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Cost Control in Foodservice Operations

What You Will Learn

- 1) The Importance of Cost Control in a Foodservice Operation
- 2) Responsibilities for Cost Control
- 3) The Use of Three Essential Cost Control Tools

Operator's Brief

In this chapter, you will learn why controlling costs in a foodservice operation is essential to the operation's financial success. The profit formula in a foodservice operation is:

$$\text{Revenue} - \text{Expenses} = \text{Profit}$$

In this chapter, you will also learn about the relationship between a food service business's **revenue**, **expenses**, and **profits**. Profit is directly affected by operating costs, and their control is extremely important. The responsibilities for controlling foodservice costs fall to owners, managers, and production and service staff. Each of these groups plays an important role in the control of costs and in this chapter you will learn how and why this is true.

Foodservice operators have a variety of valuable tools available to them. In this chapter, you will learn about three of the most important of them: the operating budget, standardized recipes, and income statements.

Your properly developed operating budget tells what you should expect regarding the generation of revenue, expenses required to obtain that revenue, and the profits likely to result. Standardized recipes are an important tool

(Continued)

that helps you ensure that the costs incurred in the production of food and beverage items sold to guests are of the proper quality and cost.

Finally, in this chapter, you will learn that the income statement (also referred to as the profit and loss statement or P&L) is a financial document that summarizes the revenue, expenses, and profit achieved by your operation during a specific time. It serves as a detailed description of your operation's unique "Revenue – Expenses = Profits" formula.

CHAPTER OUTLINE

- The Importance of Cost Control
 - The Foodservice Profit Formula
 - The Uniform System of Accounts for Restaurants (USAR)
 - The Process of Effective Cost Control
- Responsibility for Cost Control
 - Owner's Responsibilities
 - Manager's Responsibilities
 - Production Staff Responsibilities
 - Service Staff Responsibilities
- Essential Cost Control Tools
 - The Operating Budget
 - Standardized Recipes
 - The Income Statement

The Importance of Cost Control

An operator's primary food and beverage responsibility is to deliver quality products and services to their guests at a price mutually agreeable to both parties. In addition, product quality must be such that buyers will believe they received excellent value for the money they spent. As this occurs, the operation will prosper financially.

It is important operators understand that serving guests creates a need for their businesses to incur costs. It is wrong to think that "low" costs are good and "high" costs are bad. A foodservice operation with \$2 million in sales per year will have higher costs than a similar operation achieving only \$1 million in sales per year. The reason is clear: The amount of products, labor, and equipment needed to sell \$2 million worth of food and beverages is greater than that needed to sell only \$1 million. If fewer guests are served, there will be lower operating costs, and lower sales and profit as well!

For an effective foodservice operator, the question to be considered is not whether costs are high or low. The question is whether costs are *too high* or *too low* given the value a business is creating for its guests. Costs must be incurred, and they must be managed in a way that enables the operation to achieve desired profit levels.

The Foodservice Profit Formula

Every foodservice operator must know and understand the components in the profit formula:

$$\text{Revenue} - \text{Expenses} = \text{Profit}$$

When sales are made to guests, a foodservice operation receives revenue, and it also incurs the expenses required to generate those sales. Profit is the amount of money (if any!) that remains after all expenses have been paid. Since it is common in the foodservice industry, the following terms will be used interchangeably: revenues and sales, expenses and costs, and profit and net income.

The profit formula holds true even for managers in the **non-profit sectors** of foodservice.

There are a number of names commonly used to identify non-profit operations. These include non-commercial, institutional, contract feeding, on-site foodservices, and managed services. The number of non-profit foodservice operations is vast and varied and includes food operations in:

- K–12 education
- Colleges
- Universities
- Hospitals
- Nursing homes
- Retirement centers
- Correctional facilities
- Military facilities
- Businesses

Key Term

Revenue: The term indicating the dollars taken in by a business within a defined time period. Also referred to as “sales.”

Key Term

Expenses: The price paid to obtain the items required to operate a business. Also referred to as “costs.”

Key Term

Profit: The dollars that remain after all of a business’s expenses have been paid. Also referred to as “net income.”

Key Term

Non-profit sector (foodservice): Foodservice in an organization where generating food and beverage profits is not the organization’s primary purpose. Also referred to as the “non-commercial” sector.

- Factories
- Private clubs
- Sporting arenas and stadiums
- National and state parks
- Transportation providers including airlines, trains, and cruise ships

The success of a commercial (for-profit) foodservice operation is most often determined by its sales volume (dollars) and profits it generates. However, the success of non-profit operations is often evaluated by participation rate (number of people it serves). In all cases, however, revenue and expenses are just as important to non-profit operations as it is to commercial operations.

Figure 1.1 summarizes how foodservice operators generate profits by using the cash (revenue) they receive from the sale of their products and services.

When the process shown in Figure 1.1 includes the careful control of costs, guest satisfaction and profits can be optimized.

The Uniform System of Accounts for Restaurants (USAR)

Numerous individuals and groups are interested in a foodservice operation’s financial performance. Therefore, this information must be summarized in a manner that is consistent and easily read and understood.

Laws exist that require owners to properly report and pay taxes due, to file certain documents with the government, and to supply accurate business data to various other entities. As a result, many hospitality businesses use a series of standardized (uniform) accounting procedures to report their revenue and expense. These

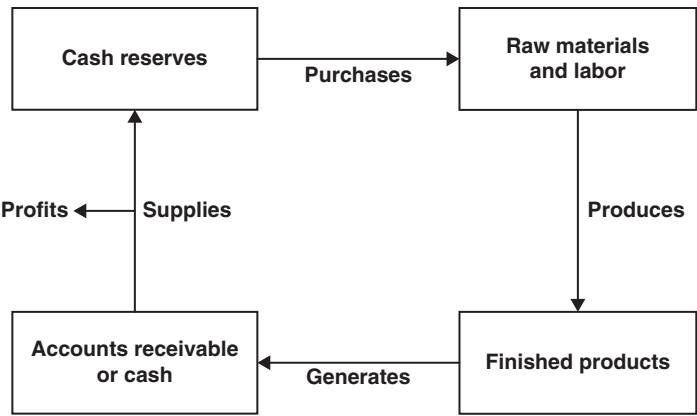


Figure 1.1 Foodservice Business Flowchart

are called a **uniform system of accounts**, and they represent agreed-upon methods to record financial transactions.

The financial information produced using a uniform system of accounts should be verifiable by a third-party, if needed, and it will be understood by lenders, investors, taxing authorities, and others who must know about this information.

