Normalization of balance sheets and income statements: a case illustration of a private plumbing enterprise

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Abstract

The normalization of financial statements is often required in the world of private enterprises. This process serves as the first step for various purposes including benchmarking, business valuation, and merger and acquisition. There are many different ways for making normalization as they are essentially based on the individual appraiser's professional judgment. However, this case demonstrates one of many ways to normalize five-year balance sheets and income statements by utilizing company information and the appraiser's assessments of officer compensation, rent and land value. The normalization of payroll tax, insurance, and profit-sharing is also illustrated in this case study.

Keywords: Normalization, Financial Statements, Private Enterprise, Business Valuation

Purpose of the Case

The purpose of this case study is to demonstrate how normalization can be done for a private company based on its historical financial statements and information discovered by analysts through the site-visit and interviewing processes. In the following section, the historical balance sheets and income statements are disclosed and the specific firm information is also given. Users of this case study are led step by step to see how to go through the normalization process by following a set-up that allows each question to be immediately followed by the answer to that question. This case is fictitious and the raw financial data – all the numbers from historical financial statements and most of the underlying facts of the company – are based on a fabricated case provided by NACVA (National Association of Certified Valuation Analysts) and used with permission. The people in this case are not real and any resemblance to real organizations is purely coincidental. All analysis of raw data in this case is done by the author.

Body of the Case

Company: General Background

Good Plumbing, Inc., is a plumbing contracting company. Taylor Smith, the father of John Smith, founded the company in Atlanta, Georgia, in 1989. The company remained fairly small until 2000 when Taylor died and John, John's wife Laura, and their family inherited the company. It is a C corporation. It was incorporated in January 1989 at Georgia. Only one class of shares, common shares, exists at Good Plumbing. Neither treasury nor preferred shares exist at the company. In terms of voting characteristics, each share has an equal voting right and family members have the right of first refusal, with the intention of having the business remain in the family for as long as practical. Taylor Smith's will specifically requested the distribution of the 55,000 shares. The value on the estate tax return was recorded as $550,000.

John and Laura Smith, two co-owners, work 100% of the time in the business. John is the CEO/president who owns 30,000 shares, and Laura is the vice-president who holds 20,000 shares. Mike and Ann, their adult children, are not involved in the daily operation of the business and own 3,000 and 2,000 shares, respectively. John is responsible for bidding jobs, marketing the company to the construction industry and supervising the construction crews. Laura is the office manager and directs all office activities. John and his family plan to sell Laura's 20,000 shares (all four stockholders are in agreement) to an interested employee, Don White. A gentleman's agreement has been reached to use the value of the company as of June 30, 2006. There is no guarantee for either party to buy or sell these 20,000 shares, which represent a 36.4% ownership of Good Plumbing. There are no prior transactions involving company stocks. Neither, as of June 30, 2006, does any explicit buy/sell agreement between owners and any interested party exist.

During the period when Taylor was in charge of Good Plumbing, the company had around 10 employees and the major market was individual households. The main service it provided was to repair and reinstall the existing plumbing systems at individual households. Business had been stable and the number of employee had stayed flat for these years. However, after Taylor died, under John and Laura's management, Good Plumbing has been more aggressive in its marketing to the general construction trade. Revenue from installing new plumbing systems to the new construction sites has been gradually increasing since John and

Laura started to run Good Plumbing. In each year since 2002, 85% of Good Plumbing's revenues have come from installing new plumbing systems at new construction sites, specifically new residential construction sites.

Good Plumbing, Inc. is a stand-alone union shop. It is neither a subsidiary nor an affiliate of other companies. As of June 30, 2006, it has gross sales of $7,295,000 and employs 51 people. Good Plumbing has an adequate facility for its current operation. This facility contains office, warehouse and workshop. The company has occupied this facility since January 1999 through a lease from Smith Family Limited Partnership (SFLP), owned by the late Taylor Smith's brother. Thus, the facility Good Plumbing operates has a long-term lease arrangement with a family member, resulting in a related-party transaction. This the only related-party transaction that applies to Good Plumbing. According to management, this arrangement increases the stability of the business and creates an incentive for the company to improve the facility in order to gain the most efficient use of the facility. Additionally, the rent is lower than what the market rate is. Furthermore, Good Plumbing's facility also has a favorable location (near a freeway) for transporting its equipment and accessing job sites. In terms of its fixed assets, most of the fixed assets on the books are plumbing equipment. Both facilities and equipment are in good shape. However, there is no proprietary content, patent or copyright, etc., under Good Plumbing's name or its owners.

Good Plumbing has a low employee turnover, which implies a high degree of employee satisfaction, a relative constant level of construction work and related low employee cost. The company workers have excellent skills and are paid accordingly. Additionally, there is also adequate supply of labor in the area when occasional help is needed and the compensation for these individuals is average for the area.

