

Staff Planning and Labor Cost Control

Learning Objectives

After reading this chapter, you should be able to:

- understand fair hiring practices;
- understand the differences between salary and wages;
- apply FLSA rules to payroll processes;
- calculate overtime pay for hourly employees;
- use governmental and voluntary deductions in payroll processes;
- use staff planning to manage employee morale and labor costs;
- schedule your staff wisely to maximize productivity;
- create a staffing guide and staffing standards;
- forecast business volume for adequate staffing;
- conduct a productivity analysis of sales volume versus labor hours;
- perform a full-time equivalent (FTE) study.

In Practice

Myla Thomas focused on controlling one of the primary costs in the food-service industry: labor costs. With planning and an effective monitoring system, she knew she could keep staff costs within budget and avoid letting these expenses get out of hand.

Myla believed strongly that ability is what you are capable of doing, motivation determines what you actually do, and attitude determines how well you do it. In each of these three areas, she felt that the team could do a better job, which would translate into satisfied customers and improved profits. Myla scheduled a meeting with Sarah Bright, the human resources manager, to discuss challenges facing the company in these areas.

Myla: *There are times when I am not satisfied with the levels of employee performance, and it is at times connected to attitude. What do you think might be contributing to low employee morale?*

Sarah: *It has a lot to do with scheduling and employee recognition. Sometimes we fall short in these two areas.*

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Myla: *Agreed. What about the current standards? Are they contributing to the problem?*

Sarah: *The standards give managers guidelines, so they can encourage staff excellence and efficiency. But I must say that we have never developed reasonable expectations and plans for these costs.*

Myla: *Why not? That should be the foundation for managing labor cost. Wouldn't you agree?*

Sarah: *Yes, of course. I took over payroll responsibilities six months ago to mitigate the challenges we were facing from business and legal reporting requirements. Part of my goal is to provide business and legal support to the team.*

INTRODUCTION

This chapter addresses a basic area of cost control: knowledge about the rules and regulations of labor costs. Then we turn to the laws governing any payroll system, because these affect how labor costs are accumulated and reported. Lastly, we examine labor standards and productivity assessment.

Business success in the food-service industry requires a balancing act among three competing pressures in staff planning and labor cost control:

1. Pressure from the owner or investors to improve productivity and minimize payroll cost
2. Pressure from employees for improved hours and wages
3. Pressure from customers for improved services

The *pressure from the owner* stems from the fact that labor costs represent a significant portion of total operation expenses. Figure 14-1 shows figures reported by the National Restaurant Association (NRA) in 2007.

Figure 14-1 Operating Expenses

	Full service restaurant (with an average check per person under \$10)	Full service restaurant (with an average check per person over \$10)	Limited service, fast food restaurants
Salaries and wages	28.0% of sales	26.9% of sales	24.2% of sales
Employee benefits	3.9% of sales	4.2% of sales	3.7% of sales
Cost of food sold	32.2% of sales	30.0% of sales	28.4% of sales

In fact, because the combination of labor and food costs typically consumes approximately 60 percent of revenue, it is often called prime cost. In this chapter, we will examine the different components of labor cost.

Employee pressure to improve hours and wages is not limited to the food-service industry. In fact, all employees' happiness and performance are largely influenced by these factors:

- When are employees available to work, versus when they are scheduled to work?
- Are employees required to maintain a minimum number of hours in order to be eligible for benefits? What are your company's policies?

- Which position or positions is each employee qualified to fill?
- Do the minimum and maximum shift length conflict with employees' other obligations?
- How many hours do employees want to work per week, versus how many hours they are scheduled?
- Are overtime work requirements an issue?
- Is seniority a factor?
- Do any union rules prevail?
- Is proficiency for a particular task required?
- Can employees get the days off that they want?
- Did the employee receive adequate job training?
- Are the company's hiring practices fair or discriminatory?

Because of the pressure from the owners, many managers often place a much higher emphasis on the bottom line than on employee morale. But the cost of low morale can be enormous: Hiring, training, and motivating staff is not only time-consuming, but also expensive. A recent study of Marriott Hotels, conducted by Schlesinger and Heskett of the Harvard Business Review, revealed that a 10 percent decrease in employee turnover has been found to correlate with a 1 to 3 percent decrease in lost customers and a \$50 to \$100 million increase in revenue. Because these front-line people are vital to the success of any food-service operation, their morale should be a prime consideration of any manager, even while he or she stays focused on the bottom line.

Discrimination in a work place

One of the key areas in which managers can influence good relations with employees is in fair hiring practices. Using proper hiring practices helps avoid discrimination based on race, gender, or other protected characteristics, and can also set the standards necessary for a non-discriminating, non-harassing environment. To ensure that employers do not discriminate against protected classes in the hiring process, the law bars employers from asking certain questions at the time of an employment interview. The ban applies to all aspects of the hiring process, including the application form, the interview, and questions contained in the testing materials the employer may utilize.

The following are some examples of broad questions that are not allowed, and some narrower, acceptable questions to elicit particular information while not violating interviewees' rights:

Not allowed: *Have you ever been arrested?*

Allowed: *Have you been convicted of any of the following crimes?* (The crimes listed must be reasonably related to the job)

This question might be applicable for jobs for which you need a driver, for example, and wish to check his or her legal driving status. Such a question is legitimate while asking whether someone has ever been arrested could discriminate against someone who was arrested for an unrelated crime or misdemeanor.

Not allowed: *What country are you from?*

Allowed: *Are you authorized to work in the United States?*

While an employer needs to know if a potential employee can legally work, asking "What country are you from?" elicits unnecessary information that could seem discriminatory.

Not allowed: *How many days were you absent from work because of illness last year?*

Allowed: *Are you able to lift 100 pound weight and carry it up to 400 yards, which is required by this job?*

The more specific you are, the better—and the specifics should be exactly those that are required by the position.

Not allowed: *Are you married? Engaged? Divorced?*

Allowed: *Would you be willing to travel as needed for the job?*

An applicant's marital status is personal and does not help the employer understand his or her willingness or availability for travel—remember to stay within the job specifications.

Not allowed: *How old are you?*

Allowed: *Are you over the age of 18?*

Asking someone's age implies that the hiring decision might be made on this basis, but all the hiring manager needs to know is whether or not the applicant is legally able to work in the position.

Not allowed: *What religion do you practice?*

Allowed: *This job requires working weekends and holidays. Is there anything that would prevent you from doing so?*

Again, someone's religion is not a legitimate basis for hiring or not hiring a person. However, you can discern whether or not the person can work the necessary days for the position in question.

Race is one of the grounds on which the relevant statute, called Title VII, outlaws discrimination. The statute's main objective in the beginning was to eliminate discrimination against blacks. Sadly, racism has been a fact in our society, requiring this remedial legislation. Its application, however, is not restricted to any one racial or minority group. In the words of the United States Supreme Court, the prohibition against discrimination in employment on the basis of race bars "discriminatory preference for any racial group, minority or majority." Additional examples of racial groups include Caucasian, Hispanic, Asian, Native American, and Inuit.

The outlawed discrimination includes not only refusal to hire, resistance to promotion, and unjustified firing, but also all other types of discrimination, such as refusal to allow an employee to wear a particular hairstyle or terminating a white employee for associating with a black colleague.

An interesting application of Title VII is found in *Singh v. Shoney's, Inc.*

64 F.3d 217 (5th Cir. 1995). An employer was able to defend against a claim of discriminatory firing by establishing a legitimate, nondiscriminatory reason for the termination. A charge of discrimination made by a Caucasian dining-room supervisor was dismissed because the employer could establish misconduct on the employee's part, thus justifying the termination.

Delores Singh filed a complaint against her former employer, Shoney's, Inc., alleging that she was fired because of her race. The district court granted summary judgment in favor of Shoney's. Singh, a white female, worked for Shoney's for more than ten years. At the time of her termination in January 1993, Singh held the position of Dining Room Supervisor in a Shoney's restaurant in New Orleans, Louisiana. Her duties included hiring, firing, supervising, disciplining, and training the hosts, wait staff, and salad bar attendants who worked in the restaurant.

In January 1993, Shoney's corporate office received a petition signed by 36 workers employed in the same restaurant as Singh. The petition alleged that Singh had been engaging in offensive, racially-discriminating conduct toward subordinate employees. Shoney's responded to the petition by sending its Vice-President of Personnel, John Southerland, and its Equal Employment Opportunity Manager, Juanita Presley (both of whom are black), to New Orleans to investigate the allegations. Southerland and Presley interviewed 44 employees at the restaurant, including Singh. Based on these interviews, Shoney's concluded that Singh had engaged in offensive, inappropriate conduct in the workplace, and terminated her employment.

During the course of the investigation, it came to Shoney's attention that the manager of the restaurant, Terry Dumars, a black male, had also engaged in inappropriate conduct in the workplace, and he was terminated. Dumars was replaced with a white male, and Singh was replaced with another white female. Singh attempted to sue Shoney's for discrimination against her in her firing.

In order to file a *prima facie* case of discrimination, which is a Latin expression meaning "on its first appearance" a plaintiff alleging discriminatory discharge must show (1) that she is a member of a protected group; (2) that she was qualified for the job that she formerly held (and performing her job at a level that met the employer's legitimate expectations); (3) that she was discharged; and (4) that after her discharge, the position she held was filled by someone not within her protected class (or the discharge occurred under circumstances giving rise to an inference of discrimination based on the plaintiff being part of protected class). Once the plaintiff establishes a *prima facie* case of discrimination, the defendant must articulate a legitimate, nondiscriminatory reason for the discharge. If the defendant states a legitimate reason, the plaintiff must show, by a preponderance of the evidence, that the reason provided by the defendant was a pretext for discrimination.

Singh failed to reach the standard of a *prima facie* case of racial discrimination in this case, because she was replaced by a white female. Moreover, Shoney's stated a legitimate nondiscriminatory reason for discharging Singh, backed up by the evidence from the in-person interviews. Shoney's management found reason to believe the allegations contained in the coworkers' petition, and they acted on it in good faith.

A second area of prime concern in hiring and staffing a business is creating a workplace free of sexual harassment or discrimination. This standard is for the benefit of all employees—both women and men have been victims of sexual discrimination and harassment in the workplace, which can destroy productivity and staff morale. Federal guidelines on this issue include the following guiding precepts:

1. Harassment can include *quid pro quo*—such as insinuating that job conditions or assignments will be based on going along with harassment—or simply create a hostile work environment.
2. Employers are responsible for harassment that they knew about or should have known about, unless they immediately act in good faith to correct the problem. This goes for employees and, in some cases, non-employees such as vendors, contractors, or others with whom their employees must come into contact in carrying out their jobs. If the harassment results in promotions or hiring for one person over another, those other persons can also sue the employer.
3. Employers need to act preventatively—ensuring that all staff know about the company's expectations for a harassment-free workplace, and that appropriate sanctions are in place and utilized when necessary.

Sexual harassment in the workplace acts to deteriorate working conditions; what is more, good employees are likely to leave such environments. Each employer should be aware of the threat and take preventive actions to avoid allowing harassment to be part of their workplaces.

