EIDGENÖSSISCHE FINANZKONTROLLE
CONTRÔLE FÉDÉRAL DES FINANCES
CONTROLLO FEDERALE DELLE FINANZE
SWISS FEDERAL AUDIT OFFICE

MONBIJOUSTRASSE 45, CH-3003 BERN

Key facts

At an extraordinary meeting on 19 March 2008 the Finance Delegation of the Federal Chambers discussed the financial and structural difficulties of Swiss Federal Railways subsidiary, SBB Cargo AG (SBB Cargo). As a result of the discussions the Swiss Federal Audit Office (SFAO) was trusted with the mandate to perform investigations in the following three key areas:

- Reporting to the Owner (Swiss Confederation - represented by the Federal Administration) and the internal reporting within the SBB AG (SBB)
- Business management tools, in particular SBB Cargo's management accounting tools
- Freight traffic subsidies and general conditions.

1.1 Reporting to the Owner and internal reporting SBB AG

The Owner's role is based upon a clear separation of responsibilities. The Owner defines the objectives whereas SBB are supposed to implement them. The reporting system supports this separation of roles, by helping the Owner to evaluate the extent to which objectives have been met and within the SBB AG, by supporting business management at Group level.

SBB′s reporting to the Owner is actually more extensive than required. This leads to a risk of the Owner influencing SBB′s corporate decisions, resulting in a blurred separation of responsibilities. As a consequence the clear demarcation between corporate and political responsibility may be affected. SBB′s internal reporting is based upon financial accounting. At Group level, the important financial management tools are the budget along with medium-term planning, forecasts and monthly reporting.

The existing reporting tools provided information to each management level regarding the development of SBB Cargo′s financial performance and potential risks. However, the forecasts were too optimistic. SBB Cargo′s progress in the first half of 2007 and its structural difficulties were not anticipated by the reporting system in place.

The Owner receives regular and comprehensive information

The Owner's role is based upon a clear separation of responsibilities. The Swiss Confederation (Federal Council supported by the Federal Administration) defines the objectives (political responsibility) whereas SBB are supposed to implement them (corporate responsibility). The Swiss Confederation sets forth its expectations in the form of strategic objectives. It monitors the achievements and may intervene if problems arise.

SBB′s reporting to the Owner is governed by guidelines, stipulating that the Owner receives quarterly, as well as annual reports. The reports include a financial statement, a progress report for the strategic objectives and a report on the budget and a medium-term planning. In addition to this, the Owner has access to the Board of Directors proceedings and SBB´s risk reporting. Finally, the reporting includes regular discussions about current issues (SBB Reports). Between 2005 and the beginning of 2007, a so-called extraordinary reporting took place regarding the development of SBB Cargo. This enabled the Owner to pay particular attention to SBB′s freight traffic business. SBB′s reporting to the Owner is actually more extensive than required. This comprehensive reporting is regarded by both the Owner and the SBB as a very useful and necessary means of building up trust.

The SFAO is of the opinion that this comprehensive reporting carries a certain amount of risk, in that the SBB′s decisions could be influenced, either directly or indirectly, by the Owner, resulting in the separation of responsibilities becoming blurred. Furthermore, there is the risk that the clear separation between corporate and political responsibility suffers to some degree. The strategic controlling tools provided to the Owner are not compatible with the frequency and the level of detail of the reports submitted. This discrepancy needs to be resolved.

The Owner′s objectives are open to interpretation. Has this been completely clarified?
The Owner, along with the SBB′s Board of Directors, determines the strategic objectives in the form of four-year Service Level Agreements. Along with the general SBB objectives (traffic policy, service provision principles), these agreements also determine the strategic direction for freight transports. SBB has to develop a detailed strategy within the framework specified by the Owner.

The SFAO compared the objectives given by the Owner for the service periods 2003-2006 and 2007-2010. In both service periods, SBB Cargo was directed to deliver a balanced budget, firstly for 2005, then later for 2007. With regard to freight transport, the Owner expects for the domestic traffic ("Wagenladungsverkehr") a nationwide and profitable service for both performance periods. As a result of SBB Cargo′s business development in the transit traffic sector the strategic objectives for the period 2007-2010 were formulated more explicitly: The transit traffic volume should only be expanded, if "the SBB can carry the associated risks and a sustainable, profitable service provision is not endangered".

From the SBB Board of Directors proceedings 2007, it can be seen that there were discussions regarding the principles of the modal shift objectives, as well as the hierarchy of objectives. It appears from the discussions and the questions left unanswered, that even among the Board of Directors, there was no common understanding regarding the Owner's mandate, or more specifically regarding prioritisation in the case of a conflict between objectives. Moreover, a debate regarding the feasibility of the Owner's objectives probably did not take place or at least not to the extent necessary. It seems that up until that period, the Board of Directors had either assumed it would be possible to resolve any conflict between objectives, or had not sufficiently discussed the issue with the Owner. Therefore a discussion by the Board regarding the principles of the framework specified by the Owner for SBB Cargo did not take place early enough.

