AGENDA — December 12, 2000 Business Taxes Committee Meeting

Proposed Revisions to Audit Manual Chapter 8, Bars and Restaurants

Action 1 — Consent Item(s) Proposed revision to Audit Manual Chapter 8, Bars and Restaurants, other than Sections 0806.42, 0806.43, 0806.55, and 0806.60.	Adopt proposed revisions as agreed upon by interested parties and staff (illustrated in Exhibit 3).
Action 2 — Overpour and Spillage For Liquor (0806.42) Exhibit 2, pages 1 – 2	Adopt either: 1) Staff's recommendation to maintain the 8% overpouring and spillage allowance as previously published in the Audit Manual, or 2) Industry's proposal to increase the overpouring and spillage allowance to 25%.
Action 3 — Overpouring, Spillage, and Spoilage for Wine (0806.43) Exhibit 2, pages 2 – 3	Adopt either: 1) Staff's recommendation to incorporate language to provide for a standard 3% wine allowance (representing wine loss due to overpouring, spillage, and spoilage), or 2) Industry's proposal to incorporate language to provide for a standard 21% wine allowance (representing wine loss due to overpouring, spillage, and spoilage).
Action 4 — Draft Beer- Drink Size and Product Loss (0806.55) Exhibit 2, pages 3 – 8	Adopt either: 1) Staff's recommendation to incorporate language to provide for a standard 3% allowance on draft beer (representing draft beer overpour, spillage, and waste), or 2) Industry's proposal to incorporate language to provide for a standard 29% allowance on draft beer (representing draft beer overpour, spillage, and waste).
Action 5 — Allowance for Bottled Beer (0806.60) Exhibit 2, pages 8 – 9	Adopt either: 1) Staff's recommendation to not incorporate an additional allowance for loss of bottled beer, or 2) Industry's proposal to incorporate language to provide for a standard 15% allowance on bottled beer (representing spillage, breakage, and theft).

Action 6 — Approval to Publish	Approve the publication of the proposed revisions to Audit Manual Chapter 8, Bars and Restaurants, as adopted in the above actions. Operative Date: None Implementation: Upon Board approval.

AGENDA — December 12, 2000 Business Taxes Committee Meeting

Proposed Revisions to Audit Manual Chapter 8, Bars and Restaurants

Action Item	Staff and Industry's Proposed Regulatory Language
Action 1 — Consent Item(s) Proposed revisions to Audit Manual Chapter 8, Bars and Restaurants, other than Sections 0806.42, 0806.43, 0806.55, and 0806.60	Refer to Exhibit 3 for revised text.

Action Item	Language Proposed by Staff	Language Proposed by Industry
ACTION 2 – Overpour and Spillage for Liquor (Section 0806.42)	OVERPOUR AND SPILLAGE FOR LIQUOR (0806.42) ~~After the size of the drink is established, a~~An 8% ~~overpour and spillage~~ allowance is given to the extent of total distilled spirits purchased (excludes beer and wine). This allowance is commonly referred to as an “overpouring and spillage allowance. The “overpouring and spillage allowance” accounts for factors such as overpouring, spillage, waste, and breakage. Any adjustment greater than 8% for overpouring and spillage must be clearly explained in the audit working papers and well documented by the taxpayer. The ~~Use of the~~ tables at the end of this chapter in Exhibits 7 – 10 automatically provide~~s~~ for this 8% allowance.	OVERPOUR AND SPILLAGE FOR LIQUOR (0806.42) ~~After the size of the drink is established,~~ A **25%** ~~overpour and spillage~~ allowance is given to the extent of total distilled spirits purchased (excludes beer and wine). This allowance is commonly referred to as an “overpouring and spillage allowance. The “overpouring and spillage allowance” accounts for factors such as overpouring, spillage, waste, and breakage. Any adjustment greater than **25%** for overpouring and spillage must be clearly explained in the audit working papers and well documented by the taxpayer. The ~~Use of the~~ tables at the end of this chapter in Exhibits 7 – 10 automatically provide~~s~~ for this **25%** allowance.
ACTION 3 – Overpouring, Spillage, and Spoilage for Wine (Section 0806.43)	OVERPOURING, SPILLAGE, AND SPOILAGE FOR WINE (0806.43) A 3% allowance is provided to the extent of total wine purchased. This allowance is commonly referred to as an “overpouring, spillage, and spoilage” allowance, and represents the variations in pour size and wine that has been discarded. Any adjustment greater than 3% for overpouring, spillage, and spoilage must be clearly explained in the audit working papers and well documented by the taxpayer.	OVERPOURING, SPILLAGE, AND SPOILAGE FOR WINE (0806.43) A **21%** allowance is provided to the extent of total wine purchased. This allowance is commonly referred to as an “overpouring, spillage, and spoilage” allowance, and represents the variations in pour size and wine that has been discarded. Any adjustment greater than **21%** for overpouring, spillage, and spoilage must be clearly explained in the audit working papers and well documented by the taxpayer.
ACTION 4 – Draft Beer-Drink Size and Product Loss (Section 0806.55)	DRAFT BEER-DRINK SIZE AND PRODUCT LOSS (0806.55) ~~Bars selling draft beer sustain a loss of liquid by being unable to draw all beer from the half barrels. They further sustain a loss in drawing off each glass by the overpouring of foam. This loss, however, is more than offset by the “head” of foam that has formed in the glass when served to the customer.~~ The auditor must be aware	DRAFT BEER-DRINK SIZE AND PRODUCT LOSS (0806.55) ~~Bars selling draft beer sustain a loss of liquid by being unable to draw all beer from the half barrels. They further sustain a loss in drawing off each glass by the overpouring of foam. This loss, however, is more than offset by the “head” of foam that has formed in the glass when served to the customer.~~ The auditor must be aware

Action Item	Language Proposed by Staff	Language Proposed by Industry
	of other factors that affect the drink size for draft beer. The first factor is the “head” of foam served in a glass of beer. Depending on the ~~height of the head~~ type of beer and the shape of the glass, ~~this gain~~ the “head” of foam served in a glass of beer can range from one-half to two ounces. The “head” of foam in a glass of beer will offset losses sustained from overpouring, spillage, beer left in the keg, etc. To quantify the effects of the offset allowed in the “head,” a bar may serve draft beer in a twelve-ounce glass with as much as a two ounce head in each glass. However, the auditor will still use the twelve-ounce glass size to determine the number of drinks served from the keg of beer. This method amounts to a 20% allowance for losses sustained from overpouring, spillage, beer left in the keg, etc. However, this method does not account for any loss if there is very little “head” of foam in the glass of beer. To account for draft losses, a standard 3% overpour and spillage allowance is provided. The 3% overpour and spillage allowance accounts for draft beer overpour, spillage, and waste (e.g., inaccessible beer left in the keg, cleaning or flushing keg lines, waste in tapping a new keg or re-tapping, etc.) Self-consumption or pilferage are not included in this allowance as they are adjusted separately and the self-consumption should be noted on the Bar Fact Sheet. This 3% overpour and spillage allowance should not be made separately in the audit working papers since the table in Exhibit 12 incorporates this 3% allowance. Therefore, the allowance for overpour and spillage will be the combination of an allowance created by the “head” of foam in each glass and the 3% allowance provided in the	of other factors that affect the drink size for draft beer. The first factor is the “head” of foam served in a glass of beer. Depending on the ~~height of the head~~ type of beer and the shape of the glass, ~~this gain~~ the “head” of foam served in a glass of beer can range from one-half to two ounces. The “head” of foam in a glass of beer will offset losses sustained from overpouring, spillage, beer left in the keg, etc. To quantify the effects of the offset allowed in the “head,” a bar may serve draft beer in a twelve-ounce glass with as much as a two ounce head in each glass. However, the auditor will still use the twelve-ounce glass size to determine the number of drinks served from the keg of beer. This method amounts to a 20% allowance for losses sustained from overpouring, spillage, beer left in the keg, etc. However, this method does not account for any loss if there is very little “head” of foam in the glass of beer. To account for draft losses, a standard **29%** overpour and spillage allowance is provided. The **29%** overpour and spillage allowance accounts for draft beer overpour, spillage, and waste (e.g., inaccessible beer left in the keg, cleaning or flushing keg lines, waste in tapping a new keg or re-tapping, etc.) Self-consumption or pilferage are not included in this allowance as they are adjusted separately and the self-consumption should be noted on the Bar Fact Sheet. This **29%** overpour and spillage allowance should not be made separately in the audit working papers since the table in Exhibit 12 incorporates this **29%** allowance. Therefore, the allowance for overpour and spillage will be the combination of an allowance created by the “head” of foam in each glass and the **29%** allowance provided in

Action Item	Language Proposed by Staff	Language Proposed by Industry
	table. In addition to self-consumption (including the treating of customers) and pilferage, the following list of account variables may affect the percentage of draft beer loss. With the exception of the tapping/retapping of a keg and the cleaning of the lines, the loss attributable to the remaining variables can be controlled by the taxpayer through proper installation, temperature and maintenance of the equipment along with the proper training of bar personnel. • Tapping and Retapping: When a keg goes empty (referred to as "blowing a keg"), a certain amount of beer is lost in the line, the down tube and dish. The tapping/re-tapping of a keg can equate to a certain loss per each foot of line, depending on the length and diameter of the line, because the taxpayer must refill the down tube and the beer line in addition to purging off the excess foam. However, kegs tapped in a series lose considerably less beer (i.e., multiple kegs are connected in a series through the draft lines). • The beer manufacturers require that the draft lines be cleaned on a periodic basis (e.g., once every two weeks). The beer distributors generally make arrangements with the bar owner (taxpayer) to comply with the manufacturer's requirements on the frequency of the cleanings per month. The amount of beer loss is dependent on the number of cleanings, the length of the lines, and diameter of the beer lines. This information may be confirmed by an examination of the invoices for the beer lines. In addition, the beer distributors recommend that at least one beer per line be discarded after each cleaning to	the table. In addition to self-consumption (including the treating of customers) and pilferage, the following list of account variables may affect the percentage of draft beer loss. With the exception of the tapping/retapping of a keg and the cleaning of the lines, the loss attributable to the remaining variables can be controlled by the taxpayer through proper installation, temperature and maintenance of the equipment along with the proper training of bar personnel. • Tapping and Retapping: When a keg goes empty (referred to as "blowing a keg"), a certain amount of beer is lost in the line, the down tube and dish. The tapping/re-tapping of a keg can equate to a certain loss per each foot of line, depending on the length and diameter of the line, because the taxpayer must refill the down tube and the beer line in addition to purging off the excess foam. However, kegs tapped in a series lose considerably less beer (i.e., multiple kegs are connected in a series through the draft lines). • The beer manufacturers require that the draft lines be cleaned on a periodic basis (e.g., once every two weeks). The beer distributors generally make arrangements with the bar owner (taxpayer) to comply with the manufacturer's requirements on the frequency of the cleanings per month. The amount of beer loss is dependent on the number of cleanings, the length of the lines, and diameter of the beer lines. This information may be confirmed by an examination of the invoices for the beer lines. In addition, the beer distributors recommend that at least one beer per line be discarded after each cleaning to

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	assure that all cleaning/rinse solution has been removed from the line. • The "first-off-beer" generally refers to the first glass of beer from each line that is poured off each morning (i.e., discarded). The beer industry recommends that each morning at least one glass of beer from each line be poured off to assure the flavors picked up by the beer lying in the line overnight are purged from the system. • Draft beer must be kept at a constant temperature, ideally in the range of 35 to 39 degrees Fahrenheit. Fluctuations in temperature can affect the pour and create unnecessary foaming. The warmer the beer becomes, the more foam waste. This is a more difficult variable to measure, in that the taxpayer would have to collect the waste and compare it to the total dispensed. • Pressure in the keg beer system needs to be balanced to the keg box temperature. If the temperature fluctuates during the day, foaming problems can occur causing waste. • Condition of glassware can effect foaming. The ideal glass is one that has been cleaned with beer compatible soap and prechilled to the same temperature as the beer. If the glass is not prechilled, foaming may occur the glass is frosted, it may cause foaming. While the frost may feel smooth to the touch, it is actually very rough and causes the beer to boil (foam). • Restriction of the line can influence foam. The shorter the beer line, the more restriction, which creates foam. Adding additional beer line will slow down the flow rate of the beer, thereby reducing the agitation, which reduces the foaming.	assure that all cleaning/rinse solution has been removed from the line. • The "first-off-beer" generally refers to the first glass of beer from each line that is poured off each morning (i.e., discarded). The beer industry recommends that each morning at least one glass of beer from each line be poured off to assure the flavors picked up by the beer lying in the line overnight are purged from the system. • Draft beer must be kept at a constant temperature, ideally in the range of 35 to 39 degrees Fahrenheit. Fluctuations in temperature can affect the pour and create unnecessary foaming. The warmer the beer becomes, the more foam waste. This is a more difficult variable to measure, in that the taxpayer would have to collect the waste and compare it to the total dispensed. • Pressure in the keg beer system needs to be balanced to the keg box temperature. If the temperature fluctuates during the day, foaming problems can occur causing waste. • Condition of glassware can effect foaming. The ideal glass is one that has been cleaned with beer compatible soap and prechilled to the same temperature as the beer. If the glass is not prechilled, foaming may occur. If the glass is frosted, it may cause foaming. While the frost may feel smooth to the touch, it is actually very rough and causes the beer to boil (foam). • Restriction of the line can influence foam. The shorter the beer line, the more restriction, which creates foam. Adding additional beer line will slow down the flow rate of the beer, thereby reducing the agitation, which reduces the foaming.

Action Item	Language Proposed by Staff	Language Proposed by Industry
	• The bartender's pouring habits can effect beer loss. Beer taps are typically set to pour a certain amount of beer per second. If the bartender's practice is to run the faucet (tap) for a second or two prior to catching the beer, a quantity of beer can be run down the drain. Therefore, a taxpayer with numerous beer lines and/or lines in excess of the average length (approximately ten feet) may claim that the draft loss is greater than the 3% standard overpour and spillage allowance. An adjustment for additional loss may be provided when the claim is documented and supported by evidence (e.g., invoices on the number, length, and diameter of beer lines, frequency of cleaning, etc.) from the taxpayer or representative(s). Since the 3% overpour and spillage allowance is incorporated into the table (Exhibit 12), if the taxpayer provides evidence of loss in excess of the 3% standard allowance, the auditor must make an adjustment for the loss already provided for in the table, and state the percentage allowed in the audit working papers. The auditor should clearly explain and document the method used to establish beer loss in excess of the combination of the allowance created by the "head" of foam and the 3% allowance provided in the table. ~~Since the losses and gains vary from bar to bar, the auditor will be justified in considering the capacity of the glass to be the size of the drink served when computing draft beer markups.~~	• The bartender's pouring habits can effect beer loss. Beer taps are typically set to pour a certain amount of beer per second. If the bartender's practice is to run the faucet (tap) for a second or two prior to catching the beer, a quantity of beer can be run down the drain. Therefore, a taxpayer with numerous beer lines and/or lines in excess of the average length (approximately ten feet) may claim that the draft loss is greater than the 3% standard overpour and spillage allowance. An adjustment for additional loss may be provided when the claim is documented and supported by evidence (e.g., invoices on the number, length, and diameter of beer lines, frequency of line cleaning, etc.) from the taxpayer or representative(s). Since the 3% overpour and spillage allowance is incorporated into the table (Exhibit 12), if the taxpayer provides evidence of loss in excess of the 3% standard allowance, the auditor must make an adjustment for the loss already provided for in the table, and state the percentage allowed in the audit working papers. The auditor should clearly explain and document the method used to establish beer loss in excess of the combination of the allowance created by the "head" of foam and the 3% allowance provided in the table. ~~Since the losses and gains vary from bar to bar,the auditor will be justified in considering the capacity of the glass to be the size of the drink served when computing draft beer markups.~~

Action Item	Language Proposed by Staff	Language Proposed by Industry
ACTION 5 – Allowance for Bottled Beer (Proposed Section 0806.60)	None.	<u>ALLOWANCE FOR BOTTLED BEER (0806.60)</u> <u>An allowance of **15%** is provided to represent the loss of bottled beer due to breakage.</u>

Issue Paper Number 00-050

- ☐ Board Meeting
- ☒ Business Taxes Committee
- ☐ Customer Services and Administrative Efficiency Committee
- ☐ Legislative Committee
- ☐ Property Tax Committee
- ☐ Other

BOARD OF EQUALIZATION
KEY AGENCY ISSUE

Proposed Revisions to Audit Manual Chapter 8, Bars and Restaurants

I. Issue

Should staff's proposed revisions to Chapter 8, *Bars and Restaurants*, be incorporated into the Sales and Use Tax Department's Audit Manual?

II. Staff Recommendation

Staff recommends that the proposed revisions as illustrated in the attached draft of Chapter 8 (Exhibit 3) be incorporated into Chapter 8 of the Audit Manual. No operative date is proposed since the revisions formalize current administrative policies and recommend appropriate standard auditing procedures.

III. Other Alternative(s) Considered

A. Alternative 1

As proposed by Industry, publish proposed Chapter 8, but with amendment/addition of the following sections:

Overpouring and Spillage for Liquor (0806.42)
Overpouring, Spillage, and Spoilage for Wine (0806.43)
Draft Beer – Drink Size and Loss of Product (0806.55)
Bottled Beer – Loss of Product (proposed section 0806.60)

The proposal provides that the allowance for distilled spirits be increased to 25%, wine to 21%, draft beer to 29%, and an allowance be established for bottled beer in the amount of 15%. Industry recommends no operative date.

B. Alternative 2

Do not incorporate recommended revisions in Chapter 8.

IV. Background

The Audit Manual (AM) is the Board of Equalization's (Board) guide for conducting sales and use tax audits. The thirteen chapters contained within the AM incorporate procedures and techniques that have evolved over the years and been proven to be sound and practical. Field auditors are required to carefully study these procedures and techniques in order to ensure that audits are conducted, and reports are prepared, in a clear and uniform manner consistent with approved audit policies and procedures.

Chapter 8, currently entitled *Bars*, provides the Board's guidelines for auditing bars and comprehensive information on the standard industry practices, and establishes the special audit procedures specific to the bar industry. However, since numerous bars also serve food, and because there are issues and procedures unique to restaurant auditing that are not addressed elsewhere in the Audit Manual, it has been recommended that the Board include a new section within Chapter 8 addressing restaurant auditing. Accordingly, the proposed chapter is renamed *Bars and Restaurants.* It provides general topics related to both bars and restaurants, as well as provides for specific sections on bar auditing and restaurant auditing.

The audit methodology used in a bar and/or restaurant will depend primarily on the records provided by the taxpayer and the auditor's analysis of these records. It has been found that the records maintained for these establishments vary from no records at all to a complete set of double entry computerized journals with supporting documentation. Notwithstanding that the records should normally be segregated between bar and restaurant sales, sales from the bar may be credited with receipts from the restaurant. The reverse is also true; food served in the bar may be included in the alcoholic beverage sales. In addition, there are many other factors to consider when auditing a bar and/or restaurant, which are unique and require special consideration. Such factors include: spillage, spoilage, breakage, pour size, glass size, type of drink, entertainment/promotional pricing, the "treating" of customers, self-consumption, specials, cold food, sales tax reimbursement, etc. While total gross receipts from a bar and/or restaurant are generally subject to sales tax, there may also be receipts from exempt or nontaxable sales.

Staff met with interested parties to discuss the proposed revisions on August 25, 2000 and October 17, 2000. Subsequent to the first interested parties meeting, Mr. Abe Golomb, Associated Sales Tax Consultants Incorporated, submitted written comments regarding the staff's proposed 3 percent allowance for draft beer overpour and spillage (Section 0806.55). Included in Mr. Golomb's correspondence was a 1996 document written by an employee of a major brewing company regarding the "account variables" that may affect the amount of draft beer loss. Much of the information set forth in the document, having been independently corroborated through staff research, has been incorporated into AM section 0806.55.

Prior to the second interested parties meeting, staff received written correspondence from Mr. Greg Turner, California Taxpayer's Association and Mr. Jot Condie, California Restaurant Association. Their letter primarily addressed concerns with respect to: (1) loss of product, (2) the Bar Fact Sheet, (3) internal controls, and (4) miscellaneous issues such as mixes, theft of cash, and pour size. Staff has modified and amended several sections within the AM to accommodate most of the recommendations stated in the above correspondence.

At the second interested parties meeting, staff received written correspondence from Mr. Kai Mickey, Premier Sales and Use Tax Consultants, primarily addressing the loss of product and the undercover pour test. Several of Mr. Mickey's suggestions have been incorporated into the AM.

In addition, at the second interested parties meeting, Mr. Condie and Mr. Turner provided a survey performed by a San Diego Bevinco franchisee. Bevinco, an inventory control company, provides its services to bar and restaurant owners nationally and worldwide. Bevinco's survey of 60 franchisees located in the United States and Canada provided information with respect to "shrinkage," which represented the loss experienced between the expected and recorded sales based on the volume of purchases (includes theft of product, self-consumption, treating of customers, unrecorded sales, as well as theft of cash).

The proposed revision to AM Chapter 8 is scheduled for consideration by the Business Taxes Committee on December 12, 2000. This chapter was revised by staff and placed into a clearance process, allowing various staff, managers, and interested parties to review the chapter and recommend additional changes. Many of the interested parties' suggestions and recommendations as well as those made by staff and managers have been incorporated into the chapter.

Proposed revisions to Chapter 8 focus primarily on four areas: (1) deletion of out-dated and gender-specific language, (2) clarification of existing audit techniques, procedures and policies, (3) inclusion of statutory or regulatory changes that occurred since the last major revision, and (4) the addition of the entire section on restaurant auditing. As mentioned above, many of industries' suggestions have been incorporated. The following discussion provides an overview of the substantive revisions proposed to be incorporated into this chapter.

GENERAL

INSPECTION OF PREMISES (0801.10)

Section 0801.10 was expanded to state "If the auditor does not observe the business operations or is unable to observe the business operations, an explanation must be provided in the audit working papers."

SPECIAL PROCEDURES (0801.15)

Section 0801.15 now requires the auditor to document in the audit working papers information with respect to the characteristics of the business, such as the hours of operation, days of operation, number of tables and chairs, type of facility, etc.

LOSSES BY FIRE (0801.35)

This section was modified to state that the 1% pilferage allowance does not include loss from fire. In addition to the pilferage allowance, the auditor should make an adjustment for claimed loss due to fire if it is supported by evidence from the taxpayer.

LOSSES RESULTING FROM NATURAL DISASTERS (0801.40)

This section was modified to state that the 1% pilferage allowance does not include loss from natural disasters. In addition to the pilferage allowance, the auditor should make an adjustment for claimed loss due to natural disasters if it is supported by evidence from the taxpayer.

BAR AUDITING

BAR FACT SHEET (0802.15)

Section 0802.15 was expanded to incorporate the following recommendations from both staff and interested parties.

- The form must be completed at the beginning of the audit.
- When possible, the Bar Fact Sheet should be completed with the assistance of a full-time bartender who has been employed for a significant length of time since this bartender will be very familiar with the bar's standard operations.
- If someone other than the taxpayer provides the information, the form should also be read and signed by the taxpayer.
- If an absentee-taxpayer provides the information for the Bar Fact Sheet, the auditor should request the taxpayer's permission to verify the accuracy of the information with a full-time bartender who has been employed by the taxpayer for a length of time.
- Whenever possible, the auditor should attach a copy of the drink price menu to the bar fact sheet.
- The information documented on the Bar Fact Sheet may be modified/revised by additional information or estimates provided by the taxpayer. If the changes are significant, a revised Bar Fact Sheet should be prepared for the taxpayer's signature. If there are minor changes, the auditor should have the taxpayer or representative initial and date the changes. The auditor may not alter the information written upon the Bar Fact Sheet without the taxpayer's knowledge and permission.
- It is recommended that the Bar Fact Sheet be reviewed by the audit supervisor to ensure the form is properly filled out, signed and dated before the audit is completed.
- If the audit conclusion is based on information other than that contained in the Bar Fact Sheet, such information must be fully documented in the audit working papers and discussed with the taxpayer.

In addition, form BOE-1131-B, Bar Fact Sheet (chapter Exhibit 2), was redesigned to become more "user-friendly" in capturing the essential information needed to perform an audit of a bar. The form is now two pages and includes a notice at the bottom, which informs the taxpayer that the information contained on the Bar Fact Sheet may be used to establish audited bar sales. The notice also states that the Bar Fact Sheet may be modified/revised by additional information or estimates provided by the taxpayer.

POUR COST PERCENTAGE (0802.52)

Section 0802.52 was incorporated into the audit manual to discuss the analysis of the pour cost percentage. Knowledge of the taxpayer's expected pour cost percentage will assist the auditor in determining the taxpayer's expected markup on liquor, beer, and/or wine sales. Exhibit 14 was incorporated into the audit manual to provide a conversion chart from pour cost percentage to profit margin to markup.

BAR SHORT TEST (0802.60)

The Bar Short Test, form BOE-1131-A (chapter Exhibit 4), has been expanded to include six categories of sales: well drinks, call drinks, cocktails, wine/liqueurs, beer - domestic, and beer - draft. If a bar short test is to be performed in a bar audit, the schedule or form used should be retained as a subsidiary schedule to support the markup analysis, whether or not a deficiency exists. Exhibit 15 is an example of a bar short test.

TOLERANCE (0802.65)

A section with respect to bar tolerance was previously included in the Board's Audit Policy and Management Guide; however it has now been incorporated into the AM. The auditor is instructed to accept recorded sales of "on sale" distilled spirits, beer and wine if the audit findings disclose a potential under-reporting of less than 10%, unless it can be established by other means that an actual understatement exists. The 10% tolerance does not apply to establishments selling beer and wine only since the markup for beer and wine can be more accurately computed. A determination should be issued for the full amount for these types of establishments when reported sales are outside the tolerance. See *Staff Recommendation* for further discussion of the tolerance.

ANALYSIS OF AUDIT FINDINGS (0802.70)

Section 0802.70 was expanded to state that when an audit approach other than the markup method is used, a post audit mark-up analysis should be performed to support the reasonableness of the audit findings. Regardless of the audit procedures used by the auditor, if a tax deficiency has been established, an alternative method must be used and documented in the audit working papers to support the reasonableness of the audit findings. This is generally referred to as a reasonableness short test.

PILFERAGE (0804.47)

Taxpayers claiming pilferage shall be given a standard 1% pilferage allowance, unless evidence supports a higher allowance. Evidence is considered to include documentation from the police, detective agencies, insurance claims, and reports from inventory control companies or similar service firms.

MIXES AND SUPPLIES (0804.65)

Examples of mixes were expanded to include items such as lime juice, pineapple juice, grenadine syrup, margarita mix, tom collins mix, sweet & sour mix, half & half, tomato juice, grapefruit and cranberry juice, bloody mary mix, triple sec, and blue curacao. Tabasco sauce, whipped cream, straws, and cocktail napkins were added to the list of examples that are considered supplies.

SALES OF OFF-SALE BEER (0805.20)

Often the taxpayer will sell certain types of beer to be consumed away from the taxpayer's premises ("off-sale"). For instance, canned beer may be off-sale whereas bottled beer is for sale on the premises. Sales of off-sale beer in single bottles/cans or packs at a price less than charged at the bar must be supported by the taxpayer. The auditor should discuss off-sale beer with the taxpayer/bartender or representative at the beginning of the audit, and the volume of sales and the prices should be noted on the Bar Fact Sheet.

SALES OF PREMIUM BEER AND KEG CONVERSION CHART (0805.22)

It was noted that not all kegs contain 1,984 ounces of beer, and certain imported (premium) beers and microbrewery beers are sold in kegs, which may be less than 15.5 gallons. The auditor is instructed to determine the type of beer sold and the correct number of gallons per keg by examining the purchase invoices, through discussion with the taxpayer or bartender, or by contacting the beer distributor.

ESTABLISHING SIZE OF DRINK-GENERAL (0806.05)

Establishing the number of ounces of alcohol served in each drink is essential in the audit of a bar. This is often referred to as the "pour size" and is critical when verifying a taxpayer's reported sales. Section 0806.05 was modified to state that the method used to determine the pour size must be clearly stated in the audit working papers and if the audit conclusion is based on information other than pour size information contained in the Bar Fact Sheet, such information must be fully explained in the audit working papers.

In addition, the auditor should avoid establishing the pour size based solely on "auditor's judgement" or "auditor's knowledge of the industry." The auditor however may accept an average pour size up to 1.5 ounces without testing; however, when the auditor accepts a pour size in excess of 1.5 ounces, this must be supported by detailed audit comments and/or documentation such as the performance of an average pour test or an undercover pour test.

AVERAGE POUR TEST (0806.30)

Appendix B, which describes procedures to use when conducting an average pour test, was added to the AM to assist the auditor in conducting an average pour test.

UNDERCOVER POUR TEST (0806.30)

Appendix C, which describes procedures to use when conducting an undercover pour test, was added to the AM to assist the auditor in conducting an undercover pour test.

OVERPOURING, SPILLAGE AND SPOILAGE FOR WINE (0806.43)

An allowance of 3% is proposed for overpouring, spillage, and spoilage of wine. See *Staff Recommendation* for further discussion of allowances.

ALLOWANCE FOR COCKTAILS, SPECIALTY, AND EXOTIC DRINKS (0806.45)

Section 0806.45 was expanded to include a discussion of specialty and exotic drinks. A definition, as well as examples, of cocktails, specialty, and exotic drinks is provided. The auditor should give consideration to these types of drinks as the size of the pour and the price charged might vary according to type of drink sold, which would affect the markup calculation.

ALLOWANCE FOR "SPECIAL EVENT" SALES (0806.52)

Section 0806.52 was added to incorporate the bar industry practice of offering special events at which time the bar either increases the size and/or selling price of the drink or decreases the price. The auditor is instructed to make allowances for special events in calculating the weighted markup. If the auditor does not make an allowance for special events, the auditor is instructed to provide detailed comments in the audit working papers.

DRAFT BEER - DRINK SIZE AND PRODUCT LOSS (0806.55)

Section 0806.55 was revised to provide an additional 3% allowance for beer loss due to inaccessible beer left in the keg, cleaning or flushing of keg lines, and waste experienced in tapping and retapping kegs, etc. See *Staff Recommendation* for further discussion of allowances.

BARS SELLING AN APPRECIABLE AMOUNT OF FOOD (0808.30)

Even though the records should normally be segregated, sales from the bar may include receipts from the restaurant. The reverse is also true; food served in the bar may be included with the alcoholic beverage sales. If this is occurring, the bar or restaurant markup may appear inadequate. In many instances, after an adjustment has been made correcting the sales segregation, both departments show an adequate markup. The auditor is instructed when auditing businesses of this type, to determine whether the sales have been properly segregated and if errors have been made.

Should it be determined that, after the sales have been properly segregated by department, the markup in one department, the bar for example, is too low but the recorded food sales indicate an adequate markup of goods purchased, it is proper to apply the markup method to the bar cost of sales to determine audited bar sales. The audited understatement in the bar should then be included in the audit report even though the food sales are accepted as correct. The auditor should make detailed comments in the audit working papers if the restaurant sales are accepted and the bar sales have been established using the markup method.

RESTAURANT AUDITING

Sections 0809.00 through 0812.30 have been added to include the issues and procedures unique to restaurant auditing. The sections are broken down into four main categories: (1) Restaurant Auditing, (2) Restaurant Audit Procedure, (3) Specific Tax Application, and (4) Special Factors. Each section provides valuable information in analyzing recorded/reported sales information and establishing audited restaurant sales. Following is a summary of each section.

80/80 RULE (0809.10)

Section 0809.10 covers the statutory and regulatory guidelines set forth in Regulation 1603 with respect to sales of cold food on a “take-out” order (commonly referred to as the 80/80 rule).

EMPLOYEE MEALS (0809.15)

If an employer furnishes a meal to an employee and makes a specific charge for the meal, the charge for the meal is part of gross receipts and subject to tax. This section defines a “specific charge.”

EMPLOYEE TIPS (0809.20)

The auditor is instructed to discuss with the taxpayer the business policy with respect to tipping. Optional tips are not included in gross receipts and are not subject to tax. However, mandatory tips, such as those applied by a restaurant when a party is in excess of a specific number of patrons, are considered part of gross receipts and subject to tax.