Different foodservice businesses have different accounting needs, and there are uniform systems of accounts produced specifically for individual business segments. In the hospitality industry, some of the best known of these uniform systems are the:

- ✓ **Uniform System of Accounts for Restaurants (USAR)**¹
- ✓ Uniform System of Financial Reporting for Clubs (USFRC)
- ✓ Uniform System of Accounts for the Lodging Industry (USALI)

Uniform accounting systems are continually reviewed and periodically revised. For example, this book was prepared using reporting principles contained in the eighth and most current edition of the USAR. Specific USAR recommendations will be addressed in detail in relevant portions of this book.

To illustrate why the use of the USAR is so important, assume that an individual owned two Italian restaurants located in two different cities, and both offered the same menu. The owner wants to assess the ability of the two individuals responsible for operating each of the restaurants. It would be very confusing if the two units' managers used different methods for preparing and reporting each of their operations' revenue, expenses, and profits. In this example, unless both operators report and account for their financial performance in a consistent (uniform) manner, the performance of the two operations and their managers could not be properly analyzed and compared.

The use of the USAR to produce accounting information for foodservice operations is not mandatory, but its use is highly recommended. One reason is that a primary purpose of preparing accounting information is to clearly identify revenue, expenses, and profits for a specific time period. The best foodservice

Key Term

Uniform system of accounts: Accounting standards used to help provide accuracy, reliability, uniformity, consistency, and comparability in reporting financial information.

Key Term

Uniform System of Accounts for Restaurants (USAR): A recommended and standardized (uniform) set of accounting procedures used to categorize and report restaurant revenue and expenses.

¹ <https://shop.restaurant.org/The-Uniform-System-of-Accounts-for-Restaurants-Print>

operators want to do this properly so the financial records of their businesses will accurately reflect their efforts.

Some foodservice operators feel that **accounting** for their businesses is an extremely complex process. While professional accounting does require attention to detail, every foodservice operator can master the basic accounting skills required to effectively record and analyze their revenue, expense, and profits.

Key Term

Accounting: The system of recording and summarizing a foodservice operation's financial transactions and analyzing, verifying, and reporting the results.

Find Out More
Some foodservice operators elect to do their accounting in-house without the assistance of outside accounting experts. However, properly accounting for a foodservice operation's revenue and expense is very important. This is especially the case when a foodservice operator seeks a bank loan or investment from outside investors, and their accounting records must reflect the use of the Uniform System of Accounting for Restaurants (USAR). Professionals working in the foodservice industry have a variety of tools available to assist with their accounting tasks. One of the best is the book "Accounting and Financial Management in Foodservice Operations" written by Drs. David Hayes and Jack Ninemeier and published by John Wiley. To review the contents of this book prepared for operators who want to utilize the USAR, go to www.wiley.com. When you arrive at the Wiley website, enter "Accounting and Financial Management in Foodservice Operations" in the search bar to examine the outline and content of this valuable accounting resource.

The Process of Effective Cost Control

The effective control of costs is a major responsibility of all foodservice operators and managers. While there are numerous ways to view the cost control process, one method is to consider where the control function lies within the five functions essential to effectively manage any foodservice operation (Figure 1.2):

- ✓ *Planning:* This initial step in the management process addresses the creation of goals and objectives. It is the first step in the management process because it identifies precisely what the organization wants to achieve through its efforts.

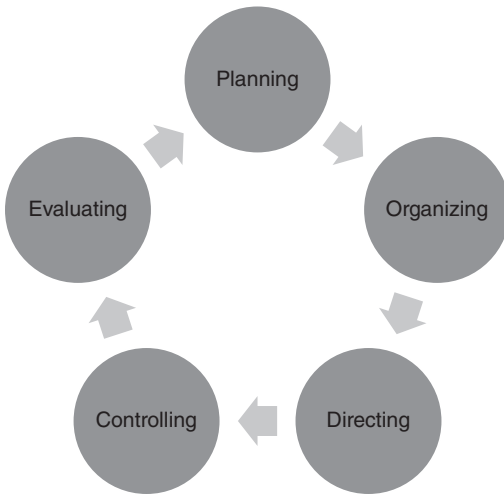


Figure 1.2 The Management Process

- ✓ **Organizing:** After its objectives have been identified, an organization must ensure it has the funding, staff, equipment, and raw materials needed to achieve its objectives. These items must then be arranged (organized) to optimize the organization's ability to achieve objectives.
- ✓ **Directing:** This important management function addresses the task of telling and showing all staff members exactly what is expected of them. When given clear directions, all staff members will know the important roles they play in helping the organization achieve its objectives.
- ✓ **Controlling:** By continually assessing the work processes and procedures they have put in place, foodservice operators can better identify situations that could prevent their business from meeting its objectives. In the foodservice industry, important processes that must be controlled include those activities related to purchasing, receiving, storing, preparing, and serving menu items.
- ✓ **Evaluating:** This final management activity requires that an organization assess its current performance and compare the performance to planned or forecasted performance. If significant differences exist, the organization must determine the reason for the differences and then either change objectives and/or change the methods used to achieve them.

Although this book addresses each of the five key management processes as appropriate, its primary focus is on control. Specifically, it addresses the important things foodservice operators must know and do to properly control costs.

Essentially, the professional control of costs in a foodservice organization requires operators to:

- ✓ Establish performance standards based on organizational objectives
- ✓ Measure and report actual performance
- ✓ Compare actual results to desired (planned for) results
- ✓ Take corrective actions as needed

An appropriate level of business profits results from effective planning, the use of appropriate management principles, and careful decision making. It is important to understand that profit should not be viewed as what is left over after all bills are paid. In fact, careful planning is necessary to earn a profit, and few investors are attracted to businesses that do not generate enough profit to make their attention worthwhile.

The foodservice business can be very profitable; however, there is no guarantee that an individual operation generates a profit. Some operations do, and others do not. A modification of the profit formula ($\text{Revenue} - \text{Expenses} = \text{Profit}$) that recognizes and rewards a business owner for the risks associated with ownership is:

$$\text{Revenue} - \text{Desired Profit} = \text{Ideal Expense}$$

In this formula, **ideal expense** is an operator's view of the correct or appropriate amount of expense necessary to generate a given level of sales, and **desired profit** is the profit that the owner wants to achieve at that level of revenue.

This modified profit formula clearly places profit as a reward for providing service, not as a "leftover." When foodservice managers deliver quality and value to their guests, anticipated revenue levels and desired profits can be achieved.

