

CHIPS FALL! COMPTROLLER’S GUIDE REMOVES EMOTION AND SUBJECTIVITY FROM HIGHLY SENSITIVE COST ALLOCATION DECISIONS, OR DOES IT?

Christopher Solano

Dena Breece

University Of North Carolina At Pembroke

In the final hours before his Company’s year-end “Hard Close,” Adrian Martin, a freshly promoted Senior Analyst at GP Corporation, faced a crucial decision. Martin had just received a significant invoice that he has been anxiously waiting for covering three months of contracted warehouse services (\$102 Million) which is both late (3 Months) and 20% over the estimated cost. As a result, Adrian must quickly decide how to allocate the \$102 Million year-to-date (YTD) project costs to all five participating Global Business Units (GBUs). Martin’s high-profile, well-respected predecessor had allocated smaller started-up cost invoices to the 5 GBUs by sales volume throughput of the common warehouse facility. However, Martin discovered during his due diligence and verification process reviewing the company’s “Comptroller’s Guide” that projects with these specifications should be allocated based on square foot usage of the facility or usage “Footprint.” Therefore, Martin must decide whether to incorrectly allocate the final invoice by GBU sales throughput via the previous allocation methodology or follow Company guidelines/protocol/and procedures as clearly established in the Company’s Comptroller’s Guide and allocate the faculty costs based on warehouse usage footprint by square footage. The allocation method Martin chooses will have enormous repercussions and financial implications on individual GBU financial performance and individual compensation, such as bonuses and performance evaluations.

INTRODUCTION

It was 4:45 AM the morning of Sunday, January 8th, 2017, when Adrian Martin was startled by the sound of his cell phone ringing. On the other line was the company’s Corporate Controller, Gayle Prince, very urgently requesting Martin’s presence in her office in the 90 minutes. Martin could tell by the tone of her voice and the urgency of her call, she was frantic! This was an usual request and tone from the normally unshakeable, experienced, and highly trusted Prince.

Martin was the newly appointed Senior Analyst at GP Corporation and was ending a 100-hour end-of-the-year closing week. With his newly minted MBA from a top 10 business school, exemplary performance on previous assignments, demonstrated leadership, and calm demeanor, Martin was fast tracked into this high-profile role.

The Fiscal Year 2016 “Hard Close” was less than 19 hours away, after which no adjustments could have been made as the Corporation’s financial information was locked and published. The night before, Martin had received a delayed invoice that he has been anxiously waiting for covering three months of contracted warehouse services (\$102 Million) which is both late (3 Months) and 20% over the estimated cost. As a result, Martin must quickly decide how to allocate the \$102 Million year-to-date (YTD) project costs to all five participating Global Business Units (GBUs).

Martin replaced a high-profile Finance Manager who had abruptly left the company. The prior Finance Manager had previously allocated smaller start-up invoices to the 5 GBUs for this warehouse project based on the percent of sales throughput of this new multi-GBU warehouse concept. However, Martin had discovered that the Corporation’s Comptroller’s Guide (which was the company’s definitive master document on all financial rules, protocols, and procedures) clearly stated that multi-GBU warehouse projects were to be allocated based on warehouse footprint (the warehouse square footage) used by individual GBU products.

The allocation method Martin chose would have enormous repercussions and financial implications on individual GBU financial performance, particularly individual compensation such as bonuses and performance evaluations. Of particular importance was information that the previous project Financial Manager had made preliminary allocation estimates based on the percent of sales and projected costs and distributed the estimates to the GBU Presidents and the company CEO and CFO. This had subsequently become the default cost allocation estimate for the project for each GBU.

BACKGROUND

GP Corporation was a multi-national, multi-business, consumer products company that manufactured and specialized in a wide range of personal health/consumer health, personal care, and hygiene products; these products were organized into several segments called Global Business Units (GBUs), including Beauty Care; Health Care; Fabric & Home Care; Baby & Family Care; and Snacks and Beverages.

The GBU and its product description, along with the net year-end sales data, net sales business percentage by segment, pick and pack services by segment, and the segment square footage, were summarized in TABLE 1 below:

TABLE 1
GBU Name, Description, Sales/Service Data, and Segment Square Footage

GBU	GBU Product Description	Net Year-End Sales	Net Sales Business % by Segment	Pick & Pack Services By Segment	Segment Square Footage
Beauty Care	Hair care, skincare, cosmetics, fine fragrances, deodorants, and feminine products	\$12.6 Billion	28%	43%	9%
Health Care	Oral care, personal health care, pharmaceuticals and pet, health, and nutrition.	\$12.2 Billion	13%	31%	20%
Fabric & Home Care	Laundry detergents, dish care, fabric enhancers, and surface cleaners	\$9.9 Billion	29%	7%	21%
Baby and Family Care	Diapers, wipes, tissue, and towels	\$5.8 Billion	23%	12%	40%
Snacks and Beverages	Coffee, snacks, commercial services, and juice	\$3.2 Billion	7%	7%	10%

The Company was investing/experimenting with a very large, expensive, and potentially game-changing initiative. The “Best Price Logistics” initiative was essentially Amazon before there was Amazon, where all the Company’s products

were available in a massive warehouse at full truckload best price. Best Price Logistics was forecasted to be potentially a multi-billion-dollar-a-year revenue opportunity designed to drive incremental volume via lowering out of stocks on the shelf.