SELF-CONSUMPTION (0809.25)

The taxpayer is the consumer of all food and beverages that are self-consumed. Use tax will apply to the consumption of non-food items, such as alcoholic beverages and sodas. Self-consumption in excess of 3% of taxable cost of goods sold should be fully explained or documented in the audit working papers.

PILFERAGE, SPOILAGE, AND WASTE (0809.30)

An allowance for pilferage, also known as "shrinkage," in the amount of 1% of the cost of goods sold is allowed. Pilferage is an adjustment made for inventory purchases that were not sold due to some type of loss, such as employee theft of merchandise, customers not paying for meals, etc. Pilferage in excess of 1% is allowable if the taxpayer provides evidence such as police reports, insurance claims, reports from inventory control companies or similar service firms.

Spoilage and waste does occur in most restaurants and the amount of spoilage and waste will depend on the type of restaurant and food served. The auditor should discuss the amount or percentage of spoilage and waste with the taxpayer at the beginning of the audit and document the taxpayer's information and/or estimates in the audit working papers. If the auditor is going to disregard some or all of the information provided by the taxpayer with respect to spoilage and waste, the reasons must be clearly stated with detailed comments and/or supported by documentation. Any adjustment made by the auditor for spoilage, which may appear excessive to those reviewing the audit, should be clearly explained and well documented in the audit working papers. In the audit working papers, the auditor should comment on any adjustment made for spoilage and waste, and express the spoilage and waste as a percentage of the taxable cost of goods sold.

If the markup method is used to establish audited taxable sales, the auditor should make a separate adjustment for pilferage and for spoilage. In the audit working papers, the auditor must express the amount of pilferage and spoilage in dollars and as a percentage of the taxable cost of goods sold.

RESTAURANT AUDIT PROCEDURE (0810.00 SECTIONS)

Sections 0810.05 through 0810.35 cover discussions of the following audit procedures: reconciliation of reported and recorded sales (0810.05), bank deposit reconciliation (0810.10), credit card projection of sales (0810.12), analysis of the achieved markup percentage (0810.35), computation of cost of sales (0810.20), shelf tests (0810.25), observation tests (0810.30), and establishing audited total and/or taxable sales. In addition, the staff has recommended that an example be provided on how to cost out a menu item. Exhibit 16 in the audit manual provides such an example.

SPECIFIC TAX APPLICATION (0811.00 SECTIONS)

Sections 0811.05 through 0811.40 discuss specific types of restaurant activities that generally require special analysis and application of specialized audit procedures. Topics include:

Drive-ins (0811.05)

Food Courts (0811.10)

Ice Cream Parlors/Bakeries/Coffeehouses (0811.15)

Caterers/Banquets (0811.20)

Catering Trucks (0811.25)

Food Carts (0811.30)

Student Meals (0811.35)

Places where admission is charged (0811.40)

SPECIAL FACTORS (0812.00 SECTIONS)

Sections 0812.05 through 0812.30 include discussions of:

Daily specials (0812.10)

Discount coupons (0812.15)

Packaged plans (0812.20)

Complimentary meals (0812.25)

Hotels providing coupons to guests (0812.30)

AM section 0812.25 specifically addresses the application of tax to complimentary food and beverages provided to guests by hotels. Proposed chapter Exhibit 17, a decision chart, has been provided to assist the auditor in analyzing the taxability of complimentary meals and beverages.

NEW APPENDICES AND EXHIBITS

In addition to the new section on restaurant auditing, three new appendices have been incorporated into Chapter 8, along with several new exhibits:

Appendix A, Audit Program for Bars

Appendix B, Audit Procedures for Average Pour Test

Appendix C, Audit Procedures for Undercover Pour Test

Exhibit 3, Statement of Internal Controls

Exhibit 14, Pour Cost Percentage Chart

Exhibit 15, Bar Short Test - Case Problem

Exhibit 16, Costing Out a Menu Item

Exhibit 17, Decision Chart: Complimentary Food and Beverages

V. Staff Recommendation

A. Description of the Staff Recommendation

Staff recommends that the proposed revisions, as illustrated in the attached draft of Chapter 8 (Exhibit 3), be incorporated into Chapter 8 of the Audit Manual. No operative date is proposed since the revisions formalize current administrative policies and recommend appropriate standard auditing procedures.

An "allowance" is an adjustment made to cost of goods sold to adjust for various types of inventory losses. Currently, AM Chapter 8 provides for an 8% spillage allowance on distilled spirits (Section 0806.42), an overall allowance for pilferage of up to 3% (0804.47), and a self-consumption allowance of up to 3% (0802.45). As part of updating and revising Chapter 8, staff is proposing to include a 3% allowance for wine overpour, spillage, or spoilage (0806.43) and a 3% allowance for draft beer overpour, spillage and waste (0806.55).

In regard to draft beer, the Sales and Use Tax Department's longstanding position has been that although there is a loss of product (beer) associated with cleaning, waste and overpouring, this loss is more than offset by the "head" of foam that forms on each glass. Depending on the height of the head and the shape of the glass, this "head" can range from one-half to two ounces. (For a 16-ounce mug of beer, this is between a 3% and 12.5% factor. For a 12-ounce mug, the range is 4% to 16.6%.) However, upon further review and recognition of a trend to serve beer with a smaller "head" of foam, a standard 3% overpour/spillage allowance is now incorporated into the table (Exhibit 12) which establishes the anticipated proceeds from the sale of one keg (1,984 ounces). Therefore, practically speaking, the loss for spillage will be the combination of an allowance created by the head of foam in each glass and the 3% allowance provided in the table. However, if a taxpayer claims that the draft loss is greater than the overpour and spillage allowance, an adjustment for additional loss may be provided when the claim is documented and supported by evidence from the taxpayer or representative(s). Information has been included in proposed Section 0806.55 to provide the auditor with information on the variables that may affect the loss of draft beer.

Staff has not recommended an additional allowance for loss of bottled beer because it is already provided for in Section 0804.47 (pilferage). Generally, bars do not normally experience a high rate of bottle breakage, and if bottled beer is broken by the distributor, it is replaced. However, bottled beer may be stolen or provided to customers outside the bar's normal "customer-treating" policy. If the taxpayer maintains a written policy with respect to the treating of customers, beer provided in excess of the written policy is considered theft and should be adjusted through the pilferage allowance.

Recognizing that there may be unaccounted for variables affecting the calculation of audited taxable sales, a 10% "tolerance" is used to evaluate whether the reported taxable sales are within an acceptable range as compared to audited taxable sales (0802.65). If after the allowances are made, the resulting difference (if any) between audited and reported taxable sales is equal to or less than 10% of reported taxable sales, the reported taxable sales are accepted.

Since the inventory loss percentages (shrinkage) provided by the Bevinco survey were substantially higher than the allowances currently in use or proposed by staff, additional research into several areas related to the allowances and tolerance was performed by staff, and are summarized as follows:

Audit Data

In order to understand the overall results of bar/restaurant audits using current auditing procedures, statistical data from the most recent three-year period was analyzed. During this period, 3.86% of all eligible bar/restaurant accounts were audited. In 40.4% of these audits, the reported taxable sales were either accepted or resulted in refunds. Next, staff specifically identified the non-compliance errors occurring in bar/restaurant audits completed during the period July 1, 1999 to June 30, 2000. During this period, of the 661 total bar/restaurant audits completed, only 381 resulted in deficiencies. Of those 381 deficiency audits, 176 (46.2%) were derived using the markup method. Thus, it is important to note that the deficiencies in the bar/restaurant audits were not all generated from the use of the markup method, but included other non-compliance errors as well. Further analysis revealed that only 26.6% (176/661) of the total bar/restaurant audits resulted in deficiencies based on the markup method, using the current allowances and 10% tolerance. Since around 40% of all bar/restaurant audits did not result in deficiency assessments, staff believes this was due in part to the current allowances and 10% tolerance and was a strong indicator that the current allowances are essentially fair.

Other States

The allowance factors provided by the Board are more generous than those allowed by other states. Board staff contacted the sales and use tax audit divisions of eleven states to learn what allowances and tolerances are provided by other states in bar audits. The other state's policies vary considerably. Florida and New Mexico have no set allowance or tolerance. New York, Illinois and Ohio have allowances of 15%, 10% and 9% respectively, but no tolerance. New Jersey applies a tolerance of 10%, but they have no standard allowances. Texas is the only other state polled that gives both an allowance (6 to 8%) and evaluates the audit results with a tolerance (5 to 7.5%). The other four states polled (Pennsylvania, Arizona, Georgia, and Utah) do not audit bars in a method comparable with California. None of the states contacted make a separate additional allowance for pilferage or self-consumption, as is done in California.

Analysis of the 10% Tolerance

Although the 10% tolerance is used as a cut-off technique (decision tool), a concern was expressed that the 10% tolerance provided for in Section 0802.65 equated to only 10% of the 8% spillage allowance provided on distilled spirits. In other words, the 10% tolerance only equated to a maximum of 0.8% allowance to the audited cost of goods sold. However, based on analysis conducted by staff, the 10% tolerance on audited taxable sales has the same effect as a 10% allowance on cost of goods sold. Therefore, California's 8 percent allowance for distilled spirits and the 10% tolerance equate to a total of 18% (10% + 8% not including pilferage up to 3% and self-consumption up to 3%).

Inventory Shrinkage

Staff's research found there are several bar inventory control companies, numerous advanced software programs (e.g., wireless liquor-control systems utilizing software that is tied to point of sale information), and other inventory loss control mechanisms (e.g., video surveillance programs), currently available to the bar industry to help minimize loss.

Excerpts taken from several of Bevinco's own advertisements/articles state that a bar's inventory shrinkage can be significantly reduced from the high 20's to within 5 to 7 percent. It should also be noted that the bottled beer and wine loss percentages presented by the Bevinco survey represent primarily the "treating" of customers outside of the bar owner's treating policy.

Pilferage is defined in Section 0804.47 as "an adjustment made for inventory purchases that were not sold due to some type of loss, such as employee theft, customers not paying, free drinks served outside of the bar's written policy on 'treating of customers,' and spillage." Pilferage in excess of 1% will be allowed if supported by documentation or evidence from the taxpayer. Documentation would include reports from inventory control companies. If the taxpayer provides a well-documented report from an inventory control company, this section recommends that the auditor consult with his or her supervisor to determine a reasonable percentage attributable to theft of product as opposed to self-consumption, treating of customers, unrecorded sales, and theft of cash. A reasonable percentage should be developed based on any information available to the auditor, such as the information contained on the Bar Fact Sheet, the Statement of Internal Controls, employee records, police reports, or other documents or evidence the taxpayer is able to provide.

It appears the companies included in the Bevinco survey believed their businesses to be experiencing a severe "shrinkage" problem, which Bevinco's data proved. However, the losses incurred by the businesses in the survey also appear to represent the high end of the loss spectrum and not the norm. Furthermore, the amounts reported by Bevinco as "shrinkage" are not quantified in any way, but simply represent the gap between the expected and recorded sales based on volume of purchases, and the loss is expressed as a single percentage of loss representing differing categories of losses related to shrinkage and not just overpouring or spillage. Bevinco's shrinkage percentages include loss of product due to self-consumption, treating of customers, unrecorded sales, theft of product, as well as theft of cash; and the theft of cash is not deductible for sales and use tax. Industry has conceded that these amounts may very well include valid sales that have not been recorded by the bar owner. In contrast, the allowance percentages proposed by the Board are segregated into categories such as pilferage, self-consumption (includes treating of customers), allowance for overpour and spillage, and unrecorded sales. These allowances are intended to represent the norm and not a high or low end. To increase the staff's proposed allowances to reflect the allowances proposed by Industry would in effect double count the allowances already provided for pilferage and self-consumption and provide an unwarranted allowance for theft of cash.

Regardless of the source of the shrinkage factors reported in the Bevinco survey, Bevinco's own information indicates that once their services are retained, the bar owner can expect to decrease losses to between 5 and 7 percent. Therefore, we believe the 8% liquor spillage allowance is adequate in conjunction with the other allowances for pilferage and self-consumption, and when these allowance percentages are taken into consideration along with the 10% tolerance, the overall allowance is well above 18% (8% allowance on liquor + 10% adjustment to cost of goods sold).

Staff has proposed the 3% wine allowance to represent the variations in pour size, and wine that has been discarded. Staff believes the new 3% allowances for both wine and draft beer adequately provide for loss of these products.

The text of the AM Chapter 8 revisions proposed by staff other than those on which staff and Industry concur, can be found in the comparison table in Exhibit 2.

B. Pros of the Staff Recommendation

- Issuance of appropriate guidelines and auditing procedures are an essential part of the effective administration of California's self-assessed sales and use tax program. Maintaining an accurate, complete, and up-to-date Audit Manual is necessary to accomplish this goal. Incorporation of these proposed revisions into the Audit Manual will further the Board's commitment to maintaining an efficient and effective tax program implemented by knowledgeable and qualified staff, as well as providing guidance and information to the public.
- The proposed changes to Chapter 8 formalize administrative policies and recommend appropriate current standard auditing procedures.
- Provides general and specific guidance to auditors in determining the application of tax to sales by bars and restaurants.
- The proposed allowances to distilled spirits, wine, and draft beer provide fair adjustments for the various types of inventory shrinkage.
- Numerous changes proposed by industry and accepted by staff have been incorporated into staff's proposed revisions.

C. Cons of the Staff Recommendation

- Does not alleviate Industry's concerns regarding loss percentages.

D. Statutory or Regulatory Change

No statutory or regulatory change is required.

E. Administrative Impact

- Requires notification of staff.
- Requires revisions to Tax Tip Pamphlet.

F. Fiscal Impact

1. Cost Impact

Negligible

2. Revenue Impact

Negligible. See Exhibit 1

G. Taxpayer/Customer Impact

None.

H. Critical Time Frames

No operative date is proposed. Upon Board approval, revised AM Chapter 8 will be posted on the Board's website and distributed to staff.

VI. Alternative 1

A. Description of the Alternative

As proposed by Industry, publish proposed Chapter 8, but with amendment to the following sections:

- Overpouring and Spillage for Liquor (0806.42)
- Overpouring, Spillage, and Spoilage for Wine (0806.43)
- Draft Beer – Drink Size and Product Loss (0806.55)
- Bottled Beer – Loss of Product (proposed section 0806.60)

The proposal provides that the overpour and spillage allowance for distilled spirits be increased to 25%; the overpour/spillage/spoilage allowance for wine increased to 21%, the allowance for draft beer to 29%, and an allowance of 15% be established for bottled beer. Industry contends the percentage of allowance provided by the current proposed revisions to Chapter 8 are inadequate based upon their members' experience and the survey conducted by Bevinco.

Whether in the form of shrinkage/pilferage or overpouring/spillage, the single largest issue faced by the restaurant and bar owners is the allowance for loss of product. Many bar/restaurant owners nationally and worldwide use the services of inventory control companies. The inventory data these companies generate are used for internal management purposes but also provide a much more accurate assessment of actual sales. Based on a national survey of their auditors, one San Diego inventory control company's combined percentage of loss due to both pilferage and spillage is, at the lower ranges, 25% for liquor, 11% on wine, 13% on bottled beer, and 24% on draft beer. While the audit manual does provide a mechanism to establish allowances higher than 9%, (8% allowance on distilled spirits + 1% pilferage), to suggest that the taxpayer would have police reports or some other specific documentation to establish such an amount ignores the basic premise that the allowance is intended to recognize a systematic loss of product, not single or multiple events that would warrant police involvement or other specific documentation.

The text of the AM Chapter 8 revisions proposed by Industry other than those on which staff and Industry concur, can be found in the comparison table in Exhibit 2.

B. Pros of the Alternative

- Issuance of appropriate guidelines and auditing procedures are an essential part of the effective administration of California's self-assessed sales and use tax program. Maintaining an accurate, complete, and up-to-date Audit Manual is necessary to accomplish this goal. Incorporation of these proposed revisions into the Audit Manual will further the Board's commitment to maintaining an efficient and effective tax program implemented by knowledgeable and qualified staff, as well as providing guidance and information to the public.
- The proposed changes to Chapter 8 formalize administrative policies and recommend appropriate current standard auditing procedures.
- Provides general and specific guidance to auditors in determining the application of tax to sales by bars and restaurants.
- The proposed allowances to distilled spirits, wine, draft beer, and bottled beer provide fair adjustments for the various types of inventory shrinkage.
- Addresses Industry's concerns regarding the allowances for loss of product.

C. Cons of the Alternative

- The shrinkage rates as shown by Industry's survey are inclusive of theft of product as well as self-consumption, treating of customers, unrecorded sales, and theft of cash. Therefore, the allowances proposed for liquor, beer, and wine do not solely represent the overpour and spillage. Adopting Industry's proposed allowances would cause a double counting of the allowances already provided for self-consumption (includes treating of customers) and pilferage.
- A standard 1% allowance is already provided for shrinkage (pilferage) without documentation. However, with documentation, such as a report from an inventory control service, a greater allowance may be given. Accordingly, to make an adjustment for shrinkage and a separate adjustment based on the Industry's percentages would amount to doubling the effect of the allowances.
- A separate allowance for bottled beer would overstate the actual loss of product due to overpour or spillage, since the 1% pilferage allowance proposed by staff includes loss of bottled beer.
- The shrinkage rates provided by industry do not represent the average loss (norm), but represent the high end of the loss spectrum.
- Increasing the allowance percentages will overstate the average loss.

D. Statutory or Regulatory Change

None proposed.

E. Administrative Impact

- Requires notification of staff.

- Requires revision of Tax Tip Pamphlet.

F. Fiscal Impact

1. Cost Impact

Negligible

2. Revenue Impact

See Revenue Estimate (Exhibit 1)

G. Taxpayer/Customer Impact

None.

H. Critical Time Frames

None.

VII. Alternative 2

A. Description of Alternative

Make no changes to Audit Manual Chapter 8

B. Pros of the Alternative

None.

C. Cons of the Alternative

- Audit Manual Chapter 8 would not be consistent with current policies and procedures
- Does not address Industry's concerns regarding allowances for loss of product.

D. Statutory or Regulatory Change

None.

E. Administrative Impact

None.

F. Fiscal Impact

1. Cost

None.

2. Revenue

None.

G. Taxpayer/Customer Impact

None.

H. Critical Time Frames

None.

Prepared by: Program Planning Division, Sales and Use Tax Department

Current as of: 11/29/00

BOARD OF EQUALIZATION
REVENUE ESTIMATE

PROPOSED REVISIONS TO AUDIT MANUAL CHAPTER 8, BARS AND RESTAURANTS

Staff Recommendation

Staff recommends that the proposed revisions as illustrated in the attached draft of Chapter 8 (Exhibit 3 of the issue paper) be incorporated into Chapter 8 of the Audit Manual. No operative date is proposed since the revisions formalize current administrative policies and recommend appropriate standard auditing procedures.

Alternative 1:

As proposed by Industry, publish proposed Chapter 8, but with amendment/addition of the following sections:

Overpour and Spillage for Liquor (0806.42)
Overpour, Spillage, and Spoilage for Wine (0806.43)
Draft Beer – Drink Size and Loss of Product (0806.55)
Bottled Beer – Loss of Product (proposed section 0806.60)

The proposal provides that the allowance for distilled spirits be increased to 25%, wine to 21%, draft beer to 29%, and an allowance be established for bottled beer in the amount of 15%. This proposal has no operative date.

Alternative 2:

Do not incorporate recommended revisions in Chapter 8.

Background, Methodology, and Assumptions

Staff Recommendation:

The staff recommendation would revise Chapter 8 to delete out-dated language, clarify existing audit techniques, procedures and policies, include statutory and regulatory changes and add a section on restaurant auditing. These revisions, for the most part, update the Audit Manual to reflect current practice and, therefore, would not have any revenue impact.

The revisions recommended by staff would, however, add an additional allowance (3%) for draft beer loss due to inaccessible beer left in the keg, cleaning or flushing of keg lines, and waste experienced in tapping and retapping kegs, etc., and an allowance of 3% for wine overpouring, spillage and spoilage. These proposals could have the potential to impact revenue. However, an analysis of recent bar audits indicates that the potential revenue loss would be negligible.

Alternative 1:

Alternative 1 would increase the allowances for liquor, beer and wine. An “allowance” is an adjustment made to cost of goods sold to adjust for various types of inventory shrinkage. Current practice and the staff recommendation include general allowances of 1 to 3% for pilferage and 1 to 3% for self consumption on all types of alcoholic beverages as well as specific allowances for distilled spirits, draft beer and wine. The allowances recommended by staff and the allowances proposed by industry are as follows:

Type	Staff	Industry
Distilled spirits	10 to 14%	25%
Draft beer	5 to 9%	29%
Bottled beer	2 to 6%	15%
Wine	5 to 9%	21%

Staff’s allowances are the combined specific allowance plus the general allowances for pilferage and self-consumption. These allowances are used in audits that are based on markup of costs. Audit statistics for the past fiscal year show that the Board conducted 176 deficiency audits of eating and drinking establishments selling alcoholic beverages based on the markup method. The additional sales and use tax determined on these audits amounted to $3.4 million. While this amount includes markup on food and other products, the majority of this amount is for alcoholic beverages.

A 10% “tolerance” is used to evaluate whether the reported taxable sales are within an acceptable range from audited taxable sales. This tolerance is used to recognize that there may be unaccounted for variables affecting the calculation of audited taxable sales. In conducting an audit on the mark-up method, if after adjustments have been made for the allowances, the resulting difference (if any) between audited and reported taxable sales is equal to or less than 10% of reported taxable sales, the reported taxable sales are accepted. An analysis of a number of these mark-up audits shows that adopting Industry’s allowances would result in nearly all mark-up audits of bars and restaurants serving alcoholic beverages to fall within the Board’s 10% tolerance, and therefore, either a “no-change” or “field waiver” report would be issued in place of a determination.

An analysis of audit statistics for deficiency audits completed during the 1999-2000 fiscal year on eating and drinking establishments serving alcoholic beverages, shows that the average number of hours per audit was 78.74. The estimated number of hours needed to perform the 176 audits mentioned above would be 13,858 hours. (176 audits x 78.74 hours per audit = 13,858 hours.) The average tax change per hour on these audits would have been $245.34. ($3.4 million / 13,858 hours = $245.35) The audit statistics for no-changes and field waivers of bar audits during the same period was on average 19.32 hours per audit. Since some time would be spent determining that an audit would not result in a tax change, the audit staff would have spent only 3,400 hours (176 audits x 19.32 hours per audit = 3,400 hours) on these audits. If the audit staff were to redirect the remaining 10,458 hours (13,858 hours – 3,400 hours = 10,458 hours) to perform other audits, the amount of audit determinations is estimated to be $1.7 million, using the tax change per hour at the margin, namely $160.00 per hour. (10,458 hours x $160 per hour = $1.7 million.) This results in a reduction of audit determinations of $1.7 million. ($3.4 million - $1.7 million = $1.7 million.)

Alternative 2:

Alternative 2 would have no revenue impact.

Revenue Summary

Staff Recommendation:

The revenue impact of the staff recommendation would be negligible.

Alternative 1:

Adopting the allowances proposed by the Industry's revision to Chapter 8 would result in nearly all audits of eating and drinking establishments serving alcoholic beverages based on the markup method falling within the 10% tolerance and thus no audit determinations would be issued. During the past fiscal year, the Board performed 176 such audits resulting in determinations of $3.4 million. Redirecting audit staff to conduct other audits once a no-change or field waiver report was issued would result in audit determinations of $1.7 million, a reduction of $1.7 million.

Alternative 2:

Alternative 2 has no revenue effect.

Preparation

This revenue estimate was prepared by David E. Hayes, Research and Statistics Section, Agency Planning and Research Division. This revenue estimate was reviewed by Ms. Laurie Frost, Chief, Agency Planning and Research Division and Ms. Charlotte Paliani, Program Planning Manager, Sales and Use Tax Department. For additional information, please contact Mr. Hayes at (916) 445-0840.

Current as of November 28, 2000

Proposed Revision to Audit Manual Chapter 8, Bars and Restaurants

Comparison of Current and Proposed Language

Current as of November 28, 2000

Action Item	Language Proposed by Staff	Language Proposed by Industry	Summary Comments
ACTION 2 - Overpour and Spillage for Liquor (Section 0806.42)	OVERPOUR AND SPILLAGE FOR LIQUOR (0806.42) ~~After the size of the drink is established, a~~An 8% ~~overpour and spillage~~ allowance is given to the extent of total distilled spirits purchased (excludes beer and wine). This allowance is commonly referred to as an "overpouring and spillage allowance. The "overpouring and spillage allowance" accounts for factors such as overpouring, spillage, waste, and breakage. Any adjustment greater than 8% for overpouring and spillage must be clearly explained in the audit working papers and well documented by the taxpayer. The ~~Use of the~~ tables at the end of this chapter in Exhibits 7 – 10 automatically provide~~s~~ for this 8% allowance.	OVERPOUR AND SPILLAGE FOR LIQUOR (0806.42) ~~After the size of the drink is established,~~ A **25%** ~~overpour and spillage~~ allowance is given to the extent of total distilled spirits purchased (excludes beer and wine). This allowance is commonly referred to as an "overpouring and spillage allowance. The "overpouring and spillage allowance" accounts for factors such as overpouring, spillage, waste, and breakage. Any adjustment greater than **25%** for overpouring and spillage must be clearly explained in the audit working papers and well documented by the taxpayer. The ~~Use of the~~ tables at the end of this chapter in Exhibits 7 – 10 automatically provide~~s~~ for this **25%** allowance.	Staff's position is that the **8%** remains adequate and fair in conjunction with the other allowances for pilferage (0804.47) and self-consumption (0802.45). The **25%** allowance proposed by industry is based on survey results that simply represent the gap between expected and recorded sales based on the volume of purchases. The **25%** does not represent only the loss from overpour and spillage, but includes self-consumption, treating of customers, unrecorded sales, pilferage, and theft of cash. Industry contends the **8%** allowance is outdated and does not represent the true loss

Action Item	Language Proposed by Staff	Language Proposed by Industry	Summary Comments
			experienced by the bar industry, which the survey indicates is **25%** on the average.
ACTION 3 - Overpouring, Spillage, and Spoilage for Wine (Section 0806.43)	OVERPOURING, SPILLAGE, AND SPOILAGE FOR WINE (0806.43) A 3% allowance is provided to the extent of total wine purchased. This allowance is commonly referred to as an "overpouring, spillage, and spoilage" allowance, and represents the variations in pour size and wine that has been discarded. Any adjustment greater than 3% for overpouring, spillage, and spoilage must be clearly explained in the audit working papers and well documented by the taxpayer.	OVERPOURING, SPILLAGE, AND SPOILAGE FOR WINE (0806.43) A **21%** allowance is provided to the extent of total wine purchased. This allowance is commonly referred to as an "overpouring, spillage, and spoilage" allowance, and represents the variations in pour size and wine that has been discarded. Any adjustment greater than **21%** for overpouring, spillage, and spoilage must be clearly explained in the audit working papers and well documented by the taxpayer.	Recognizing that the Board did not previously provide for wine overpouring, spillage, and spoilage, the staff recommends a **3%** allowance be provided. The **3%** is applied to total wine purchases. The **21%** allowance proposed by industry is based on survey results that simply represent the gap between expected and recorded sales based on the volume of purchases. The **21%** does not represent only the loss from overpour, spillage, and spoilage, but includes self-consumption, treating of customers, unrecorded sales, pilferage, and theft of

Action Item	Language Proposed by Staff	Language Proposed by Industry	Summary Comments
			cash. Industry states the **3%** allowance is inadequate and recommends the allowance be increased to **21%** based on the results of survey presented.
ACTION 4 - Draft Beer-Drink Size and Product Loss (Section 0806.55)	DRAFT BEER-DRINK SIZE AND PRODUCT LOSS (0806.55) ~~Bars selling draft beer sustain a loss of liquid by being unable to draw all beer from the half barrels. They further sustain a loss in drawing off each glass by the overpouring of foam. This loss, however, is more than offset by the "head" of foam that has formed in the glass when served to the customer.~~ The auditor must be aware of other factors that affect the drink size for draft beer. The first factor is the "head" of foam served in a glass of beer. Depending on the ~~height of the head~~ type of beer and the shape of the glass, ~~this gain~~ the "head" of foam served in a glass of beer can range from one-half to two ounces. The "head" of foam in a glass of beer will offset losses sustained from overpouring, spillage, beer left in the keg, etc. To quantify the effects of the offset allowed in the "head," a bar may serve draft beer in a twelve-ounce glass with as much as a two ounce head in each glass.	DRAFT BEER-DRINK SIZE AND PRODUCT LOSS (0806.55) ~~Bars selling draft beer sustain a loss of liquid by being unable to draw all beer from the half barrels. They further sustain a loss in drawing off each glass by the overpouring of foam. This loss, however, is more than offset by the "head" of foam that has formed in the glass when served to the customer.~~ The auditor must be aware of other factors that affect the drink size for draft beer. The first factor is the "head" of foam served in a glass of beer. Depending on the ~~height of the head~~ type of beer and the shape of the glass, ~~this gain~~ the "head" of foam served in a glass of beer can range from one-half to two ounces. The "head" of foam in a glass of beer will offset losses sustained from overpouring, spillage, beer left in the keg, etc. To quantify the effects of the offset allowed in the "head," a bar may serve draft beer in a twelve-ounce glass with as much as a two ounce head in each glass.	Not all bars experience the same amount of loss. It depends on many factors. The standard allowance for overpour and spillage is the combination of an allowance created by the head of foam in each glass and the **3%** allowance as provided in the table. However, the audit manual provides that an additional loss may be provided when the claim is documented and supported by evidence. The **29%** allowance proposed by industry is based on

Comparison of Current and Proposed Language

Current as of November 28, 2000

Action Item	Language Proposed by Staff	Language Proposed by Industry	Summary Comments
	However, the auditor will still use the twelve-ounce glass size to determine the number of drinks served from the keg of beer. This method amounts to a 20% allowance for losses sustained from overpouring, spillage, beer left in the keg, etc. However, this method does not account for any loss if there is very little "head" of foam in the glass of beer. To account for draft losses, a standard 3% overpour and spillage allowance is provided. The 3% overpour and spillage allowance accounts for draft beer overpour, spillage, and waste (e.g., inaccessible beer left in the keg, cleaning or flushing keg lines, waste in tapping a new keg or re-tapping, etc.) Self-consumption or pilferage are not included in this allowance as they are adjusted separately and the self-consumption should be noted on the Bar Fact Sheet. This 3% overpour and spillage allowance should not be made separately in the audit working papers since the table in Exhibit 12 incorporates this 3% allowance. Therefore, the allowance for overpour and spillage will be the combination of an allowance created by the "head" of foam in each glass and the 3% allowance provided in the table. In addition to self-consumption (including the treating of customers) and pilferage, the following list of account variables may affect the percentage of draft beer loss. With the exception of the tapping/retapping of a keg and the cleaning of the lines, the loss attributable to the remaining	However, the auditor will still use the twelve-ounce glass size to determine the number of drinks served from the keg of beer. This method amounts to a 20% allowance for losses sustained from overpouring, spillage, beer left in the keg, etc. However, this method does not account for any loss if there is very little "head" of foam in the glass of beer. To account for draft losses, a standard **29%** overpour and spillage allowance is provided. The **29%** overpour and spillage allowance accounts for draft beer overpour, spillage, and waste (e.g., inaccessible beer left in the keg, cleaning or flushing keg lines, waste in tapping a new keg or re-tapping, etc.) Self-consumption or pilferage are not included in this allowance as they are adjusted separately and the self-consumption should be noted on the Bar Fact Sheet. This **29%** overpour and spillage allowance should not be made separately in the audit working papers since the table in Exhibit 12 incorporates this **29%** allowance. Therefore, the allowance for overpour and spillage will be the combination of an allowance created by the "head" of foam in each glass and the **29%** allowance provided in the table. In addition to self-consumption (including the treating of customers) and pilferage, the following list of account variables may affect the percentage of draft beer loss. With the exception of the tapping/retapping of a keg and the cleaning of the lines, the loss attributable to the remaining	survey results that simply represent the gap between expected and recorded sales based on the volume of purchases. The **29%** does not represent only the loss from overpour, spillage, and waste but includes self-consumption, treating of customers, unrecorded sales, pilferage, and theft of cash. Industry contends the allowance proposed by staff is not adequate. Industry recommends the draft loss percentage be increased from **3%** to **29%.** Industry bases its loss percentage on the survey results.

