

2024

Historically vs. Zero-Based Budgeting



Bertie Bezuidenhout

Agulhas Utilities Corporation (Pty) Ltd

11/27/2024

Table of Contents

Introduction.....	3
Historically Based Budgeting: An Overview	3
Definition and Process.....	3
Annual Budgeting Procedure.....	3
Overview	3
Budget Development	3
Financial Planning and Procedure	3
Approval Procedure	4
Closing Comments	4
Advantages of Historically Based Budgeting	5
Simplicity and Ease of Use	5
Stability and Predictability.....	5
Less Time-Consuming.....	5
Disadvantages of Historically Based Budgeting	5
Wasteful Spending.....	5
Lack of Flexibility	5
Limited Focus on Efficiency.....	5
Zero-Based Budgeting: An Overview	5
Definition and Process.....	5
Lifecycle Management of Assets	6
Overview	6
Key Stages of Lifecycle Management	6
Maintenance Standards	7
Risk Management	7
Funding for Bequeathed Assets	7
Service Compliance	7
Incident Reporting and Analysis.....	7
Setting Service Levels	7
Maintenance Budgeting.....	7
Considerations for Maintenance Budgeting.....	8
Zero-Based Budgeting for Maintenance	8
Asset Condition Assessment.....	8
Refurbishment or Renovation Plan.....	8

Closing Remarks..... 9

Advantages of Zero-Based Budgeting 9

 Cost Efficiency and Resource Optimization 9

 Enhanced Accountability 9

 Alignment with Organizational Goals 9

 Flexibility and Adaptability..... 9

Disadvantages of Zero-Based Budgeting 10

 Time and Resource Intensive..... 10

 Potential for Short-Term Focus 10

 Requires Strong Leadership and Decision-Making..... 10

Why Zero-Based Budgeting is Better 10

 Encourages a Culture of Continuous Improvement..... 10

 Provides Better Financial Control..... 10

 Aligns Spending with Organizational Strategy 11

 Adapts to Changing Circumstances 11

Conclusion 11

Introduction

Budgeting is a cornerstone of financial planning, whether for personal, organizational, or governmental purposes. It plays a vital role in managing resources and ensuring that expenditures align with available funds. Two of the most common budgeting approaches are **Historically Based Budgeting (HBB)** and **Zero-Based Budgeting (ZBB)**. Both methods have distinct philosophies, processes, and outcomes, and they each come with their own advantages and disadvantages.

Historically Based Budgeting relies on the premise that past financial allocations can serve as a reliable guide for future budget decisions. On the other hand, Zero-Based Budgeting starts from a blank slate each time, requiring justification for every dollar [Rand] spent, irrespective of past allocations. The purpose of this paper is to explore the key features of both budgeting approaches, their advantages and disadvantages, and ultimately argue why Zero-Based Budgeting (ZBB) offers a more efficient, effective, and flexible approach to budgeting in the modern world.

Historically Based Budgeting: An Overview

Definition and Process

Historically Based Budgeting, often referred to as **Incremental Budgeting**, is one of the oldest and most widely used methods for creating budgets. The process is straightforward: the current year's budget serves as the baseline, and adjustments are made based on changes in revenue, inflation rates, or any new needs. Typically, a fixed percentage increase or decrease is applied to each line item to reflect changes in operational costs, inflation, or other financial factors.

For example, if an organization spent \$1 million in a previous year, and there is a 5% inflation rate, the new budget for the coming year might increase to \$1.05 million without considering the efficiency of past expenditures. The assumption is that spending patterns are largely consistent over time, and small adjustments are enough to keep the system functioning.

Annual Budgeting Procedure

Overview

Instead of following the traditional step-by-step process outlined below, refer to the document titled [Effective Asset Management - Unlocking Value](#) for a more robust framework.

Budget Development

Municipalities typically initiate their budget development cycle in November, despite the official start of the budget year being July 1. By late May or early June, the Council is expected to finalize and approve both the Financial Plan and the Annual Budget.

Financial Planning and Procedure

Each year, municipalities may establish **Financial Policies** that guide the creation of the annual **Financial Plan**. The review and approval of this plan are among the Municipal Council's most significant responsibilities.

