IMPORTANCE OF THE CONTROLLERSHIP FOR THE COMPANY PERFORMANCE - SOFTWARE COMPANY EXPERIENCE

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As industry has developed, grown, and become more complex, the need for increased efficiency and productivity has become more imperative. It is no longer sufficient just to know the cost of manufacture or sell. There is a real need to know if we are using the most economical manufacturing techniques and processes. The article presents the result of research focused on the Importance of the Controllership for the company performance. The main objective of the research was to focus on the common financial problem areas in information technology industry, especially in software companies and with the cooperation of the controllers find out the forms of financial analysis and the solutions for the company performance.

1. Development of the Controllership

The fields of controllership and management accounting have gone through an amazing series of changes in the last twenty years. To start, the field itself has evolved from cost accounting to managerial accounting to management accounting and finally to strategic cost management. The old professional organization, The National Association of Accountants (NAA) changed its name and its mission. It is currently called The Institute for Management Accountants (IMA). Their flagship magazine is called Strategic Finance, replacing Management Accounting.

The history of Controllership in general (especially in Europe) is a relatively short one: Taking Controllership as all the functions exercised by management in coordinating planning and control with the supply of information in order to achieve the firm's objectives. Controllership enables management to adapt the firm to changes in the environment by the process of planning and also to carry out any coordination functions which may be necessary. Due to the increasing amount of laws and regulations in Europe, Controllership function for top management had to meet higher demands and therefore it was investigated by several scientists ever since.

The controller was originally nothing more than a bookkeeper. This person's role was to accurate record all transactions passing through the accounting department, transactions primarily related to the payment of suppliers, the billing of customers, and the handling of cash. The controller was also required to issue periodic financial statements. The traditional career path leading to this position was through the clerical ranks, so that the person in the controller's job was intimately familiar with how to manage the transaction flow and could be relied on to keep the same old systems running forever. The function changed with the advent of computers, since accounting was one of the first company departments to adopt automation. The controller was now required to have more than a passing knowledge of computer systems, including how to select, install, and operate them. This was also a distinctly different job requirement, which led to the hiring of more college level people into the position [1].

In the 1970s and 1980s, managers became more concerned with the efficiency of all company departments, including the accounting function. The increasing pressure came to bear on controllers to find new ways to run their departments in order to wring out all possible inefficiencies. This trend forced out many old-line controllers who were uncomfortable with new systems, but brought in a new breed of heavily educated controllers, many of them with advanced educations and consulting experience, who streamlined many transactional systems and began to reach outside

of the accounting department to other areas of the company to provide a profit center and other specialized forms of financial analysis.

In the early 1970's, the NAA began a new certifying process called the Certified Management Accountant (CMA), similar to Certified Public Accountant (CPA). Recently, they have added a new designation Certified Financial Management (CFM). In a recent newsletter to its members, the Management Accounting section of the American Accounting Association (AAA) asked for opinions on changing the name of the field and the section to reflect the movement of the management accountant into a team player, binging their financial expertise to the decision making table [2].

Since the turn of the century, the focus has progressed along the same trend line we saw established in the last two decades, which is for the controller to manage the accounting department's costs and efficiencies as tightly as possible, while also using a great deal of process and financial analysis skill to assist all parts of the corporation in many ways. Over the course of one century, the controller's function has risen from one of senior clerk to one of the most advanced, highly educated, and useful positions in the entire corporate structure [8].

2. Elements of the Controllership

A controller analyzes and develops timely and accurate financial information, enabling the company to deliver and improve its future overall performance. Traditional accounting and financial functions act as rear view mirrors, measuring past performance. Controllers are forward looking, acting as the businesses headlights. They need to anticipate issues and act to resolve the issues. The earlier in the process that a controller can influence a course of action, the more likely the process will be successful. This requires those in a controller track to develop both a theoretical understanding and practical skills in advanced management accounting, process and structure cost control, and revenue stream management. In short, the controller's job is to make the company's business objectives achievable. Professionals who understand the specifics of their business environment from both a practical and conceptual standpoint contribute immediately to cost management and profit improvement efforts of the overall company and its divisions. Both controllership and financial reporting positions involve the development and maintenance of information and reporting processes to ensure that company objectives are achieved. Beyond this commonality, the focus of the controller's career path involves direct support for future operating decisions [7].

There are five essential elements that need to be emphasized in controllership:

- Production process includes the set of tools needed to manage product component cost, production cost, and revenue streams;
- Manufacturing cost standards and objectives for operations (including purchased raw materials and component parts);
- Revenue analysis methods to improve both aggregate revenue sources and per unit revenue;
- Budgeting processes and objectives such as tracking structure costs, costs behaviors and revenue streams;
- Communication process ensuring that management receives accurate information on issues in a timely manner to take appropriate action.

