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# UNIT 11 PERFORMANCE BUDGETING

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## 11.0 OBJECTIVES

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After studying this unit, you should be able to:

- explain the concept and objectives of performance budgeting
- describe the steps in performance budgeting
- discuss the performance budgeting system in India; and
- evaluate the performance budgeting system.

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## 11.1 INTRODUCTION

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In a planned economy, it is logical to think in terms of budgeting both as the nearest link in a well-integrated system of planning, programming and budgeting and as a tool of management. It provides a system of information for decision-making, coordination, evaluation and control to the appropriate levels of the organisation. During recent years, there has been a significant increase in public expenditure. Government's involvement in the stabilisation of the economy, equitable distribution of wealth, stimulating forces leading to economic growth and increase in the price levels are some of the factors that have contributed to the increasing public expenditures.

The increasing public expenditures which brought with them a good deal of complexity, led to two significant questions:

- i) how to control and regulate the increasing public expenditures; and
- ii) how to introduce efficiency into the public expenditures.

In this unit an attempt has been made to explain the concept of performance budgeting and its genesis in Indian administration. A critical review of the system has also been done in the unit.

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## 11.2 PERFORMANCE BUDGETING : CONCEPT AND OBJECTIVES

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As we have discussed in Unit 2 of Block 1 of this course, the financial system of our country during the British period was characterised by high degree of centralisation, adherence to rigid financial rules and procedures, integration of accounts and audit etc. After independence, attempts have been made to make the financial administration performance-oriented, with a view to bringing about efficiency and economy in the implementation of plans, programmes and activities. Efforts were made to make the budget an efficient tool of plan implementation. The result has been the introduction of the performance budgeting system in the government. We shall discuss in detail about the evolution of performance budgeting system in India in Section 11.4 of this unit.

Performance budgeting is generally understood as a system of presentation of public expenditure in terms of functions, programmes, performance units, viz. activities/ projects, etc., reflecting primarily, the governmental output and its cost. It is essentially a process which brings out the total governmental operations through a classification by functions, programmes and activities. Through suitable narrative statements and workload data that form an integral part of the presentation, it indicates the work done, proposed to be done and the cost of carrying these out. The main thrust of performance budgeting has been on providing output-oriented budget information within a long range perspective so that resources could be allocated more efficiently and effectively. Its emphasis is on accomplishment rather than on the means of accomplishment. The purpose of government expenditure is more important than the object of expenditure under performance budgeting. Thus performance budgeting is a programme of action for any given year with specific indicators regarding tasks, the means of achieving them and the cost of achieving them. It tries to define the physical and financial aspects of each programme and activity and thereby establish the relationship between output and inputs. Performance budgeting has to operate within the framework of clearly defined objectives which are to be achieved through successful implementation of various programmes and activities undertaken by the concerned agency. Performance budgeting, therefore, involves the development of more refined management tools, such as work measurement, performance standards, unit costs, etc.

**Objectives:** Performance budgeting seeks to:

- i) correlate the physical and financial aspects of programmes and activities;
- ii) improve budget formulation, review and decision-making at all levels of management in the government machinery;
- iii) facilitate better appreciation and review by the legislature;
- iv) make possible more effective performance audit;
- v) measure progress towards long-term objectives as envisaged in the plan; and
- vi) bring annual budgets and developmental plans together through a common language.

#### **Components of Performance Budget**

The performance budgets have certain vital ingredients that need to be constantly kept in view:

- i) a programme and activity classification that represents the range of work of each organisation;
- ii) a framework of specified objectives for each programme;
- iii) a stipulation of the targets of work or achievement; and
- iv) suitable workload factors, productivity and performance ratios that justify financial requirements of each programme.

#### **Formulation of Performance Budget**

Each performance budget will in the first instance indicate the organisational structure and the broad objectives that govern the approaches and work of the administrative agency. This is followed by a Financial Requirements Table. This Table is the most important part of the performance budget and has three basic elements:

- a programme and activity classification indicating the range of work of the agency in meaningful categories
- object-wise classification showing the same amount distributed among the different objects of expenditure such as establishment charges; and
- sources of financing indicating the budgetary and account heads under which the funds are being provided in the budget.

