Welcome

Cost Management

CHRM 2460

Agenda

- Welcome
- Ground Rules
- Warm Up Activity
- NRAEF ManageFirst
- Syllabus
- Chapter 1 – The Importance of Cost Control
- Chapter 2 – Forecasting and Budgeting
- Next week

Ground Rules

- Be on time – start on time
- All cell phones, pagers and IPods should be turned off during class
- If your phone rings in class….I reserve the right to answer it 😊
- No Internet use during class, unless part of classroom activity
- Appreciate other points of view
- Respect others desire to learn
- End on time
Information Card

- Please fill out the index card provided with the following information:
  - Front
    - Name, phone, & email
  - Back
    - What you hope to learn in cost management.

Warm Up Activity

- Break into groups of 2-3 students
- Interview each other; as you will introduce each other to the class
- Information to share:
  - Name: What is your degree path?
  - Industry Experience
  - Family, hobbies
  - Have you ever made a personal or business budget?

NRAEF ManageFirst Program

*Competency Guide*

Is required for this course

How can this book help me?

- Part of a certificate program
- Industry-driven
- Resume builder
Who is the NRAEF?

- Educational arm of the National Restaurant Association
- Bridge between academia and industry
- Work with over 60,000 restaurant, hospitality and foodservice members companies

Competency Guide Content

- Management-focused
- Application-based, not just theory
- Professional Profiles give you a "sneak peak" into the field
- "Real world" activities help build job skills

How will this certificate help me?

- Validated by over 200 restaurant, foodservice and hospitality organizations
- Resume builder
- Tangible accomplishment
- Can give you a hiring advantage over peers who didn’t use ManageFirst
The MFP credential recognizes students as having the academic and practical knowledge they need to succeed in the restaurant, foodservice, and hospitality industry.

To earn the MFP credential, students must:

- Pass four Core Credential exams and one Foundation/Elective exam
- Provide documentation for 800 hours of industry work experience

MCC offers classes that support the following courses:

**NRAEF ManageFirst Core Credential Topics**
- CHRM 2475 Leadership – Hospitality and Restaurant Management
- CHRM 2460 Cost Management – Controlling Foodservice Costs
- CHRM 2470 Supervision – Human Resources Management & Supervision
- CHRM 1020 Sanitation – ServSafe® Food Safety

**NRAEF ManageFirst Elective Topics**
- CHRM 2460 Purchasing – Inventory and Purchasing
- CHRM 2466 Financial Basics – Managerial Accounting
- CHRM 2350 Nutrition – Nutrition
- CHRM 1550 Customer Service – Customer Service
- CHRM 2410 Marketing and Industry Perspectives - Marketing

**SYLLABUS REVIEW**

[HTTP://WWW.MCNEB.EDU/MATHCENTER/HOURS.ASP](HTTP://WWW.MCNEB.EDU/MATHCENTER/HOURS.ASP)
Attendance and Participation

Attendance = 5 points (deductions for being late or leaving early)
Participation = 5 points

- Self-graded and instructor's evaluation
- 1 = Present, but did not contribute to class discussions
- 2 = Made at least 1 contribution, but did not read assigned material prior to class
- 3 = Made 1 contribution to discussions and read assigned material prior to class
- 4 = Made more than 1 contribution to discussions and read assigned material prior to class
- 5 = Made more than 1 contribution to discussions, read the assigned material prior to class and encouraged the participation of all class members.

Total = 10 points per week

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CHRM 2460 Cost Management

Chapter Learning Objectives

- Explain how restaurant and foodservice costs affect profitability.
- Describe the manager's role in cost control.
- Identify the types of costs incurred by restaurant and foodservice operations.
- Explain the importance of controlling prime costs.
- Explain the basic restaurant and foodservice cost control process.
Characteristics of Controls

- Contribute to profit making
- Start with the menu
- Affect all areas of the operation
- Are formalized through a restaurant’s policies and procedures

Why do we care?