Pressure from customers for improved service underlines the business culture of our time. Many companies in the food-service industry have used slogans to market their products and convince potential customers that their service exceeds expectations:

Burger King: “Have it your way”

Wendy’s: “Do what tastes right”

McDonald’s: “I’m lovin’ it”

DNC: “GuestPath”

Whatever slogan these companies use to distinguish themselves from the competition, the manager must balance the pressure to eliminate overstaffing, which results in wasted labor dollars, and to avoid understaffing, which would mean delivering poor customer service. In most industries, employees can produce in a steady and consistent manner; products that are produced are simply stored until a customer is ready to purchase the product. If product demand exceeds supply, production can be increased after the order has been received.

In the food-service industry, however, an employee’s usefulness is more circumscribed by work conditions. If there are no customers present, there is no productivity, but you still must pay the employee. The employee must be paid in order to be ready when the customer does walk in the door. Because food-service demand fluctuates radically with seasons, days of the week, and even hours of the day, maintaining optimal efficiency is difficult. Knowing how to budget for these fluctuating labor costs presents an additional challenge. In essence, the idle hours (unproductive hours) that the employee is on the clock are scheduled by the manager in anticipation for potential business. In most cases, unproductive hours can be greater than the productive hours the employee actually works. Figure 14-2 is an example of what these unproductive versus productive hours might look like. This is a hypothetical example, but disparities like this do exist.

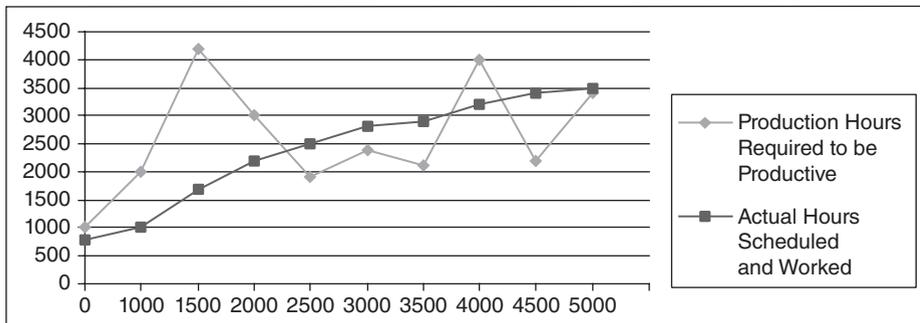


Figure 14-2 Actual Versus Required Hours

Production is inconsistent in this industry. It goes up and down in most businesses, but in food and beverage service, in which peaks and valleys characterize the hours of the day, it is an ongoing challenge. The data points above the line of production hours indicate overstaffing and wasted labor dollars. Conversely, points beneath that line indicate understaffing and jeopardized customer service. These are the challenges facing the manager. This chapter will explore both horns of this labor dilemma and give you techniques to minimize both costs and guest complaints, while getting the most out of your staff.

SALARY AND WAGES

In the beginning of this chapter, Sarah said to Myla, “But I must say that we have never developed reasonable expectations and plans for these costs.” Sarah was referring to the two major

components of labor-related costs: salaries and wages, and employee benefits and deductions. These costs make up what you saw in Figure 14-1.

The terms *salary* and *wages* are often used interchangeably, but there are important differences. Salary usually applies to managers, supervisors, and executives who receive a fixed amount each pay period regardless of the number of hours worked. They are usually paid monthly or biweekly. These employees are exempt from overtime pay. Wages, on the other hand, apply to payrolls computed on an hourly, weekly, or piecemeal basis. These employees are nonexempt from overtime pay; that means they are eligible to receive overtime whenever they go over a certain number of work hours in a given period.

Gross Pay and Net Pay

Gross pay includes all of an employee's regular pay, overtime pay, commissions, and bonuses—before any payroll deductions. Gross pay may be calculated weekly, biweekly, bimonthly, monthly, daily, or over some other time period. Salaried employees exempt from overtime do not require any special computation for gross pay because they are paid a fixed amount regardless of the actual number of hours worked. Tipped employees, on the other hand, require a special payroll computation, which is addressed in detail later in this chapter.

Net pay is the actual amount of an employee's paycheck. Net pay is the result of subtracting governmental and voluntary deductions from gross pay. Figure 14-3 is an example of how net pay is calculated.

Figure 14-3 Net Pay Calculation

Gross Pay			\$500.00
Less:	FICA	(8%)	\$40.00
	FIT	(18%)	90.00
	SIT	(5%)	25.00
	TDI	(2%)	10.00
	Union Dues		10.00
	Health Insurance		15.00
	TOTAL DEDUCTIONS		190.00
Net Pay (amount of check)			\$310.00

Source: Federal Insurance Contribution Act (FICA), Federal Income Tax (FIT), Federal Unemployment Tax Act (FUTA), Temporary Disability Insurance (TDI), State Income Tax (SIT)

RULES AND REGULATIONS GOVERNING LABOR COSTS

There are many rules and regulations governing the treatment of salary and wages in a workplace. For example, the Fair Labor Standards Act (FLSA) is a federal law adopted in 1938 to eliminate unfair methods of compensation and labor conditions injurious to the health and efficiency of workers. It mandates minimum wages, time-and-a-half pay for overtime work, equal pay for equal work, and restrictions on child labor. The act has been amended and updated numerous times since its original passage.

Minimum Wage

The FLSA requires that, with few exceptions, employers pay employees at least the minimum wage set by the U.S. Congress. As of July 24, 2008, the federal minimum wage is \$6.55 per hour. It will increase to \$7.25 per hour effective July 24, 2009. For timing purposes, examples will be based on \$7.25 per hour rate. States may have legislation that contradicts standards established by the FLSA. In cases where state and federal laws differ, the law offering greater benefits to the employees prevails. For example, the minimum wage in California is \$8 per hour. Federal laws require a lower minimum wage. Therefore, employers in California must pay the California rates.

Exceptions to Minimum Wage

There are several exceptions to FLSA rules relating to minimum wage. The low-revenue exception from the minimum-wage requirement applies to employers with less than \$500,000 in annual revenue. In the following example, the court had to decide whether a hotel and adjacent restaurant were two separate businesses, each falling below the threshold amount for FLSA coverage (the threshold was then \$362,500 in annual revenue), or one business.

Ronald and Beverly Halling appealed the district court's decision that their motel and restaurant business violated the minimum wage provisions of the Fair Labor Standards Act (FLSA). The issue in dispute was whether the Hallings' business was exempt from the provisions of the FLSA as it relates to the low revenue threshold.

Ronald Halling owned the Best Western Sundown Motel, which generated an approximate annual sales volume of \$265,000. Beverly Halling owned an adjoining restaurant, Grandmother's House, which generated an approximate annual sales volume of \$190,000. If the motel and the restaurant were taken to be separate enterprises, both would be exempt from the FLSA, in that both had an annual sales volume of less than the revenue minimum required for application of the FLSA (\$362,500 in this case). The U.S. Secretary of Labor contended that the motel and restaurant formed a single enterprise (with a total income over the \$362,500 threshold), because they were related activities performed through a unified operation and common control for a common business purpose.

The district court decided in favor of the secretary. The court found that the motel and restaurant were physically connected; that each business operated without regular payment of rent on property owned jointly by the Hallings; and that the establishments shared a telephone, laundry facilities, and advertising. The court further found that Ronald often did work in the restaurant and once signed the restaurant's income-tax return, while Beverly frequently did work at the motel. The court also found that the Hallings jointly hired a couple to manage the motel and restaurant.

Affirmed. Brock v. Best Western Sundown Motel, Inc. 883 F.2d 51 (8th Cir. 1989)

Another exception to the FLSA rules permits employers to pay a training wage of \$4.25 an hour to newly hired employees under the age of 20 for the first 90 days of employment. No specific training is required during this period. Restaurant employers should consult their particular state laws to determine whether this federal training wage is permissible in their states.

Meals and Lodging

Many states put restrictions on employers using employee meals and lodging as part of their calculations of minimum wage. One such state is California, where credit against the minimum wage is not allowed without a voluntary written agreement between the employer and the employee. When credit for meals or lodging is used to meet part of the employer's minimum wage obligation, the amount so credited may not be more than the following:

Meals

- Breakfast, \$2.90 effective January 1, 2008
- Lunch, \$3.97 effective January 1, 2008
- Dinner, \$5.34 effective January 1, 2008

Lodging

- Room occupied alone, \$37.63 per week effective January 1, 2008
- Room shared, \$31.06 per week effective January 1, 2008
- Apartment, two-thirds of the ordinary rental value, and in no event more than \$451.89 per month effective January 1, 2008
- When both members of a couple are employed by the employer, two-thirds of the ordinary rental value, and in no event more than \$668.46 per month effective January 1, 2008

Credit for Tipped Employees

Provisions of the FLSA allow employers to apply a tip credit toward the minimum wage of tipped employees. This tip credit effectively lowers the gross wages payable by the employer because tips may be treated as supplemental wages. The FLSA maximum allowable tip credit is \$2.13 per hour. This means that an employer may apply a credit of \$2.13 toward the hourly rate of tipped employees as long as the actual tips received by the employee are not less than the FLSA maximum allowable tip credit.

Effective July 24, 2009, an employer is in compliance with the FLSA minimum wage and hour standards by paying a tipped employee as follows:

Minimum hourly rate	\$7.25
Allowable tip credit	<u>\$2.13</u>
Effective hourly payment rate	\$5.12

Employee Tip Reporting

IRS Publication 531 provides information on tip income reporting and employers' responsibilities. It also includes sample tip reporting forms.

Employees must report cash, charge, or credit card tips received from customers. An employee may use IRS Form 4070 or a similar statement to report tips to the employer (Figure 14-4). A daily report or card showing the employee's name, cash tips received, and charge tips received is sufficient. Some employers require tipped employees to record their tips daily on the backs of their time cards.

Form 4070 (Rev. August 2005) Department of the Treasury Internal Revenue Service		Employee's Report of Tips to Employer		OMB No. 1545-0074
Employee's name and address		Social security number		
Employee's name and address (include establishment name, if different)		1 Cash tips received		
		2 Credit and debit card tips received		
		3 Tips paid out		
Month or shorter period in which tips were received from to		4 Net tips (lines 1 + 2 - 3)		
Signature		Date		
For Paperwork Reduction Act Notice, see the instructions on the back of this form.		Cat. No. 41320P		Form 4070 (Rev. 8-2005)

Figure 14-4 Employee Tips Report, IRS Form 4070

Service Charges

Some restaurant operations may add service charges to guests' bills. These service charges are distributed to servers and other customarily tipped employees. A service charge is not considered a tip. Such charges are defined as wages by the IRS and are treated the same as other wages for purposes of tax withholding requirements.

Application of FLSA Rules to Tip Credit

The following example illustrates how the gross wages payable by the employer are calculated when the actual tips received by an employee are greater than the maximum FLSA tip credit. Assume that Employee 1 has worked 40 hours, and the employer has elected to use the allowable tip credit against the minimum wage. The employee reports tips amounting to \$98. The maximum FLSA tip credit is \$85.20 (40 hours × \$2.13 per hour). The gross wages payable by the employer are calculated as follows:

Gross wages (minimum wage: 40 hours × \$7.25 per hour)	\$290.00
Less the lower of:	
Maximum FLSA tip credit (40 hours × \$2.13)	\$85.20
Actual tips received	\$98.00
Allowable tip credit	<u>85.20</u>
Gross wages payable by the employer	<u>\$204.80</u>

Using Actual Tips Received for Tip Credit

Another example illustrates how the gross wages payable by the employer are calculated when the actual tips received by an employee are less than the maximum FLSA tip credit. Assume that Employee 2 has worked 40 hours, and the employer has elected to use the allowable tip credit against the minimum wage. The employee reports tips amounting to \$70. The maximum FLSA tip credit is \$85.20. The gross wages payable by the employer are calculated as follows:

Gross wages (minimum wage: 40 hours × \$7.25 per hour)	\$290.00
Less the lower of:	
Maximum FLSA tip credit (40 hours × \$2.13)	\$85.20
Actual tips received	\$70.00
Allowable tip credit	<u>\$70.00</u>
Gross wages payable by the employer	<u>\$220.00</u>

Tipped Employees' Net Pay

A tipped employee's gross taxable earnings include the gross wages payable by the employer and the actual tips the employee receives from guests. Figures 14-5, 14-6, and 14-7 illustrate how net pay is computed for Employees 1 and 2 from the previous examples. To simplify the illustration, state and local taxes are not considered, a 10 percent federal income tax rate is used, and a \$15 voluntary deduction for a group health plan is assumed.