While the above elements emphasize the integration of advanced managerial and financial accounting tools, successful controllers also excel in organization behavior and leadership skills, operations (production) management, business cycle economics, and managerial finance. In aggregate, they are seen as a strong contributing member of the management team [3].

The above elements focus on an academic tool set that supports the primary objective of controllership: To assist operation management in setting and achieving operating and related financial objectives by providing timely and accurate data to support decision-making. However, there are other hard lessons from experience that evolve the trained accountant into the professional controller. There is always pressure to make projects successful, but stopping failure is just as important as enabling success. Successful controllers master the physicals by understanding what their firm designs, develops, manufactures, sells, and finances. They also know how the manufacturing process (labor, materials, and overhead) relates to, and drives their cost structures. A controller of a manufacturing operation must get on the plant

or shop floor to understand the physicals of what drives cost. Understand that timing is critical. This not only means that decisions have deadlines, but they usually need to be made sooner to be useful. Deliver decisions that you promise on time, and stick to the decision. The practical side of this is to learn how to use incomplete data to establish direction. Waiting for complete data risks making the right decisions too late to be useful.

Experienced controllers identify potential problem areas before they surface, so they develop hindsight from early data. Missed deadlines and cost problems at the early stages of a project are all signals of inadequate development and flawed planning. Recognizing the early signals of failure is an art. It is the controller who is responsible to guide management away from potential denial, and focus their attention on the problem.

Controllers lead the implementation of timely solutions based on facts and data, not popularity and politics. They outline alternatives supported by analysis, recommending an optimal course of action. With operating management‘s support, they provide a roadmap to a resolution by taking an active role in assignment of responsibilities and the implementation of the plan. Whether projects are a success or failure, controllers ensure that ownership and others with accountability are regularly informed and do not waiver from both cost discipline and maintaining focus on bottom line results. As with recent economic events, businesses have relearned that the cost of recovery is a high multiple of the cost of control. A complex reality: A budget is a commitment by operating management that clearly ties financial objectives to operating objectives. Controllers must not only lead the budget process, but also gain management commitment. At the end of the process it is all about results. Positive results require bottom line profit enhancement and managements‘ continued commitment to cost discipline (the budget). Finally, the controller ensures that everything operating management does is focused on achieving the desired results. Within the boundaries of ethics and integrity, do what it takes to achieve the results [4].

Most companies are undergoing significant change. Much of this change is dictated by business environment because companies must respond to competitors‘ improvement. The need to change has not escaped the controller‘s department. Quite frequently information technology is an area in which organizations make changes to enhance their competitive position in today‘s volatile business environment. Companies frequently are disappointed with the results of their projects. In fact, research has shown that the large majority (over 90%) of major projects fail to achieve their objectives on time and within budget. Some projects fail because they are abandoned before they can be installed. However, even if the project is completed, unless the original schedule and budget are achieved, the benefits expected from it will have eroded - perhaps seriously. Why do major projects fail so frequently to achieve their full potential? Interestingly, most of the time, the identified solution is adequate for addressing the problem or opportunity that exists. Consequently, a search for a better solution is not likely to improve the outcome. Instead, most failures are directly attributable to the implementation of the solution. Most major projects involve changes to technology and business processes. These changes will affect the way people do their work, also controllers‘ department and the way what they will do and how they will do it. Implementing a new financial system, may require people to use new equipment, understand and navigate new software packages, handle transactions in a different way, and use new types of information or report formats. In implementing such a project, careful consideration typically is given to the technology hardware platform, data and reporting requirements, interfaces, and the like. Although a high degree of care is devoted to these types of technical requirements, typically less than 5% of effort on projects is devoted to managing the effects these technical changes will have on people [5].

3. Research Accomplished in Colorado within Software Industry

We did research among software companies in information technology industry frame the group of medium-size and large businesses in the State of Colorado, mostly in Metro Denver area. The research was made with the company controllers in the form of personal interviews. We prepared structured questioner with two types of questions: open and closed. First step was to contact controllers from selected group of 50

companies by phone with the quick introduction of our main research objectives and request of participation on our project. Out of all contacted controllers, 75% were willing to help us out with our analysis. Within 3 months from February 2008 until April 2008 we visited companies and met all the controllers for the interviews, which took a place directly in the companies. Duration time of the meeting was approximately one hour. The main objective of research was to establish what kind of financial problem areas controllers see in company's performance and find the forms of financial analysis for the companies. We also focused our attention to recognize and describe possible solutions in the form of controller's recommendations.

