



Department of Distance Education

Punjabi University, Patiala

Class : B.A. II (Public Administration) Semester : 4
Paper : Financial Administration
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Lesson No.

- 1.1 Meaning and significance of Financial Administration
- 1.2 Budget - Meaning, Principles & Types
- 1.3 Performance Budgeting
- 1.4 Zero Base Budgeting
- 1.5 Preparation, Enactment and Execution of Budget in India

Department website : www.pbidde.org

LESSON NO. 1.1

FINANCIAL ADMINISTRATION

Financial administration means the Management of the finances of a state or of a Public authority and deals with taxing and spending powers. Sound financial administration is vital to the success of any enterprise. This is all the more so for any government. Efficiency and Economy are the two pillars of public finance. Financial administration seeks to raise, spend and account for the funds needed for public expenditure. Sound fiscal administration is of vital importance to government. As revenue is derived from the citizens, it is morally incumbent upon government to spend money efficiently and economically. Imprudent financial management alienates the people from the government ultimately endangering the latter's existence. Unsound financial administration, thus, may destroy the prospectus of democracy itself. There is yet another factor which has added considerable significance to financial administration today. The unprecedented increase in governmental expenditure in modern times makes it absolutely necessary that sound principles, tools and techniques of financial administration should be evolved and employed by all govts. It involves the activities of four agents: The Executive which needs and spends the funds; the Legislature which grants the funds and appropriates them to particular Ministries and Departments. The Finance Ministry which controls the expenditure, and Audit which sets in judgement over way in which the funds have been spent.

This lesson will highlight the concept of Finance and significance of Financial Administration.

In the words of W.E. Gladstone "The Finance of the country is ultimately associated with the liberties of the country. This is particularly true of England and the democratic countries of the west, where the power over the purse has been a powerful tool of legislative control over the executive."

Finance occupies a very important place in Public Administration. Finance or money is the "motivating power" of the ship or "The fuel of the engine" of administration. Really no act of government can be performed without money. Government requires money for everything that it does. The modern welfare states of today are required to discharge a variety of functions for the welfare of the people. They can achieve their ends only if they can raise large amounts of money. The policies and plans however best conceived they may be and however talented and capable the administrators charged with their execution may be, require funds to pay the personnel and purchase the required equipment and the materials. The state obtains its finances chiefly by taxing the citizens. The taxation as well as

expenditure proposals are passed by the Parliament every year. It has become an important function of the Parliament in modern democracies to pass the Budget of the State.

Meaning and Concept of Financial Administration

In brief, Finance is the life and blood of administration. Finance is the fuel for the engine of Public Administration. No government can function without finance as no car can run without petrol. Administration activity is limited in proportion to the financial resources available. The greater availability of finance, the more will be the administrative activities. The success of administration depends upon availability of finance. That is what led Kautilya to remark : "All undertakings depend upon finance. Hence foremost attention shall be paid to treasury."

Sound fiscal management is, therefore, of vital importance to government. As revenue is derived even from the humblest citizen, it is morally incumbent upon the government to spend money efficiently and economically. In democracy, there should be an unmistakable urge to evolve sound financial management, for people tend to identify extravagance and other ill practices with democracy, which consequently, stands discredited in their eyes. Unsound financial administration, thus, may blast the prospect of democracy itself. Financial administration involves operations designed to raise, spend and account of funds needed to be expended on public services.

Public Administration is largely the management and use of public finance. There is no act of government which does not have its financial aspects. "Every administrative act" says Dr. White, "has its financial implications, either creating a charge on the treasury or making a contribution to it. Nothing can be done without the expenditure of money, at the minimum for the payment of the salary or wages of the official or employee who acts. Available financial resources set a maximum limit on administrative activity as a whole and on each of its separate parts. The management of finance is, therefore, one of the first and one of the inescapable responsibilities of administrator."

Dr. White, therefore, defines financial administration as : "Those operations designed to make funds available to officials and to ensure their lawful and efficient use..... Fiscal management includes as its principal subdivisions budget making, followed by the formal act of appropriation; executive supervision of expenditures (budget execution); the control of the accounting and reporting system; treasury management and revenue collection and audit."

Financial administration, like most governmental problems, involves political and technical aspects. In its technical aspects the problem has to do with a number of practical questions involved in determining the organisation, form and methods of procedure to be employed in putting policies into execution after they are adapted.

From the political point of view, the problem of financial administration consists of four elements - planning, determining, executing and controlling.

Planning : "By planning is meant formulating a programme to provide for the future financial needs to the government. As such a programme if it is to be of value, must take into account past operations and present condition as well as future needs; it should cover the work of securing and presenting in proper form complete and detailed information regarding financial transactions in the past and the present treasury conditions as well as estimates of future revenue and expenditure needs."

Determining : While the function of planning is work of the executive, the function of determining is the job of the legislature. It means consideration by the legislature of the work programme on the basis of information submitted by the executive. The legislature decides what work would be undertaken to meet the needs of the people and issue formal orders for the same.

Executing : "By executing is meant the operation of carrying out the orders that have been issued, This covers all the varied work that has to be done in organising services, selecting and directing their personnel, and generally performing the duties which are usually embraced under the designation of administration. That this function is one that pertains exclusively to the administrative branch, need hardly be mentioned. In performing this function, this branch acts as the agent of the legislative branch. It is its duty to carry out the orders given to it by the latter, and is responsible to the latter for the manner in which it does so."

Controlling : Supervision and control is exercised by the legislature in order to ensure that the executive has faithfully carried out the orders given to it. This is particularly necessary because the executing agency has to deal with large sums of public money. The best method of supervision and control is to make the officers keep an upto date record of all their acts which should be subject to examination by government auditors for determining their accuracy, legality and justification.

Evaluation & Significance of Financial Administration : Financial administration includes all those operations which are designed to make funds available to officials and to ensure their lawful and efficient use. The principal subdivisions of financial administration include budget making, appropriation, budget execution, control and accounting, treasury management and revenue collections and audit. And all this need a network of administration which establishes its importance.

Financial administration today has assumed greater importance than ever before. There has been a tremendous increase in the amounts of money collected by the administration in the form of taxes, duties, levies, fees and fines and income from state enterprises as well as in expenditure on various state activities and social services rendered by the government. **Felix A -Nigro** says : "Financial administration is of great importance today because of the tremendous increase in the amount of

money expended for government services. Everything government does requires money, and now it does so much that it is utterly essential that sound principles and techniques of financial administration be employed".

The following are the factors that have added to the importance of financial administration

1. Concept of Welfare State : Modern age is an age of welfare state. The concept of the welfare means that the State must undertake all those operations that help in achieving the welfare of a great majority of its citizens. Not only that, it should contribute also to the establishment of peace in the world. In order to translate this concept into reality, the government has to undertake various activities connected with the welfare of an individual, right from his birth to death, And, all this has resulted in phenomenal growth of public expenditure, which in turn has led to a complicated system of management of public finance. It is, therefore, natural that financial administration must be managed by experts competent to deal with details, complexities and intricacies so as to ensure efficient administration of finance.

2. Necessity of Simplified system : Not only that, administration also needs to be simplified in order to conform to the needs of democratic institutions. As we should be aware, democracy is in vogue in large majority of states including India. It is only a signified and systematised system that becomes comprehensible to an ordinary citizen who wants to participate in the political process of the country. Here arises a problem as to how to reconcile public control and accountability to efficiency in administration and also to secure co-ordination.

3. Advancement in Management Techniques : Importance of financial administration has increased also with advancement in management techniques. People want not only simple, understandable but also efficient system of administration. The more the people understand the complexities of the state machinery, the greater the interest they show in the state machinery.

4. Importance of Finance : As we have already discussed, no government can function without finance. It is so vital to administration. So, its administration itself has got to be important. Only that government which works out a satisfactory system of financial administration can put the administration and its affair on an efficient basis. It is hardly denying the fact that "financial administration, involving the machinery and methods by which funds for the support of Public services are raised, spent and accounted for, is at the very care of modern government."

As the advancement of the country depends on correct financial policies, not only in India but in other countries also special attention is given towards the management of finances.

In fact it is the President of USA who is the Head of the fiscal organisation of

the Country. Similarly in India, not only a Cabinet Minister is incharge of Finance department but the (Finance Minister) is also always to be intouch with the Prime Minister of the country from whose he receives necessary guidance and advice from time to time. That is why a very capable and experienced person in financial matters is appointed as Finance Minister. Ministry of Finance deals with fiscal management Ministry of Finance is to play a special role, because it keeps watch on the finances of the country. It is to see that the work of collection of different types of taxes is being carried on in a proper way. It also keeps an eye on different sources of income of the country. The Budget is always under its control. In the words of an American Minister, Stephen Stacy " The executive Budget is one of the principle tools of Financial Administration. It is the basis upon which several other tools depends".

Although L.D. White also lays emphases on the fact that Finance and administration are in fact inseparable. Every administrative act has its financial implication either creating a charge on the treasury or making a contribution to it. Moreover, available financial resources set a limit to the administrative activity.

