

PRABHA IAS IPS COACHING ACADEMY

PERFORMANCE BUDGETING

According to the concept of performance budgeting, the annual budget is in essence, a work plan specifying the programme targets to be achieved by the agency concerned during the financial year. It emphasizes the purposes for which funds are provided. It correlates the physical and financial aspects of each programme and activity, by establishing a proper relationship between outputs and the corresponding inputs.

The main purposes sought to be achieved by performance budgeting are to:

- 1) Establish a correlation of the physical and financial aspects of every programme and activity.
- 2) Improve budget formulation, review decision making at all levels of management in government.
- 3) Facilitate better appreciation and review of legislature.
- 4) Make possible effective performance audit.
- 5) Measure progress towards long-term objectives as envisaged in the plan.

Development of Performance Budgeting in India

In India, the Estimates Committee of Parliament made a suggestion in 1954 to introduce performance budgeting on the basis of success of the operation of performance budgeting in U.S.A. The Administrative Reforms Committee (ARC) in its report titled "Finance, Accounts and audit", recommended to the government that starting with the 1969-70 budget, performance budgeting should be introduced in all departments and organizations of the government, which are in direct charge of development programmes.

The recommendations of the ARC for the introduction of performance budgeting were accepted by the Government of India which started introducing it gradually in more and more of its developmental departments with the budget of 1969-70. The position by now is that almost all the departments of Government of India prepare performance budgets every year and submit them to parliament. On the recommendations of the central government, all the state governments also prepare performance budgets for development departments and submit the documents to the legislature.

Elements of Performance Budgeting:

I) Formulation of Objectives

Since the budget is an annual plan of action, it is necessary to spell out the objectives in concrete and specific terms. The objectives should be formulated in such a way, that should help in evolving suitable programmes/activities.

II) Programme/Activity Classification

A functional classification of the budget is necessary under a system of performance budgeting. By functional classification, it is meant that the budget presentation of public expenditure will be in terms of functions, programmes, activities and projects.

III) Norms/ Standards

Performance budgeting establishes the correlation between the physical and financial aspect of each programme and activity. It is therefore essential to set physical targets for accomplishment in respect of each programme/activity to

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enable working of corresponding financial estimates for incorporation in the budget.

Performance budgeting envisages development of suitable work-measurement units, norms, yardsticks and other performance indicators for measuring the physical quantum of work to be done or services to be rendered. Appropriate norms and standards supported by adequate data, reduce subjectivity and increase objectivity in the framing of budget estimates.

IV) Accounting Structure

In order to operationalise the scheme of performance budgeting, it is essential that the concept is also built into the structure of accounts. It is necessary, therefore, that the budget classification in terms of functions, programmes, activities and projects is supported by a similar classification in accounts.

V) Decentralised responsibility Structure

For the preparation of a performance budget, broad guidelines need to be framed at the top level. These should include directions regarding the objectives to be achieved and the resources availability. Within the framework of these guidelines, detailed budget estimates are to be prepared at various responsibility levels and coordinated upwards.

VI) Review of performance

Measurement of actual performance both in physical and financial terms in relation to the budgeted plan are an important aspect of a performance budget. When information regarding physical accomplishments and finances is put together in terms of various responsibility centres, for a period under consideration, a picture of actual performance in terms of physical accomplishments and its related costs would emerge. The actual performance from the accounting information system can then be compared with the budgeted plan. To conclude, performance budgeting is a management tool. This can be used in government successfully if norms and standards are developed for all levels of operations.

ZERO BASED BUDGETING

Zero Based Budgeting (ZBB) requires that organizations, while preparing their budgets, should not take earlier year's expenditure for granted and therefore should start on a clean slate. It implies that the activities of an organization should be viewed afresh and priorities among competing claims for allocation of funds settled, on the basis of justifications developed by the use of evaluating techniques, like cost benefit analysis.

ZBB aims at eliminating redundant expenditure in organizations. To achieve this, it adopts four approaches.

The first approach, is the elimination of redundant expenditure, which is not serving any clearly stated purpose in an organization.

Secondly, it attempts to identify and remove duplication of expenditure as over time the same activity may be carried out by a number of agencies of the same organization.

