounting office employees could have their jobs rotated every few months. Employees who know they are not going to be doing the same job for a long time will be less likely to be dishonest. The possibilities of collusion are also reduced because the same two employees will not work together for a long time. Job rotation also has another advantage in that it prevents employees from becoming bored from constantly carrying out the same tasks. It also builds flexibility into job assignments and will give the employees a better understanding of how the various jobs relate to each other.

USE MACHINES

Whenever possible, machines should be used. Although machines cannot prevent all possibilities of theft or fraud, they can vastly reduce these possibilities. The installation of a machine may also reduce labor cost if an employee is no longer required to perform a task manually. Such machines include front office billing/audit equipment, restaurant and bar cash registers and/or point-of-sale systems (POS), and mechanical or electronic drink-dispensing bar equipment. For example, an electronic POS will eliminate many of the losses from the types of errors mentioned earlier. Also, the saving in labor (because the manual verifications will no longer be required) will contribute toward the cost of the equipment.

SET STANDARDS AND EVALUATE RESULTS

One of the requirements of a good internal control system is not only to control the obvious visible items, such as cash or inventory, but also to have a reporting system that indicates whether all aspects of the business are operating properly.

For example, one of the many benchmarks used in the food industry to measure the effectiveness of the manager is the food cost percentage. Management needs to know whether the food cost percentage actually achieved is close to the standard desired. Therefore, the manager must have a standard to which the actual cost information will be compared.

Once procedures have been established and the various employees have been given detailed written guidelines about how to perform tasks, standards of performance should be established. Later in this chapter, we shall see how cost control standards can be established and actual results evaluated.

DESIGN FORMS AND REPORTS

To evaluate results, forms and reports to provide information about all aspects of the business need to be designed. Properly designed forms or reports will provide management with the information it needs to determine whether standards are being met and to make decisions that will improve the standards, increase performance, and ultimately produce higher profits. The manager's daily report, shown earlier in Exhibit 4.6, is one type of form.

Another set of standards derives from budgets and budget reports that allow actual results to be compared with those budgeted. Budgets are discussed in Chapter 9.

BOND EMPLOYEES

Consideration should be given to bonding employees. For example, fidelity bonds protect the operation from losses incurred by employee dishonesty because the establishment is reimbursed (up to the face value of the insurance policy) for the loss suffered.

INSIST ON MANDATORY VACATIONS

Vacations should be mandatory, particularly for employees who have control of assets. Employees inclined to be dishonest may be discouraged from theft or fraud if they know that during their vacation some other person will have control of those assets and that, if theft or fraud has occurred, it may be discovered during this vacation. Even if theft or fraud has not occurred, the new person doing the job may discover weaknesses in the control system that were not previously apparent. Additional preventative controls can then be implemented.

CONDUCT EXTERNAL AUDITS

External audits conducted by an outside firm do not guarantee that fraud or theft has not occurred. However, if they have occurred they are more likely to be discovered by an objective outside firm of auditors.

CREATE AN AUDIT TRAIL

Most good internal control systems are based on having an audit trail that documents each transaction from the time that it was initiated through source documents (such as purchase orders or sales checks) and defined procedures through to the final recording of the transaction in the operation's general ledger. A good audit trail allows each transaction, where necessary, to be tracked again from start to finish.

CONTROL DOCUMENTS

Wherever possible, all documents, such as sales checks, requisitions, and purchase orders, should be preprinted with sequential numbers. In this way, individual documents can be tracked and accounted for. Numbering is particularly important for revenue control forms, such as sales checks.

When numbered documents are issued, the individual receiving the documents should be required to sign for them to establish responsibility and accountability for the documents.

The accounting department should oversee all documents, even though they are actually used by employees in other departments. In other words, they should be designed, ordered, stored, issued, and have their usage controlled by the accounting office. It is also the accounting office's responsibility to periodically check the sequence of all numbered documents to ensure that none are missing.

SUPERVISE THE SYSTEM AND CONDUCT REVIEWS

One of management's major responsibilities in internal control is constant supervision and review of the system. This supervision and review is necessary because the system becomes obsolete as business conditions change. Also, without continuous supervision the control system can collapse. For example, one of the important control techniques in a food service operation is to ensure each day that there are no missing, prenumbered checks on which sales are recorded. If an employee (after having served food and beverages, presented the sales check and collected the cash) retains both the sales check and the cash and is subsequently not questioned about this, he or she will realize that the control system is not working effectively. The employee is then free to continue to hold back sales checks and pocket cash.

In small operations, the supervision and review of the internal control system is the responsibility of the general manager. In larger establishments, with accounting departments, the supervision and review responsibility is turned over to the employees in that department. In the very large companies, internal auditing teams will be established. They will be responsible for appraising the effectiveness of the operating and accounting controls, and for verifying the reliability of forms, records, reports, and other supporting documentation to ensure that internal control policies and procedures are being followed and assets are adequately safeguarded.

CONTROL OF PURCHASES

To understand the necessity for control of purchases, assume that in a restaurant operation, every employee had the authority to buy food for resale and that there were no control procedures or forms in use. In such a situation there would be absolute confusion concerning what had been ordered and received. In addition, there would be duplications, mistakes, over- and short shipments, payments for items not received, and constant opportunities for dishonest employees to commit theft or fraud.

In order to have control over purchasing, it is necessary to divide the responsibilities among several individuals or departments. Coordination over the various purchasing tasks is achieved using five basic documents:

1. Purchase requisition
2. Purchase order
3. Invoice
4. Receiving report
5. Invoice approval form or stamp

Each of these is discussed in turn in the following sections.

PURCHASE REQUISITION

In making purchases in large multidepartment operations, the employees of the purchasing department cannot constantly be aware of the supply and service needs of the various operating departments. Generally, the responsibility for having an adequate supply of items in each department is delegated to each department manager. However, the department managers should not be allowed to deal directly with suppliers, since control of purchasing could not then be coordinated. In order to have this control over purchases and the liabilities (accounts payable) that result, purchasing must be centralized. Each department or division manager should be responsible to initiate supply requirements to the responsible purchaser, or the purchasing department. Supply requirements are initiated by use of a **purchase requisition,** prepared in triplicate. The original and duplicate are sent to the purchaser or purchasing department; the third copy is retained by the department head for later checking. A sample requisition is illustrated in Exhibit 5.6.

The purchasing department's role is to make sure that supplies, equipment, and services are available to the operation in appropriate in quantities, at the right price, and at a minimum cost to meet desired standards. Generally, those responsible for purchasing have the authority to commit the establishment's funds for buying required goods or services. Sometimes a maximum dollar amount for any individual purchase may be established beyond which a higher level of authority is required before proceeding with the purchase. Those responsible for purchasing may have authority to question individual purchase requisitions with reference to the particular need or the stipulated specifications.

PURCHASE ORDER

A **purchase order** is a form prepared by the purchasing department authorizing a supplier to deliver needed goods and services to the establishment. A sample purchase order is illustrated in Exhibit 5.7. Generally, four copies are prepared—one for the supplier, one for the department initiating the purchase requisition (this advises them that the required items have been ordered), one that remains with the purchasing department, and the fourth, with a copy of the

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Date _____ Requested by _____

Department _____ Department head checked _____

Date required _____ Purchasing manager approved _____

Note: Please use a separate purchase requisition for each item or group of related items.

Description	Quantity	Purchase Order Number	Suggested Supplier

EXHIBIT 5.6

Sample Purchase Requisition

FRANKLYN HOTEL
1260 South St., Manchester
Telephone: (261)434-5734

PURCHASE ORDER 653
(The purchase order number must appear on all invoices, bills of lading, or correspondence relating to this purchase. Invoice must accompany shipment).