The Financial Plan should prioritize essential operational and maintenance tasks that are critical to maintaining the performance of municipal assets. The goal of the budget derived from

this plan is to maximize revenue generation and minimize costs and risks over the asset's lifecycle. Unfortunately, many municipalities fail to adopt a comprehensive approach to asset management, focusing on only a small portion of assets—typically around 20%—that account for the bulk of problematic costs (80%). This narrow focus leaves asset managers vulnerable to budget cuts, as they struggle to justify the need for adequate funding across all assets.

While Eskom may employ advanced systems, doubts persist regarding the comprehensiveness of their asset management and maintenance plans. Developing a comprehensive maintenance plan is challenging and requires far more than just a set of procedures—it demands a strategic and holistic approach.

Approval Procedure

Most asset managers have a clear vision for the upcoming financial year, especially when aligned with long-term asset management strategies. However, in many organizations, the plan may either neglect a complete inventory of assets or be a mere evolution of previous years' plans. These incomplete or recycled plans are often unable to withstand the scrutiny of finance managers with the skills and experience, who actively seek opportunities for budget reductions.

Finance managers frequently perceive that asset managers lack control over their budgets and are prone to overspending on items that were not initially planned. In response, asset managers often inflate their budget requests by roughly 15%, including non-essential tasks as “critical” to offset expected cuts. Finance managers, aware of this tactic, typically reduce budget requests by an estimated percentage—often 15%—to neutralize the overstatement. As a result, asset managers end up with the budget they initially intended, but the process can feel like a mere exercise in positioning and negotiation, rather than a meaningful discussion about asset needs.

This back-and-forth process, referred to as the “positioning shuffle,” wastes valuable time that could otherwise be spent on more strategic tasks. The annual budget development and negotiation process, often spanning up to two months, is largely inefficient, especially when compared to the long-term benefits of creating a comprehensive life-cycle asset management plan. A well-developed life-cycle plan would allow for better allocation of resources toward the assets themselves, rather than administrative processes.

While Eskom staff may follow a different methodology, the end result remains largely the same—budgets are rarely tied to maintenance plans, and maintenance plans are seldom connected to Key Performance Indicators (KPIs). Consequently, service delivery suffers, and Eskom and municipalities miss opportunities to optimize asset performance.

Closing Comments

The current budget development process is not optimized for long-term asset performance and often involves inefficient negotiations and misaligned priorities. To improve service delivery and maximize the effectiveness of Eskom and municipal budgets, it is crucial that asset managers adopt comprehensive, strategic life cycle plans that directly inform the annual budgeting process. Only through this approach can Eskom and municipalities ensure that their financial resources are allocated efficiently and effectively across all assets, leading to enhanced performance and reduced risk.

Advantages of Historically Based Budgeting

Simplicity and Ease of Use

Historically Based Budgeting is simple to understand and implement. Since it builds on the prior year's budget, the process requires minimal effort to construct, and there is no need to thoroughly review every department or expense. The continuity of using historical data makes it an intuitive approach for most organizations.

Stability and Predictability

HBB offers a stable and predictable budgeting process. Since adjustments are incremental, organizations know roughly what to expect in terms of funding requirements year over year. This predictability can help streamline long-term planning and ensure a certain level of consistency in operations.

Less Time-Consuming

Because only incremental changes need to be considered, HBB is typically faster to prepare. It requires fewer resources to gather information compared to Zero-Based Budgeting, making it a time-efficient choice, especially for organizations with limited staffing.

Disadvantages of Historically Based Budgeting

Wasteful Spending

One of the key drawbacks of Historically Based Budgeting is that it can perpetuate inefficiencies. Departments may continue to receive funding for outdated or unnecessary expenses simply because those expenses were allocated in previous budgets. This perpetuation of the status quo can lead to "budgetary bloat," where resources are tied up in non-productive activities.

Lack of Flexibility

Historically Based Budgeting tends to favor past spending patterns over current needs. This can result in departments receiving funds for initiatives that are no longer relevant or necessary, while other areas requiring more urgent attention may be underfunded. It fails to prioritize innovation or reallocation of funds to more productive or cost-effective uses.

Limited Focus on Efficiency

Since the focus is on making small incremental adjustments, historically based budgets don't encourage departments or organizations to reevaluate the effectiveness of their expenditures. Without rigorous assessment of each program's value, money can be spent on initiatives that are not generating a reasonable return on investment.

