

### **Performance Budgeting:**

Performance Budgeting had its origin in U.S.A. after the Second World War. It was introduced to rectify some of the shortcomings in the traditional budget.

In the traditional budget amounts are earmarked for the objects of expenditures such as salaries, travel, office expenses, grant in aid etc. Such system of budgeting was more popularly used in government departments and many business enterprises. But in such system of budgeting control of performance in terms of physical units or the related costs cannot be achieved.

Performance oriented budgets are established in such a manner that each item of expenditure related to a specific responsibility centre is closely linked with the performance of that centre. It involves establishment of well-defined centres of responsibilities, establishment for each responsibility centre—a programme of target performance in physical units, forecasting the amount of expenditure required to meet the physical plan laid down and evaluation of performance.

Thus, performance budget follows a separate format laying down (i) objectives and the organisation structure to achieve the same and (ii) Financial requirement table which gives details of programme activity classification, object wise classification and sources of funding.

### **Steps for System of Performance Budgeting:**

(i) Establishment of well-defined responsibility centres or action points where operations are performed and financial transactions in terms of money take place.

(ii) Establishment of each responsibility centre and a programme of expected performance in physical units of that centre. For example, the performance budget for a sales department may be units of goods sold and, for production department, units of products programmed to be manufactured and for capital works, quantum of work likely to be done during the budget period.

(iii) To forecast the amount of expenditure under the various classification heads to meet the physical plan. Then the procedure of budgeting could follow the usual routine.

(iv) Evaluation performance is done under two stages i.e.

(a) The actual performance is compared with the physical target in order to determine the extent of deviation and adjusting the original rupee budget into a budget allowance for the actual physical work performed.

(b) The actual expenditure is compared with the adjusted budget (or the budget allowance) to determine the monetary variances.

(v) Performance reporting indicating the result of analysis of the variance from the budget is done like that of variance reporting.

### **Advantages of Performance Budgeting:**

(i) It presents clearly the purposes and objectives for which funds are required.

(ii) It gives better appreciation of budgeting by legislature.

(iii) It improves budget formulation process.

(iv) It enhances accountability of the executives.

### **Zero Base Budgeting (ZBB):**

This budget is the preparation of budget starting from Zero or from a clean state. As a new technique it was proposed by Peter Pyher of Texas Instruments Inc., U.S.A. This technique was introduced in the budgeting in the state of Gorgia by Mr. Jimmy Carter who was then the Governor of that state.

The use of zero-base budgeting (ZBB) as a managerial tool has become increasingly popular since the early 1970s. It is steadily gaining acceptance in the business world because it is proving its utility as a tool integrating the managerial function of planning and control.

Conventional Budgets are prepared mainly on past performance and actual costs. It is developed mainly on the concept of incrementalism. Under this approach cost levels of the previous year are often taken as a base to start within, and budget units focus their attention on ascertaining what changes from the previous year are required. Thus, a budget is developed on the basis of incremental changes from the previous year's figures taken as base.

An incremental approach to budgeting carries forward previous year's inefficiencies and extravagances because previous year's figures are taken as a base for the development of a budget. Thus, incremental approach does not promote operational efficiency because it does not require managers to review their past activities.

On the other hand, zero-base budgeting is not based on the incremental approach and previous year's figures are not adopted as a base. Rather, zero is taken as a base as the name goes. Taking zero as a base, a budget is developed on the basis of likely activities for the future period.

In ZBB, by delinking the budget from the past, the past mistakes are not repeated. Funds required for any activity for the next budget period should be

obtained by presenting a convincing case. Funds will not be available as a matter of course.

**Zero-base budgeting has been defined by its originator Peter A Pyher as follows:**

“A planning and budgeting process which requires each manager to justify his entire budget request in detail from scratch (hence zero base) and shifts the burden of proof to each manager to justify why he should spend any money at all. The approach requires that all activities be analysed in ‘decision packages’ which are evaluated by systematic analysis and ranked in order of importance.”

**CIMA** has defined it “as a method of budgeting whereby all activities are reevaluated each time a budget is set. Discrete levels of each activity are valued and a combination chosen to match funds available”. In short, an elaborate practice of having a manager justify activities as though they were being launched for the first time.

A unique feature of zero-base budgeting is that it tries to help management answer the question. Supposing we are to start our business from scratch, on what activities would we spend our money and to what activities would we give the highest priority? Thus, zero-base budgeting tries to overcome the weaknesses of conventional budgeting, especially in those areas where it is difficult to apply flexible budgeting.

It can be successfully applied to government expenditure and, within the business world, items of expenditure other than direct material, labour and overheads such as research and development, data processing, quality control, marketing and transportation, legal staff and personnel office.

### **Advantages of Zero-Base Budgeting:**

(1) Zero-base budgeting is not based on incremental approach, so it promotes operational efficiency because it requires managers to review and justify their activities or the funds requested. Past inefficiencies are not repeated.

(2) Zero-base budgeting is most appropriate for the staff and support areas (i.e., non-manufacturing overheads) of an organisation because the inputs of these areas are not directly related to the final outputs of the organisation.

(3) Zero-base budgeting considers every time alternative ways of performing the same job because zero is taken as a base every time at the preparation of a budget. Thus, management has an opportunity to get a critical appraisal of its activities.

(4) It focuses management process on analysis and decision-making because it requires managers to review their activities every time when a budget is developed.

(5) It is helpful to the management in making optimum allocation of scarce resources because a unique aspect of zero-base budgeting is the evaluation of both current and proposed expenditure and placing it in some order of priority. Funds are used on priority basis and hence there is better allocation of resources.

(6) Coordination within the firm is improved and communication channels are strengthened.

(7) Increased participation in ZBB creates a motivational impact.

(8) ZBB is particularly useful for service departments and Government

Thus, ZBB can certainly increase the usefulness of the budgeting process as it tries to overcome the weaknesses of conventional budgeting.

**Defects of ZBB:**

(i) The paper work will increase periodically due to large number of decision packages.

(ii) The cost of preparing the various packages may be very high in large firms involving vast number of decision packages.

(iii) Ranking of packages is very often subjective and may give risk to conflicts.

(iv) Bad managers may resist new ideas and changes as they feel threatened by ZBB.

(v) It may lay more emphasis on short term benefits of the organisation.

In spite of these defects, ZBB was adopted by several Governments all over the world to improve their budgeting skills. It finds application in control of service department costs. But for control of direct costs as direct materials and direct labour expenses etc. standard costing may be more useful.

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