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SUBJECT: ZERO BASED BUDGETING

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INTRODUCTION

- Zero based budgeting(ZBB) is an alternative to incremental budgeting .ZBB was introduced at Texas in USA in 1969 by Peter Pyher ,who is known as the father of ZBB.
- This is not based on incremental approach and previous year's figure are not taken as the base for preparing next year's budget instead the budget figures and developed with zero as base , which means that a budget will be prepared as if it is being prepared for a new company for the first time.

What is zero-based budgeting?

- Reverses the process of traditional budgeting by starting at \$0 and adding items in, rather than using last year's budget as the baseline.
- Time for reflection on what is important to fulfilling our mission.
- Uses some historical perspective while asking "What do we want to do this year versus last year?"

DEFINITION of ZBB

- According to **C.I.M.A.** , London ,ZBB is defined as “A method of budgeting where by all activities are revaluated each time a budget is set .Discrete levels of each activity are valued and a combination chosen to match funds available.”
- (C.I.M.A-chartered institute of management accounting...)
- According to **DAVID L.R.C. WONG**," Zero base budget is a management tool which provides a systematic method for evaluating all operations and programmes , current or new, allows for budget reductions and expansions in a rational manner and allows re-allocation of sources from low to high priority programmes.”

Explaining Zero-Based Budgeting (ZBB)5



➤ Historical development of ZBB...

- ❖ **ZBB or some modified version of it, has been used in the private- and public -sectors for decades. The first known application of zero-base budgeting was by the U.S Department of Agriculture in 1962. However, the general problem of incremental budgeting that zero-base budgeting attempts to solve has been recognized from a much earlier period.**
- ❖ **Indeed, the major next application of ZBB in government has been tracked back to GOV. Jimmy Carter's use of it in Georgia in the early 1970s.**

❖ In the private sector, the major leap forward occurred with the development at Texas Instruments Inc. of a way to handle the mass of data. This involved the implementation of a “Decision Package” approach to prepare the 1970 budget for the Staff & Research Divisions.



□ Purpose of Zero-Base Budgeting

The Objective of Zero Based Budgeting is to “reset the clock” each year. The Traditional incremental budgeting assumes that there is a guaranteed budgetary base-the previous year’ level of appropriations -and the only question is how much of an increment will be given. Zero Based Budgeting implies that managers need to build a budget from the ground up, building a case for their spending as if no baseline existed- to start at zero. Resources are not necessarily allocated in accordance with previous patterns and consequently each existing item of expenditure has to be annually re-justified.

Steps of ZBB

- 1. Identification of decision units in order to justify each item of expenditure in their proposed budget**
- 2. Preparation of decision packages each package is a separate and identifiable activity . These packages are linked with corporate objectives**
- 3. Ranking of decision packages based on cost benefit analysis**
- 4. Preparation of detailed operating budget**

1. Identification of decision units:

- **The decision units will be based on the level of responsibility.**
- **Different departments are generally identified as decision units which are capable of carrying out different programmes or activities to achieve a single objective.**
- **The decision units are the responsibility base budget centers under the charge of different senior officers of the organization.**
- **For example the education department could be a decision unit with the objective of increasing literacy and providing quality education.**

- **However adult education , child education , technical education could be sub-functions or sub-units for which the separate budgets will be prepared...**
- **Top management should specify the decision units in terms of resources required , capital projects , special projects or major expansion schemes.**



2.Preparation of decision packages:

- The decision package is the building block of the zero-base budgeting process.
- A number of decision packages make up one decision unit.
- Decision packages is a document which identifies and describes a specific activity in such a manner that management can evaluate it and ranks it against other activities competing for limited resources and decide whether to approve or disapprove it.

- **It is important that decision packages be developed in an effective manner.**
- **The decision packages will contain the following information:**
 - a. Goals of decision unit**
 - b. Description of programme & activity**
 - c. specific measure of performance**
 - d. consequences of not approving the package**
 - e. projected or expected costs**
 - f. costs and benefits for all alternatives studied including the recommended one.**

- It may , however , be pointed out that the preparation of decision packages is a gigantic task which requires technical knowledge , experience and resources.
- In order to economize resources and avoid, unnecessary controversy ,some organization may use less formal ways of presenting alternative ways of performing an activity.



3.Ranking of decision packages:

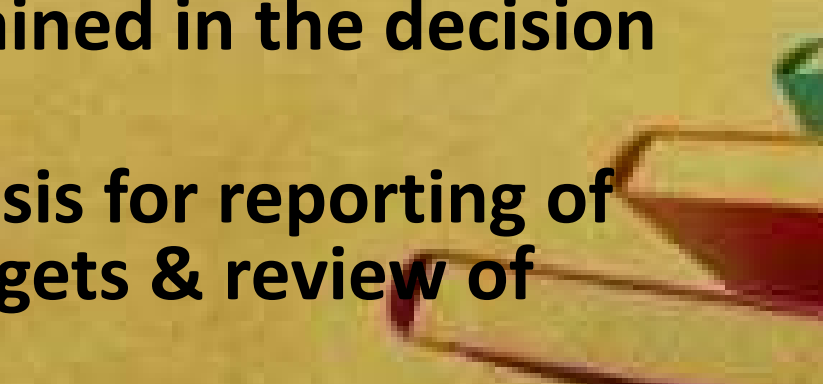
- The ranking process is concerned with the deciding about the how met and where the limited resources are to be allocated.
- A decision unit with highest benefit cost ratio is proffered and ranked as number one.
- If the costs are incurred and the benefits earned in the same year the calculation of benefit cost rate is more straight forward.
- However, if the present benefits are obtained over a long period the BCR (BANK CREDIT REPORT) should be based on the present values of benefits and costs discounted at appropriate rates.

- In case of government expenditure , the more appropriate measure is social values , and the social benefit cost ratio will guide the ranking of the decision packages.
- It may, however understood that the funds may be provided on the basis of financial cost.
- Thus the decision packages of individual decision units will be brought together and ranked in the order of importance on the basis of benefit cost ratios.
- The list will show the decision packages of various decision units in descending order of benefit cost ratios.
- Decision packages will be chosen from the top one after another to make up available quantum of jumps

- **There may be few persons in the government who may not like the test of evaluation and ranking in case of every high priority or will committed or policy programme.**
- **The zero based budgeting process in the above manner will suggest the policy makers the likely cost of carrying on or undertaking a new programme, and as such it will be in their own interest to adopt the new method of budgeting.**



4.Preparation of detailed operating budget:

- **The ranking process provides a number of approved decision packages which constitute the budget for the organization as a whole and for individual budget centers.**
 - **The decision packages incorporate in themselves the description of the activities and the performance level appropriate to the expenditure level contained in the decision package.**
 - **This will provide the basis for reporting of actuals against the budgets & review of performance.**
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QUESTIONS

- 1) Define zero-base budgeting and explain the steps involved in the implementation of zero-base budgeting.
- 2) Examine the benefits and limitation of ZBB.
How ZBB can be made an efficient tool of management planning and control?