Zero-Based Budgeting: An Overview

Definition and Process

Zero-Based Budgeting, as the name suggests, starts the budgeting process from "zero" each year. Rather than basing the budget on historical expenditures, every department must justify its expenditures from scratch, ensuring that each expense is evaluated and validated for necessity and value. This involves a detailed assessment of all programs and activities, often requiring managers to evaluate every cost as if the department were being created anew.

The process of ZBB requires a clear understanding of the goals of each department, the specific costs associated with achieving those goals, and an evaluation of alternatives. In ZBB, every dollar [Rand] allocated must be justified, making it an ideal tool for organizations looking to optimize their spending.

Lifecycle Management of Assets

Overview

Lifecycle management of assets is a holistic process that begins with the development of an **Asset Management Strategy** and **High-Level Plans**, which are the responsibility of **Asset Owners**. The process then proceeds through several stages, including the assessment of the asset's condition, evaluation of risks, and consideration of treatment options, such as maintenance, refurbishment, replacement, or disposal. Ultimately, the lifecycle approach ensures that assets are managed efficiently, from inception to decommissioning.

Key Stages of Lifecycle Management

1. Asset Management Strategy and High-Level Planning

The asset management journey starts with defining clear strategies and long-term plans that align with the organization's overall goals and service delivery expectations. These high-level plans are established by Asset Owners and are the foundation for effective lifecycle management.

2. Condition and Risk Assessment

Conducting regular assessments of an asset's physical condition and evaluating the risk of failure are critical steps in identifying potential issues and the required interventions. These assessments help determine whether assets are fit for service or require significant maintenance or upgrades.

3. Treatment Evaluation

Following assessments, various treatment options are evaluated:

- **Maintenance:** This includes selecting the appropriate maintenance strategy, whether corrective, preventive, or predictive.
- **Refurbishment/Renewal:** If the asset is aging or deteriorating but still useful, refurbishment or renewal might be the best option.
- **Replacement:** When refurbishment is no longer viable, asset replacement should be considered.
- **Disposal:** For assets that no longer serve the organization's needs, disposal becomes the final option.

4. Treatment Selection and Planning

After evaluating all options, a treatment plan is selected, detailing how and when the selected action should take place. This includes defining operating procedures, maintenance schedules, and the necessary resources to ensure optimal asset performance.

5. Performance Measurement and Review

Continuous monitoring of asset performance against predefined standards is essential. Key performance indicators (KPIs) should be established to track the effectiveness of maintenance and other treatments, and the plans should be periodically reviewed and adjusted as necessary.

Maintenance Standards

To ensure effective asset management, all relevant stakeholders, including key personnel from different departments, must collaborate to determine appropriate levels of service, maintenance standards, and asset requirements. Engaging with these stakeholders ensures that maintenance activities align with organizational objectives and service delivery expectations.

Risk Management

Assets must be managed in line with established **Risk Management Policies** and comply with relevant regulations such as the **Occupational Health and Safety Act**. This helps ensure that both operational risks and safety hazards are appropriately addressed throughout the asset's lifecycle.

Funding for Bequeathed Assets

When infrastructure is created and funded by external organizations and subsequently handed over for operation and maintenance by your organization, an agreement must be reached with the external body regarding the maintenance plan. This plan should ensure the level of service expected from the asset and clarify how the maintenance costs will be funded before your organization assumes ownership.

Service Compliance

Department heads must regularly monitor and report on the compliance of asset classes with service standards. This should be done using KPIs, ensuring that assets perform as expected and any gaps are addressed promptly.

Incident Reporting and Analysis

A comprehensive **Asset Management System** must be implemented to track incidents from the moment they are reported until they are resolved. This system should record all relevant details, including dates, times, personnel involved, and associated costs. This data must be available for analysis to assess patterns, identify recurring issues, and improve future asset management strategies.

Setting Service Levels

The General Manager, Director of Finance, and Director of Technical/Engineering Services must collaborate with key stakeholders to define the desired level and quality of service for each asset. This consultative process should take place annually to ensure that service levels align with organizational needs and available resources.

Maintenance Budgeting

Once the Service Delivery Plan is finalized, asset managers and maintenance departments must work together to develop a maintenance budget. This process involves evaluating the condition of existing assets and identifying the need for new assets or refurbishments. The organization's **Asset Management Policy** and **Strategy** should guide decisions, with a preference for prioritizing maintenance over new asset creation and considering renewal over replacement when possible.