Conclusion

In brief, the Financial Administration has got a special role to play in the progress and prosperity of a country. Hardly anyone can deny the importance of financial administration. Its importance has all the more increased with change in the nature and scope of state functions, advancement of methods and techniques of administration, prevalence of democratic control, rising expectations and scarcity of resources. Now people want efficient system of administration. The question arises, how to reconcile public and govt. control, 'accountability to efficiency in Financial Administration and also to secure public interest. The concept of accountability and transparency in administration is well recognised. Accountability of Public Servants in administration is much more important in these days to achieve government objective to increase productivity and profitability. A well regulated control system is essential. The concept of Public accountability to the public at large is particularly important for transparency in Public administration.

Although, the concept of accountability and transparency in Public Administration cover's various aspects e.g. administrative accountability, Technical accountability, answerability and ministerial accountability. Similarly, the term transparency includes symbolic relationship between Accountability and transparency and remedial measures etc. Thus the concept of accountability and transparency is vital for the development of Public administration in a new democratic set up. Its importance in new Public Management is well established.

BUDGET: Meaning, Principles and Types**Structure**

- 2.1. Introduction
- 2.2. Objectives
- 2.3. Budget
- 2.4. Contents of Budget
- 2.5. Types of Budget
 - Fixed Budget
 - Flexible Budget
 - Performance Budget
 - Zero Base Budget
 - Out come Budget
- 2.6. Principles for Preparation of a Budget
- 2.7. Preparation of a Budget
- 2.8. Budgetary Control
- 2.9. Conclusion
- 2.10. Suggested Readings
- 2.11. Answers to Self Check Exercise

2.1. Introduction

Planning for future is the basic concept for future development, and when this plan is expressed in quantitative terms alongwith its money value, this term is known as Budget for the period covered. To cite a practical example, as a student in college, one does consider the effective & alternative use of time between academic and extra curricular activities, and secures a balance between the two. This is a time budget making best use of 24 hours of the day. Then the students with limited financial resources would write down a plan for incurring expenses out of the available money, which will see them through a semester or year of studies. Then he will organise ways & means to add up his financial resources to make up the needs. Here such students have prepared an expenditure budget as also ways & means for covering up the expenditure or postponing some items, so that he is not short of money for day to day needs. This is known as a personal budget of the student. This aspect applied to wider areas - starting from family, home expenses, organisation, budget, state budgets and lastly Central Govt. budget which covers whole of India. The budget would reflect a policy statement as also ways & means to implement the policy so that the declared targets are achieved during the period or at the end of the period

and based on this further course of action is determined.

2.2 Objectives

After going through this lesson, you would be able to understand the meaning and importance of a budget and budgetary control. There are different types of budgets, as are adopted by business houses and the budget of the Govt. Our aim here is to provide brief information about the commercial budgets and a little more detailed information about the Govt. Budget. Then in the next chapter, more details would be given in regard to preparation of Govt. budget, sanction and then control of expenditure through the budget. There are recently changes in the perception of budget leading to introduction of performance budget, zero based budget and latest one being the "out-come Budget" bringing out the pace of implementation of Govt. Policies. Here implementation of such aspects in commercial budgets would be delved upon.

2.3 Budget

The term 'budget' has been defined differently by different writers.

- (1) "Budgeting may be described as the art of living within an economical constraint."
- "Encyclopedia of Social Sciences"
- (2) "Budget is the account of the moneys for which the legislature is responsible."
- Ursula K. Hicks
- (3) Budget is a proposed work programme, with estimates of the funds necessary to execute it."
- Leonard White
- (4) "Budget is a plan of financing for the incoming fiscal year. This involves an itemised estimated of all revenues on the one hand and of all expenditure on the others."
- Prof. Munro

Every entrepreneur, a small scale business unit or a large scale business house and the governments plan for the future, and framing of their plans in monetary term and guidance as a line of action for the period conceived is known as a Budget for the period. Thus budget is a forecast of the future course of activities/events. Thus a budget would show :

- (i) Anticipated revenues - receipts and its sources
- (ii) Expected expenses - revenue expenses and avenues where such expenses would be incurred.
- (iii) Likely capital expenditure major items of acquisition
- (iv) Resources to meet the capital expenditure and finally,
- (v) The financial position of the concern at the end of period covered by the Budget whether there is profit or loss on revenue side and surplus or short fall in cash balance. Systematic forecast,

management control function is exercised in two ways:

- (i) What results will be at the end of the period; periodical review of the progress provides for corrective action before the end of the period and
- (ii) Control is exercised over the persons responsible for various business functions through periodical performance evaluations.

Thus Budget provides a yardstick against which a manager's actual performance can be compared, and the variation brought to fore. Because of this aspect, many are unhappy with the budgetary restrictions. A budget puts some restrictions over the freedom of activities; rather budget provides for orderly plans of action and not an unbridled freedom. An important aspect of Budget is participation by those who would be responsible to carry out the activities. The greater the participation in the planning process, the greater is the awareness of organisation's objectives & problems likely to be faced during the year, which can be tackled in time and this provides success of budgetary process.

Budget has been defined as an aid to planning and control. Planning is necessary for any enterprise and provides a stepping stone towards success. The budget would contain quantitative and financial details in respect of the activities to be undertaken during the ensuing period of Budget. The activities are enumerated with reference to standard measurements and methodology for undertaking the same. This means that some standards have to be adopted for the implementation of the activities and measurement of the final achievements, is also w.r.t. the same standard. Periodical review provides an insight and feedback on the attainment or otherwise of the planned budgets and standards.

The word 'Budget' is derived from a French word 'bougette' meaning leather bag or wallet. This word came to be used in England in 1733. A budget named as documents containing financial statement were carried by the chancellor of Exchequer of U.K. in leather bag or statchet but now it is taken as financial statement containing the details of the income and expenditure of the government. In its current sense, the term budget means the plan of expenditure and of revenue to balance that expenditure, of a public authority.

Taylor calls the budget a financial plan of a government for a definite period. A government's budget according to Encyclopedia of Social Sciences, is usually and almost necessary its only comprehensive programme of the action for the period to which it relates. In broader sense, the term budget connotes both the financial plan presented to the legislature for its sanction and the sanctioned plan as it emerges after being passed by the legislature.

According to Constitution " Budget means the annual financial statement containing an estimate of all anticipated revenue and expenditure of the government for the coming financial year. But besides giving estimates of revenue and expenditure this statement also contains the review of the financial position of the preceding year, proposals for fresh taxation and additional money needed

to a deficit and proposals for financial capital expenditure. Sometimes we speak of a Budget of department, it is then used as an equivalent of the estimates of the expenditure only in the USA the term, Budgeting, is used to mean the entire financial process consisting of the preparation of Budget, its enactment by legislature, its execution, accounting and auditing.

Thus a budget covers the following aspects

- 1) Specifying the targets for achievement within the framework of objectives laid down in the plan.
- 2) Progressively recording of the actual working and execution of work
- 3) Periodically reviewing and comparing the actuals with the plan of work to see the variations and deviations, if any and ascertain the reasons for the same.
- 4) Taking corrective action so that the work is carried out as per plan in the direction for achievement of the objectives.
- 5) Taking a note of the actuals, to review if the plan/budget had been correctly prepared and also to have guidelines for future planning and budgeting.

In brief we may say that in a budget, it is specified, what is expected in quantitative and/or financial terms to be achieved, and what the plan is for these achievements. Thus the following can be described as advantages of having a proper budgeting system :

1. Objectives of the organisation get defined and these objectives are stated into plan & programme of action at various levels, (there becomes one common goal for different sections, functions and levels).
2. There is better coordination of activities amongst the various executives of the organisation and inter-se communication is facilitated.
3. With the clear policy of action, the responsibility can be properly delegated and management control is better exercised.
4. There is measurement of efficiency for various functions/divisions & sections at periodical intervals as also at the end of the period.
5. If there are variations and deviations, these are brought to light with a view to timely corrective action can be undertaken whereby the extent of variations from the plan is reduced.

An analysis of the reasons leading to variations/deviations can help the management to improve the system for future.

In brief the budget facilitates planning, coordination, communication and is a means of control at various levels in the organisation.

Review Exercise I

Q1. How does an undertaking present its plan of working for the next year?

Answer.....
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Q2. How does an undertaking benefit by preparing a Budget for the next year?

Answer.....
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2.4 Contents of a Budget

In any concern the budget is prepared function wise and then all these budgets are coordinated and consolidated into a master budget. The functions in general covered in a budget comprise of the following :

- 1) **Purchase budget** : Details and periodicity of the purchases to be made linked with the production budget.
- 2) **Production budget** : Level of activity or capacity utilization is considered w.r.t. available resources and its provisioning up (i.e manpower, power, services and raw material) and related to the capability for marketing of the product.
- 3) **Sales budget** : Areas wise/product wise and customer wise, all these aspects are taken into account before projecting the sales, during the year.
- 4) **Cash budget** : This is an important part of the budget. Here due note is taken of the fact that all sales are not cash sales and all purchases are not cash purchases. Due consideration is given to the time demand when these receipts/ payments need be made and the concern is not left high & dry at any point of time in respect of the cash resources. In case of need, an advance action has to be initiated to obtain necessary funds for clearing the payments due.
- 5) **Capital Budget** : There are occasions, the organisation goes in for expansion of activities and/or replacement of capital Assets. This requirement is generally met from the resources like long term loans or increase in equity capital or if there are retained earnings, then use of such savings affected during past years. Which resource is to be utilized and which capital asset is to be added, is a subject of separate study. Here only a reference has been given.
- 6) **Master Budget** : This budget takes into account and coordinates all activities so as to reflect the end results at the year end at one go. The provisions are made for ensuring the cash resources for capital expenditure as also disbursement of dividend etc. The coverage of long term needs are through long term debt and/or equity capital.