Department ____________ Purchase requistion # ____________
Purchase order date ____________ Delivery date ____________
To supplier:

Description	Quantity	Price

Purchasing manager's signature ____________

EXHIBIT 5.7

Sample Purchase Order

purchase requisition attached, sent for control purposes to the accounting department. For control purposes it is also a good idea to record the purchase order number on the purchase requisition, and to record the purchase requisition number on the purchase order.

In many cases in the hospitality industry, particularly where it involves day-to-day food and supplies ordering, a system of purchase orders is just not practical because most orders are placed at short notice and by telephone. In such cases, special procedures and forms will prevail. For example, an operation may have a list of approved suppliers from whom it can purchase supplies. If it wants to purchase from a supplier who is not on the list, it must seek approval from the purchasing department before it places an order.

INVOICE

The third document in the system of purchasing control is the **invoice.** An invoice is prepared by the supplier and is simply an itemized listing of the goods or services to be received from the supplier. Generally in the hospitality industry suppliers are asked to have the priced and totaled invoice accompany the shipped goods, since this aids the receiving department in the receiving process. However, for control purposes it is a good idea to have the supplier also send a copy of the invoice directly to the establishment's accounting office.

RECEIVING REPORT

The receiving report is used to verify that the goods being received are the goods requested and should be checked item by item against the invoice. The person or persons responsible for receiving should weigh products purchased by weight, count cased goods, and confirm that each case is full. As discussed in item 9 of the preceding section on preparing written procedures, prepare a credit memorandum invoice listing the items missing or returned. Obtain the delivery driver's signature acknowledging he or she is returning with the noted items. Staple the credit memorandum to the original invoice. A sample receiving report for food and beverages is illustrated in Exhibit 5.8 for multi-department organization. A report such as this should be completed daily and sent at the end of each day with accompanying invoices to the accounting office.

INVOICE APPROVAL FORM OR STAMP

When the accounting department receives the receiving report, it can match it with a copy of the original purchase requisition, a copy of the purchase order, and the related invoice(s). All the relevant information can be compared and verified. The items on the invoice should be compared to the purchase requisition, the purchase order, and the receiving report. The invoice prices should be compared to the prices quoted and recorded on the purchase order. Finally, the invoice should be checked for arithmetical errors. If everything is in order, the accounting department can approve the invoice for payment; stamping it or attaching a form to it can do this. An outline of this **invoice approval stamp** or **form** is illustrated in Exhibit 5.9. Initials or signatures should be put in the appropriate places to indicate that all the proper checks have been completed.

STORAGE

The following practices should be used for product storage:

- Immediately after goods have been delivered and all receiving checks performed, they should be moved to storage areas or sent directly to the departments that requested them. Proper storage facilities (such as refrigerated areas for perishable food products) should be used.
- Storage areas should be locked when the storekeeper is not present. Access to storerooms should be limited to the storekeeper and other authorized employees.

Daily Record of Purchases and Issues

Hotel ____________

Dept. ____________ Date ____________ 20____ Day of Week ____________

Purchases			Stock to Storeroom				Bar				
1	2	3	4	5	6	7	8	9	10	11	12
Name of Item	Amount of Invoice	Direct Issues to Kitchen	Meat, Fish and Poultry	Staples	Fruits & Vegetables	Dairy Products	Liquor	Beer	Wine	Mixed Ingred	Cartage
A Today's Purchases											
B Balance Forward from Yesterday											
C Total to Date This Month											

13	14	15	16	17	18	19	20	21	22	23	24	25
	Direct Issues											
	Meat	Fish	Poultry	Fruits	Veget.	Dairy Products	Bakery Products	Staples	Coffee	Butter	Eggs	Food Cost 14 to 24
Direct Les.												
Stores Les.												
Total Les.												
Fwd. Bal.												
Total M D												
I Begining Inventory Last Month End												
J Stock to Store Room C4 to 7										5c		
K Store Room Issues E 14 to 24										21 to 25		
L (I + J = K) Balance on Hand												
M Physical Inventory												
N (L + or - M) Adjustment $												
O (N% to M) Adjustment %												
P (Sales/M) Inventory Turnover												

EXHIBIT 5.8

Sample Receiving Report

Purchase order number	______________
Requisition checked	______________
Purchase order checked	______________
Receiving report checked	______________
Invoice prices checked	______________
Invoice calculations checked	______________
Approved for payment	______________

EXHIBIT 5.9

Sample Invoice Approval Form

- Storekeepers should not maintain or have access to formal inventory records, nor should accounting department employees who maintain those records have access to storerooms except to take inventories.
- Inventory counts of stored products should be taken periodically by accounting office employees and compared to perpetual inventory cards (if used). A perpetual inventory card is maintained for each separate item in stock. It has recorded on it, for each item, quantities received in and quantities issued from the storeroom to provide a running balance of what should be in inventory.

A sample perpetual inventory card is illustrated in Exhibit 5.10. The in-column figures are taken from the invoices delivered with the goods. The figures in the out column are recorded from the storeroom requisitions completed by departments requiring items from storage. A sample requisition is illustrated in Exhibit 5.11.

Item ______________ Supplier __________ Tel. # ______
Minimum ___________ Supplier __________ Tel. # ______
Maximum ___________ Supplier __________ Tel. # ______

Date	In	Out	Balance	Requisition Cost Information

EXHIBIT 5.10

Sample Perpetual Inventory Card

Department ____________________ Date ________ 6329

Quantity	Item description	Item cost	Total

Authorized signature ______________________

EXHIBIT 5.11

Sample Storeroom Requisition

Blank storeroom requisitions should only be made available, preferably in duplicate, to those authorized to sign them. The original storeroom requisition listing items and quantities required is delivered to the storekeeper. The person initiating the storeroom requisition checks the quantities received from the storeroom and keeps duplicate copies. Issuing each department with blank storeroom requisitions of a different color aids in department identification.

The best procedure for taking inventory is to make two accounting office employees responsible. One completes the actual physical count; the other compares this with the perpetual inventory card figure and then records the actual count on an inventory sheet.

- If there are any significant differences that cannot be reconciled between the inventory count and what should be in inventory according to perpetual inventory cards, the differences should be investigated to determine the cause. In this way, new procedures to help prevent future differences can be implemented.
- To aid in inventory count, preprinted inventory sheets that list items in the same order as they are located on storeroom shelves should be used.

CASH RECEIPTS

Good cash handling and control procedures are not only important to the business owner or manager but also to the employees involved, because a good system will allow them to prove that they have handled their responsibilities correctly and honestly.

In hotels and restaurants, cash is received in payment for food, beverages, and services at several places in the operation. Each position handling cash (restaurants and/or bar cashiers, front office cashiers, general cashier in the accounting office) needs definite procedures to ensure that all cash due to the business is properly received, recorded, and deposited in the bank. The procedures vary from one operation to another because of differences in use of equipment, number of employees involved, whether credit is extended to customers or guests, and for numerous other possible reasons.

In restaurants, bars, and other revenue outlets, each cash sale should be rung up on a cash register at the time of the sale. Each cash register should have a locked-in tape that prints the amount of each sale. Those ringing up sales should not have access to this tape (another example of separation of assets and the recording thereof). The accounting office should remove the tape at the end of a shift or each day. In the accounting office, an individual other than the person who collected and handled the cash should record the daily sales register readings. In this way, the tape forms the basis for the entry in the accounting records, and that entry can be verified against the records of the person who handles cash remittances. This prevents the person handling the cash from removing cash and changing the accounting records.

Control over cash received by mail in payment for accounts receivable was discussed earlier in this chapter. When checks are received in payment for those accounts, a deposit stamp should immediately endorse them with a statement such as “For deposit only to the ABC Hotel’s account number 3459.”

