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ZERO BASED BUDGETING OVERVIEW

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Zero-Based Budgeting, Organizational Strategy, Governance, Accountability

What is Zero-Based Budgeting

With Zero-Based Budgeting (ZBB) every line item will be required to be justified to be approved. It is an approach to increasing accountability to costs, improving cash flows, and improving awareness of expenditures during the budgetary process. ZBB can be used to align the operations with the strategic goals of an organisation. ZBB starts the budget procedure fresh rather than focus on variances in previous budgets. Emphasis is on utilising current resources effectively so that the organisation's operations are aligned more strategically with its operations. The process ensures that revenue and expenditure items are relevant and measurable.

The ZBB method requires requirements and outcomes to be established based on evidence by evaluating the relevance, and reliability of information. It also draws attention to budgetary priorities, including those that are of strategic importance to the organisation. As well, information necessary to determine if expenditure should

continue, be expanded, reduced, or replaced can be determined more efficiently to ensure information is of strategic value.

Organizational Strategy

The ZBB approach encourages organisational units to understand the key strategic goals. It aligns the expenditures of an organisation and challenges the traditional budgetary approach. As organisational units are challenged to explain and justify expenses and include those that are realistic and appropriate. A finance, business partner, can help organisational units to understand their costs better. Regular meetings with the organisational units and finance (such as quarterly) can allow them to understand the impact of the expenses better, as well as provide justification on the impact on the strategic goals of the organisation.

Traditional Budgetary Approach

The old budgetary approach used methods that lacked significant justification into the cost of

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operations. In some cases, it was based on a percentage increase or decreased based on a particular event occurring. The incremental approach does not challenge organisations to streamline operations, enhance budgetary accountability, and overall performance; rather it discourages it due to the nature of the process. The approach is taken for example a five to ten percent increase in a line item would be appropriate. This method is simplistic, quick, and easy, but may not be the right approach as an expenditure one year may not be one the following year. The old budgetary approach did not strike a balance between relevance and reliability. Some expense items may have been reliable, but due to the method in costs were allocated, it may not have been reliable. As well items that may longer be relevant due to changes in technology should not be included in the budgetary process.

Increased Accountability and Governance

There is more to ZBB than building a budget from the ground up. A structured approach can assist in ensuring costs are more visible, increase accountability and governance of costs. The implementation of ZBB does not mean a reign of cost reductions but enhances the understanding of cost awareness to reduce costs. The initial introduction of the ZBB approach may require initial understanding and buy-in from the organisation. As the process requires knowledge, and commitment to the process, organisations may want to consider a pilot project within an organisation unit. This approach will allow procedures that may be best suited to the organisation to be developed while not reducing the time from the ongoing operations of the organisation.

Managers of the organisational units will be required to justify their budget in detail. Although this shift from the traditional budgeting approach has increased the responsibility, and accountability of the organisational units, they do not have to go it alone. The Finance Department and the Finance

Business Partner can play a role in assisting departments with understanding and producing a budget that is justifiable. With the relevant information that can be backed-up with measurable facts, departmental managers can better justify the importance of the expenses for the unit and the organisation.

Importance of a Well Equipped Team

ZBB is only as good as the information behind it. It should begin with a well-equipped team who have the tools, resources, and commitment from others in the organisation. It will require a more proactive approach from the organisational leaders. The ZBB team will need to determine the challenges, opportunities, and objectives to support the strategy. The purpose, goals, mission, and responsibilities should be defined. The team should have the necessary internal, and relevant external information including relevant benchmarking information.

Strategic Value of Zero-Based Budgeting

There are some reasons that an organisation may undertake ZBB organisations that have gone through structural changes such as disposals, acquisitions, or mergers may benefit the as it can allow a better understanding of expenditures in light of organisational changes. As well external forces such as increased competition may bring pressure on cost controls. Other sectors may have pressures from a government for greater accountability to justify their funding. Increased complexity of overhead costs that may be difficult to analyse or defend.

Advantages of Zero-Based Budgeting:

- Examine every budgetary item as if it was new.
- Resources focused on strategic planning requirements rather than a percentage increase or decrease.
- Brings discussions within organisational units and with finance to better understand expenditures to increase efficiencies and reduce wastage.