Desired profit and ideal expense levels are not, however, easily achieved. It takes a talented foodservice operation team to consistently make the best decisions to optimize revenue while holding expenses to their ideal or appropriate amount. This book was written to teach operators how to make some of these good decisions.

Key Term

Ideal expense: An operator's view of the correct (appropriate) amount of expense necessary to generate a given quantity of sales.

Key Term

Desired profit: The profit level that an operator seeks to achieve with a predicted quantity of revenue.

Responsibility for Cost Control

Regardless of someone's talent, it is seldom possible for a single person to effectively manage all cost control activities in an entire foodservice operation. Instead, properly controlling costs requires a team effort, and each team member has specific responsibilities to address their part of an operation's cost control efforts.

Team members with specific cost control-related responsibilities include:

- ✓ Owners
- ✓ Managers
- ✓ Production staff
- ✓ Service staff

Owner's Responsibilities

Not surprisingly, the owners of a foodservice operation will be especially concerned about the proper control of costs. The owners may be one or more individuals, partnerships, or small or very large corporations, but they all will care about the performance of their investment in the operation.

Investors in a foodservice operation generally want to put their money into businesses that will conserve or increase their wealth. Sophisticated owners know that generating significant revenues in a business is important, but only if the revenue is generated with associated costs yielding reasonable profits.

Primary cost-related responsibilities of owners include providing their operating team with the appropriate staff, facilities, equipment, tools, and other resources needed for their jobs. For example, an owner providing a modern **point-of-sales (POS) system** that can track monthly, weekly, daily, and hourly sales enables managers to better control costs related to generating those revenues.

If, however, an owner provides an out-of-date or ineffective POS system (or no POS system at all!), managers will need to spend excessive amounts of time just to record and monitor their sales levels.

Key Term

Point-of-sale (POS)

system: An electronic system that records foodservice customer purchases and payments and other operational data.

Manager's Responsibilities

On-site managers are generally most responsible for the effective management of costs. Relying on their skills and experience, managers establish performance standards based on the expectations of ownership. The managers must then measure and report the actual performance of their operations and compare that performance to the desired or budgeted (planned for) results.

When significant variations between projected performance and actual performance exist, on-site managers must take corrective actions to ensure their cost control efforts are optimized.

Production Staff Responsibilities

The efforts of an operation's production staff are incredibly important to the operation's ability to control costs and generate a profit.

An operation's production staff must create the menu items a foodservice operation's guests will purchase. When those products are consistently of high quality and when they satisfy guest expectations, an operation's revenue and profits will increase. If, however, menu items are produced inconsistently or to a low level of quality, revenues and profits will likely suffer.

Even products that are properly prepared must consider the cost guidelines established by managers. For example, if a menu item is sold for \$10.00 and its projected cost of production is \$3.00, an operation will have \$7.00 (\$10.00 selling price – \$3.00 product cost = \$7.00) remaining to pay for its other operating expenses and to contribute to profit levels.

If, however, the same \$10.00 menu item that is not properly prepared costs the operation \$4.00 to produce, only \$6.00 will remain to pay the operation's other operating expenses. The best foodservice production teams know their responsibilities to control costs include the consistent production of tasty menu items at the appropriate cost.

Service Staff Responsibilities

Foodservice operators sell products, and they deliver services. When a foodservice operation advertises that it offers quality service, good service, or quick service, these concepts directly affect guest perceptions, revenue generation, and the control of costs.

Guests buying from a foodservice operation must put their faith in the operator that the service provided will be of proper quality. An operation's service staff must justify this trust by consistently delivering service at levels that meet (or even exceed!) their guests' expectations.

Most foodservice guests tend to equate the quality of service they receive with the actual person who provides it. As a result, the *rude* waitstaff member will be perceived by guests as providing poor service, while the *cheerful* waitstaff member will be perceived as providing good service (even when the precise tasks performed by the two are similar or even identical).

It is for this reason that many foodservice operators want to hire persons who will directly serve guests for their attitudes—not their initial service skills. The reason: They understand that the real job of a professional food server is to:

- ✓ Make guests feel welcome
- ✓ Make guests feel important
- ✓ Make guests feel special

- ✓ Make guests feel comfortable
- ✓ Show a genuine interest if guest expectations were not met and take appropriate corrective actions
- ✓ Correct any service shortcomings promptly and with a positive attitude

When these goals are achieved, revenue can be optimized, and costs related to the delivery of high-quality service can be controlled. It follows that foodservice operators should pay a great deal of attention to their operations' **front-of-house staff** training and service standardization efforts.

Key Term

Front-of-house staff: The employees of a foodservice operation whose duties routinely put them in direct contact with guests.

What Would You Do? 1.1

"I can't get her attention," said Sharon. "I keep trying, but she isn't looking at us."

Sharon and her co-worker Armando were having lunch at O'Neil's, a small restaurant popular for its soups, salads, and burgers served in a casual setting.

"I know you asked for a side of mayonnaise when you ordered your cheese-burger. She must've forgotten," said Armando.

"I think you're right," said Sharon, "I didn't notice it when she delivered our food. Now I'm not sure about what to do. It's been almost ten minutes, and she hasn't checked back with us."

"And your burger is getting cold," observed Armando. "Maybe they can make you a new one and serve it the right way so it will still be hot."

Assume you were the manager of O'Neil's. What do you think will be Sharon's assessment of the service and product quality of the burger she received during her visit? If the burger must be replaced, how will that impact the costs you will incur in serving Sharon and Armando's table?

Essential Cost Control Tools

This book identifies and explains many tools foodservice operators can use to help manage their costs, and operators can select those tools that best help them achieve financial goals. There are, however, three essential cost control tools that must be utilized by all foodservice operators desiring to effectively manage their costs. These tools are shown in Figure 1.3.

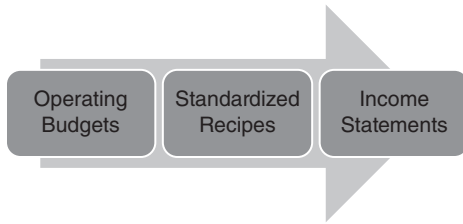


Figure 1.3 Three Essential Cost Control Tools

The Operating Budget

An **operating budget** is a financial plan that is very important if a business is to achieve its future financial goals. The operating budget tells foodservice operators what must be done if they are to meet their predetermined sales, costs, and profit objectives. Many operators believe it is the single most important cost control tool available to them.

