RCReports
Reasonable Compensation Simplified™

Definition of Adjusted Gross Profit

Adjusted gross profit is gross revenue less the direct cost of producing this income. The direct cost of producing income is all expenses that have a one to one relationship to producing income. This concept is like but not identical to gross profit.

By way of several examples:

1. Retail business, revenue of $28,000,000, cost of products sold $12,600,000. Adjusted gross profit is $15,400,000 ($28,000,000-$12,600,000).
2. Construction business, revenue of $35,000,000, material cost to produce said revenue $12,000,000, labor to produce revenue $14,000,000, equipment rental specific to construction jobs generating revenue $1,000,000, equipment rental for administration expenses $250,000. Adjusted gross profit is $8,000,000 ($35,000,000-$12,000,000-$14,000,000-$1,000,000). The equipment rental that is used for administrative is not included as there is not a one to one relationship between revenue and this equipment rent.
3. Real estate sales, revenue $30,000,000, commissions paid to agents $25,000,000. Adjusted gross profit is $5,000,000 (30,000,000-$25,000,000).

The logic behind AGP – A more reliable gage of SMB's revenues as a Reasonable Compensation parameter:

Assume two managers with equal education and experience working in different industries: Manager A works in Construction and Manger B works in Professional Services.

Assuming all parameters for determining their reasonable compensation are identical except Industry and *Gross Revenue*

Scenario One:

Manager A
Construction Firm
Gross Revenue $25m
Employees 10

Manager B
Professional Services Firm
Gross Revenue 2.5m
Employees 10

In Scenario One Manager A would command a higher reasonable compensation figure because gross revenue is significantly higher than Manager B's

Scenario Two:

Manager A
Construction Firm
Adjusted Gross Profit $2.5m
Employees 10

Manager B
Professional Services Firm
Adjusted Gross Profit 2.5m
Employees 10

In Scenario Two both Manager A and Manager B are placed on more equal footing. Theoretically Manager A and Manger B could swap places with the appropriate industry knowledge.