Review Exercise II

Q1. Elucidate the various parts of a Master Budget. How are these coordinated ?

Answer.....
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3.5 Types of Budget

There are various types of Budget

1. Fixed Budget
2. Flexible Budget
3. Performance Budget
4. Zero Base Budget
5. Out come Budget

The above types of Budget basically reflect one important factor in each case, which is given prominence for framing the budget for the ensuing period and rest of the activities are planned accordingly. These are detailed below :

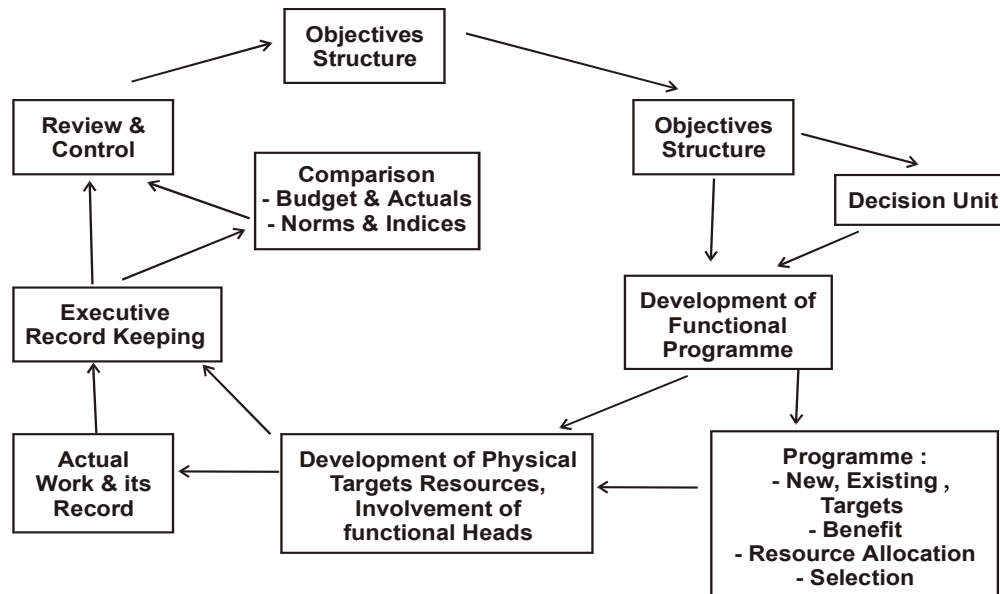
1. Fixed Budget : When the anticipated level of activity is considered as not varying much, i.e. it is fixed for the period of Budget, then all other functional budgets are prepared based on this level of activity. This type of Budget is known as 'fixed budget'.

2. Flexible budget : At occasion, the level of activity cannot be envisaged as fixed. May be, there is uncertainty about the availability of raw material (eq. sugar cane for a sugar mill) or skilled labour, or even the machine capacity may not be possible to be fully used, then different budgets are prepared with reference to (w.r.t.) the extent of the relevant factor being available, (known as key factor) This type of budget is known as flexible budget. Some items under this budget would more or less remain fixed, while others would vary w.r.t. the key factor.

Here the level of activity becomes an important factor for consideration of variable expenses, and some expenses would be semi variable i.e. not changing in direct proportion of activity but would partially change.

3. Performance Budget : When a Budget is linked with the quantum of work in terms of function, programmes and activities, providing identified end product, this would be known as a performance budget. With in the frame work of objectives, and structure of the organisation, the physical targets for the period are developed and financial resources required to accomplish the same in term of functions are indicated alongwith. Then for periodical review, it is necessary that accounting records are also tuned to be suitable for the requirements. The usual heads of account of expenditure would not hold and for that matter, periodical analysis and review is carried out at regular intervals.

In brief the plan of performance budget can be indicated in a graph shape as under:



- Record keeping - covers recording of physically/actual work done; and related accounts.
- Responsibility Accounting - for control of expenses, making the heads responsible - to the extent they are responsible for.
- coordination amongst various functional needs.
- classification of Heads - linking of budget heads & accounts heads.
- Programme evaluation & review at regular intervals. (also known as pert: programme Evaluation & Review Technique.)

4. Zero Base Budget : This is a new concept and calls for more detailed working, before an item of expenditure is included in the budget. It is not based on past records or past performance, but calls for fresh justification for each activity, whether new or old and in particular the following issues need be examined in detail :

(i) If the current activities are effective and are being carried out efficiently. and (ii) whether the current activities need be continued or be discarded/eliminated whereby the funds available could be used on some other priority programme.

This exercise of ZBB towards allocation of resources, originated in USA & has travelled to a number of countries. In India this has been adopted by the Central Govt. for some departments/Ministries at the time of finalization of various new/old schemes to be included in Annual budgets

5. Outcome Budgets : This again is an exercise by the Central Govt. where the Finance Minister has presented an outcome budget for various activities of the govt. This will be discussed in the next chapter covering Govt. Budgets.

Review Exercise III

Q1. How does a flexible budget differ from a fixed budget?

Answer.....

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Q2. Elucidate the coverage given by a Performance Budget & Out come Budget.

Answer.....

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2.6 Principles for preparation of a budget

For all activities, some principles have to be laid and then followed uniformly so that proper assessment of the situation can be ascertained. In this very context, there are some set principles, which are to be observed for the purpose of preparation of a budget and then measuring the performance. These are as under :

1. The budget should be related to the objectives and structure of the organisation.
2. The budget should have the Budget Account heads similar to those in the financial books. This is necessary for proper periodical review.
3. The estimates adopted for budget purpose should be realistic - based on ground realities.
4. For realistic estimates there should be norms, standards for working out the input factors and measuring the output results of budgeted activity.
5. If possible, the budget should be flexible to the extent, that if limiting factor varies, the proportionate variation is reflected in other items as well.
6. With the above principles, the budget can be a monitor for responsibility accounting, providing basis of performance budget and/or zero base budgeting.
7. There should be provisions for periodical review and follow up for corrective action.
8. For successful budgeting process, the management should be committed and there should be involvement of the executives in the budgeting process from the very beginning.

Review Exercise IV

Q1. What are the main considerations for preparing a realistic Budget.

Answer.....

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2.7 Preparation of a Budget : An Example

In a commercial undertaking, the process of budget starts with the policy of the management, linked with the previous year's results and projection of sales during the next year. They would take into account the likely effects of change in market situation and then fix up the sales revenue for different products over the different regions for sale. At this moment, the likely price of the item, keeping in view the competition, and stability of the company's image is kept in view. With these bases, the sales revenue is fixed both in respect of the quantity of each product to be sold and at what price; and in which market and then during which period of the year.

Then comes the sales and marketing expenses for the above. In case for some items, increased sales are anticipated, the sales force would need to be increasingly compensated. And of course, where certain product is being withdrawn or not being pushed, the relevant related expenses will have to be shifted to the product envisaged for increased sales.

Having fixed up the above programmes, the next step is to consider the production plan. Production of any one item may not be confined to one unit and/or some item would be produced at a particular one unit, & that too during a particular period of the year. As such, keeping in view, the opening stock of the year and production plan spread over the year, related to the need of the market is planned. This becomes a production budget.

Based on above, the raw material and other supportive services are to be engaged. The services would already be there, but these have to be linked and there is purchase budget.

Now we have the following budgets

1. Purchase Budget
2. Services Budget
3. Production Budget
4. Sales Budget

With the above in back ground, cash or funds flow budget is framed. This covers the payment schedule in respect of purchases and services depending upon the credit period available, receipt position in respect of sales depending upon the credit period allowed to customers and other payments like interest, rents, dividend and repayments of any loans. Also if any shortfall is expected at a particular time, provision has to be made for making arrangements of each through cash credit, short term loan or over draft from the banks. Also in case, at occasions extra cash is expected to become available, the same need be invested in short term deposits - i.e. money is not allowed to stand in waiting without earning something. Cash money retained, without any objective is a clear loss of value and is to be avoided.

2.8 Budgetary Control

At the time of preparation of budget, a number of operating objectives are listed in the budget estimates, and primary objective, in variably, is achievement of managements' profit goals. Second objective, naturally, is stabilization of production throughout the year as also to reduce the inventory of finished goods by the end of each quarter & at the end of the year. An operating budget is a set of plans for doing these things.

Now every month or every quarter, an income statement need be prepared, which will show, comparative position with Budgeted figures. The increased or decreased sales in relation to the certain fixed cost, would reflect the performance by the marketing/sales Dept.; The second aspect would be comparison of production during the period of review whether the production has been on the lines of budgeted estimates. The variation is the responsibility of the manufacturing department. General Management is responsible for maintaining control over the administrative expenses.

With a view to exercise better control, it is desirable that the over-all master budget is rearranged in a manner that provisions against centres of responsibility are reflected. These could be sales by products and territories factory overhead expenses, cash receipts and payments, man power requirement, research & development expenses etc. This way, each executive would know his goals and his part in achieving the same.

Another aspect of ability to meet the time bound obligations has been mentioned earlier. Here it may be added that management must ensure availability of funds by means of overdraft, cash credit or short term loans, so that obligation of payment to creditor or loan instalment alongwith interest is not held back. May be, if the position is difficult, it may be better not to increase the stock of inventories, there by adequate cash resource is maintained.