It is possible for the governmental and voluntary deductions of a tipped employee to exceed the gross wages payable by the employer for a payroll period. In this case, available amounts are first applied to FICA taxes, then to federal and state income taxes, and finally to voluntary deductions. However, an employee's paycheck may never be less than zero; if the gross wages payable by the employer are insufficient to cover an employee's governmental and voluntary deductions, the employee may pay the deficiency to the employer.

If the employer is unable to withhold FICA taxes, this fact is reported on the employee's W-2 form and is reported as taxes due on the employee's personal income tax return. It is not necessary to report any deficiency on withheld income taxes because any deficiency will be made up when the employee's total income tax liability is computed on his or her personal income tax return.

Tipped Employees' Overtime Pay

Overtime pay for tipped employees is calculated in exactly the same manner as for nontipped employees. However, in computing the gross wages payable by the employer, the federal or state tip credit is multiplied by the total hours worked (regular hours plus overtime hours) by the employee. For example, assume that Employee 1 and Employee 2 each work 45 hours and report actual tips received of \$100 and \$80 respectively. Assume further that the employer pays tipped employees \$6 per hour and the state's overtime provisions are identical to FLSA provisions. Figures 14-8 and 14-9 illustrate how to calculate the net pay for these employees.

As stressed earlier, the identification of overtime pay varies with different state laws, company policies, and contracts. Federal law requires that overtime be paid for any hours worked in excess of 40 in a payroll week. Thus, an employee who works ten-hour shifts for four days within a payroll week is not entitled to overtime under the FLSA. Some states require that employees receive overtime pay for any hours worked in excess of eight hours in a payroll day. You will need to understand how the laws work in your area.

Figure 14-5 Computing Net Pay For Employee 1: Hourly Rate At Minimum Wage

<u>Gross Wages Payable by Employer</u>	
Gross wages (40 hours x \$7.25 per hour)	\$290.00
Less the lower of:	
Maximum FLSA tip credit (40 hours x \$2.13)	\$85.20
Actual tips received	98.00
Allowable tip credit	<u>85.20</u>
Gross wages payable by the employer	\$204.80
<u>Gross Taxable Earnings</u>	
Gross wages payable by employer	\$204.80
Actual tips received	<u>98.00</u>
Gross taxable earnings	<u>\$302.80</u>
<u>Less Governmental and Voluntary Deductions</u>	
FICA ($\$302.80 \times 7.65\%$)	23.16
Income tax withholding ($\$302.80 \times 10\%$)	30.28
Voluntary deduction (group health plan)	<u>15.00</u>
Net pay (amount of payroll check)	<u>\$136.36</u>

Figure 14-6 Computing Net Pay for Employee 2: Hourly Rate at Minimum Wage

<u>Gross Wages Payable by Employer</u>		
Gross wages (40 hours x \$7.25 per hour)		\$290.00
Less the lower of:		
Maximum FLSA tip credit (40 hours x \$2.13)	\$85.20	
Actual tips received	70.00	
Allowable tip credit		<u>70.00</u>
Gross wages payable by the employer		\$220.00
<u>Gross Taxable Earnings</u>		
Gross wages payable by employer	\$220.00	
Actual tips received	70.00	
Gross taxable earnings		<u>\$290.00</u>
<u>Less Governmental and Voluntary Deductions</u>		
FICA (\$290.00 x 7.65%)		22.19
Income tax withholding (\$290.00 x 10%)		29.00
Voluntary deduction (group health plan)		<u>15.00</u>
Net pay (amount of payroll check)		<u>\$153.81</u>

Figure 14-7 Computing Net Pay for Employee 1: Hourly Rate Above Minimum Wage

<u>Gross Wages Payable by Employer</u>		
Gross wages (40 hours x \$8.00 per hour)		\$320.00
Less the lower of:		
Maximum FLSA tip credit (40 hours x \$2.13)	\$85.20	
Actual tips received	98.00	
Allowable tip credit		<u>85.20</u>
Gross wages payable by the employer		\$234.80
<u>Gross Taxable Earnings</u>		
Gross wages payable by employer	\$234.80	
Actual tips received	98.00	
Gross taxable earnings		<u>\$332.80</u>
<u>Less Governmental and Voluntary Deductions</u>		
FICA (\$332.80 x 7.65%)		25.46
Income tax withholding (\$332.80 x 10%)		33.28
Voluntary deduction (group health plan)		<u>15.00</u>
Net pay (amount of payroll check)		<u>\$161.06</u>

The 8 Percent Tip Regulation

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) established regulations affecting food and beverage operations with respect to tip reporting requirements. The intent of the regulation is for all tipped employees to report tips of at least 8 percent of the gross receipts of the hospitality establishment. If tips reported by employees fail to meet this 8 percent requirement for a particular period, the deficiency is called a tip shortfall. This shortfall will require allocation to those employees classified as directly tipped employees.

The 8 percent tip regulation distinguishes between directly tipped employees and indirectly tipped employees. Directly tipped employees are those who receive tips directly from customers.

Figure 14-8 Computing Net Pay for Employee 1: Overtime Pay Calculation

<u>Gross Wages Payable by Employer</u>		
Regular Pay (40 hours	\$8.00 per hour)	\$ 320.00
Overtime Pay (5 hours	\$8.00 1.5)	<u>60.00</u>
Gross Wages		\$ 380.00
Less the lower of:		
Maximum FLSA tip credit (45 hours	\$2.13)	\$95.85
Actual tips received		100.00
Allowable tip credit		<u>95.85</u>
Gross wages payable by employer		\$ 284.15
<u>Gross Taxable Earnings</u>		
Gross wages payable by employer		\$ 284.15
Actual tips received		<u>100.00</u>
Gross taxable earnings		<u>\$384.15</u>
<u>Less Governmental and Voluntary Deductions</u>		
FICA (\$384.15 7.65%)		29.39
Income tax withholding (\$289.15 10%)		38.41
Voluntary deduction (group health plan)		<u>15.00</u>
Net pay (amount of payroll check)		<u>\$ 201.35</u>

Figure 14-9 Computing Net Pay for Employee 2: Overtime Pay Calculation

<u>Gross Wages Payable by Employer</u>		
Regular Pay (40 hours	\$8.00 per hour)	\$ 320.00
Overtime Pay (5 hours	\$8.00 1.5)	<u>60.00</u>
Gross Wages		\$ 380.00
Less the lower of:		
Maximum FLSA tip credit (45 hours	\$2.13)	\$95.85
Actual tips received		80.00
Allowable tip credit		<u>80.00</u>
Gross wages payable by employer		\$ 300.00
<u>Gross Taxable Earnings</u>		
Gross wages payable by employer		\$ 300.00
Actual tips received		<u>80.00</u>
Gross taxable earnings		<u>\$380.00</u>
<u>Less Governmental and Voluntary Deductions</u>		
FICA (\$380.00 7.65%)		29.07
Income tax withholding (\$380.00 10%)		38.00
Voluntary deduction (group health plan)		<u>15.00</u>
Net pay (amount of payroll check)		<u>\$ 217.93</u>

Examples of directly tipped employees are servers, bartenders, and other employees, such as maitres d'. Indirectly tipped employees are employees who do not normally receive tips directly from customers. These employees include busepersons, service bartenders, and cooks.

When a shortfall is allocated, the employer is required to provide each directly tipped employee with an informational statement showing the tips reported by the employee and the tips that

should have been reported. An employer does not have to provide employees with tip allocation statements when the total tips reported for a period are greater than 8 percent of the gross receipts for that period. For example, assume that the Sea Breeze Hotel Restaurant record shows a gross receipt of \$100,000 for a particular period. If the actual tips reported by employees total more than \$8,000 ($\$100,000 \times 8$ percent), the employer does not have to provide employees with tip allocation statements.

An employee’s tip allocation for a calendar year is stated separately from any wages and reported tips appearing on the employee’s W-2 form. Employees should maintain adequate records to substantiate the total amount of tips included in income. If possible, the employee should keep a daily record of his or her sales, cash tips, charge tips, and hours worked. To facilitate record-keeping, a business may provide the employee with a multipurpose form similar to the one shown in Figure 14-10.

Figure 14-10 Sample Employee Report of Daily Sales and Tips

Employee Report of Daily Sales and Tips								
Business _____				Week ending <u> </u> / <u> </u> / <u> </u> <small>(Month/Day/Year)</small>				
Employee _____								
Enter day of the month	Date	Date	Date	Date	Date	Date	Date	Grand Total
	Mon.	Tue.	Wed.	Thu.	Fri.	Sat.	Sun.	
SALES								
1. Total sales to patrons	-----	-----	-----	-----	-----	-----	-----	-----
2. Charge sales in	-----	-----	-----	-----	-----	-----	-----	-----
TIPS								
1. Total cash and charge tips	-----	-----	-----	-----	-----	-----	-----	-----
2. Total charge tips in	-----	-----	-----	-----	-----	-----	-----	-----
Total hours worked	-----	-----	-----	-----	-----	-----	-----	-----
Check shift worked: <input type="checkbox"/> Days <input type="checkbox"/> Evenings <input type="checkbox"/> Split								

Allocation of Tip Shortfall

If, during a particular period, the total tips reported by directly and indirectly tipped employees fall short of 8 percent of the gross receipts of the establishment in the same period, the establishment must do the following: (1) determine the shortfall (the amount by which the total reported tips falls short of 8 percent of the gross receipts), and (2) allocate the shortfall among directly tipped employees. After these computations have been completed, the tip shortfall allocations must be reported to each affected employee. IRS Form 8027 (Figure 14-11) is used to report tip shortfall.

There are several acceptable methods by which to compute tip shortfall allocations for directly tipped employees. One method is through good faith agreement. A good faith agreement is a written agreement between the employer and employees, consented to by two-thirds of the tipped employees at the time of the agreement. This agreement becomes the basis of allocating tip amounts to employees when the actual tips reported are short of the expected 8 percent of gross receipts.

In the absence of a good faith agreement, the 8 percent tip regulation provides tip allocation methods. For purposes of allocating the tip shortfall to directly tipped employees, these regulations permit the use of the *gross receipts method* or, under certain conditions, the *hours worked method*. The following examples explain and illustrate both methods.

