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*Every phase of business life is affected by controls, but in spite of their importance there is a wide lack of understanding of their nature, of what makes a good control as opposed to a poor one—*

## THE UNFAMILIAR ART OF CONTROLLING

*by Roy A. Lindberg*

*J. H. Cohn & Company*

**I**F a random sample of American executives were asked to nominate a single function that exemplifies the spirit of modern management it is likely *control* would receive the largest number of votes. Life, generally, exemplifies the need for and the functioning of control, but only in business is the efficient fulfillment of needs thought to stem so directly from the exercise of control. Only in business is control recognized as inseparable from production, as vital to operating efficiency as finance, manufacturing, planning, and sales promotion. Hence, the function of control is commonly viewed as symbolizing the essence of business. The trouble is that control is as little understood as it

seems to be familiar; understanding of it is obscured by more than its fair share of myths.

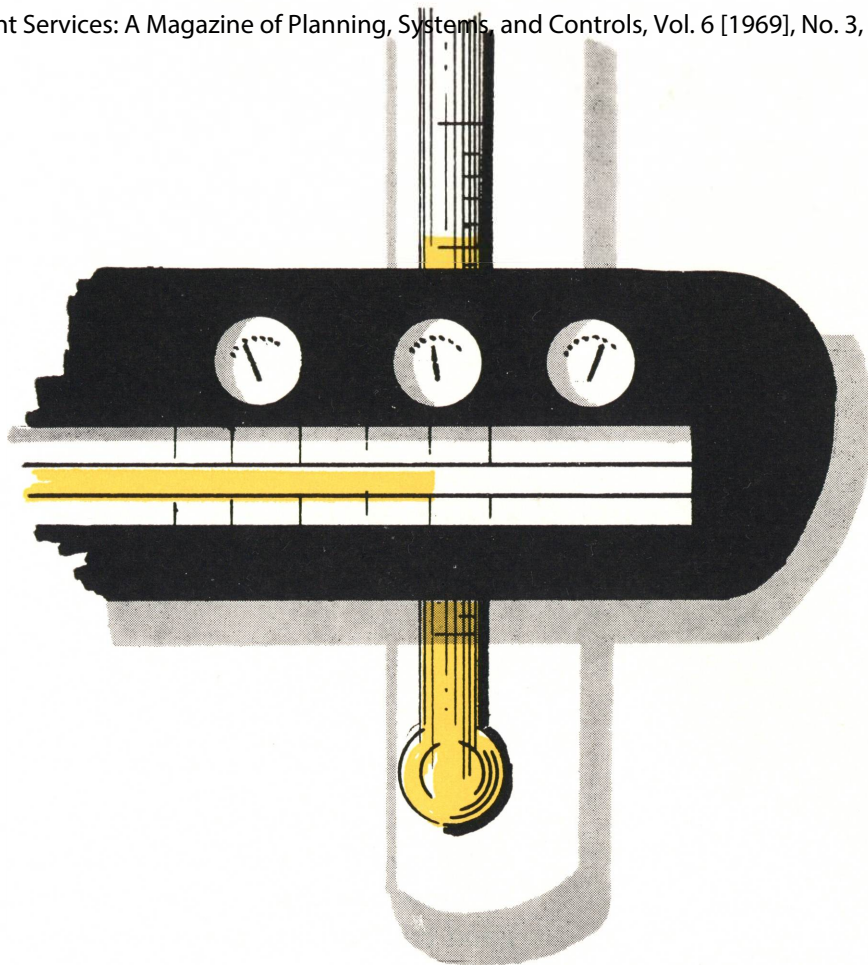
This article aims at dispelling some of these myths by reviewing a few control fundamentals and, it is hoped, creating incentive in some readers to take a fresh look at their or clients' business controls and control problems. The results of taking a fresh look won't, in many cases, be reassuring but will, without fail, be rewarding. This we know, because the business of every CPA firm is a barometer of the control climate in the companies it serves. A not inconsiderable part of public accounting business results from the existence of defective controls in client companies.