SBB Cargo′s corporate reporting is based on financial accounting and was not sufficiently reviewed by the Group

Although SBB Cargo is an SBB subsidiary with its own legal identity, it is managed within the Group as a Division. SBB Cargo's Board of Directors (required by stock company law) does not play an active role. In practice, SBB Cargo is ultimately managed by the SBB Board of Directors and the SBB Management Board.

While Swiss GAAP FER provides clear and binding standards for financial management within a financial reporting framework at both a group and a divisional level, there are no corporate standards for management accounting tools. It is therefore up to each Division to decide how they organise their accounting.

SBB Cargo carries out the reporting mandated by the Group according to the standards. Up until now, financial controlling within the SBB Group, including corporate reporting, has been based on financial accounting. It is up to the divisions concerned to comment on the financial figures. Neither an active role nor a critical review by the SBB′s central finance department was requested.

The SBB Group has an institutionalised risk management

The Corporate Risk Report informs both the Owner and the Board of Directors about SBB′s current risk situation as assessed by the SBB Management Board. The SFAO believes that the report recipients at each level of management were appropriately informed about the situation within SBB Cargo.

1.2 Business management tools, in particular SBB Cargo′s management accounting tools

The significance and usefulness of the business management tools (including management accounting tools) need to be improved. SBB Cargo was not able to completely implement the concepts developed in order to remove weaknesses in the business management tools, within the timeframe agreed. Because partial solutions were actually implemented, SBB Cargo had a minimum set of basic business management tools (since 2005). Although this situation has been continuously improved as more experience was gained, current reports show that there is still room for improvement. The SFAO′s audit shows that the management and control of SBB Cargo is hampered not only by weaknesses in the business management tools used, but that other factors are also involved.

As far as it concerned the decisions regarding site relocation or business mergers, the state of development of the management accounting tools, as well as their relevance only played a minor role.

There is considerable scope for discretion when developing business management tools

When evaluating business management tools (including management accounting tools) one has to consider that there are no legal requirements regarding their organisation. These tools are usually designed according to what the Board of Directors and the Management Board deem to be appropriate. Therefore, in practice, there are differing opinions as to their ideal design. The discussion regarding specifications for the business management tools at SBB Cargo is influenced by the requirements stipulated by the new SBB CEO.

Various factors lead to a reduced controllability of SBB Cargo

As well as shortcomings in the management accounting system, the SFAO also identified a number of other factors contributing to the fact that there was no reaction to the developments during the first half of 2007, until after the half-year financial results were known. These factors reduced financial transparency and hampered the controllability of SBB Cargo.

- **SBB Cargo has initiated the optimisation of its management tools, but has not managed to implement the concepts within the planned timeframe.**
  As early as 2002, SBB Cargo identified weaknesses in its business management tools. Already in 2003, it began to develop concepts for the optimisation of these tools. The implementation of these concepts was, however, delayed and only some elements were actually realised. SBB Cargo had therefore only a minimum set of basic tools for managing the business. This toolset was deemed sufficient by those responsible at the time, some of whom still hold positions of responsibility today. Although this toolset has been continuously developed and improved over time, there is still room for improvement today.

- **The division into business units introduced on 1.1.2007 further hampered the completion of the tools.**
  The creation of business units required an adjustment of the management tools. SBB Cargo had originally planned to synchronise the optimisation of the management tools with the creation of the new business units. However, at the suggestion of the Board of Directors, the organisational changes were introduced earlier than initially planned on 1 January 2007, before the management tools had been updated. SBB Cargo and the entire Group consciously accepted the resulting temporary lack of transparency regarding the new organisational structure. As a consequence of this, the planning and budgeting for 2007 was based on the old structure. This meant that a fundamental basis for the transfer of financial responsibility and for the acceptance of the budget by the business unit management was missing.

- **In 2007, planning and control tools were not optimally used.**
  During the budgeting process of 2007, the Owner′s requirement of a balanced budget for that year turned out to be extremely challenging. In an attempt to meet these expectations, hardly realisable measures were included in the 2007 budget. Their implementation was not adequately monitored.

