

*Ronald Kublawi's*

Appeal Considerations to the Restitution Hearing

&

Circuit Court Order by the City of Fredericksburg

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## **Summary**

## **Court Considerations to the City's Arguments**

Beyond the primary attempt of enforcing and justifying the so-called "A Liquor Purchase Mark-Up Audit" by the City before the Judge, the following alleged accusations were brought forward to augment the City's position during the hearing:

1. The POS System: An attempt to accuse the Defendant of operating a Point-of-Sale (POS) register off-line suggesting that substantial amount of cash sales were not recorded. This was easily refuted by explaining that all POS stations are networked to a primary server. The software, "Restaurant Manager", is solely installed on the server and not a single POS station can operate independently.
2. Comps & Discounts: Defendant was accused of giving-away substantial comps, thereby intentionally reducing a large amount of sales that could have generated additional meals tax income to the City. This was argued through the company's policy of discounts, returns and allowances. It is clearly admitted that the discount policy of 7% of sales is relatively high when compared with other establishments, but as an independent operation, Uncle Sam's is limited in its advertising budget to compete with corporate franchise-owned operations and its discount programs are a simple substitute to advertising, marketing or promotional expenses. It was further demonstrated that such legitimate discount programs ranged from coupons offering buy one get one free meal, buy an adult meal get a free kid's meal, selected credit card membership coupons, Sunday brunch & daily specials, happy hour menu reduced pricing, reduced room rental fees for first time corporate banquet bookings, free meals for blood donors and so forth.

3. Cash Registers: The City's auditor lied under oath, accusing defendant of not producing daily cash registers to support the sales tax returns. The auditor further argued that 60% of total sales were in the form of cash and 40% in the form of credit card deposits, thereby suggesting that the business never deposited the cash portions in the bank in order to under report sales collected. Defendant insisted that daily cash registers were provided but never inspected. Had such cash registers been properly inspected, the auditor would have satisfactorily concluded that cash never made it to the bank and was retained in-house for the purpose of purchasing weekly inventories, because neither the ABC liquor store nor the Beer suppliers would accept business checks due to the lack of Uncle Sam's credit worthiness in the midst of its Chapter-11 bankruptcy re-organization.
4. Liquor Unit Pricing: In determining the average liquor unit price for the 1.6 million drinks poured during the period from September 2002 through April 2007, the auditor convinced the Judge that she conducted a thorough review of every year's liquor prices and the make-up of every possible liquor menu item. First, it is virtually impossible to conduct such a review in the mere half an hour visit the auditor spent at Uncle Sam's. Second, it was proven that the only sales records, removed by the auditor from Uncle Sam's office at a later visit, related to a selected data for the period April through August of 2006 only.
5. The 2006 Prior Plea Agreement: The opening and misleading statement by the Commonwealth Attorney suggested that the Defendant had accepted a Plea "Guilty-Plea" agreement prior to the restitution hearing in the amount of \$16,000 payable in monthly installments of \$500 each. Such a Plea related to an alleged liability of \$48,000 for the year 2006 whereby all three LLC members equally

shared. In fact, the three members did accept a Plea for purposes of avoiding the risk of criminal felony charges, but unfortunately, the Public attorney failed to emphasize that such a prior Plea was a “No Guilty” charge. As a result, the judge was initially influenced to believe that the Defendant might possibly be equally guilty for the restitution audit years of 2002 through 2005.

6. Diversion of Trust Funds: As far as the alleged liability of 2006, a certified check in the amount of \$25,393.22 was hand delivered to the City Commissioner and Auditor at Uncle Sam’s. Attached to the check was a spreadsheet detailing the make-up of the check to include: meals taxes, admission taxes, interest and penalties for March, April, May and June of 2006. The Commissioner turned the check over to the City Treasurer who applied the full amount to corporate business license and personal property tax alleged liabilities. Under oath, all of the Treasurer, Commissioner and Auditor denied receipt of the attached spreadsheet. Such diversion of funds leaves the LLC members exposed to the meals and admissions tax trust funds. Contrary to the meals and admissions trust funds, corporate license fees and corporate property taxes do not constitute criminal exposure. Consequently, the judge denied the credit of \$25,393.22 to the Defendant and neglected the fact that this check was not an even \$25,000 advance payment of some sort, but should rather constitute a very specific allocation and utilization of funds.
7. MBAR Reports: The single most significant emphasis by the City focused on the MBAR(s), The Virginia Alcohol Beverage Control (ABC) Mixed Beverage Annual Reports. The MBAR is a mere one page annual summary filed to VA ABC by a Liquor Licensee intended for purposes of annually renewing the liquor license. The MBAR simply summarizes monthly sales broken down by liquor,

