Financial Management

Lesson 1

Framework of Financial Management

1. Introduction

Indian Railways today are fully owned by the Government of India in the Ministry of Railways. The latter is a policy making body as well as functional body monitoring the performance of operations of the railways. It is organized as the Railway Board comprising of Chairman, five other members drawn from cadres of Railway officers and the Financial Commissioner (Railways). The latter acts as a representative of Ministry of Finance in the Ministry of Railways. The relationship between the railway finance and the general finance of the central government is governed by conventions established first in 1924 by a resolution of Parliament (then Central Legislative Assembly) and developed over the last ninety six years.

2. A Brief Historical Review of Financial Management of Railways in India.

2.1 Beginning from 1853, the first railway lines in India were constructed and managed by private British companies under agreement with the Secretary of State for India (in the Govt. of U.K.). The government had guaranteed to these companies a fixed return of, say, 3.5% on the capital invested by them so that even if they made net loss in a year, they were reimbursed the loss and were also given the guaranteed return on capital. Land for railway lines and buildings etc. in India was provided to them free of cost. The agreement allowed to the government an option, recurring at fixed periodicity e.g., after every ten years, to review the agreement to take over the company railway, if it so decried, on payment of compensation as per the formula laid down in the agreement.

2.2 From 1869, another phase of railways started in India during which new railway lines were constructed and run departmentally by the Government of India. Some of these lines were built on strategic consideration in north western India connecting areas on the border with Afghanistan. Very soon, monetary constraints made the government to give up this policy.

2.3 From 1883, private railway companies were once again allowed to build and run railway lines at revised terms of financial guarantee.

2.4 In 1890, the Indian Railways Act was passed to regulate the construction, operation and inspection from angles of safety etc. The Act had no particular provisions concerning financial management of railways.

2.5 In the next decade, beginning from 1890, the Government of India took over the

ownership of many of the private railway companies but left their management with the same private companies.

2.6 The Railway Board was set up by an Act in 1905 to formulate the policy and to oversee the performance of railways. However, not many new lines were built by government after that. Instead, some small lengths of railway lines were built by District Local Boards (as in Bihar). Of the then existing private railway companies, working was handed over to the adjacent government owned railways; these are now called "worked Lines"

2.7 Thus the scenario of financial management up to the early twenties was that the government had a very limited stake in running the railways until 1924. Then, a landmark development took place in the form of the Acworth Committee Report which led to the decision that only the government should own and manage the railways in future.

The Acworth Committee also made various other recommendations aimed at separating the railway finance from the general finance of the government. Final decisions on them were incorporated in the Resolution that was adopted by the Central Legislative Assembly on 20th Sept. 1924, as a convention-a flexible arrangement instead of incorporating them in the Indian Railways Act or enacting a separate legislation. This resolution which, among other measures, provided for a separate railway budget is known as the "Separation Resolution". It also laid down that on the capital invested in them, the general revenue would receive from railways a definite annual charge by way of interest/contribution, as a first charge on their net receipts. It was decided that the Parliament would review the working of this convention after five years.

2.8 In implementation of the policy of Government ownership of all railways, the government took over ownership and management of all the major private railway lines by exercising the 'option' as and when it occurred under their respective agreement, completing the process in 1946 by taking over the last major private railway company (the Bengal Nagpur Railway). Only over half a dozen small private company lines were left out. Subsequently, while some of them closed down working of others were taken over by the adjacent Government Railways thereby bringing all railways in India in the fold of governmental financial management. In early fifties, the then large number of railway lines were regrouped first in six zones; their number reached nine by mid sixties. In 2002-03 seven new zones were carved out from the existing nine zones and thus now there are sixteen zones. Each zone under a General Manager is a unit among others, of financial performance.

3. Parliamentary Financial Control

Parliament's approval essential for withdrawing moneys from Consolidated Fund of India.

