Cases

Case 1–1

Ribbons an' Bows, Inc.

In January 2010, Carmen Diaz, a recent arrival from Cuba, decided to open a small ribbon shop in the Coconut Grove section of Miami, Florida. During the month, she put together a simple business plan, which she took to several relatives whom she believed would be interested in helping her finance the new venture. Two of her cousins agreed to loan the business $10,000 for one year at a 6 percent interest rate. For her part, Carmen agreed to invest $1,000 in the equity of the business.

On March 1, 2010, with the help of an uncle who practiced law, Carmen formally incorporated her business, which she named "Ribbons an' Bows." Normaliy, the uncle would have charged a fee of $600 for handling the legal aspects of a simple incorporation, but, since Carmen was family, he waived the fee.

As soon as the new business was incorporated, Carmen opened a bank account and deposited the cousins' $10,000 loan and her $1,000 equity contribution. The same day, she signed an agreement to rent store space for $600 per month, paid on the last day of the month. The agreement was for an 18-month period beginning April 1. The agreement called for a prepayment of the last two months' rent, which Carmen paid out of the company bank account at the signing.

Over the next few weeks, Carmen was actively engaged in getting ready to open the store for business on April 1. Fortunately for Carmen, the previous tenant had left counters and display furniture that Carmen could use at no cost to her. In addition, the landlord agreed to repaint the store at no cost, using colors of Carmen's choice. For her part, Carmen ordered, received, and paid for the store's opening inventory of ribbons and ribbon accessories; acquired for free a simple cash register with credit-card processing capabilities from the local credit-card charge processing company after paying a refundable deposit; signed service agreements with the local phone and utility companies; ordered, received, and paid for some store supplies; and placed and paid for advertising announcing the store opening in the April 2 edition of the local paper. In addition, she bought and paid for a used desktop computer with basic business software already installed to keep track of her business transactions and correspondence.

On March 31, before opening for business the next day, Carmen reviewed the activity in the company's cash bank account. Following the deposit of the loans and equity contribution, the following payments were made.

1. Last two months' rent	$1,200
2. Opening merchandise inventory	$3,300
3. Cash register deposit	$ 250
4. Store supplies	$ 100
5. April 2 edition advertising	$ 150
6. Used computer purchase	$2,000

After reviewing her cash transaction records, Carmen prepared a list of Ribbons an' Bows assets and sources of its capital (see Exhibit 1).

EXHIBIT 1 Carmen's March 31, 2010, Ribbons an' Bows Assets and Capital Sources List

	Assets		Sources of Capital
Cash	$ 4,000		
Inventory	3,300		
Supplies	100		
Prepaid rent	1,200		
Prepaid advertising	150		
Computer/software	2,000	Cousin's loan	$10,000
Cash register deposit	250	Carmen's equity	1,000
	$11,000		$11,000

Carmen eventually decided to expand her business by selling custom-designed ribbon table arrangements for weddings and other special events. This decision led to the purchase of a used commercial sewing machine for $1,800 cash on May 1.

Later, at a family Fourth of July celebration, one of Carmen's cousins reminded her that she had promised to send the cousins a financial report covering the four-month period from March 1 to June 30.

The next day, Carmen reviewed the following Ribbons an' Bows information she had gathered over the last four months.

1. Customers had paid \$7,400 cash for ribbons and accessories, but she was still owed \$320 for ribbon arrangements for a large wedding delivered to the customer on June 30.
2. A part-time employee had been paid \$1,510 but was still owed \$90 for work performed during the last week of June.
3. Rent for the three-month period had been paid in cash at the end of each month, as stipulated in the rental agreement.
4. Inventory replenishments costing \$2,900 had been delivered and paid for by June 30. Carmen estimated the June 30 merchandise inventory on hand had cost \$4,100.
5. The small opening office supplies inventory was nearly all gone. She estimated supplies costing \$20 had not been used.

Carmen believed that the initial three months of business had been profitable, but she was puzzled by the fact that the cash in the company's June 30 bank account was \$3,390, which was less than the April 1 balance of \$4,000.

Carmen also was concerned about how she should reflect the following in her financial report:

1. No interest had been paid on the cousins' loan.
2. The expenditures made for the desktop computer and its related software and the commercial sewing machine. She believed these expenditures would be beneficial to the business long after June 30. At the time she purchased the commercial sewing machine, Carmen estimated that it would be used for about five years from its May 1 purchase date, when it would then have to be replaced. Similarly, on March 31, she had estimated the desktop computer and its software would have to be replaced in two years' time. Carmen believed the sewing machine and the computer along with its software would have no resale value at the end of their useful lives.
3. The free legal work performed by her uncle and the free cash register provided by the local credit-card charge processor.
4. Carmen had not paid herself a salary or dividends during the four months of operations. If cash was available, she anticipated that sometime in July she would pay herself some compensation for the four months spent working in the business. Before starting her business, Carmen had worked for \$1,300 a month as a cashier in a local grocery store.

Questions

1. How would you report on the three-month operations of Ribbons an' Bows, Inc., through June 30? Was the company profitable? (Ignore income taxes.) Why did its cash in the bank decline during the three-month operating period?
2. How would you report the financial condition of the business on June 30, 2010?
3. Do you believe Carmen's first three months of operation could be characterized as "successful"? Explain your answer.