- We are a huge industry
  - National Restaurant Association
  - Pocket Fact Book 2014
  - Nebraska Facts
- Responsibility

Relationship of Sales and Expenses

- Sales (Income or Revenue) are 100%
- In an Income Statement or Budget, the relationship of the Expenses to Sales is listed as a percent
- Profit (or loss) is the percent of Sales left after all expenses have been stated
Types of Costs continued

- Fixed Costs
  - Do not vary with sales volume
  - Do not change from one accounting period to the next

- Variable Costs
  - Increases and decreases are directly related to sales volume

- Semivariable Costs
  - Increase or decrease with changes in sales volume, but not in direct proportion
  - Contain both fixed and variable components

Classify these costs

- Electricity
- Beverages
- Disposables (paper plates, silver, cups, etc.)
- Repairs and Maintenance

Variable Costs

- Directly affect profitability
- Can be controlled by management
- Are compared to an established standard
Types of Costs

- **Controllable Costs**
  - Food
  - Labor
  - Cleaning supplies

- **Noncontrollable Costs**
  - Insurance
  - Mortgage payments
  - Cost of licenses

**Prime Costs**

- Include those expenses classified as
  - Food and Beverage
  - Labor
- Are directly controlled by management
- Make up the majority of a restaurant’s total costs
- Are directly related to profitability
The costs of food and labor are a restaurant’s greatest expenses.

**Prime Cost Calculation**

**Exhibit 1.5**

### CALCULATING PRIME COST

- **How to Calculate Prime Cost**
  - Food Cost
  - + Beverage Cost
  - + Labor Cost
  - = Prime Cost

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**Percent of Total**

- A percentage is a way of expressing a number as a fraction.
- For example, 45% (read as “forty-five percent”) is equal to 45/100, or 0.45.
- Percentages are used to express how large/small one quantity is, relative to another quantity.
- Ratios are similarly an expression of one number relative to another.
Computation of Percent Difference

Actual cost of $48,000
Budgeted cost of $45,000

\[
\text{Actual cost} - \text{Budgeted cost} = \text{Cost difference}
\]

\[
$48,000 - $45,000 = $3,000
\]

Computation of Percent Difference continued

\[
\frac{\text{Cost difference}}{\text{Cost budgeted}} = \text{Percent difference}
\]

\[
\frac{$3,000}{44,000} = 0.067, \text{ or } 6.7\%
\]

Income Statement Computation

- Revenue – Expenses = Profit (or loss)
  - Revenue
  - Minus Variable Costs
  - Minus Fixed Costs
  - Equals Profit (or loss)
Prime Cost as a % of Total Sales

<table>
<thead>
<tr>
<th>Prime Cost on the Income Statement</th>
<th>October</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales:</td>
<td></td>
</tr>
<tr>
<td>Food</td>
<td>$78,464</td>
</tr>
<tr>
<td>Liquor</td>
<td>4,796</td>
</tr>
<tr>
<td>Beer</td>
<td>6,223</td>
</tr>
<tr>
<td>Wine</td>
<td>6,859</td>
</tr>
<tr>
<td>Total sales</td>
<td>$98,442</td>
</tr>
<tr>
<td>Cost of sales:</td>
<td></td>
</tr>
<tr>
<td>Food</td>
<td>5,250,991</td>
</tr>
<tr>
<td>Liquor</td>
<td>991</td>
</tr>
<tr>
<td>Beer</td>
<td>1,369</td>
</tr>
<tr>
<td>Wine</td>
<td>3,133</td>
</tr>
<tr>
<td>Total cost of sales</td>
<td>$5,315,126</td>
</tr>
<tr>
<td>Labour costs:</td>
<td></td>
</tr>
<tr>
<td>Management salaries</td>
<td>5,657,771</td>
</tr>
<tr>
<td>Hourly staff wages</td>
<td>19,196</td>
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<tr>
<td>Payroll taxes</td>
<td>2,855</td>
</tr>
<tr>
<td>Workers compensation</td>
<td>1,063</td>
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<tr>
<td>Group medical insurance</td>
<td>391</td>
</tr>
<tr>
<td>Other employee benefits</td>
<td>295</td>
</tr>
<tr>
<td>Total labour costs</td>
<td>$5,315,126</td>
</tr>
<tr>
<td>Prime cost</td>
<td>343,017</td>
</tr>
<tr>
<td>% of total costs</td>
<td>14.3%</td>
</tr>
</tbody>
</table>