Action Item	Language Proposed by Staff	Language Proposed by Industry	Summary Comments
	variables can be controlled by the taxpayer through proper installation, temperature and maintenance of the equipment along with the proper training of bar personnel. • Tapping and Retapping: When a keg goes empty (referred to as "blowing a keg"), a certain amount of beer is lost in the line, the down tube and dish. The tapping/re-tapping of a keg can equate to a certain loss per each foot of line, depending on the length and diameter of the line, because the taxpayer must refill the down tube and the beer line in addition to purging off the excess foam. However, kegs tapped in a series lose considerably less beer (i.e., multiple kegs are connected in a series through the draft lines). • The beer manufacturers require that the draft lines be cleaned on a periodic basis (e.g., once every two weeks). The beer distributors generally make arrangements with the bar owner (taxpayer) to comply with the manufacturer's requirements on the frequency of the cleanings per month. The amount of beer loss is dependent on the number of cleanings, the length of the lines, and diameter of the beer lines. This information may be confirmed by an examination of the invoices for the beer lines. In addition, the beer distributors recommend that at least one beer per line be discarded after each cleaning to assure that all cleaning/rinse solution has been	variables can be controlled by the taxpayer through proper installation, temperature and maintenance of the equipment along with the proper training of bar personnel. • Tapping and Retapping: When a keg goes empty (referred to as "blowing a keg"), a certain amount of beer is lost in the line, the down tube and dish. The tapping/re-tapping of a keg can equate to a certain loss per each foot of line, depending on the length and diameter of the line, because the taxpayer must refill the down tube and the beer line in addition to purging off the excess foam. However, kegs tapped in a series lose considerably less beer (i.e., multiple kegs are connected in a series through the draft lines). • The beer manufacturers require that the draft lines be cleaned on a periodic basis (e.g., once every two weeks). The beer distributors generally make arrangements with the bar owner (taxpayer) to comply with the manufacturer's requirements on the frequency of the cleanings per month. The amount of beer loss is dependent on the number of cleanings, the length of the lines, and diameter of the beer lines. This information may be confirmed by an examination of the invoices for the beer lines. In addition, the beer distributors recommend that at least one beer per line be discarded after each cleaning to assure that all cleaning/rinse solution has been	

Action Item	Language Proposed by Staff	Language Proposed by Industry	Summary Comments
	removed from the line. • The "first-off-beer" generally refers to the first glass of beer from each line that is poured off each morning (i.e., discarded). The beer industry recommends that each morning at least one glass of beer from each line be poured off to assure the flavors picked up by the beer lying in the line overnight are purged from the system. • Draft beer must be kept at a constant temperature, ideally in the range of 35 to 39 degrees Fahrenheit. Fluctuations in temperature can affect the pour and create unnecessary foaming. The warmer the beer becomes, the more foam waste. This is a more difficult variable to measure, in that the taxpayer would have to collect the waste and compare it to the total dispensed. • Pressure in the keg beer system needs to be balanced to the keg box temperature. If the temperature fluctuates during the day, foaming problems can occur causing waste. • Condition of glassware can effect foaming. The ideal glass is one that has been cleaned with beer compatible soap and prechilled to the same temperature as the beer. If the glass is not prechilled, foaming may occur the glass is frosted, it may cause foaming. While the frost may feel smooth to the touch, it is actually very rough and causes the beer to boil (foam). • Restriction of the line can influence foam. The shorter the beer line, the more restriction, which	removed from the line. • The "first-off-beer" generally refers to the first glass of beer from each line that is poured off each morning (i.e., discarded). The beer industry recommends that each morning at least one glass of beer from each line be poured off to assure the flavors picked up by the beer lying in the line overnight are purged from the system. • Draft beer must be kept at a constant temperature, ideally in the range of 35 to 39 degrees Fahrenheit. Fluctuations in temperature can affect the pour and create unnecessary foaming. The warmer the beer becomes, the more foam waste. This is a more difficult variable to measure, in that the taxpayer would have to collect the waste and compare it to the total dispensed. • Pressure in the keg beer system needs to be balanced to the keg box temperature. If the temperature fluctuates during the day, foaming problems can occur causing waste. • Condition of glassware can effect foaming. The ideal glass is one that has been cleaned with beer compatible soap and prechilled to the same temperature as the beer. If the glass is not prechilled, foaming may occur. If the glass is frosted, it may cause foaming. While the frost may feel smooth to the touch, it is actually very rough and causes the beer to boil (foam). • Restriction of the line can influence foam. The shorter the beer line, the more restriction, which	

Action Item	Language Proposed by Staff	Language Proposed by Industry	Summary Comments
	creates foam. Adding additional beer line will slow down the flow rate of the beer, thereby reducing the agitation, which reduces the foaming. • The bartender's pouring habits can effect beer loss. Beer taps are typically set to pour a certain amount of beer per second. If the bartender's practice is to run the faucet (tap) for a second or two prior to catching the beer, a quantity of beer can be run down the drain. Therefore, a taxpayer with numerous beer lines and/or lines in excess of the average length (approximately ten feet) may claim that the draft loss is greater than the 3% standard overpour and spillage allowance. An adjustment for additional loss may be provided when the claim is documented and supported by evidence (e.g., invoices on the number, length, and diameter of beer lines, frequency of cleaning, etc.) from the taxpayer or representative(s). Since the 3% overpour and spillage allowance is incorporated into the table (Exhibit 12), if the taxpayer provides evidence of loss in excess of the 3% standard allowance, the auditor must make an adjustment for the loss already provided for in the table, and state the percentage allowed in the audit working papers. The auditor should clearly explain and document the method used to establish beer loss in excess of the combination of the allowance created by the "head" of foam and the 3% allowance provided in the table. ~~Since the losses and gains vary from bar to~~	creates foam. Adding additional beer line will slow down the flow rate of the beer, thereby reducing the agitation, which reduces the foaming. • The bartender's pouring habits can effect beer loss. Beer taps are typically set to pour a certain amount of beer per second. If the bartender's practice is to run the faucet (tap) for a second or two prior to catching the beer, a quantity of beer can be run down the drain. Therefore, a taxpayer with numerous beer lines and/or lines in excess of the average length (approximately ten feet) may claim that the draft loss is greater than the 3% standard overpour and spillage allowance. An adjustment for additional loss may be provided when the claim is documented and supported by evidence (e.g., invoices on the number, length, and diameter of beer lines, frequency of line cleaning, etc.) from the taxpayer or representative(s). Since the 3% overpour and spillage allowance is incorporated into the table (Exhibit 12), if the taxpayer provides evidence of loss in excess of the 3% standard allowance, the auditor must make an adjustment for the loss already provided for in the table, and state the percentage allowed in the audit working papers. The auditor should clearly explain and document the method used to establish beer loss in excess of the combination of the allowance created by the "head" of foam and the 3% allowance provided in the table. ~~Since the losses and gains vary from bar to~~	

Action Item	Language Proposed by Staff	Language Proposed by Industry	Summary Comments
	~~bar, the auditor will be justified in considering the capacity of the glass to be the size of the drink served when computing draft beer markups.~~	~~bar,the auditor will be justified in considering the capacity of the glass to be the size of the drink served when computing draft beer markups.~~	
ACTION 5 - Allowance for Bottled Beer (Proposed Section 0806.60)	None.	<u>ALLOWANCE FOR BOTTLED BEER (0806.60)</u> <u>An allowance of **15%** is provided to represent the loss of bottled beer due to breakage.</u>	Staff does not propose a new section be incorporated for loss of bottled beer, since bars do not experience an enormous amount of breakage. Shrinkage of bottled beer is provided in the **1%** pilferage allowance (0804.47). The **15%** allowance proposed by industry is not representative of loss of product due to breakage and the majority of the loss represents treating of customers or pilferage. Since the staff has not recommended a new section on bottled beer loss, the Industry proposes a new section be incorporated to address loss of bottled beer. The survey

Action Item	Language Proposed by Staff	Language Proposed by Industry	Summary Comments
			presented indicates that the average loss due to shrinkage of bottled beer is **15%**.

Audit Manual

Chapter 8

Bars and Restaurants

Sales and Use Tax Department
*California State
Board of Equalization*

*This is an advisory publication providing direction to staff administering the Sales and Use Tax Law and Regulations. Although this material is revised periodically, the most current material may be contained in other resources including Operations Memoranda and Policy Memoranda.
Please contact any board office if there are concerns regarding any section of this publication.*

CHAPTER 8

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CHAPTER 8

BARS AND RESTAURANTS 0800.00

INTRODUCTION 0801.00

GENERAL 0801.05

It is the purpose of this section of the manual to include information to assist in the audits of bars, restaurants, and other similar establishments. Notwithstanding the information included in Audit Manual Chapter 4, General Audit Procedure, this section is intended to assist the auditor in developing and applying the standard and specialized audit techniques to bars and restaurants. This section will initially address those topics applicable to both bars and restaurants, followed by sections specific to bar and restaurant auditing respectively. The auditor should recognize that there are many variations in the auditing procedures, which are necessitated by the application of the law, rules, regulations, the taxpayer's method of reporting, and types of records encountered. By the very nature of the business (bar and/or restaurant), most sales are generally subject to tax. Therefore, in bar and restaurant auditing, it will often be necessary to verify or establish gross receipts and make allowances for exempt or nontaxable sales.

A preliminary review of the business operations is essential in bar and restaurant auditing. Although a restaurant may contain a bar or sell alcoholic beverages, not all bars contain restaurants or sell food. Some bars may have a full service restaurant while others provide a minimal selection of food as a courtesy or complimentary to its patrons. In many bars that sell food, the premises where the food is served are **separated from the bar. In either case, food and bar sales should normally be segregated in the** taxpayer**'s records. When performing an audit of a bar combined with restaurant activities, it is imperative that the auditor separates the two activities. The procedures that follow are not intended to be a substitute for independent thinking and sound judgement on the part of the auditor**. **All information used to establish sales must be included in the audit working papers to support the auditor's recommendation.**

INSPECTION OF PREMISES 0801.10

Whenever possible, the auditor should inspect~~,~~ and~~,~~ if practical, perform the audit at the business premises. If the audit is not conducted at the business premises, the auditor should make an effort to observe the bar and/or restaurant in operation. If the auditor does not observe the business operations or is unable to observe the business operations, an explanation must be provided in the audit working papers.

When the audit is to be transferred to another district, a ~~b~~Bar ~~f~~Fact ~~s~~Sheet and other significant information regarding the business should be prepared by the district in which the bar and/or restaurant is located~~,~~ and all the information should be forwarded with the assignment and a Waiver of Limitations, when appropriate.

SPECIAL PROCEDURES 0801.15

~~Accounting records which appear on the surface to be adequate may not disclose the correct tax liability because not all sales have been recorded. Consequently, p~~Prudent tax auditing requires that the auditor ~~also~~ observe and evaluate factors outside the accounting records, and document in the audit working papers information on the following: ~~such as;~~

- ~~the~~ P~~p~~hysical characteristics of the business premises~~,~~
- Number of days of operation
- Hours of operation
- Type of facilities available (number of chairs, tables, stools, etc.)
- Number of cash registers
- N~~n~~umber of employees ~~the~~
- T~~t~~ype of patronage~~,~~
- ~~the~~ L~~l~~ifestyle of the taxpayer~~,~~
- E~~e~~xpected sales ~~based on~~ the auditor's observation ~~of the~~ business activity~~etc.~~
- Changes that have occurred during the audit period (e.g., expansion of the business)

~~Such an approach is especially important in bar auditing. In this industry sales generally are for cash; the s are often absent from the business premises; employee turnover may be high; consumption of alcoholic beverages, or distraction of employees by entertainment and conversation with customers may lead to carelessness; also internal controls and accounting systems are sometimes minimal.~~

Chapter 4 of the Audit Manual describes general auditing procedures ~~which~~that may be useful in any sales tax audit. Many of these procedures are applicable to audits of bars and restaurants~~.~~; ~~H~~however, additional procedures and techniques have been developed in response to issues~~problems~~ ~~which~~that are ~~peculiar~~ unique to the bar and restaurant industry. ~~Most of t~~These techniques and procedures ~~involve quantitative analysis. They~~ are described in the following sections.

Additional information may also be obtained by contacting other agencies, such as the local Alcoholic Beverage Control or Employment Development Department. The auditor should be aware that industry-wide reports are available detailing historical studies on average food costs, average pour costs, sales volume per seat, sales volume per employee, and other operating ratios. Comparison of audited and reported operating results with recognized industry averages may indicate whether reported or audited results are reasonable. The auditor should consult with his or her supervisor with respect to industry averages. In addition, current and historical telephone directory yellow pages, which can be found at local libraries, may be useful in determining the start date of a segment or second location of a taxpayer's business.

ADEQUACY AND COMPLETENESS OF RECORDS 080~~2~~1.25~~5~~0

The auditor should include comments in the working papers describing the procedures used by the taxpayer to record business transactions, methods and procedures used for reporting, what records were made available, and whether the records available for audit were complete. At a minimum, the auditor should review the following records:

- Federal income tax returns (FITR's), including all schedules
- Profit and loss statements
- All journals and books of account
- Sales and use tax returns and all supporting documentation, including daily worksheets
- Bank statements and cancelled checks if available
- Purchase invoices (including cash paid outs)
- Cash register tapes
- Documentation regarding self-consumption
- Source documents to support all sources of income and expenses
- Documentation to support excess monies received from non-operating sources (i.e., loans, insurance proceeds, video games and other vending machines, etc.)

In addition to supporting total sales, cash register tapes are an important part of the records of a bar and/or restaurant. The cash register tapes may be used to support price changes, cocktail sales, "happy hour" sales, specials, two-for-one promotions, and price increases during periods when entertainment is provided, etc. If the taxpayer contends that the business operations have changed during the audit period, a review of the cash register tapes may also provide the documentation needed. In addition, in any bar audit, if the taxpayer contends that no liquor, beer, or wine was sold during a specific period of the audit, the auditor should contact the Alcoholic Beverage Control to verify the type(s) of licenses issued to the taxpayer and the corresponding date(s) each license was issued. This information must be documented in the audit working papers. The auditor should also verify purchases of liquor, beer, and wine with local vendors.

ADJUSTMENTS FOR SELF-CONSUMED MERCHANDISE 080~~4~~1.2~~3~~5

Almost every bar and restaurant has self-consumed merchandise. Some of the more common uses are:

- Gifts of package goods
- Home consumption by ~~owner(s)~~taxpayer(s)
- Drinks and/or food consumed by ~~owner~~taxpayer on premises
- Drinks consumed by employees on premises
- "Treating" customers
- Employee meals
- Food used for complimentary hors d'oeuvres

Self-consumption of both food and beverages should be discussed at the beginning of the audit with the taxpayer and the amount of alcohol noted on the Bar Fact Sheet (Exhibit 2). ~~Effect~~ Adjustments should always be given for self-consumed merchandise in auditing bars and restaurants, except in situations as found in Section 0801.30. Since taxpayers seldom maintain records of self-consumption, the auditor should, with the aid of the taxpayer, estimate the amount as realistically as possible. *~~When differences~~ If an understatement in self-consumed merchandise ~~are~~is established, ~~they~~ it should be shown separately in the audit report.*

Note: Use tax should be assessed on self-consumed merchandise when material.

SELF-CONSUMED MERCHANDISE DISCLAIMED 080~~4~~1.~~4~~30

~~Often a~~A taxpayer, ~~being~~ fearful that he or she has committed an illegal act, ~~will~~may falsely tell the auditor that they do not have any self-consumption, especially of alcoholic beverages. The auditor should point out to the taxpayer the effect self-consumption has on sales computed by the mark-up method. If the taxpayer still insists no food or beverages are consumed in any manner, no adjustment should be made for this item in computing sales, and the auditor should make comments to this effect in the audit working papers. However, if the taxpayer later states that they actually did have some self-consumption, an adjustment should be made for the amount of self-consumption. The Bar Fact Sheet (if applicable) should also be revised to reflect any changes in the amount of self-consumption purported by the taxpayer.

LOSSES BY ~~THEFT OR~~ FIRE 080~~4~~1.~~3~~55

Occasionally, taxpayers will state that merchandise ~~either~~ has been ~~stolen~~ destroyed by fire. The 1% pilferage allowance discussed in Sections 0804.47 and 0809.30 does not include loss from fire. In addition to the allowance for pilferage, the auditor should ~~give effect~~ make an adjustment for ~~these~~ claimed loss due to fire if ~~the taxpayer can support them properly.~~ it is supported by evidence from the taxpayer or representative(s). Examples of such support include:

- A report to the police department giving the date of the fire and approximate loss
- A fire department report
- A claim for loss filed with an insurance company

Losses of money ~~moneys received from sales by theft or pilferage~~by fire cannot be ~~allowed~~ offset against taxable sales since the sale has already ~~been made.~~ taken place and thus the tax is owed to the state.

LOSSES RESULTING FROM ~~AN ACT OF GOD~~ NATURAL DISASTERS 080~~4~~1.~~6~~40

~~Losses of this type are caused~~ Earthquakes, floods, and hurricanes are examples of losses by natural disasters. The 1% pilferage allowance discussed in Sections 0804.47 and 0809.30 does not include natural disasters. In addition to the allowance for pilferage, the auditor should make an adjustment for claimed loss resulting from natural disasters if it is supported by evidence from the taxpayer or representative(s). In many instances, the taxpayer will have insurance to cover such losses, and documentation concerning a settlement with the insurance company will be sufficient evidence of loss. In the event the taxpayer does not have insurance, a reasonable allowance should be made based upon any valid information obtainable.

Draft

SALES TAX INCLUDED 080~~9~~1.~~0~~45

~~On or after January 1, 1979, C~~Certain presumptions concerning the addition of sales tax reimbursement are created by Civil Code Section 1656.1. It shall be presumed that the parties agreed to the addition of sales tax reimbursement to the sales price of tangible personal property sold at retail to a purchaser if: ~~certain conditions are met. See Regulation 1700(a).~~

- The agreement of sale expressly provides for such addition of sales tax reimbursement;
- Sales tax reimbursement is shown on the sales check or other proof of sale; or
- The retailer posts in his or her premises in a location visible to purchasers, or includes on a price tag or in an advertisement or other printed material directed to purchasers, a notice to the effect that reimbursement for sales tax will be added to the sales price of all items or certain items, whichever is applicable.

It shall be presumed that the property, the gross receipts from the sale of which is subject to sales tax, is sold at a price which includes sales tax reimbursement if the retailer posts in his or her premises, or includes on a price tag or in an advertisement (whichever is applicable) one of the following notices:

- "All prices of taxable items include sales tax reimbursement computed to the nearest mill."
- "The price of this item includes sales tax reimbursement computed to the nearest mill."

~~For periods prior to January 1, 1979, if sales tax is added to the bar price when beverages are served at tables, or added to dinner checks, refer to Regulation 1700, Reimbursement for Sales Tax, for requirements of the deduction.~~

~~Ordinarily, bars do not make a separate charge for tax on alcoholic beverages sold. In setting the sales prices the bar owner has apparently taken sales tax into consideration thereby complying with Section 6012 of the law.~~Notwithstanding the above, it is the overwhelming custom of the bar trade to serve alcoholic beverages tax included. Some bars with restaurants sell their drinks for a "tax-included" price at the bar, but in the restaurant sell the drink without tax reimbursement for the same price and separately add tax reimbursement. The auditor must be aware of the different ways for handling sales tax reimbursement to ensure the proper selling price is obtained. The auditor should also verify whether the recorded sales in both restaurants and bars are ex-tax or tax-included by conducting a random test of sales tickets or cash register tapes.

~~PRELIMINARY~~ BAR AUDITING PROCEDURE 0802.00

GENERAL 0802.05

A preliminary review of the business operations is essential in bar auditing. ~~The review procedures which~~that ~~follow are not intended to be a substitute for~~ independent~~creative thinking and sound judgment on the part of the auditor. They are not inflexible, but~~ The following procedures should be ~~accepted and~~ used as a guidelines~~s~~ in making a determination as to the accuracy of the recorded sales. While acceptable, any deviation from the established review procedures must be fully documented and explained in the audit working papers. Due to the variety of retail establishments that serve alcoholic beverages, the Audit Program for Bars, Appendix A, is provided as a guideline to assist the auditor in planning and conducting a routine bar audit.

All ~~This kind of~~ information used to establish sales must~~should~~ be included in the audit working papers to support the auditor's recommendation. Although the importance and utility of quantitative analysis in computing audit deficiencies cannot be discounted, such an approach should be used only when there are adequate reasons for disregarding the taxpayer’s recorded sales.

If the taxpayer’s recorded sales are impeached and sales are established by generally accepted tax-auditing procedures (i.e., the mark-up method or other auditing technique), the auditor must explain why it was necessary to disregard the taxpayer’s records.

DEFINITION 80~~1~~2.105

For purposes of this chapter, a bar is defined as any retail establishment serving alcoholic beverages. Exhibit 1 identifies the various types of alcoholic beverage retailers.

BAR FACT SHEET 0802.~~40~~15

The preparation of Form BOE-1311-B, Bar Fact Sheet (Exhibit 2), is an essential and required preliminary step in any bar audit. The Bar Fact Sheet will assist the auditor and taxpayer in documenting the essential information needed to perform a bar audit. This form is to be used as a tool to gather information in conducting bar audits, as well as to ensure the taxpayer is aware of important considerations that might impact the audit. The Bar Fact Sheet provides documentation for many areas that affect a bar markup, such as:

- Pour size and glass sizes (including changes during entertainment, “happy hour” and special events)
- Drink prices (including changes during entertainment, “happy hour” and special events)
- Estimated percentage of sales by category, (i.e., mixed drinks, cocktails, or “on-the-rocks”)
- Theft (pilferage), fire loss, and loss due to natural disasters
- Self-consumption

This form must be completed at the beginning of the audit. The information to be entered on the Bar Fact Sheet must be ~~secured~~obtained from the ~~owner~~taxpayer or someone authorized to act on his or her behalf. When possible, the Bar Fact Sheet should be completed with the assistance of a full-time bartender ~~is on duty~~ who has been employed for a significant length of time, which would allow him or her to be very familiar with the bar’s standard operations. The completed fact sheet should be read and signed by the person who provided the information. *If someone other than the ~~owner~~taxpayer provided the information, the form should also be read and signed by the ~~owner~~taxpayer*. If an “absentee-taxpayer” provides the information, the auditor should request the taxpayer’s permission to verify the accuracy of the information with a full-time bartender who has been employed by the taxpayer for a length of time. If there is an inconsistency between the information provided by the absentee-taxpayer and the bartender, the auditor should discuss the differences with the taxpayer and if the taxpayer is in agreement, a revised Bar Fact Sheet should be prepared for the taxpayer's signature that reflects the change(s). However, if the taxpayer declines the auditor's request to verify the information presented or if the taxpayer is in disagreement with the bartender's statements, the auditor should document such disagreement in the audit working papers.

The size of drinks reflected on the Bar Fact Sheet should be consistent with the size of the jiggers and glasses used at the bar. If drink sizes were changed during the audit period, purchase invoices may be available that reflect new glassware or jigger ~~size~~ purchases. Changes in selling prices, sales at lower prices during "happy hour~~s~~," and sales at higher prices when entertainment is provided or a special event is held~~is provided~~ can often be established from cash register tapes. Whenever possible, the auditor should attach a copy of the drink price menu to the Bar Fact Sheet.

The Bar Fact Sheet will provide much of the information that will be needed later to complete the audit working paper documentation and comments. The information documented on the Bar Fact Sheet may be modified/revised by additional information or estimates provided by the taxpayer based upon information obtained during the audit. If significant changes are necessary to the original Bar Fact Sheet, a revised Bar Fact Sheet should be prepared for the taxpayer's or representative's signature. The words "REVISED" should be written in the top right hand corner of the document. A copy of both the original and revised Bar Fact Sheet should be provided to the taxpayer and/or representative. The auditor may not alter the information on the Bar Fact Sheet without the taxpayer's knowledge and permission. If there are minor changes to the original Bar Fact Sheet, the auditor should have the taxpayer/representative initial and date the change(s). The original Bar Fact Sheet and any revised Bar Fact Sheet(s) must be included in the audit working papers as a subsidiary schedule.

It is important that the taxpayer is made aware that the Bar Fact Sheet data may be used to establish audited bar sales and the auditor must disclose this fact to the taxpayer before preparing the form. The statement at the bottom of the Bar Fact Sheet states:

> **Please Read Before Signing:**
>
> The completion of the Bar Fact Sheet is a collaborative effort by the auditor and taxpayer to document the essential information needed to perform an audit of a bar, and **this information may be used to establish audited bar sales**. If someone other than the taxpayer has provided the information, the form should also be reviewed and signed by the taxpayer. The information documented on this form may be modified/revised by additional information or estimates provided by the taxpayer. If an audit conclusion is based on information other than that contained in this Bar Fact Sheet, such information must be fully documented in the audit working papers and discussed with the taxpayer.

Therefore, if the audit conclusion is based on information other than that contained in the Bar Fact Sheet(s); such information must be fully documented in the audit working papers and discussed with the taxpayer. Additionally, if the auditor is going to disregard some or all of the information contained on the Bar Fact Sheet(s) (e.g. size of pour), the reasons must be clearly stated with detailed comments and/or supported with testing.

To ensure the accuracy and to prevent any misunderstanding of the information provided, this form should be completed in the presence of the auditor with the information and estimates provided by the taxpayer. The auditor should not influence the taxpayer's responses to the questions on the Bar Fact Sheet. Unless unavoidable, the Bar Fact Sheet should not be mailed or left with the taxpayer for completion. In addition, it is recommended that the auditor have the Bar Fact Sheet reviewed by the audit supervisor to ensure the form is properly filled out, signed and dated before the audit is completed.

BUSINESS LOCATION, FACILITIES, AND PATRONAGE 0802.20~~10~~

The auditor should observe~~note~~ and provide a general description of~~evaluate~~ the bar's ~~following~~ characteristics as set forth in Section 0801.15, such as:

- The business location (e.g., residential, industrial, urban, suburban, etc.)
- The physical facilities (e.g., number of cash registers, tables, chairs, dance floor, sound system, TV, age and condition of equipment and ~~&~~ furnishings, etc.)
- The general nature of the customers (e.g., local residents, local employees, transient, etc.)

~~of the area in which the business is located (residential, industrial, urban, suburban, depressed, middle class, etc.), the physical facilities used in the business (number of cash registers, number of tables, dance floor, age and condition of equipment and furnishings, etc.), and the general nature of the customers (neighborhood residents, businessmen, etc.).~~ Such an approach is especially important in bar auditing because~~In this industry,~~ sales are generally ~~are~~ for cash, the ~~owner~~taxpayers ~~are often~~ may be absent from the business premises, and~~;~~ employee turnover may be high. ~~;also , internal controls and accounting systems are sometimes minimal. consumption of alcoholic beverages, or distraction of employees by entertainment and conversation with customers may lead to carelessness~~ In addition, ~~T~~this kind of information often indicates the volume of sales, size of drinks, types of drinks, and selling prices which might be expected. It may ~~also~~ be useful in estimating cocktail sales, "~~H~~happy ~~H~~hour" sales, sales during entertainment periods, and self-consumption. The information may also be useful in analyzing losses incurred and/or the varying degrees of internal controls, etc.

Since a preliminary review of the business operations is essential in bar auditing, if the auditor is unable to visit the business premises, an explanation must be provided in the audit working papers.

EMPLOYEE INFORMATION 0802.2~~1~~5

Through discussion with the taxpayer or his or her representative(s), and by examining the available records, the auditor should determine the number of paid bartenders and servers~~waitresses~~, the shifts worked by each, the rate of employee turnover, the level of salaries, and whether any employees have been discharged for dishonesty. Such information is valuable in judging the existence of any employee theft~~.~~ and determining whether all employee wages are recorded in the books. Employees working "off the books" may be a source of unreported sales that are used to pay their wages.

COMPLIMENTARY AND EMPLOYEE DRINK POLICY 0802.3~~2~~0

Discussion with the taxpayer or the representative(s) and review of the taxpayer's written policies will enable the auditor~~'s~~ to determine:

- The amount of self-consumption by ~~owner~~taxpayer/employee
- The taxpayer's policy regarding complimentary drinks to customers
- If documentation is available to support the above items

~~Through discussion with the taxpayer and by reference to written directives to employees, if such documents ore available, the auditor should determine the taxpayer's policy regarding employees consuming free drinks and providing complimentary drinks to customers. Such information is useful in estimating self consumed merchandise and may also provide~~Reviewing the taxpayer's policies, if any, and discussing the practices regarding self-consumption and complimentary drinks may also provide some insight into the degree of care exercised by employees in pouring drinks, ringing up sales, etc. If possible, an estimate of the amount of self-consumption and complimentary drinks should be discussed with each bartender, as his or her practice may differ from the ~~owner~~taxpayer's policy.

CIGARETTE SALES 0802.35

Some bars may sell cigarettes either through vending machines or over the counter. The auditor should first determine if the taxpayer sells cigarettes or other tobacco products. The Bar Fact Sheet contains a question regarding cigarette-vending sales. If the taxpayer does sell cigarettes or other tobacco products, the auditor should discuss such sales with the taxpayer and review purchase invoices. The auditor should obtain clarification on the following issues:

- Are cigarette (tobacco) sales segregated?
- What are the selling prices? Tax-included or ex -tax?
- Rebates and incentives (as discussed in Section 0902.45).

A comment should be made in the audit working papers with respect to cigarette sales.

INTERNAL CONTROLS 0802.4~~3~~0

The existence, or lack, of comprehensive and effective internal controls is an extremely significant factor in tax audits of bars. If such controls have been combined with a sound accounting system, it is ~~very unlikely~~more likely that recorded sales are not understated, unless the records have been deliberately altered. -The auditor should determine the extent and nature of internal controls through discussions with the ~~owner~~taxpayer or manager, observation, physical inspection, and examination of pertinent records. Exhibit 3 contains a "Statement of Internal Controls" that the auditor may complete with the assistance of the taxpayer. Completing a "Statement of Internal Controls" will assist the auditor (and others reviewing the audit) in understanding what type of internal controls are present in the taxpayer's business. A "Statement of Internal Controls" should be completed at the same time as the Bar Fact Sheet and, if prepared, it should be signed and dated by the taxpayer and included in the audit working papers.

The following suggest some of the internal controls used in the bar industry.

a) Cash Controls

- ~~(1)~~ Are cash register drawers closed after each sale?
- ~~(2)~~ Do the cash registers print sales tickets?
- ~~(3)~~ Are sales tickets given to customers?
- ~~(4)~~ Is access to the register tapes restricted?~~, and~~ I~~i~~f so, to whom?
- ~~(5)~~ Are the cash registers checked out at the end of each shift? ~~, and i~~If so, by whom?
- ~~(6)~~ If two or more bartenders work simultaneously, do they use the same or different cash registers?
- ~~(7)~~ Are beginning and ending register tapes (Z-tapes) in sequential order?~~transaction numbers compared?~~
- ~~(8) Are register tape tears matched?~~Does the recorded time on the register (Z-tape) tape correspond to the bar's closing time?
- ~~(9) Are cash payments supported by receipts signed by the payee~~Do receipts signed by the payee support cash payments?
- ~~(10)~~ If servers~~waitresses~~ are employed, how are sales by them controlled?
- ~~(11)~~ Is a third party~~shopping service~~ retained to conduct periodic checks?
- ~~(12)~~ Is the cash reconciled to the register tapes and deposited in the bank intact? ~~, and i~~If so, at what intervals and by whom?
- Are surveillance cameras used to monitor sales at the register?

b) Inventory Controls

- Who is responsible for purchasing inventory?
- How often are purchases made?
- Are vendors paid with cash, check or money order?
- Are all bottles in the bar purchased from distributors?
- ~~(1)~~ Is the inventory of alcoholic beverages stored in a locked stockroom?
- ~~(2)~~ Who has access to the stockroom?
- ~~(3)~~ Who restocks the bar from the stockroom inventory and at what intervals?
- ~~(4)~~ Is a record maintained of stock removed from the stockroom?
- ~~(5)~~ Are empty (or broken) bottles from the bar exchanged for full bottles removed from the stockroom?
- ~~(6)~~ Who checks incoming merchandise into the stockroom?
- ~~(7)~~ Are the contents of incoming cases verified?
- ~~(8)~~ At what intervals are physical inventories of merchandise in both the stockroom and the bar taken, and by whom?