The gross receipts method requires that gross receipts (food and beverage sales) and tip records be maintained for each directly tipped employee. Gross receipts are used as a basis for allocating each directly tipped employee’s share of the tip shortfall. The tip shortfall allocation may be performed weekly, monthly, quarterly, annually, or at some other designated time period

Form 8027 Department of the Treasury Internal Revenue Service	Employer's Annual Information Return of Tip Income and Allocated Tips ▶ See separate instructions.	OMB No. 1545-0714 <div style="font-size: 2em; font-weight: bold; text-align: center;">2008</div>
Name of establishment _____ Number and street (see instructions) _____ City or town, state, and ZIP code _____		Employer identification number Type of establishment (check only one box) <input type="checkbox"/> 1 Evening meals only <input type="checkbox"/> 2 Evening and other meals <input type="checkbox"/> 3 Meals other than evening meals <input type="checkbox"/> 4 Alcoholic beverages
Employer's name (same name as on Form 941) _____ Number and street (P.O. box, if applicable) _____ Apt. or suite no. _____ City, state, and ZIP code (if a foreign address, see instructions) _____		Establishment number (see instructions)
Does this establishment accept credit cards, debit cards, or other charges? <input type="checkbox"/> Yes (lines 1 and 2 must be completed) <input type="checkbox"/> No		Check if: Amended Return <input type="checkbox"/> Final Return <input type="checkbox"/>
Attributed Tip Income Program (ATIP). See Revenue Procedure 2006-30 <input type="checkbox"/>		
1 Total charged tips for calendar year 2008.	1	
2 Total charge receipts showing charged tips (see instructions)	2	
3 Total amount of service charges of less than 10% paid as wages to employees.	3	
4a Total tips reported by indirectly tipped employees	4a	
b Total tips reported by directly tipped employees	4b	
Note. Complete the Employer's Optional Worksheet for Tipped Employees on page 6 of the instructions to determine potential unreported tips of your employees.		
c Total tips reported (add lines 4a and 4b)	4c	
5 Gross receipts from food or beverage operations (not less than line 2—see instructions)	5	
6 Multiply line 5 by 8% (.08) or the lower rate shown here ▶ _____ granted by the IRS. (Attach a copy of the IRS determination letter to this return.)	6	
Note. If you have allocated tips using other than the calendar year (semimonthly, biweekly, quarterly, etc.), mark an "X" on line 6 and enter the amount of allocated tips from your records on line 7.		
7 Allocation of tips. If line 6 is more than line 4c, enter the excess here	7	
▶ This amount must be allocated as tips to tipped employees working in this establishment. Check the box below that shows the method used for the allocation. (Show the portion, if any, attributable to each employee in box 8 of the employee's Form W-2.)		
a Allocation based on hours-worked method (see instructions for restriction) <input type="checkbox"/>		
Note. If you marked the checkbox in line 7a, enter the average number of employee hours worked per business day during the payroll period. (see instructions) _____		
b Allocation based on gross receipts method <input type="checkbox"/>		
c Allocation based on good-faith agreement (Attach a copy of the agreement). <input type="checkbox"/>		
8 Enter the total number of directly tipped employees at this establishment during 2008 ▶ _____		
Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.		
Signature ▶ _____	Title ▶ _____	Date ▶ _____
For Privacy Act and Paperwork Reduction Act Notice, see page 6 of the separate instructions. Cat. No. 49989U Form 8027 (2008)		

Figure 14-11 IRS Form 8027

during the year. The following hypothetical example demonstrates the computations involved when the gross receipts method is used to allocate a tip shortfall among the directly tipped employees of the Sea Breeze Hotel Restaurant.

The Sea Breeze Hotel Restaurant is a food and beverage establishment with an equivalent of more than ten employees and, therefore, is subject to the government's 8 percent tip regulation. The Sea Breeze Hotel Restaurant has food and beverage sales of \$100,000 for a particular period. According to the government's 8 percent tip regulation, directly and indirectly tipped

employees should have reported a minimum of \$8,000 in tips for that period ($\$100,000 \times 8$ percent $\times \$8,000$); this amount will be referred to as 8 percent gross receipts. The tip records show that all employees reported total tips of only \$6,200 for that period. Therefore, a tip shortfall of \$1,800 ($\$8,000 - \$6,200$) has occurred.

Figure 14-12 presents information compiled by Myla, Sea Breeze’s restaurant manager for this particular period, including the gross receipts (food and beverage sales) and tips reported by each directly tipped employee. It also shows that the total shortfall to be allocated is \$1,800. This information will be used later in Figures 14-13 and 14-14 to compute tip shortfall allocations for directly tipped employees.

Figure 14-12 Sales and Tips Analysis: Sea Breeze Restaurant

<u>Directly Tipped Employee</u>	<u>Gross Receipts for Period</u>	<u>Tips Reported</u>
1	\$18,000	\$1,080
2	16,000	880
3	23,000	1,810
4	17,000	800
5	12,000	450
6	14,000	680
Total	<u>\$100,000</u>	<u>\$5,700</u>
Indirectly tipped employees		500
Total		<u><u>\$6,200</u></u>
Tips that should have been reported (100,000 8%)		= \$8,000
Actual tips reported		= <u>6,200</u>
Shortfall to be allocated		= <u><u>1,800</u></u>
Tips that should have been reported		= 8,000
Tips reported by indirectly tipped employees		= 500
Directly tipped employees portion of 8% gross receipts		= <u><u>\$7,500</u></u>

While directly tipped employees are required to account for the tip shortfall, the tips of indirectly tipped employees may be counted toward the 8 percent of gross receipts estimate of total tips that should have been reported. For the Sea Breeze Hotel Restaurant, total tips that should have been reported by all employees are \$8,000; the tips reported by indirectly tipped employees total \$500. Therefore, the directly tipped employees’ portion of 8 percent gross receipts is \$7,500.

Figure 14-12 uses the directly tipped employees’ portion of 8 percent gross receipts as the basis for calculating shortfall allocation ratios. The shortfall allocation ratios will be used to allocate the \$1,800 tip shortfall among directly tipped employees. However, before tip shortfall allocation ratios can be computed, a method must be used to determine each employee’s share of the \$7,500 portion of tips that should have been reported by directly tipped employees. Each employee’s share will be compared to the tips actually reported by the employee in order to determine whether the employee reported tips above or below his or her share of the \$7,500 portion of 8 percent gross receipts.

Under the gross receipts method, a gross receipts ratio is used to determine each employee’s share of the \$7,500. A gross receipts ratio is the proportion of gross receipts attributable to each employee relative to the total gross receipts for the period. This ratio is multiplied by \$7,500 (directly tipped employees’ portion of 8 percent gross receipts) to determine each directly tipped employee’s share of this amount. Figure 14-12 illustrates these calculations for Sea Breeze Hotel Restaurant.

The actual tips reported by each employee are then subtracted from the employee’s share of 8 percent gross receipts. The resulting figure is the employee shortfall numerator. For the Sea

Breeze Restaurant, this subtraction process is greater than the share of the tips that should have been reported. From Figure 14-12, Employee 3 declared \$1,810, which is above the threshold of \$1,725. Therefore, he or she does not have a tip shortfall. The total shortfall (\$1,800) must be allocated on a proportional basis among the remaining directly tipped employees.

Figures 14-13 and 14-14 show how the \$1,800 tip shortfall is allocated among directly tipped employees whose reported tips did not equal or exceed their share of the 8 percent tip estimate. This proportional allocation is accomplished by the use of a shortfall ratio. The total of the employees' shortfall numerators, or \$1,885, is used as the denominator of the shortfall ratio. Each employee's shortfall numerator, together with the shortfall denominator, forms the shortfall ratio used to allocate his or her share of the tip shortfall.

Figure 14-13 Determining Shortfall Ratios: Sea Breeze Restaurant

Directly Tipped Employee	Total Portion of 8% Gross Receipts	Gross Receipts Ratio	Employee's Share of 8% Gross Receipts	Actual Tips Reported	Employee Shortfall Numerator
1	7,500	18,000/100,000 =	\$1,350	\$1,080	\$270
2	7,500	16,000/100,000 =	1,200	880	320
3	7,500	23,000/100,000 =	1,725	1,810	0
4	7,500	17,000/100,000 =	1,275	800	475
5	7,500	12,000/100,000 =	900	450	450
6	7,500	14,000/100,000 =	1,050	680	370
Total			\$7,500	\$5,700	\$1,885

Shortfall Denominator

Figure 14-14 Allocation of the Tip Shortfall: Sea Breeze Restaurant

Directly Tipped Employee	Shortfall Ratio	Shortfall to be Allocated	Tips Allocation
1	270/1,885	\$1,800	\$258
2	320/1,855	1,800	306
3	475/1,855	1,800	453
4	450/1,855	1,800	430
5	370/1,885	1,800	353
Total			\$1,800

The use of the hours worked method is limited to establishments with fewer than the equivalent of 25 full-time employees during the payroll period. The mathematical procedures in this method are identical to those explained for the gross receipts method. The only difference between the hours worked method and the gross receipts method is that employee hours worked are substituted wherever employee gross receipts were used in the previous method.

Regular Pay and Overtime Pay

The definition of regular pay varies with different state laws, company policies, and contracts. However, under the FLSA, regular pay is based on a 40-hour workweek. The term *regular hourly rate* refers to the rate per hour that is used to compute regular pay.

The definition of overtime pay also varies with different state laws, company policies, and contracts. According to the FLSA, overtime pay is required for any hours worked in excess of 40 hours in a week. The term *overtime hourly rate* refers to the rate per hour used to compute

overtime pay. According to FLSA provisions, overtime is paid at the rate of 1.5 times the employee's regular hourly rate. The FLSA prescribes this rate regardless of the number of overtime hours worked and regardless of whether the overtime hours were worked on a weekend or on a legal holiday. In order to calculate the overtime pay for some employees, it may first be necessary to convert either a weekly wage or a monthly salary to an hourly rate.

To qualify for a manager exemption, the employee must pass a duties test and a salary test. To qualify as a manager, the employee's duties must include managing the business (or part of it) and regularly directing the work of two or more employees. In addition, the employee must either (a) be paid a salary (as opposed to an hourly wage) of at least \$250 per week, or (b) have the authority to hire, fire, or promote, and be paid a salary of at least \$155 per week. If either of these conditions holds, the employee can be considered a manager, and is therefore exempt from overtime.

The issue of whether an employee's job responsibilities satisfy the executive employee test is not strictly a question of how much time is allocated to managerial duties as opposed to other tasks. Rather, a court also would evaluate such factors as the importance of the managerial duties as opposed to other responsibilities, the frequency with which the employee exercises discretion, and his or her relative freedom from supervision, as illustrated in the following example.

A chain restaurant claimed that its lowest-level manager, whose job title was associate manager, was in an executive position and therefore was exempt from overtime pay. The job, an entry-level position, included work that regular crew members do (preparing pizzas, salads, and other food; running the cash register; waiting on customers; and cleaning), tasks described by the company as "learning by doing," and studying company manuals to prepare for management tests. Associate managers perform little or no supervision of other employees, are not in charge of a restaurant, and do not supervise shifts. Not surprisingly, the court held that the position of associate manager was not an executive position.

Dole v. Papa Gino's of America, Inc., 712 F.Supp.1038 (Mass. 1989)

In the case of bonus pay, the U.S. Department of Labor (DOL) now requires employers to add bonuses paid to hourly employees to their gross pay before calculating overtime payment (CFO & Controller Alert. September 1, 2006. Bonuses).