Overall, Good Plumbing is well established with 17 years of successful operation and is well known and respected in the Atlanta construction industry. It hence has a favorable experience curve.

Financial Background

The Process of Generating Financial Statements

At Good Plumbing, an outside CPA compiles statements from the data supplied by Good Plumbing's controller, who supervises an accountant who is in charge of accounts payable and taking care of billing, while the controller, is in charge of accounts receivable and taking care of invoices from their suppliers. Laura reviews the financial records and is in charge of reconciliation.

The practice of the "segregation of duty" implemented at Good Plumbing, has provided checks/balances on power and ensured an acceptable level of accounting quality. Compilation reports are generated monthly by an outside CPA. The CPA provides no review or audit. Accounting at Good Plumbing is basically accrual, though there are a lot of cash changing hands. Fiscal year-end of the Company is set on June 30. The company utilizes LIFO (Last-In-First-Out) for costing inventory for tax purposes. Depreciation is GAAP based. Tax planning is done annually and a financial plan is done yearly. This financial plan is updated quarterly, based on actual costs of jobs performed. This plan is used to budget and estimate new jobs for the coming quarter.

Additional Information

The following is additional financial information provided by the management:

- Assets (mostly plumbing equipment in good shape) are of five-year useful life (as defined by the GDS Class Life for Construction Assets) and depreciated accordingly based on the MACRS Table A-1, 5-year property, half-year convention. Assets are appraised at $1,358,250 as of June 30, 2006. (Note: this appraisal was done by an appraiser at Quality Appraisal Company, who was hired by John Rogers, Good Plumbing's attorney, for this purpose.)
- The inventory value under FIFO (First-In-First-Out) as of June 30, 2006, is $53,650. The ratio between the inventory's FIFO values and the company's revenue has not demonstrated much change in the past.
- Annual reasonable compensation for John Smith is $100,000 and for Laura Smith is $58,000[1] as of June 30, 2006. (These figures are calculated by Personnel Consultants, hired by John Rogers, Good Plumbing's attorney).
- There is a long-term financing arrangement for the lease of the facility[2] where the company is currently located. This facility is leased from SFLP at a monthly rent of $5,500 ($66,000 per year). The current market rent of this facility is appraised at $6,000/per month ($72,000 per year) as of June 30, 2006. (The appraiser, Commercial Realty Company, was hired by John Rogers, Good Plumbing's attorney).
- The company owns land that is adjacent to the current operating location and is intended for future expansion. Its current market value is $900,000 and it is treated as non-operating investment property at Good Plumbing.
- Owners have had Good Plumbing cover monthly expenses of $1,000 for their recreation vehicle (RV) since June, 2002. These expenses are not business-related.
- Laura's health insurance is covered under John's family plan. John's premium has maintained at $1,000 per month since June 2002.
- All travel and entertainment expenses are business-related.
- John and Laura have received equal annual compensation to each other in each year from 2002 to 2006.
- Employee benefit: a type of defined contribution plan is utilized. Each year from 2002 to 2006, a constant percentage of the salary of each employee has been paid out by the employers to this plan as the employee's share of contribution. John Smith intends to maintain this ratio in the future to motivate and reward his employees.
- The company has a $500,000 credit line at its bank, which it rarely, if ever, needs to use. John indicates such a credit line helps him to get better-funded customers.
- There is no key-man insurance policy in place.
- There have been no dividends issued in the past.
- There are no non-recurring or extraordinary expenses.
- There is no recent change in accounting policies.

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[1] These figures exclude signing bonus, relocation, candidate search fees and fringes.

[2] This facility is two-story, with 5400 square feet total usable space. Upper floor is offices with some inventory storage; with shops, work area, garaging and inventory on lower floor. This facility is in good shape. There is outdoor parking.

- There is no threatened litigation pending and none in the past.
- Good Plumbing has not been denied when applying for credit.

Historical Balance Sheets and Income Statements

A five-year period is suggested in Revenue Ruling 59-60, commonly used in the valuation community, and generally considered sufficient to identify trends in the construction business. In this section, the historic balance sheets and income statements during the period from 2002 to 2006 are presented and used as a basis for normalization purposes.
[Insert Table 1: Historical Balance Sheets and Table 2: Historical Income Statements here]

Normalization

One of the objectives of financial statement analysis is to ensure that the historical financial statements, which can provide the basis for any forward-looking estimates, reliably reflect the true operating performance of the enterprise. Therefore, the historical financial statements may need to be normalized for certain items that, in the analyst's judgment, distort the true operating performance of the business. Normalization generally involves adjusting for a number of board categories[3]:

- Unusual items
- Nonrecurring items
- Extraordinary items (both unusual and nonrecurring, per Accounting Principles Board (APB) Opinion #30)
- Non-operating items
- Changes in accounting principles
- Nonconformance with GAAP
- Degree of ownership interest, including whether the interest has control

Normalization Adjustments Applied to Balance Sheets

Question 1:
Based on the categories and information given above, what line items of the balance sheets are subject to normalization and how?
Answer:
Changes in accounting policy:

- The inventory value under LIFO for tax purposes is adjusted to $53, 650 as of June 30, 2006 to reflect its value under FIFO policy. Management indicates the ratio between the inventory's FIFO values and the Company's revenue has not encountered much change in the past. Therefore, the ratio of 0.74% ($53,650 (FIFO inventory)/$7,295,000 (Revenue)), is used to normalize the inventory items on the historic balance sheet in each year from 2002 to 2005.

