FUNDAMENTALS OF MANAGEMENT CONTROL
1. INTRODUCTION

Management Control can be defined as the process oriented to verify:

- the advancement status of the planned objectives;
- the efficacy and efficiency of the organization through the analysis of the resources, costs and proceeds.

Management Control has not to be seen as an activity of the administration area’s exclusive competence, but rather as a process which involves, at the appropriate levels of responsibilities, all the company’s functions.

As with all processes, Management Control is constituted by different elements, connected to each other:

- the structure (personnel charged of the duty of control),
- the tools (general accounting, analytical accounting, budgeting, reporting, income statement analysis),
- the procedures (coordination, optimisation).

The Management Control acts through the following phases in sequence:

- planning, where for any company’s unit a set of objectives must be defined, that is of specific expected results, which need to be: understandable, agreed, measurable in extent and time, reachable, consistent with one another and with the available resources,
- programming, where a programme is drawn up in order to get the planned objectives, taking into account the internal and external restraints to the company,
- result checking, where it is measured whether each company’s unit has achieved or not the assigned objectives,
- shifting analysis, where the possible shifting between objectives and results is analysed,
- corrective action implementation, in order to optimise the units’ behaviour against the planned objectives.

To realize a project of Management Control it is necessary to carefully evaluate the reference context where it is intended to be applied and in particular:

- the diffusion of the Management Control culture into the company,
- the availability of appropriate computer and accounting systems.
2. GENERAL AND ANALYTICAL ACCOUNTING

General Accounting is the aggregate of the economical and financial records finalised to determine:
- the results of the accounting period and
- the relevant working capital.

Its most important aims are:
- to inform the stakeholders (i.e. involved people, organizations and authorities, such as: shareholders, clients, suppliers, treasury officers, etc.) on the company’s economics and financial situation,
- to work out the balance sheet of the accounting period.

Analytical Accounting requires detailed book-keeping checks in order to realise:
- where and how the costs originate,
- where and how the revenues originate and therefore
- where and how the margins of profit originate.

3. PRODUCTIVE FACTORS AND PRODUCTION COSTS

Productive Factors, through which the company’s activity is carried out, can be divided in two groups:
- durable productive factors (tangible assets: plant, equipment, computer systems, etc.; intangible assets: trade-marks, patents, accreditations, etc.),
- transient productive factors (materials, power, personnel, processes, etc.).

The values of Productive Factors, spent to realize a specific product or service, are defined Production Costs.

On the basis of what they are referring to, the Production Costs can be divided into:
- specific costs, when they can be directly attributed to a defined product or service,
- general costs, when they are indirectly assigned according to agreed sharing criteria, depending mainly on the company’s organisation.

On the basis of their variability, the Production Costs can be divided in:
- fixed costs (or capacity costs), sustained for the acquisition of the productive factors necessary to guarantee a defined production capacity; they don’t vary, at least in the short run and within certain production volumes,
- **variable costs** (or **capacity use costs**), sustained for the acquisition of the productive factors necessary to reach a **defined production volume**; they vary according to the production volumes.

4. **COST CONFIGURATIONS**

According to the **Productive Factors**, it is possible to define different **Cost Configurations** that give pieces of information consistent to the objectives of the analysis, on the grounds of the basic concept **“the cost cannot ever be severed from the configuration through which has been obtained.”**

The most important **Cost Configurations** are:

- **direct costing** and
- **full costing**.

**Direct costing** takes into consideration only the **variable costs** (or **capacity use costs**) and finds application in the efficiency and economical convenience evaluation in the short term, where the result indicator is the **contribution margin** (**revenues** minus **variable costs**) which represents the capability of a product or service to contribute at the covering of its relevant costs.

**Direct costing** is defined as **“advanced”** when, besides the **variable costs**, also the **fixed specific costs** attributable to a defined product or service (**such as: plant exclusive costs, publicity exclusive costs, etc.**) are taken into consideration.