Converting Weekly Wage to Hourly Rate

Some employees are hired at a stated weekly wage. This wage is generally fixed, except for overtime pay and adjustments for absences. For these employees, it is often necessary to convert the weekly wage to a regular hourly rate. These calculations may require rounding. Actual practice varies as to the number of decimal places used in calculating a regular hourly rate. For our purposes, all hourly rates are rounded to the nearest cent.

The regular hourly rate is computed by dividing the weekly wage by the number of hours in a regular 40-hour workweek. For example, assume that an employee is hired at \$300 per week for a regular workweek. The regular hourly rate for this employee is calculated as follows:

$$\text{regular hourly rate} = \frac{\text{weekly wage}}{\text{number of hours in a regular workweek}}$$

$$\text{regular hourly rate} = \frac{\$300}{40 \text{ hour}} = \$7.50$$

Once an employee's regular hourly rate is known, an overtime hourly rate can be determined. Following FLSA provisions, overtime is paid at the rate of 1.5 times the employee's regular hourly rate. Therefore, the overtime hourly rate is simply 1.5 times the regular hourly rate:

$$\begin{aligned}\text{overtime hourly rate} &= \text{regular hourly rate} \times 1.5 \\ \text{overtime hourly rate} &= \$7.5 \times 1.5 = \$11.25\end{aligned}$$

Converting Monthly Salary to Hourly Rate

As stated previously, some salaried employees may not be exempt from overtime pay. Therefore, it may be necessary to calculate an overtime hourly rate for some salaried employees. Since the number of pay weeks (and, therefore, the number of hours worked) varies from month to month, it is first necessary to annualize the monthly salary and then convert it to a weekly amount. Once the weekly amount is determined, the regular hourly rate and the overtime hourly rate can be computed by following the same procedure as in changing a weekly wage to an hourly rate. For example, assume that an employee is hired at a monthly salary of \$1,500 and that the employee is not exempt from overtime pay provisions. First, the monthly salary is annualized by multiplying the monthly salary by 12 months. Then, the weekly regular pay of the employee is calculated by dividing the annual salary figure by 52 weeks. These computations are summarized as follows:

$$\begin{aligned}\text{annualized salary} &= \$1,500 \times 12 = \$18,000 \text{ per year} \\ \text{weekly rate} &= \frac{\$18,000}{52} = \$346.15\end{aligned}$$

Calculating Overtime Pay

Two methods by which to compute an employee's overtime pay are the overtime pay method and the overtime premium method. These methods produce identical results with respect to gross pay. The major difference is in the classification of regular pay and overtime pay. According to the overtime pay method, all overtime hours are classified as overtime pay. According to the overtime premium method, overtime hours are separated into regular pay and overtime premium pay.

The overtime pay method computes overtime pay by multiplying the number of overtime hours by the employee's overtime hourly rate. In a state where FLSA provisions prevail, overtime hours are those hours worked in excess of 40 hours in a week. Using the overtime pay method, hours worked up to this 40-hour limit are the basis for computing regular pay. Any hours worked over the 40-hour limit are the basis for computing overtime pay.

Using the overtime pay method and assuming that FLSA provisions prevail, the gross pay for an employee is calculated as follows: (1) computing the employee's regular pay, (2) computing the employee's overtime pay, and (3) totaling the employee's regular and overtime pay. For example, assume that an employee receives a regular hourly rate of \$7.50 and reports time worked of 46 hours. Using the overtime pay method, regular pay is computed on a basis not to exceed 40 hours. Multiplying 40 hours by the hourly rate of \$7.50 results in \$300 regular pay.

The employee's overtime pay is computed by first determining the employee's overtime hourly rate and then multiplying the overtime hourly rate by the number of overtime hours. Under the FLSA provisions used in this example, the employee's overtime hourly rate is \$11.25 (1.5 times the regular hourly rate of \$7.50). Since the employee worked 6 hours in excess of the 40-hour limit for regular pay, the employee's overtime pay is \$67.50 (6 overtime hours multiplied by the \$11.25 overtime hourly rate). The employee's gross pay can now be determined as follows:

regular pay (40 hours \times \$7.50)	\$300.00
overtime pay (6 hours \times \$11.25)	<u>\$67.50</u>
gross pay	<u>\$367.50</u>

As previously stated, if employers are paying bonuses to hourly employees as a way of motivating and encouraging high performance, those payments should be added to the gross pay before calculating overtime rate. Using the overtime premium example above, and assuming an employee received \$100 bonus pay, the calculation will be as follows:

regular pay (40 hours \times \$7.5)	\$300.00
bonus	\$100.00
overtime rate ($\$400 \div 40$) \times 1.5 = \$15	
overtime pay (6 hours \times \$15)	<u>\$90.00</u>
gross pay	<u>\$490.00</u>

The overtime premium method differs from the overtime pay method in two respects. First, the overtime premium method computes regular pay by multiplying the total hours worked (regular and overtime hours) by the employee's regular hourly rate. Second, the overtime premium method multiplies overtime hours by an overtime premium rate, which is half of the employee's regular hourly rate.

For example, using the overtime premium method and assuming that FLSA provisions prevail, the gross pay for an employee who receives a regular hourly rate of \$7.50 and works 46 hours in one week is calculated as follows: (1) computing the employee's regular pay, (2) computing the employee's overtime premium, and (3) totaling the employee's regular pay and overtime premium. The employee's regular pay is computed by multiplying the 46 hours worked by the hourly rate of \$7.50. The employee's overtime premium is computed by multiplying the six overtime hours by half the employee's regular hourly rate, or \$3.75 (0.5 times the regular hourly rate of \$7.50). The employee's gross pay can now be determined as follows:

regular pay (46 hours \times \$7.50)	\$345.00
overtime pay (6 hours \times \$3.75)	<u>\$22.50</u>
gross pay	<u>\$367.50</u>

The benefits of using premium and regular methods are the same; both methods are easy to apply.

EMPLOYEE BENEFITS AND DEDUCTIONS

An employee's gross pay is reduced by payroll deductions. Payroll deductions are classified as either governmental deductions or voluntary deductions. It is critically important that deductions be handled correctly to avoid employee frustration, which could affect employee morale and result in poor customer service.

Governmental Deductions

Governmental deductions are mandatory deductions over which an employee has little control. These deductions consist of federal income taxes, FICA taxes, state income taxes, garnishments, disability insurance, and other state taxes on employee earnings. These deductions are not an expense of the business because the employer merely acts as a collection agent for the government. These are considered employee expenses.

government deductions
Mandatory deduction from employees' gross pay, including federal and state income taxes, FICA taxes, garnishments, disability insurance, and other taxes.

voluntary deductions

Deductions from employees' gross pay that are authorized by the employee, such as insurance premiums, retirement plan contributions, or union dues.

Voluntary Deductions

Voluntary deductions may include premiums for health insurance group plans, life insurance group plans, retirement plans, savings plans, stock purchase plans, union dues, and contributions to charities. The employee must approve all voluntary deductions. Employees usually indicate approval by signing authorization forms. When the payroll check is processed, governmental deductions are subtracted before any voluntary deductions are made.

Federal Insurance Contributions Act (FICA)

The Federal Insurance Contributions Act, commonly known as FICA, was enacted to provide workers with retirement and medical benefits. It is also referred to as Social Security and Medicare. The law requires (1) a tax upon the employer, and (2) a tax upon the employee that is deducted from the employee's paycheck. The FICA tax imposed on the employer will be discussed later in this chapter.

The retirement and medical benefits of this act also extend to self-employed persons under provisions of the Self-Employment Contributions Act. The self-employed person pays the FICA tax, which is computed based on the profits of the business. This computation is performed on a special form that is part of the individual's personal income tax return.

The FICA tax consists of two computations, one for the Social Security tax and one for the Medicare tax. Each tax has its own rate, and Social Security has a ceiling—a maximum amount of earnings subject to taxation for a calendar year. Many companies combine these two taxes and show them as one deduction on the paycheck, usually labeled as FICA tax or Social Security tax.

Effective January 1, 2001, the FICA tax rate and ceilings are as follows:

	<u>Tax Rate</u>	<u>Ceiling</u>
Social Security	6.2 percent	\$80,400
Medicare	1.4 percent	none

If the Social Security rate is 6.2 percent and the wage ceiling is \$80,400, the Social Security deduction for any individual cannot exceed \$4,984.80 (\$80,400 x 6.2 percent) in a single year. However, the Medicare portion of the FICA tax is unlimited because there is no wage ceiling for this portion.

For example, assume an employee earns \$500 gross pay in a given week. The employee's year-to-date (YTD) Social Security deductions total \$3,000 prior to this week's earnings.

The current week's FICA deduction is calculated as follows:

Social Security portion:	$\$500.00 \times 6.2 \text{ percent}$	= \$31.00
Medicare portion:	$\$500.00 \times 1.45 \text{ percent}$	= <u>\$7.25</u>
FICA deduction:		\$38.25

Note: The employee's new YTD Social Security deduction totals \$3,031.00, which is less than the maximum deduction of \$4,984.80.

The procedure is different when the current week's calculated Social Security tax causes the YTD amount to exceed the maximum legal deduction. When this happens, the Social Security percentage computation is ignored and the actual deduction is "squeezed." For example, an employee earns \$500 gross pay in a given week. The employee's previous YTD Social

Security deductions total \$4,957.40. The first step is to test the Social Security percentage computation:

$$\begin{aligned}
 \$500 \times 6.2\text{percent} &= \$31.00 \\
 \$31.00 + \$4,957.40 &= \$4,988.40 \text{ (exceeds maximum of } \$4,984.80)
 \end{aligned}$$

The second step is to compute an amount for the current week’s Social Security deduction that will bring the YTD deduction to \$4,984.80.

Maximum allowable Social Security deduction:	\$4,984.80
Previous YTD Social Security taxes deducted:	<u>\$4,957.40</u>
Allowable Social Security deduction:	\$27.40

The current week’s FICA deduction can then be calculated as follows:

Allowable Social Security deduction	= \$27.40
Medicare portion: \$500.00 × 1.45percent	= <u>\$7.25</u>
FICA deduction:	\$34.65

Federal Income Tax (FIT)

The federal government requires an employer to withhold income taxes from the salary and wages of employees and pay these taxes directly to the federal government. This constitutes part of the system under which most people pay their income tax during the year in which income is received or earned. For many employees whose entire income is wages, the amount withheld approximates the total tax due so that the employee will pay little or no additional tax at the end of the year. Circular E of the tax code schedule outlines the requirements for withholding income tax and includes tables showing the amounts to be withheld.

Before a newly-hired employee starts to work, he or she should complete and sign an IRS Form W-4 (Figure 14-15). This form provides the employer with the employee’s marital status (for tax withholding purposes), withholding allowances (defined below), and other pertinent data. The employer retains this form, and the information is transferred to the employee’s payroll record for future use in preparing the employee’s paycheck.