Non-operating assets:

[3] See p. 63, *Hitchner*, 2006

- Short-term investments, land and deposits[4] are found to be non-operating assets. These items are taken out completely from the balance sheet in each year from 2002 to 2006.

Concern regarding excess cash:

- Analyst of this case notice that compared to its peers, Good Plumbing has relatively higher levels of cash on its balance sheets. However, as John indicated that the high levels of cash has, in the past, yielded a favorable impact on the company's bonding capacity and enabled Good Plumbing to enter bids for higher-stake, higher-pay jobs, the analyst decided to count *all* levels of cash as operational assets.

Concern regarding Net Fixed-Asset Adjustment:

- Based on p. 68, Hitchner (2006), there are two opposite positions on the normalization of fixed assets. Many analysts do not make this adjustment since industry or guideline-company benchmark data do not usually have this adjustment, thus making comparisons to the subject company more difficult. Others think that making the adjustment results in a better comparison over the historical period analyzed. I have sided my choice with the group of analysts who do not make this normalization.

The above adjustments are summarized in Table 3. Table 4 presents the normalized balance sheets from 2002 to 2006.

[Insert Table 3 and Table 4]

Normalization Adjustments Applied to Income Statements.

Question 2:
Based on the given information, what line items of the income statements from 2002 to 2006 are subject to normalization?
Answer:
The purpose of normalization is to reflect the true operating performance of the enterprise. For cases in which owners of a small company also serve as officers in the same enterprise, there is a tendency for owners to overpay themselves. This is the case for Good Plumbing; therefore, the line item of Officer's Compensation requires adjustment. The rent item is also subject to normalization, as this is a related-party transaction – Good Plumbing is renting its facility form John's uncle. The amounts currently assigned to the rent item do not reflect its economic reality. Payroll taxes are adjusted to reflect the results of the normalized officer's compensation.

Question 3:
Based on the given information, how might the Officer's Compensation line item in the income statements be normalized?
Answer:
For this line item, there is enough information to conduct an adjustment for the year 2006. Reasonable annual market compensation for John Smith is assessed at $100,000 and for Laura Smith at $58,000. The line item of Officer's Compensation is therefore reduced by $82,000 to be equal to $158,000 as of June 2006. The related adjustments from 2002 and 2005 are based on the newly adjusted 2006 figures, and reflect inflation/deflation based on the Consumer Price Index

[4] Deposits here represent the balance of various CDs in Good Plumbing's account at its bank – Wells Fargo.

(CPI). The CPI series used in the following table was obtained from the Bureau of Labor Statistics, and the combined salary of $158,000 for 2006 is used as a basis.
[Insert Table 5: Adjusted Officer's Compensation]

Question 4:
Based on the given information, how might the Rent line item in the income statements be normalized?
Answer:
The facility that Good Plumbing leases is adjusted up to its annual market rent of $72,000 ($6000/per month). In each year of the previous four years, the normalization is also based on inflation/deflation. Again, the CPI index is applied and the market rent of $72,000 as of June 30, 2006, is benchmarked.
[Insert Table 6: Adjusted Rent]

Question 5:
What are the components of payroll tax? How to normalize the payroll tax based on the adjusted officer's compensation?
Answer:
There are three components of employer payroll taxes – Federal Unemployment Taxes (FUTA), State Unemployment Taxes (SUTA) and FICA (Federal Insurance Contributions Act) tax. The FICA tax consists of both Social Security and Medicare Taxes. Social Security and Medicare taxes are paid both by the employees and the employer. Both parties pay half of these taxes. Employees pay half, and the employers pay the other half. Together both halves of the FICA taxes add up to 15.3% of taxable wages. The 15.3 FICA is broken down as follows:

- Social Security (Employee pays 6.2%)
- Social Security (Employer pays 6.2%)
- Medicare (Employee pays 1.45%)
- Medicare (Employer pays 1.45%)

The Federal Unemployment Tax Act (FUTA) authorizes the Internal Revenue Service to collect a federal employer taxes used to fund state workforce agencies. The FUTA tax rate is 6.2% of taxable wage. The taxable-wage base is the first $7,000 paid in wage to each employee during a calendar year. Employers who pay the state unemployment tax on a timely basis will receive an offset credit of up to 5.4% regardless of the rate of tax they pay the state. Therefore, the NET FUTA tax rate is generally 0.8% (6.2% - 5.4%), for a maximum FUTA tax of $56 per employee, per year (0.008*$7,000). Both John and Laura's adjusted market salaries are well above $7,000 in each year from 2002 to 2006; therefore, there is no adjustment needed regarding this FUTA component of payroll taxes. The State Unemployment Tax Act (SUTA) in Georgia is governed by the *Employment Security law*. This SUTA tax is 8% of the first $8,500 paid in wage. Therefore, no adjustment is needed as both adjusted officers' compensations are higher than $8,500 during the 2002-06 period.