While every foodservice operation should approach budgeting from its own perspectives, in most cases an operating budget is produced by:

- 1) Establishing realistic financial goals
- 2) Developing an operating budget (financial plan) to achieve the goals
- 3) Comparing actual operating results with budgeted results
- 4) Taking corrective action, if needed, to modify operational procedures and/or revise the financial plan to better meet future financial goals

Preparing a budget and staying within its parameters helps operators meet their financial goals. Without such a plan, operators must guess about how much revenue they will generate and how much they should spend to generate those sales.

Advantages of Operating Budgets

The owners of a foodservice operation want to know what they can expect to earn on their investments, and an operating budget is necessary to project those earnings. Questions related to the amount of revenue likely generated, the amount of cash that will be available for bill payment or distribution as earnings, and the proper timing of major purchases are all important to all foodservice operators. As a result, in organizations of all sizes, proper budgeting is an essential process that must be properly planned and implemented.

The advantages of preparing and using an operating budget are numerous and are summarized in Figure 1.4.

Key Term

Operating budget: An estimate of the income and expenses of a business over a defined accounting period. Also referred to as a “financial plan.”

- 1) It is a way of analyzing alternative courses of action, and it allows operators to examine these alternatives before adopting a specific plan.
- 2) It requires operators to examine the facts regarding what is necessary to achieve desired profit levels.
- 3) It provides defined standards that managers can use to develop and enforce appropriate cost control systems.
- 4) It allows operators to anticipate and prepare for future business conditions.
- 5) It helps operators periodically carry out a self-evaluation of their business and its progress toward meeting financial objectives.
- 6) It provides a communication channel in which the operation's objectives can be passed along to various constituencies including owners, investors, managers, and staff.
- 7) It encourages those who have participated in the preparation of the budget to establish their own operating objectives and evaluation techniques and tools.
- 8) It provides operators with reasonable estimates of future expense levels and serves as an important aid in determining appropriate selling prices.
- 9) It identifies time periods in which operational cash flows may need to be supplemented.
- 10) It communicates realistic financial performance expectations to owners and investors.

Figure 1.4 Advantages of Preparing and Using an Operating Budget

Creating an Operating Budget

Some operators believe it is not cost-effective to establish an operating budget, and they do not take the time to do so. Creating an operating budget, however, does not need to be a complex process, and similar procedures are needed even if a budget is not planned.

Before operators can begin to develop a budget, they must know about some essentials required for its creation. Note: If these essentials are not addressed before a budget is created, the budget development process is unlikely to yield a budget that is accurate or helpful.

Before creating an operating budget, its developers will need to know about and understand:

- 1) Prior-period operating results (if an existing operation)
- 2) Assumptions made about the next period's operations
- 3) Knowledge of the organization's financial objectives

1) Prior-period operating results

The task of budgeting is easier when an operator knows financial results of prior accounting periods. Experienced foodservice operators know that what has occurred in the past is often a good indicator of what is likely to happen in the future. The further back and more detailed an operator can track their historical revenues and expenses, the more accurate a future budget is likely to be.

2) Assumptions about the next period's operations

Evaluating future conditions and business activity is always a key part of developing an operating budget. Examples of this include the opening of new competitive restaurants in the immediate area, special scheduled occurrences including local sporting events and concerts, and significant changes in operating hours. Local newspapers, trade or business associations, and Chambers of Commerce are possible sources of helpful information about changes in future guest demand.

If significant changes will occur in the operation such as the addition of new menu items and the estimated impact of marketing efforts, assumptions about the impact of these actions are necessary. After important demand-affecting factors have been considered, assumptions regarding revenues and expenses become possible.

3) Knowledge of the organization's financial objectives

An operation's financial objectives may consist of a given profit target that might be a percent of total sales, a total dollar amount, and/or attainment of specific financial and operational ratios. Many of these financial objectives will be determined by an operation's owners based on their desired **return on investment (ROI)**, and the operating budget must address these goals.

An investor's ROI is expressed as a percentage of money earned to money invested using the following formula:

$$\frac{\text{Money Earned on Funds Invested}}{\text{Funds Invested}} = \text{ROI}$$

For example, if an operator invested \$1,000,000 in a foodservice business and generated \$200,000 in profits during the first year, the operator's ROI for that year would be calculated as

$$\frac{\$200,000}{\$1,000,000} = 0.20 \text{ or } 20\% \text{ ROI}$$

The budgeted profit level and resulting ROI an operation seeks can be achieved when the operation realizes its budgeted sales levels, and it spends only what was budgeted to generate those sales. If revenues fall short of forecast and/or if expenses are not reduced to match the shortfall, budgeted profit levels are not likely to be achieved.

Key Term

Return on investment

(ROI): A measure of the ability of an investment to generate income

Foodservice operators establish their budgets by focusing on each of the three components of the profit formula addressed earlier in this chapter:

- ✓ Revenue
- ✓ Expenses
- ✓ Profits

Revenue

Accurately forecasting an operation's sales (see Chapter 2) is critical because all forecasted expenses and profits will be based on revenue forecasts. Effective operators know that, in most cases, revenues should be estimated on a monthly (or weekly) basis and then be combined to create an annual operating budget.

Forecasting revenues to establish the revenue portion of an operating budget is not an exact science. However, it can be made more accurate if operators:

- ✓ **Review historical revenue records.** Many operators begin the revenue forecasting process by reviewing revenue records from previous years. A budget being planned for one or more months can often yield trends or data that can be used to predict future revenue patterns. This is generally useful because historical revenue “numbers” are often used to develop future budgets.
- ✓ **Consider internal factors affecting revenues.** In this step, operators consider any significant changes in the type, quantity, and direction of their marketing efforts. Other internal activities that can impact future revenues include those related to facility renovation that may affect capacity and times when the operation may be disrupted because of renovations. In other operations, the number of hours to be open or menu prices may change. Any internal initiation or change that an operator believes will likely impact future revenues should be considered in this step.
- ✓ **Consider external factors affecting revenues.** There are numerous external issues that could affect an operation's revenue forecasts. These include new competitors' planned openings (or competitors' closings) and other factors such as road improvements or construction that could disrupt normal traffic patterns. Other external factors may include changes in local regulations regarding signage and, important for many hospitality businesses, economic upturns or downturns that impact potential guests as they spend discretionary income on hospitality services.

Key Term

Fixed cost: An expense that stays constant despite increases or decreases in sales volume.