To develop a maintenance plan, it is essential to:

- Review the asset's performance history, including past incidents and maintenance efforts.

- Analyze costs associated with repairs and performance improvements.
- Ensure that the plan aligns with relevant maintenance standards, legal requirements, and budget constraints.
- Assess affordability and intergenerational equity to ensure that resources are allocated effectively to minimize risks of failure.

Once the maintenance plan is in place, resources—such as labor, materials, and tools—must be allocated appropriately. The skill level and qualifications of personnel are crucial factors in deciding who will carry out the work.

Considerations for Maintenance Budgeting

When formulating a maintenance budget, the following elements should be taken into account:

- **Asset Management Policy and Strategy**
- **Action Plans** for asset management
- **Maintenance Management Framework**
- **Capital Investment Plan (CIP)**
- **Departmental Refurbishment Plans**

Zero-Based Budgeting for Maintenance

Maintenance budgeting should be based on **Zero-Based Budgeting (ZBB)**, where each budget item must be justified starting from a zero base. This approach ensures that:

- Resources are allocated efficiently, based on needs and benefits.
- Managers are encouraged to find cost-effective solutions to improve operations.
- Inflated or unnecessary budget items are identified and eliminated.
- Service departments are incentivized to improve operations by linking budgeting to measurable outcomes.
- Wasteful practices are minimized, and opportunities for outsourcing are identified.

Utilizing a **Computerized Maintenance Management System (CMMS)** can streamline the budgeting process by providing accurate data for budgeting based on actual needs and performance.

Asset Condition Assessment

A structured **Condition Assessment Process** is integral to the Asset Management Strategy. This process evaluates the physical state of assets, ensuring their continued suitability for service delivery. Competent assessors, with the required training and experience, must perform these assessments, which should be conducted at least every three years for all assets.

The integrity of the assessment depends on matching the skills of the assessor to the specific asset being evaluated. Additionally, assessors must have the appropriate qualifications and, where applicable, licenses or accreditations to ensure the reliability of the outcomes.

Refurbishment or Renovation Plan

During condition assessments, assets may be identified as unsuitable for continued service. These assets should undergo further assessment to determine if refurbishment or restoration is a viable option. If refurbishment is possible, these assets should be incorporated into a **Refurbishment Program**.

Annually, the effectiveness of standard maintenance practices should be reviewed. Assets that no longer meet service expectations should undergo the same assessment process as described, and if refurbishable, should be added to the refurbishment/restoration program.

Closing Remarks

Effective lifecycle management of assets is an ongoing, dynamic process that requires regular assessments, strategic planning, and continuous performance monitoring. By aligning maintenance efforts with organizational objectives, adhering to established service standards, and employing efficient budgeting techniques such as zero-based budgeting, Eskom and municipalities can optimize asset performance, minimize risks, and ensure the long-term sustainability of their assets.

While this may initially appear to be a complex task, the process becomes significantly more manageable once a solid framework is established. Leveraging a **Computerized Maintenance Management System (CMMS)** can simplify and accelerate asset management. A well-configured CMMS streamlines the budgeting process by allowing users to input just a few key criteria and instantly generate financial requirements. This approach provides accurate, data-driven insights based on real-time asset performance and needs, removing guesswork and enhancing decision-making precision. By automating these processes, asset managers can focus on strategic decisions rather than administrative tasks, ultimately driving better outcomes for both operations and budgets.

Advantages of Zero-Based Budgeting

Cost Efficiency and Resource Optimization

One of the most significant advantages of ZBB is its ability to eliminate wasteful spending. Since every expense must be justified, departments are more likely to scrutinize costs and look for ways to do more with less. Unnecessary or outdated programs can be identified and cut, resulting in a leaner, more efficient organization. This focus on resource optimization ensures that every dollar spent contributes directly to the organization's strategic goals.

Enhanced Accountability

Zero-Based Budgeting fosters greater accountability at all levels of an organization. Since every department is required to explain its spending, managers are more inclined to ensure that funds are being used appropriately and that there is a clear return on investment for every expenditure. This accountability creates a culture of fiscal responsibility, which is essential for long-term financial sustainability.