Control began to emerge as a distinctive sub-discipline within management in the last half of the last century. Henry Fayol\* was among the first to put a finger on its essence:

“Control is the examination of results. To control is to make sure that all operations at all times are carried out in accordance with the plan adopted, with the orders given, and the principles laid down. Control compares, discusses and criticizes. It tends to stimulate planning, to simplify and strengthen organization, to increase efficiency of

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\**General and Industrial Management* by Henry Fayol, Pitman Publishing Corporation, New York, 1949, p. 77.



The warning red lines on an airplane's instrument panel, a thermostat, a car's speedometer—all are forms of control.

command and to facilitate coordination.”

For auditing purposes the plainest definition of a control is that it is action taken to make sure intentions are realized. A fuller definition is that a control is a mechanism for systematically detecting and correcting significant deviations from planned occurrences. A more precise definition is that a control is an environmental element that operates on feedback exceeding standards of deviations tolerable to the objectives sought.

These definitions share at least two things in common; each of them implies that controls have no life of their own and that they

are future-oriented. Controls are derivative and as such are transient and impermanent. Controls are future-shaping devices and as such operate according to views of what tomorrow can and should bring.

#### **Primary misconception**

The primary misconception associated with the function of control is that, because it is essential to successful accomplishment, its costs are unavoidable and, therefore, not to be counted. This would be acceptable in a world where control is unfailingly exercised with skill. The plain fact is, however, that controls differ greatly in effectiveness and cost and these sel-

dom vary in direct relationship. Some companies have good controls at least cost; other companies have poor controls at maximum cost. Every combination imaginable exists in between.

Business control and the cost of doing business have powerful relationships. One of the strongest lies in the fact that the costs of control are always among the heaviest incurred by business and can seriously threaten the best of businesses unless they, too, are controlled. A company spending \$10,000 to catch a thousand \$2 losses has to sell \$50,000 worth of goods at 20 per cent gross margin to make up for having a control that produces savings of only one-fifth of its

## The real purpose of control is to *make things happen*

costs. Though it makes little sense to have controls that do not return something near their cost, many such exist, nevertheless, because it is rare for the relationship between control costs and savings to be known.

A major distortion in ideas held about control is that it is negative in character, aimed primarily at keeping things from happening (e.g., preventing theft of finished goods, keeping unbudgeted funds from being spent, restricting the use of vehicles to company purposes, etc.). The reverse of this view happens to be the truth, however. The real purpose of control is to *make things happen* (e.g., raise the profitability of a product, achieve an objective within cost, successfully move into a new market, etc.).

### *Make controls positive*

This is not an academic point. In the first place, a company that has mainly negative controls clearly has no sense of direction or knowledge of where it wants to go. In the second place, and dealing just with the psychological aspect, controls that do not convey a positive flavor, that are repressive and do not support the higher aims of the business, invite evasion by employees. Controls that invite evasion can lead to greater losses than would occur if they didn't exist. What is worse, these kinds of controls, simply because they give the appearance of control, can lead to the assumption that control objectives are being met. This, in turn, can lead to the making of decisions with disastrous consequences.

Another important misconception is represented by the common condition of controls being created in a vacuum. Controls are often

established independent of the broader needs and other functions of the business. This, too, is a major error. Effective controls can never exist in isolation. Controls contribute to a business when they are linked with other functions, such as planning, organizing, and directing; the more vital the linkage the more effective the control.

Plans, especially, bear relationship to controls. Plans are commitments to actions leading to pre-identified accomplishments. The life and design of controls rest, therefore, in the obligation for seeing to it that commitments are carried out at the least cost and as close as possible to the time needed. Thus, where controls fail, so do plans, and where plans succeed, so do controls. The connection and proof of mutual dependency is inescapable.

Despite the obviousness of the relationships, there are in every company controls that are not plan-oriented and that should be terminated. How to identify them? It is not too difficult. Those that are plan-oriented have shorter duration and review periods than those viewed as valuable in and by themselves. Signs of "unhealthy" controls are long life, the lack of recent review, and—ultimately speaking—the lack, even, of being identified (as a control). It is likely that nothing can be done in so short a time that will prove so amazingly resultful as making a list of your client's controls accompanied by the dates of their installation. This is a most revealing exercise.