Review Exercise

Q1. Give names of various budgets which lead to formation of a Master Budget.

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Q2. How the management can ensure that the Executives working do not deviate from the plan of action given to them.

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2.9 Conclusion

Budgeting is not merely concerned with the accounting function of the administration but embraces all the activities of government departments as well as public corporations and government aided agencies. It is an operational document and as such, it serves as a valuable tool for administration. It functions as an instrument of execution of public policy. An approved budget gives the administrator a summary of the financial environment within which he has to work. It makes readily available to him the information on many features of his department's plan and prospects which need to be taken into account in considering any change in policy. In other words, the budget functions as a guide to various departmental heads for what they have to do during the budget year. The emphasis, in this regard, is on projects, programmes and activities for which there is administrative responsibilities in terms of cost, time and accomplishment. In a number of advanced countries, at all levels of government, executive staffs now use the budget for the "programming of approved goals into specified projects and activities, the design of organizational units to carry out approved programs., and the staffing of these units and the procurement of necessary resources."

The development of performance budgeting in the United States and its adoption by several developing countries over the last twenty five years has triggered off several related budgetary innovations such as function classification, management accounting, organisation and methods, operations research, costing and achievement audit and use of quantitative methods as aids of improve financial administration. It facilitated the fixing of proprieties, management control, evaluation of the various projects and activities with due regard for efficient and economy in public expenditure. "When planning coordination, control, evaluation, reporting and review are combined in a budgetary system, it becomes an effective tool of management. Performance budgets have provided a reliable basis for making the best use of available resources, for appropriate delineation of responsibilities, for ensuring effective managerial co-ordination, for establishing an objective basis for evaluation and reporting of performance for a meaningful legislative supervision and ccontrol as well as for improved public relations."

In an effective budgetary system. all the administrative levels are involved for its preparation as well as smooth implementation. It requires a synchronization of authority and responsibility at various levels of operation; establishment of a smooth two way channel of communication from top to bottm; and maintenance of a steady continuity flow of financial and management data for suitable decision-making at appropriate levels of administration.

2.10 Suggested Readings

1. Accountability - The Basis of Business Decision -Walter B. Meigs;
-Charles E. Johnson, - Robert F. Meigs
2. Account Code : (Govt. of India)
3. Management Accountancy - J. Battey
4. Finance & Accounting for Managerial Competitiveness - Nand Dhameja;
& K.S. Sastry
5. Key features of union Budget 2005-06 - Management Acctt. March 2005
6. Constitution of India.
7. Financial Administration - Sahib Singh, Swinder Singh
8. Financial Administration - Thaveraj

Self Check Exercise

- Q 1. Define Budget
Q 2. Explain Fixed Budget
Q 3. Write various principles of budgeting

2.11 Answers to Self Check Exercise

Read the relevant portion of the text, understand and memorize it then write your answer.

For Q.1. Read 3.3 - Budget

For Q 2. 3.5 Contains the answer to your question

For Q 3. (Principles) 3.6 provides answer

LESSON NO. 1.3

PERFORMANCE BUDGETING AND PROGRAMME BUDGETING

- (i) Introduction
- (ii) Draw backs of Traditional Budgeting
- (iii) Performance and Programme Budgeting
- (iv) Difference between Programme and Performance Budgeting
- (v) Planning Programming Budgeting System (PPBS)
- (vi) Limitations of PPBS

(I) Introduction :

The word 'budget' has been derived from the French word 'Bougette' which means leather bag. The word budget was used for the first time in 1778 in England to describe the bag containing the financial proposals of the government and carried by the Chancellor of Exchequer (person-incharge of government treasury). Since then the process of budgeting has covered a long way and budgeting has now become much more efficient and result-oriented than in the past. Today, the budget is an informative document, showing how the departments and their agencies spend their money.

Although it is the general political process that determines government expenditures, it is through budgeting that the specific decisions are reached. A budget is a detailed statement of a government's expenditure and revenue. In traditional budgeting the executive branch of the government prepares its expenditure and revenue proposals and the legislative branch considers these proposals and votes the fiscal plans (i.e. revenue and expenditure sides) of the government into law. Once the budget becomes the law, it is referred to administrative officers for enforcement. In traditional budgeting system a major emphasis is laid on the financial aspects of the government activities. Budget usually contains financial data for the previous year (or years), estimated figures for the current year, and recommended (budgeted) figures for the coming year, both revenue and expenditure.

(II) Drawbacks of Traditional Budgeting :

A primary function of the budget system is to facilitate evaluation of proposals and to compare their relative merits and demerits. Unfortunately the traditional presentation of the budget does not facilitate this task.

First, the usual budget is organised on the basis of various agencies or departments independently of one another i.e. without regard to the interdependencies among agencies of the conduct of closely related work by other agencies. As a consequence, all costs of particular activities are not properly revealed and the

estimation of benefits is made difficult.

Second, in the traditional budget a major emphasis is usually put on inputs i.e. purchase of various types of items, hiring of various classes of personnel etc. without reference to the activities or outputs (i.e. achievements or accomplishments) are not established, and no basis is provided for comparing the relative effectiveness to various programmes from year to year in a deferral set-up between different states. The traditional budget also fails to recognise, that to achieve the same end result there may be various alternative means (like private individual who is confronted with scarce resources having alternative uses) and the chosen path may not be the most efficient one.

Thirdly, the typical budget is usually formulated on a year-to-year basis without regard to future prospects or commitments arising out of the proposals included in this year's budget.

In fact, in traditional budgeting the primary objective is to check legal abuses. Traditional budget is not designed to facilitate comparisons in terms of priorities. More and more attention is now focussed upon programmes in relation to needs, the task which performance and programming Budgeting can handle much more easily.

(III) Performance and Programme Budgeting :

The above deficiencies have been recognized for decades. Many suggestions have been made for remedying them. The principal approach suggested in this regard is the replacement of the traditional agency and input emphasis by the performance or programme budget.

The Hoover Commission (U.S.A.) also recommended that in the interest of intelligibility, "The whole budgetary concept of federal government be refashioned by the adoption of a budget based upon functions, activities and projects : This we designate as a "performance budget." The commission went on to explain that the performance budget should focus attention on the accomplishment of objectives rather than on allocation to agencies. A system of reporting and review is an essential component of a scheme of performance budgeting.

Performance budgeting focuses upon workloads, such as tons of garbage collected, number of school children graduated, number of income tax returns processed, etc. It is especially useful in administrative management and in appraising various proposal. In the defence department, performance budgeting takes the form of what is called programming in which a calculation is made of what constitutes adequate defence in terms of physical units providing a retaliatory striking force of a certain magnitude. The programme approach which has now been

1. *The Hoover Commission Report* (New York : Mc Graw Hill Book Company, 1949), page 36, as quoted in H.M. Grooves : *Financing Government* (Sixth Edition).

extended to other sectors as well, stresses the end product such as the elimination of poverty, reducing the drop-out rates, public housing, flood controls etc. rather than the inputs of various types of men and material.

Secondly, programme budgeting stresses the relationship between various outputs or programmes and the necessary inputs to produce them. The work of each department is classified into programmes, which are broken into sub-categories. Programmes include all work seeing to obtain the same objective. This in turn facilitates the use of PPBS (Planning Programme Budgeting System) and cost-benefit analysis discussed later in the present lesson.

The primary advantage of the programme budget structure is obvious from its nature. It provides a more useful basis for evaluation of various proposals by concentrating on end products rather than on inputs and by providing better information on costs and benefits. Use of this structure forces the various agencies in preparing their budget proposals to lay more emphasis on inputs-to-inputs and other relationships and to give attention to a wider range of benefits and costs.

(IV) Difference Between Programme and Performance Budgeting

Although most of the scholars use programme budgeting and performance budgeting as synonymous terms, yet there does exist a thin line of demarcation between the two. The programme budgeting is forward looking. It is a projection of the government activities. It tells us how amongst, the alternative activities, the best should be chosen. Performance budgeting must be based on the past performance i.e. what has actually been achieved. The UNO has made the distinction between the two in the following words : In programme budgeting the principal emphasis is on a budget classification in which functions, programmes and their sub-divisions are established for each agency and these are related to accurate and meaningful financial data. Performance budgeting involves the application of more refined management tools, such as unit costs, work measurement and performance standards.

(V) Planning Programming Budgeting System (PPBS)

The Programme budget is merely a form of budgetary presentation - a particular type of budget document. However, the introduction of performance budget has followed by a growing use of Planning-Programming System (PPBS), first introduced in defence department of the USA and subsequently-extended to other sectors.

This system tries to integrate long range Planning of government activities and programming specific activities with annual budgeting, making use of programming-budget structure and of various quantitative techniques, with quantification of costs and benefits. This helps in the selection of best alternatives. Planning involves the statement of the relationships of inputs and outputs under various alternatives to achieve the desired objectives. This approach is helpful in defining the goals and in choosing among the goals, in specifying alternative

programmes to attain the goals, in choosing the best alternatives, and finally in measuring performance. Emphasis is placed on trade off within and between programmes. Cost analysis stress marginal relationships rather than mere overall or average figures. Planning is extended forward for several years. Because of long-range approach, advance Planning is possible, and a better picture is given for all costs and benefits over a period of several years. Steps involved in a Planning-Programming-Budgeting System can be briefly summarized as below :

- (1) To define the budget in terms of the final product or goals of the government (e.g. flood control, elimination of poverty, developing a tactical defence force) ;
- (2) To make explicit comparisons and trade-off among final goals and make explicit comparisons among alternative ways of attaining any one goals;
- (3) To look at the full costs and benefits of their proposals ; and finally
- (4) To undertake long range planning by making explicit costs of various projects over a number of years.

