# Fundamentals of Management Control

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# 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* ***structur****e (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 cots**, 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 T**op Management**;*
- *t**aking 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