FICA includes Social Security (6.2%) and Medicare (1.45%) taxes. Both taxes are based on the gross earnings of each employee each year. The historical FICA tax information[5] is listed in the following.

[Insert Table 7: Historical FICATax]

As indicated in each year, the Medicare tax is based on *all* amounts of gross earnings of each individual, while the Social Security tax (6.2%) is only applied to a capped amount each year. Therefore, adjustments of FICA taxes resulting from normalizing compensation are needed. The following shows these adjustments.

[Inset Table 8: Payroll Tax Adjustment]

Question 6:
Is any normalization needed for the Truck/Equipment/Auto Expenses line item? If so, how?
Answer:
Owners have Good Plumbing cover the monthly expense of $1,000 for their recreation vehicle (RV). These expenses are not business-related. For normalization purposes, in each year from 2002 to 2006, $12,000 is taken out from this line item on the income statement.

Question 7:
Is any normalization needed for the Insurance line item? If so, how?
Answer:
As Laura is John's wife, her health/medical coverage is under John's family premium. However, for a comparable non-family co-owner who takes Laura's place at Good Plumbing, an additional premium for this person will be necessary. John's $1,000 monthly premium is used as a comparable insurance premium for this person and a $12,000 annual insurance premium is added to this line item on the income statement for each year.

Regarding insurance for Worker Compensation, as the capped amount is applicable, there is no need to adjust for this premium due to the normalization made to officer's compensation. In addition, the company has offered this coverage to every officer[6] and employee in the past and intends to continue this policy due to the hazardous nature of the construction business. Therefore, there is no need to add additional fees to the Worker Compensation premium in a hypothetical situation when Laura is replaced by a comparable co-owner.

Question 8:
Should the Travel and Entertainment line item be normalized?
Answer:
No. There is *no* non-business-related travel and entertainment found for this item in this 5-year period.

Question 9:

[5] This information comes from the table compiled by Steven J. Wilson, Professor of Mathematics, Johnson County Community College, http://staff.jccc.net/swilson/businessmath/taxes/fica.htm

[6] Based on the Georgia State Board of Workers' Compensation (Http://sbwc.georgia.gov/00/article/0,2086,11394008_11400533_13292004,00.html), corporate officers (maximum of 5) may exempt themselves from coverage by filing a Form WC-10 with their insurance company.

Good Plumbing has put a constant percentage of the employee salaries each year into a pension fund. What is this percentage?
Answer:
One type of defined contribution plan is utilized in Good Plumbing. In each year during this period, a specific percentage of the salary of each employee has been paid out by the employers to this plan as the employee's share of contribution. Based on a relationship between the line item of "Pension and Profit Sharing" and the sum of items of "Officer's Compensation" and "Other Salaries & Wages", shown in the following table, the constant ratio of 2% is found.

[Insert Table 9: Pension and Profit Sharing]

Moreover, confirmation was obtained from the owner John regarding the nature of and method applied for the employer-sponsored retirement plan implemented at Good Plumbing, as follows:

- A Defined Contribution Plan (Not a defined *benefit* plan)
- The Profit-Sharing Plan is the only type of pension fund plan utilized by the company.
- Contributions come only from employers;
- The contribution is based on the salary ratio of 2%, which means that all eligible employees would be allocated 2% of compensation as their share of contribution.
- John intends to maintain this 2% salary ratio into the future.

Question 10:
Based on this 2% of salaries as the contribution ratio to the pension plan, how would the Pension and Profit-sharing line item be normalized given the existence of the difference between the book and adjusted value of the officers' compensation?
Answer:
The 2% difference between the officer's reasonable compensation and the amount recorded on book will be used for the adjustment made to this item. See the following table: [Insert Table 10: Adjustment for Profit Sharing]

Question 11:
How would the Tax line item be adjusted, based on the corporate income tax table valid from 2002 to 2009?
Answer:
The Corporate Income Tax table, valid from 2002 to 2009, is applied to *adjusted* Pretax Income for calculating federal corporate income tax. The adjusted income tax, including the federal income tax based on the tax table, and the 6% state income tax in Georgia, is listed below.