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### **11.3 STEPS IN PERFORMANCE BUDGETING**

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Four basic steps are involved in the introduction of performance budgeting:

- i) Establishing a meaningful classification of public expenditure in terms of functions,

- ii) the establishment, improvement and extension of activity schedules for all measurable activities of the government;
- iii) the establishment of work output, employee utilisation, standard or unit costs by objective methods, i.e. bringing the system of accounting and financial management into accord with the classification; and
- iv) the creation of related cost and performance recording and reporting system.

The important requirement for performance budgeting is a programme of action for any given year with specific indications regarding the tasks, the means of achieving them and the costs of achieving them. This is important even in traditional budgeting process. The distinction, however, is that under performance budgeting the organisations are compelled to think of their future activities not merely in terms of financial plans but in terms of the results, work assignment and organisational responsibilities. It is normally held that in the context of planning for economic growth, planning is a thinking process and budgeting is a doing process. Since the physical and financial aspects go together and the programme structure is expected to be the same, performance budgeting facilitates the functional integration of the thinking and doing process.

The formulation of programmes for achieving the organisational goals is an important task in the budgetary process. A programme is a segment of an important function and represents a homogeneous type of work. These programmes of work need to be developed for meeting the short-term plans, medium-term plans and long-term plans and involve formulation of schemes, laying down their targets, measuring the financial costs and benefits. The programme has to be assessed in the light of financial and economic factors i.e. ensuring adequate resources for the programme so chosen and examination of the impact of the proposed outlays on the economy as a whole through cost-benefit analysis. Complex programmes are divided into sub-programmes to facilitate execution in specific areas. Each programme or sub-programme further consists of many activities which are shown in the respective budgets. For example immunization programme is a programme under the function 'health'. As each programme has many activities, provision for storage of vaccines could be an activity under the programme.

The real commencing point in the budgetary process is allocation of resources. In the conventional system primary emphasis is laid on the previous level of allocations and spendings and no emphasis is laid on its performance in terms of its objectives and the programme of action that it has set out for itself for the next year. Under performance budgeting the primary agency prepares the budget, submits its requirements as per programme classification. It indicates its past activities, their costs, the activities to be taken up during the next year, the results expected and the pattern of assignment of responsibilities. The very basis of the performance budgeting is commitment to achievement and the awareness of accountability. The budget so prepared is reviewed at higher level and resources are allocated keeping in view the priorities of the proposal. Some times due to financial constraints resources may not be available in full and a cut has to be imposed. However, this may be done in full awareness of the implications of the cut on the programme. Under performance budgeting, the programme classification and the rationale behind it indicate a group of choices with their priorities, already made. This minimises the dislocational effect of cuts and ensures a better identification of their impact on programme achievement.

Resource allocation is followed by budget execution. Budget execution must ensure achievement of objectives and for that the following budgetary and managerial considerations must be kept in view:

- i) Communication of the grants to the various subordinate agencies well in time
- ii) Ensuring the initiation of action for implementing the schemes provided for in the budget
- iii) Overseeing the regular flow of expenditures
- iv) Prevention of cost over-runs; and
- v) Time phased plan for expenditure and work.

The final stage in the performance budgeting process is appraisal and evaluation.

Under the existing system evaluation of the physical achievements in certain sectors is being undertaken by the Programme Evaluation Organisation. Under performance budgeting, each programme would lend itself to an evaluation by the agency concerned, even before it is undertaken by an outside organisation. The important aspect is that evaluation should, as far as possible, follow the completion of a programme and the administration should be enabled to formulate its future course of action in the light of results obtained.

**Check Your Progress 1**

Note: i) Use the space given below for your answers.  
ii) Check your answers with those given at the end of the unit.

1) Explain the concept of performance budgeting.

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2) List the objectives of performance budgeting.

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3) Describe the budgetary process involved in performance budgeting.