Form W-4		Employee's Withholding Allowance Certificate		OMB No. 1545-0074
Department of the Treasury Internal Revenue Service		▶ Whether you are entitled to claim a certain number of allowances or exemption from withholding is subject to review by the IRS. Your employer may be required to send a copy of this form to the IRS.		2007
1 Type or print your first name and middle initial.		Last name		2 Your social security number
Home address (number and street or rural route)		3 <input type="checkbox"/> Single <input type="checkbox"/> Married <input type="checkbox"/> Married, but withhold at higher Single rate. <small>Note. If married, but legally separated, or spouse is a nonresident alien, check the "Single" box.</small>		
City or town, state, and ZIP code		4 If your last name differs from that shown on your social security card, check here. You must call 1-800-772-1213 for a replacement card. ▶ <input type="checkbox"/>		
5 Total number of allowances you are claiming (from line H above or from the applicable worksheet on page 2)				5
6 Additional amount, if any, you want withheld from each paycheck				6 \$
7 I claim exemption from withholding for 2007, and I certify that I meet both of the following conditions for exemption. <ul style="list-style-type: none"> • Last year I had a right to a refund of all federal income tax withheld because I had no tax liability and • This year I expect a refund of all federal income tax withheld because I expect to have no tax liability. If you meet both conditions, write "Exempt" here				7
Under penalties of perjury, I declare that I have examined this certificate and to the best of my knowledge and belief, it is true, correct, and complete.				
Employee's signature (Form is not valid unless you sign it.) ▶				
Date ▶				
8 Employer's name and address (Employer: Complete lines 8 and 10 only if sending to the IRS.)		9 Office code (optional)	10 Employer identification number (EIN)	
For Privacy Act and Paperwork Reduction Act Notice, see page 2.				
Cat. No. 102200			Form W-4 (2007)	

Figure 14-15 W-4 Form

An employee may submit a new W-4 form whenever there is a change in his or her marital status or withholding allowances. For tax withholding purposes, marital status is designated as either single or married. A married employee may claim a single status in order to have larger amounts withheld from his or her paycheck. However, an unmarried employee may not claim a married status in order to have smaller amounts withheld.

Withholding allowances may be claimed by an employee in accordance with the rules provided on the W-4 form. Generally, an employee may claim (1) an allowance, called a personal allowance; (2) an allowance for each dependent the employee is entitled to claim on his or her federal income tax return; and (3) other special withholding allowances and tax credit allowances as described on the W-4 form. An employee does not have to claim all the allowances to which he or she is entitled, but an employee may only claim valid allowances.

The amount to be withheld from an employee's gross pay for federal income taxes is computed by using income tax withholding tables or by using the income tax withholding percentage method. Both of these methods are explained in IRS Circular E, the tax code schedule. Computerized payroll procedures usually involve the income tax withholding percentage method, while employers using manual payroll systems commonly find it more convenient to use the tax-withholding tables. Circular E contains a full set of these tables, which are beyond the scope of this book.

Employers use tax-withholding tables by selecting the proper table and then locating the intersection of the number of withholding allowances claimed and the employee's wages. The following example demonstrates how to use tax-withholding tables to calculate the FIT withholding for an employee who has claimed single marital status and is paid on a weekly basis. Refer to the tax-withholding tables in Appendix. Assuming an employee has claimed zero withholding allowances and receives wages of \$245, the FIT withholding is calculated by following a four-step procedure:

1. Select the approximate tax table. Since the employee has claimed single marital status and is paid on a weekly basis, the Single Persons—Weekly Payroll Period table is used.
2. Locate the column that identifies the number of allowances claimed. In our example, the appropriate column is the one labeled 0.
3. Locate the row that identifies the amount of the employee's wages. Since our example employee's wages are \$245, the correct row is "at least \$240 but less than \$250."
4. Locate the figure at the intersection of the allowances claimed column and the wages row. The figure is \$47.74. This means that \$47.74 will be withheld as FIT from the employee's paycheck.

The same steps can be used to calculate the FIT withholding for an employee who has claimed married status and is paid on a weekly basis. Assuming an employee has claimed two withholding allowances and receives wages of \$270, the FIT withholding is calculated as follows:

1. Select the appropriate tax table. Since the employee has claimed married status and is paid on a weekly basis, the Married Persons—Weekly Payroll Period table is used.
2. Locate the column that identifies the number of allowances claimed. In our example, the appropriate column is the one labeled 2.
3. Locate the row that identifies the amount of the employee's wages. Since our example employee's wages are \$270, the correct row is "at least \$270 but less than \$280."
4. Locate the figure at the intersection of the allowances claimed column and the wages row. The figure is \$27.04. This means that \$27.04 will be withheld as FIT from the employee's paycheck.

State and City Income Tax

Most states have a state income tax. The employer is responsible for withholding these taxes from the employee's gross pay and remitting them to the state as prescribed by law.

Computing the amount to be withheld from an employee's wages for state income taxes is similar to the methods used to compute the withholding of FIT. The state's division of taxation provides employers with the proper tax tables or withholding percentages. In some states, state income taxes are a "piggyback tax" on the FIT. For example, a state may impose its income tax at the rate of 25 percent of the FIT. Therefore, once the FIT is determined, the state income tax may be computed at 25 percent of the FIT.

The methods for computing withholdings for city income taxes are similar to the methods for computing federal and state income tax withholdings.

Employers' Payroll Taxes

The previous sections have discussed payroll taxes imposed on the employee. In these cases, the employer deducts governmental taxes from the employee's gross pay and remits them to the appropriate federal or state agency. Since these payroll taxes are levied on the employee, they are not an expense of the business.

In addition to payroll taxes imposed on employees, there are payroll taxes imposed on the employer. Such taxes are a business expense. This section discusses the following employer's payroll taxes:

- Social Security taxes (FICA)
- Federal unemployment taxes
- State unemployment taxes

Social Security Taxes

The Federal Insurance Contributions Act (FICA) imposes a separate tax on the taxable payroll of a business. Generally, the FICA rate and the FICA taxable ceiling are similar to those specified for employees.

The Social Security tax deducted from an employee's payroll check is not a business expense because the tax is collected from the employee (withheld from his or her wages to arrive at net pay). In addition to the employee Social Security tax, there is an employer Social Security tax that is imposed directly on the employer. A business is responsible for an employer Social Security tax on each employee's wages and tips until the wages (including tips) reach the maximum amount subject to Social Security taxes. This employer's Social Security tax is a business expense.

IRS Form 941 is filed quarterly by an employer. The purpose of this form is to report the amount of employees' FICA and federal income taxes withheld, the FICA tax imposed on the employer, and the remittance of these taxes made by the employer as required by law. Appendix contains a sample of IRS Form 941 and the instructions for completing the form.

Unemployment Taxes

The Federal Unemployment Tax Act (FUTA) imposes a tax on the taxable payroll of a business. Only the employer pays FUTA tax, which is based on the wages of each employee. Like FICA tax, FUTA tax is assessed at a given rate and is subject to a ceiling. The federal government passes the collected taxes on to the state agencies that administer each state's unemployment program.

Similarly, a state may have an unemployment insurance act (commonly referred to as SUTA). Generally, the SUTA tax is imposed on the employer based on the SUTA-taxable portion of

each employee's gross pay. However, some states impose this tax on both the employer and the employee.

IRS Form 940¹ is filed annually by an employer. The purpose of this form is to report the employer's liability for FUTA taxes. Appendix contains a sample of IRS Form 940, instructions for completing the form, and a reprint from Circular E. Circular E is the IRS publication that explains the rules for making 940 tax deposits and general information for filing Form 940.

THE PAYROLL SYSTEM

The primary function of a payroll system is to provide information necessary for computing employee payroll. An employee's earnings record is the basis for preparing his or her payroll check. Once the payroll checks have been prepared, they are recorded on a payroll register. From data in the payroll register, journal entries are prepared to record the payroll expense as well as the liability for payroll taxes. The net pay shown on the payroll register represents the cash demand that will be placed on the company's checking account. A payroll system comprises the forms, records, and procedures required to carry out these and other tasks.

Computerized Payroll Applications

Advances in computer technology have made computers affordable, practical, and cost-efficient for most restaurant operations. An operation lacking a sophisticated guest accounting system may still use a computer to prepare payroll checks, to perform general ledger accounting, and to carry out other tasks involving numerical computation and accumulation of data.

However, a small property may not be able to justify an in-house computer system. In this case, banks and computer service companies offer a low-cost alternative. They sell computer services such as payroll preparation and general ledger accounting for modest fees.

In a computerized payroll application, information, such as employee number, pay rate, deductions, and earnings, is not recorded on paper, but rather is stored in a computer file. Computer files are usually maintained on back-up drives, which allow random access of information. In computer terminology, the earnings records for all employees are called the payroll master file or **database**.

database Collection of records or files containing information for users.

The payroll process begins when hours worked are entered into the payroll master file. The computer then processes each employee's hours worked in accordance with information on that employee's file record and instructions in the computer program. This process emulates the manual procedures previously discussed.

The output of a computerized payroll application is similar to that of a manual system—namely, the payroll register and the payroll checks.

LABOR COST STANDARDS

Now that we have discussed the rules and composition of labor costs, in this section we will examine how to control these costs by applying productivity standards and comparing actual payroll results to those standards.

¹ U.S. Department of Treasury, Internal Revenue Service, Publication 15, Circular E, Employer's Tax Guide. This publication can be obtained at an Internal Revenue Service office or found online at www.irs.gov.

Productivity is measured by the production results of an outlet or of a staffing level, and is generally defined as the relationship between output and input. Achieving high productivity in the food-service industry requires minimizing waste and reducing costs per cover. Standard labor costs can be set as a predetermined unit cost for each food and beverage product produced. In determining the standard labor cost, the manager calculates the cost of direct and indirect labor required to produce each unit of a product via its specific recipe processes. For example, producing a tenderloin steak might include the following:

- The receiving clerk's time in receiving, verifying, storing, and extending the price of an order of tenderloin
- The storeroom clerk's time in checking the product for freshness and delivering it to the outlet kitchen
- The butcher's time in trimming, portioning, and packaging the beef
- The prep cook's time in marinating the beef
- The chef's time in preparing the plated item
- The server's time in promoting and presenting the item to the customer

Quantifying the time for each step, and thereby understanding the cost structure of your offerings, gives you a standard against which to compare actual cost data. This system could reveal costs that are out of line, and it permits analysis to locate and deal with trouble spots.

You can establish standard labor costs with one of two basic approaches. You can use a system of performance standards based on historical costs under favorable conditions, or you can use staffing guides based on management's determination of various job cost elements.

Performance Standards

Determining the precise amount of time needed to perform any specific job function derives what is called a *performance standard*. These specific standards are then categorized into an acceptable standard for each job. There is no universal method of determining specific time standards for all jobs; for example, performance standards of restaurants engaged in fast-food delivery will differ greatly from those in a fine-dining atmosphere. Yet setting performance standards will help you with labor cost budgeting for any type of restaurant, so you should determine your time expectations of service staff. Performance standards are used to do the following:

- Establish labor requirements
- Calculate the anticipated number of hours needed
- Convert estimated hours to direct labor dollars
- Establish direct labor controls and forecasts
- Plan any overtime requirements
- Forecast indirect cost rates
- Evaluate competitors.

The goal of this kind of analysis is to establish a productivity program that will enhance labor control and forecasts without sacrificing service levels. Typically, you'd use the criteria in Figure 14-16 to report performance standards for the departments within a hotel establishment. These are

productivity A measure of effectiveness in utilizing labor and equipment; the relationship between input and output.

Figure 14-16 Performance Standard

Department	Criteria
Rooms Division	Occupied rooms and #s of guest (in-house, arrival and departure)
Food and Beverage	Covers (guests) per hour
Laundry and Dry Cleaning	Pounds per hour
Telephone / PBX	Calls per hour
Garage / Valet Service	Cars parked per hour
Maintenance/Facility	# of work orders and special planned projects per hour
Housekeeping room attendant	# of rooms cleaned per hour

based on necessary productivity; that is, the criteria are tied precisely to the work output you are seeking from your employees.