[Insert Table 11: Corporate Income Tax Table and the Normalization for Tax]

Question 12:
Summarize all adjustments made on Good Plumbing's income statements from 2002 to 2006 and present Good Plumbing's normalized income statements for this period.
Answer:

[Insert Table 12: Income Statement Adjustments]
[Insert Table 13: Adjusted Income Statements]

References

Hitchner, James R. (2006), *Financial Valuation*, 2nd Edition, New York: John Wiley & Sons, Inc.
Steven J. Wilson, Professor of Mathematics, Johnson County Community College, http://staff.jccc.net/swilson/businessmath/taxes/fica.htm

Georgia State Board of Workers' Compensation. (http://sbwc.georgia.gov/00/article/0,2086,11394008_11400533_13292004,00.html),

Table 1: Historical Balance Sheets (in $000s), 2006-2002

	Year Ended June 30, 2006	Year Ended June 30, 2005	Year Ended June 30, 2004	Year Ended June 30, 2003	Year Ended June 30, 2002
Assets:					
Current Assets					
Cash	1,403	1,435	1,005	350	209
Accounts Receivable	891	714	689	750	290
Inventory	49	45	39	30	25
Other Current Assets					
Short term Investments	2,150	1,220	514	65	50
Total Other Current Assets	2,150	1,220	514	65	50
Total Current Assets	4,493	3,414	2,247	1,195	574
Fixed Assets - Net					
Property, Plant & Equipment	900	675	550	475	450
Land	900	900	900	900	900
Other Fixed Assets	25	18	13	15	12
Total Fixed Assets - Net	1,825	1,593	1,463	1,390	1,362
Intangible Assets - Net					
Other Non-Current Assets					
Deposits	150	150	150	150	150
Other Assets	0	0	0	0	0
Total Other Non Current Assets	150	150	150	150	150
Total Assets	6,468	5,157	3,860	2,735	2,086
Liabilities and Equity:					
Liabilities					
Current Liabilities					
Accounts Payable	10	12	15	13	11
Short Term Notes Payable	135	119	111	88	73
Other Current Liabilities	3	4	2	5	3
Total Current Liabilities	148	135	128	106	87
Long Term Debt					
Notes Payable	1,831	1,517	1,158	830	705
Other Long-term Liabilities	0	0	0	0	0
Total Long-Term Debt	1,831	1,517	1,158	830	705
Other Non Current Liabilities	0	0	0	0	0
Total Liabilities	1,979	1,652	1,286	936	792
Equity					
Common Stock	55	55	55	55	55
Add'l Paid-In Capital	465	465	465	465	465
Retained Earnings	3,969	2,985	2,054	1,236	774
Other Equity					
Dividends	0	0	0	43	0
Total Other Equity	0	0	0	43	0
Total Equity	4,489	3,505	2,574	1,799	1,294
Total Liabilities and Equity	6,468	5,157	3,860	2,735	2,086

Table 2: Historical Income Statements (in $000s), 2006-2002

Historic Income Statements	**Year Ending June 30, 2006**	**Year Ending June 30, 2005**	**Year Ending June 30, 2004**	**Year Ending June 30, 2003**	**Year Ending June 30, 2002**
Revenues					
Total Revenue	7,295	6,489	5,755	4,156	3,529
Total Revenues	7,295	6,489	5,755	4,156	3,529
Cost of Goods Sold					
Gross Profit	7,295	6,489	5,755	4,156	3,529
Operating Expenses					
Officers' Compensation	240	192	168	144	120
Other Salaries & Wages	3,495	3,109	2,757	1,991	1,691
Rent	66	54	48	42	36
Payroll Taxes	405	360	320	231	196
Truck/Equipment/Auto Expense	633	520	463	411	325
Insurance	78	61	49	36	29
Legal/Professional Expenses	41	31	29	27	26
Travel & Entertainment	5	5	5	4	4
Director Fees	18	10	6	5	3
Pension & Profit Sharing	73	65	58	42	35
Other Operating Expenses	522	469	416	332	286
Depreciation & Amortization	73	84	86	68	57
Total Operating Expenses	5,649	4,960	4,405	3,333	2,808
Operating Profit	1,646	1,529	1,350	823	721
Other Income/(Expense)					
Interest Expense	-120	-107	-94	-68	-58
Other Income	84	67	53	31	22
Total Other Income/(Expense)	-36	-40	-41	-37	-36
Income Before Taxes	1,610	1,489	1,309	786	685
Income Taxes	626	558	491	324	270
Net Income/(Loss)	984	931	818	462	415

Table 3: Balance Sheet Adjustments (in $000s), 2006-2002

Year		2006	2005	2004	2003	2002
Sales		7295	6489	5755	4156	3529
FIFO Inventory/Sales	0.74%	54	48	43	31	26
Inventory on Book		49	45	39	30	25
Adjustment on Inventory		5	3	4	1	1