The **full costing** is obtained, as a subsequent cost stratification, by adding to the **advanced direct costing** the **fixed general costs** (**such as: management and administrative general expenses**) up to the determination of the product or service whole cost.

5. **RESPONSIBILITY CENTRES**

Because of the **Analytical Accounting** has the purpose to analyse where and how revenues and costs originate, the localisations, named **“Responsibility Centres”**, where such an origination process is realised, acquire a particular relevance.

The **Responsibility Centres** can deal with:

- **costs**, when their mission is to minimise costs,
- **revenues**, when their mission is to maximise revenues,
- **profits**, when their mission is to maximise the difference between revenues and costs.

### 6. MANAGEMENT PROCESS CONTROL

From the organisational point of view, *Management Control*, normally carried out by an *Organ* identified in the *Staff* list at the Company’s top management (the person at the head of this *Organ* is qualified as the *Controller*), is implemented according to a periodic cycle (normally annual) through the following phases:

- **preventive control**;
- **concurrent control**;
- **final control**.

The *Preventive Control* or *Budgeting* gets substantial with the drawing up of the *budget* where, through the appropriate simulations, the Company' course in the defined period is anticipated, taking into account all activities, both internal and in outsourcing.

According to its reference sector, the *budget* can be related to:

- **commerce**;
- **production**;
- **purchases**;
- **investments, etc.**

According to its purpose, the *budget* can be:

- **economics**;
- **financial**;
- **patrimonial, etc.**

Through the *budget*, the objectives are:

- made measurable, with the definition of proper *indicators* and their relevant *targets*, that is the values that the indicators must acquire in order to realize that the corresponding targets have been reached;
- supplied with the resources (human, financial, etc.) necessary to their achievement;
- assigned, together with the necessary resources, to the *Responsibility Centres* entrusted with their attainment.

The function of the *indicators* is then that of representing complex phenomena on the basis of synthetic measurements; they are parameters expressed by simple algorithms where measurable...
variables are put in relation to one another. The indicators must, therefore, satisfy the following essential requirements:

- the **measurability** of the phenomenon in terms of the existing correlation among the variables that determine the phenomenon itself;
- the **completeness** and **timeliness** of the information in terms of possibility of monitoring the phenomenon itself in a complete way, according to required frequency;
- the **essentiality** of the datum, in terms of capability of catching the essential features of the observed phenomenon;
- the **inexpensiveness** of the elaboration in terms of cost/benefit, that is the costs sustained for the elaboration of the indicator and the added value obtainable by its knowledge.

Finally the indicators can be:

- **efficacy** related, when they are expressible as a relationship between the obtained result and the expected target;
- **efficiency** related, when they are expressible as a relationship between the obtained result and the resources spent to obtain it.

**Concurrent Control** develops side by side with the management and consists of:

- **periodic measurement** of the indicators;
- **transmission** of gathered information to the Responsibility Centres and the Top Management;
- **taking on of corrective action**, aimed at filling up the variance between the expected results and the actual ones;
- **putting into effect of the decisions taken**.

The **Final Control** closes the control cycle and substantiates itself into the communication, to the Responsibility Centres and the Top Management, of the information about the final measurement of the indicators, with the aim of:

- supporting the subsequent budgeting cycle;
- providing elements for the evaluation of the context where the Responsibility Centre operates, as suggested in the Management by Objectives’ approach.

The **Concurrent Control** as well the **Final Control** express themselves with the Reporting, that is the transmission, to the Responsibility Centres and the Top Management, of Reports from the Management Control Body.
7. DIFFERENTIAL ANALYSIS

In the area of the Company Control Systems, taking expediency choices, against different possibilities, can be necessary. In these cases the Differential Analysis finds its application.

It consists in the evaluation of the cost and revenue variation, according to alternative choices, with the aim of defining the differential result among them. The Differential Analysis develops, in particular, comparing the revenues and costs, both emerging and ceasing, that take place in each considered option, without considering the non eliminable cost, which are insignificant as for the Differential A