(VI) Limitations of PPBS :

One of the greatest difficulties in PPBS centres around the specification of output. Many government activities involve outputs or services which are not clearly distinguished from the activities themselves (e.g. education, police protection) and hence are not easily defined or measured. The ultimate objective of police protection is to reduce crime, but this accomplishment is not easily measured or compared. The result is to use some proxy measure, such as the number of arrests yet maximisation of this is not the ultimate at all. Similarly many governmental activities (e.g. education, construction of dams etc., serve more than one objective. And it may be difficult to lay stress on one objective at the cost of other objectives.

Secondly, apart from the measurement of output, there is the problem of defining objectives and establishing priorities of objectives. These decisions require value judgement and being mostly subjective are not susceptible to scientific interpretations. Even actual costs are often difficult to ascertain and the overhead or fixed costs are arbitrarily allocated to various activities. Then in the face of uncertainty benefit from various services cannot be estimated with any degree of accuracy. This is particularly true for activities having cross-country ramifications, e.g. defence and foreign fields. Thus the application of PPBS involves many inherent conceptual problems which have only arbitrary solutions.

Another, criticism against PPBS is that it tends to centralize decision making in government, thereby lessening the chances of innovation. The some observes that PPBS relies undue on economic efficiency alone and ultimately the decision may be arrived at by the computers. This rules out the process of political decision making. Thus too much significance to the quantities magnitude produced by PPBS may depersonalise government programmes for the people whom they tend to serve.

Then, sometimes non-economic benefits which cannot be covered under PPBS, may be more relevant than the economic ones. Suppose the goal is to reduce the drop out from schools. Now the drop out from school by a private individual is an economic choice. The person thinks that the gains in terms of expected earnings after completing school education are less than the costs to be incurred on completing education. Now public expenditure on extra-counselling and special help to reduce drop out rate may not pass the test of PPBS. But its non-economic benefit in terms of reducing the crime rate by breaking the circles of poverty that trap families from generation to generation may be more significant for the society.

On the whole, programme budgeting, and PPBS may make very significant contributions to rational decision making about governmental activities and expenditures, but they cannot solve all problems. They do little to define objectives in the light of the preference pattern of the society. Then there are uncertainties particularly on the front of benefits. However PPBS does increase the rational element in government decision making.

LESSON NO. 1.4

ZERO BASE BUDGETING (ZBB)

- (i) Introduction
- (ii) History of the Concept
- (iii) Meaning of Zero Base Budgeting (ZBB)
- (iv) Definitions of ZBB
- (v) Emergence of ZBB Approach
- (vi) Process of ZBB
- (vii) Benefits of ZBB
- (viii) Problems of ZBB
- (ix) Conclusion

(I) Introduction :

Government budgeting systems are used to manage government spending. As discussed in lesson no. 5, programme budgeting and performance budgeting systems are attempts to face bureaucrats to think in terms of inputs and outputs and reducing costs. In this lesson, we have to discuss Zero-base budgeting system. Zero-base budgeting requires bureaucrats to justify their programmes at minimum levels and specify decision packages that involve increments in their outputs above the minimum level.

(II) History of the Concept :

Zero Base budgeting is a new concept and new kind of Budgeting of modern times. The concept of ZBB was presented by English budget expert Mr. Hilton Young in 1924. A system of zero-base budgeting was first introduced in a formalised way in United States Department of Agriculture in its 1964 budget, but it proved unsuccessful. However, it was Peter A. Phyrre, who is known as the father of zero-base budgeting, who designed its logical basic framework in 1970, successfully developed and implemented it in his company at the private sector and popularised its wider use.

In the sphere of public budgeting, ZBB was first tried by Mr. Jimmy Carter in 1973 when he was the Governor of Georgia, with proper remoulding ; and during his administration as President the technique was used throughout the federal government by executive order. ZBB was applied e.g. to all 65 budgeting agencies in the State of Georgia (health, highway, education, agriculture, public safety, game and fish, family and children's services welfare) etc. later on it was adopted by a number of States in the U.S.A. Currently, this type of thinking is being extended to India as well though in a guarded and uncertain manner. The first application of ZBB was in the Department of Science and Technology. The Government of India,

faced with mounting non-plan expenditure and declining public savings, is eager to apply the technique of ZBB. The Seventh Five Year Plan had also emphasised the need for introducing zero-base budgeting. For public sector undertakings are notorious for their inefficiency in resource utilisation, high incremental Capital-Output Ratio and mounting losses. It is clear that we have a good deal of wasteful expenditure which should be avoided. ZBB is considered to be an innovative technique to have against wastage in public expenditure, so the centre is reported to be quite firm on adopting ZBB in a meaningful way. All the ministries and departments have been advised to adopt it. They are expected to arrange the activities and schemes in order of priorities. The ministers have also to evaluate the performance of the existing institutions under their control.

(III) Meaning of ZBB :

ZBB requires that organisations while preparing their budgets should not take earlier year's expenditure for granted and should start a fresh.

This concept implies that a complete re-examination of the on-going programme and activities should be carried out to assess their continued utility instead of following the incremental approach to budgeting. Under it new expenditure proposals are to compete on the same footing with the on-going expenditure based on their respective merits to claim a share of the available sources.

Basically, it is a system for evaluating an organisation its entire budget, starting from a base zero. ZBB's applications are appropriate to those programmes and operations over which management has some measure of discretionary expense control. It is , therefore, inappropriate manufacturing areas where costs are largely directed by sales volume, but it is applicable to such areas as marketing, personnel finance and other staff and support functions.

Zero Base Budgeting is essentially a fresh base review exercise seeking a complete justification for the deployment of resources and the work to be accomplished. Every programme, project, activity and other items of expenditure are given a fresh look. In other words, year in which such an in depth review is made, the budget for the various departments and ministries for the forthcoming year will be formulated without any reference to what had happened in the past years, in terms of performance as well as utilisation of resources. The first step in this exercise, is the reprioritisation of programmes, projects get dropped and desirable projects get included in the budget. Also manpower, capital equipment, and other resources are shifted from products/activities with low priority to those with high priority. Consequently an improved use is made of all resources for enhancing benefits to the people at large.

(IV) Definitions of ZBB :

There has been a series of definitions of ZBB. "ZBB is a system whereby each government programme, regardless of whether it is a new or existing, must be justified

in its entirety and each time a new budget is formulated."¹

"An operating planning and budgeting process which requires each manager to justify its entire budget request in detail from scratch (hence zero base). Each manager states why he should spend any money at all. This approach requires that all activities be identified as "decision packages" which will be evaluated by systematic analysis ranked in order of importance."²

These definitions imply that ZBB is the act of starting or preparing the budget from scratch or requiring each programme or activity to be justified from the "ground up". But actually, ZBB refers to the review and justification of selected and not all current programmes/elements starting some where at a point in the base area. It is necessary at the zero base.

The analytical definition of Peter Sarant can be appropriately used in any environment public and private. "ZBB is a technique which complements and links the existing planning, budgeting and review process. It identifies alternative and efficient methods of utilising limited resources in the effective attainment of selecting benefits. It is a flexible management approach which provides a credible rationale for reallocating resources by focusing on the systematic review and justification of the funding and performance levels of current programmes or activities."

Thus in simple words, ZBB is a way to justify its budget requests from the bottom up, evaluating alternative programme package and ranking programmes as to select the best alternative and allocate resources. P.L. Joshi has aptly remarked, "ZBB is not a budgeting process in the traditional sense of the word-it is first, a management process secondly a planning process and thirdly, a budgeting process".

(V) Emergence of ZBB Approach :

ZBB has a rather long gestation period and a brief infancy. Some of its principles were developed from ideas dating back decades in such areas as capital budgeting. While others are more contemporary. Here are several budgeting techniques that either preceded zero base budgeting or share many of its features :

- (a) Capital Budgeting :** Capital budgeting encompasses such topics as the selection of projects, the timing of the investment, the determination of the amount to be invested at any given time period and the arrangement of the financial means necessary for the completion of the projects. In more recent years return on investment, opportunity cost, years to break even, cash flow impact, and net present value come to mind. If the same measures have been used across the board, all projects can be ranked quickly and objectively and the most promising ones are selected. In a

1. Peter Sarant, "Zero Base Budgeting", 1979.

2. Peter A. Phyrr, "Zero Base Budgeting", quoted in Dr. P. L. Joshi, "Introduction to Zero Base Budgeting."

real sense, this is nothing more than the zero-base concept, modified to fit the needs of particular area.