The financial management of SBB Cargo is carried out within a difficult environment
For a complete evaluation of financial management within SBB Cargo, it is necessary to take the predominant environmental factors into account, in particular the following ones:

- The development of SBB Cargo from a state-controlled company to an independent player in a fully liberalised market with intra- and intermodal competition; the pioneering role taken to increase the attractiveness of rail for freight traffic and thereby enhancing the overall Traffic Shift
- The risk-associated, highly competitive cargo business, and the cyclic, volatile freight market.
- The difficulty of correctly anticipating the consequences of changes to the business environment (e.g. 40t/HVF, reduction of subsidies)
- The parameters defined by the Owner by means of the strategic objectives influence the corporate activity of SBB Cargo. The SBB Cargo Management has the difficult task of balancing corporate decisions with traffic policies
- Regarding the development of appropriate management tools, it should be noted that there are no impartial guidelines or general standards relevant to SBB Cargo's business activities – in particular its international business. To some extent it can be said that SBB Cargo was breaking new ground in developing these tools**.**

.

Decisions regarding site relocations or business mergers did not take management accounting data into consideration
Management decisions regarding site relocations and business mergers are of a strategic nature. In principle, management accounting serves other purposes and played only a minor role in the decision-making process. The measures taken at the maintenance plant in Bellinzona were justified mainly because of lacking productivity, a backlog of investments and the poor outlook for the location. Less importance was attached to the excess capacity present in the maintenance sector of the passenger traffic division. The cessation of the divisionalisation of maintenance (which until a short time ago was still supported) enables SBB to realise considerable synergies.

1.3 Freight traffic subsidies and general conditions

The subsidy regime is complicated and lacks transparency
Together with the Cantons, the Confederation finances the uncovered planned costs of the rail service. On the one hand, these funds are used for the construction, maintenance and operation of the infrastructure of passenger and freight traffic, while on the other hand, operators of extensive regional passenger services or combined traffic operators also benefit from these funds. The main cash flows between the Confederation and the transport industry are listed in chapter 7.1.

Overall, the railway reform has been a success, albeit fraught with risks
The railway reform involves the financial and organisational separation of infrastructure and traffic, the introduction of the commissioning principle for operating subsidies, the regulation of rail network access and the liberalisation of the rail freight traffic.

The liberalisation has been successfully initiated and has led to increased market concentration. The resulting improvement in productivity, in comparison with road traffic, is an important factor for the success of the Traffic Shift policy. In retrospect, however, it is not clear if the SBB was sufficiently prepared for this step.

An increase in market concentration is not without risk. The creation of a monopoly in the rail traffic market would endanger the achievement of the Traffic Shift objectives. The question as to whether these objectives can be reached without the market participation of SBB Cargo therefore remains open. SBB Cargo is more than likely facing lean times until the opening of the Gotthard Base Tunnel. The SFAO, in the interest of the Traffic Shift policy, therefore recommends evaluating how far SBB Cargo should be supported until then at a political and administrative level.

The subsidy regime creates for the most part the right incentives

The key tools give good results. However, it is not possible to quantify the effect of each individual tool on the modal shift policy.

- The introduction of the Performance-related Heavy Vehicle Fee, for example, led to a 16 percent reduction in lorries crossing the Alps, between the reference years 2000 and 2006, and a 10 percent reduction up until 2007. According to new estimates, the Traffic Shift target of 650,000 trans-alpine journeys by 2009 will not be reached unless further measures are taken.
- Modernisation of the infrastructure gives traction service providers a cost-efficient means of service provision based upon optimised use of railway carriages and engines and a more efficient deployment of human resources. A marked improvement and realisation of competitive prices will be achieved at the earliest when the Gotthard Base Tunnel goes into operation.
- The subsidisation of combined traffic is the most important collateral measure of the Traffic Shift policy. The SFAO recommends increasing incentives and steering options by subsidising the operator and not the infrastructure provider.
- The Service Level Agreement between SBB and the Licensed Transport Companies finances the operation of the infrastructure and to a partial extent the investment in the infrastructure. Financial controlling of the Service Level Agreement with the transport companies is difficult. There is limited transparency regarding cash flows between infrastructure and operation.

In principle, subsidies are regularly scrutinised by the Federal Finance Administration and the Federal Office of Transport. The SFAO supports the Federal Council in its approach to evaluating subsidies to help finance private railroad sidings, as windfall gains may exist.

The usefulness of individual subsidies needs to be examined

The subsidies that have been paid to infrastructure providers and which in turn are passed on to the operator by means of lower prices (partial costs), result in reduced transparency, impaired Federal Office of Transport controlling and limitations in traffic monitoring. Potential solutions involving independent infrastructure providers, full cost allocation and direct subsidisation of operators, raise concerns regarding loss of security, efficiency and performance. However, neither the possible positive aspects nor the conceivable negative consequences have been comprehensively examined to date. The SFAO therefore recommends to carefully examin the consequences of a continued separation between infrastructure and operation with regard to both cash flow transparency and traffic monitoring as well as efficiency, performance and security of railway business ventures, so that these fundamental discussions can be carried out based on verified data.

Original text in German