	30-Jun	30-Jun	30-Jun	30-Jun	30-Jun
Year	2006	2005	2004	2003	2002
Balance Sheet Adjustments					
	Normalize /Adjust	**Normalize /Adjust**	**Normalize /Adjust**	**Normalize /Adjust**	**Normalize /Adjust**
Assets:					
Current Assets					
Cash					
Accounts Receivable					
Inventory	5	3	4	1	1
Other Current Assets					
Short-term Investments	-2,150	-1,220	-514	-65	-50
Total Other Current Assets	-2,150	-1,220	-514	-65	-50
Total Current Assets	-2,145	-1,217	-510	-64	-49
Fixed Assets - Net					
Property, Plant & Equipment					
Land	-900	-900	-900	-900	-900
Other Fixed Assets					
Total Fixed Assets - Net	-900	-900	-900	-900	-900
Other Non-Current Assets					
Deposits	-150	-150	-150	-150	-150
Other Assets					
Total Other Non-Current Assets	-150	-150	-150	-150	-150
Total Assets	-3,195	-2,267	-1,560	-1,114	-1,099
Liabilities and Equity:					
Liabilities					
Current Liabilities					
Accounts Payable					
Short Term Notes Payable					
Other Current Liabilities					
Total Current Liabilities	0	0	0	0	0
Long-Term Debt					
Notes Payable					
Other Long-term Liabilities					
Total Long-Term Debt	0	0	0	0	0
Other Non-Current Liabilities					
Total Liabilities	0	0	0	0	0
Equity					
Common Stock					
Add'l Paid-In Capital					
Intentionally Left Blank					
Retained Earnings	-3,195	-2,267	-1,560	-1,114	-1,099
Other Equity					
Dividends					
Total Other Equity	0	0	0	0	0
Total Equity	-3,195	-2,267	-1,560	-1,114	-1,099
Total Liabilities and Equity	-3,195	-2,267	-1,560	-1,114	-1,099

Table 4: Adjusted Summary Balance Sheets (in $000s), 2006-2002

Adjusted Summary Balance Sheets (in $000s)	Adjusted Year Ended June 30, 2006	common size	Adjusted Year Ended June 30, 2005	common size	Adjusted Year Ended June 30, 2004	common size	Adjusted Year Ended June 30, 2003	common size	Adjusted Year Ended June 30, 2002	common size	Average Growth Rate %
ASSETS											
Cash	1,403	43%	1,435	50%	1,005	44%	350	22%	209	21%	74%
Accounts Receivable	891	27%	714	25%	689	30%	750	46%	290	29%	45%
Inventory	54	2%	48	2%	43	2%	31	2%	26	3%	20%
Other Current	0	0%	0	0%	0	0%	0	0%	0	0%	0%
Total Current Assets	2,348	72%	2,197	76%	1,736	75%	1,131	70%	525	53%	51%
Fixed Assets	925	28%	693	24%	563	24%	490	30%	462	47%	19%
Net Intangible	0	0%	0	0%	0	0%	0	0%	0	0%	0%
Other Non-Current	0	0%	0	0%	0	0%	0	0%	0	0%	0%
Total Assets	3,273	100%	2,890	100%	2,300	100%	1,621	100%	987	100%	36%
LIABILITIES & EQUITY											
Accounts Payable	10	0%	12	0%	15	1%	13	1%	11	1%	-1%
Short Term Notes Payable	135	4%	119	4%	111	5%	88	5%	73	7%	17%
Other Current Liabilities	3	0%	4	0%	2	0%	5	0%	3	0%	20%
Total Current Liabilities	148	5%	135	5%	128	6%	106	7%	87	9%	14%
Long Term Debt	1,831	56%	1,517	52%	1,158	50%	830	51%	705	71%	27%
Other Non-Current Liabilities	0	0%	0	0%	0	0%	0	0%	0	0%	0%
Total Liabilities	1,979	60%	1,652	57%	1,286	56%	936	58%	792	80%	26%
Total Equity	1,294	40%	1,238	43%	1,014	44%	685	42%	195	20%	81%
Total Liabilities & Equity	3,273	100%	2,890	100%	2,300	100%	1,621	100%	987	100%	36%

Table 5: Adjusted Officer's Compensation, 2006-2002

Adjusted Officer's Compensation, 2006-2002					
	2006	2005	2004	2003	2002
CPI	113.8	113.8	115.9	116.2	118.7
Officer Compensation (Market)	$ 158,000	$ 158,000	$ 160,916	$ 161,332	$ 164,803
Office Compensation (Book)	240,000	192,000	168,000	144,000	120,000
Adjustment	$ (82,000)	$ (34,000)	$ (7,084)	$ 17,332	$ 44,803
Adjustment (rounded, in $000s)	-82	-34	-7	17	45

Table 6: Adjusted Rent, 2006-2002

Adjusted Rent, 2006-2002:					
	2006	2005	2004	2003	2002
CPI	113.8	113.8	115.9	116.2	118.7
Rent (Market)	$ 72,000	$ 72,000	$ 73,329	$ 73,518	$ 75,100
Rent (Book)	66,000	54,000	48,000	42,000	36,000
Adjustment	6,000	18,000	25,329	31,518	39,100
Adjustment (rounded, in $000s)	6	18	25	32	39

