

Human Resource Accounting

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Abstract

Human resource accounting is basically the accounting of human resources of the company. As the human resources are the important resources of the company without which it cannot survive, hence it should be properly accounted for. In the present era, the companies have to work hard to face the stiff competition and to become the pace setter of the market. This will become possible only when the companies capitalize its investments in the human resources. There are various approaches to quantify the value of human resources. This paper is based on secondary data and focuses on the meaning, need, importance, methods, present position, and criticisms of human resource accounting.

Keywords Human resource, Capitalizing, Employees, Assets, Accounting

INTRODUCTION

Human resource accounting is basically the accounting of human resources of the company. As the human resources are the important resources of the company without which it cannot survive, hence it should be properly accounted for. In the present era, the companies have to work hard to face the stiff competition and to become the pace setter of the market. This will become possible only when the companies capitalize its investments in the human resources. There are various approaches to quantify the value of human resources. The importance of Human resource accounting is recognized by many organizations in India but till date it has not been compulsory by Companies Act.

Objectives of the Study

The objectives of the study are as follows

- To understand the meaning of Human resource accounting
- To discuss the necessities for capitalization of Human Resource Expenditure
- To discuss various methods of Human resource accounting.
- To know the present status of HRA
- To discuss criticisms of HRA

RESEARCH METHODOLOGY

The present research is secondary data base. The data for the study is collected through internet and other published sources.

Meaning of Human Resource Accounting

According to American accounting association committee, Human Resource Accounting is the process of identifying and measuring data about human resource and identifying and measuring data about human resource and communicating this information to interested parties.

Flamholtz refers HRA as the process, which involves measuring the cost incurred by business firms and other organizations to recruit, select, hire, train and develop human asset.

Literature Review

Batra (1996) conducted a study for the period 1991-92 in BHEL, SAIL and CCI and suggested that HR valuation and audit helps for improving efficiencies of their human resources.

Dhade (2005) in his study concluded that for the future growth of the company, it should properly focus on its intangible assets like human resources.

Ratti (2012) had determined the human resource efficiency quotient by calculating the value of human resources of fifteen companies. His study concluded that the value of

human resources is not dependent upon the number of persons employed.

A study conducted by **Cherian and Farouq (2013)** revealed that implementation of HRA was difficult for the organization but on the other hand it disclosures on human assets acted as evidence for wealth creation and helped in calculating the human resources capital, worth of management development and enhances the value of management accounting.

Kumar (2014) had made a comparative study regarding disclosure and reporting of HRA in some selected Private and public sector banks. In the study it was found that public sector discloses more quality information regarding HRA in comparison to private banks. The study also emphasized that HRA help the company Infosys for identifying the right person for right job. It was suggested that the government should take appropriate measures for measurement and reporting of human resource assets.

Sharma and Lama (2014) had conducted a study on the growth and development of HRA in some Indian companies. They found that Indian companies are conscious about the reporting and benefits of HRA and also suggested in their study that the Regulatory Bodies for Accounting Standards in both the National and International level have to focus on the measurement and reporting aspect of HRA and enforce sound standards for it.

Bullen and Eyler concluded that HRA gained positive effect overseas assignment on personal development. It was suggested to follow the international trends emerging in intangible reporting, capitalized human resource information, so that HRA can become more prevalent.

Necessities for Capitalization of Human Resource Expenditure

The success of an organization is very much dependent on the assets that it owns. Now among all the assets, Human resources are such an important asset without which the targets set by the company can't be achieved. This can be considered as the basic reason as to why the companies are spending a huge amount of capital on the advertising, interview selection and recruitment of their employees.

There are certain other reasons also for spending capital on their employees which can be enumerated as following

(i) Each organization wishes to have the best brains with it: Every organization wishes to work with intellectuals, those who are fit for the vacant position. This is the reason for spending a huge amount in the recruitment process. This one time huge spending will help the organization to choose the best brain out of many. The capability of an individual determines his future productivity and fruitfulness towards the organization. It also helps the organization in determining the nature of training required to be given to him.

