Case D: Mills Fitness

Julia Mills started an instructional fitness program five years ago. Her business venture, called Mills Fitness, had started with two clients who each paid her $100 a week (two one-hour classes) to guide them with in-home exercises. Over time, Julia's client base had grown, and she had hired other instructors to teach things like Tai Chi and Karate. Last year, she had even rented a warehouse and filled it with gym equipment so classes could be held there.

Unfortunately, Julia had underestimated the costs of building and running a larger operation. Partway through equipping the gym, she had run of cash and maxed out her credit cards. However, she had been able to secure a $20,000 line-of-credit at 6.50% to finish the project. Julia has been paying the interest on her debts, but hasn't been able to generate enough free cash flow to pay down any principal.

Here is the Liabilities and Shareholder's Equity section of Julia's balance sheet:

Liabilities		
Credit card debt, 20%	$12,500	
Line-of-credit, 6.50%	20,000	
Long-term bank loan, 4.75%	50,000	
Total Liabilities		$82,500
Shareholder's Equity		
Julia Mills, Capital		$30,000
Total Liabilities and Shareholder's Equity		$112,500

Julia suspects that she has not been able to pay off any debt because of her rising expenses. Over the past year, she has hired three full-time staff at a salary of $50,000 each. Prior to this hire, Julia mainly used contractors who charged her between $40 and $50 per hour. Here is a list of Julia's other major expenses:

Julia's salary	$6,000 per month
Rent for office space	$1,500 per month
Rent for warehouse	$3,000 per month
Equipment maintenance	$300-$500 per month
Janitorial services	$2,000 per month
Contractors (4 fitness trainers)	$10,000-$12,000 per month

Julia estimates that her other expenses such as utilities and telecommunications bills total between $1,500 and $2,000 a month.

To cover her expenses, Julia has increased her rates over time. She wonders if certain rates are too low. She is charging more than most of the other fitness training services in the area, but her competition typically pursues people with gym memberships. By having her own facility and offering in-home training, Julia feels that she has access to a larger market than her competitors. Last month, Julia's sales numbers looked like this:

In-home sessions (124 individual)	$7,440
In-home sessions (40 monthly memberships)	20,000
Gym training sessions (33 individual)	1,980
Gym training sessions (26 monthly memberships)	2,600
Specialized group sessions (71 monthly memberships)	9,230

Julia promotes her company by allowing customers to "try before they buy." She lets newcomers experience a free training session of their choice prior to purchasing memberships or more individual sessions. Furthermore, she lets monthly subscribers pay the end of each month, as opposed to the beginning. Of course, this occasionally presents collection problems, but Julia believes her friendly policies do more good than harm. She is expecting 5% monthly growth for the remaining 6 months of 2020.

Julia has been reading up on the importance of budgeting and wants to do a better job of managing short-term finances. Unfortunately, she has no idea where to start. Recently, she has run into issues with paying bills on time. Her suppliers have been understanding for the most part, but Julia is wondering what the long-term impact of delaying payments might be.

A sizeable union has approached Julia with a proposal. In short, Julia would offer 300 union members access to all services for $100 per month, with in-home and gym training sessions capped at five per month for each member. If this initial arrangement goes well, the union has the option of adding 700 more members to the agreement. Julia isn't sure if this arrangement will be profitable for her, but she is both excited and anxious at the prospect of adding so many customers at once.

Julia knows she will have to hire an additional staff member to make things work. However, she is confident that her four salaried trainers will be able to handle the full workload of the new contract, after some of their current workload (maybe 30 hours per month) is moved to contract employees. Julia estimates there will be 20% increases in janitorial and equipment maintenance costs with the increased volume. If 1,000 members are added, Julia expects current contractor, janitorial, and maintenance costs to double. She will also need a bigger facility in the near future.

Finally, she is growing increasingly concerned about handling the business side of things. Julia's passion is growing her business and providing great service to her clients, but keeping track of bills, collections, and other menial tasks have really eaten up her time. Her tax accountant has warned her that bookkeeping should be done on a monthly basis at minimum, so Julia has tried to learn things on the fly with online tutorials. She is worried that she isn't doing the work correctly and her accountant will refuse to complete her tax return this year.

Required: Identify all accounting issues raised in this case and make recommendations for Julia. Help her prepare budgets and stress the importance of budgeting. Also, advise if she should accept the special order or not (discuss ALL relevant factors). You are encouraged to refer to course information as well as other sources. Present your work in professional report form.