



The high points

- A detailed business profile will help determine if there's employee skimming, if the owner is under-reporting sales to evade taxes and other liabilities, or a combination of both.
- Some restaurant employees rationalize and justify the theft of receipts because they see their employers remove funds from the businesses without recording the sales.
- A restaurant's cash register will contain the all-important Z Report, which contains a summation of most sales activity during a certain period.
- If Z Tapes, register journal tapes, or reports containing the Gross Totals from those tapes can be located, the income of the business often can be determined.
- Restaurants using electronic recording of credit and debit card transactions also generate a journal report of those transactions. Discrepancies are often apparent when comparing the credit card journal tapes with the cash register journal tapes.

Restaurant skimming TAKING A LITTLE CREAM OFF THE TOP

With a little cash register magic, restaurant employees and owners can slyly skim receipts and decrease taxes. Here's how to catch them at their game.

SALLY, THE CASHIER, WAS A HAPPY WOMAN. HER SALARY AT THE SUCCESSFUL CAP'N BUDDY'S SEAFOOD RESTAURANT WASN'T LARGE BUT SHE HAD FOUND WAYS TO "SUPPLEMENT" IT.

One of her favorite schemes was to cut out Cap'n Buddy 10 percent discount coupons from the newspaper, apply them to diners' bills, and then pocket the cash later.

But she wasn't the only one stealing. Cap'n Buddy's owner, Fred, was routinely underreporting sales to the state and local tax authorities and realizing a fine profit. Both Sally and Fred were skilled in the fine art of "skimming."¹

Restaurant skimming by employees and owners amount to thousands of dollars annually in losses both to restaurants and citizens. Often fraud examiners, auditors, and investigators fail to recognize the many criminal violations that can be found in this type of transaction. In addition to the obvious tax violations, the skimming often involves more serious violations (such as postal infractions, and banking, structuring, and conspiracy violations) that are often easier to prosecute than income tax violations.

Profiling suspicious restaurants and employees

In preparing business profiles of suspected restaurants, it's essential to obtain the following information:

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- 1) excise tax rates of the taxing agencies;
- 2) the method of determining the cost of any required business licenses to determine if the cost of those licenses are based on generated revenue;
- 3) the method of filing required reports and remittance of required taxes; and
- 4) a review of the business operations to determine if the taxes are assessed and collected on the sales. This is essential to show larceny. If the merchant fails to collect the tax, some courts have ruled that no larceny has occurred. This wouldn't relieve the merchant of the responsibility of reporting all sales, and the use of the U.S. Postal Service to assist in those fraudulent returns could constitute mail fraud violations.

The business profile will help determine if there's employee skimming, if the owner is underreporting sales to evade taxes and other liabilities, or a combination of both.

As a state government agent, I have the advantage of obtaining reports of filings with other governmental agencies, which include the State Alcoholic Beverage Control and the Virginia Department of Taxation. I compare those reports for consistency and also the reported sales with physical observations of the business.

Determination of alcoholic beverage sales is a unique challenge. Wholesale alcoholic beverage distributors are required to provide my agency with records of all alcohol purchases. Those purchases, extended by markup, can provide evidence of substantial underreporting of sales. This information is available to the auditor who has access to the business records.

A major obstacle is determining the amount of alcohol used in the finished product and the price charged for that product. This can be ascertained by interviewing management, observing the operation, and scheduling the products based on the menu price.

Employee theft can be profiled by changes in ratios when management controls are relaxed. These could include increased refunds, No Sale activity, voids, and abnormal use of discounts.

As with other retail businesses, the restaurant owner would be wise to listen to complaints from customers about product quality and unusual employee conduct. It's not uncommon for a waiter or bartender (and often noticed by the customer) to substitute or add water to liquor to cover the theft of products or receipts from the business.

Employee skimming

Many restaurant employees view their employers as affluent and unconcerned about their plight and they often see their employers removing funds from the businesses without recording the sales. All of this can cause some employees to rationalize and justify the theft of business receipts.

Restaurant employees often are part of a transient labor pool. Many have had the opportunity to master the skills of embezzling of sales revenue. Their methods range from the

simple theft of recorded cash from the register to unique methods to mask the theft of funds. When the owner is absent from the business and relies on employees to perform the tasks of management, the risk of employee theft greatly increases. Some methods include:

- 1) cash paid out and cash refund schemes;
- 2) failure to record the sale, or underreport the sales amount; and
- 3) recording discounts to sales when no discount was given.