An important aspect to controlling losses from uncollectable accounts is to age them periodically. This should be done monthly. (Aging of accounts is discussed in Chapter 11.)

If any accounts receivable are to be written off as uncollectable, this should only be authorized by the general manager or a delegated responsible person who does not handle cash or have any access to recording amounts on accounts receivable. When it is apparent that someone is delinquent in paying an account, all collection efforts should be carefully documented before the final decision to write off the uncollectable amount is made.

All *cash receipts* should be deposited intact each day in the bank. A deposit slip stamped by the bank should be kept by the business. This is a form of receipt showing how much was deposited each day. If all cash received is deposited daily, no one who handles cash will be tempted to “borrow” cash for a few days for personal use. It also ensures that no payments are made in cash on invoices (if this were allowed, a dishonest employee could make out a false invoice and collect cash for it).

Employees who handle cash (and other assets, such as inventories) should be bonded. In this way losses are less likely to occur because the employee knows he or she will have to answer to the insurance company.

CASH DISBURSEMENTS

To handle minor *cash disbursements*, a petty cash fund should be established. Initially, the fund should be established with sufficient cash to handle approximately one month's transactions. The responsibility for accountability and administration of the fund should be controlled by one person. The amount of cash placed into the fund is called the fund limit and is accounted for at least monthly. A receipt, invoice, voucher, or a memorandum explaining the purpose of each disbursement must support payments from the fund. The receipt, invoice, voucher, or memoranda should be noted as "paid" in such a manner as to preclude reuse.

Accountability of the fund is summarized as follows:

Fund limit = Cash (coin and currency on hand) + Receipts

Random spot checks of the fund should be made to ensure that the amount of cash on hand in the fund, plus the receipts, invoices, and so on, equal the limit of the fund. No IOUs or post-dated checks should be allowed. The fund is replenished as required to bring the fund back to its limit by exchanging cash for the receipts, invoices, and so on.

All other disbursements should be made by check and should be supported by an approved invoice. All checks should be prenumbered sequentially and should be used in sequence. The person who prepared checks in payment of invoices should not be the person who has authority to sign checks. Preferably, two authorized signatures should be required on checks, and invoices should be canceled in some way when paid so they cannot be paid twice. Those authorized to sign checks should not be allowed to prepare them or control the supply of unused (blank) checks. Only those who prepare (but do not sign) checks should have access to blank checks. Any checks spoiled in preparation should be voided in some way so that they cannot be reused. Voided checks must be kept. Used checks should be audited to ensure that all numbered checks are accounted for.

It is advisable to use a check protector to print amounts on checks, because this generally prevents anyone from altering the amounts.

If a mechanical check-signing machine is used, the key that allows this machine to operate should be in the hands of the employee authorized to use it. If the machine keeps a sequential count of the number of checks processed through it, someone in authority should maintain a separate count of the number of blank checks used and reconcile this periodically with the machine count. Once checks have been signed (either manually or mechanically), they should not subsequently be available to the person who prepared them. They should immediately be mailed to suppliers, or distributed to employees in the case of payroll checks.

Some larger hotels and restaurants control check disbursements using a voucher system. With a **voucher** system, the procedures for control of purchases outlined earlier in this chapter are assumed to be in effect. When the invoice receives approval for payment (see Exhibit 5.9), a final document called a voucher is prepared. Vouchers are numbered in sequence and summarize some of the information from the other documents. There is also space on the voucher for recording the date of payment and number of the check made in payment of the voucher. The supporting documents are attached to the voucher. When the voucher is to be paid, it is given to the person who prepares the checks. The person (or persons) who eventually signs the checks then knows the transaction is an authentic one since the check is accompanied by a voucher and the voucher has attached to it the purchase requisition and purchase order, the receiving report showing goods received, and the invoice, which has been checked for accuracy. There is little likelihood of fraud, unless all the documents were stolen and authorized signatures forged, or unless there is collusion.

PAYROLL

The procedures for cash disbursements discussed so far are intended to control purchases made externally. Since labor cost is such a high proportion of operating costs, equal care must be taken to ensure that proper control is exercised in this internal cost. Payroll checks should be written on a different bank account than that used for general disbursement checks, and the preparation and signing of payroll checks should be supported by a sound internal control system so that only properly authorized labor is paid for.

In addition, the following internal control procedures should be in effect for payroll:

- Only the general manager, a department head, or the personnel department (in a large hotel) should authorize the hiring or replacement of an employee and approve a salary or wage rate. The person or persons with this authority should have nothing to do with payroll check preparation.
- After an employee is hired, any subsequent pay rate increase should be authorized and approved on a change in rate of pay form, such as that illustrated in Exhibit 5.12.
- Procedures should be implemented for recording hours worked for hourly paid employees and reporting them to the person who prepares payroll checks. In some establishments, hours worked are recorded by time clock. The employee’s department head should approve time clock cards before they are forwarded to the payroll department.

Employee ______________________
Position ______________________
Current pay rate ______________________
New pay rate ______________________
Effect date ______________________
Signatures ______________________
Department head ______________________
Manager ______________________

EXHIBIT 5.12
Authorization for Change in Rate of Pay

- Alternatively, the department head should not refer to the time cards, but instead record on a separate form each employee's starting and finishing hours for each day of the pay period. In such a case, the payroll department should then compare the department head's record with each employee's time card and investigate any serious differences by discussing the situation with the employee and the department head.
- No overtime hours should be paid without approval by the employee's department head. An overtime approval form is illustrated in Exhibit 5.13.
- From time to time, an authorized accounting office employee should spot-check all payroll sheets to verify that hours worked, pay rates, and gross and net pay calculations are accurate.
- All payments for work performed should be made by check. Check usage control procedures should be the same as outlined earlier, in the section on cash disbursements.

Date ______________ Department ______________
Employee ______________________
Position ______________________
Overtime hours ______________ Overtime rate ______________
Reason ______________________
Department head signature ______________________

EXHIBIT 5.13
Overtime Authorization Form

- A separate payroll bank account should be maintained with sufficient funds transferred to it each payday to cover payroll checks issued.
- Employees independent of each other should handle payroll check preparation and check distribution. Payroll checks should be handed to employees or mailed to the employees' home address. They should not be left for employees to pick up.
- Any paychecks that cannot be distributed to employees should be turned over to the chief accountant or to some other delegated person who has no responsibility for payroll check preparation. That person should hold employee checks until they are picked-up by the employees.
- In small hospitality operations, each employee generally picks up checks from the payroll office. In larger establishments, department heads often receive, sign for, and distribute checks to their department's employees. In such cases, employees are often known either to the payroll office employee(s) or to the department heads.
- For further control in some large establishments, an employee of the accounting or audit office is delegated to ensure that an employee actually exists for each check prepared and issued. Because that employee might not be able to identify that each person receiving a paycheck is actually an employee, each person receiving a check is required to sign for it on a form that lists all current employees according to personnel office records. Some operations take this control one step further by ensuring that the employee's signature for the check compares with the one on that employee's initial job application form.
- Wherever possible, avoid paying wages in cash because a dishonest department head can easily forge cash wage forms. Alternatively, department heads may get around full-time staffing restrictions by employing part-time employees and authorizing cash payments to them.

However, it is recognized that sometimes payment of cash wages cannot be avoided. For example, banquet employees are often hired as needed for each separate function, and it would be unfair to make an employee who has worked for only a few hours during a pay period wait until the end of the pay period before being paid by check. Indeed, in many hospitality operations such employees are paid at the end of each function by check or, more often, by cash. In the latter case, each employee should be required to sign a banquet cash-payment form, indicating that the pay (less any necessary deductions) has been received.