3.1 Under Article 266 of the Constitution, all receipts of the Central Government (which

controls the railways also) from fees, taxes and all other sources get credited to the Consolidated Fund of India; and nothing can be withdrawn from it, except as per the procedure laid down in the Constitution. In keeping with the latter, approval of Parliament is obtained through the medium of annual budget. This means that all receipt of railway freight, fare etc. automatically becomes part of the Consolidated Fund and even salary of staff cannot be taken out from this fund unless the Parliament has sanctioned the appropriation of money required for railways expenses through the budget.

3.2 Articles 112, 113 and 114 of the Constitution lay down the procedure to be followed in Parliament in the matter of budget in general which has to be followed in the case of separate railway budget also. Under these provisions:

(i) Every year, estimates of receipt and expenditure (cumulatively called the 'Budget') of Government railways are required to be presented to Parliament; as a part of General Budget the estimates of expenditure are to be presented in the form of Demands for grants, each Demand representing one or more major categories or objects of railway expenditure. The Railway Budget involves 16 Demands; these are enumerated in Annexure I. Budget is presented by Finance Minister which includes Railways Demands.

(ii) From financial year 2017-18 Presentation of Separate Railway Budget in Parliament is dispensed with. The Railway Budget is now merged in to the General Budget of the Government of India.

3.3 On-account Budget: In a year in which it is not possible to complete the procedure described above before 31st March for reasons like convening of new Parliament after general Election, the outgoing Parliament is presented with an on-account budget asking for sanction to appropriation from the Consolidated Fund sufficient for a few months by which time the new Parliament would consider in details and pass the full budget.

3.4 Contingency Fund of India has been provided for in the Constitution of India so that when a contingency arises for providing a 'new service' for which appropriation of even a token amount from the Consolidated Fund of India was not sanctioned by Parliament through the budget, a limited amount for starting the new service can be advanced on behalf of the President from the Contingency Fund. Later, an appropriation from the Consolidated Fund is got sanctioned by Parliament at the earliest and the amount advanced from the Contingency Fund is recouped.

3.5 Audit of expenses on Railways and Review of Parliamentary Appropriation by the Comptroller and Auditor of India.

(a) As the Parliament has to be apprised of the amounts actually spent by the railways vis-à-vis the appropriation of budget-estimates sanctioned by it, each of the Zonal railways prepare their annual Appropriation Accounts which also explains the reasons for variation

between Appropriation and the actuals wherever the extent of variation is beyond 5% for revenue expenses and beyond 10% in other cases. The Consolidated Appropriation Account of Indian Railways signed by Chairman Railway Board and Financial Commissioner/ Railways and duly checked and certified by the Comptroller and Auditor General of India, is presented to the Parliament.

(b) The propriety of financial transactions on the railways is also post-audited on test-check basis by the representative of C & A G on each Zonal railway (called the Principal Director of Audit). The major instances of irregularities are noted by them and examined by the office of C & A G, paragraph by paragraph, after discussions first by the Principal Directors of Audit with the railway administrations and then with the Railway Board. Finally, the C & A G prepares a Consolidated Audit Report (Rlys) and presents it to the Parliament. Thus, indirectly, the C & A G acts in this regard as a watch dog on behalf of the Parliament.

3.6 Public Accounts Committee of Parliament (P.A.C.): The PAC is an important institution of parliamentary financial control over railways. The Appropriation Accounts and the Audit report of Indian Railways submitted by the C & A G to the Parliament are examined by the PAC in details. Each Audit para is also scrutinized by this Committee, often by summoning the members of the Railway Board to seek their clarifications of how the financial irregularities reported by the C & AG took place. The PAC then communicates their recommendations sometimes suggesting change in internal procedures and asking for necessary preventive and corrective action. The Railway Board is required to submit their 'Action Taken' Report to the PAC.

