

Controlling in a region

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Introduction

Controlling

Controlling is a relatively new concept compared with financial accounting. Control is about planning, organizing, staffing and directing. It is an important function because it helps to check the errors and to take the corrective actions necessary so that deviations from standards are minimized and the stated goals of the organization are achieved in a desired manner. According to modern concepts, control is an anticipating action whereas earlier the concept of control was used only when errors were detected. Control in management means *setting standards, measuring actual performance and taking corrective action*. Control includes analysis, planning and inspection of the business' procedures, processes and principles.

Definitions

In 1916 Henri Fayol¹ formulated one of the first definitions of control regarding management

Control consists of verifying whether everything occurs in conformity with the plan adopted, the instructions issued and principles established. Its objective is to point out weaknesses and errors in order to rectify them and prevent recurrence.

According to Harold Koontz²

Controlling is the measurement and correction of performance in order to make sure that enterprise objectives and the plans devised to attain them are accomplished

A short and concise definition according to Stafford Beer³

Management is the profession of control

Robert J Mockler presented this definition of managerial control

Management control can be defined as a systematic effort by business management to compare performance to predetermined standards, plans, or objectives in order to determine whether performance is in line with these standards and presumably in order to take any remedial action

¹ Henry Fayol (1841-1925) French management theorist.

² Harold Koontz (1909-1984) American professor of Business Management at the UCLA. Author of the book *Principles of Management*.

³ Stafford Beer (1926-2002) British theorist, consultant and professor at the Manchester Business School.

required to see that human and other corporate resources are being used in the most effective and efficient way possible in achieving corporate objectives

From these definitions it can be stated that there is a close link between planning and controlling. Planning is a process by which an organization's objectives and the methods of achieving the objectives are established, furthermore, controlling is a process which measures and directs the actual performance against the planned objectives of the organization. Thus, planning and controlling are often referred to as the Siamese twins of management.

A short summary of the characteristics of control

- Control is a continuous process
- Control is a management process
- Control is embedded in each level of organizational hierarchy
- Control is forward looking / anticipatory
- Control is closely linked with planning
- Controlling is a tool for achieving organizational activities

Operative management

As stated before in the chapter about “Accounting” there is a difference between financial accounting and management accounting even though they often are based on the same information. Financial accounting is surrounded by rules and is by law compulsory for every type or size of business. Whereas management accounting is voluntary and is performed in addition to financial accounting to supply more information in order to make the right decisions.

Real estate companies often consist of several legal companies which own one or several properties. The legal ownership determines the financial accounting, whereas the management accounting is determined by the way the organization and the responsibility within it is divided. For example a company may legally own properties that are situated in many different regions/cities and therefore is divided between different divisions of management and responsibility. This means that the management does not go hand in hand with the legal structure. The financial accounting cannot in this case be used as the single information of performance because of the shared areas of responsibility. An important tool for presenting financial accounting in accordance with the operative management is to use some kind of database which links information from the company's different “expert systems” such as rental system, accounting system, invoice system, system for energy consumption etc. The economical reports and information presented in this database are important tools for analyzing the performance made by the different divisions of responsibility.

Operative processes

Important operative processes and routines which need to be controlled

- Routines concerning authorization
 - Payments
 - Rental agreements
 - Other binding agreements

- Routines around rentals and rent administration
- Closing process
- Budget process
- Due diligence – transactions
- Process involving building projects and procurement
- Real estate valuation process
- Preparedness - property management

Controlling in a region

As mentioned previously in this essay, controlling is about planning and following up the performance in accordance with the objectives and goals that are stated by, and for the organization. The management in a region has to deal with day to day property management, rental activities, project management, acquisitions and sales as well as property valuation. The cash management and overall financing is often taken care of by financial managers and is not included in the responsibilities within a region.

Business plan

Every year the region states a *business plan*, which includes a reconciliation of current year's objectives, the strategy for next year which includes the objectives within the business area and the financial budget or goal. The business plan of the region is a reflection of the different responsibilities within the region. It is also a reflection of the economic prerequisites and strategy that is stated by the top management and the board. The business plan is the guideline and the objectives must be communicated to the organization, to enable each and everyone to perform according to this plan. Besides the financial goals, which often are stated as desirable key ratios, the business plan also includes "soft" objectives concerning employees and customers.