Cost Control Process

- Develop Performance Standards
- Monitor Actual Performance
- Compare Actual to Standard
- Address Performance Discrepancies

Cost Standards

- Are used to compare actual results to planned results
- Are established by management
- Standards may be designed to
  - Ensure a profit
  - Stay within the budget
  - Achieve planned quality levels
Costs Impact Profit

Excessive costs reduce restaurant profitability.

Costs as a “Piece of the Pie” of Sales

Example of an Income Statement with %’s
### The Cost Control Process Steps

**Step 1 – Develop performance standards**
- Collect sales and cost data.

**Step 2 – Monitor actual performance**
- Monitor and analyze sales and cost data.

**Step 3 – Compare actual performance to standard**
- Evaluate for discrepancies (variances).

**Step 4 – Address performance discrepancies**
- Take corrective action as appropriate.

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### The Cost Control Process

**Step 1 – Develop performance standards**
- Collect sales and cost data.
  - Yearly and monthly data are used for budgets and income statements.
  - Weekly and monthly data are used for purchasing and scheduling.
  - Meal period data are used for production planning.
The Cost Control Process

Step 2 – Monitor actual performance
Evaluate reports on actual performance
- The line item’s name
- Budgeted cost
- Actual cost
- Cost difference
- Percentage difference

The Cost Control Process continued

Step 3 – Compare actual performance to standard
Monitor and analyze sales and costs.
- Compare actual sales and costs to
  - Budget (line item review)
  - Operational standards
  - Historical information
- Identify variances-
  - Actual – Budget = Variance

Cost Variations
- Can be preventable
- May be unpreventable
- Take corrective action on preventable cost variations
The Cost Control Process continued

Step 4 – Address Performance Discrepancies
Take corrective action as appropriate.

- Variations from anticipated results may be
  - Large and significant
  - Small, but still significant
  - Small and insignificant

Corrective Actions for Cost Control continued

- Do you think food or labor costs are higher in this restaurant?
- Why?
How Would You Answer the Following Questions?

1. Who is responsible for the size of a restaurant’s fixed expense?
2. Which of the following vary with sales volume?
   A. Fixed expense
   B. Semivariable expense
   C. Variable expense
   D. Both B and C
3. Who is responsible for monitoring controllable costs?
4. What two components make up “prime cost?”

Chapter 1 The Importance of Cost Control

Key Terms:
- Controllable cost: A cost that a manager can directly control.
- Controls: A series of coordinated actions that help keep financial results within an acceptable target range.
- Corrective action: Steps that are taken to address a problem.
- Cost structure: The proportion or percentage of expense items to sales.
- Cover: One meal served to a customer.
- Fixed cost: A cost that remains the same regardless of sales volume.
- Line item review: The checking of every item on the budget against actual figures, and noting the difference, or variance.
- Loss: A situation that occurs when an operation’s expenses are greater than its sales.
- Noncontrollable cost: A cost over which a manager has little or no control.

Key Terms continued:
- Operational standard: The measures established for making comparisons and judgments about the degree of excellence in operations.
- Prime cost: An operation’s total food cost, beverage cost, and labor cost for a specific time period, usually a week or a month.
- Profit: The dollar amount that remains after all expenses are paid.
- Quality standard: A standard that sets the degree of excellence of raw materials, finished products, and production standards for the employees.
- Quantity standard: A standard that refers to weight, count, or volume measure, such as portion sizes for menu foods and beverages, and employee production standards such as one cook per 50 covers.
- Sales: The dollar amount the establishment has taken in for food and beverages.
- Semivariable cost: A cost that increases and decreases as sales increase and decrease, but not in direct proportion.
Key Terms continued:

**Variable cost** A cost that increases and decreases in direct proportion to sales.

**Variance** The difference between actual results (i.e., sales) and targeted or budgeted results.