3.7 Railway Convention Committee (R.C.C.) for reviewing the rate of Dividend etc.

This a major instrument of financial control by Parliament on railways, particularly in respect of relationship between Railway Finances and the General finances of the Central Government. As its name suggests, it reviews the working of the Parliamentary Convention, a system that was initiated by the Convention Resolution in 1924. Accordingly, the first concern of the Railway Convention Committee appointed by Parliament every 5 years is to review the chargeable rate of dividend to be paid by the railways on the capital at charge invested in them by the general finance towards the Railways' capital outlays, and to recommend the rate for the future. The R.C.C. also examines and recommends the annual contribution of Indian Railways to their Depreciation Reserve Fund and Pension Fund, as also other allied matters. The recommendations of R.C.C. take effect after they are formally approved by the Parliament.

4. Dividend payable by Indian Railways to General Revenues and their other financial burdens

4.1 Dividend payable to General Revenues

Based on recommendations of Railway Convention Committees 1965, and 1971, further extended by subsequent RCCs duly approved by Parliament, following are the salient features of the rules affecting payment of dividend:-

- Dividend to General Revenues is payable in accordance with the recommendations of the Railway Convention Committee, approved by Parliament in terms of resolutions adopted from time to time.
- Based on the sixth report of RCC (2004) , the dividend, from 2007-08, is payable at the rate of 7% on the dividend-paying capital of the Railways irrespective of year of investment (including 1.5% of the dividend paying capital less subsidy capital invested up to 31st March, 1964 in lieu of Passenger Fare Tax). Out of the above-mentioned computation at 1.5%, an amount of Rs. 23.12 Cr. is for transfer to States as payments in lieu of Passenger Fare Tax and the balance is to appropriate to Railway Safety Fund to finance road related safety works.
- Concessional dividend rate of 3.5% is applicable on capital cost of residential buildings.
- Dividend on capital invested on New Lines is calculated at the least of the average borrowing rate and the normal rate of Dividend, but the payment is deferred during the period of construction and first five years after opening of the line. The deferred payment was recoverable from the sixth year provided the net income of the new line leaves a surplus after payment of current dividend. Un-liquidated liability at the end of 20 years from date of opening is extinguished.
- Annual loss on working of strategic lines is borne by General Revenues and surplus, if any, in their working is transferred to General Revenues upto the level of normal dividend.
- Shortfall in payment of dividend is carried to Deferred Dividend Liability Account, without interest liability, to be paid in years of surplus.

4.2 Subsidy (Reliefs in Dividend Liability)

Subsidy was paid by Ministry of Finance on Capital invested by Railways in the following cases-

- Strategic lines
- Gauge Conversion works taken up on strategic consideration.
- 28 new lines taken up on or after l .4. 1955 on other than financial consideration, if they incur operating losses.
- Jammu-Kathua, Tirunevelli-Kanyakumari-Trivandrum, Bimlagarh-kiribiru and Sambalpur-Titlagarh lines, if they incur operating losses.
- Unremunerative branch lines.
- North-east Frontier Railway (Non-strategic portion)
- Ferries and Welfare Buildings.

- 50% of the capital invested in current year and in two previous years, excluding the capital otherwise qualifying for subsidy as above, capital on new lines on which dividend is deferred, and capital cost of line wires taken over from P&T Department.

4.3 The balances in various railway reserve funds (except Development Fund) carry the same rate of interest at which dividend is paid to Central Government. The balance under Development Fund carries the average borrowing rate of government i.e., the rate of interest as would be applicable on loan for Development Fund from General Revenues.

4.4 Other Financial Burdens borne by Indian Railways

On first look, it may appear to a layman that the charge of 7% dividend payable by railways was low when compared with the prevailing rates of interest on loans, and dividends received on equity shares prevailing outside. In this connection, it is pertinent to mention that the Indian Railways do not charge full cost of haulage through their fare and freight structure in respect of a number of their services. Fare of monthly/quarterly season tickets for suburban commuters, and charges for sleeper accommodation in long distance trains have been kept at level lower than the cost of haulage as a matter of social policy, despite its resulting in financial loss. Similarly, freight rates to low rated commodities like sugarcane, livestock, firewood, vegetable etc. have been kept below the level of haulage cost. The social burden by way of bearing financial losses from these items means a substantial monetary amount, in addition to the dividend.