Similarly, cash wage advances should be avoided unless a real hardship case is evident. Employees given wage advances often find that it makes their situation more difficult (because they will receive less than the normal pay amount on the regular pay day). Employees who have a track record of advance-pay requests make most requests for wage advances.

BANK RECONCILIATION

An essential control procedure in an effective internal control system is a monthly bank reconciliation. Bank reconciliation is a most effective tool for the management of money. The person completing a bank reconciliation compares the bank statement balance to the check register (or checkbook) and adjusts both the bank statement and the check register to the same total closing balance. The check register (checkbook) is an important tool that records all cash payments. Each month, the operation should receive a bank statement from the organization's bank providing essential items of information, which at a minimum should include the following:

- Deposits made, amount, and date
- The amount and date of each check paid, by check number
- Amounts added to the bank account and why they were added
- Amounts deducted by the bank from the business's account and why each was deducted
- Checks paid and canceled, returned for your records and information

The essence of the bank statement reconciliation is to bring the reported bank statement balance into equality with the check register balance (Exhibit 5.14). Adjustments are made to the reported bank balance by adding or deducting information shown in the check register but not yet handled by the bank. Typically, bank omissions will be deposits made but not shown and checks issued but not cashed by the bank. The bank statement will inform the business of additions and deductions made from the business's checking account that are not known until shown on the bank statement.

To ensure control of cash, the person who controls cash should not control the reconciliation. There are four steps in the bank reconciliation:

1. Review information in the bank statement, noting date and balance reported by the bank, which will be reconciled to the check register (checkbook).
2. Review the company's records of deposits and compare bank deposits made to those shown as received by the bank. Deposits made but not shown on the bank statement are deposits to be added to the bank statement balance.
3. Review the checks cashed and returned by the bank to the checks written per the check register. All checks issued but not cashed by the bank are noted and classified as "outstanding" and deducted from the reported bank statement balance. Any errors made by the bank should be reported to the bank for correction.
4. Note the balance of the check register and use information regarding additions and/or deductions to the company bank account that are not known until receipt of the bank statement. Adjust the check register (or checkbook).

To illustrate how the bank reconciliation is carried out, the following hypothetical information is used:

Reported bank statement balance		$4,442
Check register (checkbook) balance		$5,012
Deposits in transit		$1,206
Outstanding checks:	#2820 @ $284	
	#2828 @ $138	
	#2832 @ $332	$ 754
Interest earned on checking account		$ 42
NSF* check		$ 125
NSF* check charges		$ 15
Bank service charges		$ 20

*NSF refers to a deposited check that was not cashed due to insufficient funds in the account of the maker.

Example reconciliation is shown as follows:

Bank Statement Reconciliation

Bank statement balance	$4,442	Check register balance		$5,012
Add: Deposits in transit	1,206	Add: Account interest		42
Subtotal	$5,648	Subtotal		$5,054
Deduct: Outstanding checks		Deductions:		
#2820 @ $284		NSF check	$125	
#2828 @ 138		NSF check charge	15	
#2832 @ 332	(754)	Service charges	20	(160)
Reconciled Balance	$4,894	Reconciled Balance		$4,894

A separate reconciliation should be conducted on each individual bank account maintained by a business. Exhibit 5.14 is a sample format.

CASHIER'S DEPARTMENT

To reduce the possibility of fraud, the head cashier and other employees in that department should not have the responsibility for nor be allowed to do any of the following:

- Prepare or mail invoices or month-end statements to customers who owe the establishment money

Company X
Bank Reconciliation
For the Month of October 0001

Cash Account Balance		$ xxxxx
ADD		
Items not recorded		
Interest earned		
Errors made in the books		
Loan payments received but not recorded		
Items collected by the bank		
Subtotal	$ a (circle a)	
DEDUCT		
Items not recorded		
Errors made in the books		
Service charges not recorded		
Subtotal	$ b (circle b)	
Total Adjustments		$ a − b (circled)
Adjusted Cash Account Balance		**
Bank Statement Balance		$ yyyyy
ADD		
Deposits in transit (outstanding)		
Errors made by the bank		
Subtotal	$ c (circle c)	
DEDUCT		
Outstanding checks		
Errors made in the books		
Subtotal	$ d (circle d)	
Total Adjustments		$ c − d (circled)
Adjusted Bank Statement Balance		**

**These two figures must be the same and, therefore, the bank account has been reconciled with the general ledger.

EXHIBIT 5.14

Bank Reconciliation Sample Format

- Record any amounts in or have any access to accounts receivable records
- Authorize rebates, allowances, or any other reductions to any accounts receivable
- Write off any account as uncollectible
- Prepare checks or other forms of cash disbursement
- Reconcile bank accounts

ESTABLISHING COST STANDARDS

One of the requirements of a good internal control system is not only to control the obvious visible items, such as cash or inventory, but also to have a reporting system that indicates whether all aspects of the business are operating properly and according to desired standards.

For example, one of the benchmarks used in the food service industry to measure the effectiveness of the business is the food cost percentage. Management needs to know if the food cost percentage actually achieved is close to the standard desired.

If proper procedures are established for receiving, storing, issuing, and producing menu items, they are useful for good internal control. To improve the situation further, standard recipes for all menu items should be established, standard portion sizes determined, and menu items individually costed. The individual menu items' standard costs would be revised, when necessary, to reflect changes in prices of ingredients used in the recipes or changes in the recipes or the portion sizes. Therefore, these costs should be current and should not be estimated or based on some past situation that no longer reflects the current situation. Selling prices can then be determined to give a fair markup over cost and to offer the customer a competitive price.

A form, such as that illustrated in Exhibit 5.15, can then be used to record information about the individual menu items' costs and selling prices. The quantities sold figures are the quantities actually sold of each particular menu item during the past week. This information can be obtained by taking a tally from all the sales checks used that week. Alternatively, it can be obtained from electronic sales register records. The total standard cost column is a multiplication of the menu item cost and the quantity sold figures. The total standard sales are calculated by multiplying the menu item selling price by the quantity sold figures.

The final column of Exhibit 5.16 shows the individual standard cost percentage for each menu item. This information is useful when analyzing the food cost results. A standard cost represents what the cost is expected to be using projected conditions. For example, a change in the sales mix can affect the food cost percentage. If the operation sells more of a menu item with a higher cost percentage, the overall cost percentage will also increase. The individual menu items' standard cost percentage information might also be useful when deciding which items to add to or delete from a menu or to promote. However, a menu item's cost percentage is not the only point to be considered; if a menu item with a higher cost percentage also has a higher contribution margin than an item with a lower cost percentage, the operation might be better off with the menu item that has the higher cost percentage.

Menu Item	Menu Item Cost	Menu Item Selling Price	Quantity Sold	Total Standard Cost	Total Standard Revenue	Cost Percentage
1	$ 4.00	$ 6.50	486	$ 1,944.00	$ 3,159.00	61.5%
2	2.10	6.00	1,997	4,193.70	11,982.00	35.0
3	1.25	2.75	1,810	2,262.50	4,977.50	45.5
4	1.50	5.50	939	1,408.50	5,164.50	27.3
5	0.75	2.00	602	451.50	1,204.00	37.5
TOTALS				$10,260.20	$26,487.00	

$$\textit{Standard cost percentage} = \frac{\text{Total standard cost}}{\text{Total standard revenue}} = \frac{10{,}260.20}{26{,}487.00} \times 100 = \underline{\underline{38.7\%}}$$

$$\textit{Actual cost percentage} = \frac{\text{Total actual cost}}{\text{Total actual revenue}} = \frac{}{} \times 100 = \underline{}$$

$$\text{Difference} \quad \underline{\underline{}}$$

EXHIBIT 5.15

Partially Completed Standard vs. Actual Cost Form—Week 1

The overall standard cost percentage can be calculated using information from the total standard cost and total standard sales columns, as illustrated in Exhibit 5.15. Finally, the actual cost percentage should be calculated, as illustrated in Exhibit 5.16. The information for actual cost is taken from the accounting records and from actual physical inventories using the general equation: Beginning of the period inventory + Purchases − End of the period inventory = Cost of goods sold (actual cost of food used). As discussed in Chapter 2, the actual food used might have to be adjusted for interdepartmental transfers during the period and for employee meals. Actual sales would normally be the same as standard sales. A difference between the two might occur if sales prices were recorded incorrectly on the sales checks or on the sales register.