Controls depend, of course, for their working upon information—information that arises out of the activities controlled. This kind of information is called feedback. The practical implication of this is that controls are not ends in themselves but elements in systems of some

kind. For example, a control receives the energy used for discrimination from the activity it is set up to govern and operates when system output does not compare favorably with the performance desired. A familiar example of control based on feedback is the household thermostat; as the heat provided (plan) rises past a pre-determined point (standard) it actuates a thermocouple (control) that shuts the heat off (return to plan).

It can be seen from this example that four steps are always taken when establishing a successful control. The steps are:

1. Developing effective standards
2. Setting them at strategic points
3. Creating feedback for performance comparison
4. Setting up the machinery for



Controls that cost far more than they could possibly save are silly—and all too common in business practice.



able and seldom given a mechanism of information generation, processing, and utilization that enables the controls to operate. Thus, most controls are *verbal* and little else. A control with so insubstantial a character usually requires a sizable portion of an employee's time to make it work. Very wasteful!

**Control only large variances**

Another vital idea is associated with the word "destructive" in point four. The great bulk of repetitive activities (and these are the ones to be most carefully controlled) vary in some degree from the standard. To act on every variance is to invite economic disaster; controls must—if they are not to eat you out of house and home—operate only when a variance appears that threatens to prevent the established goal from being reached. Finding the degree of variance that can be tolerated is a cost-critical task that must be done with considerable nicety if the control to be set up is to serve the purposes of the business and not vice versa. If this can't be done, forget it!

If it is accepted that business controls are a form of system, then a number of systems engineering principles apply to them, knowledge of which assures the auditor of sound guides in his investigation and evaluation of controls. The more important of these principles, loosely stated, are:

1. Effective controls use no more of the primal energy than is needed to assure that the activity monitored accomplishes its task as intended.
2. While in force, effective controls are energized continually but "operate" infrequently.
3. Controls can operate infrequently only when activated by exceptions.
4. Exceptions come into being when control sensory thresholds are set that are ex-

These steps are generally recognized as essential and separate moves in building any effective control, but one seldom sees them being taken. How often have you seen them taken in setting up or upgrading controls? If you are honest about it, your answer has to be, "Not very often." If this is your answer, you will also have to say "The controls are out of control."

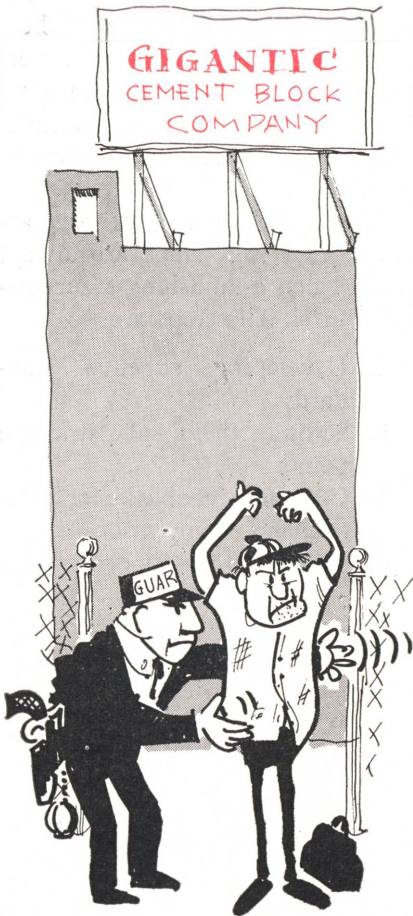
The ideas embodied in the steps previously outlined must be comprehended and followed if effective controls are to be built.

Take the idea of developing standards; how often are controls thought of as inconstant things, mechanisms that operate only intermittently? An effective control only operates in the exceptional circumstance — as a door-closer only operates when a door is opened. The rest of the time it is inactive. For a control to operate in this fashion standards must be set, and set so that the control operates only when events take place that are, in their nature, undesirable. The setting of standards is often the weakest part of control design.