- (b) Programme, Planning and Budgeting (PPB) ZBB's origin can be traced back to PPB System, which was developed in the early 1960s in the Department of Defence's office of System Analysis and in a refined form, broadly applied to U.S. space programme, PPB was a programme-oriented technique with a long range horizon that demanded cost justification of several alternative approaches against an established strategic need. Its primary thrust was toward planning not budgeting.
- (c) **Project Management :** In the late 1960s this concept came to be applied in the space programme. The primary focus was on evaluating and ranking outputs by programme rather than summing up inputs (or costs). But the analytical techniques for ranking were further refined and expanded to include such non-economic factors as technical feasibility, legal requirements, operational feasibility, as well as intangible benefits and the risks of not acting. These techniques have found direct application to ranking in zero base budgeting.
- (d) **Management by Objective (MBO) and Work Measurement :** At the same time many organisations began to introduce principles of management by objective (MBO) into their planning and performance appraisal processes. At Texas Instruments, the system was called, "Objectives, Strategies and Tactics" (OST) planning system. In a nutshell, OST Linked MBO and long range planning with zero based budgeting.
- (e) **Over-head Value Analysis (OVA) and Cost Benefit Analysis :** OVA emerged in its full form in the mid 1970s. OVA focuses on programmes or services and subjects each to a rigorous cost-benefit analysis. Each manager who incurs the cost must work closely with those who benefits and who specify what's required. Although top management makes the final decision, the supplier must get the sign-off the receiver by "selling" his service. Many organisations using zero-base budgeting having incorporated this "sign-off" technique into their procedure.
- (f) **Bracket Budgeting :** Bracket Budgeting, a recent technique, shares a similarity with one of zero base budget's refinements by using sophisticated statistical analysis, it attempts to assess the probability of a programme's benefit being achieved.

From the above discussion it is clear that ZBB technique should not replace a management system but build upon those already in existence.

(VI) Process of ZBB :

The following procedure of ZBB is workable in any environment of the real world whether private or public sector :

- (1) Identification of Decision Units (DU)
- (2) Analysis of Decision Units
- (3) Creating of Decision Packages (DP)
- (4) Ranking

There are four basic elementary steps in ZBB. The process of ZBB starts by identifying the decision units in an organisation and communication of the objectives as established by the management to the decision unit heads. A decision unit is a subdivision of the organisation that has the responsibility of implementing a particular action. The documentation of this analysis for each decision element is usually called a 'decision package'. This decision package details the purpose of the element, provides a summary of operations and resources needed. A particular unit's budget request is, therefore, incremental into a number of decision packages each covering an element of levels of service and providing an indication of benefits associated with that particular level of service and the consequences of not performing the service to that level. Thus under ZBB each operating manager is forced to have serious thinking about the function. Consideration of alternatives enables him to identify some different ways of performing activities i.e. in house operation versus purchased services, centralisation versus decentralisation, combination of similar activities from separate budget areas, assignment of responsibilities to staff.

Each decision package essentially represents the financial requirements to support a particular level of operation, viz. minimum level, reduced level, current level, improved level.

Once formulated, the decision packages are ranked or assessed in their order of importance by each higher level of management up through the organisation. While the final ranking has been accomplished by top management and a funding level can be determined so that only those activities where the added cost satisfactorily offset by the benefits provided will be funded.

(VII) Benefits of ZBB :

Proponents of ZBB system claim that the system would certainly prove very effective as :

- (i) Selection of the best alternative - every proposal is considered afresh every year and is evaluated on the basis of cost-benefit analysis and ranks are given to them. All alternatives are considered and only the most profitable one is selected.
- (ii) Best utilisation of resources - In the business activity under-taken with the help of ZBB the resources of the enterprises are utilised in the best possible manner with the maximum benefits and economy even the feasibility of mechanisation and modernisation can be evaluated.
- (iii) Increase in overall efficiency of business - The present and future

proposals are re-evaluated every year and comparative studies are made for all alternative proposals. This will reduce the unnecessary expenses and wastage and will lead to increase in overall efficiency.

- (iv) Useful for policy formulations - Before formulating a budget the future factors like changes in the consumer's demand, fashions, government policy and development of new technology and research are considered. These factors can guide the management in policy formulation.
- (v) Acceptance of budget proposals with zeal - Managers at all levels contribute to the formulation of budget and their sense of ego is satisfied as they feel they have contributed to the formulated of budgets. Therefore they accept and implement the budget proposals with zeal and enthusiasm.
- (vi) Continuity of long term plan-Every year new proposals are considered and implemented. Though them, the long term objectives and projects are linked with annual budget so that continuity of long term projects is maintained.
- (vii) No carry forward of past mistakes - Every proposal whether past or present is considered a fresh, signifying that past inefficiencies are not carried forward. Thus ZBB highlights the budget process in a comprehensive way making clear cut analysis of priorities, objectives and needs of the economy. It incorporates management proven concepts such as cost benefits analysis. ZBB links planning and budgeting, it facilitates identification of those activities which are poorly operated and managed and it provides management with tremendous data base of information and analysis. Besides, it can be significant aid to operational audit and it may also reduce the scope, timing and cost of external audit.

(VIII) Problems of ZBB :

Regarding the various problems faced by the application of zero-based budgeting, Prof. Musgrave observed that "It is a helpful procedure but clearly impracticable in detailed application. A more realistic approach would be better for the zero based method to particular department of programme on a rotating basis."¹

1. The problem of ZBB range from a conceptual to its practical application. There are conceptual problems such as what is a decision package ? What are appropriate levels of funding ? How can decision packages be realistically ranked ? Among the practical problems are such as how to educate supervisors and managers to handle the technique ?
2. As its process is complicated, it involves a great deal of time. It is an expensive method. It is possible that expenditure incurred in

1. R.A. Musgrave and P.B. Musgrave : *Public Finance in Theory and Practice*.

establishing the system may exceeds the savings accruing from it. For instance, "It is estimated that the 1975 budget preparation costs double in Washington, Delaware in establishing a zero base budgeting system."¹

3. Thirdly, the preparation of decision packages entails unnecessary documentation work.

Managers are required to evaluate various decision packages and rank them. Some objectives base is required for the results achieved in respect of different proposals have to be decided. It is not easy to have such measuring rod.

(IX) Conclusion :

In brief ZBB tries to uncover what is really going on in an organisation, why it is being done, what better ways might be available, and which activities are really important as well as what they cost. If we know what these efforts are, how they relate both to each other and broader goals of the organisation, we have a powerful tool to manage and allocate our resources and, in so doing, to achieve our objectives. And this is precisely the virtue of ZBB. In India, ZBB can be proved very useful to the management in its efforts to improve the performance of public sector undertakings; to revive the sick industrial units ; and to meet the challenges of rising prices.

Preparation, Enactment and Execution of Budget in India**Structure**

- 5.1. Introduction
- 5.2. Objectives
- 5.3. Composition of Government Budget
- 5.4. Functional Classification
- 5.5. Budget Process
- 5.6. Presentation of Budget
- 5.7. Expenditure Part
- 5.8. Revenue or Income Part
- 5.9. Appropriation and Finance Bill
- 5.10 Execution
- 5.11 Conclusion
- 5.12 Key Words and Terms

5.1 Introduction

Prior to independence, the Government was mainly concerned with function of Law or order, and protecting individual rights to property. Then there were some regulatory measures in respect of industrial activities. However, the post independence has brought in a sea change in the realm of activities of the Govt. The Govt. is no longer confined to the administrative aspects but is well concerned with other developmental activities covering protection of rights of weaker section, a stabilizer, pioneer innovator and entrepreneur. It has to provide economic services to the weaker section and make efforts to reduce the inequality of income. For this purpose, a number of commercial enterprises have been undertaken. So apart from public administration, there is management of public sector undertakings and development projects for benefits of public at large and this reflects the aspect of social accounting.

All this has made it necessary for the Government to classify the expenditure & revenue part of the Govt. financial management in a manner that would help economic interpretation of the public finance, and reflect its activities in a form which conforms to the plan of action of the Govt. This objective is achieved through economic classification of the receipts and out lays including capital account of the Govt. Thus the Govt. Budget is a financial plan and a means of approval of the legislature. This is the main instrument of financial accountability and control to ensure that the amount spent for various purposes

is within limits laid down in the Budget. Thus the Govt. Budget is a financial plan and a means of approval of legislature through which financial accountability is called for and control over the activities is exercised to ensure that the amount spent for various purposes are within the limits laid down in the budget.

5.2 Objectives :

By going through this chapter, you would appreciate the need for budgeting in government, and how the same is framed. Also through this budget the Govt. exercise control over the expenditure as also measures are reflected, where by the executive is made accountable for carrying out the policy of the Govt. This is reflected and achieved through the Appropriation Budget, Performance Budget and Zero Base Budget.

Then there are items of expenditure which are treated as charged expenditure and rest are all voted. Further the expenses & receipts are classified into current and capital accounts. Also there is a public account with the Govt. where in the money deposited does not belong to Government, but is controlled by the Govt. Further the Government has a contingency fund to meet the unexpected and emergency need, which account is recouped later by approval. All these are explained in this chapter.

5.3 Composition of Govt. Budget

Normally the budgeting provision of the Central Govt. are classified on the basis of purchase of commodities, services and then considered under Current & Capital Account. The expenditure on current is presented into two accounts (i) expenditure on Govt. administration and (ii) expenditure on departmental commercial undertaking eq. Railways, P & T etc.

The former is further subdivided into (i) consumption expenditure consisting of (a) salaries and wages, commodities and services, and (ii) transfer payments consisting of (a) interest, (b) grants to states and union territories, to local authorities, and to others and (c) other current transfers. These cover subsidies, compensatory and compassionate pensions and other payments, of similar nature.

