Income Statement Explanation

This explains how the participant, as a sole proprietor, is presenting his income statement and revenue model. We want to provide a refresher on the three differences from a corporate structure before you critique his presentation.

The Executive Summaries include financial information to show the business's economic performance in the first year of operation. As you review each participant's plan, please realize he will almost certainly start his business as a sole proprietorship—not as a corporation. The Executive Summary reflects three ways that a sole proprietorship financial presentation is different from that of a corporation.

1. Cost of goods sold does not include the owner's labor cost in arriving at the financial statement gross profit number. This is because in calculating taxable income, a sole proprietor receives no deduction for the value of his labor.

   The Executive Summary includes a revenue model to give you a quick financial overview of the participant's product offering. The revenue model differs from the financial statement in that the revenue model does include an estimate of the owner's labor (shown after the financial statement gross profit—highlighted in the following example) so you can assess the pro forma gross profit of the products and/or services. Estimating this pro forma gross profit requires the participant to value his time in calculating a realistic sales price for the company's services.

	Basic Package			Deluxe Package			Total Package		
Per *Unit* Dollars									
Sales price	$	30.00	100%	$	35.00	100%	$	45.00	100%
Non-owner labor cost		-			-			-	
Other variable costs		(3.00)			(6.00)			(8.00)	
Fin. stmt. gross profit		27.00	90%		29.00	83%		37.00	82%
Owner labor value		(10.00)			(25.00)			(35.00)	
Pro forma gross profit	$	17.00	57%	$	4.00	11%	$	2.00	4%
Year 1 total units sold		830			120			82	

2. The money the owner takes as his salary is shown after calculating tax expense (highlighted yellow in the following example). In the Executive Summary, the cost of goods sold and overhead lines do not include any deduction for owner labor. In a corporate structure, owner's salary is an overhead expense in arriving at earnings before income taxes.

Year one summary financial statement:		
Sales:	$ 32,700	100%
COGS	3,800	12%
Gross profit	28,900	88%
Overhead	7,000	21%
Pretax income	21,800	67%
Tax expense	5,400	17%
Owner withdrawals	15,000	46%
Net income	$ 1,400	4%

The estimated tax rate is 25% (15% for self employment tax and 10% for personal income taxes). This is higher than the corporate tax rate but reflects the rates a participant will initially face as an individual taxpayer.