Budget process

The *budget* is to reflect the most likely operative result for the next business year to be compared with a *goal*, which is the desirable to achieve. A goal aims a little higher than a budget. The difference is subtle but still it is important to communicate whether it is a budget or a goal that is to be stated. In the following text I will refer to budget.

Along with the budget you also state the expected outcome over time the following two or more years. The budget is set for each account, group of accounts, for each property and overhead costs. When the budget is accepted by the executive management and the board, it represents the economical framework for the coming financial / fiscal year. It is the steering tool with which economical performance is compared and evaluated.

In the real estate business, there are more or less variable and predictable items in the income statement. Residential income is relatively easy to predict, it is affected by the yearly negotiation within the Municipal Housing Corporations in Sweden. Predicted vacancy is also a factor to take into consideration. The income from lease-bound activities is more volatile and is dependent on the terms of the valid contract. The cost of heating, which exceeds 50 % of total operating cost, usage bond is affected by climate and tariffs, where the first mentioned is hard to predict. You often use statistics such as "normal" annual consumption when budgeting for the cost of heating. Operating costs such as non usage bond, running maintenance, and maintenance due to tenant movements (omflyttningskostnad) are relatively stable and are affected by inflation, service agreements and the

turnover rate in tenant movements. Planned maintenance on the other hand fluctuates more over time and is due to the status of the property. A several year plan and budget is essential for planned maintenance, which often involves large amounts of money. By budgeting and planning for this a few years in advance, you get important signals ahead of time to be able to take adequate actions such as for example well planned procurement, planning financing or even selling in time.

During the current fiscal/financial year the budget is followed up by one or more prognoses. The prognosis has the same time frame as the budget and functions as a review during the year. Furthermore, we are dealing with estimations and planned operative result and not actual outcome.

Economical performance

Reconciliation of actual economical outcome compared with budget is done regularly but especially in connection with balancing the books which may occur one, three or four times per year. Balancing the books every third month is most common. The accumulated result is compared with the annual budget, this demonstrates the accumulated reprocessing rate (*upparbetningsgrad*) to budget. A more accurate comparison is to compare with a divided budget which means the income and costs are divided during the year when you expect them to occur. For example cost of heating is more than 25 % the first and last quarter of the year. Planned maintenance and cost of lease-bound maintenance do not occur with 25 % each quarter, but follow the maintenance plan. If the accumulated reprocessing rate (*upparbetningsgrad*) is 100 % compared with the divided budget, you perform according to plan/budget.

As mentioned previously evaluation can be done on each account; however, most of the reconciliation is done on a group of accounts, at property level and at regional level. The portfolio of properties changes due to transactions. This means that evaluation of the total portfolio includes both acquired and sold properties, i.e. properties which show a result only part of the year. For a correct comparison you need to exclude properties owned for a part of the year, to the ones you own and manage the whole budget year you talk about “*identical portfolios*” and only properties in this portfolio are comparable. Another distinction is properties that undergoes extensive renovation which makes the management part subordinated. These properties should also be excluded from the comparison of an identical portfolio of investment properties.

Other controlling

Budget, prognosis and closing of the books are the main processes when it comes to evaluating and controlling the operative result during a business year. Beside these processes, there is continual follow up of: the vacancies, the energy consumption, building project’s reprocessing rate compared with granted investment amount, changes in lease-bound contracts, items affecting the value of the property and so on. Areas of responsibilities and staff might also be revised due to changes in the property portfolio.

Summary

Controlling is about creating check points for control in the daily business, to bring to attention the signals about how the business is performing at an early stage and to take the necessary corrective actions. Controlling is about planning, communicating and informing, and not least about clarifying and simplifying the routines and processes that are involved. “A chain is not stronger than its weakest link”; which is true for all processes and routines in our business. This includes everything from which type of information and how it is registered in the rental system, to evaluating a building project and the transactions of one or more properties or companies.