Key Term

Variable cost: An expense that generally increases as sales volume increases and decreases as sales volume decreases.

Expenses

When preparing budgets, operators must account for each **fixed cost** and **variable cost** they will incur in generating revenue.

Fixed costs are simple to forecast because items such as mortgage payments or rent typically stay the same from month-to-month.

Variable costs, however, are directly related to the amount of revenue produced by a foodservice operation. An operation that forecasts sales of 50 prime rib dinners on Friday night will have meat and server costs higher than the operator in a similar facility that forecasts the sale of only 10 such dinners. Variable expenses such as food and beverage and labor costs are directly affected by sales levels. Fixed and variable costs can be budgeted by dollar amount or as a percentage of sales.

Profits

The profit formula states that after expenses are subtracted from revenue, the remaining amount is profit. For example, if an operator budgets revenues of \$50,000 in a specific month and expenses of \$45,000 in that month, a \$5,000 profit will result:

$$\$50,000 \text{ budgeted revenue} - \$45,000 \text{ budgeted expenses} = \$5,000 \text{ budgeted profit}$$

When an operation's expenses exceed its revenue, however, no profits are generated. Instead, the operation budgets for a loss. This can be the case, for example, when an operation initially opens, or when other factors dictate that expenses will exceed revenue for a specific time.

Technology at Work

The preparation and monitoring of operating budgets in the foodservice industry can be a time-consuming process. Today, however, there are a variety of software programs available, in both PC and Mac formats, to help owners of foodservice businesses develop and monitor their operating budgets.

To review the features of some of these helpful tools, enter "budgeting software for restaurants" in your favorite search engine and view the results.

Standardized Recipes

Experienced operators know that, to stay within their budgets, they must be able to predict and control their costs. Although it is the menu that determines what is to be sold, and at what price, the **standardized recipe** (addressed in greater detail in Chapter 6) controls both the quantity and the quality of what a kitchen or bar will produce.

Key Term

Standardized recipe: The instructions needed to consistently prepare a specified quantity of food or drink at an expected quality level.

A standardized recipe details the procedures used to prepare and serve each of an operation’s food or beverage items. A standardized recipe ensures that each time guests order a menu item they receive exactly what management intended them to receive. A high-quality standardized recipe contains the following information:

- 1) Menu item name
- 2) Total recipe yield (number of portions produced)
- 3) Portion size
- 4) Ingredient list
- 5) Preparation/method discussion, if needed
- 6) Cooking time and temperature
- 7) Special instructions, if necessary
- 8) Recipe cost (optional)

Figure 1.5 shows a sample standardized recipe for an operation. If this standardized recipe represents the quality and quantity the operation wishes its guests to receive, and if it is followed carefully each time the item is prepared, then guests will always receive the quality and value the operation intended.

Roast Chicken

Special Instructions:
Serve with

Recipe Yield:
48 portions

Crabapple Garnish (see
Crabapple Garnish
Standardized Recipe)

Portion Size:
¼ chicken

Serve on 10-in. plate.

Ingredients	Amount	Method
Chicken Quarters (twelve 3–3½-lb. chickens)	48 ea.	Step 1. Wash chicken; check for pinfeathers; place on 24-inch × 20-inch baking sheets.
Butter (melted)	1 lb. 4 oz.	Step 2. Clarify butter; brush liberally on chicken quarters; combine all seasonings and mix well; sprinkle over chicken quarters.
Salt	¼ C	
Pepper	2 T	
Paprika	3 T	
Poultry Seasoning	2 t	
Ginger	1½ t	
Garlic Powder	1 T	Step 3. Roast in oven at 325°F for 1.5 hours or to an internal temperature of at least 165°F.

Figure 1.5 Standardized Recipe: Roast Chicken

The best foodservice operators create and then enforce the use of standardized recipes because:

- 1) Accurate purchasing is impossible without the existence and use of standardized recipes.
- 2) Dietary concerns require some foodservice operators to know the exact ingredients and the correct amount of nutrients in each serving of a menu item.
- 3) Accuracy in menu laws require that foodservice operators can tell guests about the type and amount of ingredients in the recipes.
- 4) The responsible service of alcohol is impossible without adhering to appropriate portion sizes in standardized drink recipes.
- 5) Accurate recipe costing and menu pricing is impossible without standardized recipes.
- 6) Matching food and beverages prepared and sold is impossible without standardized recipes.
- 7) New production employees can be trained faster and better with standardized recipes.
- 8) The computerization of a foodservice operation is impossible unless the elements of standardized recipes are in place. In fact, the advantages of using advanced technological tools are restricted or even eliminated if standardized recipes are not used.

Experienced foodservice operators agree that use of standardized recipes is essential to any serious effort to produce consistent, high-quality food and beverage products at a known cost to stay within cost budgets.

The Income Statement

Operating budgets estimate income and expenses, but a foodservice operation's *actual* revenue, expense, and profits for a particular time period are summarized and reported on its **income statement**.

The income statement precisely reports a business's actual revenues from all its revenue-producing sources, the expenses required to generate all revenues, and the business's resulting profits or losses that are often referred to as the operation's **net income**.

Key Term

Income statement: Formally known as "The Statement of Income and Expense," a report summarizing a foodservice operation's profitability including details regarding revenue, expenses, and profit (or loss) incurred during a specific accounting period. Also commonly called the profit and loss (P&L) statement.

Key Term

Net income: A number calculated as revenue minus operating expenses including depreciation, interest, and taxes, among others. It is useful to assess how much revenue exceeds the expenses of operating a business in a defined time period.

There are several ways foodservice operators *could* report their revenue, expense, and profits. The USAR has recommendations for how an income statement *should* be produced. The USAR recommendations are not mandatory, but they are highly recommended and are followed by most operators and all hospitality accounting firms.

To illustrate the production of an income statement using USAR recommendations, consider Figure 1.6. It shows the USAR-suggested income statement format used to report revenue and expenses for Shondra's Restaurant for the year ending December 31, 20xx. Note: The "Line" column has been added by the authors for the reader's ease in identifying data locations.

The USAR income statement is arranged on the above income statement *from the expenses that are most controllable to least controllable* by a foodservice operator. The format of a USAR income statement can best be understood by dividing it into its main sections:

- 1) Sales (Revenue)
- 2) Total Cost of Sales
- 3) Total Labor
- 4) Prime Cost
- 5) Other Controllable Expenses
- 6) Non-Controllable Expenses
- 7) Income Before Income Taxes (Profits)

Sales (Revenue)

After listing the name of an operation and the accounting period addressed, the USAR format for an income statement lists sales (Line 1; revenue, first and on the top line). **Topline revenue** represents the total sales generated by a business before any expense deductions.