5. Where the Money comes from and where the money goes on Indian Railways –An Overview.

5.1 For Financing Investment in Assets & Works.

5.1.1 All Commercial Undertakings raise their capital in the form of:

(a) Equity shares (shareholders' money) on which they pay dividend based on profits.

(b) Debt i.e. loans and borrowings from banks and financial institutions and public bonds & debentures on which they have to pay interest, irrespective of profits, at pre-determined rate as a first charge after meeting the cost of producing the goods/services but before working out the surplus and declaring profits.

5.1.2 But in the case of Indian Railways, there is no equity capital of shareholders. The Government of India being the sole owner of railways, the General Revenues of Government have been providing the capital requirements of railways as perpetual loan. The charge payable to general revenue on this loan is now termed as dividend, after the terms of interest at fixed rate and 'contribution' as proportion of surplus left thereafter used earlier were given up on the recommendation of the Convention Committee 1949. Viewed from a broad angle, use of the term dividend to describe the charge payable by Indian Railways on their loan-capital is also justified by the fact that in a manner of speaking the people of India are now the shareholders in this venture.This is now changed as their will be no Dividend Payable by the Railway.

5.1.3 EBR-Extra Budgetary Recourses are also permitted to the railway for the Projects Approved by the Parliament. Railway projects being funded through EBR-IF (Extra Budgetary Resources – Institutional Finance) are projects which were sanctioned to facilitate network decongestion on critical sections, capacity creation/enhancement, operational requirements, etc. with the aim to increase the throughput of the Indian Railways network through corridor approach. As an alternative source of funding projects, which would enhance the sectional throughput, EBR-IF supplements the resources from Budgetary Support and internal generation, for funding such sanctioned projects which would otherwise languish for want of adequate resources. Mainly, projects under Plan Heads pertaining to doubling, electrification and augmentation of train haulage capacity, etc. which would increase the line capacity of congested sections and thereby facilitate running of more number of freight trains, have been financed through EBR-IF. These projects are generally expected to be bankable and yield adequate returns, once commissioned, for servicing the debt taken to financethem.

5.2. For producing the Service

Cost for providing serviceby Indian Railways is met entirely from their traffic revenues generated through fares and freight charges. This cost comprises:

(a) Expenses incurred on general superintendence and services in offices of Zonal General Managers and Divisional Railway Managers,

(b) Expenses on repair and maintenance of permanent way and works, rolling stock (motive power, carriage & wagons) and other plant and equipment;

(c) Operating expenses on running trains (rolling stock &equipment) and the stations, and expenses of fuel-diesel oil, electric power and coal; and

(d) Expenses on staff welfare (medical, educational and other facilities), miscellaneous service like security, catering, compensation-claims and retirement benefits.

These together are called Ordinary Working Expenses.

5.3 Then, they have to provide for two essential liabilities of Depreciation and Pension, by putting adequate amount every year in Depreciation Reserve Fund and the Pension Fund.

5.3.1 Depreciation Reserve Fund:

Every Commercial concern debits its revenue with the money value of depreciation of their assets, generally on the basis of their book value. For the purpose of income tax, this amount is treated as their deductible expenditure of business; however, Indian Railways being a government department are not subject to income tax. They put the depreciation amount in a Reserve Fund called the Depreciation Reserve Fund (DRF) and use the moneys in DRF for meeting the cost of replacement and renewal of depreciated assets. Keeping this requirement in view, the annual contribution of railways to the DRF is need-based; it takes into account the prevailing cost of replacement of assets, not their original book values. The DRF bears the full costs of replacement and the money realised by disposal of