The warehouse and pick and pack services were outsourced to a third-party provider (Premier Warehouse and Logistics) and managed by GP's Corporate Shared Services. The finance lead of "Best Price Logistics" recently left the company for another competitor in the middle of the project. Corporate services had just assigned a relatively new senior analyst, Adrian Martin, to the project to finish the Pro-forma modeling and, more importantly, complete the Year End closing process, which included allocating the Year-To-Date project costs to all five participating GBU (Global Business Units). Corporate Central Services have finally received a delayed invoice for three months of contracted services (\$102 Million) which was both late (3 Months) and 20% over the estimated cost (see TABLE 2 below). Martin consulted the Corporate Comptroller's guide (the company's definitive master document on all financial rules, protocols, and procedures) regarding cost allocation for warehouse services and followed guidelines for allocating costs to participants based on the square footage used. *Note Martin's predecessor had allocated prior smaller invoices for startup costs/other to the GBUs based on the sales volume percentage through the facility.

TABLE 2
Premier Warehouse and Logistics Cost of the Project Invoice Data for GP Corporation as of December 2016

October 2016	
Warehouse	\$ 16,280,000
Pick and Pack	\$ 11,840,000
Admin & Other	\$ 1,480,000
Total	\$ 29,600,000
November 2016	
Warehouse	\$ 10,470,000
Pick and Pack	\$ 22,685,000
Admin & Other	\$ 1,745,000
Total	\$ 34,900,000
December 2016	
Warehouse	\$ 11,250,000
Pick and Pack	\$ 24,375,000

Admin & Other	\$ 1,875,000
Total	\$ 37,500,000
Total Invoice	\$ 102,000,000

Consistent with the Comptroller’s Guidelines, Martin obtained a square footage report from the 3rd party warehouse operator and allocated the cost to the participating GBUs in the accounting system at 11:20 PM on Saturday after completing a grueling 100+ hour work week to order to meet the Hard Close (when the Corporation’s books would have been finalized/closed and were reported to the public) deadline for Fiscal Year 2003at less than 25 hours away. After the hard close, no adjustments could have been made to the Company’s financial information. The system would have been locked, financials published, and everyone would have gone home.

Martin was awakened by a phone call 4:45 AM from the Company’s Controller stating there was an emergency meeting at Head Quarters (HQ) in 2 hours, and his presence was urgently requested 30 minutes prior. On the way to HQ, Martin was informed that all 5 GBU Presidents would be present in the meeting/conference call to review the magnitude and the allocation method of the Best Price Logistics expenses. It was further determined that some GBUs had estimated and accrued the expected allocated costs based on the previous allocation method of sales volume. Other GBUs had not accrued any expenses based on the limited sales activity throughout the project. Martin reviewed all the information with the Corporate Controller and Chief Financial Officer before the meeting/conference call with the GBU Presidents. It was determined that the costs were validated. The allocation method was according to guidelines.

During the meeting, it was confirmed that although the Company was expensed the correct amount for the overall project activity, the allocation of the \$102 Million had significant ramifications and implications for individual GBU financial performance and, more importantly, individual and GBU compensation and bonus implications.

The GBU Presidents were demanding answers as to what happened to their forecasted net income, what changed, why it changed, who adjusted their GBU financials, whether this was the final accounting, and whether there was any opportunity for readjustment.

With all the data reviewed and the Comptroller’s guide consulted, Gayle Prince, the company’s Controller, said, “Chips Fall,” meaning this was correct, and this was what would be reflected in the final financial closing.

This was immediately escalated to the Chief Executive Officer for further discussion, and Martin was politely excused from further conversations involving this matter.

DILEMMA

Martin was faced with a dilemma regarding allocating this very late, substantial, highly material, and impactful invoice to the awaiting GBUs.

1. Option 1 was to incorrectly allocate the final invoice by GBU sales throughput via the previous allocation methodology:
 - Precedent and, unfortunately, cost allocation expectations were incorrectly set by his predecessor when the start-up costs for this warehouse project were incorrectly allocated to the GBU based on the sales throughput of this facility. Additionally, the logistics provider's late timing of this invoice had facilitated the need for GBUs to estimate and accrue the expected cost allocation of this project based on the previous allocation methodology of sales throughput into their Profit and Loss Statements, whereby performance and bonus expectations were set. As a result, the final invoice adjustment would be a mere confirmation.
2. Option 2 was to follow Company guidelines/protocol/and procedures as clearly established in the Company's Comptroller's Guide and allocate the faculty costs based on warehouse usage footprint by square footage.
 - This would have been a substantial material departure from the previously implemented allocation methodology, creating significant winners and losers versus expectations and forecasts.

DECISION

Martin had to decide whether to adjust the allocation to follow the predecessor's allocation methodology of sales throughput. Alternatively, Martin could have followed the established protocol and rules documented in the Company's Comptroller's Guide for allocating costs of shared warehouse and logistics facilities based on "Warehouse Footprint in Square Footage" and let the allocation stand as posted.

CLOSING

Under normal circumstances, Martin's decision would have been relatively straightforward, following the Company's guidelines and procedures and allocating accordingly. However, given the timing of the decision, the expectations created by his predecessor, the impact and magnitude the decision would have had on the GBU business performance, and individual evaluations and compensations, Martin's

decision took on a much higher level of complexity and consideration. So, what was he to do? The timing was tight! What allocation should have been posted? Furthermore, was there a different allocation methodology as opposed to sales throughput or warehouse footprint in square footage that could have been applied to these common costs, and why? What would the allocation to the five GBUs look like under an alternative method? How was Martin going to make the best decision for the GP Corporation while doing the right thing and closing out with the best allocation?