ETCFO Insight: Performance budgeting in Indian Railways

Performance budgeting offers ways to gain by way of cost efficiency, productivity, time and quality. All worthwhile goals for CFOs and their companies, says Sanjay Gupta, President, Institute of Cost Accountants of India.

Railway reforms are still very much in progress in many countries including in India.

One of the major objectives driving these reforms has been to ensure that end-user prices are at an efficient level (considering the level of costs and the price of substitute services), productive efficiency is high (and therefore subsidies are low), and investment and innovation guarantee a satisfactory level of service quality, safety and variety.

Facilitating economic growth requires efficient movement of ‘people’ and ‘products’ with safety, comfort, longer haulage and heavy loads.

It is well accepted fact that more efficiently the railways are managed, the greater will be their role in the markets they serve, the more will be their contribution to economic development and the higher will be their external benefits.

An efficient rail network can help people to have safe and comfortable journeys and the industry to transport raw materials and products at lower costs associated with lower environmental issues ,and comparatively better energy efficiency and reduced congestion.

Indian Railways are facing intense competition from other transport sectors such as road, air, water, pipelines, etc. At present, the freight business of Railways is heavily subsidising the passenger business.

Despite the low costs of rail transport, businesses prefer road transport for short distances and air transport for longer haulage. This is especially the case with
higher income passengers. The net result has been that over the years, the Indian Railways has lost a sizeable market share in both segments, especially in the goods transport segment.

As a result, the Indian Railways stands at a fork in the road in an increasingly complex and competitive business environment. It urgently needs to find ways to maintain and improve competitiveness.

And first up on this list is the reform of **accounting** procedures. And this includes the simultaneous implementation of performance costing and outcome budgeting. These moves will put Indian Railways at par with the best in the world.

At the heart of this change is cost information that is accurate and relevant. Therefore, Indian Railways need a costing system that is:

- location-based,
- function-based,
- activity-based,
- responsibility-based,
- performance-based, and
- outcome-based

**Performance or outcome budgeting**

Successful and responsible public spending requires establishing the relationship between 'Outlays' and 'Outputs' and then between 'Outputs' and real 'Outcomes'.

The traditional way of budgeting was largely focused on fund allocation to different government programmes and initiatives.

There was not enough focus on the desired results that needed to be achieved from the use of the allocated funds. Such a budgeting technique does not seem to be appropriate in the present environment.

In the current economic climate of fiscal pressures, the government faces extraordinary pressure to do more with existing, or fewer, resources.

In such a situation, wisdom demands that the government's focus should be on getting the optimum results from limited resources. The need for outcome budgeting arose from such constraints.

Outcome budgeting hinges on the real impact of investments. Its purpose is to determine the performance indicators for outcomes of various activities of the Railways in quantitative terms and then allocating resources accordingly. It also emphasises the qualitative benefits of these programmes. For instance, it may take into account metrics
such as improvement in service quality also.

Successful implementation of outcome budgeting would help Indian Railways to improve its decision making, aligning the overall strategy with operations and achieving a more efficient allocation of scarce resources.

It would also result in provision of improved services to customers and public at large and would also help make the organisation adapt to an ever changing environment.

However, for ensuring successful implementation, Indian Railways needs to have clearly defined and stated desired outcomes. It also needs to identify meaningful performance metrics for outcomes of various programmes. To accomplish a successful roll-out of the system it needs to set up a strong governance framework, provide tracking of outlays to the outcomes (i.e., link operations and outcomes) and also needs to ensure proper monitoring and evaluation systems.

For best results, it is desirable to have in place an integrated framework of accounting arrangement which connects budget of field units to costing (cost per unit of service output) and the final outcome.

There is a need for a system of planning, budgeting and evaluation that emphasises the relationship between money budgeted and outcome expected. This should also include narrative descriptions of each programme or activity.

The budget needs to be organised into quantitative estimates of costs and accomplishments and must focus on measuring and evaluating outcomes. It should eventually aim to improve effectiveness and efficiency of public expenditure.

The need for optimum utilisation of scarce resources makes it essential to have a well calibrated programme of cost control in conjunction with appropriate budget management tools of performance costing. A thorough comparison of the cost per unit of service output of similar field activity units of a division or workshop is also needed.

The budget proposal should be relatable to cost metrics. The cost unit should be an integral part of the outcome budgeting accounting architecture. Focus on this aspect paves the way for an integrated accounting framework, which connects various facets of a financial transaction with various accounting sub-heads to facilitate a desired outcome.

The outcome budget, therefore, helps gauge the effectiveness of the money spent under various heads. It also helps ensure that budget provisions do not continue indefinitely without an independent and in-depth evaluation.

This will help Indian Railways to examine the expenditure before it is made, instead of doing a post-expenditure inspection.
Performance Budgeting will enable the Indian Railways to take correct business decisions and to improve resource utilisation, cost competitiveness, profitability, and sustainability of the organisation. All this will make the Railways an efficient organisation and a viable entity.

Sanjay Gupta, President, Institute of Cost Accountants of India

So at the planning stage itself, there will be a mechanism of checks and balances. This will result in reduction of unnecessary expenses.

When compared to activity-based costing, performance costing is similar. This allows the Railways to find onboard cost of each activity from trains, routes, sections to take strategic decisions. These critical decisions could well span the entire spectrum from cost management and outcome analysis to performance improvement of the system as a whole.

Performance or outcome budgeting together with performance costing is a powerful management tool that has evolved in response to the ineffectiveness of traditional ways of budgeting and cost accounting and cost management practices.

This combination is perhaps the only way that the Railways can achieve the following milestones.

- Re-position itself as 'market leader' in the transport sector by capturing the market share from other transport sectors;
- Rationalise the existing tariff structure;
- Make strategic investments in expansion of the rail infrastructure;
- Induce foreign and indigenous private players to invest in rail infrastructure;
- Improve capacity utilisation and revenue earnings from both passenger business and freight business; and
- Become the 'first choice' of all customers in the country.

Sanjay Gupta is the President of the Institute of Cost Accountants of India. The Institute has been closely involved with the Indian Railways' exercise to rejig its planning and budgeting process.