Table 7: Historical FICA Tax, 2006-2002

Historical FICA Tax Information: 2006-2002		
	Social Security	Medicare
2006	6.2% on first $94,200	1.45% on all
2005	6.2% on first $90,000	1.45% on all
2004	6.2% on first $87,900	1.45% on all
2003	6.2% on first $87,000	1.45% on all
2002	6.2% on first $84,900	1.45% on all

Table 8: Payroll Tax Adjustment (in $000s): FICA

Payroll Tax Adjustment: FICA					
The Management has advised that as observed in the 2006, the practice of an equal pay to John and Laura was also applied in the past.					
	2006	**2005**	**2004**	**2003**	**2002**
Compensation on Book (John, in $000s)	120	96	84	72	60
Capped Amount for Social Security	94.2	90	87.9	87	84.9
John's Social Security Tax	5.8	5.6	5.2	4.5	3.7
John's Medicare Tax	1.7	1.4	1.2	1.0	0.9
John's FICA	7.6	7.0	6.4	5.5	4.6
Laura's FICA (same as John's)	7.6	7.0	6.4	5.5	4.6
Total FICA for John and Laura	15.2	14.0	12.8	11.0	9.2
The salary ratio of 100/58 (John's market alary of $100,000, divided by Laura's $58,000 as of June 30, 2006), is applied to the total *normalized officer's compensation* from 2002 to 2006 , in order to calculate the each individual's share of this total figure.					
Total Normalized Compensation	158	158	161	161	165
John's Compensation	100	100	102	102	104
Capped Amount for Social Security	94.2	90	87.9	87	84.9
John's Social Security Tax	5.8	5.6	5.4	5.4	5.3
John's Medicare Tax	1.5	1.5	1.5	1.5	1.5
John's FICA Tax	7.3	7.1	6.9	6.9	6.8
Laura's Compensation	58	58	59	59	60
Capped Amount for Social Security	94.2	90	87.9	87	84.9
Laura's Social Security Tax	3.6	3.6	3.7	3.7	3.8
Laura's Medicare Tax	0.8	0.8	0.9	0.9	0.9
Laura's FICA Tax	4.4	4.4	4.6	4.6	4.7
Total FICA for John and Laura (based on the normalized compensation)	11.7	11.5	11.5	11.5	11.5
Total Book FICA for John and Laura	15.2	14.0	12.8	11.0	9.2
Adjustments Made for FICA Tax	-3.5	-2.5	-1.3	0.5	2.3

Table 9: Pension and Profit Sharing (in $000s) , 2006-2002

Based on the Unadjusted Income Statement, 2006-2002.					
	2006	2005	2004	2003	2002
Pension & Profit Sharing	73	65	58	42	35
Officer's Comp	240	192	168	144	120
Other Salaries and Wages	3495	3109	2757	1991	1691
Ratio	1.95%	1.97%	1.98%	1.97%	1.93%
Average	1.96%				
Rounded	2.00%				

Table 10: Adjustment for Profit Sharing, 2006-2002

Adjusted Officer Compensation, 2006-2002:					
	2006	2005	2004	2003	2002
CPI	113.8	113.8	115.9	116.2	118.7
Officer Compensation (Market)	$ 158,000	$ 158,000	$ 160,916	$ 161,332	$ 164,803
Office Compensation (Book)	240,000	192,000	168,000	144,000	120,000
Adjustment	$ (82,000)	$ (34,000)	$ (7,084)	$ 17,332	$ 44,803
Adjustment (rounded, in $000s)	-82	-34	-7	17	45
Adjustment for Profit Sharing (in $000s)					
(2% Salary Ratio)	-1.6	-0.7	-0.1	0.3	0.9

Table 11: Corporate Income Tax Table and the Normalization for Tax

Taxable Income Over		Not Over	Difference	Tax Rate
$ -		$ 50,000	$ 50,000	15%
50,000		75,000	25,000	25%
75,000		100,000	25,000	34%
100,000		335,000	235,000	39%
335,000		10,000,000	9,665,000	34%
10,000,000		15,000,000	5,000,000	35%
15,000,000		18,333,333	3,333,333	38%
18,333,333		………………….		35%