- ~~(9)~~ Is an~~Are~~ automatic liquor dispensing devices used?
- ~~(10)~~ Is the beginning bar inventory, plus stockroom withdrawals, less ending bar inventory periodically extended to retail prices and compared to recorded receipts?
- ~~(11)~~ Does management demand a certain gross profit margin or pour cost?
- ~~(12)~~ Is a written record maintained of complimentary and self consumed drinks?
- If the taxpayer operates two or more locations, is the inventory commingled or transferred between locations?

SELF-CONSUMPTION 0802.45

Self-consumption should be discussed at the beginning of the audit and amounts noted on the Bar Fact Sheet (Exhibit 2). To support the amount of self-consumed merchandise, the auditor should include a schedule showing the number and type of drinks (beer, wine, and liquor) in each of the following categories:

- self-consumed by taxpayer and family
- consumed by employees
- treating of customers

Each category should then be totaled to arrive at the total self-consumption allowance. The dollar value of all self-consumed alcohol should be calculated as a percentage of total taxable cost of sales, and the percentage should be noted in the audit working papers. Generally, this amount should not exceed 3% of total taxable cost of sales without supporting evidence.The auditor should make detailed comments in the audit working papers if the amount of audited self-consumption differs from the amount scheduled on the Bar Fact Sheet.

PROFIT AND LOSS STATEMENTS 0802.50~~35~~

Operating statements for the business, ~~preferably~~ in conjunction with ~~from~~ the income tax returns, should be analyzed for the audit period~~, and in some circumstances for several years prior to the audit period if available~~. If the net profit and return on invested capital is high~~,~~; it is less likely that recorded sales are understated.~~very difficult to refute recorded sales, or conclude that a tax deficiency exists, even if the markup reflected by the records is low.~~ On the other hand, if the profit produced by the business does not constitute a reasonable return on the ~~owner's~~taxpayer's invested time and capital, or the cash ~~available~~ flow from the business is insufficient to support the ~~owner's~~taxpayer's life style, and he or she has no other income, it is possible that recorded sales and net profit are understated. It would be prudent, whenever possible, to compare the recorded sales to observed sales to ensure that the records reflect economic reality.

In analyzing the return on invested capital, the hours worked in the business by the ~~owner~~taxpayer and his or her family should be considered. What appears to be a reasonable profit and return on capital may in fact be compensation for long hours of work.

To compute the cash flow for the business, use the following formula:

Net Income:

Add:

- Depreciation
- Increase in accounts payable
- Decrease in ~~I~~inventory

Subtract:

- Capital expenditures
- Decrease in accounts payable
- Increase in ~~I~~inventory ~~(Cont.) 0802.40~~

Equals:

Cash Flow from Business Operations

~~The cash available from the business consists of the net profit, depreciation, any increase in accounts payable, and any decrease in inventory, less purchases of assets to be depreciated, any decrease in accounts payable, and any increase in inventory.~~ If the cash ~~available~~ flow from ~~the~~ business operations is insufficient to support the ~~owner's~~taxpayer's life style, and the ~~owner~~taxpayer contends that the difference represents borrowing~~,~~ or income from sources other than sales, then ~~he~~ the taxpayer should be requested~~asked~~ to substantiate such contentions. The auditor should document such contentions and include any evidence with the audit working papers.

Pour Cost Percentage 0802.52

The pour cost percentage is an indicator of profit and loss performance because it analyzes the relationship between costs and sales. The pour cost percentage is obtained by dividing the cost of goods sold by sales (portion cost/selling price). Thus, a 20% pour cost means that it costs the taxpayer $.20 to generate $1.00 of liquor sales, which translates to a gross profit margin of 80% and a markup on cost of 400%. Since liquor, beer, and wine each vary in their respective sales prices and costs, a pour cost percentage should be calculated separately for each category if the information is available. Many taxpayers will attempt to achieve a certain pour cost percentage, and the auditor should discuss the pour cost percentage with the taxpayer at the beginning of the audit.

Knowing the taxpayer's expected pour cost percentage will assist the auditor in determining the taxpayer's expected markup on liquor, beer, and/or wine sales. Exhibit 14 provides for the conversion from pour cost percentage to profit margin to markup. From this information, the auditor can perform a preliminary analysis to determine whether or not a more detailed review of the taxpayer's records will be necessary.

MARKUPS 0802.5~~4~~5

~~In a bar audit, consideration must be given to whether the records account for all merchanise which was available for sale.~~ A markup is the amount added to cost to obtain the sales price, and generally is referred to in terms of percentages. The percentage of markup is computed by dividing gross profit by cost of goods sold: G.P./C.G.S.=% of M.U. Taxpayers often discuss gross profit in terms of percentages based on sales (e.g., profit margin = G.P./Sales) but seldom discuss the markup on cost. The auditor should make certain the taxpayer understands the difference between the markup on cost and profit margin. (See Exhibit 14).

For example:

Sales= $1,000 Cost of Goods Sold= $400

Gross Profit= $1,000-400= $600

Markup on Cost= $600/400=150%

Profit Margin= $600/1,000= 60%

~~The auditor should abstract the sales and cost of sales figures from the taxpayers profit or loss statements and compute the markup on cost reflected by the records.~~ The achieved ~~This~~ markup on the taxpayer's recorded sales should be evaluated in terms of other information which has been developed, such as the data on the Bar Fact Sheet~~,~~ and the auditor's experience with similar businesses, to determine whether the recorded sales are consistent with the established cost of merchandise sold. (See Section 0807.00.)

In a bar audit, consideration must be given to whether the records account for all merchandise ~~which~~ that was available for sale. In order for a mark-up analysis to be meaningful, it is imperative for the auditor to verify that the recorded purchases are complete. The auditor should become familiar with the products sold in the establishment and verify that all items are accounted for when reviewing purchase invoices.

To the extent that it is practical to do so, based on available records, the mark-up should be computed separately for each class of merchandise (beer, distilled spirits, food, etc.), for each year in the audit period rather than on a composite basis for the entire audit period.

BAR SHORT TEST 0802.650

The Bar Short Test (Exhibit 4) provides a preliminary analysis to determine whether or not a more detailed review of the taxpayer's records will be necessary. A Bar Short Test, Form BOE-1311-A, is provided to assist the auditor in performing a quick test of a taxpayer's markup. The auditor may use BOE-1311-A or an equivalent form at his/her discretion. If a short test is to be performed in a bar audit, the schedule or form used should be retained as a subsidiary schedule to support the mark-up analysis, whether or not a deficiency exists.

The Bar Short Test is divided into six categories: well drinks, call drinks, cocktails, wine/liqueurs, beer domestic and beer premium/microbrew. The auditor should take the most popular drink sold by the establishment from each category and develop a weighted mark-up percentage. Input from the taxpayer or representative(s) is essential to the accuracy of this analysis. The percentage of total purchases may be based upon a discussion with the taxpayer or the representative(s). The auditor may want to perform purchase segregation for a purchase cycle if the expected mark-up percentages differ substantially for each category of drinks. The expected markup should be based upon a supporting schedule that lists the selling price of the drink used from each category and the cost per drink. The reference used for establishing the cost of the drink must be noted on the form. To establish the cost of the drink, the auditor should reference recent purchase invoices.

The mark-up percentages from the Bar Short Test must then be compared to the mark-up percentages achieved based upon the taxpayer's records. The auditor should indicate whether the achieved markup per record is tax included or ex tax, as well as the mark-up percentages developed in the Bar Short Test. The auditor must comment on any differences between the markups and whether or not further analysis is warranted. The auditor should always seek his/her supervisor's guidance if there is uncertainty on whether to proceed with an audit or accept reported sales. An example of a Bar Short Test is provided in Exhibit 15.

~~A bar short test based on a limited examination of the taxpayer's records should assist the auditor in judging whether all sales have been recorded. This test should be made as part of the preliminary procedures in every audit of a bar, and is only as accurate as the information used to complete it.~~

TOLERANCE 0802.65

When performing a mark-up analysis, there are many factors that may potentially affect the results. For example, pour sizes, self-consumption, "happy hour" and entertainment prices all affect a bar's markup. As a result, a tolerance of 10% is used in analyzing bar audit findings on an annualized basis.

The auditor should accept recorded sales of "on sale" distilled spirits, beer and wine if the audit findings disclose a potential under-reporting of less than 10%, unless it can be established by other means that an actual understatement exists. The 10% tolerance applies only to on-premise sales for establishments serving distilled spirits. *It does not apply to establishments selling beer and wine only since the markup for beer and wine can be computed more accurately.* A determination should be issued for the full amount for these types of establishments when reported sales are outside the tolerance.

The 10% tolerance for bar audits can provide assistance to the **auditor in applying cut-off techniques when analyzing a short test (see Sections 0405.15 and 0405.35).**

ANALYSIS OF AUDIT~~PRELIMINARY~~ FINDINGS 0802.70~~55~~

The information developed through procedures outlined in the preceding sections should be carefully documented and evaluated by the auditor and included as part of the audit report. If it is concluded that a tax deficiency greater than the tolerance discussed in Section 0802.65 may exist~~s~~, the auditor should proceed to establish the amount of the deficiency using generally accepted tax auditing procedures ~~such as~~(e.g., the mark-up method of computing sales, an analysis of bank deposits, gross profit and net worth analysis, cash flow analysis, ~~See Sections 0405.25 and 0406.40)~~etc.).

When an audit approach other than the mark-up method is used, a post audit mark-up analysis should be performed to support the reasonableness of the audit findings. This is done by adding the amount of the deficiency to the reported sales and computing the mark-up percentage on the cost of sales.

Regardless of the audit procedures used by the auditor, if a tax deficiency has been established, an alternative method must be used and documented in the audit working papers to support the reasonableness of the audit findings. This is generally referred to as a reasonableness short test. Alternative methods for supporting audit findings may include an analysis of the taxpayer's net income (Section 0803.15), cash flow analysis, analysis of bank deposits (Section 0405.25), and gross profit and net worth analysis (0406.40), etc.

~~If the use of these procedures is not practical, the auditor should resort to the use of the markup method of computing sales. However, use of the markup method must be supported as explained in the previous sections.~~

MARK-UP METHOD OF COMPUTING SALES 0803.00

GENERAL 0803.05

The Board's authority to ~~"go behind"~~ impeach the taxpayer's records is ~~contemplated in~~authorized by Revenue and Taxation Code ~~S~~section 6481~~. of the Sales and Use Tax Law.~~ Specifically, ~~T~~the validity of using the mark-up method of computing sales, when there is a basis for disregarding recorded sales, was ~~sustained~~ upheld by the court in Maganini v. Quinn, (1950) 99 Cal. App. 2d l.

Even though the taxpayer's books and records are comprehensive and in agreement with each other, the Board is not required to accept such evidence as conclusive and may use recognized and standard accounting procedures to establish audited sales. Where the Board establishes a deficiency, the burden of proof is upon the taxpayer to explain any disparity between their books and records and the results of the Board's audit (**Riley B's, Inc**. v **State Board of Equalization** (1976) 61 Cal. App. 3d 610).

The ~~use of the~~ mark-up method ~~presumes~~ may only be used when there is support that the taxpayer's records are inadequate. If the taxpayer's recorded sales are impeached and sales are established by generally accepted tax auditing procedures (i.e., mark-up method), the auditor must explain why it was necessary to disregard the taxpayer's records. The comments on the back of Form B~~T~~OE-414-A, under the caption "Books and Records" (Section 0206.36), should explain why it was necessary to disregard the records. ***The comments should never indicate that the records were adequate when it was necessary to compute sales by the*** *mark-up* ***method. Such a comment is inconsistent with the use of the*** *mark-up* ***method.***

ACCURACY 0803.10

The accuracy of the bar mark-up method depends upon the following factors:

- ~~(a) Correctness~~ Accuracy of cost of sales.
- ~~(b)~~ Accuracy~~Correctness~~ of drink sizes and all selling prices.
- ~~(c)~~ Accuracy of all calculations.
- ~~(d)~~ Correct weighting of the various types of drinks and other merchandise sold.
- ~~(e)~~ Adequacy of tests to determine the markups.

REASONABLENESS 0803.15

~~When an understatement of sales is computed using the markup method the result should meet acceptable standards of reasonableness and logic.~~ When a mark-up analysis indicates that there were unreported sales during the audit period, an additional analysis must be utilized to evaluate and reinforce the assessment whenever possible (i.e., reasonableness short test).

A preferred method is an analysis of the taxpayer's *net income* (per income tax returns or financial statements). This will include a schedule showing the deficiency per audit added to the taxpayer's income per financial statements or income tax returns. In the example below, a taxpayer's $50,000 annual recorded income is added to a hypothetical audit assessment which projects additional annual unrecorded sales of $150,000. This results in an audited annual income of $200,000 for the taxpayer.

	1999 Income
Reported Net Income per FITR	**$ 50,000**
Add: Unreported Sales per Mark-u~~-U~~p Analysis	**150,000**
Audited Income	$ **200,000**

The reasonableness of the computed understatement should be evaluated as a whole and as to the amount per month, the amount per day or shift, etc. In this case, we have income of $200,000 per year, or approximately $16,667 per month, or $3,846 per week, etc.

Consideration should be given to adjustments for unrecorded cash payments, such as unrecorded purchases, employees working "off the books," etc.

Example:

Reported net income	$ 20,000
Add: Unreported sales per markup analysis	100,000
Less: Unreported wages	
Hours open per day	14
Employees needed for staffing	2
Staffing hours required per day	28
Average hourly wage	$ 7
Daily payroll	$ 196
Days open per year	360
Employee payroll	$ 70,560
Recorded wages per FITR	15,000
Unreported wages	55,560
Audited Income	$ 64,440

The auditor should make specific comments regarding the reasonableness of the audited figures to explain and reinforce the proposed audit assessment. Comments should be based upon the type and size of the business as well as the taxpayer's lifestyle, growth of assets or reduction of personal debt (e.g., reduction of principal balance of mortgage based on a review of interest claimed on income tax returns).

AUDIT WORKING PAPERS 0803.20

Audit working papers must include sufficient references so the audit schedules can be traced back into the taxpayer's records. For example, schedules of purchase invoices for test periods should include the name of the vendor, the invoice date, a description of each item of merchandise on the invoice, the number of units and the purchase price of each type of merchandise~~.~~ (~~See Table~~

~~1~~Exhibit 5). When facilities are available, ~~this can be accomplished by making~~photocopies of the purchase invoices in the test period should be included as support for the purchase segregation.

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COMPUTATION OF COST OF SALES 0804.00

GENERAL 0804.05

To correctly compute the cost of sales, it is necessary that the auditor determine:

- ~~(a)~~ Beginning and ending inventories
- ~~(b)~~ Total purchases
- ~~(c)~~ Adjustments for self-consumed merchandise
- ~~(d)~~ Adjustments for losses (e.g., pilferage)
- ~~(e)~~ Whether mixes and supplies are included in purchases

INVENTORIES 0804.10

Inventories, if supported by detailed work sheets, may be accepted as correct. If, however, inventories presented are not so supported and there is reason to believe they are ~~mere~~ estimates, it would be preferable to regard the inventories as being constant. The auditor must include comments in the audit working papers reflecting these types of situations. Inventories should be compared to those reflected in the records and income tax returns of the taxpayer.

TOTAL PURCHASES 0804.15

In cases where the achieved markups based on the taxpayer's records appear to be reasonable, yet total recorded sales are lower than expected, it is possible that total purchases may have not been recorded (in addition to total sales). When there is reason to believe the purchase records do not properly reflect total purchases, some or all of the following verification should be performed:

- ~~(a)~~ Adjust for changes in accounts payable ~~fluctuations~~.
- ~~(b)~~ Examine expense records to determine whether some purchases may have been concealed therein to improve the relationship between recorded purchases and reported sales.
- Annualize the segregated purchases (0807.10) and compare the total to recorded annual purchases. Annualized purchases greater than recorded purchases may indicate that all purchases are not accounted for in the financial records presented. Annualized purchases less than recorded purchases may indicate that not all purchase invoices were provided.
- ~~(c) Review purchasing cycle. Are purchases made at regular intervals?~~ Analyze the purchasing cycle to determine if vendors arrive at regular intervals.
- ~~(d)~~ Examine current purchase invoices to determine if all brands of liquor on taxpayer's shelves and in inventory are represented on vendors' invoices of liquor purchases.

  ~~(e) In unusual cases it may be necessary to examine sales invoices of wholesale liquor dealers whose distributing areas include taxpayer's premises.~~

- ~~(f)~~ Compare vendors' statements with invoices.
- ~~(g) Verify cash purchases~~Ensure that items purchased with cash are accounted for in recorded purchase summaries.
- If it appears that purchases may be understated, all liquor distributors in the taxpayer's area should be contacted to obtain a purchase history.
- Consider contacting the Department of Alcohol and Beverage Control or the Bureau of Alcohol, Tobacco, and Firearms to obtain information regarding purchases from non-licensed wholesalers or other violations.
- Review the taxpayer's purchase invoices for purchases of liquor, beer, or wine made at wholesale and warehouse stores.

The auditor should be aware that the Bureau of Alcohol, Tobacco, and Firearms (ATF) requires every retail dealer who makes sales of distilled spirits, wines, or beer in quantities of 20 wine gallons (75.7 liters) or more to the same person at the same time to prepare and keep a record of each such sale, which shows the (1) date of sale, (2) the name and address of the purchaser, (3) the kind and quantity of each kind of liquor sold, and (4) the serial numbers of all full cases of distilled spirits included in the sale. (27 C.F.R. Section 194.234 (2000).) These records are to be maintained for a period of not less than three years and during this period the records are to be made available at the business premises for inspection and copying by ATF officers. If it appears that the taxpayer is purchasing from a retailer, such as a "warehouse store," the auditor should contact the "warehouse store" and inquire if these records are available.

QUANTITY DISCOUNTS 0804.25

The custom of the liquor industry is to periodically allow quantity discounts to retailers. Purchases are ordinarily recorded net of discount. Sufficient testing of overall purchases should be conducted to ensure that such discounted purchase prices are representative of the overall purchasing habits of the taxpayer. If the auditor determines that the sampled discounted purchases are customary or recur on a regular basis, then~~In such cases,~~ the auditor should list the discounted purchase price when scheduling purchases for the shelf test. However, if such discounted purchases are not customary or do not recur on a regular basis, then the non-discounted prices should be utilized in the shelf test.

CREDIT REGULATIONS 0804.30

Business and Professionsa~~l~~ Code ~~S~~section 25509 states that ~~of the Alcoholic Beverage Control Act regulates credit on sales of distilled spirits and beer. When the retailer has not paid by the expiration of the 42nd day from date of delivery, the~~a wholesaler of alcohol shall~~must~~ charge the retailer 1% of the unpaid balance when the invoice is not paid timely~~on the 43rd day and an additional 1% for each 30 days thereafter~~. When a delinquency charge is levied pursuant to this section, ~~A~~any such delinquency charge is an interest charge and should not be included in audited purchases.

SELF-CONSUMED MERCHANDISE OVER-REPORTED 0804.45

In some instances, taxpayers may report what appears to be an excessive amount of self-consumed merchandise. The auditor should in all cases verify the amounts reported, and if it is determined the amount is excessive, the excess should be restored to the cost of sales for purposes of computing sales by the mark-up method. Comments must be provided in the audit explaining why the information provided in the Bar Fact Sheet regarding self-consumption is different.

Self-consumed merchandise is sometimes over-reported because it is rung up at the retail selling price and included in sales. These amounts should be eliminated from sales and only the cost considered as self-consumed merchandise, where applicable.

PILFERAGE 0804.47

An allowance for pilferage, also known as "shrinkage," in the amount of 1% of the cost of goods sold is allowed. Pilferage is an adjustment made for inventory purchases that were not sold due to some type of loss, such as employee theft, customers not paying, free drinks served outside of the bar's written policy on the "treating of customers," and spoilage. If the taxpayer does not maintain a written policy on "free drinks" or "treating of customers," the total number of drinks provided without charge should be considered as self-consumption and not as pilferage. Self-consumption and loss from fire and/or natural disasters are not included in this amount and should be adjusted for separately. The pilferage adjustment is made after an adjustment for self-consumption. The total amount of pilferage allowed should be stated and expressed as a percentage of total taxable purchases in the audit working papers. See Exhibit 6.

Taxpayers claiming pilferage shall be given a standard 1% pilferage allowance, unless evidence supports a higher allowance. Any adjustment exceeding the 1% for pilferage must be clearly explained in the audit working papers and well documented by the taxpayer. Such documentation may include police reports, reports from regularly employed private security guards, private detective agencies, insurance claims, reports from inventory control companies or similar service firms. If the taxpayer provides a well-documented report from an inventory control company, the auditor should consult with the audit supervisor to determine a reasonable percentage of the loss attributable to theft of product as opposed to self-consumption, treating of customers, unrecorded sales and theft of cash. A reasonable percentage should be developed based on any information available to the auditor, such as the information contained on the Bar Fact Sheet, the Statement of Internal Controls, employee records, police reports, or other similar documents or evidence provided by the taxpayer.

ALCOHOLIC BEVERAGES USED IN COOKING 0804.50

Delete~~Eliminate~~ the cost of alcoholic beverages used for cooking meals for resale, if significant. (The amount so used should not be included in the measure of self-consumption as it is for resale.)

MIXES AND SUPPLIES 0804.65

The mixes and supplies listed below can be recorded either as supplies or as purchases. It is important in calculating the rate of mark-up that they ~~be~~are treated consistently, i.e., if included in the taxpayer's purchases, they must be included as purchases in the test base. A more accurate result would be obtained, however, if they were excluded from both the test and purchases.

Mixes	Supplies
Ginger Ale/ other lemon lime sodas	Cherries
~~Coca~~ Cola	Olives
~~7-Up~~Tonic Water	Cocktail Onions
Soda/Mineral Water	Lemons
Orange Juice	Oranges
Lemon Juice	Angostura Bitters
Lime Juice	Orange Bitters
Pineapple Juice	Tabasco Sauce
Grapefruit Juice	Cocktail Napkins
Cranberry Juice	Straws
Tomato Juice	Whipped Cream
Half & Half	~~Grenadine Syrup~~
*Sweet Vermouth	
*Dry Vermouth	
Grenadine Syrup	
Sweet & Sour Mix	
Tom Collins Mix	
Margarita Mix	
Bloody Mary Mix	
*Triple Sec	
*Blue Curacao	

*Although Sweet Vermouth, Dry Vermouth, Triple Sec, and Blue Curacao are distilled spirits, they are generally considered as mix.

COMPUTATION OF SELLING PRICES 0805.00

MIXES SOLD AS BEVERAGES 0805.05

Almost all bars sell mixes (ginger ale, lemon lime sodas, ~~Coca- C~~colas,~~ 7-Up,~~ etc.) as soft drinks. If sales of these mixes are significant, they should be added to total sales of alcoholic beverages computed from the mark-up method. If ~~a separate record of such sales is not maintained by the~~ the taxpayer does not maintain a separate record of such sales, it will be necessary to compute the dollar value of these sales from any information available.

BARS PROVIDING ENTERTAINMENT 0805.10

Some bars increase their beverage prices when entertainment is provided. The prices charged before and during entertainment should be noted on the Bar Fact Sheet and considered in making the audit. The method for computing the weighted average markup for sales made during periods of entertainment may be computed using the same formula used in Section 0805.15.

When computing achieved markups from the taxpayer's recorded sales, the auditor should exclude entertainment "cover charges" (if any) from recorded sales.~~Following is a method for computation of average selling prices where increased entertainment prices are involved:~~

~~Selling Prices~~	~~Beer~~	~~Liquor~~	
~~Before Entertainment~~	~~$.60~~	~~$.80~~	
~~During Entertainment~~	~~.80~~	~~1.25~~	
~~Average Selling Prices (See Below)~~	~~$.655~~	~~$.909~~	
~~Assumed Sales~~			
~~Sales before Entertainment (Incl. Sales Tax)~~			~~$20,000~~
~~Sales during Entertainment (Incl. Sales Tax)~~			~~$10,000~~
~~Beer~~	~~No. Drinks~~		
~~$20,000 ÷ $.60~~	~~= 33,333~~		
~~10,000 ÷ .80~~	~~= 12,500~~		
~~$30,000 ÷~~	~~45,833~~	~~= $.655 = (Average Selling Price)~~	
~~Liquor~~	~~No. Drinks~~		
~~$20,000 ÷ $.80~~	~~=25,000~~		
~~10,000 ÷ 1.25~~	~~= 8,000~~		
~~$30,000 ÷~~	~~33,000~~	~~= $.909 = (Average Selling Price)~~	

"HAPPY HOUR" & SPECIAL EVENT SALES 0805.15

Many bars, as a means of increasing patronage, feature a period in the late afternoon or early evening where drinks are sold either at a reduced price or a larger drink is served at the regular price. This period is commonly referred to as “happy hour.” Additionally, many bars have “special event” periods (i.e., Superbowl Sunday, Monday N~~n~~ight F~~f~~ootball, etc.) that may include draft beer discounted or served in oversized pitchers. The sales during ~~this so-called~~ “happy hour” and special events will generally yield a lower markup than regular sales. The auditor must give consideration to this in establishing the overall weighted markup. “Happy hour” and special event sales should be discussed with the taxpayer (i.e., the type and frequency of discounts), and the auditor must fully document this information in the audit working papers.

This situation is the reverse of the entertainment situation~~condition~~ (discussed in the ~~preceding~~previous section) where the prices of drinks are increased during the period of entertainment. ~~However, if happy hour sales are segregated in the taxpayer's records, the average selling price per drink can be computed by using the formula illustrated above. Also see Section 0806.50.~~

An analysis of the taxpayer’s register tapes is the best way to determine the percentage of sales occurring during “happy hour.” However, in some cases, an analysis using the register tapes may not be possible. The following is an alternative method for computing the weighted average markup where there are different price structures in place.

Mark-up Percentages (based on cost of goods sold):

	Happy Hour	**Regular**
Mark-up Percentage on Liquor (ex-tax)	**500%**	**600%**
Mark-up Percentage on Beer (ex-tax)	**300%**	**400%**

Per Bar Fact Sheet, taxpayer estimates **that 25% of** total **sales are at “happy hour” prices.**

Percent of Purchases per 4 Qtr 1999 Purchase Segregation:

Liquor	**35%**
Beer	**65%**

Computation of Average Weighted Mark-up:

Happy Hour		(Markup % X % of purchases X estimated % of sales)	
	Liquor	500% X 35% X 25% =	.4375
	Beer	300% X 65% X 25% =	.4875
Regular			
	Liquor	600% X 35% X 75% =	1.575
	Beer	400% X 65% X 75% =	**1.950**
Weighted Average Markup			**4.45**

SALES OF OFF-SALE BEER 0805.20

~~Effect~~ Adjustments must be ~~given~~ made to account for off-premise sales of beer in quantity (six packs, twelve packs, etc.) ~~six-can packs~~. These types of sales ~~can~~ may be verified from ~~purchases~~a review of register tapes, discussion with the taxpayer/bartender, and a review of the purchase invoices. Sales of off-sale beer in single bottles/cans ~~of beer~~ or packs at a price less than charged at the bar must be supported by the taxpayer. Often the taxpayer will sell only canned beer off-sale as opposed to bottled beer. Off-sale beer sales should be discussed with the taxpayer/bartender or representative at the beginning of the audit, and the amount and prices so noted on the Bar Fact Sheet.

SALES OF PREMIUM BEER AND KEG CONVERSION CHART 0805.22

The auditor should be aware that not all one-half kegs contain 15.5 gallons (1,984 ounces) of beer. Certain imported beers and microbrewery beers are sold in kegs, which may be less than 15.5 gallons. Before calculating the proceeds from a keg of beer (Exhibit 12), the auditor should determine the type of beer sold and the correct number of gallons per keg by examining the purchase invoices for a representative period, discussion with the taxpayer/bartender, and/or contacting the beer ~~distributor~~. The auditor should document this type of information in the audit working papers.

Keg Size Conversion Chart			
Size of Keg	Ounces of Beer	Size of Keg	Ounces of Beer
½ bbl. = 15.5 gal	1,984	25 Liter = 7.92 gal.	845
13.5 gal.	1,728	¼ bbl. = 7.75 gal.	992
50 Liter = 13.2 gal	1,690	1/6 bbl. = 5.17 gal.	661
30 Liter = 7.92	1,014	1/8 bbl. = 3.88 gal.	496

PRICE CHANGES DURING AUDIT PERIOD 0805.25

Changes in prices will affect the markup. The auditor should determine the date and amount of any price changes. Ordinarily, this information can be obtained from discussion with the ~~owner~~taxpayer, and in some instances can be supported by cash register tapes, menus, ~~lists~~advertisements, etc. Price changes should be documented on the Bar Fact Sheet.

ESTABLISHING SIZE OF DRINK AND PRODUCT LOSSES 0806.00

GENERAL 0806.05

Determining the size of drinks as accurately as possible cannot be over-emphasized. One or more of the following methods can be used as necessary:

- Glass size
- Count of pour (free hand)
- Measurement of ~~size of~~ jigger size
- Dispenser gun
- Average pour test and discussion
- Undercover test

The auditor should avoid establishing the pour size based solely on "auditor's judgement" or "auditor's knowledge of the industry." The auditor may accept an average pour size up to 1.5 ounces without testing; however, when the auditor accepts a pour size in excess of 1.5 ounces, the pour size must be supported by detailed audit comments and/or documentation such as the performance of an average pour test or an undercover pour test. In general, a separate pour size must be established for cocktails and exotic drinks. The pour size related to cocktails and exotic drinks should be established using one of the methods discussed below or through discussion with the taxpayer/bartender. ***The method used*** *to determine the pour size* ***must be clearly stated in the audit working papers*** *and if an audit conclusion is based on information other than the pour size information contained in the Bar Fact Sheet, such information must be fully explained in the audit working papers.*

GLASS SIZE 0806.10

The first step in determining any drink size is to obtain the glass size used by the taxpayer for each drink. The Bar Fact Sheet requires the taxpayer to list the different glass sizes (e.g., beer, wine, cocktail, and shot glasses). The glass size used to serve a drink is the starting point to establish the drink size and provides the maximum drink size.

Since most drinks are not filled completely to the top of the glass, one of the following methods, in conjunction with the Bar Fact Sheet, should be used to determine the drink size.

FREE HAND POURING METHOD 0806.15

Free ~~H~~hand pouring is a method by which liquor is poured directly from the bottle into the glass without using the jigger as a measuring device. To measure the pour size, a bartender will often count the number of seconds in the pour. The accuracy of this method depends upon the bartender and the consistency of the type of spouts used on the various bottles. ~~A jigger may or may not be used as a pouring aid.~~ Experienced bartenders using this method are usually very proficient in consistently pouring the desired amount of liquor. ~~There has been a trend to more free hand pouring in recent years.~~ If a bartender is using the free hand pouring method, the auditor should discuss with the bartender what “count” the bartender is using to establish a specific pour size and perform a quick test of the bartender’s method. Information on the pour size established using the free hand pouring method should be documented in the audit working papers.

JIGGER POURING METHOD 0806.20

The jigger pouring method uses the jigger as a measuring device for the amount of liquor prior to the pour into the glass. However, the auditor should note that although a jigger may be used, some bartenders add a free pour to the drink, a method commonly referred to as “pouring with a tail.”

MEASUREMENT OF SIZE OF JIGGER 0806.25

This method assumes the size of the jigger represents the size of the drink poured. ~~It is meaningless if the drinks are poured free hand.~~

The jigger size in currently~~ly~~ used~~d~~ should be determined through discussion with the taxpayer and/or bartenders. This should be verified by examining purchase invoices covering purchases of jiggers and/or by actual measurement with a pharmaceutical graduate.

If the taxpayer contends that larger sized jiggers were used in prior periods, the auditor should require the taxpayer to furnish evidence in support of his or her contention.

AVERAGE POUR TEST 0806.30

Comprehensive discussion with the taxpayer and/or bartender together with a pour test ~~is necessary~~may be performed to determine the average pour size of drinks. ~~if they are poured free hand~~. If performed, the average pour test should generally be conducted at the time the Bar Fact Sheet is prepared.