So, how do you set performance standards? The process begins with watching your staff and estimating the time needed to complete a task. Are employees standing around with nothing to do? Are customers receiving inadequate service even though employees are working at top efficiency? Managing in this observant, commonsense manner means managing “from the front door and not the back office,” and it has great benefits in evaluating labor standards and productivity. For example, in the kitchen, many staff members typically work on each product by completing multiple steps. You can use your recipes to isolate each step and estimate the time for completion. You will also want to evaluate how volume fluctuates during a shift, and how this affects productivity.

The process of setting performance standards is more valuable for variable and semivariable staffing costs, which are affected by volume, than for fixed labor costs, which are paid regardless of volume. Variable and semivariable labor costs usually involve servers and kitchen personnel, whom you schedule on the basis of volume, while fixed labor costs are often those costs associated with managers, who are working despite volume fluctuations.

Looking at a possible scenario, from your evaluation of productivity, you might say that you expect your dinner servers to handle fourteen covers per hour, or you might decide that your dinner chefs should handle eighteen covers per hour. Then you can evaluate their performance based on your expectations and based on how business fluctuates. If the chefs easily meet the requirement and have time left over for standing around, perhaps your standards need to be set a little higher by including side work or prep work. On the other hand, if your servers are getting complaints about poor service, perhaps fourteen covers per hour is too high a standard to demand. Keep in mind that your standards will be different for a fine-dining restaurant than for a fast-paced lunch spot. Your customers will get an impression of your establishment from your prices, menu, ambience, and image, and they will form expectations of your level of service. These expectations should figure into your calculations of productivity and how your staff should perform. These performance standards may change with the seasons, menu changes, and your own commonsense reassessments.

Although these techniques offer succinct methods for analyzing labor utilization, you must use them with caution; in analyzing labor productivity, there is no substitute for direct observation and common sense. If you can combine management acumen with objective productivity assessment, you will have the tools necessary to keep labor costs as low as possible while satisfying your guests through employees’ schedules.

Staffing Guides

The second approach to establishing standard costs involves what is called a **staffing guide**. This is often more practical and easily quantifiable in an environment where there is a continuous flow of product or service with minimal change, such as a restaurant. Once again, common sense and direct observation are vital when setting standards. With a staffing guide, it is not uncommon to alter your standards during the course of a year to meet changing conditions, such as an expansion of the restaurant or a modification of the existing menu. A staffing guide will need to be monitored and updated as your restaurant changes. Figure 14-17 is an example of a simple staffing guide. The number of people needed in each position grows as the number of covers increases. Note, however, that each position has a different rate of increase. How these numbers increase will depend on the potential productivity of the individual and the position requirements.

staffing guide A document establishing labor time standards for productivity evaluation of employees.

Figure 14-17 Sample Staffing Guide

COVERS	WAITSTAFF	COOKS	BUSPERSON
from 0 to 15	1	2	1
from 16 to 35	2	3	2
from 36 to 55	3	3	3
from 56 to 75	4	3	3

To take this guide further and to make it more useful, you will need to convert those personnel numbers to hours that the individuals are needed (Figure 14-18). Then you should relate these numbers to an actual business forecast. You can also include your fixed labor costs, such as managers' salaries, to estimate your total labor costs. Remember that these costs will not vary with volume. It is important to note, however, that most labor costs, while normally classified as either fixed (not related to volume) or variable (directly related to volume), are in reality semivariable (neither fully fixed nor variable).

Figure 14-18 Sample Staffing Guide by Hours. *(Note: the italicized supervisor's time is a fixed amount)*

Date of the month	1	2	3	4	5	6	7	8	9	10	11	12	13	14
Covers forecasted	9	49	50	90	81	37	57	19	83	91	41	65	27	34
HOURS NEEDED:														
Host @ \$6.50 / hr	4	4	4	8	8	4	4	4	8	8	4	8	4	4
Server @ \$5.25 / hr	4	12	12	20	20	12	16	8	20	20	12	16	8	8
Busser @ \$5.75 / hr	4	12	12	16	16	12	12	12	16	16	12	12	8	8
Prep cook @ \$6.75 / hr	0	5	5	10	10	5	5	0	10	10	5	10	5	5
Line cook @ \$8.25 / hr	5	15	15	20	20	15	15	15	20	20	15	15	15	15
Dishwasher @ \$7.00 / hr	5	5	10	15	15	5	10	5	15	15	5	10	5	5
<i>Supervisor @ 8.75 / hr</i>	4	4	4	4	4	4	4	4	4	4	4	4	4	4

This staffing guide in Figure 14-18 uses the hours from Figure 14-17, plus a few additions in terms of positions and greater numbers of covers, and relates this to the forecasted cover information. Remember that this guide is in hours needed, not numbers of people needed. We can make a forecasted labor total from these labor amounts and also be sure to have the correct amount of staff members working at all times. A limited number of the staff members in our example may continue on through the lunch shift; simply repeat this guiding process through the different meal periods of the day, and minimize staffing levels during slow times to keep costs down.

Review of Labor Standards

Management can review the effectiveness of the staffing guide by a method called *revenue per staff-hour*. This is an extension to the staffing guide, and it is often used by top management to measure the effectiveness of the staffing guide or production standards in use. This method takes revenue and divides it by the number of hours spent to generate that revenue. It can be calculated by individual position, as in Figure 14-19, or by department. For the numbers to be relevant, different positions or departments should be measured according to their contributions to the company. Figure 14-19 shows how you would measure these revenue contributions in a hotel operation.

Figure 14-19 Revenue Per Staff Hour

Department	Criteria
Rooms Division	Measurement should be based on room revenue only
Kitchen	Food only
Restaurant (excluding Kitchen)	Total Food and Beverage Revenue
Retail Outlet	Retail revenue only
Spa Outlet	Spa revenue only
Housekeeping	Room revenue only
Administrative departments such as accounting and personnel	Total company revenue

In practice, most restaurants prepare their weekly forecasts and projected revenue figures before posting a schedule on the bulletin board for employees. The next week's revenue projections and your staffing guide set the stage for employee staffing. With accurate forecasting and a workable staffing guide, you should be able to minimize the variance between your standards and the actual hours used. Figure 14-20 provides an example worksheet that would be used to guide staffing decisions for the week ahead.

From the example, the kitchen revenue per labor hour standard is \$145, and the projected food revenue for the following week is \$116,000. Therefore, the kitchen labor hours schedule is $\$116,000 \div \$145 = 800$ hours. This is equivalent to 100 8-hour shifts, with an average of 14 employees per day for a week.

The advantage of using revenue per labor hour to determine employees' scheduled hours is that it is very simple to calculate. The main disadvantage is that it fails to take into account possible discounts and complimentary meals, which produce no revenue but require production hours for which the manager must schedule.

Other Labor Costs

Whoever is responsible for preparing employees' schedules must be aware of the circumstances that influence cost fluctuations and, as a result, their appropriate use. Thoroughly assess your company's historical labor expenses and trends. Be sure the data is valid, useful, and complete. As with all control measures, the system used must be cost-effective. It would be counterproductive to spend \$1,000 analyzing, planning, and controlling to save just \$500 in labor costs.

One cost to consider is restaurant setup time. The cost of setting up the restaurant for operations cannot be related directly to the number of covers. This is one of the many job functions

Figure 14-20 Weekly Labor Control**Labor Control worksheet - weekly**

Department	Revenue per labor hour-Standard	Projected revenue	Hours allowed*	8 hour shifts [appx.]	head count average / day
Housekeeping	\$95.00	\$222,000	2,337	292	42
CSA	\$110.00	\$55,000	500	63	9
Dining Room	\$90.00	\$95,000	1,056	132	19
Kitchen	\$145.00	\$116,000	800	100	14
Retail	\$93.00	\$14,000	151	19	3
Front Desk	\$505.00	\$222,000	440	55	8
		\$386,000	5,283		

*"hours allowed" includes all hourly positions in each department

that are difficult to allocate as either fixed or variable labor expenses. A question often raised is whether the setup costs should be treated as direct labor or as part of other labor costs. In many situations, the restaurant opening period fluctuates widely in relation to covers; the impact of the setup cost in these cases can be more significant than the actual direct labor production time. The cost per cover can vary solely because of the length of the time the restaurant is open, rather than due to the efficiency of the waitstaff.

To establish a consistent cost system, estimate the standard work time that you think is necessary to complete the setup work. Use this figure to compute the standard cover cost. Alternatively, each detail involved in the restaurant setup could be scrutinized using a precise **time and motion study**; then, a total of the required time for all duties can be calculated. Time and motion studies use film to record a continuous operation. One type of time and motion study, micromotion study, can reduce the costs of very fast, very repetitive activities by analyzing the fine motions made. Micromotion studies can help reduce the cost of intermittent operations by using a time-delayed camera to record activities, then using that information to encourage greater efficiency in daily work. Any time you use film, you have a reviewable account of how the process goes, and you can make better decisions based on this fuller knowledge.

One drawback is that this method mixes two different labor elements, each of which is subject to different parameters and cost controls. Where this practice is followed, setup costs should be identified within both the budgeted and the actual labor cost accumulations. In this way, you can measure labor efficiency independently for the productive versus setup time elements.

Another degree of uncertainty exists because the method fails to take into account the unique circumstances of each day's production. For example, if all orders to the kitchen come in early, and then business slows down early, it is desirable for the employees to start on the next day's setup and production while they await the arrival of more customers. A classic adage in the food-service business is "Time to lean, time to clean." Likewise, orders arrive in different sequences or patterns during a shift, and these patterns and sequences affect productivity. For example, it is easier to produce twenty meals if ten orders of the same item come in together than if no two items of the twenty are alike. Some items are easier to prepare than others, so the mix of items affects productivity as well. This is why good managers closely observe the actual production process to assess actual efficiency versus "paper" efficiency. Generally, kitchen hours are regarded as semivariable or fixed labor hours, because as much as they are tied to production, there is much work that must be done whether there is production or not, and menu variety can create an ever-changing efficiency rate.

time and motion study

A systematic observation, analysis, and measurement of the separate steps in the performance of a specific job. This study is done for the purpose of establishing a standard time for each performance, with the goal of improving procedures and increasing productivity.

Scheduling and Labor Forecasting

The schedule is your tool to meet service needs, which you will predict through revenue and labor forecasting. But it is not just your tool; when your employees see the schedule, they feel that they are looking at a map of their livelihood! You will want to be as accurate as you can in forecasting so that you will have enough, but not too much, service staff on hand. But you also need to look at the schedule through your employees' eyes. An employee's happiness and performance are largely influenced by his or her schedule.

To balance the three competing pressures of owners, employees, and guests, you need to understand the task of forecasting business. Expected business levels are crucial in predicting how many employees to schedule. The following information offers a pattern for developing your own solid forecast. To forecast business for next Monday, analyze business volume for the past four Mondays and for this Monday last year. Did you have enough employees for each day? If so, it may be safe to schedule the same number of people for the coming Monday according to the staffing guide.

Extend the forecast, modifying it if necessary, to accommodate economic patterns, upcoming holidays, or special events. For example, research convention business in your area and how it affects your company. If you want to increase scheduling for an event such as a convention, use comparable scheduling data from other such events. If you are new to a company, consult others who have been there during such times. If the company itself is new, you should compile the necessary data yourself and make decisions for the future based on what you learn. You will need to consider the dietary requirements or price elasticity of various convention or event groups, and even watch how weather conditions affect your business volume.