The difference between the standard and actual food cost percentages can then be recorded. A difference can be expected because the standard is based on what the cost should be if everything goes perfectly. Such perfection seldom exists. Management must decide what difference will be tolerated before an investigation is carried out to determine the cause.

Exhibit 5.17 shows the completed form for the following week. Note that the figures for both the standard and actual percentages have changed. The reason is that different quantities of the various menu items offered have been sold

Menu Item	Menu Item Cost	Menu Item Selling Price	Quantity Sold	Total Standard Cost	Total Standard Revenue	Cost Percentage
1	$ 4.00	$ 6.50	486	$ 1,944.00	$ 3,159.00	61.5%
2	2.10	6.00	1,997	4,193.70	11,982.00	35.0
3	1.25	2.75	1,810	2,262.50	4,977.50	45.5
4	1.50	5.50	939	1,408.50	5,164.50	27.3
5	0.75	2.00	602	451.50	1,204.00	37.5
TOTALS				$10,260.20	$26,487.00	

$$\textit{Standard cost percentage} = \frac{\text{Total standard cost}}{\text{Total standard revenue}} = \frac{10{,}260.20}{26{,}487.00} \times 100 = \underline{\underline{38.7\%}}$$

$$\textit{Actual cost percentage} = \frac{\text{Total actual cost}}{\text{Total actual revenue}} = \frac{10{,}281.40}{26{,}487.00} \times 100 = \underline{\underline{38.8\%}}$$

$$\text{Difference} \quad \underline{\underline{0.1\%}}$$

EXHIBIT 5.16

Completed Standard vs. Actual Cost Form—Week 1

and the ratio of what has been sold among the various menu items has changed (i.e., there has been a change in the sales mix).

Therefore, it is to be expected that the total standard cost and sales figures, as well as actual cost and sales figures (and the related percentages), will change. With this analysis technique, management can now monitor the situation in an ongoing way. However, note that there has been no change in the cost percentage of any individual menu item.

Even though calculating a weekly standard cost seems like a lot of work, it can be readily computerized. As long as menu item cost and selling prices do not change, the only information that has to be entered each week is the quantity figure for each item sold, and in most operations today these figures are readily available from point-of-sale terminals. Any computer can be programmed to carry out all of the remaining calculations.

Although the discussion and illustrations in this section have been related to food, the same technique can be used for alcoholic beverage sales.

There are many other techniques applicable for control for food cost and also for beverage cost, labor cost, labor productivity, and so on. Because of the complex nature of complete internal control, it is impossible in this chapter to describe and illustrate all of them. Furthermore, most of these techniques have

Menu Item	Menu Item Cost	Menu Item Selling Price	Quantity Sold	Total Standard Cost	Total Standard Revenue	Cost Percentage
1	$ 4.00	$ 6.50	502	$ 2,008.00	$ 3,263.00	61.5%
2	2.10	6.00	1,724	3,620.40	10,344.00	35.0
3	1.25	2.75	1,828	2,285.00	5,027.00	45.5
4	1.50	5.50	759	1,138.50	4,174.50	27.3
5	0.75	2.00	742	556.50	1,484.00	37.5
TOTALS				$9,608.40	$24,292.50	

$$\textit{Standard cost percentage} = \frac{\text{Total standard cost}}{\text{Total standard revenue}} = \frac{9{,}608.40}{24{,}292.50} \times 100 = \underline{\underline{39.6\%}}$$

$$\textit{Actual cost percentage} = \frac{\text{Total actual cost}}{\text{Total actual revenue}} = \frac{9{,}816.70}{24{,}292.50} \times 100 = \underline{\underline{40.4\%}}$$

$$\text{Difference} \quad \underline{\underline{0.8\%}}$$

EXHIBIT 5.17

Completed Standard vs. Actual Cost Form—Week 2

to be developed for or adapted to each establishment with its unique operating problems. Suffice to say that good internal control would not be complete without such monitoring techniques.

METHODS OF THEFT OR FRAUD

The remainder of this chapter will be devoted to the ways in which theft or fraud has occurred in hospitality industry enterprises. These lists are not exhaustive; they include the more common ways in which misappropriations of assets have occurred. The lists can never be complete because, regardless of the improvements that are made to internal control systems, there is always a method of circumventing the control system, particularly if there is collusion between employees.

DELIVERIES

Suppliers or delivery drivers can use various methods to defraud a hotel or restaurant when they observe that the internal control procedures for receiving are not being used:

- Invoice for high-quality merchandise when poor quality has been delivered.
- Put correct-quality items on the top of a box or case with substandard items underneath.
- Open boxes or cases, remove some of the items, reseal the boxes or cases, and charge for full ones.
- Deliver less than the invoiced weight of meat and other such items.
- Use padding or excess moisture in items priced by weight.
- Put delivered items directly into storage areas and charge for more than was actually delivered.
- Take back unacceptable merchandise without issuing an appropriate credit invoice.

RECEIVING AND INVENTORY

The people working in and around receiving and storage areas, if not properly controlled, could defraud by doing any of these:

- Work with a delivery driver approving invoices for deliveries not actually made to the establishment. The driver and the receiver could split the proceeds.
- Work with a supplier approving invoices for high-quality merchandise when poor-quality merchandise has been delivered. The driver and the receiver could split the proceeds.
- Pocket items and walking out with them at the end of the shift.
- Use garbage cans to smuggle items out the back door.
- Remove items from a controlled storeroom and changing inventory records to hide the theft.

CASH FUNDS

Cash funds include general reserve cash under the control of the head cashier, the petty cash fund, and banks or change funds established for front office or food and beverage cashiers for making change. People handling cash can cheat by doing any of these:

- Remove cash and showing it as a shortage.
- Use personal expenditure receipts and recording them as expenses for business purposes.

- Remove cash for personal use and covering it with an IOU or postdated check.
- Under-add cash sheet columns and removing cash.
- Sell combinations to safes.
- Fail to record cash income from sundry sales, such as vending machines, empty returnable bottles, and old grease from the kitchen.
- Remove and adjust the register readings or voiding sales.

ACCOUNTS PAYABLE AND PAYROLL

The person(s) handling accounts payable and/or payroll can practice fraud by doing any of these:

- Set up a dummy company and making out checks on false invoices in the name of this company.
- Work in collusion with a supplier and having the supplier send padded or dummy invoices directly to the accounts payable clerk.
- Make out checks for invoices already paid and cash the checks for personal use.
- Pad payroll with fictitious employee(s) and collect the wages for the fictitious employee(s).
- Pad gross pay amount on employee(s) checks in collusion with the employee(s) by paying more hours than the employee(s) worked or paying a higher rate of pay than the employee(s) was entitled to.
- Carry employee(s) on the payroll beyond termination date.

