Case Study #2 THE GREEN NATURAL WELLNESS COMPANY

The Green Natural Wellness Company, aka GNWC, sells select, high-end nutritional and health and beauty products to small health food stores throughout the United States. Its headquarters and warehouses are located in Clear Lake, Texas, only a couple of miles from the NASA Space Center.

GNWC’s key success factor is its ability to quickly bring to market new products before other suppliers do. The company has two full-time buyers who spend all their time traveling around the world in search of unique “nutraceuticals.” For example, one of the buyers recently discovered that when a common plant in the Brazilian rain forest is mixed with natural emollients, the result is a cream that eliminates even the most difficult cases of acne. After the discovery, GNWC took only six weeks to bring the product to market.

GNWC has four sales divisions that report to the vice president of sales: skin care, hair care, nutritional supplements, and dried foods. Each division operates autonomously with its own revenue and expense budgets. The controller’s office reviews and approves all divisional budgets.

Barbara Larkin is the head of the skin care division. In recent years, her division has done spectacularly well with annual sales growth rates averaging in the 20 percent range and the most recent quarter’s sales being just over $4 million.

Until several years ago, Barbara’s division was so independent that it managed its own collections of accounts receivable, although it forwarded all incoming customer checks to the central finance division for deposit, and all purchase orders had to be approved by the finance division before being forwarded to the purchasing division for addi­tional approval.

About two years ago, Barbara decided to turn over the collection of customer accounts to the collections department in the finance division. Because of the rapid growth in her skin care division, there was a shortage of staff, and she was having a difficult time keeping up with collections. Things were so bad that she wasn’t even able to get good aging reports.

Martin Mouse runs the collection department in the finance division; he is an up-and-coming star in the company. Rumor has it that he’s in line for the vice presidency of finance as soon as the existing VP retires or leaves the company. Furthermore, he’s a cousin of the CEO, so no one wants to get on his bad side.

Under both the present and past system, Barbara’s division has a single master budget account used for crediting all the division’s incoming cash receipts and charging the division’s payments. As a result, the master account should effectively reflect the bal­ance in cash funds available to the division.

Barbara has been having problems with Martin over the last year. First, he has been
asking Mac Plata, the controller, to use his influence to permit Martin to charge
Barbara’s division 7 percent of its revenues for the collection services. That fee would have a seriously detrimental effect on Barbara’s master account and would hinder her ability to continue to grow. Second, Martin’s collection department has not been doing a good job with Barbara’s collections, especially in sending out bills on time and deal­ing with overdue accounts.

The problem with the collection efforts is that Martin periodically shifts his staff’s efforts to the dried foods division and doesn’t give proper attention to the skin care division. The obvious reason for this is that Betty Riley, the head of the dried foods division, has been with the company since it was founded 15 years ago. She regularly eats lunch with the CEO and knows everyone in the company, so Martin wants to win her favor in the hope of furthering his climb to the finance position.

Barbara is very careful with her division’s budgets and her management of its master account. Because her division operates as an investment center, she maintains at least a $1 million balance in the master account at all times as a safety net. She needs this money to be available in case there is a sudden interruption or downturn in sales so that she could continue to operate and pay employees until she could resolve the sales issue.

On the first day of a new month, Barbara reviewed the balance in her master account; it was about $2.3 million. Following her normal practice, she attempted to reconcile this against her internal sales records. She couldn’t reconcile the balance against actual cash receipts because Martin’s collections department handles and processes all receipts. Furthermore, Barbara had to estimate collected sales because sales collection reports were about three months behind in the system, thanks to the fact that Martin inputs all collection data into spreadsheets and forwards them only sporadically to the accounting department.

Barbara took the beginning balance in the master account, subtracted new expenses (which she knew because she has to submit purchase requisitions and payroll authori­zation), and then added an estimate of newly collected sales. She had a pretty good idea of what the collected sales should be because when she handled her division’s col­lections, 95 percent of accounts receivables were collected within 30 days of billing. Barbara checked and rechecked her calculations. The balance in her master account should have been about $1.1 million, not $700,000 as the system reported. That meant that her account was short about $400,000.

Being a little afraid of Martin and mindful of their argument over the collection depart­ment’s charging for her services, Barbara caught him in the hallway and casually asked him to look into the matter. She didn’t immediately blurt out her request but inserted it into a casual conversation regarding an injury accident that had occurred in the ware­house the day before.

Over the following week, Barbara again mentioned the issue on the phone with Mar­tin, but he seemed totally uninterested in helping. Finally, Barbara called him again and told him that if she didn’t get an answer in one day, she would have to report the issue to Martin’s boss, the VP of finance.

Barbara was absolutely sure that the $400,000 had disappeared. She was afraid that Martin had been embezzling incoming receipts. Furthermore, regardless of what happened to the missing funds, Martin had the responsibility for keeping up with col­lections and should have been able to explain what happened to the missing funds.

The next morning Barbara received a call from Myrna Wilson, the secretary to Victor Vaccio, the VP of finance. Myrna spoke as if Barbara were in trouble:

“Mr. Vaccio considers this to be a serious problem. He’s looking into it.”

Barbara was a little shaken because she hadn’t even reported the problem yet.

Barbara had friends in various places in the company. One friend, who works in the assistant controller’s office, told her that Martin was telling Victor and everyone else that Barbara had overspent her budget in the previous quarter.

Barbara then received an e-mail from the CEO’s secretary advising her that her master account was frozen and that Victor must personally approve any expenditures except for continuing payroll. The CEO himself had told Victor to conduct a complete investi­gation. He wanted a complete audit of all sales and collections beginning with the previous quarter.

Barbara was stunned. The CEO had swallowed Martin’s story about Barbara overspending her budget in a previous period, hook, line, and sinker. And Martin was doing the audit.

To make things worse, Barbara’s sales analysis and reconciliation to her master account made her sure that the money had disappeared in the current quarter, not in the previous one. That meant that the investigation would go nowhere for some time, and in the meantime, her budget would remain frozen, and she would have to live with the embarrassment and disgrace that come with being suspected of irresponsible financial conduct.

Barbara called Martin and offered her help in locating the missing funds, but he refused. “I’ve been instructed to keep our investigation independent,” he said. “Sorry, but this means we can’t use any outside help.”

1. From a process standpoint, evaluate how well this investigation began to unfold.
2. Should Barbara have done anything differently?
3. What changes, if any, would you recommend be made to the system?