

A CRITICAL ANALYSIS OF THE ZERO-BASED BUDGETING

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1. INTRODUCTION

The budget is a financial plan for upcoming period based on forecasting of incomes and expenditures. Atrill and McLaney (2009) reveal that budget should be set it out in details of the short-term plans and targets to support to achieve the strategic objective of an organization. In addition, it should contain all the main features such as policies, data, documentations, and period which can give clear idea to managers to realize and examine in terms of what they have done and what they could do (Dyson, 2010). That is why budget preparation is a crucial process in firms especially in the public sector due to difficulty of defining the objectives in quantitative ways (Acca, 2018).

1.1 Types of budgets and budgeting methods

There are number of budgets such as master, functional, fixed, flexible, long-term, short-term, basic, and current budget which can be categorized based on coverage, capacity, period, and conditions (Shim and Siegel, 2005; Tulsian and Tulsian, 2012). Here, the coverage based functional budget and master budget are commonly used among the organizations. The functional budget is associated with individual functions or inter-departmental in an organization for an example sale budget, production budget, and direct labour budget (Tulsian and Tulsian, 2012). The master budget is a consolidated summary of various separate budgets which are related to functional budgets (Shim and Siegel, 2005). On the other hand, there are number of budgeting techniques have evolved such as top-down, bottom-up, rolling, zero-based, activity-based, incremental, and feed-forward control budgeting (Ryan, 2017).

2. ZERO-BASED BUDGETING

The Zero-based budgeting (ZBB) is a budgeting technique which was introduced long time ago; but it has recently begun to popular among the organizations in term of budget preparation. In addition, the Zero-based budgeting term was used by Peter F. Drucker in 1960s (Dropkin, Halpin and Touche, 2007). In the ZBB technique, nothing to continue from the last year budget and the budgeting process starts as completely new from zero based. It is works from bottom up with individual revenue, expense, asset, and liability (Nelson, 2008). Furthermore, ZBB encourages managers to cut-off unwanted costs and activities by asking questions such as necessity of activity, need to ceases the activity, level of provision adequate, any other way of carrying-out, activity cost, and benefits at least match the costs (Acca, 2018). Therefore, every department functions should be reviewed critically from zero based with proper evidences to get approval from top management. However, Lalli (2012) argues that ZBB is not a budgeting technique but it is a management approach which helps to decision making process by top management.

2.1 Stages in ZBB process

The stages of ZBB can be differed among the organizations based on their uniqueness, but literatures reveal that there are mainly basic five steps are in ZBB process such as identifying the decision units, making the decision packages, ranking, allocating resources, and controlling as illustrated as in Figure 1 (Acca, 2018; Prasath, 2017; Ryu, 2014; Schmidt and Rieck, 2000).

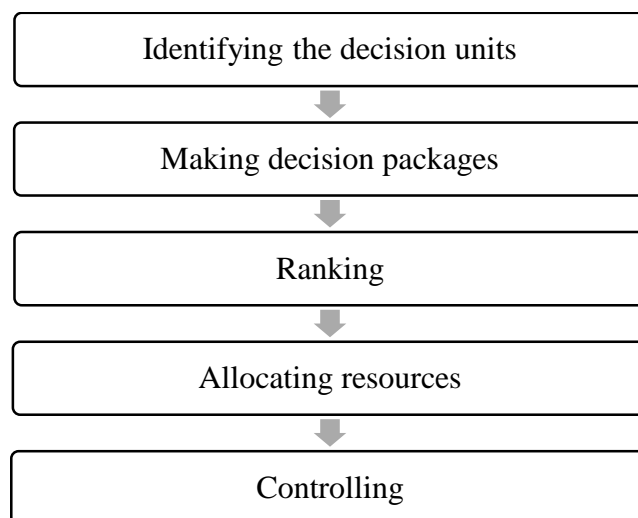


Figure 1: ZBB process steps

The initial step is identifying the decision unit which can have one or more independent activities. Here, organization can have many decision units such as sale department, production department, and material purchasing department. In this step, department managers should identify, evaluate, and justify the expenditure in the budget from zero based (Prasath, 2017). The second step of ZBB process is making decision packages which must align with organization's objectives (Acca, 2018). Here, goals, functions, expenditure, benefits, and funds are defined for each identified decision units by dividing into smaller decision packages (Schmidt and Rieck, 2000). As a third step, decision packages will be ranked within the decision units based on importance and priority of the decision packages. Based on this ranking, fund and resources will be allocated with concept of optimum utilization. Finally, as a last step of ZBB preparation process, controlling and monitoring will be done by evaluating the performance and outputs (Prasath, 2017).