The expenditure on departmental commercial undertaking is divided into the following categories :

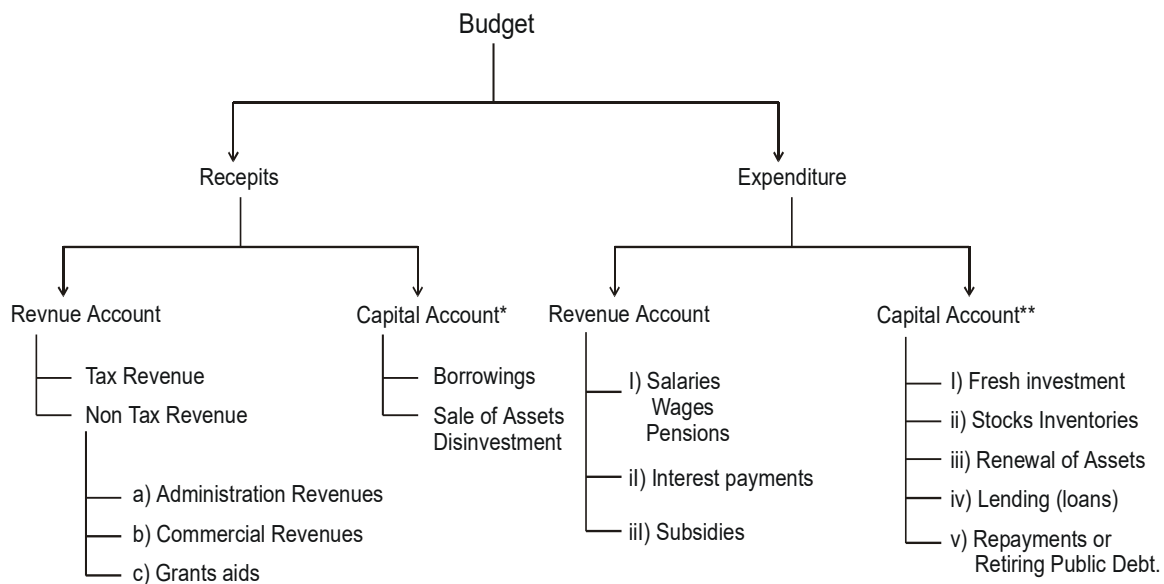
1. Salaries and wages, including expenses incidental to services by the employees.
2. Pensions : Retired employees
3. Commodities and services-contingent expenses and purchases.
4. Repairs and maintenance of Capital (fixed) Assets.
5. Interest on the funds provided as loans to the undertaking

6. Provisions for descriptions

7. Retained profits of departmental commercial undertakings

The third account relates to capital transaction' of Govt. Administration and departmental commercial undertakings. The expenditure under this head is divided into gross fixed capital formation, increase in inventories, and capital transfer'. Gross fixed capital formation is further sub-divided into buildings and other construction, and machinery & equipment. Then under each of these, there are sub-heads consisting of new outlays, renewals and replacements. The increase in inventions is sub-divided into stores and stocks of foodgrain etc.

Capital transfers include (i) grants for capital formation to states and union territories non-departmental commercial undertakings, local bodies and others; (ii) gratuity and commuted value of pensions (iii) compensation paid to displaced persons and (iv) other capital transfers. All the above can be shown in the form of a chart as under :



* Receipts on capital account are these receipts, which increase the liabilities or decrease assets

**Expenditure on capital account are those expenses which increase the assets (assets are formed) or reduce the liabilities.

This economic classification becomes economic & functional classification, when super imposed on different functions performed by the Govt. these are detailed in the next paragraph.

Review Exercise

Q1. What is the normal distribution of Revenue expenditure of a Govt. Deptt.?

Answer.....

.....
.....
Q2. How do you define a Capital Expenditure?

Answer.....
.....
.....

5.4 Functional Classification :

As mentioned in the beginning, the functions of the govt. stand enlarged many fold. These have to be performed and can be classified as under :

- (i) Defence services
- (ii) General Services - Administrative Services
- (iii) Fiscal services
- (iv) Economic services and
- (v) social services.

The budgetary needs of each of the services mentioned above, are presented in the form of economic classification as already stated. The budgetary operation has been becoming more & more important, when the same is linked with economic development of the country. There it becomes necessary to make a distinction between govt.'s outlay in the nature of consumption expenditure, which results in capital formation from the rest. Such outlays are intended to indirectly promote and assist further capital formation in the economy. Other expenses are normal consumption expenses which do not add to the capital formation.

Review Exercise

Q1. What are the main services, under which Govt. expenditure is made.

Answer.....
.....
.....

5.5 Budget Process :

The Govt. Budget is generally known as appropriation budget. The main difficulty in this budget is that the output measurement of all departments-activities are not practicable to be so recorded. The activities of the Govt. concerning health, education, agriculture, law & order etc. can not be made susceptible to performance on year to year basis. As such where the effectiveness of the expenses is difficult to be measured, it is largely a matter of judgement to allocate the budget provision and this is known as appropriation budget. Here an upper limit of expenditure on the given activity is given and the executive has to abide by that. Here the budget is 'Line item' or 'object classification' as outlays for the year and these are in terms of nature of expenses (like salaries & wages, contingent expenses, purchases of material and services) for which requests for appropriation are made. This is also known as conventional budget.

The format of this budget contains columns for the Head of Account - distinguished with an account number, description of expenditure, current year's budget, current year's actual-todate, current year's revised estimate - with any change or no change) and next year's, budget. The focus of this budget is mainly on inputs, rather than the output or on the expenditure to be incurred, rather than the task to be performed or goals to be achieved. Most of the time the budget for the next year is provided on incremental basis - adding some percentage to the current year's actual expenditure or revised estimates. The format is as under : (figure of Budget for the year 2005-06)

Conventional Budget at a Glance

					(Rs. in crores)
Sr. No.	Account Head	Actuals	B.E.	R.E.	B.E.
		2003-07	2007-05	2007-05	2005-06
1.	Revenue Receipts	xxx	xxx	xxx	xxx
2.	Tax Revenues	186982	233906	225807	273766
	xxx	xxx	xxx	xxx	xxx
9.	Non Plan Expenditure				
10.	Revenue A/c	283502	293650	296396	330530

This is consolidated position of the activities collected by the Ministry of finance from all deptts. of the Govt. Separate details for each department are appended in support of this statement. Then while preparing and consolidating the budgetary details, new proposal are added & some of the existing provision deleted, as also tax structure is amended with a view to provide benefit to weaker section, improve infrastructure, economic development in the field of industry, agriculture, capital formation and be competitive in the world market. For example the key features of the budget 2005-06 were as under :

Macro Economic

- Overall growth rate estimated for 2007-05 as 6.9% & manufacturing sector growth rate @ 8.9%
- Inflation to be reined in

Assault on Poverty & employment

- National food for work programme - allocation increase
- Rural Health - Training programme
- ICDS - Increase in Anganwadi centres
- Mid-day meals - increased, rope in more school
- Drinking water & sanitation and so on.

Bharat Nirman

- Irrigation of more land.

- Connect all villages with a Road
- Additional houses for the poor
- Electricity & telephone to all villages.

Investments - Equity support to public undertakings. Similarly provisions are made for agriculture & manufacturing sectors.

Indirect & direct taxes, developments of infra-structure & so on.

As may be seen, the above budget would have the following characteristics :

- (1) Oriented towards the financial aspect or mainly money aspect.
- (2) Emphasis is mainly on salary and wages, and other expenses and not on the purpose of expense. The consideration is that financial accountability permeates the entire budgeting process.
- (3) The focus is on exhausting of funds provided in the budget; rather than on performance or the end result of the money spent as related to the objective.
- (7) This budget relies heavily on the cash basis of payments rather than utilization of inputs and result of these inputs.

Review Exercise

Q1. What have been the planned policy of Govt. for Poverty & employment/ Bharat Nirman.

Answer.....

In a way, it is presumed that the in puts have been properly utilized. Any shortcomings in this regard are pointed out by audit - a post expense affair, in between corrective action is not expected.

5.6 Presentation of Budget in Parliament

What ever has been mentioned in the preceding section, it culminates into Annual taxation and expenditure proposals, embodied in Annual Financial statement - popularly known as Budget. Art. 112 of the Constitution, requires that this annual financial statement shall contain only a statement of the estimated receipts and expenditure for the coming financial year, However, in practice, the budget includes the following :

- (a) A review of the financial position of the previous year including the actual receipts and expenditure of that year;
- (b) Original estimates of the receipts and expenditure for the current year
- (c) Revised estimates for the current year,
- (d) Estimate of the receipts and expenditure for the coming year and
- (e) Proposals for meeting the requirements of the coming year.

This Budget is presented by the Finance Minister in the Houses of

Parliament. Considering Railways as a commercial undertaking of the Govt., the Railway Budget has been separated and is presented by the Railway Minister, a few days in advance. In the main budget, the total receipts and expenses of the Railways are included in lumpsum, for the reason that receipt & expenditure of the Railways is a part of the total receipts & expenditure of the Central Government, (or Union Govt.). After detailed considerations, two separate Appropriation Acts - one for Railways and the other for general budget are passed by the Parliament.