FOOD AND BEVERAGE REVENUE

For good revenue control, a system of sales checks and duplicates should be established (although there are exceptions; for example, a cafeteria). Even with sales checks, servers or cashiers could practice the following:

- Obtain food and beverages from kitchen or bar without recording items on original sales check; these items would be for personal consumption.
- Work in collusion with the kitchen, obtain food and beverages without recording the sale, and collect cash from the customer.
- Collect cash from the customer without a sales check and not record the sale.
- Collect cash from the customer with a sales check already presented to another customer and not record the sale.
- Collect cash from the customer with a correct sales check, destroy the check, and not record the sale.
- Over-add the sales check, collect from the customer, and then change the total of the check to correct amount.

- Purposely under-add the sales check or neglect to include an item on it to influence a bigger tip.
- Collect cash with the correct sales check and record the sales check as canceled or void.
- Collect cash with the correct sales check and record it as a charge, with a false signature, to a room number or credit card number.
- Use sales checks obtained elsewhere to collect from customers and not record the sale.
- Not return a customer's credit card after the sale is complete, and subsequently use this stolen card to convert cash sales to charge sales using a false signature.
- Since the customer in the preceding situation will eventually discover his or her card is missing and report it to the credit card company, exchange this stolen card after a few days with one from another customer (since customers seldom check to see if they are getting the correct card back); this can prolong the fraud for a long time.
- Collect the credit card from the customer for an authentic charge transaction, but before returning the card to the customer, run off additional blank charge vouchers with this card through the imprinter and subsequently uses the vouchers to convert cash sales to charge ones.
- Collect cash but record sale as a "customer walkout." One should always be alert to actual walkouts (both intentional and unintentional) in all sales revenue areas.

BAR REVENUE

In bars where the bartender also handles cash, one needs to be even more alert to the possibilities for fraud. In particular, watch for collections of toothpicks, matches, or coins the bartender is using to keep track of under-poured drinks or drinks sold but not recorded so that the bartender knows how much cash to remove when the bar is closed. Watch also for these scams:

- Under-pouring drinks (assume by one-eighth ounce on a one-ounce drink). For every eighth drink sold, do not record the sale, and pocket the cash. Using shotglasses with clear nail polish in the bottom or other measuring devices brought in personally that are smaller than the establishment's standard is one way to hide this.
- Over-pouring drinks (and under-pouring others to compensate) to influence a bigger tip.
- Bringing in personally purchased bottles, selling their contents, and not recording sales.
- Not recording sales from individual drinks until sufficient to add up to a full bottle, then recording the sale as a full-bottle sale (which usually has a lower markup) and keeping the difference in cash.

- Selling drinks, keeping the cash, and recording the drinks as spilled or complimentary.
- Diluting liquor and pocketing the cash from the extra sales.
- Substituting a low-quality brand for a high-quality brand requested and paid for by customer, pocketing the difference in cash.

FRONT OFFICE

The front office area can also be a source of extra income for dishonest employees. A dishonest desk clerk could practice these tricks:

- Registering a late-arriving guest who is also checking out early, collecting in advance, destroying the registration card, and failing to record the revenue on a guest account or folio. This may require collusion between the desk clerk and the housekeeper who cleans the room.
- Keeping cash from day-rate guests under circumstances similar to those in the previous situation.
- Registering the guest, collecting the advance, and subsequently canceling the registration card and blank guest folio as a “did not stay.” Again, this may require collusion between the desk clerk and the housekeeper.
- Charging a high rate on the guest’s copy of the account and recording a lower rate on the hotel’s copy where the accounting system is a manual one.
- Changing the hotel’s copy of the account to a lower amount after the guest has paid and is gone.
- Making a false allowance/rebate voucher with a forged signature after a guest has paid and is gone and using this voucher to authenticate a reduction of the hotel’s copy of the guest folio.
- Creating false paid-outs for fictitious purchases for the hotel or using personal expenditure receipts to justify the payout.
- Charging cash-paid guest accounts to corporate accounts.
- Using credit cards from authentic charge sales to convert a cash sale to a charge sale subsequently (see tenth, eleventh, and twelfth situations under Food and Beverage Revenue).
- Lapping payments received on city ledger accounts (see earlier section in this chapter where this was discussed).
- Collecting cash from a city ledger account thought to be uncollectible, pocketing the cash, and writing the account off as a bad debt.
- Collecting cash from a city ledger account previously considered to be a bad debt and not recording the cash credit to the account.
- Recording the guest account as a “skip” (a guest who intentionally leaves without paying) after the guest has actually paid the account.
- Receiving deposits for room reservations in advance of the guest’s arrival and failing to set up a folio in advance with the deposit credited.

- In collusion with the guest, not charging for an extra person in the room in order to receive a tip.
- Selling deposit box or room keys to thieves or burglars.

Here is what Doubletree Corporation, a major hotel company, had to say in a recent annual report about its internal control system:

> The Company maintains a system of internal control over financial reporting, which is designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation of reliable financial statements. The system includes a documented organizational structure and division of responsibility, established policies and procedures, which are communicated throughout the Company, and the selection, training, and development of employees. Internal auditors monitor the operation of the internal control system and report findings and recommendations to management and the board of directors, and corrective actions are taken to control deficiencies and other opportunities for improving the system if and as they are identified.

There are inherent limitations in the effectiveness of any system of internal control, including the possibility of human error and the circumvention or overriding of controls. If employees conspire with someone else to steal from the corporation, it is very difficult to establish a control system that will prevent the theft and allow for efficient operations. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation.

Furthermore, the effectiveness of an internal control system can change with circumstances.

COMPUTER APPLICATIONS

Word processing software allows management to easily produce internal control policies and procedures manual for each new employee. When policies and/or procedures change, manuals can be revised and new copies distributed to all affected employees.

Computers can also be used for many aspects of internal control, such as preparing and issuing purchase orders, inventory, cash, and payroll preparation. Security can also be enhanced. For example, the person recording cash payments received in the mail can access the cash account to make the necessary entries but will not be able to access the accounts receivable account, and vice versa. Computerized point-of-sales (POS) systems can be used to reduce theft in food and beverage operations. The wait staff should only be able to receive food and beverage items after the product's requested are entered into the POS system. The wait staff is then responsible for the collection of sales revenue from the guests since the amount to be collected is already in the POS system.

In particular, a spreadsheet program can be used for producing the daily receiving report and completing all the calculations necessary for preparation of a standard versus actual cost form, as illustrated in Exhibits 5.15, 5.16, and 5.17.

SUMMARY

An important aspect of any business is safeguarding its assets. A good internal control system will accomplish this and will provide management with information on which to base business decisions. The internal control system should include methods and procedures for the employees to follow and reliable forms and reports to provide the required information. With any internal control system, it is important to realize that the system may not prevent all forms of loss or dishonesty. If collusion is occurring, it is sometimes difficult to detect.

Once established, the control system needs to be monitored from time to time to ensure it is working well and continuing to provide valid and timely information. It is important to establish clear responsibilities for the various jobs to be performed so that a specific employee can be held accountable for errors or losses. Employees who are given responsibility should also be provided with detailed written procedures about how to perform their functions.

Written records (forms or reports) should be established to help employees carry out their jobs and to document information. A major principle of good internal control is to separate, whenever possible, record keeping and the actual control of the assets. For example, the person who handles cash should not be the same person who makes entries in the accounting records; otherwise it would be too easy to remove cash and alter the accounting records to hide the theft. By separating the two functions, collusion would then be required to hide theft. Similarly, wherever possible, the responsibility for related transactions should be divided so that the work of one employee will also check on the work of another. This does not mean to suggest that another person should duplicate the work of one person.