The information technology cluster is divided into two sub-sectors: software and hardware. The software sector, which is covered in this report, includes companies involved in a broad range of activities, ranging from those that develop off-the-shelf software products to those that provide custom computer programming, computer systems design or data processing services. Metro Denver ranks fifth out of the 50 largest metros areas in software employment concentration in 2007. Major software companies are: Ciber Inc., Cisco Systems, eBags.com, EMC Corporation, Encoda Inc., Evolving Systems Inc., IBM, Intrado Inc., Oracle Corporation, Sun Microsystems Inc., ViaWest, Webroot Software Inc. etc. As already mention; the research was made as personal interviews with the company controller(s). On the basis of the requirements of the controllers in the examined companies, we agreed to protect confidential information with regard to processing of company data.

The most common financial problem areas within our research, which we set up with the cooperation of the controllers in examined companies, are as fallow: the investments in accounts receivable is increasing, the investments in inventory is increasing, the investments in fixed assets in increasing, the funding supplied by accounts payable is shrinking, the return on equity is worsening, sales are declining, the company is no longer making money at historical sales levels, material costs are increasing, freight costs are increasing, direct labor costs are increasing.

These symptoms are in the order according to the assigned value of each priority from the most important to the least important one. There are not great differences in percentage representation between individual symptoms. We would like to explain in more detail first seven groups of financial symptoms and assign them the right form of financial analysis, followed by descriptions of possible solutions. In the next chapter are the main problem areas in the examined companies and some of the brief advises of the controllers.

4. The Most Common Financial Problem Areas within Our Research and Possible Solutions

If *the investment in accounts receivable is increasing*, we can check the turnover trend. The first step is to see if the increase in accounts receivable is based on an increase in sales volume. For example, if a customer has purchased far more than the usual amount recently, the company will be funding the customer for the amount of this purchase until the contractually agreed-upon payment date has been reached. Consequently, to determine if the accounts receivable turnover rate has changed, run a trend line for this measure for at least the last quarter by dividing accounts receivable into the annualized sales for each month being measured. Controller's recommendation; review sales to see if the increase in sales will continue. If so, arrange for more debt funding to cover the projected increase in accounts receivable. Another option is to check turnover trend by customer. If the accounts receivable turnover trend is worsening, the next step is to determine which customers are not paying on time. This can be done either by calculating the turnover trend for each customer or by skimming through the accounts receivable aging to see which customers have large overdue balances. Controller's recommendation; if a specific customer is not paying on time, than possible remedies range from a visit to the customer to discuss payment terms, to cutting off additional credit, reducing the preset credit limit, or even filing a lawsuit to collect funds.

If *the investment in inventory is increasing* we have couple options. First of all, we can check the turnover trend. If sales are increasing, then the amount of inventory needed to support those sales may be justified. To verify if this is the case, calculate a trend line of inventory turnover for at least the last quarter of a year. To do so, divide

the current inventory balance into the annualized cost of goods sold. If the turnover proportion has dropped, then there is proportionally more inventory on hand than is justified by the increase in sale. Controller‘s recommendation; review the cause of any increase in sales to see if the increase is projected to continue. If so, the increased inventory level is unlikely to decline, and additional funding will be necessary to support the added inventory investment. If it is evident that the bulk of the inventory is in finished goods, one should verify the sales trends for all products for which there is some inventory. If sales trends are declining and the amount of on-hand inventories are high, there may be a problem liquidating the inventory. Controller‘s recommendation; set up a procedure with the production scheduling staff to ensure that additional production is not scheduled for any item that is experiencing a drop in sales. Also, have the sales staff run a promotion or temporary price decrease to clear out all excess finished goods inventories for products that are experiencing slow sales volume.

If t*he investment in fixed assets is increasing*, you can compare assets purchased to the original budget. They may be nothing wrong with a rapid increase in the asset base, as long as the additions were purchased in accordance with the original fixed asset budget. Simply compare all purchases to the original budget, and verify that all authorizations are in place for everything purchased. Controller‘s recommendation; institute a tight capital budgeting procedure o ensure that no assets are purchased that have not gone through the entire budget approval process. Also, verify that capital approval levels are low enough to ensure that the correct managers are affixing their signatures to the purchase orders for the bulk of the money volume spent on fixed assets. If someone has inadvertently altered the depreciation method being used, this can result in a significant change in the net value of all fixed assets. Review the fixed asset register to ensure that the same depreciation method is being used for all items within each fixed asset category. Controller‘s recommendation; create an internal audit procedure for checking the depreciation method used for a sample of all fixed assets in the assets register.

