TRADITIONAL CRAFT DESIGNS: GETTING THE NUMBERS RIGHT! [1]
A CASE EXERCISE IN FINANCIAL ACCOUNTING AND ANALYSIS

INTRODUCTION

Traditional Craft Designs (TCD) was a sole proprietorship owned and managed by Ms. Debra Atwell. The firm was founded in June 2006 and operated from a room in Ms. Atwell's home in Santa Rosa Heights, Arima, Trinidad and Tobago. TCD employed two direct sales representatives who marketed the firm's products to potential customers in specially targeted geographic locations using a web-based catalogue.

Ms. Atwell was offered an attractive opportunity to lease space at the Crown Point International Airport, Tobago to establish a retail outlet. Following the offer she met with an officer of the National Entrepreneurship Development Company (NEDCO)[2] to discuss the opportunity and seek a $40,000[3] loan to finance the capital and operating costs associated with the proposed retail outlet.

The NEDCO officer was impressed by Ms. Atwell's passion for her business, and the fact that she had operated the business for some time, gaining a good understanding of her potential market and business model. The officer advised Ms. Atwell that she needed to prepare a formal business plan as part of the loan application process. He indicated that the business plan must include historical financial statements for at least two years and forecasted monthly financial statements for one year. The officer also advised Ms. Atwell that she needed to submit the business plan within three days to ensure that the loan application would be processed in time to meet her deadline for responding to officials at the Crown Point International Airport.

Ms. Atwell approached your accounting firm to assist her in completing the financial elements of her business plan.

BACKGROUND

Ms. Atwell was a university graduate with an honors degree in Social Sciences. She had 15 years work experience in the corporate sector of Trinidad and Tobago. Her initial work experience spanned 13 years with a regional commercial bank as an administrative officer. In the past two years, she worked as a coordinator for graduate programs at a private university.

Ms. Atwell started business as TCD on June 1, 2006 to supplement her income and fulfill her desire to "help Caribbean women rediscover their ancestral heritage." On that date she transferred $30,000 into a checking account in the business's name at the Tunapuna branch of First Citizens Bank Limited (FCB). Also, on October 1, 2007 Ms. Atwell deposited her income tax refund check for $15,000 into the business's FCB account.

TCD specialized in the sale of afro-centric jewelry and household items. Most of the merchandise inventory was purchased from a few international suppliers. However, Ms. Atwell also designed some items and contracted with local craft persons to have them manufactured.

Ms. Atwell was not the stereotypical entrepreneur. While she loved the creative, sales and marketing aspects of the business, she also understood the importance of the routine administrative and accounting functions. Typically she placed all her sales invoices, receipts and other source documents in an inbox when they were received or issued; and, as time permitted, she recorded them in a columnar note book.

Ms. Atwell employed two sales representatives. One representative was based in Port of Spain, the capital of Trinidad and Tobago, and the other representative was based in San Fernando, the industrial hub of the country. The sales representatives were independent consultants and were responsible for their own taxes, health insurance and other statutory requirements. They were paid a 30 percent commission based on the invoice amount of each sale. All sales were either on a cash basis or on a layaway[4] plan. They earned their commission immediately on cash sales; however, commissions on layaways were paid when customers made their final payment on the merchandise.

Ms. Atwell promoted her business and its products primarily through a web-based catalog and by referrals from customers. The catalog was developed by Ms. Atwell's son as a gift. He also trained Ms. Atwell to maintain and update the catalog, which she did after each purchase of inventory and as products were sold. Ms. Atwell used a high-speed internet service to access the website. The internet service was shared with Ms. Atwell's son who used it extensively.

The sales representatives had access to the web-based catalog and received selected inventory items on consignment. These items were collected by the sales representatives at Ms. Atwell's home. When a sales representative sold an item that was not in her consignment, she would notify Ms. Atwell who then packaged the item and arranged for it to be collected by, or delivered to, the sales representative. Each sales representative provided Ms. Atwell with a biweekly sales report with supporting invoices and receipts. Additionally, Ms. Atwell verified the inventory held by each sales representative on a monthly basis.

FINANCIAL ASPECTS OF THE BUSINESS

Typically, Ms. Atwell purchased inventory every 2 months using funds from TCD's bank account. The average markup was 200 percent on cost on all items. Ms. Atwell routinely paid household expenses using business funds.