In conducting~~making~~ a pour test, the taxpayer and/or bartender ~~is~~are asked to pour several~~one or more~~ representative drinks generally using water. When possible, such tests should be done when a full-time bartender is on duty that has been employed for a significant length of time. The sizes of the drinks are~~is~~ then measured with a pharmaceutical graduate and averaged to determine the average pour size. To assist the auditor, the procedure to conduct an average pour test is described in Appendix B.

UNDERCOVER POUR TEST 0806.40

The prior approval of the District ~~or Subdistrict~~ Principal Auditor or Branch Office Supervisor is required for an undercover pour test. The auditor is encouraged to perform an undercover pour test when the taxpayer has indicated on the Bar Fact Sheet a pour size that exceeds the 1.5 ounces for mixed drinks, over-the-rocks, and straight shots, and the pour size cannot be verified by other means.

When an undercover test is conducted, a complete report must be prepared and included in the audit working papers. This report should include the date and time ~~when~~ the test was conducted, the name of the bartender, the approximate number of customers present, the type of drink, how it was measured, and other pertinent information. When possible, such tests should be done when a full-time bartender is on duty that has been employed for a significant length of time. In addition, if possible, the tests should be conducted during a period (i.e., hour) that is most representative of the business activity. This may entail conducting the test after normal work hours.

It is important in conducting the test for the auditor to consider that the pour size may vary according to the type of drink, the proof of the alcohol, and the temperature of the drink. The auditor should also consider that the pour size might vary depending whether or not the customer is a “regular customer” and whether or not a customer is drinking excessively.

The results of the test should be discussed with the taxpayer and/or bartender at the time it is completed. To assist the auditor, the procedure to conduct an undercover pour test is described in Appendix C. Unless an employee of the Department of Justice or the Alcoholic Beverage Control accompanies the auditor(s), the taxpayer or bartender may legitimately refuse to let the alcohol be taken off the premises for testing. The auditor may contact the Department of Justice or the Department of Alcohol and Beverage Control to obtain their assistance or information (e.g., reports on any prior undercover tests).

OVERPOURING AND SPILLAGE FOR LIQUOR 0806.42

~~After the size of the drink is established,~~ A~~a~~n 8% ~~overpouring and spillage~~ allowance is given to the extent of total distilled spirits purchased (excludes beer and wine). This allowance is commonly referred to as an “overpouring and spillage allowance.” The “overpouring and spillage allowance” accounts for factors such as overpouring, spillage, waste, and breakage. Any adjustment greater than 8% for the overpouring and spillage allowance must be clearly explained in the audit working papers and well documented by the taxpayer. The ~~Use of the~~ tables ~~at the end of this chapter~~in Exhibits 7 - 10 automatically provide~~s~~ for this 8% allowance.

~~The liquor industry made a study and concluded that overpouring and spillage accounted for approximately 8% of total purchases of distilled spirits. There will be instances where the operator will claim that overpouring and spillage somewhat exceeds this amount. When confronted with this situation, the auditor must arrange for a pour test and or an undercover test to determine the amount of distilled spirits actually served~~

OVERPOURING, SPILLAGE, AND SPOILAGE FOR WINE 0806.43

A 3% allowance is provided to the extent of total wine purchased. This allowance is commonly referred to as an “overpouring, spillage, and spoilage” allowance, and represents the variations in pour size and wine that has been discarded. Any adjustment greater than 3% for overpouring, spillage, and spoilage must be clearly explained in the audit working papers and well documented by the taxpayer.

ALLOWANCE FOR COCKTAILS, SPECIALTY, AND EXOTIC DRINKS ~~SERVED~~ 0806.45

A “cocktail” is a drink containing two or more distilled spirits combined with a mixer. This differs from a “mixed drink,” which contains only one type of distilled spirits combined with a mixer. Examples of mixed drinks include a gin and tonic, rum and cola, or bourbon and ginger ale (highball). A “shot” is one form of alcohol only, with no mixer. Cocktails usually contain more distilled spirits than mixed drinks or straight shots, and the price charged may be higher. In ~~some~~ most cases, a ~~cheaper~~ less expensive brand of distilled spirits ~~will~~ may be used for cocktails (e.g. well liquor). The following is a list of typical cocktails:

Black Russian	Margarita
Brandy Alexander	Martini
Brave Bull	Pink Squirrel
Grasshopper	Rusty Nail
Golden Cadillac	Stinger
Godfather	Tequila Sunrise
Manhattan	White Russian

Many bars serve specialty or exotic drinks, and the distinction between a specialty drink and an exotic drink depends entirely on the bar where it is served. A specialty or exotic drink is generally determined by the bar glass used and is often served in a hurricane, tulip champagne, pilsner, or zombie glass. A specialty or exotic drink may or may not contain two types of liquor; however, it usually contains more distilled spirits than a mixed drink or straight shot. An exotic drink is generally a blended type drink mixed with fruit juices and containing a garnish (e.g. pineapple and an umbrella). However, a specialty or exotic drink may also be a straight shot of multiple liquors (e.g. tequila popper, Mexican flag, or a B52). The following are examples of additional specialty and/or exotic drinks:

Brass Monkey	Pina Colada
Fuzzy Navel	Planters Punch
Long Island Ice Tea	Zombie
Mai Tai	

If a considerable number of cocktails, specialty, and exotic drinks are sold, an adjustment for these types of drinks must be given in the audit. In many cases, estimates by bartenders or ~~owners~~taxpayers may be sufficient to determine if such sales are material to the audit report~~. Sometimes the purchases of vodka and gin can be used to develop an estimate~~. The percentage of cocktails, specialty, or exotic drinks may be computed from the cash register tapes, or the inventory of glasses maintained for each type of drink may be used to develop an estimate of the percentage of cocktails, specialty, or exotic drinks served. The auditor should discuss the sales of cocktails, specialty, or exotic drinks with the taxpayer when preparing the Bar Fact Sheet.

In addition to cocktails, it may be necessary~~,~~ on occasion to give consideration to drinks sold "~~over~~on-the-rocks" (with ice)~~.~~. This is especially important ~~if~~ when ~~it can be established by the~~ the taxpayer can establish that the number of ounces served in these drinks exceeds the number of ounces served in mixed drinks. In some bars, there may be a prevalence of drinks sold "on~~ver~~-the-rocks" in which case these sales would have a material effect on the audited amounts. Mark-ups established by audit should be based on the facts at hand. Adjustments for drinks sold "on~~ver~~-the-rocks" should be made only if the auditor's analysis of the situation indicates that such adjustments are warranted. The reasons for allowing~~,~~ or not allowing adjustments for drinks sold "on~~ver~~-the-rocks" should be noted in audit working papers.

ALLOWANCE FOR “HAPPY HOUR” SALES 0806.50

Some bars increase the size of drinks during a specific period of the day or lower the prices. The auditor must make allowance for this increased pour of distilled spirits during this period. If "happy hour" sales are separately stated in the records, the average weighted markup ~~the number of drinks served~~ may be computed by using the formula in Section 0805.15~~0~~. If not, the size and number of drinks served must be estimated from the best information obtainable. If necessary, a test may be performed for a period of time to determine the number of "happy hour" sales. This can be done by having the taxpayer total out (also known as "X" out) the register at the beginning and the end of "happy hour." The percentage of daily sales may be computed and proper weight given in any analysis.

ALLOWANCE FOR "SPECIAL EVENT" SALES 0806.52

Some bars increase the size of the drink and/or increase or lower the selling prices during "special events" or "promotions." The auditor must make allowance for any increased pour of distilled spirits and/or the size of the beer served. If special event sales or promotions are separately stated in the records, the average weighted markup may be computed by using the formula in Section 0805.15. If not, the size and number of drinks served must be estimated from the best information available. The auditor should discuss with the taxpayer and/or bartender whether special events or promotions are provided, what type, and how often. If the taxpayer participates in special events or promotions, often the taxpayer will retain advertising, which will assist the auditor in verify the type and frequency of the special event or promotion. The reason for allowing or not allowing an adjustment for special events or promotions should be noted in the audit working papers.

DRAFT BEER-DRINK SIZE AND PRODUCT LOSS 0806.55

~~Bars selling draft beer sustain a loss of liquid by being unable to withdraw all beer from the half barrels. They further sustain a loss in drawing off each glass by the overpouring of foam. This loss, however, is more than offset by the "head" of foam that has formed in the glass when served to the customer.~~ The auditor must be aware of other factors that affect the drink size and product loss for draft beer. The first factor is the "head" of foam served in a glass of beer. Depending on the ~~height of the head~~ type of beer and the shape of the glass, ~~this gain~~ the "head" of foam served in a glass of beer can range from one-half to two ounces. The "head" of foam in a glass of beer will offset losses sustained from overpouring, spillage, beer left in the keg, etc.

To quantify the effects of the offset allowed in the "head," a bar may serve draft beer in a twelve-ounce glass with as much as a two ounce head in each glass. However, the auditor will still use the twelve-ounce glass size to determine the number of drinks served from the keg of beer. In this example, this method amounts to a 20% allowance for losses sustained from overpouring, spillage, beer left in the keg, etc.

However, this method does not account for any loss if there is very little "head" of foam in the glass of beer. To account for draft losses, a standard 3% overpour and spillage allowance is provided. The 3% overpour and spillage allowance accounts for draft beer overpour, spillage, and waste (e.g., inaccessible beer left in the keg, cleaning or flushing keg lines, waste in tapping a new keg or re-tapping, etc.) Self-consumption or pilferage are not included in this allowance as they are adjusted separately and the self-consumption should be noted on the Bar Fact Sheet. This 3% overpour and spillage allowance should ***not*** be made separately in the audit working papers since the table in Exhibit 12 incorporates this 3% allowance. Therefore, the allowance for overpour and spillage will be the combination of an allowance created by the "head" of foam in each glass and the 3% allowance provided in the table.

In addition to self-consumption (including the treating of customers) and pilferage, the following list of account variables may affect the percentage of draft beer loss. With the exception of the tapping/retapping of a keg and the cleaning of the lines, the loss attributable to the remaining variables can be controlled by the taxpayer through proper installation, temperature and maintenance of the equipment along with the proper training of bar personnel.

- Tapping and Retapping: When a keg goes empty (referred to as "blowing a keg"), a certain amount of beer is lost in the line, the down tube and dish. The tapping/re-tapping of a keg can equate to a certain loss per each foot of line, depending on the length and diameter of the line, because the taxpayer must refill the down tube and the beer line in addition to purging off the excess foam. However, kegs tapped in a series lose considerably less beer (i.e., multiple kegs are connected in a series through the draft lines).

- The beer manufacturers require that the draft lines be cleaned on a periodic basis (e.g., once every two weeks). The beer distributors generally make arrangements with the bar owner (taxpayer) to comply with the manufacturer's requirements on the frequency of the cleanings per month. The amount of beer loss is dependent on the number of cleanings, the length of the lines, and diameter of the beer lines. This information may be confirmed by an examination of the invoices for the beer lines. In addition, the beer distributors recommend that at least one beer per line be discarded after each cleaning to assure that all cleaning/rinse solution has been removed from the line.
- The "first-off-beer" generally refers to the first glass of beer from each line that is poured off each morning (i.e., discarded). The beer industry recommends that each morning at least one glass of beer from each line be poured off to assure the flavors picked up by the beer lying in the line overnight are purged from the system.
- Draft beer must be kept at a constant temperature, ideally in the range of 35 to 39 degrees Fahrenheit. Fluctuations in temperature can affect the pour and create unnecessary foaming. The warmer the beer becomes, the more foam waste. This is a more difficult variable to measure, in that the taxpayer would have to collect the waste and compare it to the total dispensed.
- Pressure in the keg beer system needs to be balanced to the keg box temperature. If the temperature fluctuates during the day, foaming problems can occur causing waste.
- Condition of glassware can effect foaming. The ideal glass is one that has been cleaned with beer compatible soap and prechilled to the same temperature as the beer. If the glass is not prechilled, foaming may occur. If the glass is frosted, it may cause foaming. While the frost may feel smooth to the touch, it is actually very rough and causes the beer to boil (foam).
- Restriction of the line can influence foam. The shorter the beer line, the more restriction, which creates foam. Adding additional beer line will slow down the flow rate of the beer, thereby reducing the agitation, which reduces the foaming.

- The bartender's pouring habits can effect beer loss. Beer taps are typically set to pour a certain amount of beer per second. If the bartender's practice is to run the faucet (tap) for a second or two prior to catching the beer, a quantity of beer can be run down the drain.

Therefore, a taxpayer with numerous beer lines and/or beer lines in excess of the average length (approximately ten feet) may claim that the draft loss is greater than the 3% standard overpour and spillage allowance. An adjustment for additional loss may be provided when the claim is documented and supported by evidence (e.g., invoices on the number, length, and diameter of beer lines, frequency of line cleaning, etc.) from the taxpayer or representative(s). Since the 3% overpour and spillage allowance is incorporated into the table (Exhibit 12), if the taxpayer provides evidence of loss in excess of the 3% standard allowance, the auditor must make an adjustment for the loss already provided for in the table, and state the percentage allowed in the audit working papers.

The auditor should clearly explain and document the method used to establish beer loss in excess of the combination of the allowance created by the "head" of foam and the 3% allowance provided in the table.

~~Since the losses and gains vary from bar to bar, the auditor will be justified in considering the capacity of the glass to be the size of the drink served when computing draft beer markups.~~

COMPUTATION OF MARKUP 0807.00

GENERAL 0807.05

It is essential that the computed markup of purchases be as accurate as possible. If purchases are segregated by type of merchandise sold, a markup should be computed for each product in the test period. Mark-up percentages should be calculated to two decimal places. This markup can then be applied to each category of purchases for the entire audit period to determine total sales. If purchases are not segregated, it will be necessary to compute a weighted average markup for a test period.

PURCHASE SEGREGATION 0807.10

The purpose of a purchase segregation is to establish the proportion of purchases made in each beverage category (e.g., liquor, beer, and wine). See Exhibit 5. Whenever possible, the auditor should schedule segregated purchases made over the audit period. If a purchase segregation is not possible, a weighted markup applicable to all purchases should be computed. For bars, the following categories are commonly used to develop a purchase segregation:

Liquors/Liqueurs

- Well drinks
- Call drinks (if applicable)
- Premium drinks

Bottled Beer

- Domestic
- Import/Premium

Draft Beer

- Domestic
- Import/Premium/Microbrew

Wine

Food (if applicable)

The categories used in performing the purchase segregation should be representative of the taxpayer's business, business records, and purchasing cycle. If for example, no premium liquor is sold, no premium category is needed. However, it is important to differentiate between draft and bottled beer purchases, and to give proper weighting to the percentage of sales of draft beer by the pitcher versus draft beer sold by the glass. Depending on the sophistication of the taxpayer's records, the auditor may expand the above noted purchase segregation categories. The auditor will extend the purchases to retail to determine individual markups for each class of merchandise. A weighted average markup can then be computed that combines the individual markups described above. This weighted average markup will later be applied to the audited cost of sales to establish the measure of audited sales.

In instances where an accurate purchase segregation is available for the entire audit period, individual markups will be computed for each class of merchandise and applied to their respective purchase categories for the entire audit period. If this segregation is not possible, this method should not be used.

If inventories supported by detailed work sheets are available, the markup is to be applied to the audited cost of sales. If, however, there is reason to believe the inventories are estimates, it would be preferable to regard the inventories as being constant and purchases may be considered cost of goods sold. Appropriate audit comments must be made in the working papers.

PURCHASE INVOICES TO BE EXAMINED FOR A REPRESENTATIVE PERIOD 0807.15~~0~~

Many ~~bar operators~~taxpayers buy merchandise in quantities to secure larger discounts. This may represent normal usage for three or even six months. Sufficient invoices must be examined to be sure a complete purchasing cycle has been covered, and that seasonal variations are considered. If the taxpayer operates more than one business location, the auditor should also verify whether the taxpayer commingles the inventory. To compute the taxpayer's purchasing cycle, the auditor should divide the total purchases by the inventory. For example, assume that a taxpayer has $400,000 in purchases for a year, and their inventory is $100,000. The purchasing cycle is four times a year, or three months. The auditor should document the computation and use the purchasing cycle when analyzing purchase invoices.

~~PURCHASES TO BE GROUPED IN COMMON SALES CATEGORIES 0807.15~~

~~For ease in computing the weighted markup, purchases of items with like selling prices should be grouped together (Table 1). The markup can then be computed as illustrated in Table 2.~~

COMPUTATION OF TOTAL SALES 0808.00

GENERAL 0808.05

Audited ~~T~~total sales are determined by applying the computed weighted average markup (Section 0805.15) to the audited cost of goods sold ~~for as long a period as possible for which the cost of goods sold markups is accurate~~ (Exhibit 6). A percentage of error is calculated and applied to quarterly recorded total~~taxable~~ sales for the entire audit period. The auditor should verify whether the audited total sales are tax included or ex tax. This would depend entirely on whether the auditor applied a tax-included or ex-tax markup to the cost of goods sold. If applicable, an adjustment for tax included should be made to the audited measure of tax.

CHANGES THAT AFFECT MARK-UP COMPUTATION 0808.10

The following changes will affect the weighted mark-up computation:

- Change in the cost of liquor without a corresponding change in the price of drinks.
- Change in the size of drinks without a corresponding change in the price of drinks.
- Change in the price of drinks without a corresponding change in the cost of liquor and/or change in the size of drink.

If any of the above changes are significant, it will be necessary to compute separate weighted mark-ups for periods between changes. If a separate weighted markup cannot be computed, the percentage of error derived from periods believed accurate may be used and applied.

DIFFERENCES BETWEEN ~~COMPUTED~~REPORTED AND RECORDED SALES 0808.15

When reported and recorded bar sales are different, ~~a percentage of error must be computed by comparing audited with recorded bar sales. The percentage of error must be applied to quarterly recorded bar sales. Differences between reported and recorded bar sales, if not reconcilable, should be shown separately as unexplained differences.~~ the differences must first be analyzed. Differences may exist due to nontaxable revenue derived from pool tables, video games, or other miscellaneous income. Differences resulting from unreported taxable sales should be scheduled and assessed accordingly.

~~Recorded taxable bar sales must exclude self-consumed merchandise, machine income, sales of equipment, and other miscellaneous income and sales.~~ Sales including taxes should never be compared with ex-tax sales~~. ex-taxes.~~

PROCEDURE WHEN BAR HAS AN OFF-SALE LICENSE 0808.25

~~Many~~ Some bars selling alcoholic beverages by the drink also have an "off-sale" license permitting them to sell ~~these beverages~~ beer or wine by the bottle or can. Normally, separate cash registers are used to record the sales in the two departments, and separate recordings are made in the sales journal. In some instances, however, receipts from both departments are commingled, with an informal record being kept of "off-sales."

The usual audit procedure is to reduce the sales of recorded "off-sales" to cost and consider the balance of the cost of goods sold ~~to have been sold~~ "on sale,"~~,~~ unless there is evidence to the contrary.

BARS SELLING AN APPRECIABLE AMOUNT OF FOOD 0808.30

In this type business, food and bar sales are normally segregated. In many of these places, the premises where food is served is separated from the bar, and the common practice is to have one person responsible for the bar operations and another person responsible for the restaurant and kitchen.

If the achieved markup on recorded total sales appears adequate, but the achieved markups for the individual operations are inconsistent, the bar markup too low and the food markup too high, for example; further analysis may disclose that this condition is caused by the restaurant being credited with receipts from alcoholic beverages served to diners. The reverse is true in those instances where the bar markup is high; the restaurant markup is low. Food has been served in the bar and included in the alcoholic beverage sales. In many instances, after an adjustment has been made correcting the sales segregation, both departments show an adequate markup. When auditing business of this type, the auditor should determine whether the sales have been properly segregated and if errors have been made. ~~It is sometimes found that food served in the bar is rung on the bar register and beverages served in the restaurant are rung up on the restaurant register. This can cause bar or restaurant markups to be too high or too low. If possible, r~~Recorded bar and restaurant sales should be adjusted for any such difference before markups are calculated and analyzed.

Should it be determined that after the sales have been properly segregated by departments that the markup in one department, for example, the bar, is too low but the recorded food sales indicate an adequate markup of goods purchased, ~~If restaurant sales appear adequate, but bar sales do not,~~ it is proper to apply the mark-up method to the bar cost of sales to determine audited bar sales. The audited understatement in the bar should then be included in the audit report even though the food sales are accepted as correct. The auditor should make detailed comments in the audit working papers if the restaurant sales are accepted and the bar sales have been established based on the markup method.

~~EMPLOYEE MEALS AND TIPS 0808.35~~

~~Employee meals credited as part of the minimum wage (difference between the allowable minimum wage and the actual cash wage paid, if less) are taxable as part of the gross receipts of the employer.~~

~~Current information on State minimum wages is available from the local office of the Division of Industrial Welfare, Department of Industrial Relations, State of California. Information on Federal regulations can be secured from the Wage and Hour Division, Department of Labor, U. S. Government.~~

SALES ~~TAXES INCLUDED IN SALES OF BEVERAGES~~ ~~0809.00~~

~~SALES TAX~~GENERAL ~~0809.05~~

~~Ordinarily, bars do not make a separate charge for tax on alcoholic beverages sold. In setting the sales prices the bar owner~~taxpayer ~~has apparently taken sales tax into consideration, thereby complying with Section 6012 of the Law.~~

~~For periods prior to January 1, 1979, if sales tax is added to the bar price when beverages are served at tables, or added to dinner checks, refer to Regulation 1700, Reimbursement for Sales Tax, for requirements of the deduction .~~

~~On and after January 1, 1979,~~ Certain presumptions concerning the addition of sales tax reimbursement are created by Civil Code Section 1656.1. ~~It shall be presumed that the parties agreed to the addition of sales tax reimbursement to the sales price of tangible personal property sold at retail to a purchaser if~~: certain conditions are met. See Regulation 1700(a).

RESTAURANT AUDITING 0809.00

GENERAL 0809.05

The audit methodology used by the auditor will depend on the type of restaurant activity, the taxpayer's method of reporting, the records provided by the taxpayer, and/or the records (information) secured by the auditor. The auditor will encounter a variety of businesses such as the following that serve food and beverages;

- Typical sit-down restaurant serving breakfast, lunch, and dinner (e.g. Denny's, Lyons, IHOP, etc.)
- Drive-in restaurant
- Bakery
- Delicatessen
- Bars
- Ice cream parlors
- Coffeehouses
- Caterers/Banquets
- Catering trucks
- Hotels
- Bed and Breakfast Inns
- Student Meals
- Places where admission is charged
- Food carts

When performing an audit of a restaurant combined with other activities, it is imperative that the auditor separates the two activities. This is especially true when a restaurant also operates a bar. All purchases and sales activities must be segregated and analyzed separately when performing a mark-up analysis. A mark-up analysis should be performed and included in the audit working papers for both restaurant and bar sales.

The audit working papers should include a description of the type of restaurant activity as noted in Section 0801.15. A description of the menu items and hours of operation should be included. If available, a photocopy of the menu should also be included.

80/80 RULE 0809.10

The application of tax to a restaurant's sales of cold food on a "take-out" or "to-go" order will generally depend on whether the establishment qualifies under the 80/80 rule (as provided by Regulation 1603(c)(3)). If the taxpayer operates multiple locations or more than one type of food operation, each individual location must be considered separately in determining if that location meets the specified criteria. However, combination locations such as restaurant-bakery or food court location may be considered one operation for purposes of applying the 80/80 rule. Before applying the 80/80 rule, the auditor must first determine if:

More than 80% of the business's gross receipts are from the sale of food products (note: although the sales of alcohol and carbonated beverage are subject to tax, alcohol and carbonated beverages are not considered food products); **and**

More than 80% of the retail sale of food products are taxable because they constitute:

- Sales of food products that are furnished, prepared, or served for consumption at facilities provided by the taxpayer;
- Sales of meals or hot prepared food products; or
- Sales of food products by a "drive-in" (food products sold for immediate consumption at or near a location, at which parking facilities are provided primarily for the use of the patrons in consuming the products, even though they may be sold to go).

If a business meets both criteria of the 80/80 rule, the sales of cold food on a "to-go" or "take-out" basis, in a form suitable for consumption on the seller's premises, are subject to tax. However, with supporting documentation such as cash register receipts or sales tickets, the following exceptions may apply:

- Cold food sold in a form ***not*** suitable for consumption on the premises. A cold food product is not "suitable for consumption on the premises" if it requires further processing by the purchaser, or it is sold in a size not ordinarily consumed by one person. In general, containers larger in size than a pint (excluding milkshakes and similar milk products) are considered to be in a form not suitable for immediate consumption.
- Effective April 1, 1996, the taxpayer may elect to separately account for sales of cold food sold on a "to-go" or "take-out" basis. The sales must be separately accounted for and substantiated by supporting documentation. Without adequate documentation, tax applies to the gross receipts with no deduction for these items.
- Sales for resale, exempt, or excluded sales, such as to the U.S. Government.

When evaluating sales under the 80/80 rule, a test period of 90 days is recommended. However, a lesser period of time is appropriate if the business activity appears to have little fluctuation from month to month. The auditor should make comments in the audit working papers detailing which periods were selected to test and why the period was representative of the taxpayer's business operations.

Example:

Hot prepared food products	$ 85,000
Cold food products:	
Sold to-go	5,000
Sold for consumption	
on seller's premises	4,000

Nonfood Sales (alcohol and carbonated beverages)	6,000
Total Sales	$100,000

In the above example, over 80 percent of the taxpayer's sales are food sales ([$85,000 + $5,000 + $4,000] / $100,000 = 94%), and over 80% of the food sales are taxable ([$85,000 + $4,000] / [$85,000 + $5,000 + $4,000] = 95%). Do not include alcoholic and carbonated beverages as part of the food product sales. Although their sales are subject to tax, alcoholic and carbonated beverages are not food products. For that business not meeting both criteria for the 80/80 rule, hot prepared food products are subject to tax, including hot prepared food sold on a "to-go" or "take-out" basis. A food product is considered a hot food product if it is heated to a temperature above room temperature. A sale of hot prepared food is taxable even if it has cooled by the time of sale since it was intended to be sold as hot food. The application of tax to the sale of a cold food product depends on the form in which it is sold and where it is to be consumed. Notwithstanding the application of the 80/80 rule, sales of cold food sold on a "take-out" or "to-go" basis are exempt from tax. However, a sale of a combination of hot and cold foods for a single price is subject to tax. A combination package is two or more items sold together for a single price. The sale of a combination package is taxable if it includes any of the following items:

- A hot prepared food (such as a hot sandwich or hot bakery item)
- A hot beverage (such as coffee, hot chocolate, or tea)
- A carbonated beverage (such as a soda or sparkling water)
- An alcoholic beverage

If a combination package sold "to-go" does not include one of the items listed above, it is not taxable (for example a cold sandwich and milk sold together for a single price). All carbonated and alcoholic beverages are taxable, whether sold "to-go" or for consumption on the taxpayer's premises. Carbonated beverages include sparkling mineral water and soft drinks.

If a combination of cold food products is sold in an individual **returnable** container, from which the individual serving is intended to be eaten, the sale is subject to tax. The sale is considered a sale of a served meal, which is generally taxable.

For a newly established business, the taxpayer should estimate the percentage of taxable food product sales. If the estimated percentage is less than 80%, records should be maintained detailing the nontaxable sales of food products, and at the end of 90 days the actual percentage should be calculated. If the resulting percentage meets the 80/80 rule criteria for two consecutive quarters, tax will be due on a prospective basis unless sales are separately accounted for by the taxpayer. If the resulting percentage does not meet the criteria, the taxpayer should verify quarterly that the 80/80 rule criteria has not yet been met. The quarterly test of taxable sales should be performed on a continuous basis or until it has been determined the taxpayer meets the criteria for two consecutive quarters. Once the taxable sales meet the established criteria for two consecutive quarters, tax would be due on a prospective basis. Furthermore, once the criteria has been met, the sales remain subject to tax unless there is a significant change in the business operations, or unless the taxpayer elects to separately account for the sales and retains the proper documentation.

EMPLOYEE MEALS 0809.15

If an employer furnishes a meal to an employee and makes a specific charge for the meal, the charge for the meal is part of gross receipts and subject to tax. A specific charge is made if one or more of the following condition exits:

- The employee pays cash for the meal.
- The value of the meal is deducted from the employee's wages
- The employee receives meals in lieu of cash to bring compensation up to legal minimum wage. (i.e., the employee meal is credited as part of the minimum wage: difference between the allowable minimum wage and the actual cash wage paid, if less).
- The employee has the option to receive cash for meals not consumed.

If the taxpayer furnishes a meal to an employee and none of the above conditions are present, the meal is considered to have been provided on a complimentary basis and the meal will be treated in the same manner as the taxpayer's self-consumption; i.e., the measure of tax is the cost of the nonfood product items only, such as the carbonated beverages and alcoholic drinks.

Current information on the State minimum wage is available from the local office of the Division of Industrial Welfare, Department of Industrial Relations, State of California. Information on Federal regulations can be secured from the Wage and Hour Division, Department of Labor, U.S. Government.

EMPLOYEE TIPS 0809.20

No employer shall collect, take, or receive any gratuity or part thereof, paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of such gratuity, or require an employee to credit the amount, or any part thereof, of such gratuity against and as a part of the wages due the employee from the employer. (Labor Code section 351.) If this prohibition is violated, any amount of such gratuities received by the employer will be considered a part of the gross receipts of the employer and subject to tax.

Optional tips are not included in gross receipts and are not subject to tax.

Mandatory tips, such as those applied by a restaurant when a party exceeds a specific number of patrons, are considered part of gross receipts and subject to tax. Each restaurant may have its own policy with respect to the specific number of patrons necessary before a charge for tipping is mandatory. Ex: "A 17% gratuity will be added to parties of 8 or more."

The auditor should discuss tipping with the taxpayer and if necessary examine the taxpayer's payroll records as verification of the taxpayer's policies.

SELF-CONSUMPTION 0809.25

An allowance for s**elf**-consumption as discussed in Section 0801.25 should always be given in an audit of a restaurant. The amount of self-consumption should be discussed with the taxpayer and include merchandise consumed by the taxpayer, “treating” of customers, and the furnishing of employee meals (if not otherwise taxable). Since the taxpayer is the consumer of all food and beverages that are self-consumed, use tax will apply only to the consumption of those non-food items, such as alcoholic beverages and sodas. The amount of self-consumption should be expressed as a percentage of the taxable cost of sales. Self-consumption in excess of 3% of taxable cost of goods sold should be fully explained or documented in the audit working papers.

PILFERAGE, SPOILAGE, AND WASTE 0809.30

An allowance for pilferage, also known as “shrinkage,” in the amount of 1% of the cost of goods sold is allowed. Pilferage is an adjustment made for inventory purchases that were not sold due to some type of loss, such as employee theft of merchandise, customers not paying for meals, etc. An allowance for pilferage in excess of 1% may be given if the taxpayer provides evidence such as police reports, insurance claims, reports from inventory control companies, or similar service firms. Pilferage excludes loss due to fire or natural disaster. Documented losses resulting from fire or natural disaster should be addressed separately from the 1% allowed for pilferage. Thefts of cash are more likely to occur in a restaurant than the actual pilferage of the merchandise. However, no adjustment is made for robberies of cash for sales tax purposes because tax is measured by sales. The auditor must express the amount of pilferage as a percentage of the taxable cost of goods sold in the audit working papers.

Spoilage and waste occurs in most restaurants, and the amount of spoilage and waste will depend on the type of restaurant and food served. The auditor should discuss the amount or percentage of spoilage and waste with the taxpayer at the beginning of the audit and document the taxpayer’s information and/or estimates in the audit working papers. If the auditor is going to disregard some or all of the information provided by the taxpayer with respect to spoilage and waste, the reasons must be clearly stated with detailed comments and/or supported by documentation. Any adjustment made by the auditor for spoilage that may appear excessive to those reviewing the audit, should be clearly explained and well documented in the audit working papers. In the audit working papers, the auditor should comment on any adjustment made for spoilage and waste, and express the spoilage and waste as a percentage of the taxable cost of goods sold.

If the markup method is used to establish audited taxable sales, the auditor should make a separate adjustment for pilferage and for spoilage. In the audit working papers, the auditor must express the amount of pilferage and spoilage in dollars and as a percentage of the taxable cost of goods sold.