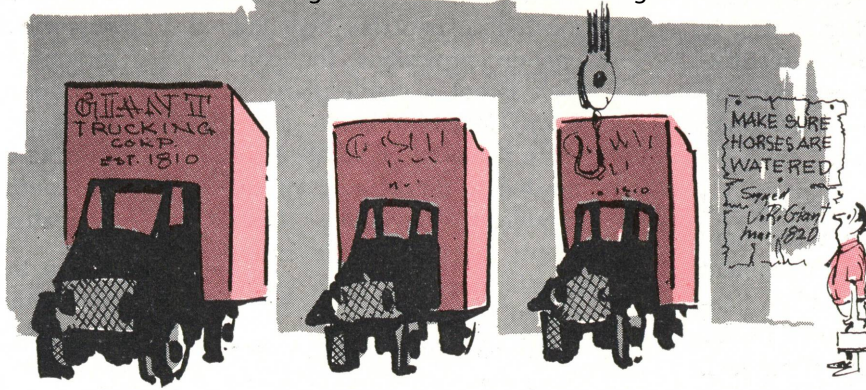
**Controls at definite points**

As to the idea of inserting standards at strategic points, how often is it realized that processes, as such, cannot be controlled? Just as measurements can only take place at points, so controls can only be actuated at points, junctions, interfaces. This being the case, the best place to insert control is where something is likely to happen, where *change* of some kind occurs, e.g., at the point a purchase order becomes an invoice, when a petty cash voucher becomes an outlay, when a picked order becomes a shipment.

In step three the idea of creating feedback is made explicit. The reason for this is that controls are far more often than not set up as definitions of what is undesir-



Controls that are repressive invite evasion and often greater losses.



A sign of "unhealthy control" is long life and no regular review.

ceeded only by actions that threaten to destroy the objectives set.

5. When the activity a control is set up to monitor ceases, the control should become inoperative.

Some of these items have been stated (in different words) or implied earlier. Each of them has, in turn, powerful implications for control design. Take item 2, "effective controls . . . operate infrequently"; this seems to imply that a poor control operates frequently. But what about a plan that happens to be monitored by a well designed control; if the plan is going sour, isn't the control going to operate frequently? The answer to this must be no, for the reason that a well designed control has a "cascade" feature. When unacceptable performance under a plan becomes commonplace, the control triggers another class of re-

ceivers (causing alterations in implementation of the plan, the plan itself, or abandonment of the plan).

Manifestly, if this process were to be automated it would become too rigorous, and, in view of the transient nature of controls, the equipment investment would be unjustified. Hence, the most adaptable and redirectable element of business—an individual human being—is employed as controller at one control level and as interface medium between control levels. Economic cost alone (there are other kinds of cost) decrees that business controls be designed with a place for the exercise of human judgment in their loops.

The subject could be pursued forever. There is room left for only one more illustration of the applicability of control engineering principles. Empirical evidence shows that the simpler the tasks imposed upon the human member of a control system the more precise will the execution of control be. Hence, when you are next called upon to help devise a control make sure that its operator is given the simplest control tasks (decisions to make) as possible under the circumstances.

Among the myths afflicting the concept of control is the view that the setting up of a control is sufficient to guarantee its working. Further, we are faced with the inescapable truth that plans can go awry (and quite often do) without causing undue disturbance;

but controls, once invoked, produce either the results sought or all sorts of others, always serious and costly. In short, the results of misapplied controls are always consequential. Therefore, keep this in mind: *Don't apply controls unless you are reasonably sure they will work!*

How to attain such reasonable assurance? Always follow three basic rules:

1. *Necessity*: Always make sure that the control being contemplated is *required* in fulfilling the terms of clearly stated objectives or plans. Controls do not, so to speak, stand on their own feet. They must always be faced with the question, "Why?"
2. *Measurability*: Institute control only where some form of *measurement* can be employed. The ideal yardsticks are quantitative in character. While it is not always possible to find such yardsticks, be wary of departing too far from them. Controls diminish rapidly in effectiveness, both organizationally and psychologically, as yardsticks become inexact.
3. *Enforceability*: Employ only controls that are *enforceable*. The astute manager recognizes that exceptions that cannot be acted upon constitute avoidance of control and cause erosion of control.



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He is, therefore, not only wary of instituting control in the first place but of instituting it where exceptions are not likely to be acted upon without exception.