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Thirdly, it involves searching for better alternatives (For instance solar equipment may be a better alternative to an electric gadget) for incurring expenditure to achieve an established objective.

The fourth way is to optimize expenditure by making it productive and efficient. This requires application of performance budgeting.

The Government of India adopted ZBB approach with effect from the budget of 1978-88. The Budget division of the ministry of finance has been requesting the ministries / departments, since the introduction of ZBB, through their budget circular every year for adopting the principles of ZBB for expenditure estimates.

Steps Involved in ZBB

The methodology employed in ZBB involves:

I) Identification of Decision Units

A decision unit is a distinct segment of an organization for which budget is prepared. It can be a programme, scheme, project or an operation.

II) Formulation and Development of Decision Packages

According to ZBB, the budget of a decision unit has to be prepared in terms of decision packages, which contain the following:

- * A description of the function or activity of the decision unit.
- * The goals and objectives of the various functions/ activities
- * Benefits to be derived from financing the activity/programme.
- * Relevance of the activity/programme to the overall objectives of the organization/ department in the present context.
- * The consequences of its non-funding.
- * The projected/estimated cost of the package.
- * The yearly phasing of the proposed expenditure/project cost.
- * Alternative ways of performing the same activity or achieving the same objectives.

III) Evaluating and Ranking Decision Packages in order of Priority

ZBB requires that the manager-in-charge of the decision unit should rank the decision packages in order of priority. There are various methods followed in ranking decision packages, such as judgement approach, committee system, standardised formula, single criterion approach etc. The available resources are allocated among the various decision packages, according to prioritization established in terms of their ranking.

IV) Preparation of Budget by allocation Resources to Activities or Decision Packages by utilizing Hierarchical funding cut-off Levels

ZBB requires that the available funds should be allocated in accordance with the ranking of decision packages as finally settled by the top decision unit in the hierarchy of decision units. In a situation of resource crunch, i.e., if funds available are not adequate to cover all the decision packages, a cut-off level is determined and the decision-packages figuring above are financed and those falling below the cut-off level are not allocated funds. The cut-off level is moved upwards or downwards in the event of any revision in the availability of funds.

Problems in the Implementation of ZBB

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A major factor contributing to the failure of ZBB has been too much paper work involved in the process. Also the reviews and analysis required to be carried out could not be handled within the normal cycle of budget process spread over a few months.

The second problem in the implementation of ZBB is the non-availability of trained personnel full aware of the concept, who can make an analysis of expenditure by applying cost-benefit analysis and other techniques.

The third problem is redeployment of resources, like manpower, material, machinery and equipment, which become surplus, when a scheme or activity is found redundant and has therefore to be eliminated. Redeploying manpower is a very difficult and delicate issue.

In brief, ZBB is a useful system for exercising control over expenditure. Its utility can hardly be overemphasized in a situation of resources crunch. Any progressive organization would find it useful for ensuring the effectiveness, efficiency and economy of expenditure.

Outcome Based Budgeting

In USA, a recent trend in government budgeting is to establish a correlation between the money spent on each program to its return in terms of impact of each public policy. This type of budgeting links budget with performance measurement system.

For example, in Catawba country, North Carolina, local officials used this to enhance their government's system of service delivery. The country in the past few years had experienced limited growth in revenues; yet during this time the call for human services continued to rise. County leadership responded by handling decision-making authority to agency administrators challenging them to reduce costs while more effectively meeting citizen demands. Those who achieved 90 per cent of their goals would be able to apply their savings to unrestricted needs. Catawba county administrators embarked on a citizen driven, outcome based system of budgeting to ensure that resources were targeted to meet specific community goals. Over time, they not only saved money but also enhanced government responsiveness (Denhardt and Grubb, 2003).

In Indian financial system, recently, in its first-ever budgetary exercise aimed at gauging the quality of implementation, the finance Minister presented an "Outcome Budget" in the Parliament. It is a compilation of the intended and anticipated outcomes as identified by 44 ministries and their respective departments, sought to be achieved through allocations made in the budget for the current financial year (the Hindu, 2005).