Alignment with Organizational Goals

ZBB ensures that budgets are more closely aligned with organizational priorities. By evaluating each program and activity based on its importance and contribution to the organization's overall mission, it allows resources to be focused on high-priority areas. This makes it easier for organizations to redirect funds toward new or evolving objectives, improving overall strategic alignment.

Flexibility and Adaptability

Unlike HBB, which is rigid and based on past spending, Zero-Based Budgeting is adaptable and forward-looking. It allows organizations to adjust their budgets according to changing circumstances, ensuring that funds are allocated where they are most needed in the present,

rather than being anchored to past patterns. This makes ZBB particularly valuable for organizations facing rapid change or disruption.

Disadvantages of Zero-Based Budgeting

Time and Resource Intensive

One of the key challenges of **Zero-Based Budgeting (ZBB)** is the perception that it is time-consuming and resource-intensive. Since every expense must be justified from the ground up, departments are required to invest considerable time and effort into preparing detailed assessments of asset conditions and associated costs. This can be especially burdensome for large organizations, where managing and evaluating hundreds or even thousands of assets add significant complexity, potentially slowing the process considerably. However, despite these challenges, ZBB is entirely feasible—an example of which is the successful implementation at Eskom during the late 1990s and early 2000s, proving that with the right planning, structure, and commitment, even large-scale organizations can effectively adopt and benefit from Zero-Based Budgeting.

Potential for Short-Term Focus

While ZBB helps align spending with organizational priorities, there is a risk that departments may prioritize short-term goals over long-term objectives. The intense focus on justifying immediate expenditures can sometimes overshadow strategic investments that may take longer to show returns.

Requires Strong Leadership and Decision-Making

ZBB requires strong leadership and decision-making to ensure that all departments are fairly evaluated and that the budget is allocated in line with organizational objectives. Poor leadership can result in misallocated resources, with certain departments or initiatives being unfairly underfunded or overfunded.

Why Zero-Based Budgeting is Better

Encourages a Culture of Continuous Improvement

Zero-Based Budgeting challenges organizations to continuously assess and improve their processes. Unlike Historically Based Budgeting, which often encourages complacency, ZBB promotes a culture of constant evaluation and refinement. As a result, organizations adopting ZBB are more likely to be innovative, responsive to change, and proactive in identifying opportunities for growth.

Provides Better Financial Control

ZBB allows organizations to exercise tighter control over their finances. Since each expenditure must be justified, the likelihood of wasteful spending is significantly reduced. Over time, this can lead to substantial cost savings, which can then be reinvested into more productive areas. In contrast, Historically Based Budgeting often allows inefficient spending to persist, reducing the ability to identify and correct financial inefficiencies.

Aligns Spending with Organizational Strategy

One of the key strengths of Zero-Based Budgeting is its focus on aligning spending with strategic goals. By requiring departments to justify every expense, organizations can ensure that their resources are being directed toward their highest priorities. This creates a more cohesive approach to budgeting, ensuring that funds are used to advance the organization's core mission, rather than simply maintaining the status quo.

Adapts to Changing Circumstances

In a rapidly changing world, flexibility is key. Zero-Based Budgeting provides the adaptability necessary to respond to new challenges, shifting priorities, and unexpected opportunities. It ensures that resources are allocated where they are most needed, rather than being locked into outdated spending patterns. Historically Based Budgeting, on the other hand, may not be as responsive to change, as it assumes that past patterns will continue into the future.

Conclusion

While Historically Based Budgeting has been the go-to method for many organizations due to its simplicity and ease of use, its limitations in addressing inefficiency and adaptability to change make it less suitable for today's fast-paced, dynamic environments. Zero-Based Budgeting, on the other hand, offers a more thorough and strategic approach that emphasizes cost efficiency, accountability, and alignment with organizational goals. Despite its resource-intensive nature, the long-term benefits of ZBB—such as improved financial control, resource optimization, and adaptability—far outweigh the drawbacks.

In conclusion, Zero-Based Budgeting represents a more effective method for modern organizations seeking to maximize the impact of their financial resources, eliminate wasteful spending, and align their budgeting practices with their strategic priorities. For organizations that wish to foster continuous improvement, agility, and better financial discipline, Zero-Based Budgeting is the superior choice.