Remember what Prohibition did to America. Violation of it did more to foster disdain for government than anything before or after. Sensible men foresaw these results and warned of their seriousness. Similar results occur in the company that fails to devise its controls in the light of enforceability and, having done that, enforces them.

In addition to the three basic requirements listed above there are other characteristics desirable in controls, some of which are mentioned in the text. These are included in the following summary of tips for building better controls:

1. *Control Positively*—control is exercised not so much to keep things from happening as to make the “right” things happen; realization is the highest purpose of controlling.
2. *Control Decisively* — control does not end with detection; it is completed with the taking of corrective action leading to the elimination of non-productive effort.
3. *Dovetail Plans and Controls*—plans alone can tell us what, where, and how to control and should, therefore, identify and specify the controls

needed; a plan that does not contain provisions for controls is not a viable plan.

4. *Keep Controls Simple*—make them no more elaborate than needed to detect and correct significant deviations from plans; testing for deviation significance is a good guide for control design.
5. *Combine Responsibility for Execution and Control*—many problems are avoided and coordination is simplified when the manager responsible for executing a plan is also made responsible for the associated controls.
6. *Control by Comparing*—effective and efficient control requires the adoption of objective, accurate, and suitable standards of measurement.
7. *Control Through Variance*—control is simplest when it acts on the evidence of departure from standards; on this basis, attention should be given primarily to the definition and detection of exceptions.
8. *Control at Points*—it is impossible to control processes throughout their operation; control must be exercised at points (interfaces) where change occurs.
9. *Locate Controls Advantageously*—the exercise of control should not place strain on organizational relationships;

make sure that the machinery of control and the organization are compatible.

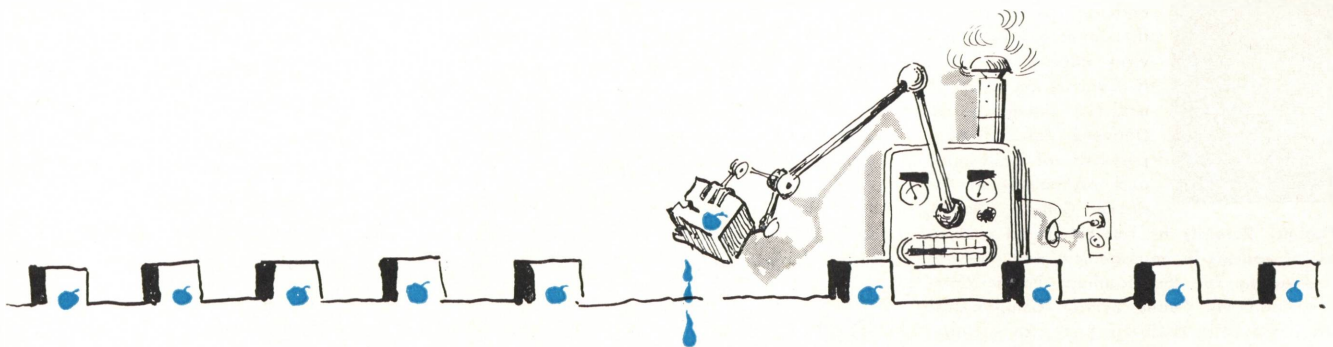
10. *Continue Control for Life of Plan*—as long as a plan is causing action control should be continued until the plan is realized or discontinued.

Lists like this are, in their way, useful. But they are no substitute for understanding, and, where control is concerned, the most important thing to understand is that *self control is the best control* of all. Wherever possible, build on that.

### Summary

The main facts about controls are these: Effective accomplishment demands effective controls; few companies have even a faint notion of what their controls cost and what their controls produce; and even fewer companies know how to design controls properly. The company that has effective controls has a competitive advantage equal to the best.

This article could have been subtitled “industry’s hiddenest costs.” This awkward phrase reflects the homely truth that controls are taken too much for granted. Because they are necessary to accomplishment they are thought to be fixed requirements offering few, if any, cost alternatives. This view is usually the first block laid in the foundation of many business failures.



Controls must, if they are not to eat you out of house and home, operate only when a variance appears that threatens attainment of the goal.