RESTAURANT AUDIT PROCEDURE 0810.00

RECONCILIATION OF RECORDED AND REPORTED SALES 0810.05

The auditor should conduct a reconciliation between the taxpayer's recorded sales (including the sales tax accrual account) and the reported sales, using the taxpayer's books and records which include the taxpayer's federal income tax returns (FITR's) and profit and loss statements. If differences are noted, the differences should be analyzed and discussed with the taxpayer. Any unexplained differences noted should be well documented. While conducting the reconciliation, the auditor should also calculate and analyze the taxpayer's achieved markup based on recorded sales and reported markups in conjunction with any prior audits conducted on the taxpayer's restaurant and/or with industry standards or averages.

RECONCILIATION OF BANK DEPOSITS 0810.10

A reconciliation of the taxpayer's bank deposits is also recommended as a preliminary auditing procedure. It should be kept in mind that bank deposits are generally considered tax included, unless it can be shown that the taxpayer did not collect sales tax reimbursement. At the beginning of the audit, the auditor should question the taxpayer with respect to income from non-sales sources. If the taxpayer contends that income is deposited into the bank from non-sales sources, any adjustments should be verified through documentation. The auditor should also analyze the bank deposits for any transfers between accounts, extraordinary, unusual, or recurring deposits.

CREDIT CARD PROJECTION OF SALES 0810.12

While performing a reconciliation of the bank deposits, the auditor should consider analyzing sales by using the credit card deposit information. Since sales made by credit card are required to be deposited directly into the taxpayer's bank account, the credit card deposits provide a verifiable source of information. Thus, the credit card projection of sales has proven to be an effective audit procedure in establishing total sales. The credit card projection of sales can be used to analyze reported sales, establish audited sales, or provide an alternative method to support the reasonableness of the audit findings based on another auditing approach. To use the credit card projection method, the auditor should pick a representative test period. This can be accomplished either during an observation test or based on a review of daily sales tickets for a test period. For the test period chosen, the auditor should schedule the sales paid by credit card and schedule the total sales. The auditor should then compute a percentage of credit card sales to total sales. Total credit card deposits are scheduled from the bank information for the audit period, then divided by the credit card sales percentage to establish total sales. Total sales will generally be considered tax included, unless it can be shown that the taxpayer did not collect tax reimbursement. Therefore, adjustments for sales tax included, tips, and credit card company withholds should be taken into consideration, if applicable. The following is an example of the credit card projection of sales being used to support the audit findings based on the observation method.

Example:

Percentage of credit card sales:

Observation test #1	$627	
Observation test #2	**662**	
Total ex-tax credit card sales combined observation tests		$1,289
Total sales observation test #1	1,298	
Total sales observation test #2	**1,096**	
Total ex-tax sales combined observation tests		2,394
Percentage of credit card sales to total sales		53.84%

Total credit card deposits for audit period, tax inc.	$ 615,680
Total credit card deposits, ex tax <$615,680 /1.0825>	568,757
Total audited sales for audit period ($568,575 / 53.84%)	1,056,385
Total sales reported for audit period, ex tax	**864,236**
Unreported sales based on credit card deposits	$ 192,149
Unreported sales based on observation test	175,720
Difference	**$ 16,429**

ANALYSIS OF ACHIEVED MARK-UP PERCENTAGES 0810.15

Many factors may influence the achieved mark-up percentage on recorded total sales. Generally, the achieved mark-up percentage is derived from the cost of goods sold and total sales as indicated on the taxpayer's FITR's or financial statements. Achieved mark-up percentages will vary depending on the type of food sold, the location, and clientele. The auditor will have to determine if the taxpayer's achieved markup on recorded sales is reasonable based on all the information available such as:

- If the restaurant contains a bar
- The taxpayer's method of recording bar and restaurant sales and costs
- Quantity of food sales in the restaurant in comparison to food sold in the bar
- Size of the portions in relation to the sales price of the menu items

The auditor is cautioned to verify the taxpayer's method of recording sales and costs, because bar sales/costs may be commingled with food sales/cost or vice versa. If this occurs, the achieved individual markups on recorded sales may not be representative and the auditor may find it necessary to perform a segregation of sales and/or purchases before the achieved individual mark-up percentages can be computed and analyzed.

Proper weight must be given to the food sales in relation to the establishment, especially if the audit is of a bar that also serves food. As an example, some bars have a full restaurant while others provide a minimal selection of food as a courtesy to bar patrons. The achieved mark-up percentages on recorded sales **should be compared to the mark-up percentages based on re**ported **sales, with any differences noted in the audit working papers. If the auditor believes that achieved mark-up percentages need further support, an estimate of sales should be performed based upon a "shelf test" of selected menu items (Section 0810.**25**).**

COMPUTATION OF COST OF SALES 0810.20

As with any mark-up analysis, one of the most important factors in calculating the markup will be the correct computation of the cost of sales. When the auditor performs the initial analysis of the achieved markup on recorded sales, the auditor generally uses the cost of goods sold as shown on the ~~owner~~taxpayer's federal income tax returns or profit and loss statements. If a more detailed analysis is warranted or the auditor is contemplating establishing sales based on the mark-up method, the auditor must determine:

- Beginning and ending inventories (if available).
- Total purchases.
- Adjustments for self-consumed merchandise (which includes complimentary meals and hors d'oeuvres).
- Adjustments for pilferage/spoilage.
- Whether supplies are included in purchases.

The reasonableness of reductions made to purchases when computing cost of sales must be evaluated by the auditor. If the taxpayer's adjustments appear questionable, the taxpayer should be asked to provide documentation, such as order tickets to support complimentary meals. If self-consumption appears excessive, the auditor should prepare a schedule of the quantity and type of food that is taken for any given period. Prices may be obtained from purchase invoices to determine self-consumption or a reasonable estimate developed from available information.

The auditor may find that the taxpayer **does not take a physical inventory or estimates the inventory for financial statement purposes. If no adjustment is made for beginning or ending inventory because the information is unavailable or unreliable, the auditor should consider purchases as costs of goods sold and provide detail**ed **comments in the audit working papers.**

SHELF TEST 0810.25

A shelf test is performed to assist the auditor in analyzing the taxpayer's achieved mark-up percentage(s) on recorded sales and/or to develop a weighted markup to establish total sales when the auditor feels that the achieved mark-up percentages are not reasonable (i.e., too low). The auditor should discuss the test in detail with the taxpayer and request the taxpayer's assistance in costing out menu items. The auditor should start by costing out the items that the restaurant sells most (the most popular dishes) including "plate cost" items such as the vegetable, butter, baked potato, and sauces. The most popular dishes may be determined from a discussion with the taxpayer and a review of the quantity of purchases for the primary ingredients. The quantity and ingredients should be obtained for each serving from the taxpayer. The auditor should note the total volume/weight of the ingredients to ensure reasonableness. The quantity of ingredients should be scheduled, with the cost of each derived from purchase invoices. The total cost of an item should be carried forward to a schedule summarizing all menu items in the test. The mark-up percentages should be computed on an individual and aggregate basis to examine consistency. Exhibit 16 provides an example of how to cost out a menu item.

When the use of the mark-up method is impractical, the auditor may establish sales using other generally accepted tax **audit**ing **procedure**s **such as**, **but not limited to**, **the observation test (0810.30), bank deposit reconciliation** (0810.10)**, or the** credit card **projection of sales** (**0810.12). When an audit approach other than the mark-up method is used, a post audit mark-up analysis should be performed to support the reasonableness of the audit findings. Regardless of the audit procedures used by the auditor, if a tax deficiency has been established, an alternative method must be used and documented in the audit working papers to support the reasonableness of the audit findings** (i.e., a reasonableness short test)**. Alternative methods for supporting audit findings may include an analysis of the** taxpayer**'s net income (0803.15), analysis of bank deposits (0810.10, 0405.25),** credit card projection of sales, **or a gross profit and net worth analysis (0406.40).**

OBSERVATION (SITE) TEST 0810.30

An alternative method to support recorded total sales or taxable sales, and/or establish audited total sales or taxable sales is the observation (site) test. A site test is the physical observation and recording of the activity of the business for a specified period of time. Initially, as a tool in analyzing recorded total/taxable sales, the site test should be performed for an entire day if possible. If the site test is used as the basis to establish audited total and/or taxable sales, to ensure the result is representative, the observation test should generally include several days; one of which should be a weekend, if the business is operated on the weekends. If possible, the auditor should avoid conducting the observation test immediately preceding or following a holiday.

In performing an observation test, the day(s) most representative of the average sales day should be used when possible. This day(s) may be chosen based on a review of the cash register tapes, sales tickets, and/or a discussion with the taxpayer. The auditor should request the taxpayer to maintain and provide the cash register tape(s) or sales tickets for the test day(s) for later comparison against the auditor's scheduling of sales. When performing the observation test, the auditor should schedule the sales as they are rung on the register or at the time the sales ticket is written. For purposes of the observation test, if the taxpayer or employee asks the customer if an order for cold food is to be eaten "here" or "to-go" and the customer responds "to-go," the food is served in a condition of "to-go," but subsequent to receiving his/her order consumes a portion of the food at the facilities of the taxpayer, the auditor should regard this of sale as a valid sale of cold food sold on a "to-go" basis. The following factors are important in an observation test and should be considered by the auditor. The auditor should provide documentation and/or comments in the audit working papers with respect to:

- Days of operation

- Hours of operation
- Seating capacity (i.e., the number or chairs and tables, and whether the seating capacity has changed during the audit period)
- Employees per shift
- Number of shifts
- Menu/ prices/ special pricing (daily specials and two-for-one coupons)
- Banquet room/ catering/ delivery/ take-out and how take-out is rung up
- Cash register controls. How many cash registers? Do they ring out the register after each shift? Are multiple people using the same register? Does the taxpayer operate with an open drawer?
- Occurrence of cash payouts
- How are sales rung up? Are take-out sales, banquet sales, bar sales, etc. recorded differently?
- Is tax charged, is tax included in the price, or is no tax charged?
- Percentage of credit card sales
- Weather conditions. Rainy days may affect establishments with limited seating capacity and increase or decrease the amount of sales sold on a "to go" basis.
- Have the business operations changed during the audit period (expanded, contracted, new menu items added or items deleted)?
- Have there been any unusual circumstances during the audit period that would affect sales (robberies, fire, and natural disasters)?

In addition to the comments with respect to the above, to avoid any misunderstanding, confusion, or perhaps the need for further testing, the auditor should state in the audit working papers the criteria that was used in the observation test to establish taxable or exempt sales. In addition, the audit work paper schedule of sales for the observation test should include not only a taxable and exempt column, but if possible should also provide a brief description of the item sold and whether it was sold "to-go" or for consumption at the facilities. The following is a brief example:

Description	**Selling price (ex-tax)**	**Taxable**	**Exempt**	**To-go**	**Dine-in**
Toasted bagel	1.00		1.00	X	
Toasted bagel	1.00	1.00			X
Toasted bagel w/coffee	2.00	2.00 Combination		X	
Toasted bagel w/coffee	2.00		**2.**00 sold	X	

			separately		
Total	6.00	3.00	3.00		

The results of the test should be reconciled to the taxpayer's records for the day of the test. If differences were noted, the differences should be analyzed and discussed with the taxpayer. The results of the observation test should be extrapolated for a period of time, generally a year, and compared to reported/recorded amounts. However, if the taxpayer's records are not available for a representative period, the percentage of error developed in the test period may be projected to the remainder of the audit period. Consideration should be given to the seasonal nature of the business (if applicable) and any other relevant factors should be clearly explained in the audit working papers.

If a tax deficiency has been established using the observation test, an alternative method must be used and documented in the audit working papers to support the reasonableness of the audit findings (i.e., a reasonableness short test).

ESTABLISHING AUDITED TOTAL AND/OR TAXABLE SALES 0810.35

If the auditor notices a discrepancy between recorded and reported sales based on the initial examination/analysis as noted above, and/or the taxpayer's records are not adequate for sales and use tax purposes, the auditor may establish total sales and/or taxable sales based on one or more of the following auditing procedures. Regardless of the audit procedure used by the auditor, if a tax deficiency has been established, an alternative method must be used and documented in the audit working papers to support the reasonableness of the audit findings. This is generally referred to as a reasonableness short test. Each of the following methods is described in more detail in Audit Manual Chapter 4, with the exception of the observation test (Section 0810.30) and the credit card projection of sales (0810.12):

- Reconciliation of Recorded to Reported sales (0406.35)
- Reconciliation of tax accrual account (0405.10)
- **Reconciliation of FITR's (0406.50)**
- Bank Deposits (0405.25)
- Credit Card Projection of Sales (0810.12)
- Markup method (0407.10)
- Net Worth Analysis/Cost of Living Analysis (0406.40)
- Observation test (0810.30)

SPECIFIC APPLICATION OF TAX 0811.00

DRIVE-INS 0811.05

Tax applies to sales of food products ordinarily sold for immediate consumption on or near a location at which parking facilities are provided primarily for the use of patrons in consuming the products purchased, even though such products are sold on a "take-out" or "to-go" basis and are actually packaged or wrapped and taken from the premises.

Food products when sold in bulk, i.e., in quantities or in a form not suitable for consumption on the retailer's premises, are not regarded as ordinarily sold for immediate consumption on or near the location at which parking facilities are provided by the taxpayer.

With the exception of sales of hot prepared food products and sales of cold food under the 80/80 rule, sales of ice cream, doughnuts, and other individual food items in quantities obviously not intended for consumption on the taxpayer's premises, without eating utensils, trays or dishes and consumed on the taxpayer's premises, are exempt from tax. A taxpayer claiming a deduction on account of food sales of this type must support the deduction with complete and detailed records.

FOOD COURTS 0811.10

Many shopping malls maintain food courts. A food court generally refers to a grouping of small restaurants that share a common area (i.e., eating facilities). The facilities are provided and/or maintained by either the mall operator (management) or the participating restaurants. The taxpayer leases the specific restaurant area from the mall operator generally based on the square footage of its respective restaurant operation, including a portion attributable to the seating area within the food court. In addition, the taxpayer often pays the mall operator additional fees based on a percentage of the taxpayer's total gross revenue. In addition to reviewing the records provided by the taxpayer, the auditor may also contact the mall operator to secure information on the total gross revenue reported to the mall operator by the taxpayer. The information may be provided on a monthly or yearly basis depending on the records of the mall operator.

Generally, tax applies to sales of food products ordinarily sold for immediate consumption at the food court, since it generally constitutes facilities of the retailer (taxpayer). In regards to sales of cold food "to-go" or on a "take-out" basis, the auditor should review the type of food products sold and apply the result of the 80/80 rule, as provided by Regulation 1603(c)(3), accordingly.

ICE CREAM PARLORS/BAKERIES/COFFEEHOUSES 0811.15

In auditing an ice-cream parlor, bakery, or coffeehouse it is important for the auditor to first understand the method of reporting used by the taxpayer and to pay specific attention to the type of merchandise being sold and whether facilities are provided. It may be necessary to test for whether the business meets the criteria of the 80/80 rule for the purpose of its sales of cold food "to-go" or on a "take-out" basis. In addition, the auditor should analyze the reported taxable sales ratio in relation to total sales. If the taxable sales ratio is low, the auditor should consider conducting an observation test as described in Section 0810.30.

If the taxpayer makes a sale of a cold food product, which is subsequently heated by the customer in a microwave available for the customer's use, the sale is not subject to tax as a sale of hot prepared food. However, if the taxpayer heats the cold food product, the sale is taxable as a sale of hot prepared food.

CATERERS AND BANQUETS 0811.20

There are special factors to consider when auditing a caterer or restaurant that provides banquet facilities. The auditor should make specific comments in the audit working papers addressing any of the following if applicable:

- Charges for serviceware, tables, chairs, etc.
- Charges for coordinator, consultation, and/or designer fees
- Labor charges and preparation charges for the serving of the meals
- Facility charges (room charges)
- Rental equipment, dance floors, stage equipment, props, etc.
- Parking attendants and security guards,
- Entertainment
- Mandatory and optional gratuities
- Corkage fees

Many caterers will maintain a job folder for each event. Other documents might include a "Log" book or copies of the computer sheets that list the events occurring on each specific day. A careful review of the contract is essential when auditing a caterer. The contract may contain elements that will not be billed directly to the caterer's customer, such as "No-Host" cocktails. When a "No-Host" bar is involved, the selling price(s) charged to the end-consumer (i.e., the guest) is generally negotiated between the caterer's customer and the caterer prior to the event. The auditor may not be able to determine how many drinks were actually served at the event unless the caterer maintains a beverage inventory report for each event. Often, "No-Host" sales will need to be traced to other sales records such as the cash deposits journal or bank deposits.

If a caterer has contracted for an event at a government owned convention facility (e.g., city or county owned), the auditor may consider reviewing the report issued to the government entity in an attempt to establish total sales.

If a caterer has contracted with a specific organization based on a "guaranteed minimum," e.g., sandwiches, sodas, snacks and candy, and the minimum was reached, the organization may or may not receive a separate billing, and the contract may be the controlling document. If a separate billing is not issued, the receipts may not be recorded in the normal books of account, such as the caterer's sales journal. Therefore, a review of the cash receipts journal or bank deposits is a recommended auditing procedure.

The auditor should be cautious of timing differences when using bank deposits to establish total or taxable measure (Section 0405.25), because customers may have paid deposits in advance to secure the caterer's services. In addition, when the caterer provides its services "off-site," e.g., not in the taxing jurisdiction of the caterer's physical business location, the auditor should verify that the caterer reported tax based on the rate applicable to where the sale was made.

Tipping may be provided on a mandatory or optional basis. Optional tips are not subject to tax. Mandatory tips are included in gross receipts. Generally, a caterer or a banquet facility will automatically apply a certain gratuity to parties over a certain number of guests; this is a mandatory tip. Often the caterer or banquet facility will apply a mandatory "service charge." Although the service charges may represent tips, which are later provided to the employees, the service charges are mandatory and are included in gross receipts.

A charge for corkage fees by the caterer or banquet facility is considered a service in connection with a sale and part of taxable gross receipts. Corkage fees remain taxable whether the caterer, banquet facility, or the customer provides the champagne or wine.

CATERING TRUCKS 0811.25

In general, sales made by catering truck operators are subject to tax. Generally, a catering truck operator makes sales in designated territories (routes) on a regular basis. In conducting an audit on a catering truck operator, it may be necessary to contact the catering truck operator's vendors to secure purchase information (confirmations). Notwithstanding the audit techniques provided in Audit Manual Chapter 4, an alternative audit approach to verifying total or taxable sales is the observation test (Section 0810.30). The auditor would accompany the catering truck operator on the daily route to observe and document sales. The auditor may find that catering truck operators generally do not maintain cash register tapes or guest checks. However, the catering truck operator (taxpayer) should be requested to maintain cash register tapes or daily tickets for the respective test day(s). During the test, the auditor should schedule sales by providing a brief description of the item sold along with the selling price. The auditor should also state in the audit working papers the criteria that was used in the observation test to establish taxable or exempt sales. Auditors have found it convenient at times to copy the catering truck operator's menu with the corresponding prices and then place a tick mark beside each item as it is sold. The auditor should compare audited total and/or taxable sales with the taxpayer's recorded sales for the period(s) tested. Daily sales should be projected to weekly/monthly/quarterly sales for the audit period.

It is important that an observation test is conducted for a representative period. This period should be discussed with the catering truck operator (taxpayer) and documented prior to the testing. Otherwise, the projection of the results of the observation test may not be representative.

FOOD CARTS 0811.30

For purposes of this section, food carts refer to small self-contained units that are mobile. Food carts typically offer no seating arrangements, compared to restaurants that have full seating facilities. Carts are generally located within a building or on a street or sidewalk. In general, the majority of food cart sales consist of beverages and bakery items, or walk away type food products sold strictly on a "to-go" basis and served in disposable cups or on disposable plates. The taxability of the food and beverage sales is dependent on the type of food being sold and whether facilities are provided.

Sales of hot beverages such as coffee, tea, cocoa or cider are not taxable if sold for a separate price on a "to-go" basis. Similarly, bakery items such as bread, croissants, pastries, muffins, cookies, bagels, and the like are also not taxable if sold on a "to-go" basis. However, when a hot beverage and bakery item are sold for a single price, the sale is taxable.

Sales of carbonated beverages are not considered food products for purposes of the Sales and Use Tax Law. Sales of carbonated beverages and carbonated water are taxable regardless of whether sold "to-go" or consumed at the facilities provided.

Facilities: If the cart is located within a place where common seating is provided for the consumption of food (such as a shopping mall food court or a cafeteria) or is located in a place where admission is charged (such as a county fair) the food sold is generally subject to tax. Similarly, if food items are served in ***returnable*** containers such as crockery mugs or glass plates, the sale of the food will be subject to tax. The taxpayer should maintain proper documentation for claimed exempt sales of food (i.e., cold food sold to-go or cold food sold in a form not suitable for immediate consumption).

If the taxpayer makes a sale of a cold food product, which is subsequently heated by the customer in a microwave available for the customer's use, the sale is not subject to tax. However, if the taxpayer heats the cold food product, the sale is taxable as a sale of hot prepared food.

STUDENT MEALS 0811.35

The application of tax to sales of student meals is explained in Regulation 1603(j). Generally at issue in an audit that involves student meals is whether or not the meals were sold by a qualifying group. If a private caterer rather than a qualifying group sold the meals, then the sales may be subject to tax. The auditor should verify through an examination of the records and/or contracts who actually contracted with the caterer to provide the meals to the students and whether the following criteria for exemption have been met:

- The facilities used by the operator to serve the lunches to the students is used by the school for other purposes such as sporting events and other school activities during the remainder of the day;
- The fixtures and equipment used by the operator are owned and maintained by the school; and
- The students purchasing the meals cannot distinguish the operator from the employees of the school.

As provided in the John Chris Mogannam Memorandum Opinion, assuming the response to the three statements above is in the affirmative, then the sale of the meals is regarded as qualifying for the exemption provided in Revenue and Taxation Code section 6363.

PLACES WHERE ADMISSION IS CHARGED 0811.40

Tax applies to sales of food products when sold within, and for consumption within, a place the entrance to which is subject to an admission charge, during the period when the sales are made with the exception of:

- National and state parks and monuments
- Marinas
- Campgrounds
- Recreational vehicle parks

The auditor should be aware that that the phrase "National and state park and monuments" does not include city, county, regional, district or private parks.

In addition, the following do not qualify as places where admission is charged:

- Places where admission is based on membership dues that among other things, entitle the member to entrance to a place maintained by the organization;
- Places where admission is based on the use of a student body card (e.g., school auditorium where dance is being held; or
- Places where there is a charge to use the facilities, but no entrance charge is made for spectators (e.g. golf courses or bowling alleys).

Places where admission is charged generally include theatres, sporting and music events, swapmeets, fairs, and amusement parks. It is the taxpayer's responsibility to document the exemption for sales of food products that would not likely be consumed within the place where it was sold. An example of such food products would include cake mixes, spices, boxed recipes, etc. Nonprofit youth organizations or nonprofit parent-teacher organizations are consumers and not retailers of the tangible personal property they sell. The auditor should examine the type of organization and the products being sold before any conclusions on the taxability of the sales are drawn.

SPECIAL FACTORS 0812.00

GENERAL 0812.05

Consideration must be granted and audit comments must be made in the audit working papers reflecting special factors such as:

- Daily specials
- Discount coupons
- Packaged plans
- Complimentary food and beverages
- **Hotels providing coupons**

DAILY SPECIALS 0812.10

In establishing sales, the auditor should take into consideration "daily specials," if offered by the taxpayer to the patrons. Daily specials generally provide for a specific menu item(s) to be sold for a reduced price or sold in a combination for a reduced price. The auditor should make specific comments in the audit working papers with respect to any adjustments made due to daily specials. The auditor should examine sales ticket or cash register tapes for verification of daily specials and the application of sales tax reimbursement. The auditor should also perform a reconciliation of the sales tax accrual account.

DISCOUNT COUPONS 0812.15

Certain restaurants promote two-for-one coupons or other discounts or cards that allow the customer to purchase food and/or beverages at a reduced price (e.g. $4.00 off or 20% off). If the taxpayer does not receive reimbursement from a third party (e.g. a promoter) for the amount of the discount, the measure of tax is the amount received from the customer. If the taxpayer receives any reimbursement from a third party for the discounted amount, the amount received from the third party is also subject to tax and must be included in gross receipts.

When there is no indication that the discount was computed on the selling price exclusive of sales tax reimbursement, it will be presumed that the discount was allowed on the total sales price including sales tax reimbursement. This is usually the case with unit or lump-sum discounts. When there is evidence that the discount was computed by applying a percentage to the selling price exclusive of sales tax reimbursement, the discount will not be allowed as a deduction since the taxpayer has retained excess tax reimbursement. (See also Audit Manual section 0412.10)

The following examples provide for the application of tax to certain situations:

Example A:

A customer provides the taxpayer with a coupon which states, "Buy One Meal Get One of Equal or Lesser Value Free." The two meals each cost $15.00. The taxpayer bills the customer $15.00. The measure of tax is the $15.00.

Example B:

The same facts as in example A; however one meal is $15.00 and the other meal is $10.00. The taxpayer bills the customer $15.00. The measure of tax is the $15.00.

Example C:

The customer provides a coupon, which states the holder, is to receive 50% off the regular meal price, with a maximum discount of $4.00. The meal served is valued at $15.00. The taxpayer bills the customer $11.00 ($15.00-$4.00). The measure of tax is the $11.00.

Example D:

Same fact patter as in example A. However, the taxpayer bills the customer for both meals totaling $30. Sales tax reimbursement of $2.33 is applied (7.75%). The total bill is $32.33. The taxpayer reduces the bill by the ex-tax price of one meal, $15.00. The customer pays $17.33, which represents the ex-tax price of one meal ($15) and sales tax reimbursement of $2.33. In this instance, the taxpayer has collected excess tax reimbursement of $1.16.

The auditor should review the taxpayer's policies and practices with regard to discounted meals and perform a reconciliation of the sales tax accrual account.

PACKAGED PLANS 0812.20

Bed and Breakfast Inns, American Plan or other Similar Plans

Many Bed and Breakfast establishments offer what is commonly referred to as the "American Plan." The American Plan is generally offered by an establishment, wherein the establishment charges the guest a fixed sum by the day, week, or other period for room and meals combined. If the establishment offers an American Plan or other similar plan, the establishment must make segregation in its records between the charges for the room and the charges for the meals, hot prepared food products, and beverages. In addition, charges for delivering and/or serving the meals, hot prepared food products, and beverages are also included in the measure of tax, whether the charges are separately stated or not. If no segregation is made, the auditor should develop segregation based on the information available.

COMPLIMENTARY FOOD AND BEVERAGES 0812.25

Lodging establishments which furnish, prepare, and serve complimentary food and beverages to guests in connection with the rental of rooms are consumers and not retailers of such food and beverages when the retail value of the complimentary food and beverages is "incidental" to the room rental service regardless of where within the hotel premises the complimentary food and beverages are served. For complimentary food and beverages to qualify as "incidental" for the current calendar year, the average retail value of the complimentary food and beverage (ARV) furnished for the preceding calendar year must be equal to or less than 10% of the average daily rate (ADR) for that year. Exhibit 17 is provided to assist the auditor in analyzing whether the hotel or similar establishment is the consumer or retailer of the food and beverages.

"Complimentary food and beverages" means food and beverages (including alcoholic and non-alcoholic beverages) which are provided to transient guests on a complimentary basis and:

- No segregation between the charges for the room and the charge for the food and beverages appears on the guests hotel bill; and
- The guest is not given the option to refuse the food and beverage in return for a discounted room rental rate.

The application of tax to hotels and similar establishments providing complimentary food and beverages is explained in Regulation 1603(a). If applying the formula results in the complimentary food and beverages being ten percent or less, such food and beverages are deemed incidental to the lodging, and not subject to sales tax. For example, if the average daily rate for a hotel in 1995 was $80.00, and the cost of the complimentary food and beverages per occupied room for the same year was $3.00, the retail value of the food and beverages would be $6.00 ($3.00 with 100% markup). Thus, the retail value of the food and beverages is less than ten percent ($6.00/$80.00 = 7.5%). The hotel is the consumer of the food and beverages and tax applies to its cost, where appropriate.

Computing the ADR for Concierge floors, club level, or similar programs: If the hotel provides concierge floors, club levels, or other areas designed to provide for similar programs, the auditor should apply the formula separately with respect to the complimentary food and beverages furnished to the guests who participated in the concierge floors, club level, or similar programs. The auditor should treat the concierge floors, club level, or similar programs as an independent hotel separate and apart from the hotel in which it is operated. To compute the ADR, the formula would include only the "yearly room revenue" and the "yearly number of rooms rented" from these specific rooms.

HOTELS PROVIDING COUPONS 0812.30

If a hotel provides its guests with coupons or similar documents that are exchanged for complimentary food and beverages that are "incidental" to the room rental service in an area of the hotel where food and beverages are sold on a regular basis to the general public, the hotel will be considered the consumer and not the retailer of the food and beverages if the coupons or other similar documents are non-transferable. Although the coupon must be non-transferable, pursuant to a memorandum to the District Principal Auditors from the Program Planning Manager, dated March 1, 1999, for periods prior to January 9, 1999, the coupon need not identify the guest by name. Effective January 9, 1999, if the coupons or other documents are transferable or the guest is not specifically identified, the food and beverages provided will be considered sold to the guest(s) at fair retail value of similar food sold to the general public. The auditor should review and document the hotel's policy with respect to such coupons and/or other documentation.

If a hotel issues its guests coupons, which are to be redeemed at restaurants not operated by the respective hotel or lodging establishment, the hotel is the consumer of the food and beverages when the coupons are redeemed by the guests. The restaurant providing the food and beverages is the retailer and tax will apply to the charge by the restaurant to the hotel.

Exhibit 17 is provided to assist the auditor in analyzing whether the hotel or similar establishment is the consumer or retailer of the food and beverages.

APPENDIX A

AUDIT PROGRAM FOR BARS

AUDIT OBJECTIVE

The primary objective of the tax audit is to determine, with the least possible expenditure of time; the accuracy of reported tax. Additionally, tax audits are to provide information and assistance for taxpayers to correctly and efficiently report and pay future tax liabilities.

PRELIMINARY REVIEW

1. Review district file.
2. Review prior audits.
3. Consider an early visit. This may be done before the official contact if there is reason to believe that sales may be understated and should be done only with Supervisor approval. The purpose is to observe the operations of the business: type of drinks, prices, pour, signs, promotions, etc.

OBTAIN GENERAL FACTS and INFORMATION

1. Meet at business with taxpayer and bar manager, if applicable.
2. Observe the business in operation.
3. Note the type of establishment and clientele. Is it a neighborhood bar, tourist bar, business bar, entertainment bar? *(Section 0801.10, 0801.15)*
4. How long have employees been there? High turnover? *(Section 0801.15)*
5. Is the ~~owner~~taxpayer actively involved in the business?
6. Prepare Bar Fact Sheet. *(Section 0802.15)* Know the purpose of the Bar Fact Sheet and verify the facts. Make sure the taxpayer is aware of the purpose of the Bar Fact Sheet.
7. Know glass size. Measure glasses if necessary. ***(Section 0806.10)***
8. Prepare and do meaningful pour tests. *(Section 0806.30)*
9. Note the methods and devices used to pour drinks. *(Section 0806.00)*
10. Develop a percentage of drinks sold by type to be used on Form BOE-1131-A, *Bar Short Test Sheet*. ***(Section 0802.60)***

REVIEW RECORDS

Records Available *(Section 0801.20)*

First, ask the taxpayer to demonstrate the flow of their accounting system and controls from the time a drink is ordered until the sales tax return is prepared. Note who is responsible for each function. Are the following documents available:

APPENDIX A (Cont.)

1. Sales and use tax returns and worksheets
2. Federal income tax returns
3. Bank statements, deposit worksheets
4. Register tapes
5. Daily recap sheets
6. Cash paid outs
7. Purchase invoices and cancelled checks
8. Documentation for self-consumption
9. Documentation for any income and expenses
10. Documentation to support additional monies received (loans, video games, pool, "cover charges," etc)

Cash register tapes can provide information regarding:

- Changes in prices during the audit period (note: price changes are often imposed when the retailer experiences a change in COGS, i.e., change in excise tax on liquor, or the use of a different glass size, and therefore may not be indicative of a change in mark-up percentages achieved).
- Price and volume of "happy hour" sales and other periods where prices may be different.
- Volume and percentage of types of drinks sold.
- Percentage of credit card sales.