As already stated, the budget is divided into (a) expenditure part (b) Revenue part. Expenditure part would again show separately (i) the items of expenditure which are charged upon the consolidated fund of India and items which are not so charged. and (ii) expenditure on revenue account, distinguished from capital expenditure, and/or expenditure to be met from borrowing, loans and other ways & means proposals. The terms charged expenditure, voted expenditure; consolidated fund and contingency fund will be explained, after the process of budget approval is covered here after.

5.7 Expenditure part

After the Annual Financial Statement, in common language known as Budget, is placed before the house, it takes time, before the same is voted & passed. After initial presentation, it is left to be discussed in both the houses - Lok Sabha (House of people) and Upper House (Council of States). Both the Houses are accorded full opportunity to discuss any item of expenditure provided in the budget - charged as well as voted. It is a general discussion and no individual item is adopted for vote. After general discussion the estimates are submitted to the House of people in the form of demands for grants. The house has the power to give assent, to a demand, refuse it or reduce it, but it has no power to increase or change the purpose of a grant by putting any condition or otherwise. The members may, sometime move "cut motions" for particular demands. The cut motion could be "disapproval or Policy cuts", 'Economy cut' or a token cut to reflect the specific grievances of the members.

Review Exercise

Q1. Can the Parliament propose to increase a demand for a particular Project?

Answer.....
.....
.....

5.8 Revenue or Income Part :

After voting on expenditure part is over, the house takes up the revenue part to consider ways & means to meet the expenses. Here the house approves imposition of taxes as contained in the budget. Here also the house does not have a power to increase the rate or suggest a new tax, while for existing

proposals, the House may reduce the rate and/or may reject a new proposal of tax.

Review Exercise

Q1. Can the Parliament propose to levy a new tax or increase the rate as already proposed in the Bill?

Answer.....

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5.9 Appropriation and Finance bill

After the two parts of the budget, have been voted, these are consolidated in two bills, known as Appropriation and Finance Bills. The speaker would certify these as money bills and these are referred to the upper house. The council of states must make its recommendation, if any, within a period of 17 days failing which the bills are deemed to have been passed by both the houses, and are sent to the President for his assent. On his assent, the bill becomes an Appropriation Act, and through this the amounts are fixed to be drawn out of the consolidated fund to meet the entire expenditure - both voted as well as charged. Similarly through the Finance Act, various proposals of taxation for raising the funds are authorised and implemented thereafter.

Review Exercise

Q1. When does a Finance Bill become an Act for implementation by the govt.

Answer.....

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5.10 Execution of Budget

Discussion about the budgetary system in India would be incomplete if one ignores the execution side of the Budget. Execution of Budget is a wide term and includes many things. Once the Budget is passed the problem before the administration is that of its execution. The amount authorised under the Budget can be withdrawn from the treasury and spent on the purpose for which it was approved. Unauthorised withdrawal is prohibited and thus illegal. Moreover, taxes can also be levied and collected as authorised by the budget. The main object on the execution stage is that neither any authorised collection is made.

The main responsibility of the execution of the Budget lies on the Ministry of Finance. It is divided into many Departments. Apart from them, there are many attached and subordinate offices. So far as expenditure side is concerned, it is the duty of the Ministry of Finance to see that there is no wastage and possible economies are exercised. It can issue instructions and circulars to that effect and it does so in practice. All the subordinate field officers get guidance

from Finance Ministry.

So far as assessment and collection of taxes is concerned, this work in India has been handed over to Central Board of Revenue, which has got two separate wings to deal with the above two functions. The chairman of this board is always a man of towering personality and enjoys vast powers. In rank he is equal to secretary. He is assisted by some members who are equal in rank to Deputy Secretaries and Joint Secretaries, Chairman and members of the Board are helped in their work by inspection staff and other establishment.

In Districts there are treasuries that receive money collected on behalf of the Government. The head of the Treasury is Treasury Officer, who is assisted by and Assistant Treasury Officer. Each sub-division has got a separate sub-treasury of its own. At State headquarters there is a treasury or treasuries as the need may be.

On the apex, there is Reserve bank of India, which keeps the Government money in its custody, information about the amount deposited is passed on to the Accountant General for adjustment.

Disbursement of funds according to authorisation is another step that has to be taken with regard to proper execution of the Budget. Different Departments have the authority to draw the amount from the treasury after the Budget has been passed. Disbursing is with the Head of Department or it may be delegated to subordinate officers. However, ultimately responsibility lies on the Head of Department. The work of disbursement goes in accordance with budget provisions, otherwise it will be considered as an illegal transaction.

Accounting is also included in the execution of Budget. Account must be kept properly as directed by the Comptroller and Audit General of India.

In states, there are accountant Generals who receive instructions in matter of accounts from the Comptroller Audit General.

Auditing is also a part of the execution of the Budget. The purpose of auditing is to see that public money is being spent after authorisation and in an economical manner. It prevents embezzlements and checks irregularities.

In brief, without execution the budget remains simply paper work.

5.11 Conclusion

After studying this lesson, you have come to know the components of government budget and the process of preparation, enactment and execution of the budget. Various important terms used in the budget have been discussed under the key words/terms explained.

5.12 The various terms used are explained as under :-

Consolidated fund of India

The central government and the state government have separate

consolidated funds of their own entitle 'consolidated fund of India' & "consolidated fund of the state" respectively, into which the revenues received by the central/state government, loans raised by it, by issue of treasury bills, other loans or ways & means advances, and money received in repayments of loans are credited and from which the entire expenses of that government, when so authorised by the appropriate legislature are met.

This consolidated fund is the foundation stone of financial control, and no payment there from can be made except under the authority of an Appropriation Act duly passed by the legislature and except for the purpose for which the money has been authorised to be drawn out of this fund.

Public Account : In case some money is received by or deposited with any office of the Government other than the revenues, for credit to any cause, matter, account or person, shall be credited to another account - known as "public account" of the government.

Contingency Fund : The Central Govt. (and the states as well) may have a separate contingency fund of India which will be at the disposal of the President (Governor in case of state) to enable him to make advances for meeting the unforeseen expenditure, pending authorisation of such expenditure by the parliament or state legislature under appropriations made by law. This fund is in the nature of an imprest placed by the legislature at the disposal of the President (Governor) who operate this fund in case of emergent needs. This fund is subsequently recouped with requisit sanction of legislature.

Charged expenditure :

The expenditure part of the Budget is divided into 'charged & voted'. The charged items are not subject to vote of the house though these can be discussed. These items are excluded from the vote of the legislature because these are of a fixed and inevitable nature and are not subject to variation. These provisions add to the independence of the officers like judges, Comptroller & Auditor General, Members of the public service commission, so that they continue to discharge their duties without fear or favour. Provision for this have been made under art 112(3) of the Constitution which cover the following :

1. President of India & his office.
2. Chairman/Dy chairman of Upper House, Speaker and Dy. speaker of the Lok Sabha
3. Debt charges interest & repayment of loans etc.
4. Judges of the Supreme Court & their offices
5. Comptroller & Auditor General of India, & his office
6. Some grants in aid to some states
7. Loans to states

8. Member of Public Service Commission and their offices.

General Budget - This is an Annual Financial Statement and allocation of funds to various departments and ministries for different projects and normal working.

Out come budget - This is a progress report of different projects of ministries and departments, to show the actual work covered, as against the plan laid down.

Performance budget - This is a project wise report card at the end of the financial year of the targets achieved and unfulfilled

The three documents - General Budget, Outcome Budget and Performance Budget, read together would reflect a much better picture of what had been achieved on the outlays made over the year - against the targets laid down. The shortfalls would have to be explained adequately.

For the above purpose, it would be necessary to have an economic survey a report of the state of the economy during the year with macro-economic analysis. Here it would not be out of place to define a few more terms :

Plan expenditure is that expenditure which is meant for a particular plan and it has to be incurred during the plan period.

Non-plan expenditure sometimes is also called committed expenditure, which has always to be incurred.

Development expenditure is meant for promoting the development of economy or which is helpful for economic development.

Non development expenditure is linked with administration of law & order, defence etc.

There is a myth that plan expenditure is always developmental and non-plan expenditure is non-developmental. It may not always be true. Non plan expenditure or committed expenditure on salaries of teachers, doctors, technocrats etc. may be helpful for economic development, while some plan expenditure may be unproductive and hence non-developmental.

5.13 Suggested Readings

1. Accountability -The Basis of Business Decision - Walter B. Meigs; Charles E. Johnson, - Robert F. Meigs.
2. Account Code : (Govt. of India)
3. Management Accountancy - J.Batthey
4. Finance & Accounting for Managerial Competitiveness - Nand Dhameja; & K.S.Sastry
5. Key features of union Budget 2005-06 - Management Acctt. March 2005
6. Constitution of India
7. Financial Administration - Sahib Singh, Swinder Singh
8. Financial Administration - Thaveraj

Self Check Exercise

- Q1. What are the charged expenses of the Govt. and why these are not subject to vote by the Parliament?
- Q2. What are the different amongst consolidated fund, Public Account & Contingency Fund?
- Q3. How it is ensured that the expenditure incurred by the Executive is on the purpose for which the money was drawn and has not been over spent.
- Q4. Indicate the areas of Govt. expenditure which goes towards development activity even though it is non-plan expenditure.

5.14 Answers to Self Check Exercise

Read the questions carefully and answer appropriately.