What you are doing is establishing a capture ratio based on historical trends and management experience. The term **capture ratio** refers to the number or percentage of customers a restaurant attracts, depending on set variables such as marketing, convention business, or menu offerings. If you are forecasting company sales, you should consider the time, the economy, the guest count, and any local conventions or marketing campaigns. If these variables change, so will your results.

Once the forecast is established, calculate how many employees are needed at the varying levels of business volume, and determine each employee's availability. Many businesses schedule each employee a certain number of hours every week, whether or not there is an increase or decrease in volume or sales. This method is easy, and it guarantees that the payroll will not exceed the budget, but it fails to account for changes in demand. A more precise, and likely more profitable, method is to complete a business forecast, affording you the luxury of adding or subtracting labor hours from your schedule based on current conditions.

One prevailing technique for managing schedules with forecasting is to adjust the number of hours for each worker by the increase or decrease in volume of business according to your forecast and staffing standards. Scheduling should be based on the volume of business, not simply on company sales—especially in companies with multiple restaurant outlets, such as hotels. For example, your hotel's occupancy rate may rise due to complimentary or discount packages, but restaurant revenue might not necessarily follow. However, if you do not schedule more workers to accommodate any increase in guests, your customer service standards may suffer. You will have to balance these pressures based on forecasting and then monitoring actual volume fluctuations.

The Difference Between Actual and Standard Labor

Regardless of how labor standards are determined, variances from the standards must be computed and analyzed for control purposes. For direct labor, both wage rate variances and

capture ratio The number or percentage of customers a restaurant attracts, depending on set variables such as marketing, convention business or menu offerings.

efficiency variances are computed. Typical factors causing wage rate variances include the following:

- Inaccurate or unrealistic wage rate estimates
- Unanticipated overtime hours required to complete work
- A more experienced—and therefore more expensive—grade of labor required than estimated
- Increases in the minimum wage or union pay scale

Efficiency variances generally occur more frequently than variances of wage rate. The following are some common factors that cause a labor efficiency variance:

- Stated labor hour amounts per cover may be accidentally or deliberately set low or high.
- Poor scheduling or materials shortages cause delays or idle time.
- Equipment breakdown causes lost time.
- Inexperienced or apprentice labor needs extra learning time.
- A defective order results in time lost while staff makes corrections.
- More staff may be needed than anticipated in the standards.
- Low morale or motivation to work results in less than 100 percent efficiency.

The causes of any variance should be calculated and explained on a timely basis.

Full-Time-Equivalent Reporting

The full time equivalent, or FTE, technique is a process commonly used to measure performance ratios between departments and companies of similar size. Most companies undertake this step in considering the wisdom of outsourcing a particular function. An FTE study uses special formulas to combine actual regular time, overtime, and double-time hours worked in order to compare them to what would happen if only regular hours were used to produce the same results.

The goal of FTE analysis is to highlight extreme cost of overtime to the company. Restricting overtime hours requires accurate volume and staff predictions. If FTE results are compared against competitors or industry levels, then they must measure against the same benchmarks to ensure relevance. Data collection for the production of FTE reports uses two general classifications: production units and work hours. Nearly all the production unit data required to prepare an FTE report involve familiar business volume units, such as restaurant covers, beverage units, and average unit selling price. These types of figures establish standards that are repeatable and quantifiable, and by which you can judge staff productivity.

To calculate FTE, retrieve work hours from your payroll system. Overtime hours should be reflected in equivalent terms. Thus, four hours of overtime work compensated at time-and-a-half is calculated as six work hours. This means that, for someone who earns \$8 an hour, his or her pay, with overtime, was \$48. To you, in these FTE calculations, that looks like working six regular hours. Work hours associated with holiday pay should be reflected as straight time. Thus, 8 hours worked on a holiday on which the pay rate is doubled should be calculated as 8 hours, not 16 hours. Vacation hours should not be reflected in the calculation of work hours. Also, some employees may work in more than one department in a larger establishment. While the payroll system often captures their work hours in only one department, it is important to implement a system for identifying interdepartmental transfer of work hours when applicable.

Regardless of the number of days in a month or actual hours worked, the hours reported for salaried employees who have been employed for the entire month are 173.33 per month. Note

that salaried work hours are not to be included in work hour calculations for productivity, but only in the calculations of FTEs. If the salaried employee is present regardless of volume, then his or her 173.33 hours are fixed. Some companies include vacation, sick leave, and holiday pay when calculating FTEs, unless the position is filled during these absences. The calculations should exclude work hours reported in connection with disability pay.

The calculation of FTE converts the total number of work hours, both salaried and hourly, to an equivalent number of full-time shifts performed in the relevant period. An FTE workload for hourly employees is equal to 8 hours per day multiplied by the number of workdays available in a month, then multiplied by 5/7. This last fraction is included to account for the 5 days out of 7 worked in an FTE week.

Available work hours are calculated as follows:

$$31\text{-day month} = 31 \times 8 \times 5/7 = 177.14$$

$$30\text{-day month} = 31 \times 8 \times 5/7 = 171.43$$

$$29\text{-day month} = 31 \times 8 \times 5/7 = 165.72$$

$$28\text{-day month} = 31 \times 8 \times 5/7 = 160.00$$

To calculate FTEs for salaried employees, the total number of hours in the particular period is divided by 173.33, regardless of the number of workdays in the specific month. For hourly employees, use the values from the list. The calculation in Figure 14-21 is for a 30-day month.

Figure 14-21 FullTime Equivalent

	Salaried	Hourly
1) Regular hours	450.1 hours	1750 hours
2) Overtime @ 1.5	N/A	32 (actual hours worked = 24; but for FTE purposes, this is expressed at 1.5 times the rate, or 32)
3) Vacation hours	40	N/A
4) Total hours	490.1	1782
5) FTE	$490.1 / 173.33 = 2.8$	$1782 / 171.43 = 10.4$
6) Total FTE =	$2.8 + 10.4 =$	13.2

This calculation results in 13.2 FTE, without overtime. You can compare this to what you actually spent and see where variances are eating into your labor budget. Many food and beverage managers use the results of this calculation to report covers, revenue totals, and payroll amounts per FTE. It is also useful to compare rate of pay and FTE results with competitors once a reliable history has been established, after perhaps one year. A rate-of-pay survey should be done at least once a year to remain competitive.

SUMMARY

Business success depends directly on wise staff planning. Labor costs in the industry typically range from 30 to 40 percent of food and beverage revenue. In conjunction with food cost, labor cost is often referred to as prime cost because it constitutes the vast majority of expenses in most operations.

Staff planning must balance the needs of three groups: management, to minimize costs; employees, for improved hours and pay; and customers, for improved service. Staffing in service industries is extremely challenging because of the widely fluctuating demand from hour to hour, day to day, and season to season. Staffing impulsively, by the needs of the minute, results in wasted money; restaurant production cannot be shelved and resold later. Likewise, understaffing results in dissatisfied guests, which you cannot remedy by overstaffing later.

To control labor costs, the first step is to establish standard labor costs based on historical data or a staffing guide. The second step is to forecast sales. By knowing production needs, and the staff required to meet those needs, scheduling can be done efficiently. Labor costs may be categorized as direct or indirect and scheduled accordingly. Generally, direct labor varies more closely with variations in sales levels than does indirect labor.

Differences between actual and standard labor costs must be analyzed closely and constantly for control purposes. Variances result from either wage rate or efficiency variances, both of which you can monitor and change. Numerous methods are used to analyze labor productivity, but the bottom line is that management must closely observe and control productivity.

CHAPTER QUESTIONS

Discussion Questions

1. Why is staff planning vital to success?
2. What competing interests need to be balanced when scheduling staff?
3. What are labor standards, and why are they critical to proper scheduling?
4. What factors can cause actual labor cost to deviate from standard costs?
5. How can a manager decide what products should be outsourced?
6. What is the purpose of FTE analysis?

Critical Thinking Questions

1. What types of pressure, and from what sources, does operational management receive in attempting to control labor costs? How can management best balance these competing pressures?
2. When are labor costs too low? Too high?
3. What criteria are most pertinent when establishing performance standards?
4. What factors need to be evaluated in forecasting business activity?
5. If a review of labor cost variances indicates that labor costs are below budget standards, what should management do?
6. If the cost of food sold is 30 percent, and labor costs are 32 percent, what is the prime cost?
7. If operating standards indicate the labor cost per cover should be \$2, and labor costs for the period were \$1,000 with 450 covers served, what is the actual variance in labor cost per cover?

8. If the average nonovertime wage rate is \$5 per hour, but hourly employees average 50 hours per week, what is the actual wage average per hour?
9. If staffing guidelines call for 40 hours of hourly labor to produce 100 covers on Monday, and for 60 hours to produce 200 covers on Friday, what is the actual operating efficiency on Monday?
10. If total sales are \$12,000 and the cost of labor is \$4,200, what is the labor cost percentage?
11. If sales drop to \$10,000 and the cost of labor drops to \$4,000 what is the labor cost percentage?
12. If the average wage rate increases from \$5.00 to \$5.50, without an increase in productivity, and labor costs are 35 percent, what will be the new labor cost percentage?
13. In a 30-day month, if 1,000 hours are worked by hourly and/or salaried nonexempt employees, what is the number of FTEs?
14. In a 28-day month, if 1,100 hours are worked by salaried exempt employees, what is the number of FTEs?

Objective Questions

1. In controlling labor costs, direct observation of employees and customer service is superior to accounting analysis. True or False?
2. Because of the high cost of labor, it is essential to control these costs regardless of the time, energy, and expense involved. True or False?
3. Budget standards equal operating standards throughout the fiscal year. True or False?
4. When scheduling staff, a manager focused on maximizing profitability should place more emphasis on performance and operating standards than on any other factor. True or False?
5. The cost of training employees to perform multiple jobs typically increases the cost of labor. True or False?

Multiple Choice Questions

1. According to the NRA, in which food-service category(s) does the cost of wages, salaries, and employee benefits exceed the cost of food sold?
 - A. Full service, check average over \$10
 - B. Full service, check average under \$10
 - C. Limited service, fast food
 - D. All of the above
2. Which of the following is directly related to the precise amount of time needed to perform any job function?
 - A. Performance standards
 - B. Productivity standards
 - C. Staffing guides
 - D. Labor standards

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3. What two groups would be most likely to find labor costs too low? (select two)
 - A. Upper management
 - B. Customers
 - C. Employees
 - D. The IRS

 4. Scheduling should be based on
 - A. Company sales.
 - B. Volume of business.
 - C. Occupancy.
 - D. Capture ratio.

 5. In a flexible budget, what technique can be used to help measure the efficiency of semivariable labor costs such as indirect labor?
 - A. Variance factor
 - B. Business forecasting
 - C. Labor cost percentage
 - D. Operating standards

 6. Raising wages can lower total labor costs when
 - A. labor efficiency increases.
 - B. employees have more experience.
 - C. a greater number of people apply for jobs at the company.
 - D. productivity analysis is performed more often and accurately.

 7. FTE reporting is useful for all of the following EXCEPT
 - A. comparison of labor efficiency to competitors.
 - B. comparison of labor efficiency between departments.
 - C. establishing performance standards.
 - D. revealing the costs of overtime.