Employees should have their work explained to them so that they understand why they are doing specific tasks. In this way, the job should have more meaning to them. Job rotation is also a good idea. One way to reduce the possibilities of fraud is to employ machines to do certain tasks that improve internal control; this may also lead to a labor cost-saving. Other principles of internal control are to limit access to assets, to carry out surprise checks at unusual times, to bond employees, to make vacations mandatory, to use external audits and provide audit trails, and to number all control documents.

Finally, any system of internal control requires constant supervision and review by management to guard against the system becoming obsolete. A major area requiring a good system of internal control is purchasing. This can be accomplished using five basic documents: a purchase requisition, a purchase order, an invoice, a receiving report, and an invoice approval stamp or form. Special procedures must be established for those handling cash, such as the cashiers at the various sales outlets, the front office cashier in a hotel, and the general cashier in the accounting office. Cash is the most liquid of assets, and without complete control can disappear too easily if employees are dishonest. Employees who are handling cash should be bonded.

Precautionary procedures for the handling of checks must be instituted and a bank reconciliation should be performed once a month. Standards of performance should be established and results evaluated so that management can determine if standards are being met and so that decisions can be made that will improve standards, increase performance, and ultimately produce higher profits.

DISCUSSION QUESTIONS

1. What are the two basic requirements for an internal control system?
2. Define collusion and explain why you think it is difficult to detect.
3. Why is it necessary to define responsibility for particular jobs?
4. Explain what separation of record keeping from control of assets means.
5. Explain how lapping works.
6. What does the term division of responsibilities mean?
7. List the five documents or forms used for control of purchases. Briefly explain the use of any two of these documents.
8. List and briefly discuss appropriate procedures for control over product storage and explain how perpetual inventory cards can be used in inventory control.
9. Why should all cash receipts be deposited intact each day in the bank?
10. Describe how a petty cash fund is established.
11. In paying invoices by check, how can control be established?
12. List the special procedures that are necessary for control of payroll and distribution of paychecks.
13. Explain the reasons why payment of cash wages should be avoided.
14. The balance of a company's check register normally will not agree with the bank statement balance prior to reconciliation. Why?
15. List the steps to reconcile the bank statement balance to the check register balance.

ETHICS SITUATION

A restaurant manager recently decided to change wine suppliers and switch to a supplier whose owner is a good friend. The first purchase order was for 15 cases (each containing 12 bottles) of various wines. When the manager arrived home that night, she found an unsolicited case of wine at the house provided free by the supplier. She decided not to tell the restaurant's owner and to keep the free case for herself. Discuss the ethics of this situation.

EXERCISES

E5.1 Define the major objective of internal control.

E5.2 Define the purpose of a petty cash fund.

E5.3 A petty cash fund with a $150 limit had receipts of $112 and cash (coin and currency) of $36. Explain the status of the fund.

E5.4 Explain the purpose of a bank reconciliation.

E5.5 Explain the purpose of standard cost control.

E5.6 Identify to what standard food cost percentage is compared.

E5.7 Assume the same person handles all cash and checks received in payment of an account. Explain how lapping works. Using the following information showing the day in July each payment was received, determine the amount lapped on each day. Comment on how lapping can be prevented.

Customer Name	*Amount of Check*	*Date Payment Received*
Arnold	$ 51.40	2
Sayers	62.11	4
Carter	101.10	7
Tuney	110.90	12
Lossie	141.20	14
Martie	162.75	17
Buddy	172.83	22
Smithe	185.22	27
Brown	202.90	30

E5.8 Explain the difference between a purchase order and a purchase requisition.

PROBLEMS

P5.1 A motel has established a petty cash fund of $100 that is controlled by the day shift desk clerk. During October, the following disbursements supported by receipts or memoranda were made from the fund. Calculate the amount of the reimbursement check to the fund at the end of October 2003.

October	2	$13.51	flowers for a VIP guest
	2	4.30	postage stamps
	5	15.28	cleaning supplies
	7	7.11	freight on delivery of linen
	8	1.58	office supplies
	15	11.50	postage stamps
	16	5.00	refund to guest
	20	12.00	replacement light bulbs
	22	0.48	postage due
	28	3.75	cutting new keys
	31	6.45	gas for the lawnmower

In the same establishment, the following disbursements were made from the petty cash fund in November 2003:

November	1	$ 3.07	office supplies
	4	14.20	flowers for lobby
	7	1.30	office supplies
	7	12.00	casual wages to cut the lawn
	10	0.32	postage due
	13	11.50	postage stamps
	14	4.60	COD parcel for owner
	18	11.00	taxi cost for owner
	21	3.26	collect telegram
	24	4.02	freight on linen delivery
	24	1.16	office supplies
	29	10.50	postage stamps (note there was no receipt for this)
	30	1.16	stamps

The desk clerk has added these items and requests a reimbursement check for $86.09. A count of the cash by the manager shows there is $1.91 still in the fund, plus an IOU from the clerk for $12.00. What comments do you have about the petty cash fund for November 2003?

P5.2 Tavara's Tavern reconciles its bank statement monthly. At the beginning of July, it found the following concerning the June reconciliation: The bank balance on the bank statement was $4,810, and the bank balance according to the tavern's records was $5,112. Checks #306 in the amount of $27, #309 in the amount of $108, and #311 in the amount of $87 were still unpaid by the bank at June 30. At the end of June, the bank had added to the tavern's bank account an amount of $38 for interest earned on a separate savings account it has at the bank and had deducted $8 for a service charge. A deposit made by the tavern on June 30 in the amount of $554 did not appear on the bank's statement. Prepare Tavara's bank reconciliation for June 30, 2003.

P5.3 A hotel company carries out a monthly bank reconciliation. At the beginning of November, it found the following concerning the October reconciliation: The bank balance on the bank statement was $3,506, and the bank balance according to the company records was $4,740. Checks #3581 and #3650 in the amounts of $298 and $402, respectively, were still unpaid by the bank. The bank had credited (added) to the company's bank statement an amount of $356, which the company had earned from a separate savings account it has at the bank. The bank had also debited the bank statement wrongly with a check in the amount of $20 that had not been drawn by the hotel company. There was a $4 service charge on the bank statement. The October 31 deposit of $2,266 had not been recorded as received by the bank on the statement. Prepare the company's bank reconciliation for October 2003.

P5.4 A restaurant carries out a monthly bank reconciliation. The August 31 reconciliation showed the following: The restaurant bank balance is $4,112 and the bank statement balance is $2,760. Deposits in transit August 30, $456, and August 31, $1,212, have not yet been recorded by the bank. Checks #167 for $61, #169 for $30, and #175 for $172 are outstanding. The bank statement showed a service charge of $6 and an interest credit amount of $61. A check received by the restaurant in payment of a customer's meal for $11, and deposited in the bank on August 25, was debited back to the bank statement on August 31 with the notation that there was not sufficient money in the customer's bank account to pay the check. In verifying the bank's record of daily deposits against the restaurant's records, it is discovered that the bank statement deposit of August 11 shows $1,321 while the company records show $1,312. Further checking shows the bank statement figure is the correct one. Prepare a bank reconciliation for August 2004.

P5.5 The bookkeeper who has worked for a small hotel for more than 30 years is retiring. Because he was such a reliable employee, he was given more and more responsibility over the years and did virtually all of the work, such as keeping all the accounting records, approving invoices for payment, preparing checks, and, in the absence of the hotel's owner, signing checks that needed to be sent to suppliers. His daily duties included collecting the cash at the end of the day from the front office and restaurant, clearing the machine tapes, counting and verifying cash against tapes, depositing the cash in the bank, and making the necessary entries in the hotel's bookkeeping records. At month-end he would do the bank reconciliation. The hotel's owner realizes that she cannot hire and train someone to take over all the responsibilities of the retiring bookkeeper and that it would not be desirable for internal control purposes to do so. She knows that she will have to assume some of the retiring employee's duties. She is busy already, since, as well as generally managing the hotel she does all the ordering of food supplies for the restaurant and all the ordering and receiving of bar supplies.