A favorite of servers in tourist markets, as described in the lead-in case history, is to cut restaurant discount coupons from local publications and apply those discounts to cash sales. A 10 percent discount on high-priced restaurant bills kept by fraudster employees adds up to major losses.

A dishonest employee is hesitant to skim receipts in the presence of customers or other employees but will often record part of the sale, open the register, deposit the total receipts, and make a mental note of the amount of the overage that he or she will remove at a more convenient time. The best way to foil this scheme is to have unannounced surprise cash counts to insure the proper recording of sales.

Many restaurant operators often will require repayment of cash shortages. However, the vigilant employer would be remiss to allow any employee to accumulate any overages. Excess cash can only be created through shortchanging customers or placing funds into the register without recording the sale, neither of which would be in the best interest of the restaurant.

Owner skimming

Owner skimming is defined as the failure of a business to report total receipts to governmental taxing agencies for the purpose of evading or reducing tax liability. This would include schemes to evade income taxes as well as underreporting fiduciary funds collected by the business and held in trust for the taxing agency. (There are additional motives and benefits of not reporting all gross receipts. They include defrauding landlords in percentage leases, insurance carriers in rate determination, and creditors attempting to collect on prior debts.)

My investigations have been limited to persons and businesses operating in the state of Virginia. In Virginia, as in most states, sales are assessed as an excise tax or sales tax payable by the purchaser at the time of purchase. Many localities require the payment of local food and beverage tax as well as an annual business license tax, the cost of which is often based on the gross receipts of the prior year.

With state and local sales taxes, the merchant enters into an agreement with the taxing agency in which the merchant agrees to act as an agent for the government, collects the taxes due from the purchaser, holds those funds for the government agency, then files periodic reports of sales (usually monthly), and remits the taxes collected. In many localities the combined restaurant food and beverage sales taxes often exceed 10 percent of the products sold.

Each monthly filing of sales, and the taxes collected, that underreports the amount of sales and subsequently fails to remit collected taxes contains the elements of the crimes of fraud and larceny, or embezzlement, of fiduciary funds. With the amount of monies involved, the threshold for the crime to be punishable as a felony is easily reached.

In my experience, successful restaurant operators keep detailed records of sales and related expenses. Operating a cash-based business, they know the need for monitoring costs and the income generated from the operation of the business. The goal for the fraud examiner is to locate those records to accurately determine business activity. In the absence of complete records, the fraud examiner must arrive at a determination of the revenue and expense using the best information available, and then present that information in a manner understandable to the reviewer.

as "Z1 0001." Gross Totals probably will be recorded in a continually increasing amount. The sales of the period being cleared are added to the prior period sales, which provide a cumulative total for the register. (An easy way to visualize this feature is to compare it to the odometer of an automobile with the trip odometer recording period miles and the primary odometer recording total miles. Just like a primary automobile odometer, the Gross Total isn't designed for the user to reset or clear the cumulative total.)

Also, most registers are able to produce an "X" report, which shows activity up to any point in the reporting period but doesn't reset the registers.

Journal tape option

Many registers produce a "journal" tape, which reports all transactions at the time of cash register activity. In addition

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A restaurant generating significant sales, and depending on employees, routinely records those sales in its cash registers. Cash registers range from the most basic devices that record sales and store receipts to elaborate computerized systems which generate kitchen or bar orders instructing the service personnel the products to be prepared, prepare guest checks, and record sales in extreme detail. Regardless of the type of cash register, a common feature is an internal memory summarizing sales at the end of the sales period, which is normally daily. When different employees use the register, those summations are often done at the end of an employee's work shift with the cash counted and the register drawer balanced. At that time, overages and shortages are reconciled, and a report is often generated for management.

All-important Z Reports

Most cash registers are cleared by "Z-ing out." "Z" is an industry term used to designate the final activity of the reporting period and indicates that the register has been reset.

When management, or those who management authorizes, Z out the register, the results are reported in a "Z Report," which has the letter Z printed on it and a heading indicating that it's a final report of sales activity. Depending upon the cash register and the manner in which it was programmed, the Z Report will contain a summation normally including sales, refunds, discounts, and No Sale activity.

Each Z Report may be assigned a progressive number such

to sales activity, the journal tape will usually record the restaurant-clearing activities, including the Z Report with the Gross Totals. This tape is usually maintained inside the register and removed when it reaches capacity. In the more advanced systems, the journal report is maintained electronically in the register. So if this type of cash register is seized as evidence, the electric power must be restored as soon as possible. This type of register has a back-up battery for power interruptions.