PERFORMING THE AUDIT

General

1. Reconcile reported total sales to FITR, profit & loss statements, etc.
2. Perform sales tax accrual analysis.
3. Review ex-tax purchases of assets and consumable supplies.
4. Review sales of assets.
5. Document internal controls. (***Section 0802.****40)*

Testing *(Section 0802.00)*

1. Perform Bar Short Test.
2. Perform quick purchase segregation.
3. Analyze Bar Short Test. ***(Section 0802.****60)*
4. Make decision if further testing is warranted or accept recorded sales.

APPENDIX A (Cont. 2)

Cost of Goods Sold *(Section 0804.00)*

1. Examine cost of goods sold. What is included and what is not?
2. Determine what is paid for by cash vs. check, and verify that both are recorded.
3. Look for evidence of unrecorded purchases. Are all brands in the bar recorded in the purchases? Know what is in the storeroom.
4. Verify that all invoices are recorded. Does the vendor come weekly, bimonthly or monthly? Check that there are invoices recorded on a regular basis.
5. Determine if purchases are segregated by types (beer, wine, etc.).
6. If purchases are not segregated, perform a purchase segregation for a representative period of time. *(Section 0807.15)*
7. Make sure that purchases are recorded net of discounts.
8. Adjust for inventory changes if they can be supported. *(Section 0804.10)*
9. Are all empty/broken bottles exchanged for new ones?
10. Self-consumption (i.e., complimentary and employee drink policy). *(Section 0801.25)*

Total Sales *(Section 0808.00)*

1. Compare reported and recorded sales.
2. Note the number and types of registers in use.
3. Note the number of bar stools and chairs.
4. Determine gross profit structure and net income. Are wages shown and to whom do they belong?
5. Examine register tapes and use them if appropriate for cumulative totals, key breakdown by type or dollar amount, operating hours.
6. Determine who does the banking, purchasing, closing of registers, and recording of daily sales.
7. Examine bank deposits.
8. Determine how sales of mixes and sodas are recorded.
9. Verify “off sales” and sales of quantity packs to go.

Mark--up Test *(Section 0807.00)*

1. Determine representative purchase cycle for the test period. *(Section 0807.15)*
2. Determine percentages of brands sold through discussions with the taxpayer and from examination of records performed above. Perform purchase segregation if needed. *(Section 0807.15).*

APPENDIX A (Cont. 3)

3. Refer to and use the Bar Fact Sheet in your detailed markup.
4. Review and/or clarify all the facts obtained from the taxpayer and recorded by you on the Bar Fact Sheet and in the detailed mark-up.
5. Establish cost of goods sold (net of consumption and allowances not included in Exhibits 7-12.)
6. Establish selling price of drinks.
7. Calculate markup. *(Section 0807.00)*
8. Determine total audited sales by applying calculated markup to COGS *(Section 0808.00).*
9. Develop a percentage of error and apply to reported taxable measure.
10. Analyze potential audit findings for tolerance *(Section 0802.65).*
11. Support audit findings *(Sections 0802.70 and 0803.15).*

CONCLUSIONS

1. Project unreported taxable measure based on the percentage of error.
2. Compute material self-consumption not reported.
3. Educate the taxpayer on proper recording and reporting procedures (i.e., self-consumption, internal controls)

APPENDIX B

Average Pour Test Procedures

The average pour test is an informal method of establishing the typical pour size of a drink(s). The average pour test should generally be conducted at the time the Bar Fact Sheet is prepared and performed in the presence of the taxpayer with the assistance of the taxpayer or a bartender who has been employed by the taxpayer for a significant length period of time.

Items Needed:

1. Pitcher or graduate of water
2. Bar glasses, various sizes (Highball, Tall, Rocks, Wine)
3. Work area to conduct test
4. Graduated cylinder(s)
5. Bar ice

Pour Test Steps:

1. Observe the pour size of typical drinks being ordered in the bar.
2. If the bartender pours using a jigger, record the jigger size and measure the contents of the jigger using water and the graduate. If the bartender pours using a jigger and adds a free pour to the drink (pouring with a tail), discuss with the bartender the size of the pour that he/she is attempting to achieve and measure the pour using the graduate. If an automatic pourer (gun) is used, discuss the preset pour and take measurement of pour.
3. If the bartender uses a free pour, discuss with the bartender his “count,” (generally every second equals approximately ¼ ounce of fluid). Fill graduate with more than enough water to pour several drinks. Record beginning level of graduate.
4. Have the bartender line up 2 to 3 glasses on the bar filled with bar ice. Using the graduate full of water, ask bartender to pour 2 to 3 glasses at once over the ice.
5. Determine the amount of water “poured” (beginning level of graduate minus ending level of graduate, divided by the number of drinks (glasses) poured in the test.
6. Repeat test to get a test average.
7. Repeat same steps for other size/type of drinks, as needed.

APPENDIX B (Cont.)

Comments

If the results from pour test using water appear unrealistic, request that the bartender or taxpayer do a couple pours using alcohol into typical drink(s) glass without any “mix.” Take measurement of pour. Compare results with test using water. If both methods produce unrealistic results, the auditor should consider returning for an unannounced undercover pour test. The auditor should record the procedures used, discussions, persons involved, and the test findings in detail in the audit working papers.

APPENDIX C

UNDERCOVER POUR TEST PROCEDURES

BEFORE THE TEST

1. Obtain written approval for the test from the District Principal Auditor or the Branch Office Supervisor.
2. Determine the days and hours of the business operations.
3. Determine a representative day and time to conduct the test. Avoid holidays, special events, happy hour, and entertainment hours.
4. Choose three auditors to conduct the test. The auditor assigned to the audit should not participate in the undercover pour test. One auditor will be assigned as the designated driver and the same auditor should also conduct the actual measuring of the pour size.
5. Be sure all participants have both their BOE ID's and a driver's license with them.
6. Examine the Bar Fact Sheet to determine the type of drinks sold, and decide beforehand what drinks will be purchased. Drinks are to be ordered straight or mixed with only water.
7. Decide beforehand whether the testing will be done at the bar by the auditors or sent to a designated lab for results. However, unless an employee of the Department of Justice or the Alcoholic Beverage Control accompanies the auditors, the bar taxpayer/bartender may legitimately refuse to let the alcohol be taken off the premises for testing.
8. Have all necessary equipment available (See equipment list). Be familiar with the equipment before the test by performing several test runs at the office.

EQUIPMENT

1. 4 to 5 ounce graduate
2. Hydrometer (generally a Van Waters & Rogers Inc. #3417-1)
3. Hydrometer Cylinder: 1 ¼ inches in diameter and 10 inches tall. This is used to float the hydrometer.
4. Thermometer
5. Funnel
6. Temperature Conversion Table
7. Calculator
8. If transporting the container to the lab or delivering the container within 24 hours, the auditor must keep the drinks in a refrigerated container (cooler w/ice or stored in refrigerator).

APPENDIX C (CONT.)

DURING THE TEST

1. Two drinks will generally be purchased, one call and one well drink (a mixed drink, a straight shot or "on-the-rocks," or a cocktail, if either is claimed to have significant sales volume). When testing is done with a hydrometer, only drinks mixed with water can be ordered. Pay for the drinks. If the assigned designated driver orders a drink (this would be an additional drink); it should be a straight shot and should not be drunk by the Board of Equalization (BOE) employee. This drink may be used as a "control test" to test the proof listed on the liquor bottle if the testing is to be done by a lab; otherwise it may be included as one of the drinks used to test the pour size if the measurement is done at the business location. The other two drinks are to be drunk by the BOE employees.
2. Order an identical round of drinks. Pay for drinks.
3. At this point, identify yourself to the bartender. Inform the bartender of your name, where you work, the reason why you are there, and what you intend to do with the drinks (i.e., to test the drinks at the business location or transport the drinks to a lab). If necessary present your BOE identification card.
4. Ask bartender to see the liquor bottles from which the drinks were poured. Note the proof and brand name of each drink being tested.
5. If the taxpayer/bartender has agreed to let the BOE employees remove the drinks from the premises for testing by a lab, pour each drink into a sealable container for transporting to the lab. When transporting the container to the lab or delivering the container to the lab within no more than 24 hours, the BOE employees must keep the container cool by storing it in a refrigerated container (cooler with ice or stored in a refrigerator). Each container submitted for analysis must be properly labeled with all the pertinent information. (i.e., the proof of the liquor; if more than one liquor, list each along with ratios, the taxpayer's name, permit number, brand of liquor, the date sample was obtained, the name of the person obtaining the sample, bartender's name).
6. If the testing is to be done at the business location, request that the bartender notify the taxpayer and request from the taxpayer/bartender an appropriate location to perform the testing. If possible, avoid using a main room or the bar.
7. Remove any ice from the drinks being tested. Do this by pouring the drink into the graduate, which has a lip for pouring. Pour drink back into glass through a funnel to strain off the ice. Discard the ice. The reason for this is to allow the drink to warm to 60 degrees Fahrenheit. Pour drink back into graduate being careful not to lose liquid.
8. If the drink was ordered "straight-up," measure the amount of liquid in the glass. Place thermometer in the measurement glass. After three to five minutes, record the temperature. Remove the thermometer and record the liquid volume total. Use recorded temperature, recorded proof, and the attached conversion table to obtain the correct factor. Multiply the factor by the liquid volume total. Record you answer as the measured pour.

APPENDIX C (Cont. 2)

9. If drink was ordered on the rocks, chilled, or shaken, pour tap water into measurement glass until the total amount of liquid equals four to five ounces.
10. Place thermometer in the measurement glass. After three to five minutes, record temperature. A temperature correction factor is used as hydrometers are calibrated at 60 degrees Fahrenheit. Remove the thermometer and record the liquid volume total.
11. Pour the liquid into the graduated cylinder.
12. Place the hydrometer in the cylinder. Verify that the hydrometer is buoyant. If the hydrometer is still touching the base of the cylinder, you will need to add additional water. Water will have no effect on the outcome of the test.
13. Record the hydrometer reading. If the hydrometer is somewhat difficult to read because of the capillary action of the liquid, the reading at the tip of the capillary curve has been found to be most accurate.
14. Use the total test volume of liquid multiplied by the hydrometer reading (or temperature corrected hydrometer reading). Divide by the proof. Record your answer as the measured pour.
15. Provide detailed comments on the results of the pour test with all pertinent information: type of drink(s), method of pour, date, time, proof, bartender's name, auditors' names, etc. The auditor may use the "Results of Undercover Pour Test" form or an equivalent form at his or her discretion.
16. Do not forget to clean and dry all equipment.

FORMULA

$$\frac{\text{Total Test Volume x Hydrometer Reading}}{\text{Proof}}$$

The following is a sample problem, which shows that the temperature of the drink can have a material effect on the pour size.

Hypothetical Facts

Whiskey and water (after ice melt)	5.9 oz.
Temperature of whiskey and water solution	71 degrees F
Hydrometer reading (after ice melt)	18
Proof of whiskey used	80 proof

APPENDIX C (Cont. 3)

Calculation of Pour Size without Temperature Correction:

$$\frac{5.9 \text{ oz. x } 18}{80 \text{ proof}} = 1.33 \text{ oz. of whiskey}$$

Calculation of Pour Size Adjusting for Temperature

$$\frac{5.9 \text{ oz. x } 16.1}{80 \text{ proof}} = 1.18 \text{ oz. of whiskey}$$

Using the conversion tables, a hydrometer reading of 18 would produce a reading of 16.1 at 71 degrees Fahrenheit. Consequently, the reading of 16.1 should be substituted in calculating the drink size.

APPENDIX C (CONT. 4)

Results of Undercover Pour Test

Taxpayer Name: Account No:

DBA: Case No:

Address: Date:

City: Auditor Name:

I. Pre-Test Information:

A. Date and time for test

B. Circle type of test desired: Measured Pour or Hydrometer

C. Approved by:

(DPA or Branch Office Supervisor approval must precede testing)

Type	Brand	Proof	Mix w/water	Mix w/ice	Straight	Comments
Well						
We;;						
Call						
Call						

II. Test Results:

A. Date and time:

B. Name of Bartender(s):

C. Type of pouring method:

Type	Brand	Proof	Price	Temp	Liquid volume(oz)	Hydrometer Reading	Mix w/water	Pour size (oz)	Notes
Call									
Call									
Well									
Well									

Test conducted by:

Test conducted by:

Test conducted by

Table of Exhibits

Date Published

DESIGNATIONS FOR TYPES OF ABC LICENSES — EXHIBIT 1

Wholesale and Off-Sale Licenses

01	Beer Manufacturer
02	Wine Grower
03	Brandy Manufacturer
04	Distilled Spirits Manufacturer
05	Distilled Spirits Manufacturer Agent
06	Still
07	Rectifier
09	Beer & Wine Importer
10	Beer & Wine Importer's General
11	Brandy Importer
12	Distilled Spirits Importer
13	Distilled Spirits Importer's General
14	Public Warehouse
15	Customs Broker
16	Wine Broker
17	Beer & Wine Wholesaler
18	Distilled Spirits Wholesaler
19	Industrial Alcohol Dealer
20	Off-Sale Beer & Wine
21	Off-Sale General
22	Wine Blender
23	Small Beer Manufacturer
24	Distilled Spirits Rectifier's General
25	California Brandy Wholesaler
26	Out-of-State Beer Manufacturer Cert.
27	California Wine Growers Agent
28	Out-of-State Distilled Spirits Shippers Cert.
29	Winegrape Growers Storage License

On-Sale Licenses

40	On-Sale Beer
41	On-Sale Beer & Wine Eating Place
42	On-Sale Beer & Wine Public Premises
43	On-Sale Beer & Wine Train
44	On-Sale Beer Fishing Party Boat
45	On-Sale Beer & Wine Boat
47	On-Sale General Eating Place
48	On-Sale General Public Premises
49	On-Sale General Seasonal
50	On-Sale General Club
51	Club
52	Veteran's Club
53	On-Sale General Train
54	On-Sale General Boat
55	On-Sale General Airplane
56	On-Sale General Vessel 1,000 ton
57	Special On-Sale General
58	Caterer's Permit
59	On-Sale Beer & Wine Seasonal
60	On-Sale Beer Seasonal
61	On-Sale Beer Public Premises
62	On-Sale General Dockside, 10,000 ton
63	On-Sale Special Beer & Wine, Hospitals
64	Special On-Sale General Theater
65	Special On-Sale Beer & Wine, Symphony
66	Controlled Access Cabinet Permit
67	Bed & Breakfast Inn
68	Portable Bar
69	Special On-Sale Beer & Wine Theater
70	On-Sale General Restrictive Service
75	On-Sale General Brew-Pubs
76	On-Sale General Maritime Museum Association
77	Event Permit

BOE–1311–B, BAR FACT SHEET

EXHIBIT 2
Page 1 of 2

BOE–1311–B (FRONT) REV 6 (12–00)

BAR FACT SHEET

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

NAME | ACCOUNT NUMBER | CASE NUMBER

DBA | PERIOD From | To

AUDITOR | DATE

POURING METHOD: ☐ Free Pour ☐ Jigger ☐ Automatic Dispenser, Size of Pour: _________ Standard _________ Long

CONTAINER	GLASS SIZE	Pour Size REG	HH	ENT	SE	CONTAINER	GLASS SIZE	Pour Size REG	HH	ENT	SE
Shot Glass						Draft Glass					
Highball Glass						Draft Pitcher					
Rocks Glass						Wine Glass					
Cocktail Glass						Wine Carafe					

SELF-CONSUMED MERCHANDISE:

Self-consumed merchandise is subject to use tax. Use tax is based on the cost of the merchandise consumed, not the retail selling price.

Is self-consumed merchandise reported? ☐ YES NO ☐

	Distilled Spirits		Beer		Wine	
	# of Drinks per months	Cost per month	# of Drinks per month	Cost per month	# of Drinks per month	Cost per month
Self-Consumed, Taxpayer						
Self-Consumed, Employee						
Treating of Customers						
Other						
Total Number of Drinks and Cost per Month						

SELLING PRICES PER DRINK

Liquor / Wine

	Period:				Period:			
	Regular	Happy Hour	Entertainment	Special Events	Regular	Happy Hour	Entertainment	Special Events
Well Standard								
Well Other								
Call Standard								
Call Other								
Premium Standard								
Premium Other								
Cocktails								
Cocktails								
Cocktails								
Exotic/Specialty								
Over Rocks								
Wine House								
Wine Premium								
Other								

Beer

Domestic:

Bottled/Canned	oz.								
Off-Sale	oz.								
Draft Glass	oz.								
Draft Glass	oz.								
Draft Pitcher	oz.								
Draft Pitcher	oz.								

Premium/Microbrew:

Bottled/Canned	oz.								
Off-Sale	oz.								
Draft Glass	oz.								
Draft Glass	oz.								
Draft Pitcher	oz.								
Draft Pitcher	oz.								

BOE–1311–B (BACK) REV 6 (12–00)

BAR FACT SHEET

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

QUESTIONS ABOUT OPERATIONS FOR THE AUDIT PERIOD __________ TO __________

1. Did glass size change? ☐ YES NO ☐
   If yes, date of change_________to what___________
2. Did prices change? ☐ YES NO ☐
   If yes, date of change__________to what__________
3. Automatic liquor dispenser in use? ☐ YES NO ☐
   a. For what periods? ____________________________
   b. What distilled spirits? ___________________________
   c. Set for what pour size? ___________________________
4. Was there a Happy Hour (HH)? ☐ YES NO ☐
   a. What days/hours? ____________________________
   b. For what periods? ____________________________
   c. Estimated percentage of sales______
5. Was entertainment (ENT) provided? ☐ YES NO ☐
   a. What days/hours?_____________
   b. For what periods?_____________
   c. What kind of entertainment?_____________
   d. Estimated percentage of sales?_____________
6. Were there special events (SE)? ☐ YES NO ☐
   a. When/How often? ____________________________
   b. For what periods? ____________________________
   c. What kind of special event(s)? ____________________
   d. Estimated percentage of sales? ____________________
7. What are the days & hours of operation?
   ______day______hrs.
   If days/hours changed, when __________ to what __________
8. Estimated percentage of special drink sales to total drink sales:
   a. Cocktail sales to total sales? ____________________
   b. Exotic/Specialty drinks to total sales?_____________
   c. Rocks drinks to total sales?____________________
9. Was there any inventory loss due to:
   Theft? ☐ YES NO ☐
   Fire? ☐ YES NO ☐
   Natural disaster(s)? ☐ YES NO ☐
   If yes to any of the above, please provide explanation / documentation & amount of loss
10. Are appropriate tax reimbursement notices displayed per Regulation 1700? ☐ YES NO ☐
11. Are cigarettes sold? ☐ YES NO ☐
    If vending machine, who reports cigarette vending receipts?
    ____
12. Are customers allowed to run a tab? ☐ YES NO ☐
    If yes, how are charge sales handled? _______________
    How are bad debts handled? _______________________
13. Are cash register tapes available? ☐ YES NO ☐
    For what period(s)? ____________________________
14. Does the establishment sell food? ☐ YES NO ☐
    a. If yes, is food sold in separate area? ☐ YES NO ☐
    b. For what period? ____________________________
    c. Are separate records maintained? _______________
    d. If bar sales are made in restaurant, or restaurant sales are made in bar, how are drink sales and taxes handled?
    ____
15. Are pouring costs (PC) evaluated? ☐ YES NO ☐
    If yes, by whom/how often? _______________________
    What is the pour cost percentage for the following?
    ______Liquor____Wine_____Beer
16. Is there a cover charge? ☐ YES NO ☐
    If yes, when/how much? __________________________
    For what period(s)? ______________________________
17. How are complimentary drinks accounted for? __________
18. Is the bar operated by an absentee taxpayer? __________
19. What are the well brands?
    Whiskey ______________ Scotch ______________
    Gin ___________ Vodka _________ Rum __________
    Brandy _________ Tequila _________
20. List suppliers names:
    ____
21. Is a drink price menu available? ☐ YES NO ☐
    If yes, please attach.
22. Other ______________________________________

Please Read Before Signing

The completion of the Bar Fact Sheet is a collaborative effort by the auditor and taxpayer to document the essential information needed to perform an audit of a bar, and ***this information may be used to establish audited bar sales***. If someone other than the taxpayer has provided the information, the form should also be reviewed and signed by the taxpayer. The information documented on this form may be modified/revised by additional information or estimates provided by the taxpayer. If an audit conclusion is based on information other than that contained in this Bar Fact Sheet, such information must be fully documented in the audit working papers and discussed with the taxpayer

I have reviewed the above information and state that to the best of my knowledge it is accurate and complete.

SIGNATURE OF TAXPAYER OR AUTHORIZED AGENT	DATE

A copy of this form was provided to the taxpayer on ________________________.
(Date)

STATEMENT OF INTERNAL CONTROLS

Cash Controls

	YES	NO	
1			Are cash register drawers closed after each sale? Date observed
2			Do the cash registers print sales tickets? Date observed
3			Are sales tickets given to customers? Date observed
4			Is access to the register tapes restricted, and if so, to whom? Name/Title?
5			Are the cash registers checked out at the end of each shift, and if so, by whom? Name/Title?
6			If two or more bartenders work simultaneously, do they use the same cash registers? Date observed
7			Are beginning and ending register transaction numbers compared? If yes, by whom?
8			Are register tape tears matched? If yes, Name/Title?
9			Are cash payments supported by receipts signed by the payee? Date verified
10			If servers are employed, how are sales by them controlled?
11			Is a third party retained to conduct periodic checks (e.g., inventory, internal controls, etc.)? If yes, what is the frequency of the service? Weekly / Monthly / Quarterly / Other
12			Is the cash reconciled to the register tapes and deposited in the bank intact, and if so, at what intervals and by whom? What intervals? Daily / Weekly / Monthly

Inventory Controls

	YES	NO	
1			Is the inventory of alcoholic beverages stored in a locked stockroom?
			If not, specify
2			Who has access to the stockroom?
			Bartender / Servers / Shift Manager / Others
3			Who restocks the bar from the stockroom inventory and at what intervals?
			Whom / Intervals
4			Is a record maintained of stock removed from the stockroom?
5			Are empty bottles exchanged for full bottles removed from the stockroom?
6			Who checks incoming merchandise into the stockroom?
			Person / Title
7			Are the contents of incoming cases verified?
			If yes, by whom?
8			At what intervals are physical inventories of merchandise in both the stockroom and the bar taken, and by whom?
			Weekly / Monthly / Quarterly / Other
			By whom?
9			Are automatic liquor dispensing devices used?
			Gun type: Automatic Pourer / Other
10			Is beginning bar inventory, plus stockroom withdrawals, less ending bar inventory periodically extended to retail prices and compared to recorded receipts?
			If yes, how often? / By whom?
11			Does management demand a certain gross profit margin?
			If yes, what margin is desired?
12			Is a written record maintained of complimentary and self consumed drinks?
			Who verifies the amount self-consumed?
13			Is self consumed reported?
			If yes, where: / Line 1 / Line 2
14			Does the taxpayer operate 2 or more locations?
			Is the inventory commingled or transferred between locations?

SIGNATURE OF TAXPAYER OR AUTHORIZED AGENT	DATE

BOE–1311–A REV 3 (12–00)

BAR SHORT TEST SHEET

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

TAXPAYER NAME	ACCOUNT NUMBER	CASE NUMBER
DBA	TELEPHONE NUMBER	
AUDITOR	DATE	
RECORDS AT		
INFORMATION NEEDED TO SUPPORT MARKUP COMPUTATIONS OBTAINED FROM		

Type of Drink		SALES PRICE	OZ. SERVED	(A) % OF TOTAL PURCHASES	(B) EXPECTED MARKUP	WEIGHTED MARKUP (A x B)
Well	BRAND			%	%	%
Call	BRAND			%	%	%
Cocktails (2 or more liquors)	BRAND(S)			%	%	%
Wine/ Liqueurs	BRAND			%	%	%
Beer - Domestic	BOTTLED/CANNED			%	%	%
	BOTTLED/CANNED OFF-SALE			%	%	%
	DRAFT GLASS			%	%	%
	DRAFT GLASS			%	%	%
	DRAFT PITCHER			%	%	%
	DRAFT PITCHER			%	%	%
Beer - Premium/ Microbrew	BOTTLED/CANNED			%	%	%
	BOTTLED/CANNED OFF-SALE			%	%	%
	DRAFT GLASS			%	%	%
	DRAFT GLASS			%	%	%
	DRAFT PITCHER			%	%	%
	DRAFT PITCHER			%	%	%
TOTAL WEIGHTED MARKUP	☐ Tax included	Ex Tax ☐				%

MARKUP PER RECORDS

(Adjusted for Self-Consumed) ☐ *Tax included* *Ex Tax* ☐

YEAR OF %	YEAR OF %
YEAR OF %	AVERAGE %

SELF-CONSUMED MERCHANDISE

Self-consumed merchandise of $ ____________ /mo, or $ __________________ /yr. excluded before computing the percentage of total purchases and the markup per records.

Purchase Segregation
-Distilled Spirits
4th Quarter 1999

12A-3 Page 1 of 2
SR GH 12-345678
S. M.
12/08/99

	A	B	C	D	E	F	G	H	I	J	K	L	M
REF	Invoice Date	Invoice Number	Vendor	Brand	Well Fifths	Well 750ml	Well Liters	Other	Call Fifths	Call 750ml	Call Liters	Cost Net of Discounts	Comments
1	10/04/99	30129	No Wine & Spirits	Grand Marnier						2		$ 65.50	
2	10/04/99	30129	No Wine & Spirits	Walker Schnapps			6					$ 53.55	
3	10/04/99	30129	No Wine & Spirits	Barton Vodka			36					$ 199.60	
4	10/06/99	1234567	Yang's Market	Ron Antigua Rum			12					$ 84.30	
5	10/06/99	1234567	Yang's Market	Giro Tequila			12					$ 83.20	
6	10/06/99	1234567	Yang's Market	Absolute Vodka							6	$ 89.50	
7	10/06/99	1234567	Yang's Market	Dewars Scotch							1	$ 25.60	
8	10/06/99	1234567	Yang's Market	Johnnie Walker							1	$ 25.60	
9	10/11/99	30284	No Wine & Spirits	Myer's Dark Rum							4	$ 84.40	
10	10/11/99	30284	No Wine & Spirits	Capt Morgan Rum							2	$ 28.80	
11	10/11/99	30284	No Wine & Spirits	Barton Vodka			12					$ 65.20	
12	10/14/99	1696988	Yang's Market	Gallo Chardonnay				24				$ 66.80	
13	10/14/99	1696988	Yang's Market	Hennessy Cognac							1	$ 36.65	
14	10/14/99	1696988	Yang's Market	Seagram's Seven							12	$ 145.60	
15	10/14/99	1696988	Yang's Market	Jack Daniels					6			$ 82.20	
16													
17													
18													
19													
20													
21			**Total for 4 Qtr 1999**		72	38	496	216	27	14	352	$9,483.13	
22			Less: Wine Included in Totals					216				$ 322.80	
23													
24			Total Distilled Spirits 4 Qtr 1999		72	38	496	0	27	14	352	$9,160.33	
25													
26													
27													
28													
29													
30													

Note: A review of purchase invoices indicate that vendors are recorded consistently on a weekly basis.

This exhibit is intended to be one example of a method to perform a purchase segregation. Many different methods exist for performing a purchase segregation.

Copy to Taxpayer
Date: __________

Purchase Segregation
-Beer
4th Quarter 1999

12A-3 Page 2 of 2
SR GH 12-345678
S. M.
12/08/99

	A	B	C	D	E	F	G	H	I
					Number of Cases		Number of 1/2 Barrel Kegs		
REF	Invoice Date	Invoice Number	Vendor	Brand	Regular	Premium	Regular	Premium	Cost Net of Discounts
1	10/08/99	1234	Sahara Distributors	Coors Long Neck 12 oz.	15				$ 224.60
2	10/08/99	1234	Sahara Distributors	Coors Light 12 oz.	8				$ 116.40
3	10/08/99	1234	Sahara Distributors	O'Douls 12 oz.	6				$ 54.80
4	10/08/99	1234	Sahara Distributors	Sierra Nevada				4	$ 280.00
5	10/08/99	1234	Sahara Distributors	Sam Adams				4	$ 320.00
6	10/08/99	1234	Sahara Distributors	Henieken		6			$ 156.00
7	10/11/99	56789	A.H.B. Distributors	Budweiser 12 oz.	30				$ 460.60
8	10/11/99	56789	A.H.B. Distributors	Bud Light 12 oz.	15				$ 230.30
9	10/11/99	56789	A.H.B. Distributors	Michelob 12 oz	6				$ 90.00
10	10/11/99	56789	A.H.B. Distributors	Miller GD 12 oz.	6				$ 96.00
11	10/15/99	1468	Sahara Distributors	Coors Long Neck 12 oz.	15				$ 224.60
12	10/15/99	1468	Sahara Distributors	Coors Light 12 oz.	8				$ 116.40
13	10/15/99	1468	Sahara Distributors	O'Douls 12 oz.	6				$ 54.80
14	10/18/99	57015	A.H.B. Distributors	Budweiser 12 oz.	45				$ 690.90
15	10/18/99	57015	A.H.B. Distributors	Bud Light 12 oz.	15				$ 230.30
16	10/18/99	57015	A.H.B. Distributors	Michelob 12 oz	12				$ 180.00
17	10/18/99	57015	A.H.B. Distributors	Miller GD 12 oz.	12				$ 192.00
18	10/18/99	57015	A.H.B. Distributors	Bud kegs			10		$ 620.00
19	10/18/99	57015	A.H.B. Distributors	Bud Light kegs			10		$ 620.00
20									
21									
22									
23									
24									
25			**Total for 4 Qtr 1999**		753	255	55	26	$ 22,262.70
26									
27									
28									
29									
30									

Notes: Purchase amounts include CRV when applicable.

Copy to Taxpayer
Date: _________

MARKUP ANALYSIS

EXHIBIT 6

MarkUp Analysis

12A-1
SR GH 12-345678
S. M.
12/08/99

REF	A	B	C 1997	D 1998	E 1999	F	G	H
1	<per FITR>	Purchases (or CGS)	204,738	234,566	255,898			
2	<per purchase segregation>	Less: Supplies	2,047	2,346	2,559			
3	<per Bar Fact Sheet>	Less:Self-Consumption	1,500	1,500	1,500			
4	(L1-2-3)	Adjusted Purchases	201,191	230,720	251,839			
5	(L4*1%)	Less: 1% Pilferage	2,012	2,307	2,518			
6	(L4-5)	Cost of Sales	199,179	228,413	249,321			
7	<12A-2>	Weighted MarkUp (+100%)	389.00%	389.00%	389.00%			
8								
9	(L6*7)	Audited Taxable Sales (ex-tax)	774,806	888,527	969,859			
10	<per 414>	Reported Taxable Sales	541,233	626,254	702,365			
11	(L9-10)	Difference	233,573	262,273	267,494			
12								
13	(L11/10)	Percentage of Error	43.16%	41.88%	38.08%			
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								

Note: The percentage of error, if any, should be applied to each reporting period.