Income Tax Adjustment (in $000s), 2006-2002:					
	2006	2005	2004	2003	2002
Adjusted Pretax Income	1,691	1,508	1,292	736	598
State Income Tax (6%)	101	90	78	44	36
Federal Taxable Income	1,590	1,418	1,214	692	562
Federal Income Tax	541	482	413	235	191
Total Income Tax	642	573	490	279	227
Income Tax on book	626	558	491	324	270
Income Tax Adjustment	16	15	-1	-45	-43
Federal Income Tax (in $000s):					
	2006	2005	2004	2003	2002
Federal Taxable Income	1,590	1,418	1,214	692	562
Taxable Income at the First Three Brackets	335	335	335	335	335
Taxable Income Subject to 34% Tax Bracket	1,255	1,083	879	357	227
34%	$ 427	$ 368	$ 299	$ 121	$ 77
Tax for Taxable Income Below $335,000	114	114	114	114	114
Total Federal Income Tax	$ 541	$ 482	$ 413	$ 235	$ 191
(In $000s):					
Adjusted Pretax Income	1,691	1,508	1,292	736	598
Total Income Tax	642	573	490	279	227
Net Income	$ 1,049	$ 935	$ 802	$ 457	$ 371

Table 12: Income Statement Adjustments (in $000s), 2006-2002

Income Statement Adjustments	**2006 Normalize /Adjust**	**2005 Normalize /Adjust**	**2004 Normalize /Adjust**	**2003 Normalize /Adjust**	**2002 Normalize /Adjust**
Revenues					
Total Revenues					
Cost of Goods Sold					
Gross Profit					
Operating Expenses					
Officers' Compensation	-82	-34	-7	17	45
Other Salaries & Wages					
Rent	6	18	25	32	39
Payroll Taxes	-3.5	-2.5	-1.3	0.5	2.3
Truck/Equipment/Auto Expense	-12	-12	-12	-12	-12
Insurance	12	12	12	12	12
Legal/Professional Expenses					
Travel & Entertainment					
Director Fees					
Pension & Profit Sharing	-1.6	-0.7	-0.1	0.3	0.9
Other Operating Expenses					
Depreciation & Amortization					
Total Operating Expenses	-81	-19	17	50	87
Operating Profit	81	19	-17	-50	-87
Other Income/(Expense)					
Interest Expense					
Other Income					
Total Other Income/(Expense)					
Income Before Taxes	81	19	-17	-50	-87
Income Taxes	16	15	-1	-45	-43
Net Income/(Loss)	65	4	-16	-5	-44

Table 13: Adjusted Income Statements (in $000s), 2006-2002

Adjusted Income Statements:	Normalized /Adjusted June 30, 2006	Common Size June 30, 2006	Normalized /Adjusted June 30, 2005	Common Size June 30, 2005	Normalized /Adjusted June 30, 2004	Common Size June 30, 2004	Normalized /Adjusted June 30, 2003	Common Size June 30, 2003	Normalized /Adjusted June 30, 2002	Common Size June 30, 2002	Average Growth Rate %
Revenues											
Total Revenue	7,295	100%	6,489	100%	5,755	100%	4,156	72%	3,529	100%	20%
Total Revenues	7,295	100%	6,489	100%	5,755	100%	4,156	72%	3,529	100%	20%
Cost of Goods Sold											
Gross Profit	7,295	100%	6,489	100%	5,755	100%	4,156	72%	3,529	100%	20%
Operating Expenses											
Officers' Compensation	158	2%	158	2%	161	3%	161	3%	165	5%	-1%
Other Salaries & Wages	3,495	48%	3,109	48%	2,757	48%	1,991	35%	1,691	48%	20%
Rent	72	1%	72	1%	73	1%	74	1%	75	2%	-1%
Payroll Taxes	402	6%	363	6%	318	6%	231	4%	198	6%	20%
Truck/Equipment/Auto Exp	621	9%	508	8%	451	8%	399	7%	313	9%	19%
Insurance	90	1%	73	1%	61	1%	48	1%	41	1%	22%
Legal/Professional Expense	41	1%	31	0%	29	1%	27	0%	26	1%	13%
Travel & Entertainment	5	0%	5	0%	5	0%	4	0%	4	0%	6%
Director Fees	18	0%	10	0%	6	0%	5	0%	3	0%	58%
Pension & Profit Sharing	71	1%	64	1%	58	1%	42	1%	36	1%	19%
Other Operating Expenses	522	7%	469	7%	416	7%	332	6%	286	8%	16%
Depreciation & Amortizatio	73	1%	84	1%	86	1%	68	1%	57	2%	8%
Total Operating Expenses	5,568	76%	4,941	76%	4,422	77%	3,383	59%	2,895	82%	18%
Operating Profit	1,727	24%	1,548	24%	1,333	23%	773	13%	634	18%	31%
Other Income/(Expense)											
Interest Expense	-120	-2%	-107	-2%	-94	-2%	-68	-1%	-58	-2%	20%
Other Income	84	1%	67	1%	53	1%	31	1%	22	1%	41%
Total Other Income/(Exper	-36	0%	-40	-1%	-41	-1%	-37	-1%	-36	-1%	0%
Income Before Taxes	1,691	23%	1,508	23%	1,292	22%	736	13%	598	17%	32%
Income Taxes	642	9%	573	9%	490	9%	279	5%	227	6%	32%
Net Income/(Loss)	1,049	14%	935	14%	802	14%	457	8%	371	11%	30%