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**11.4 PERFORMANCE BUDGETING SYSTEM IN INDIA**

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The need for performance budgeting in India was felt ever since India entered into planning era. The then existing budgeting and control system was found inadequate as no input-output relationship could be established between financial outlays and physical targets. The first study regarding the relevance of performance budgeting to our institutional set-up and needs was made by Dean Appleby in 1953. At that stage, however, the system of performance budgeting was still incipient in the federal government and Dean Appleby was not very certain of the outcome of the system. The Estimates Committee of the Lok Sabha, in its 20th report recommended that "... the Performance-cum-Programme System of budgeting would be ideal for a proper appreciation of the schemes and outlays included in the budget, especially in the case of large scale developmental activities. The Performance Budgeting should be the goal which should be reached gradually and by progressive stages without any serious budgeting dislocation." The recommendation was primarily made to strengthen the parliamentary control over expenditure.

The Estimates Committee raised the issue again in their 73rd report in 1960 and suggested that the recommendation regarding performance budgeting be implemented at the earliest possible. These recommendations brought results. In 1961, the Union Finance Ministry accepted the recommendations of the 73rd report of the Estimates Committee and issued instructions exhorting the public enterprises to adopt performance budgeting. However due to operational problems, no undertaking implemented the instructions.

In 1964 performance budgeting again became a focus of attention when the Planning

Commission held that "the stage has reached when appropriate methods of Performance Budgeting should be evolved, so that these become an integral part of the machinery for planning and supervision over plan fulfilment." As a part of the implementation of this suggestion, the planning commission formed a Performance Budgeting unit in the Committee on Plan Projects in 1965. In order to identify the benefits this unit conducted a number of studies which provided the database for Administrative Reforms Commission. When Administrative Reforms Commission was set up, a working group on performance budgeting was established by the Commission.

The working group recommended the introduction of performance budgeting in India in the developmental departments both at the Centre and in the States, in a phased manner.

The Administrative Reforms Commission further recommended that the introduction of Performance budgeting should be initiated with the budget of 1969-70 and completed by 1970-71. In view of this, the Union Finance Ministry submitted a document known as "Performance Budgets of Selected Organisations 1968-69" to the Lok Sabha in April 1968.

The Government of India, on the recommendation of ARC (Administrative Reforms Commission) issued guidelines for the adoption of Performance Budgeting in all ministries, departments and State Governments w.e.f. 1973-74. American budget experts were also invited to advise the Government of India on the introduction of performance budgeting.

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## 11.5 PERFORMANCE BUDGETING SYSTEM — A CRITICAL EVALUATION

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The government accepted performance budgeting and initiated the process of change, gradually and cautiously, almost two decades ago. The system has since been introduced in all development departments at the centre. Some of the states like Maharashtra, Punjab, Rajasthan, Tamil Nadu and Uttar Pradesh have introduced performance budgeting in a large number of departments. The progress has, however, been very slow in most of them, it is, therefore, necessary to take stock of the gains and limitations relating to performance budgeting. This shall help in consolidating gains and tackling problems and making performance budget an effective tool of internal financial management at all levels of government.

Performance Budgeting improves legislative review by presenting a comprehensive view of the various departments and agencies of the government. In fact this system ensures all the advantages that are likely to accrue from an organic integration of the process of planning and budgeting.

Performance Budgeting helps to improve public relations by providing clearer information for a rational public appraisal of responsible government. The welfare content of a progressive budget on an activity basis would strengthen the democratic process and evoke meaningful participation of the citizens in the implementation of the tasks set out in the budget.

In any organisation decision-making with regard to allocation of resources, determining order of priorities and the structure of responsibilities, is dependent upon the efficiency of the system of information and communication. Only performance budgeting accompanied by decentralised accounting and systematic reporting could provide such informational support.

Functional classification (about which we have discussed in Unit 7 of Block 2) facilitates integration of the process of planning, programming and budgeting. If annual budget is essentially a part of the long-term development plan relating to the public sector, the traditional budget does not facilitate the interweaving of the physical and financial aspects. The advantages of performance budgeting in such a situation is that it brings the financial and physical aspects together right from the beginning of the proposal to the final stage of the scheme.