Historically, food sales (Line 2) include income from the sale of all food items and non-alcoholic beverages such as soft drinks, coffee, tea, milk, bottled water, and fruit juices. When alcoholic beverages are sold, the revenue from the sales of these beverage products (Line 3) is added to food sales to yield an operation's **total sales** (Line 4).

When using the USAR, the physical layout of the income statement for different types of business can vary somewhat in their formats. For example, a foodservice operation that serves alcohol would want its income statement to identify the

Key Term

Topline revenue: Sales or revenue shown on the top of a business's income statements.

Key Term

Total sales: The sum of food sales and alcoholic beverage sales generated in a foodservice operation.

Shondra's Restaurant Income Statement For the Year Ended December 31, 20xx		
Line		
1	SALES	
2	Food	\$1,891,011
3	Beverage	\$ 415,099
4	Total Sales	\$2,306,110
5	COST OF SALES	
6	Food	\$ 712,587
7	Beverage	\$ 94,550
8	Total Cost of Sales	\$ 807,137
9	LABOR	
10	Management	\$ 128,219
11	Staff	\$ 512,880
12	Employee Benefits	\$ 99,163
13	Total Labor	\$ 740,262
14	PRIME COST	\$1,547,399
15	OTHER CONTROLLABLE EXPENSES	
16	Direct Operating Expenses	\$ 122,224
17	Music and Entertainment	\$ 2,306
18	Marketing	\$ 43,816
19	Utilities	\$ 73,796
20	General and Administrative Expenses	\$ 66,877
21	Repairs and Maintenance	\$ 34,592
22	Total Other Controllable Expenses	\$ 343,611
23	CONTROLLABLE INCOME	\$ 415,100
24	NON-CONTROLLABLE EXPENSES	
25	Occupancy Costs	\$ 120,000
26	Equipment Leases	\$ 0
27	Depreciation and Amortization	\$ 41,510
28	Total Non-Controllable Expenses	\$ 161,510
29	RESTAURANT OPERATING INCOME	\$ 253,590
30	Interest Expense	\$ 86,750
31	INCOME BEFORE INCOME TAXES	\$ 166,840

Figure 1.6 Sample USAR Income Statement

revenue generation and costs associated with serving alcoholic drinks. In a family-style pancake restaurant that serves only food and non-alcoholic beverages, the income statement would not include a line for alcoholic beverages.

The USAR's suggested income statement format recommends, at minimum, that food and (alcoholic) beverage sales be reported separately. There are a variety of reasons for this recommendation. They include the ability to better control costs when these sales are separated, and the requirement of most states to record alcohol sales separately from food sales.

In Figure 1.6, Shondra's food sales are separated from alcoholic beverage sales. In other operations, individual revenue categories may be created for catering sales, on-premises banquet sales, take-out versus dine-in sales, merchandise (e.g., logo hats, cups, and T-shirts), or any other revenue category that would be helpful to the operation's managers as they analyze their sales.

In some foodservice operations, the sale of logoed and other merchandise types can be significant. Those readers who are familiar with the Cracker Barrel restaurant group are likely aware of the significant amount of merchandise it sells. Note: Even if an operation's merchandise sales are relatively small, they should be reported separately on the income statement.

Find Out More

To achieve desired sales levels, foodservice operators must have an effective marketing plan in place. Increasingly, an operation's marketing efforts must include both traditional approaches and newer Internet-based approaches.

While there are a large number of publications addressing general marketing strategies for businesses, few publications exclusively address the marketing needs of foodservice operations. One of the best and most up-to-date marketing resources available to foodservice operators that exclusively addresses the marketing of foodservice operations is *Marketing in Foodservice Operations* (January 2024) by Drs. David K. Hayes and Jack D. Ninemeier.

To learn more about the content and availability of this valuable new publication, enter Wiley: *Marketing in Foodservice Operations* in your favorite search engine and review the results.

Total Cost of Sales

Food and beverage **cost of sales** (Line 5) are entered separately on the income statement. The reporting of food sales and the related cost of food sales (Line 6) separately from the cost of

Key Term

Cost of sales: The total cost of the products used to make the menu items sold by a foodservice operation.

beverage sales (Line 7) is useful for analyzing a foodservice operation. Without this separation an inefficient food operation could be covered up by a highly profitable beverage operation (or the reverse could occur).

A separate income statement listing for “Cost of Sales: Food” and “Cost of Sales: Beverages” equal to total cost of sales (Line 8) is integral to product control procedures. This topic will be discussed more fully in Chapter 6 (Cost Control in Food and Beverage Production).

Labor

While **payroll** generally refers to salaries and wages a foodservice operation pays to its employees, the USAR income statement provides greater labor cost-related details.

“Payroll” as shown in Figure 1.6, “Labor” (Line 9), for a USAR-formatted income statement is separated into three categories:

- ✓ Management
- ✓ Staff
- ✓ Employee Benefits

Management (Line 10) includes the total amount of salaries paid during the accounting period, and Staff (Line 11) refers to payments made to hourly (non-salaried) workers.

The employee benefits category (Line 12) includes the cost of all benefits payments made for managers and hourly workers. Some benefit payments are mandatory (such as FICA [Social Security]), and others are voluntary (such as the cost of providing health insurance).

Specific employee benefits paid by an operation will vary but can include:

- ✓ FICA (Social Security) taxes including taxes due on employees’ tip income
- ✓ FUTA (federal unemployment taxes)
- ✓ State unemployment taxes
- ✓ Workers’ compensation
- ✓ Group life insurance
- ✓ Health insurance, including:
 - Medical
 - Dental
 - Vision
 - Disability

Key Term

Payroll: The term commonly used to indicate the amount spent for labor in a foodservice operation. Used for example in “Last month our total payroll was \$28,000.”

- ✓ Pension/retirement plan payments
- ✓ Employee meals
- ✓ Employee training expenses
- ✓ Employee transportation costs
- ✓ Employee uniforms, housing, and other benefits
- ✓ Vacation/sick leave/personal days
- ✓ Tuition reimbursement programs
- ✓ Employee incentives and bonuses

Not every operation will incur all the benefit costs listed above, but some operations may have all of these and perhaps even additional benefits.