2.2 Advantages of ZBB

There are number of advantages in ZBB while literatures argue its limitations in terms of cost and time. Anyhow, ZBB is bottom-up process which increases the employee's involvement at all level (Nelson, 2008). Therefore, it can help to organizational cultural change at all level of employees to align with organizational objectives. In addition, ZBB can identify the inefficient activities in the decision units and remove from the future budget (Lalli, 2012). Therefore, it encourages decision units to create SMART activities which can be easily approved by top management. According to Acca (2018), ZBB responds to economic and business environmental changes from last year to this year. Therefore, it is more suitable to implement when the country in economic crisis and recession. Finally, ZZB is not repeating bad budgeting decision of past years and overall result in more efficient allocation of resources (Acca, 2018; Nelson, 2008).

2.3 Limitation of ZBB

ZBB has significant numbers of disadvantages and limitations in terms of flexibility, cost, and time. The main limitation of this budgeting technique is more rigid which lead to unable to react in uncertainty situation in terms of business opportunities and threats. Acca (2018) reveals that the decision unit's managers should have skills and expertise in constructing decision packages. Therefore, they need proper training which leads to extra cost and time. In addition, need high manpower requirement in this budgeting process due to increase of paper work and preparing the

decision packages from the zero based (Shim and Siegel, 2005). It can be more expensive and cannot tolerate by small organizations. In the ranking process of ZBB, top management is mainly focusing in quantitative basis but some activities can give more benefit and measurable in qualitative; this process can demotivate the decision unit's managers (Acca, 2018; Lalli, 2012).

2.4 Comparison of budgeting techniques

There are huge numbers of budgeting techniques are in use such as zero-based budgeting, incremental budgeting, activity-based budgeting, rolling budgeting, traditional budgeting, top-down/ bottom-up budgeting and so on. However, Table 1 illustrates the comparison among the main three budgeting techniques;

Table 1: Comparison of budgeting techniques

Basic differences	Zero-based budgeting (ZBB)	Incremental budgeting (IB)	Activity-based budgeting (ABB)
Basis of preparation	Current year budget is prepared as completely new without considering last year's budget.	Current year budget is prepared by making changes in past year's budget.	Current year budget is prepared after considering cost drivers and not consider last year's budget
Objectives	Clear objectives with critically evaluated expenditure	Not clear objective with unrelated expenditure	Clear objectives with pattern of analysis of expenditure
Analysis level	None to superficial	In-depth and comprehensive	In-depth and comprehensive
Involvement	Top management	All level of employees	All level of employees
Preparation time	Less	high	high
Time span	Short-range	Short-range	Short-range
Staff requirements	Minimal	Expensive	Expensive
Information	Minimal enough	Need more information	Need more information
Skills/ expertise	Less	high	high
Resource allocation	After adjusting the inflation factor based on last year	After justifying the expenses based on decision packages	After justifying the cost drivers

3. CONCLUSION

Zero-based budgeting is a budgeting technique to prepare completely new budget from zero based with proper analysis. Nowadays the Zero-based budgeting technique is very popular among the business organizations to sustain from increasing business uncertainties, economic crisis and recession. The main features of this technique are high employees' involvement and removal of inefficient activities from the decision units. On the other hand, organization are struggling in the Zero-based budgeting technique implementation process due to less flexibility, more expensive, time consuming, and lack of expertise. Anyhow, as a conclusion, it is situational budgeting technique is having more unique advantages while having significant numbers of limitations.

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