Copy to Taxpayer
Date: _________

PROCEEDS FROM SALES FROM ONE FIFTH BOTTLE OF DISTILLED SPIRITS

EXHIBIT 7

Anticipated Proceeds From Sale of Drinks

One Fifth Bottle

	Pour Size - in Ounces												
	3/4	7/8	1	1 1/8	1 1/4	1 3/8	1 1/2	1 5/8	1 3/4	1 7/8	2	2 1/8	2 1/4
Drinks Per Bottle	34.13	29.26	25.60	22.76	20.48	18.62	17.07	15.75	14.63	13.65	12.80	12.05	11.38
* 8% Allowance	2.73	2.34	2.05	1.82	1.64	1.49	1.37	1.26	1.17	1.09	1.02	0.96	0.91
Net Drinks	31.40	26.92	23.55	20.94	18.84	17.13	15.70	14.49	13.46	12.56	11.78	11.09	10.47
Price per Drink	Proceeds From Sales												
1.00	31.40	26.92	23.55	20.94	18.84	17.13	15.70	14.49	13.46	12.56	11.78	11.09	10.47
1.25	39.25	33.65	29.44	26.18	23.55	21.41	19.63	18.11	16.83	15.70	14.73	13.86	13.09
1.50	47.10	40.38	35.33	31.41	28.26	25.70	23.55	21.74	20.19	18.84	17.67	16.64	15.71
1.75	54.95	47.11	41.21	36.65	32.97	29.98	27.48	25.36	23.56	21.98	20.62	19.41	18.32
2.00	62.80	53.84	47.10	41.88	37.68	34.26	31.40	28.98	26.92	25.12	23.56	22.18	20.94
2.25	70.65	60.57	52.99	47.12	42.39	38.54	35.33	32.60	30.29	28.26	26.51	24.95	23.56
2.50	78.50	67.30	58.88	52.35	47.10	42.83	39.25	36.23	33.65	31.40	29.45	27.73	26.18
2.75	86.35	74.03	64.76	57.59	51.81	47.11	43.18	39.85	37.02	34.54	32.40	30.50	28.79
3.00	94.20	80.76	70.65	62.82	56.52	51.39	47.10	43.47	40.38	37.68	35.34	33.27	31.41
3.25	102.05	87.49	76.54	68.06	61.23	55.67	51.03	47.09	43.75	40.82	38.29	36.04	34.03
3.50	109.90	94.22	82.43	73.29	65.94	59.96	54.95	50.72	47.11	43.96	41.23	38.82	36.65
3.75	117.75	100.95	88.31	78.53	70.65	64.24	58.88	54.34	50.48	47.10	44.18	41.59	39.26
4.00	125.60	107.68	94.20	83.76	75.36	68.52	62.80	57.96	53.84	50.24	47.12	44.36	41.88
4.25	133.45	114.41	100.09	89.00	80.07	72.80	66.73	61.58	57.21	53.38	50.07	47.13	44.50
4.50	141.30	121.14	105.98	94.23	84.78	77.09	70.65	65.21	60.57	56.52	53.01	49.91	47.12
4.75	149.15	127.87	111.86	99.47	89.49	81.37	74.58	68.83	63.94	59.66	55.96	52.68	49.73
5.00	157.00	134.60	117.75	104.70	94.20	85.65	78.50	72.45	67.30	62.80	58.90	55.45	52.35
5.25	164.85	141.33	123.64	109.94	98.91	89.93	82.43	76.07	70.67	65.94	61.85	58.22	54.97
5.50	172.70	148.06	129.53	115.17	103.62	94.22	86.35	79.70	74.03	69.08	64.79	61.00	57.59
5.75	180.55	154.79	135.41	120.41	108.33	98.50	90.28	83.32	77.40	72.22	67.74	63.77	60.20
6.00	188.40	161.52	141.30	125.64	113.04	102.78	94.20	86.94	80.76	75.36	70.68	66.54	62.82
6.25	196.25	168.25	147.19	130.88	117.75	107.06	98.13	90.56	84.13	78.50	73.63	69.31	65.44
6.50	204.10	174.98	153.08	136.11	122.46	111.35	102.05	94.19	87.49	81.64	76.57	72.09	68.06
6.75	211.95	181.71	158.96	141.35	127.17	115.63	105.98	97.81	90.86	84.78	79.52	74.86	70.67
7.00	219.80	188.44	164.85	146.58	131.88	119.91	109.90	101.43	94.22	87.92	82.46	77.63	73.29

'* The 8% allowance accounts for overpouring, spillage, waste, and breakage.

PROCEEDS FROM SALES FROM ONE QUART BOTTLE OF DISTILLED SPIRITS

EXHIBIT 8

Anticipated Proceeds From Sale of Drinks

One Quart Bottle

	Pour Size - in Ounces												
	3/4	7/8	1	1 1/8	1 1/4	1 3/8	1 1/2	1 5/8	1 3/4	1 7/8	2	2 1/8	2 1/4
Drinks Per Bottle	42.67	36.57	32.00	28.44	25.60	23.27	21.33	19.69	18.28	17.07	16.00	15.06	14.22
* 8% Allowance	3.41	2.93	2.56	2.28	2.05	1.86	1.71	1.58	1.46	1.37	1.28	1.20	1.14
Net Drinks	39.26	33.64	29.44	26.16	23.55	21.41	19.62	18.11	16.82	15.70	14.72	13.86	13.08
Price per Drink	Proceeds From Sales												
1.00	39.26	33.64	29.44	26.16	23.55	21.41	19.62	18.11	16.82	15.70	14.72	13.86	13.08
1.25	49.08	42.05	36.80	32.70	29.44	26.76	24.53	22.64	21.03	19.63	18.40	17.33	16.35
1.50	58.89	50.46	44.16	39.24	35.33	32.12	29.43	27.17	25.23	23.55	22.08	20.79	19.62
1.75	68.71	58.87	51.52	45.78	41.21	37.47	34.34	31.69	29.44	27.48	25.76	24.26	22.89
2.00	78.52	67.28	58.88	52.32	47.10	42.82	39.24	36.22	33.64	31.40	29.44	27.72	26.16
2.25	88.34	75.69	66.24	58.86	52.99	48.17	44.15	40.75	37.85	35.33	33.12	31.19	29.43
2.50	98.15	84.10	73.60	65.40	58.88	53.53	49.05	45.28	42.05	39.25	36.80	34.65	32.70
2.75	107.97	92.51	80.96	71.94	64.76	58.88	53.96	49.80	46.26	43.18	40.48	38.12	35.97
3.00	117.78	100.92	88.32	78.48	70.65	64.23	58.86	54.33	50.46	47.10	44.16	41.58	39.24
3.25	127.60	109.33	95.68	85.02	76.54	69.58	63.77	58.86	54.67	51.03	47.84	45.05	42.51
3.50	137.41	117.74	103.04	91.56	82.43	74.94	68.67	63.39	58.87	54.95	51.52	48.51	45.78
3.75	147.23	126.15	110.40	98.10	88.31	80.29	73.58	67.91	63.08	58.88	55.20	51.98	49.05
4.00	157.04	134.56	117.76	104.64	94.20	85.64	78.48	72.44	67.28	62.80	58.88	55.44	52.32
4.25	166.86	142.97	125.12	111.18	100.09	90.99	83.39	76.97	71.49	66.73	62.56	58.91	55.59
4.50	176.67	151.38	132.48	117.72	105.98	96.35	88.29	81.50	75.69	70.65	66.24	62.37	58.86
4.75	186.49	159.79	139.84	124.26	111.86	101.70	93.20	86.02	79.90	74.58	69.92	65.84	62.13
5.00	196.30	168.20	147.20	130.80	117.75	107.05	98.10	90.55	84.10	78.50	73.60	69.30	65.40
5.25	206.12	176.61	154.56	137.34	123.64	112.40	103.01	95.08	88.31	82.43	77.28	72.77	68.67
5.50	215.93	185.02	161.92	143.88	129.53	117.76	107.91	99.61	92.51	86.35	80.96	76.23	71.94
5.75	225.75	193.43	169.28	150.42	135.41	123.11	112.82	104.13	96.72	90.28	84.64	79.70	75.21
6.00	235.56	201.84	176.64	156.96	141.30	128.46	117.72	108.66	100.92	94.20	88.32	83.16	78.48
6.25	245.38	210.25	184.00	163.50	147.19	133.81	122.63	113.19	105.13	98.13	92.00	86.63	81.75
6.50	255.19	218.66	191.36	170.04	153.08	139.17	127.53	117.72	109.33	102.05	95.68	90.09	85.02
6.75	265.01	227.07	198.72	176.58	158.96	144.52	132.44	122.24	113.54	105.98	99.36	93.56	88.29
7.00	274.82	235.48	206.08	183.12	164.85	149.87	137.34	126.77	117.74	109.90	103.04	97.02	91.56

'* The 8% allowance accounts for overpouring, spillage, waste, and breakage.

PROCEEDS FROM SALES FROM ONE 750ML BOTTLE OF DISTILLED SPIRITS

EXHIBIT 9

Anticipated Proceeds From Sale of Drinks

One 750ml. Bottle

	Pour Size - in Ounces												
	3/4	7/8	1	1 1/8	1 1/4	1 3/8	1 1/2	1 5/8	1 3/4	1 7/8	2	2 1/8	2 1/4
Drinks Per Bottle	33.81	28.98	25.36	22.54	20.29	18.44	16.91	15.61	14.49	13.53	12.68	11.93	11.27
* 8% Allowance	2.70	2.32	2.03	1.80	1.62	1.48	1.35	1.25	1.16	1.08	1.01	0.95	0.90
Net Drinks	31.11	26.66	23.33	20.74	18.67	16.96	15.56	14.36	13.33	12.45	11.67	10.98	10.37
Price per Drink	Proceeds From Sales												
1.00	31.11	26.66	23.33	20.74	18.67	16.96	15.56	14.36	13.33	12.45	11.67	10.98	10.37
1.25	38.89	33.33	29.16	25.93	23.34	21.20	19.45	17.95	16.66	15.56	14.59	13.73	12.96
1.50	46.67	39.99	35.00	31.11	28.01	25.44	23.34	21.54	20.00	18.68	17.51	16.47	15.56
1.75	54.44	46.66	40.83	36.30	32.67	29.68	27.23	25.13	23.33	21.79	20.42	19.22	18.15
2.00	62.22	53.32	46.66	41.48	37.34	33.92	31.12	28.72	26.66	24.90	23.34	21.96	20.74
2.25	70.00	59.99	52.49	46.67	42.01	38.16	35.01	32.31	29.99	28.01	26.26	24.71	23.33
2.50	77.78	66.65	58.33	51.85	46.68	42.40	38.90	35.90	33.33	31.13	29.18	27.45	25.93
2.75	85.55	73.32	64.16	57.04	51.34	46.64	42.79	39.49	36.66	34.24	32.09	30.20	28.52
3.00	93.33	79.98	69.99	62.22	56.01	50.88	46.68	43.08	39.99	37.35	35.01	32.94	31.11
3.25	101.11	86.65	75.82	67.41	60.68	55.12	50.57	46.67	43.32	40.46	37.93	35.69	33.70
3.50	108.89	93.31	81.66	72.59	65.35	59.36	54.46	50.26	46.66	43.58	40.85	38.43	36.30
3.75	116.66	99.98	87.49	77.78	70.01	63.60	58.35	53.85	49.99	46.69	43.76	41.18	38.89
4.00	124.44	106.64	93.32	82.96	74.68	67.84	62.24	57.44	53.32	49.80	46.68	43.92	41.48
4.25	132.22	113.31	99.15	88.15	79.35	72.08	66.13	61.03	56.65	52.91	49.60	46.67	44.07
4.50	140.00	119.97	104.99	93.33	84.02	76.32	70.02	64.62	59.99	56.03	52.52	49.41	46.67
4.75	147.77	126.64	110.82	98.52	88.68	80.56	73.91	68.21	63.32	59.14	55.43	52.16	49.26
5.00	155.55	133.30	116.65	103.70	93.35	84.80	77.80	71.80	66.65	62.25	58.35	54.90	51.85
5.25	163.33	139.97	122.48	108.89	98.02	89.04	81.69	75.39	69.98	65.36	61.27	57.65	54.44
5.50	171.11	146.63	128.32	114.07	102.69	93.28	85.58	78.98	73.32	68.48	64.19	60.39	57.04
5.75	178.88	153.30	134.15	119.26	107.35	97.52	89.47	82.57	76.65	71.59	67.10	63.14	59.63
6.00	186.66	159.96	139.98	124.44	112.02	101.76	93.36	86.16	79.98	74.70	70.02	65.88	62.22
6.25	194.44	166.63	145.81	129.63	116.69	106.00	97.25	89.75	83.31	77.81	72.94	68.63	64.81
6.50	202.22	173.29	151.65	134.81	121.36	110.24	101.14	93.34	86.65	80.93	75.86	71.37	67.41
6.75	209.99	179.96	157.48	140.00	126.02	114.48	105.03	96.93	89.98	84.04	78.77	74.12	70.00
7.00	217.77	186.62	163.31	145.18	130.69	118.72	108.92	100.52	93.31	87.15	81.69	76.86	72.59

'* The 8% allowance accounts for overpouring, spillage, waste, and breakage.

PROCEEDS FROM SALES FROM ONE LITER BOTTLE OF DISTILLED SPIRITS

EXHIBIT 10

Anticipated Proceeds From Sale of Drinks

One Liter Bottle

	Pour Size - in Ounces												
	3/4	7/8	1	1 1/8	1 1/4	1 3/8	1 1/2	1 5/8	1 3/4	1 7/8	2	2 1/8	2 1/4
Drinks Per Bottle	45.09	38.65	33.81	30.06	27.05	24.59	22.54	20.81	19.32	18.03	16.91	15.91	15.03
* 8% Allowance	3.61	3.09	2.70	2.40	2.16	1.97	1.80	1.66	1.55	1.44	1.35	1.27	1.20
Net Drinks	41.48	35.56	31.11	27.66	24.89	22.62	20.74	19.15	17.77	16.59	15.56	14.64	13.83
Price per Drink	Proceeds From Sales												
1.00	41.48	35.56	31.11	27.66	24.89	22.62	20.74	19.15	17.77	16.59	15.56	14.64	13.83
1.25	51.85	44.45	38.89	34.58	31.11	28.28	25.93	23.94	22.21	20.74	19.45	18.30	17.29
1.50	62.22	53.34	46.67	41.49	37.34	33.93	31.11	28.73	26.66	24.89	23.34	21.96	20.75
1.75	72.59	62.23	54.44	48.41	43.56	39.59	36.30	33.51	31.10	29.03	27.23	25.62	24.20
2.00	82.96	71.12	62.22	55.32	49.78	45.24	41.48	38.30	35.54	33.18	31.12	29.28	27.66
2.25	93.33	80.01	70.00	62.24	56.00	50.90	46.67	43.09	39.98	37.33	35.01	32.94	31.12
2.50	103.70	88.90	77.78	69.15	62.23	56.55	51.85	47.88	44.43	41.48	38.90	36.60	34.58
2.75	114.07	97.79	85.55	76.07	68.45	62.21	57.04	52.66	48.87	45.62	42.79	40.26	38.03
3.00	124.44	106.68	93.33	82.98	74.67	67.86	62.22	57.45	53.31	49.77	46.68	43.92	41.49
3.25	134.81	115.57	101.11	89.90	80.89	73.52	67.41	62.24	57.75	53.92	50.57	47.58	44.95
3.50	145.18	124.46	108.89	96.81	87.12	79.17	72.59	67.03	62.20	58.07	54.46	51.24	48.41
3.75	155.55	133.35	116.66	103.73	93.34	84.83	77.78	71.81	66.64	62.21	58.35	54.90	51.86
4.00	165.92	142.24	124.44	110.64	99.56	90.48	82.96	76.60	71.08	66.36	62.24	58.56	55.32
4.25	176.29	151.13	132.22	117.56	105.78	96.14	88.15	81.39	75.52	70.51	66.13	62.22	58.78
4.50	186.66	160.02	140.00	124.47	112.01	101.79	93.33	86.18	79.97	74.66	70.02	65.88	62.24
4.75	197.03	168.91	147.77	131.39	118.23	107.45	98.52	90.96	84.41	78.80	73.91	69.54	65.69
5.00	207.40	177.80	155.55	138.30	124.45	113.10	103.70	95.75	88.85	82.95	77.80	73.20	69.15
5.25	217.77	186.69	163.33	145.22	130.67	118.76	108.89	100.54	93.29	87.10	81.69	76.86	72.61
5.50	228.14	195.58	171.11	152.13	136.90	124.41	114.07	105.33	97.74	91.25	85.58	80.52	76.07
5.75	238.51	204.47	178.88	159.05	143.12	130.07	119.26	110.11	102.18	95.39	89.47	84.18	79.52
6.00	248.88	213.36	186.66	165.96	149.34	135.72	124.44	114.90	106.62	99.54	93.36	87.84	82.98
6.25	259.25	222.25	194.44	172.88	155.56	141.38	129.63	119.69	111.06	103.69	97.25	91.50	86.44
6.50	269.62	231.14	202.22	179.79	161.79	147.03	134.81	124.48	115.51	107.84	101.14	95.16	89.90
6.75	279.99	240.03	209.99	186.71	168.01	152.69	140.00	129.26	119.95	111.98	105.03	98.82	93.35
7.00	290.36	248.92	217.77	193.62	174.23	158.34	145.18	134.05	124.39	116.13	108.92	102.48	96.81

'* The 8% allowance accounts for overpouring, spillage, waste, and breakage.

Date Published

PROCEEDS FROM SALES OF BOTTLED BEER — EXHIBIT 11

Anticipated Proceeds From Sale of
Bottled Beer

	Number of Bottles Per Case			
Price per Bottle	**12**	**18**	**24**	**36**
1.00	12.00	18.00	24.00	36.00
1.25	15.00	22.50	30.00	45.00
1.50	18.00	27.00	36.00	54.00
1.75	21.00	31.50	42.00	63.00
2.00	24.00	36.00	48.00	72.00
2.25	27.00	40.50	54.00	81.00
2.50	30.00	45.00	60.00	90.00
2.75	33.00	49.50	66.00	99.00
3.00	36.00	54.00	72.00	108.00
3.25	39.00	58.50	78.00	117.00
3.50	42.00	63.00	84.00	126.00
3.75	45.00	67.50	90.00	135.00
4.00	48.00	72.00	96.00	144.00
4.25	51.00	76.50	102.00	153.00
4.50	54.00	81.00	108.00	162.00
4.75	57.00	85.50	114.00	171.00
5.00	60.00	90.00	120.00	180.00
5.25	63.00	94.50	126.00	189.00
5.50	66.00	99.00	132.00	198.00
5.75	69.00	103.50	138.00	207.00
6.00	72.00	108.00	144.00	216.00
6.25	75.00	112.50	150.00	225.00
6.50	78.00	117.00	156.00	234.00
6.75	81.00	121.50	162.00	243.00
7.00	84.00	126.00	168.00	252.00

Note: No overpour or spillage allowance is given on sales of bottled (or canned) drinks.

However, the standard 1% allowance for pilferage is given after adjusting for self consumption. To compute anticipated proceeds, multiply the sales price times the number of units per case.

PROCEEDS FROM SALES OF DRAFT BEER — EXHIBIT 12

Anticipated Proceeds From Sale of
One Half (1/2) Keg (1,984 ounces) of Draft Beer

Size of Glass (oz)	6	8	10	12	14	16	18	20	22	24	32
Number of Drinks	330.67	248.00	198.40	165.33	141.71	124.00	110.22	99.20	90.18	82.67	62.00
*3% overpour & spillage	9.92	7.44	5.95	4.96	4.25	3.72	3.31	2.98	2.71	2.48	1.86
Net Drinks	320.75	240.56	192.45	160.37	137.46	120.28	106.91	96.22	87.47	80.19	60.14

Price per Drink	Proceeds From Sales										
1.00	320.75	240.56	192.45	160.37	137.46	120.28	106.91	96.22	87.47	80.19	60.14
1.25	400.93	300.70	240.56	200.47	171.83	150.35	133.64	120.28	109.34	100.23	75.18
1.50	481.12	360.84	288.68	240.56	206.20	180.42	160.37	144.33	131.21	120.28	90.21
1.75	561.31	420.98	336.79	280.65	240.56	210.49	187.10	168.39	153.08	140.33	105.25
2.00	641.49	481.12	384.90	320.75	274.93	240.56	213.82	192.44	174.94	160.37	120.28
2.25	721.68	541.26	433.01	360.84	309.29	270.63	240.55	216.50	196.81	180.42	135.32
2.50	801.87	601.40	481.13	400.93	343.66	300.70	267.28	240.55	218.68	200.47	150.35
2.75	882.05	661.54	529.24	441.03	378.03	330.77	294.01	264.61	240.55	220.51	165.39
3.00	962.24	721.68	577.35	481.12	412.39	360.84	320.74	288.66	262.42	240.56	180.42
3.25	1042.43	781.82	625.46	521.21	446.76	390.91	347.46	312.72	284.28	260.61	195.46
3.50	1122.61	841.96	673.58	561.31	481.13	420.98	374.19	336.77	306.15	280.65	210.49
3.75	1202.80	902.10	721.69	601.40	515.49	451.05	400.92	360.83	328.02	300.70	225.53
4.00	1282.99	962.24	769.80	641.49	549.86	481.12	427.65	384.88	349.89	320.75	240.56
4.25	1363.17	1022.38	817.91	681.59	584.22	511.19	454.38	408.94	371.76	340.79	255.60
4.50	1443.36	1082.52	866.03	721.68	618.59	541.26	481.11	432.99	393.62	360.84	270.63
4.75	1523.55	1142.66	914.14	761.77	652.96	571.33	507.83	457.05	415.49	380.89	285.67
5.00	1603.73	1202.80	962.25	801.87	687.32	601.40	534.56	481.10	437.36	400.93	300.70
5.25	1683.92	1262.94	1010.36	841.96	721.69	631.47	561.29	505.16	459.23	420.98	315.74
5.50	1764.11	1323.08	1058.48	882.05	756.05	661.54	588.02	529.21	481.10	441.03	330.77
5.75	1844.29	1383.22	1106.59	922.15	790.42	691.61	614.75	553.27	502.96	461.07	345.81
6.00	1924.48	1443.36	1154.70	962.24	824.79	721.68	641.47	577.32	524.83	481.12	360.84
6.25	2004.67	1503.50	1202.81	1002.33	859.15	751.75	668.20	601.38	546.70	501.17	375.88
6.50	2084.85	1563.64	1250.93	1042.43	893.52	781.82	694.93	625.43	568.57	521.21	390.91
6.75	2165.04	1623.78	1299.04	1082.52	927.88	811.89	721.66	649.49	590.43	541.26	405.95
7.00	2245.23	1683.92	1347.15	1122.61	962.25	841.96	748.39	673.54	612.30	561.31	420.98

*The 3% allowance consists of overpour, spillage, and waste (e.g., inaccessible beer left in keg, cleaning lines, waste in tapping a new keg, etc.). Claims for amounts greater than 3% must be clearly explained and well documented.

Date Published

METRIC STANDARDS AND THEIR U.S. SIZES FOR CONTAINERS EXHIBIT 13

Wine Metric Standards

Metric Size	Fluid Ounces	U.S. Size Near Equivalent	Fluid Ounces	Bottles Per Case
3 Liters	101	Jeroboam	102.4	4
1.5 Liters	50.7	Magnum	51.2	6
1 Liter	33.8	Quart	32	12
750 Mililiters	25.4	Fifth	25.6	12
375 Mililiters	12.7	Tenth	12.8	24
187 Mililiters	6.3	Split	6.4	48
100 Mililiters	3.4	Miniature	2	60

There are no new metric equivalents for wines in the following U.S. sizes:

U.S. Size	Fluid Ounces
One Gallon	128
Half Gallon	64
Pint	16

Distilled Spirits Metric Standards

Metric Size	Fluid Ounces	U.S. Size Near Equivalent	Fluid Ounces	Bottles Per Case
1.75 Liters	59.2	1/2 Gallon	64	6
1 Liter	33.8	Quart	32	12
750 Mililiters	25.4	Fifth	25.6	12
500 Mililiters	16.9	Pint	16	24
200 Mililiters	6.8	1/2 Pint	8	48
50 Mililiters	1.7	Miniature	1.6	120

POUR COST CONVERSION CHART

EXHIBIT 14

POUR COST PERCENTAGE	GROSS PROFIT MARGIN	MARK-UP PERCENTAGE
10	90	900
11	89	809.09
12	88	733.33
13	87	669.23
14	86	614.29
15	85	566.67
16	84	525
17	83	488.24
18	82	455.56
19	81	426.32
20	80	400
21	79	376.19
22	78	354.55
23	77	334.78
24	76	316.67
25	75	300
26	74	284.62
27	73	270.37
28	72	257.14
29	71	244.83
30	70	233.33
31	69	222.58
32	68	212.50
33	67	203.03
34	66	194.11
35	65	185.71
40	60	150
50	50	100

EXAMPLE:

SALE	= $50
COST	= $10
GROSS PROFIT	= $40
MARKUP (GP/COST)	= 400%

PROOF:

100% - 20% (PC)	= 80% (GP)
80% (GP) / 20% (PC)	= 400% Markup

BAR SHORT TEST — CASE PROBLEM

A Bar Short Test will be compiled from the facts below:

Purchases and Sales Information

The purchase cycle for this case problem is one month. Selling price per drink and pour size were scheduled from Bar Fact Sheet.

Description	Purchases (Month)	Selling Price/drink (tax inc)	Pour Size
Well whiskey, Ltr ($175/cs)	$2,800	$ 3.00	1.5 oz
Call whiskey, Ltr ($225/cs)	1,125	4.00	1.5 oz
Cocktails, Ltr ($175/cs)	1,750	5.00	2.0 oz
Beer: Domestic, draft ($80/ ½ keg)	1,040	2.00	10 oz
Beer: Domestic, bottled ($13/cs)	325	2.50	12 oz
Beer: Domestic, off-sale ($13/cs)	91	10.00	6 pack
Beer: Premium, bottled ($16/cs)	192	3.00	12 oz
Total Purchases	$7,323		

Self-consumption (SC)

$100 per month; $1,200 per year (well liquor)

Recorded Markup

	Cost of Goods Sold	Recorded/Reported Total Sales, tax inc	Recorded Markup (adjusted for SC)
1998	$69,741	$226,322	230.20 %
1999	$74,390	$253,530	246.40 %
2000	$79,039	$267,766	244.00 %

Purchase Percentages: Test period of one month

Purchases: test period of one month

Description	Total Cost	Percentage of Total
Liquor: Well ($2,800-100)	$2,700	37.38
Liquor: Call	1,125	15.57
Cocktails: Well	1,750	24.23
Beer: Domestic bottled	325	4.50
Beer: Domestic, draft	1,040	14.40
Beer: Domestic, off-sale	91	1.26
Beer: Premium, bottled	192	2.66
Total (net of self-consumption)	$7,223	100.00

Bar Short Test — Case Problem

Exhibit 15
Page 2 of 3

Expected Markup

Description	Cost	Selling Price (tax inc)	Markup Factor (tax inc)	Markup (tax inc)
Well, Ltr (12/cs)	$175	$746.64	426.65	326.65
Call, Ltr (12/cs)	225	995.52	442.45	342.45
Cocktails (Well liquor, 12/cs)	175	933.60	533.49	433.49
Beer: Domestic bottled (24-12oz/cs)	13	60.00	461.54	361.54
Beer: Domestic canned, off-sale (24-12oz/cs)	13	40.00	307.69	207.69
Beer: Domestic draft ½ keg	80	384.90	481.13	381.13
Beer: Premium, bottled (24-12oz/cs)	16	72.00	450.00	350.00

Solution

A	B	C	D	E	F
Year	Weighted Markup per Bar Short Test	Weighted Markup per Records	Difference	Weighted Markup Factor per Records	Percent of Error
			(B - C)	(C + 100%)	(D / E)
1998	363.53	230.20	133.33	330.20	40.38
1999	363.53	246.40	117.13	346.40	33.81
2000	363.53	244.00	119.53	344.00	34.75

Key Points

1. The weighted markup per Bar Short Test and the weighted markup per Records are both tax included.
2. Self-consumed merchandise and bar supplies are excluded before computing purchase percentages.
3. Computations are generally made on tax included basis.
4. Reconciliation between the weighted markup per the Bar Short Test and the Markup Per Records should be on the same basis (i.e., tax included or ex tax).
5. The anticipated proceeds from sales of one-liter bottles of distilled spirits (i.e., selling price per case) were scheduled from Exhibit 10.

BOE–1311–A REV 3 (12–00)

BAR SHORT TEST SHEET

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

TAXPAYER NAME | ACCOUNT NUMBER | CASE NUMBER

DBA | TELEPHONE NUMBER

AUDITOR | DATE

RECORDS AT

INFORMATION NEEDED TO SUPPORT MARKUP COMPUTATIONS OBTAINED FROM

Type of Drink		SALES PRICE	OZ. SERVED	(A) % OF TOTAL PURCHASES	(B) EXPECTED MARKUP	WEIGHTED MARKUP (A x B)
Well	BRAND Whiskey	3.00	1.5	37.38 %	326.65 %	122.10 %
Call	BRAND Whiskey	4.00	1.5	15.57 %	342.45 %	53.32 %
Cocktails (2 or more liquors)	BRAND(S) Gin/Vodka	5.00	2.0	24.23 %	433.49 %	105.03 %
Wine/ Liqueurs	BRAND			%	%	%
Beer - Domestic	BOTTLED/CANNED Bottled/canned	2.50	12	4.50 %	361.54 %	16.27 %
	BOTTLED/CANNED OFF-SALE Off-sale	10.00	12	1.26 %	207.69 %	2.62 %
	DRAFT GLASS Draft glass	2.00	10	14.40 %	381.13 %	54.88 %
	DRAFT GLASS			%	%	%
	DRAFT PITCHER			%	%	%
	DRAFT PITCHER			%	%	%
Beer - Premium/ Microbrew	BOTTLED/CANNED Bottled/canned	3.00	12	2.66 %	350.00 %	9.31 %
	BOTTLED/CANNED OFF-SALE			%	%	%
	DRAFT GLASS			%	%	%
	DRAFT GLASS			%	%	%
	DRAFT PITCHER			%	%	%
	DRAFT PITCHER			%	%	%
TOTAL WEIGHTED MARKUP	☒ Tax included Ex Tax ☐					363.53 %

MARKUP PER RECORDS

(Adjusted for Self-Consumed) ☒ *Tax included* *Ex Tax* ☐

YEAR OF	1998	230.20 %	YEAR OF	2000	244.00 %
YEAR OF	1999	246.40 %	AVERAGE	Average	240.20 %

SELF-CONSUMED MERCHANDISE

Self-consumed merchandise of $ 100 /mo, or $ 1,200 /yr. excluded before computing the percentage of total purchases and the markup per records.

COSTING OUT A MENU ITEM **EXHIBIT 16**

Schedule_________________Page________
Account No. ________________________
Case No.____________________________
Auditor__________________Date________

Name of Item: Filet Mignon Dinner

REF	A	B	C	D	E
	Description	**Unit**	**Unit Price**	**Portion**	**Cost per Portion**
	Filet (85% yield)	**1 lb.**	**$ 8.00/lb**	**8 oz.**	**$ 4.71**
	Baked Potato	**Each**	**$ .20**	**1**	**$ .20**
	Vegetable	**1 lb..**	**$ .80**	**4 oz.**	**$ .20**
	Butter	**1 1b.**	**$ 2.00**	**2 oz.**	**$ .25**
	Sour Cream	**Qt.**	**$ 1.50**	**3 oz.**	**$ .05**
	Salad-lettuce	**Head**	**$ 1.30**	**4 servings**	**$ .33**
	Dressing	**Qt.**	**$ 3.50**	**2 oz.**	**$ .22**
	Sub-Total				**$ 5.96**
	ADD: Waste, Spoilage, Spices, etc.(based on a %)				**.60**
	Total Portion Cost				**$ 6.56**

	Selling Price	**$17.99**
	Portion Cost	**$ 6.56**
	Gross Profit	**$11.43**
	Markup on Cost	**174.24%**

Comment:
This cut of filet mignon yields a serving 85% of its total weight. Therefore, one pound (16 oz) will actually yield 13.6 ounces. At $8.00/lb, each ounce costs approximately $.588. Serving size per dinner is 8 oz. 8 oz. x $.588 = $4.71 per serving cost of filet.

Additional Information:
- **16 ounces to 1 pound**
- **32 ounces to 1 quart**
- **128 ounces to 1 gallon**
- **#10 can equal 103.7 ounces**
- **#303 can equals 15.6 ounces**

DECISION CHART: COMPLIMENTARY FOOD AND BEVERAGES EXHIBIT 17

Process to determine if formula as set forth in Regulation 1603(a) is controlling.

If the complimentary meals are provided in an area of the hotel where food and beverages are sold on a regular basis to the general public, the following decision chart should be used to decide whether the formula in Regulation 1603(a) applies and is controlling. If the meals are not provided in such an area, the formula should be applied to determine whether the hotel is the consumer or retailer of the complimentary meals provided.