From an internal control point of view, discuss which of the retiring bookkeeper's responsibilities the owner should take over while, at the same time, minimizing the amount of time this would require.

P5.6 The owner of Charlene's Restaurant believes that her food cost is higher than it should be. Charlene thinks that the problem might be in the receiving area and/or the dining area because she says she has good control over food in storage and production. She has asked you to see what you can determine. By observation, you notice that when drivers make deliveries they obtain a signature from any restaurant employee who happens to be near the receiving dock in the absence of the receiver/storekeeper. Deliveries are then left at the receiving dock until the goods received can be moved to a storage area. Sometimes invoices are left with food containers; at other times no documentation is left. It is assumed that suppliers will mail the missing invoices to Charlene's office.

In the dining area you notice that the servers do not use printed sales checks to record customers' orders but simply note orders on scratch pads. They then tell the cooks what they need and pick up and deliver food to the customers. When the customers wish to pay, the servers jot down the total amount due on the scratch pad page, present the page to the customer, collect the cash, and put it into a cash drawer. No sales are recorded in the cash register. "Used" scratch pad pages are placed in a box beside the cash drawer.

In both receiving and dining areas, outline the possible problems that current procedures create and suggest to Charlene practices that would probably solve the problems.

P5.7 A restaurant has been in operation for the past five years and has successfully increased its revenue each year. One of the reasons is that in the third year the owner began extending credit to local businesspeople who regularly used the restaurant. They were allowed to sign their sales checks and were then sent an invoice at each month-end. The owner is concerned that this credit policy may have led to increases in losses from bad debts (uncollectable accounts receivable) that were not justified by increases in revenue. The restaurant operates at a 60 percent gross profit ratio, and other operating expenses (not including bad debts) are 50 percent of revenue. Following are the credit revenue and bad debt figures for the past five years:

Year	*Credit Revenue*	*Bad Debts*
1	$160,000	$ 960
2	180,000	900
3	240,000	3,840
4	300,000	4,500
5	360,000	5,400

In a columnar schedule for each year, record the credit revenue, cost of sales, gross profit, operating expenses, income before bad debts, bad debts, and net income. In addition, for each year, calculate the bad debts as a percentage of charge or credit revenue. Write a brief report to the owner with particular reference to control over bad debt losses and the restaurant's credit policy.

P5.8 A small hotel has an outside accountant prepare an income statement after the end of each month. For the last three months the amount shown as bad debts had increased considerably over any previous month. The owner asked the accountant to verify the authenticity of all accounts receivable written off as bad debts over the last three months. The accountant discovered that a number of accounts in large amounts had in fact been paid, and the persons contacted had canceled checks endorsed with the hotel's stamp to prove this. About three months ago a new hotel bookkeeper was hired to carry out all record keeping and also act as cashier, receiving and depositing the cash from the front office cashier and handling and depositing payments on accounts receivable received by mail. As the hotel's outside accountant, explain to the owner what you think has been happening and suggest how the problem can be resolved so that the same situation does not occur again.

P5.9 At some of the banquets held in a hotel, the bar is operated on a cash basis. All drinks are the same price. Banquet customers buy drink tickets from a cashier at the door. The customers then present the tickets to the bartender to obtain drinks. The bartender will not serve any drink without a ticket. As each ticket is presented, it is torn in half by the bartender to prevent its reuse. Torn tickets are subsequently discarded. At the end of the function the amount of drinks sold, calculated by taking an inventory of liquor still in bottles and deducting from the opening inventory, is compared with the cash taken in by the cashier and with the number of tickets sold.

In order to cut costs, the hotel is considering eliminating the cashier's position and the sale of tickets. The customers will pay the bartender directly for the drinks. From an internal control point of view, what comments do you have about this proposal?

P5.10 A fast-food restaurant features only three entree items on its menu with the following cost and selling prices:

Item	*Cost*	*Selling Price*
1	$2.00	$6.60
2	4.40	8.80
3	3.90	9.75

a. For each item calculate the food cost percentage.

b. If 50 of each item are sold each day, what will the standard food cost percentage be? What is the contribution margin in dollars?

c. If only 25 each of items one and three were sold and 100 of item two, what effect will this have on the standard cost percentage? What is the contribution margin in dollars?

d. Comment on the results of this analysis.

P5.11 The sales records for a coffee shop that has only six items on its menu show the following quantities sold during the month of January. Item standard cost and selling prices are also indicated.

Item	*Cost*	*Selling Price*	*Quantity Sold*
1	$2.00	$6.00	654
2	1.10	4.50	2,196
3	2.25	7.00	1,110
4	1.75	5.00	990
5	2.25	5.00	295
6	2.00	7.95	259

Actual cost for the month of January was $9,201. Actual revenue for the month of January was $30,060.

a. Calculate the standard cost percentage and the actual cost percentage for January. Round all dollar amounts to the nearest dollar.

b. Compare the results. If you were the dining room manager, explain why you would or would not be satisfied with the results.

P5.12 A fast-food restaurant uses a standard cost approach to aid in controlling its food cost. The following are the standard cost, sales prices, and quantities sold of each of the five items featured on the menu during a particular week:

Item	*Standard Cost*	*Sales Price*	*Quantity Sold*
1	$1.80	$3.95	260
2	2.10	4.95	411
3	4.20	8.95	174
4	3.05	6.95	319
5	1.40	3.95	522

Total actual cost for the week was $3,804.10 and total actual sales revenue was $8,873.40.

a. Calculate actual and standard food cost percentages and comment on the results.

b. The following week, with no change in menu or standard cost and selling prices, there was a change in the sales mix. Although quantities sold of items two, three, and five were virtually the same, many more of item four and many less of item one was sold. As a result of this, would you expect the overall standard cost percentage to increase or decrease? Explain your answer.

CASE 5

a. The 4C Company's restaurant, with 84 seats, is not large. For this reason it does not have a large number of people on the payroll. Charlie has been handling the general manager's responsibilities and has a good friend working half a day, five days a week, to take care of such matters as bank deposits, preparing accounts payable and payroll checks, and all other routine office and bookkeeping work.

Charlie is not concerned about the honesty of the person, but he has learned from courses that he has taken that there is a need for any company, however small, to have some internal controls. Write a short report to Charlie pointing out three specific areas where you believe controls might need to be implemented. For each of the three areas, advise Charlie what might happen if a dishonest bookkeeper were hired and how internal control can be implemented to prevent dishonesty.

b. From his experience in the mobile catering company, Charlie had learned the value of standard cost control. In that business he purchased most of his food items preportioned and wrapped, and portion sizes were always the same. Food cost was easy to control since, each day, an inventory count of each item he carried, plus the quantity purchased of that item that day, less the quantity still in inventory at the day's end, gave him a figure that, when multiplied by the selling price of the item, produced the standard sales revenue that he should have. When this was done for all food items, he could then compare his total standard food revenue each day with the actual revenue to make sure there were no differences. In this situation he was in complete control of the entire operation.

In the 4C Company's restaurant, because food dishes are produced in its own kitchen, it is not feasible to operate and control costs and revenue as with the 3C Company. The restaurant operates with eight main entree items on its menu, plus three soups and four desserts. These are changed seasonally. Coffee is free if an entree is ordered; otherwise there is a charge. Explain as briefly as possible to Charlie the steps that could be implemented to have a system of standard food cost and revenue control. What about the problem that some people have free coffee while others pay, and the fact that customers have to pay for items such as milk and soft drinks?