If *the funding supplied by accounts payable is shrinking*, we can verify that no additional discounts are being taken. The amount of accounts payable may drop if the accounting staff becomes more aggressive in taking early payment discounts on all billings from suppliers that offer a discount rate exceeding the company‘s cost of capital. The best way to check this is to review the accounts payable to determine the money value of discounts taken. Controller‘s recommendation; create a discounts tracking system that records the money amount of all discounts taken in a separate general ledger account, thereby making it easier to track changes in the dollar value of total discounts taken. See if payments are being made too soon. It is possible that the accounts payable staff is paying suppliers prior to the dates on which their invoices are due. To review this, audit a sample of recent payments and compare due dates on the supplier invoices to the dates on the check copies that are attached to the invoices. Controller‘s recommendation; provide additional training for the accounting staff to ensure that they know when to pay suppliers. Also, include this training in a detailed accounts payable procedure. If the previous two possibilities turn up no variations from previous periods, then it is possible that supplier terms have been changed by the suppliers. To test this, either audit a sample of billings and compare supplier terms to those from previous periods, or else use the keystroke tracking function in the accounting software, of course if it exists to determine which supplier terms have been changed in the computer system. Controller‘s recommendation; have the purchasing staff renegotiate payment terms with suppliers to lengthen the time required before payment. Also, set up a warning system whereby the accounts payable staff issues a notice to the purchasing staff whenever a supplier tries to shorten its payment terms.

In case t*he return on equity is worsening*, check the amount of equity. The return on equity may be worsening simply because more equity was added since the last time this measurement was calculated and the amount of profit must now be spread over a larger equity at the time of the previous measurement to the amount currently on the books. Controller‘s recommendation; maintain tight control over additions to equity. There should be chief financial officer level approval required before any additional stock is issued, as well as for any options that can be converted

into stock. If the level of equity has remained the same, then the primary option left is that profit levels have dropped in comparison to the amount of equity on hand. To see if this is true, divide total equity into total earnings for all time periods being compared to see if the trend line drops. Controller‘s recommendation; review all reports related to sales and expenses in order to improve profitability. Also, consider using debt or cash generated from operations to buy back equity, which will improve the return on equity, though there is more risk in this approach, in the event that future cash flows cannot support payments on the added debt levels.

If *sales are in decline*, it is possible that the entire market is shrinking, and that the company is actually doing quite a good job of maintaining its proportion of a shrinking sales. To see if this is the case, review industry statistics and projections of current total sales levels for those regions in which the company does business. Keep in mind that any such estimate will be extremely rough and will give only a general indication of actual sales levels. Controller's recommendation; If the overall market is shrinking, there are several options. One is to cut off all further cash investments in favor of milking all possible cash out of the business while letting it die out. Another option is to do the reverse and invest cash in hopes of taking over the smaller market as other competitors pull out. It may also be possible to invest cash in hopes of creating grater efficiencies, while the final options are to invest funds in either creating products targeted at new markets or to purchase companies or product lines that are already positioned in new markets. We can also check sales by customer. Individual customers may not be buying as much as was previously the case. To review this, conduct a Pareto analysis of all sales, reviewing the 20 percent of the customer list that accounts for 80 percent of total sales. Compare current or year-to-date sales of each customer in this subgroup to sales in an earlier period to determine which customers are not buying as much as was formerly the case. Controller's recommendation; there are several ways to deal with this problem. One approach is to reduce prices, though this approach will result in increased profits only if there will be a resulting disproportionate improvement in sales volume. Another option is to run short-term promotions to briefly capture more market share, which may result in some longer-term though marginal increases in sales. Another possibility is to have the engineering staff enhance the product and re-release it to the market, though this possibility is time consuming and may be expensive. Another option is to have the marketing staff repackage the product and sell it in a different market. Finally, it may be necessary for the engineering staff to completely replace the product with something else, which is usually the most expensive option of all. We can also check seasonality, check the business cycle or check customer complaints [6].

In *case the company is no longer making money at historical sales levels*, construct a breakeven chart. Sometimes a company is plodding along, garnering sales at the same old historical rate but is unaccountable, earning less, or loosing more money than in previous periods when sales were the same. What happened? The cause can only be declines in the gross margin or increases in the underlying fixed costs. Controller's recommendation; based on the results of the breakeven analysis, create a trend line of expenses, either in the gross margin of fixed cost areas, and focus attention on those items for which the trend of expenses has increased, with a strong emphasis on cost reduction.

Conclusion

The research was focused on the Importance of the Controllership for the company performance - Software Company experience. The main objective of our research was to focus on the main financial problem areas in information technology industry in state Colorado, especially in software companies and with the cooperation of the controllers find out the forms of financial analysis and the solutions for the company performance. We arranged the most common financial areas in examined companies in ten groups and explained them in more detail. Also we pointed to the importance different financial analyses which could be used in the companies when the financial symptoms appear.

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ABSTRACT

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Key Words: *Controllership, controller, managerial accounting, financial analyzes.*

JEL Classification: *L86, M49.*