Allen Frame Company (AFC) is a privately owned family corporation that designs and manufactures picture frames for artist and retail stores. AFC also provides a custom framing service to individual artists. AFC began two years ago when the Allen family acquired a bank loan for $100,000. AFC has grown to $800,000 in sales for 2005. $700,000 of its sales came from the manufacturing of picture frames, and $100,000 in sales were from the custom framing service it provides to individual artists. AFC sees its manufacturing business growing rapidly over the next three years.

The following is the accounting/operational activity that has occurred over the first two years of operation:

Allen Frame Company 2004 and 2005 Activity				
No.	Activity	2004	2005	Total
1	Received cash from second mortgage	100,000	0	100,000
2	Paid startup costs	10,000	0	10,000
3	Paid for market & location research costs	5,000	0	5,000
4	Bought raw materials to manufacture frames	125,000	170,000	295,000
5	Paid salaries to selling and office employees	50,000	52,000	102,000
6	Paid wages to production workers	75,000	100,000	175,000
7	Bought office furniture and equipment	15,000	0	15,000
8	Bought manufacturing equipment	30,000	0	30,000
9	Posted depreciation on office furniture	2,200	2,200	4,400
10	Posted depreciation on manufacturing equipment	3,000	3,000	6,000
11	Paid rent on manufacturing facility	12,000	12,000	24,000
12	Paid utility cost on manufacturing facility	4,000	4,000	8,000
13	Realized sales from frame manufacturing	300,000	400,000	700,000
14	Realized sales from custom framing	50,000	50,000	100,000
15	Paid rent on office space	3,000	3,000	6,000
16	Paid utility cost on office building	800	800	1,600
17	Paid advertising costs	3,000	4,000	7,000
18	Cost of goods sold	155,435	292,800	448,235

Assume that all transactions were cash transactions except for adjusting entries for depreciation.

In 2004, AFC manufactured 17,000 picture frames and sold 15,000 picture frames. It completed and sold 1,000 custom framings for artist customers.

In 2005, AFC manufactured 23,000 picture frames and sold 20,000 picture frames. It completed and sold 1,000 customer framings for artist customers.

The AFC management team feels it can increase framing production by 25% without increasing fixed costs. AFC, however, would like to double its revenue over the next two years. This will require a $75,000 increase in its fixed costs for the addition of manufacturing space, equipment, and salaries.

Some of the issues that will confront management during this growth period is maintaining the level of expertise in the design and manufacturing areas and developing the level of competence to control a family business of this size.

Management is also concerned about growing its profitability to become a publicly traded corporation within the next five years, pay a reasonable bonus to key management, and maintain its ability to pay a competitive wage and salary (when compared to the industry standards). These concerns focus AFC's responsibility to its current customers and its current family share holders and will influence how AFC classifies these costs by recording them as assets or expenses. Additional concerns include the following:

- Should AFC purchase/build a manufacturing facility or continue to pay rent?
- Should AFC consider outsourcing some of its manufactured products, and if so, will it maintain a competitive cost structure to price its frames at a competitive level?
- How should AFC determine its pricing strategy when customers are concerned mostly about price?

You report to Jon Allen, the president and owner of AFC, as the corporate controller. You have been asked to evaluate the first two years' performance and research the possible problems AFC may encounter during this growth period.