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- Encourage constant improvement, development and understanding with the budgetary process.
- Reduces the likelihood that budget could be made to meet pre-determined desirable results.
- Eliminates historical buffering of expenses that are no longer relevant such as positions that no longer exist.
- Engages departments in the decision-making process which may assist in aligning departmental strategies with that of the organisation.
- Improved communication outside of the department to better monitor, coordinate, and measure performance.
- Variances from the actual to the budget can be explained with more clarity, thus providing more meaningful insight.

Challenges of Zero-Based Budgeting:

- ZBB is more sophisticated and time-consuming
- Unit managers will need to be responsible for the decision-making process, and budget process for their group. Without support from finance, or an understanding of the budgetary process this can be a challenge.
- Conflicts between short-term and long-term planning may occur.
- Lack of buy-in from managers who may expect the numbers just to work
- Annual scheduling conflicts related to other important tasks may result in some functions not receiving full attention.
- Time-consuming for organisations to undertake on a yearly basis without creating an excessive amount of work.

Transition towards Zero-Based Budgeting

Ideally conducting ZBB throughout the organisation would be ideal. However, a transition towards ZBB may be preferable. Processes should be documented to create a baseline for the shift towards ZBB. The development team should also determine the ideal state, that is the opportunities and how it aligns with the organisational strategy.

The collection of such information can be used to determine which activities can be combined, or enhanced to meet the strategic needs of the organisation. Such an approach assists in identifying the risks and rewards as well as challenges that it may face during the transition. The bottom-up approach can allow organisational units to have a better handle on future costs, priorities, and resources required. The shift towards ZBB does not necessarily mean the movement to outsourcing functions or departments. Rather, it encourages efficient use of resources without compromising necessary quality standards while maintaining a focus on overall organisational strategy.

Where to Start

One option maybe to start with Human Resources related costs such as payroll, benefits, and training costs. A large part of the overall costs of an organisation is relatively standard throughout the organisation. Information collected in this area for ZBB could include headcount information, consultant fees, temporary employees, as well as full-time headcount. An understanding of these costs and categories is necessary to quantify the financial costs.

Review Process

As part of the ZBB process including collecting and analysing data from some sources such as relevant financial information, business unit plans, and budgets. Dashboard information such as Key Performance Indicators (KPI), best practices benchmarking information, organisational policies as well as other relevant information that can provide valuable insight into the data analysis review.

In keeping with the strategic goals of the organisation a review to identify areas that can benefit from a further in-depth analysis to gain efficiencies. Areas could include better cost



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management, as well as identifying potential risks that may be mitigated. Opportunities should be prioritised based on organisational strategy, feasibility, and operational efficiencies. The review process is the starting point for the discussion of corporate capabilities.

In determining efficiencies and ensuring the effectiveness of the ZBB the various stakeholders within the organisation as part of the review process during the development process. The methods of obtaining relevant information will depend on the nature and complexity of the expenditure. A comparison of benchmark efficiencies could be undertaken based on available information that may be available to compare to organisations that may be in the same sector. Based on the data analytics, and discussion of areas that may have some uncertainty due to the uniqueness, or complexity need to be monitored more closely during the monthly, or quarterly periods to ensure that the information provided by ZBB is reliable including capturing such information in the time variance analysis.

The actual process of information collected both financial, and non-financial, the various stakeholders, and outcomes will vary depending on the organisational structure. The process no doubt will enable the organisation to understand better its associated costs to more effectively manage it, and where applicable justify any additional resources to be allocated.

How Often Should a Detailed Process Be Undertaken

Depending on the complexity of the organisation a detailed ZBB can occur on an annual or every few years for other organisational units. As noted there are decent advantages for undertaking a detailed ZBB annually, but it may not be practical in all cases. A cycled approach at a minimum at least every few years will go a long way compared to the traditional budgetary approach that organisations have undertaken. A standardised process for all

organisations cannot be carried out as the inherent uniqueness.

When transitioning towards ZBB, it requires the commitment from organisational units. As well determining the ZBB budgetary method that best suits the organisation based on the competitive forces it faces, as well as resources that are available within the organisation will have a determining factor on how ZBB implementation within an organisation. The steps taken for the implementation of ZBB should be documented, and include all the relevant stakeholders so that it provides relevant and reliable information.

About the author:

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