food, beer, wine and miscellaneous items. It also includes total annual purchases of liquor, food, beer and wine. The VA ABC board reviews this report to ensure that the licensee is complying with the food/liquor ratios. The City's auditor did not conduct a truly sales audit recognized by GAAP (Generally Accepted Accounting Principles). Instead, she relied on the MBAR reports to determine that the MBAR sales figures exceeded the City Meals Tax Return sales figures by approximately \$2 million, thereby alleging that the Defendant has committed fraud by understating sales to the City and deprived the City from additional meals tax revenues. Even the Public Attorney himself could not comprehend the reconciling differences constituting the \$2 million sales deficiency. As clearly demonstrated by the Defendant, the MBAR sales figures were Gross sales instead of Net sales including and not limited to \$676,000 in discounts over the 5-year period. Furthermore, the \$2 million deficiency also included \$1.1 Million in admissions revenue to be accounted for, and the balance of \$224,000 constitutes non-taxable revenue relating to banquet room rental deposit fees. Consequently, the MBAR reports were revised to VA ABC with a copy to the City in removing the discounts to reconcile gross and net sales. After all, meals tax is payable on net sales and admission tax is filed and paid separately. The judge could not perceive this analysis, neither.

8. Expert Witness Testimony: An expert witness, Michael Lafayette, was appointed by the Court to review the business sales records and analyze the City's mark-up audit approach. Lafayette was also required to conduct his own independent audit and issue a report summarizing his expert findings. Lafayette happened to have served on the VA ABC board and is currently a practicing attorney specializing in liquor audits. Due to the substantial volume of records

to be reviewed, the Court had approved additional hours to be granted to Lafayette to complete his task. Lafayette presented his final model and articulately testified on every input variable that constituted his expert findings. Such input variables included the nature of the liquor business, the average drink price, the industry's standard discount percentage, the standard breakage/spillage factors, the standard happy hour pricing, bartenders' theft practices, and most importantly the size of variable liquor pours in each drink. The judge simply ignored Lafayette's expert findings in favor of the Defense.

### **Court In-considerations to the Defense Position**

1. Business Financial Conditions: The Defendant was examined with respect to his faulty business practice. Defendant clarified that even during the first year of operations, when peak sales had been posted, Uncle Sam's still fell short of achieving the minimum required \$200 in sales per square foot. With Kublawi's 20-year financial experience, a financial model was put in place in order to compete with the chain of corporate franchise systems surrounding the neck of Uncle Sam's facility. With a 30,000 Sq Ft facility, peak sales of \$4 million were still \$600,000 short of the break-even mark. The company had endured continuing losses amounting to over -\$1.0 million in 5 years and its relentless struggle to seek financing to remain as a viable business. Despite SBA loan approvals and new partner equity injections, the continuing landlord pressures for eviction did not help matters. To make matters worse, Uncle Sam's continued to suffer tremendous inventory shortages resulting from bartenders' theft practices. Even when the whole bartender staff was threatened and dismissed, the new generation of bar-backs who were promoted to become

bartenders, familiarized themselves with every theft trick in the bar business. The judge concurred that no wonder why every independent restaurant/bar fails.

2. Liquor Audits by BEVINCO: In an effort to halt further damages, Uncle Sam's recruited a nationally known franchised liquor audit firm by the name, Bevinco. Bevinco came in once every 2 weeks for an "on and off" period of one year. During its audits, Bevinco electronically weighed every ounce of liquor, conducted accurate beginning and ending inventories for both liquor and beer and issued Par/Variance reports. Bevinco also sent in secret spotters posing as regular customers to further demonstrate the amount of theft being incurred. Lafayette accurately studied all the Bevinco reports and concurred with their findings. Lafayette and Bevinco equally agreed that the average acceptable pour level per drink at Uncle Sam's amounted to 1.75 ounces. Theft occurred when the bar staff exceeded the average pour and excessively poured over 2.00 ounces per drink, let alone the liquor cash revenues that never made it inside the cash registers, but the tip buckets instead.
3. Management's Testimony: Further evidence supporting the average pour size and the continuing theft problem was available for production through the witness testimonies of Uncle Sam's General Manager, Kitchen Manager, Front of the house & Floor Managers and the Bar Manager. The judge got tired of the first testimony of the General Manager and advised the Public Attorney not to introduce the rest of the management staff if their testimony was to deliver the same message. At this point in time, it became obvious that the judge was not going to entertain the idea of 1.75 ounces per drink, because that would essentially throw the whole City's case in shambles out of Court.



4. Public Attorney's Cross Examinations: During the cross examination of the City's auditor by the Public Attorney, the auditor was literally embarrassed when the Defense cited many of the City's calculations that simply did not arithmetically add up. The auditor's excuse was that a Calculator does not produce the same mathematics as that of a spreadsheet. Of course, since the spreadsheet rounding errors were forced to exaggerate the City's favorable outcome, the auditor would refuse to justify her numbers by simply using a calculator inside the court. Again, the judge got tired of the contradicting results between a calculator and a spreadsheet and advised the Public Attorney to no longer harass the auditor.
5. Expert Witness Findings: The mark-up audit conducted by Lafayette took into consideration the following variable and fixed criteria: A) the aggregate volume of bottled liquor purchased from the ABC store, B) the size of each bottle and the respective amount of drinks generated from each bottle, C) a total fixed amount of 1,576,000 drinks sold, D) an average price of \$4.94 per drink assuming that liquor prices remained the same during all 5 years, E) taking into consideration a 10% factor for breakage and spillage, F) happy hour sales representing only 10% of aggregate sales which is highly conservative, G) no allowance for theft which is extremely unreasonable, H) no allowance for company fraud in placing a POS register off-line, I) every Bevinco Par/Variance & Spotter reports, J) the average pour size per drink depicted from other independent bar owner clients, K) and most importantly adhered to the same purchase mark-up audit methodology and approach utilized by the City.