The income of the business often can be determined if Z Tapes, register journal tapes, or reports containing the Gross Totals from those tapes can be located. The earliest total is subtracted from the latest and added to the first report of daily sales activity, which equals total sales income for the period. When using this method, it isn't essential that all the tapes or daily reports are located, as long as a sufficient number of Gross Total readings are available to validate the findings. Sales can be determined by subtracting a beginning tape an ending tape.

In an investigation of the owners of several Virginian nightclubs, we made a long-term commitment to research their sales activities without them being aware. We were able to reconstruct discarded, shredded documents, which established period sales of the businesses.

While many of the daily sales amounts weren't available,

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the recovered Gross Total figures were sufficient to establish sales for the year. This evidence resulted in convictions in federal court for numerous offenses including obstruction of justice, money laundering, income tax evasion, and maintaining unreported foreign bank accounts, along with the recovery of a substantial amount of unreported taxes.

However, in the most advanced systems that are capable of producing a tape or disk backup, it's possible for unscrupulous business owners to reset the Gross Totals and other counters using this method:

1. The cash register system must have the capability of having the information downloaded from an internal hard drive.
2. The system must allow the backup disks to update the register system if internal data is lost.
3. The fraudster purposely crashes the system often by removing its power supply and backup.
4. The fraudster then reboots the system with a backup disk from an earlier period, which removes any sales activity for the time period between the time of the original backup and the time of the crash.

The system of recording sales may be less structured at a restaurant in which the owner is also the operator. When visiting these restaurants, it's not uncommon to see cash deposited directly into an open register drawer or observe a sale recorded as a No Sale. The business uses the register totals to report sales and those reports understate sales. While this situation makes it harder to determine sales, it can still be done.

In addition to the cash register Z tape, restaurants using electronic recording of credit and debit card transactions generate a journal report of those transactions, normally daily, often when the cash register is cleared. The credit card journal report lists all activity by time, unique control number of each transaction, amount, and type of card used.

Discrepancies are often apparent when comparing the credit card journal tape with the cash register journal tape. Both the cash register journal tape and the credit card journal tape will record the transaction by time. There's evidence that all the sales income of the business isn't recorded in the cash register when the credit card journal indicates a transaction at a specific time and the corresponding cash register journal shows no activity or a No Sale entry.

The value of No Sale transactions can be established by totaling the credit card transactions not recorded in the cash register and dividing that amount by the number of transactions to determine the average sale of each transaction. That amount is then multiplied by the total number of No Sale transactions to obtain the amount of the unrecorded sales. A second method involves subtracting recorded credit card sales from the recorded gross sales, which produces a total of recorded cash sales. That amount is then divided by the num-

ber of recorded cash sales to determine the average cash sale value, which is multiplied by the number of No Sale transactions less the number of known No Sale credit card sales.

This method won't be successful in those incidents where the receipts are deposited into an "open" register. However, comparing the credit card journal tape to the cash register journal tape should produce evidence of credit card activity that isn't recorded in the cash register. While there isn't a record of the number of transactions, because the drawer was open and the money was deposited directly into it, a case can be developed. The mere evidence of sales that aren't reported should support a case of underreporting of sales.

The value of those sales may be limited to the credit card transactions not recorded in the cash register; however, it does show the evidence of underreporting of gross receipts. Assuming that a summary that doesn't include unreported sales is forwarded to the taxing authority by use of the U.S. Postal Service, the major elements of the mail fraud charge are present.

When retrieving the cash register reports, credit card journals, and other evidence involving the use of cash registers, the fraud examiner should attempt to recover the following:

1. available cash register journal tapes including the journal tape that may be in the cash register;
2. credit card journal tapes and any individual credit card reports;
3. customer guest checks of completed sales to compare with the activity recorded on the cash register journal tape; and
4. backup media for computerized register systems.

When retrieving the documents, compare the date and time used by the cash register with the date and time used by the credit card terminal. This will be vital in the later comparison of the two reports. After a thorough review and analysis, the true character of the business often can be developed.

Skim no more

Though many restaurant employees and owners are skilled at skimming revenue, fraud examiners can catch them at their games by securing sales activity records on cash registers. Though the more sophisticated fraudsters can electronically change receipts, most registers contain enough evidence to nab the guilty and prevent them from skimming any more cream. 🔍

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¹ This fictitious case is used for illustrative purposes.