In brief, performance budgeting provides for more effective controls, makes legislative control more meaningful, helps to gear the process of decentralisation of authority in conformity with responsibility and improves public relations.

Having considered the different aspects of the technique it shall be in the fitness of things to briefly enlist some of its limitations as well. Important among these are as under:

- i) The very basis of performance budgeting is classification of governmental work into functions, programmes and activities. But in practice it may not be possible to have such well-organised categories.
- ii) The programme and activity classifications developed are sometimes too broad to reveal the significant activities of the department to serve as a basis for budgetary decisions and management.
- iii) This technique focuses on quantitative than a qualitative evaluation.
- iv) The process of allocation of cost estimates over programme elements is difficult and often these estimates may not be as meaningful as they should be.
- v) Performance budget aids but does not solve the greatest problem in budget decision making, viz., the comparative evaluation of projects, functions or activities, unless it is supported by cost-benefit analysis which itself is far from perfect especially when the indirect and intangible costs and utilities are involved in a big way.

**Check Your Progress 2**

- Note:** i) Use the space given below for your answers.  
 ii) Check your answers with those given at the end of the unit.

1) Trace the events which led to the adoption of performance budgeting in India.

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2) Critically evaluate the suitability of performance budgeting.

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**11.6 LET US SUM UP**

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Performance budgeting is a system of presenting public expenditure in terms of functions and programmes reflecting the government output and its cost. It is designed to serve the purposes of long range planning. If it is to be of operational significance, it must be built from operating levels of responsibility and summarised suitably for higher level of management. It must be remembered that performance budgeting is a tool. Whether it is manageable or unwieldy depends largely on the skill of the toolmaker. Efficacy of its application depends on the skill, imagination, energy and strength of purpose of the user. All it can provide is meaningful basis for administrative planning, executive coordination, legislative scrutiny and administrative accountability at all levels of government.

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**11.7 KEY WORDS**

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**Cost Benefit Analysis:** A systematic comparison between the cost of carrying out any service or activity and the value or the benefit of that service or activity. An attempt is made to quantify as far as possible all costs and benefits arising from that activity.

**Financial Requirements Table:** It refers to the table indicating programme and object-wise classification of activities indicating budgetary and account-heads under which the funds are provided.

**Performance Budget:** An output-oriented budget emphasising the accomplishment rather than means to accomplishment.

**Performance Audit:** Assessment of the performance of an organisation with a view to know that the results achieved have been commensurate with the expenditure of resources.

**Work Measurement:** It is a method of establishing the time taken by a qualified worker to carry out a specified job at a defined level of performance.

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## 11.8 REFERENCES

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## 11.9 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

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### Check Your Progress 1

- 1) Your answer should include the following points:
  - It is a system of presentation of public expenditure in terms of functions, programmes and performance units.
  - Output-oriented budget information.
  - Accomplishment based.
- 2) Your answer should include the following points:
  - Correlating the physical and financial aspects of programmes and activities.
  - Improves budget formulation, review and decision-making at all levels of management in the government machinery.
  - Facilitates better appreciation and review by the legislature.
  - Makes possible more effective performance audit.
  - Measures progress towards long-term objectives as envisaged in the plan; and
  - Brings close annual budgets and developmental plans.
- 3) Your answer should include the following points:
  - Formulation of programmes and establishment of meaningful classification in terms of functions, sub-functions, programmes, sub-programmes, activities, etc.
  - Allocation of resources.
  - Budget Execution.
  - Appraisal and Evaluation.

### Check Your Progress 2

- 1) Your answer should include the following points:
  - Inadequacy of budgeting and control system in the early era of planning.
  - Suggestions of Estimates Committee of Lok Sabha in its 20th report.

- Setting up of Administrative Reforms Commission and its recommendations.
- Implementation of performance budgeting in India.

2) Your answer should include the following points:

- Improves legislative review.
- Meaningful participation of the masses.
- Provides informational support.
- Integration of process of planning, programming and budgeting.
- Some of the limitations of performance budgeting include:
  - Classification of work difficult and broad.
  - No qualitative evaluation.
  - Dependent upon support from other techniques.