Total labor expense (Line 13) is listed prominently on a USAR income statement because controlling and evaluating total labor cost is important in every foodservice operation. In fact, many operators feel it is even more important to control labor costs than product costs. One reason is that labor and labor-related benefit costs comprise a larger portion of their operating costs than do food and beverage product costs.

Key Term

Total labor: The cost of the management, staff, and employee benefits expense required to operate a business.

Prime Cost

Prime cost (Line 14) is defined as an operation's total cost of sales added to its total labor expense. Note: As previously defined, "total cost of sales" represents the amount paid for the food and beverage products sold by an operation. In contrast, "total labor" represents the cost of the management, staff, and employee benefits expense required to operate the business.

Prime cost is clearly listed on the income statement because it is an excellent indicator of an operator's ability to control product costs (cost of sales) and labor costs, the two largest expenses in most foodservice operations.

The prime cost concept is also important because, when prime costs are excessively high, it is difficult to generate a sufficient level of profit in a foodservice operation even when other controllable and non-controllable expenses are well-controlled.

While each foodservice operation is different, prime costs in the range of 60% to 70% of revenue are common for **full-service restaurant**

Key Term

Prime cost: An operation's cost of sales *plus* its total labor costs.

Key Term

Full-service restaurant: A foodservice operation at which servers deliver food and drink offered from a printed menu to guests seated at tables and/or booths.

operations, while prime costs below 60% are most common in **fast casual** and **quick-service restaurants (QSR)**.

Other Controllable Expenses

As shown in Figure 1.6, after prime cost, the next major section is reserved for identifying **other controllable expenses** (Line 15): the non-food/non-alcoholic and labor costs controlled by managers and incurred from operating the business. In most cases, other controllable expenses can be influenced by a foodservice operator's own decisions. The USAR identifies and allows for the use of several "other controllable expense" categories.

The specific other controllable expense categories of an operation listed on its income statement may vary. As shown in Figure 1.6, in the example, Shondra's Restaurant's controllable expenses include:

Direct Operating Expenses (Line 16): Operators use this expense category to list the cost of uniforms, laundry, supplies, menus, kitchen tools, and other items incidental to service in dining areas to provide support in kitchen and storage areas.

Music and Entertainment (Line 17): These costs, if significant, should be shown separately. Many foodservice operations offer little or no music or entertainment. When this is the case and the expenses are small, they may be recorded as "Miscellaneous" within the direct operating expense category.

Marketing (Line 18): This expense category includes newspaper, magazine, radio and TV, and Internet advertising, and expenses for outdoor signs and direct mailings. Loyalty program costs, donations, and special events that promote the business can be additional marketing costs. In some cases, marketing fees associated with third-party meal-delivery companies such as DoorDash and Uber Eats are included in this category.

Key Term

Fast casual (restaurant): A sit-down foodservice operation with no wait staff or table service. Customers typically order off a menu board and seat themselves or take the purchased food elsewhere.

Key Term

Quick-service restaurant (QSR): Foodservice operations that typically have limited menus and often include a counter at which customers can order and pick up their food. Most quick-service restaurants also have one or more drive-through lanes that allow customers to purchase menu items without leaving their vehicles.

Key Term

Other controllable expenses: Expenses (costs) that a foodservice operator can influence with increases or decreases based on business decisions. Examples include marketing costs and utility costs.

Utilities (Line 19): This category includes the cost of water, sewage, electricity, and gas used to heat the building. When facilities are rented and the restaurant pays the utilities, these costs are recorded as “utilities” rather than rent.

General and Administrative Expenses (Line 20): This group of costs includes expenses generally classified as operating “overhead.” These expenses are necessary for business operation as opposed to being directly connected with serving guests. They often include the cost of items such as office supplies, postage, credit card fees, telephone charges, data processing, general insurance, professional fees, and security services.

Repairs and Maintenance (Line 21): These expenses include painting and decorating costs, maintenance contracts for elevators and machines, and repairs to an operation’s equipment and mechanical systems. This section is not used to record the purchase of new equipment.

The individual entries in Other Controllable Expenses are summed to yield the amount for Total Other Controllable Expenses amount (Line 22). That amount and the operation’s prime costs are subtracted from sales to yield the operation’s

Controllable Income (Line 23).

Controllable income is often used to evaluate the effectiveness of unit-level managers because it represents sales minus only those costs that unit managers generally can directly control or influence. In many foodservice companies, controllable income is the basis for determining at least some portion of a foodservice manager’s incentive (bonus) pay.

Non-Controllable Expenses

Non-controllable expenses (Line 24) are listed next on the income statement in Figure 1.6, and they include all costs not under the immediate control of management.

Non-controllable expenses include those previously committed and must be incurred irrespective of an operation’s sales volume. In a foodservice operation, examples of non-controllable expenses include rental payments, interest on long-term loans, and **depreciation**.

Non-controllable expenses listed in Figure 1.6 include:

Key Term

Controllable income: The amount of revenue remaining after an operation’s prime costs and other controllable expenses have been subtracted from its total sales.

Key Term

Non-controllable expenses: Costs that, in the short run, cannot be avoided or altered by management decisions. Examples include lease payments and depreciation.

Key Term

Depreciation: The allocation of equipment costs and other depreciable assets based on the projected length of their useful life.

Occupancy costs (Line 25): These include the costs of renting buildings and land, property taxes, and insurance. These expenses can vary considerably between foodservice operations. Since the owners of a business most often control these costs, they are only infrequently under the direct control of those operating the business.

Equipment leases (Line 26): These expenses (if any) include the costs incurred from the leasing or renting of equipment used in a foodservice operation. Common examples include charges for leasing POS systems, beverage dispensing equipment, and ice machines. In the example shown in Figure 1.6, no equipment lease cost is incurred.

Depreciation and Amortization (Line 27): These **non-cash expenses** are the result of depreciating buildings and **furniture, fixtures, and equipment (FF&E)**.

The individual entries in the Non-Controllable Expenses section of the income statement are summed to yield Total Non-Controllable Expenses (Line 28). That amount is then subtracted from Controllable Income to yield the operation's Restaurant Operating Income (Line 29).

Restaurant operating income represents all of an operation's revenue minus all of its controllable and non-controllable expenses.

Income Before Income Taxes (Profit)

It is interesting to note that the word "profit" does not actually appear anywhere on a USAR income statement. Some foodservice operators consider Restaurant Operating Income (Line 29) to be their business's profit because it represents an operation's sales (revenue) minus all controllable and non-controllable expenses, and it reflects the profit formula introduced earlier in this chapter:

$$\text{Revenue} - \text{Expenses} = \text{Profit}$$

Key Term

Occupancy costs: Costs related to occupying a space including rent, real estate taxes, personal property taxes, and insurance on a building and its contents.