His expert findings were simply summarized as follows:

<u>Average Pour Size per Drink</u>	<u>"Potential" Meals Tax Liability</u>
1.25 Ounces / Drink	\$ 198,000
1.50 Ounces / Drink	\$ 43,000
1.75 Ounces / Drink	\$ 13,000
1.89 Ounces / Drink	\$ -0-
2.00 Ounces / Drink	\$ Tax Refund

## Conclusions

1. Pre-Hearing Plea Offer: It is worth noting that within minutes prior to the Restitution hearing, the Defendant was approached by the Public Attorney and was further advised to accept a settlement Plea of \$90,000 that was being offered by the Commonwealth Attorney. The Defendant refused on the basis of total innocence and the Defendant remains be-wildered on what the charges are? The Defendant was further advised by the Expert Witness that his professional findings were clearly to the benefit of the Defense. Lafayette still warned of the possibility that the judge might not fully comprehend this case and could grant the City full support, without any consideration to an overwhelming series of facts and findings that would require weeks of deliberation in a court setting. Basically, the Defendant is being advised to take the Plea because he will be facing a judge who has no patience for details and would like things to be clear cut and over with.
2. Forensic Accounting: Anyone of education and GAAP experience can only conduct a sales audit of a restaurant/bar through its daily sales cash receipts and credit card deposits. Cash receipts are typically reconciled with cash registers that would detail the incoming source

of cash via the POS system and the outgoing utilization of cash disbursements with supporting receipts and invoices. Cash is typically trailed through either checking account deposits or in this case through in-house petty cash that was disbursed daily to meet either inventory requirements or other cash-only obligations. Credit card sales are clearly auditable through the credit card bank statements. MBAR reports are not an accurate measure of revenue. Federal and state tax returns, monthly financial statements including balance sheets and profit and loss statements can be verified. A statement of changes in cash flows is crucial to an appropriate audit to verify the sources and utilization of funds. Relying on MBAR reports and Arbitrary Mark-Up suggestions to determine sales is almost ridiculous. Such an approach would require a more extensive forensic type of accounting, which in itself, would ultimately fail in proving that Fraud was committed by Uncle Sam's LLC members who presumably have hid away \$5 million in sales. After all the \$192,000 judgment ordered by the Court does represent 4% tax on \$5 million allegedly unreported or missing revenue.

3. VA ABC Rules & Regulations: If we were to neglect GAAP accounting audits, and let us accept the City's mark-up approach, which the expert witness has fully accepted and utilized, then we would have to fully rely on the VA ABC rules and regulations. Without the need of Lafayette's opinion, who happened to serve on the VA ABC Board, *there is in fact NO ABC ruling that identifies or restricts the amount of ounces poured in a single serving.* The only ABC ruling which could be of relevance, dictates a licensee to charge more for a double drink if the amount of alcohol is double what is typically poured in a single drink. *The definition of a "Drink" in ABC regulation does not dictate the amount of ounces that are typically*

*poured in a single serving.* Accordingly, Lafayette's expert findings should have been accepted in Court and Bevinco's audits should have been of relevance in determining that 1.75 ounces per drink is the typical measure at Uncle Sam's and should legally be acceptable by the Court.

4. Arbitrary Mark-Ups: Even if the Court was fully convinced that the mark-up approach on liquor sales is justified, there is absolutely no reciprocity to the remaining components of sales to include Food, Beer, Wine and Non-Alcoholic Beverages. The City has arbitrarily applied its mark-up factor across all components of sales. This global approach basically alleges that the LLC members have somehow confiscated \$5 million in unreported sales.
5. Racial Discrimination: The above facts and the summary below can only ascertain that what I had personally endured is nothing but racial discrimination, without any respect and total disregard to me as a citizen whose civil rights have been violated in every form of shape.

### **Summary**

1. I was unlawfully arrested before any remote chance for a trial in a Civil Court.
2. The prosecution manipulated the timing of trial to be held in the court room of an offense-favorable judge.
3. My rights for a due process of law and equal protection under the law have been robbed and violated.
4. Any immunity that protects me from the City hindering my life has not been afforded to me by law. This hindering continues to affect my life and future till this very day.

5. The unjust discrimination and unfair treatment is a pure result of governmental abuse of power and authority in public office.
6. Clear negligent errors were imposed by the Court in misapplying and misinterpreting the ABC rules and regulations.
7. In the absence of forensic accounting, the Judge failed to consider expert witness testimony that was appointed by the Court and allowed hear say testimony instead.
8. The Court clearly permitted prosecution to make improper closing arguments with respect to a mark-up audit approach that has been totally refuted by experts.
9. The Court and prosecution failed to prove all of the elements of offense beyond a reasonable doubt.