During the first month of operations, Ms. Atwell purchased a prepaid cellular phone for $1,500 for business purposes. She also bought a laptop computer and a laser printer for $4,500 for use in the business; she estimated that the cellular phone, computer and printer each had a useful life of three years when purchased and no residual value.

TCD's business office (room) was fitted with two storage cabinets, a desk, a secretarial chair, two general purpose chairs, and two pedestal fans. These items were purchased at a garage sale shortly after the business started operations for a lump sum of $1,600. At the time of the purchase the items had an estimated useful life of 4 years and no residual value.

Ms. Atwell arrived at your office with three large envelopes containing (1) sales invoices, (2) bills and purchases invoices, and (3) the following summary of the expenses and revenues of the business for TCD's first two years of operation, respectively:

Summary of Expenses and Revenues

	Details	**2007**		**2008**
1.	Internet services (25% of which was chargeable to the business)	2,640		2,640
2.	Electricity (20% of which related to the business)	1,320		1,568
3.	Transportation (for Ms. Atwell to visit customers and suppliers)	1,784		2,245
4.	Prepaid cards for cellular phone	925		1,345
5.	Rent for Ms. Atwell's home (20% of which related to the business)	25,200		25,200
6.	Miscellaneous household expenses	630		760
7.	Stationery and supplies	1,945		2,416
8.	Bank charges	643		875
9.	Depreciation was computed using the straight–line method			
10.	Commissions paid to sales representatives	8,628		11,741
11.	Sales by Ms. Atwell*	15,450		23,175
	* These amounts included the value of layaway sales outstanding as at the end of each period.			

The following additional information was provided by Ms. Atwell:

		2007		**2008**
a.	Cash collected for customers on layaway items not yet delivered	$3,124		$2,794
b.	Unpaid electricity bills for services used during April and May	230		256
c.	Merchandise inventory on hand at year end (paid for prior to year end)	2,100		3,200
d.	Office supplies on hand	-		320
e.	TCD's fiscal year end was May 31.			

Assignment:

1. Prepare a Balance Sheet for TCD just after the bank account was opened on June 1, 2006 (i.e., immediately following the initial investment by Ms. Atwell).

2. Record all the transactions completed by TCD in 2007 and 2008, including associated adjusting (journal) entries using the Fundamental Accounting Equation with a separate column for each account. The computer, printer and cell phone should be classified as "Office Equipment," while the storage cabinets, desk, chairs, and pedestal fans should be classified as "Office Furniture." (**Hint:** review the case material for information on the financial transactions not included in the summary on page 5. For example, the first

financial transaction is described on page 1, and involves Ms. Atwell's initial investment in the business. There is also a transaction for 2008 on page 2).

3. Prepare Income Statements for TCD for the periods ended May 31, 2007 and 2008, respectively.

4. Prepare Statements of Owners' Equity for TCD for the periods ended May 31, 2007 and 2008, respectively.

5. Prepare Balance Sheets for TCD as at May 31, 2007, and 2008, respectively.

6. Prepare Statements of Cash Flows for the period ended May 31, 2007 and 2008, respectively.

7. Compute the following financial ratios for TCD for 2007 and 2008:

a.	Quick ratio	e.	Gross profit ratio
b.	Current ratio	f.	Net profit ratio
c.	Number of Days Sales in Inventory	g.	Return on Average Total Assets
d.	Asset (Average Total) Turnover ratio		

8. Using the financial ratios computed in requirement 7 above, and the financial statements prepared in requirements 3 through 6, evaluate the strengths and weaknesses of TCD (Ms. Atwell) as a candidate for the loan she is seeking from NEDCO.

9. List three other factors that a financial institution will usually consider when evaluating a loan application.

10. Would you approve the loan for TCD?

11. What conditions would you place on the loan if it was approved?

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[1] This is a factual case based on a real company and real people. The names of the companies and the key actor have been changed as requested by the owner of the firm.

[2] NEDCO is a state owned company which facilitates the success of small and micro enterprises by providing financing, training and management advisory services at subsidized prices.

[3] All dollar amounts are in Trinidad and Tobago currency (TT$). The TT$ has a floating exchange rate that is pegged to the US dollar. It has traded between TT$6.20 and TT$6.35 to US$1.00 during the past 5 years.

[4] Layaway, also called lay-by in some countries, involves the customer purchasing an item by making a series of payments over time, rather than paying the entire cost at once. The layaway customer does not receive the item until it is completely paid for. The seller usually sets the item aside in storage until full payment is received from the layaway customer.