Key Term

Non-cash expense: Expenses recorded on the income statement that do not involve an actual cash transaction. Examples include depreciation and amortization, which are expenses, and an income statement entry reduces operating income without a cash payment.

Key Term

Furniture, fixtures, and equipment (FF&E): Movable furniture, fixtures, or other equipment that have no permanent connection to a building's structure.

Restaurant Operating Income in Line 29 does not consider any **interest expense** payments made by a business. Interest Expense (Line 30) is the cost of borrowing money and is recorded on this line of the income statement even if the interest incurred has not yet been paid.

Restaurant operating income represents all of an operation's revenue minus its controllable and non-controllable expenses, and it may be further adjusted to account for corporate overhead, interest expense, or other owner-controlled expenses.

Income Before Income Taxes (Line 31) on the income statement is calculated as Restaurant Operating Income minus Interest Expense.

In Figure 1.6, the operation's Income Before Income Taxes is a number that is frequently referred to as a business's "profit." If total operating expenses *exceed* revenue, the resulting negative numbers (losses) shown on this line of an income statement are typically designated in one of the three ways:

- 1) By a minus "–" sign in front of the number. For example, a \$1,000 loss would be shown in the budget as $-\$1,000$.
- 2) By brackets "()" around the number. For example, a \$1,000 loss would be presented as $(\$1,000)$.
- 3) With red ink rather than black ink to designate the loss amount. For example, a \$1,000 loss would be presented in the budget as "\$1,000," but the number would be printed in red. Note: This approach gives rise to the slang phrase to "operate in the red": a business that is not making a profit. In a similar vein, to "operate in the black" indicates the business is profitable.

The income statement is a valuable cost control tool because it allows operators to compare their budgeted (forecasted) results with their actual results. Significant differences between the two can then be investigated and addressed.

A food service operation's expenses are directly tied to the revenue they achieve. Therefore, it is essential that operators concerned with controlling costs effectively forecast their future sales. When they do, they can better forecast their future expenses. Accurately forecasting future sales in a food service operation is so important it will be the sole topic of the next chapter.

Key Term

Interest expense: The cost of borrowing money.

Key Term

Income before income

taxes: The amount of money remaining after an operation's interest expense is subtracted from the amount of its restaurant operating income. Also, a business's profit before paying any income taxes due on the profits.

Technology at Work

The demands of operating a foodservice business are such that, in many cases, foodservice operators employ a professional accountant whose responsibilities include ensuring proper recording of income and expenses and the creation of the operators' income statements.

Some foodservice operators, however, prefer to do their own accounting, and they utilize accounting software developed specifically for the foodservice industry. QuickBooks, Restaurant 365, and ZipBooks are examples of accounting software packages used by foodservice operators.

To learn more about the features and costs of some currently popular foodservice-specific accounting software programs, enter "accounting packages for restaurants" in your favorite search engine and review the results.

What Would You Do? 1.2

"Don't keep me in suspense," said Lani, "how did we do?"

Lani, the general manager of Reggie's Pizza Parlor, was talking to Reggie Stone, the restaurant's owner. Reggie had just been e-mailed the previous month's P&L from their accountant.

"Well, the good news," said Reggie, "is that our sales exceeded our forecast. I guess maybe the lesser good news is that our expenses exceeded forecasts as well!"

The accountant for Reggie's Pizza Parlor used the Uniform System of Accounts for Restaurants (USAR) to prepare the business's monthly P&L, and it usually took the accountant a few days to finalize the previous month's numbers. It was the third of the month and the previous month's P&L had just been received.

One important part of Lani's job was to compare the business's actual performance to its forecasted performance.

"Forward that e-mail to me," said Lani, "Let me take close look at those expenses and our profits."

Assume you were Lani. Since sales exceeded the forecasts, would you be surprised to find that expenses exceeded the forecast as well? How do you think your budgeted profits would be affected when your business exceeds its sales forecast, but also exceeds its expense forecast?

Key Terms

Revenue	Operating budget	Quick-service
Expenses	Return on investment	restaurant (QSR)
Profit	(ROI)	Other controllable
Non-profit sector	Fixed cost	expenses
(foodservice)	Variable cost	Controllable income
Uniform system of	Standardized recipe	Non-controllable
accounts	Income statement	expenses
Uniform System of	Net income	Depreciation
Accounts for	Topline revenue	Occupancy costs
Restaurants (USAR)	Total sales	Non-cash expense
Accounting	Cost of sales	Furniture, fixtures, and
Ideal expense	Payroll	equipment (FF&E)
Desired profit	Total labor	Interest expense
Point-of-sales	Prime cost	Income before
(POS) system	Full-service restaurant	income taxes
Front-of-house staff	Fast casual (restaurant)	

Operator’s 10-Point Tactics for Success Checklist

Evaluate your need for, and the current status of, each of the following operational tactics. For those tactics you think are important, but not yet in place, develop an action plan for its implementation including who will be responsible for the tactic’s completion and the target date by which it should be completed.

Tactic	If Not Done				
	Don't Agree (Not Done)	Agree (Done)	Agree (Not Done)	Who Is Responsible?	Target Completion Date
1) Operator can identify the three components of the foodservice profit formula.	___	___	___		
2) Operator discerns the importance of utilizing the Uniform System of Accounts for Restaurants (USAR) when reporting the financial performance of a foodservice operation.	___	___	___		

(Continued)

Tactic	Don't Agree (Not Done)	Agree (Done)	Agree (Not Done)	If Not Done	
				Who Is Responsible?	Target Completion Date
3) Operator understands that the effective control of costs in a foodservice operation is an ongoing process.	_____	_____	_____		
4) Operator recognizes the important role of business owners in the effective management of costs.	_____	_____	_____		
5) Operator recognizes the important role of managers in the effective management of costs.	_____	_____	_____		
6) Operator recognizes the important role of production staff in the effective management of costs.	_____	_____	_____		
7) Operator recognizes the important role of service staff in the effective management of costs.	_____	_____	_____		
8) Operator understands the importance of an operating budget in the effective management of costs.	_____	_____	_____		
9) Operator understands the importance of utilizing standardized recipes in the effective management of costs.	_____	_____	_____		
10) Operator understands the importance of and the components of the income statement (P&L) to effectively manage costs.	_____	_____	_____		