(ii) For achieving the pre-determined objectives of the organization:

To achieve the predetermined objectives in terms of productivity and profitability for ensuring maximization of shareholders wealth, the organizations have to make the best combination of its available resources i.e. men, money, machines and materials. The most important asset that is men is to be selected effectively so that the efficient personnel can come to the organization for achieving its objectives by delivering his best performance.

(iii) To fulfill Stakeholders' Expectations:

Efficient and productive personnel are the milestone of success of an organization. They increase the goodwill of the company, helps in bringing investments and also maintaining its high reputation. All this provides help in upgrading the shareholders wealth. These also work as a factor for making high investments in the human resources.

(iv) To gain Competitive Advantage:

To attract the recognition of the people the companies have to work with uniqueness rather than with uniformity. To stand first in this stiff competition the organizations need such personnel who bring something extra which must be different from others. All this require selection and recruitment of the best among the available human resources and also motivate them in this direction.

(v) To Act as Pace Setter and Market Leader:

Market leaders such as Microsoft, NIIT, Samsung, LG, Coca-Cola, etc gain competitive advantage and become the pace setter in the market through their best human resources. These organizations select the quality personnel by making huge investments in hiring them.

Need of Human Resource Accounting

The development of an organization is dependent on its human resources. No other physical asset can move or develop by itself without the help of the human resources. This is the basic reason for their accounting. Human Resource Accounting plays an important role in an organization by providing the Cost value information about the time of acquisition, development, allocation and maintenance of HR. The human asset can be effectively controlled through the use of HRA as it provides the relevant information about that whether the value of its human assets are appreciating or depreciating and the management can take appropriate steps to motivate its employees by providing the training and development measures.

Likert (1971) explained that Human Resource Accounting is a tool which serves several purposes in an organization. To attain cost-effectiveness HRA provides cost/value information for taking management decisions about acquiring, allocating, developing, and maintaining human resource. It provides an effective tool to the management to scrutinize effectively the use of human resources.

A research conducted by Mainona (1995) concluded that investors' decision making is significantly affected by the

appropriate reporting of human resources by the organizations.

The need for human resource accounting on India is also emphasized by Jasrotia (2004). According to him, the economy have shifted from manufacturing to service industry, the success of which is dependent to a large extent on the knowledge and intellectual capabilities of the personnel working in it. So, Human resource accounting should be made compulsory for every organization by the Indian Government in the same manner as it has been done in Denmark from the year 2005 onwards.

Leading management scholar, Flamholtz (1979) explains the human resource accounting model as "psycho-technical systems" (PTS) approach to organizational measurement. This approach emphasized that the human resource are very important for the fulfillment of short term as well as the long term objectives of the organization to increase productivity and expansion.

Importance of Human Resources

- Human Resource is an asset which has the ability of value creation like any other physical and financial asset. One of the worth mentioning point about the human resources is that it not only create value but also appreciate over time. The value of other physical assets depreciates over time but no such depreciation occurs in case of human resources.
- It is the contribution of human resources to make effective use of financial and physical assets which contributes to increase market value of shares of the company.
- The efficiency of two companies having same capital employed can be compared only on the basis of the value of its human resources.
- Success of a company is very much dependent on its human resources. So, in order to retain them and not to face the difficulty created after they leave the organization, it must take proper steps to motivate them in order to gain their loyalty towards the company.

Methods of Human Resource Valuation followed by companies in India

Human resources have started gaining due importance with the change of time. Various human resource accounting models have been developed to quantify the talent, skills and knowledge of employees or workforce. Some of the models for human resource valuation are as follows

- **Historical Cost Method**

This method was developed by William C. Pyle (and assisted by R. Lee Brummet & Eric G. Flamholtz) and is adopted in 1969 by R.G. Barry Corporation, a leisure footwear company.

Under this method, the historical cost is considered to be the cost incurred on hiring, selecting, training and developing employees. A proportion of this cost is written off to the income or the benefits which the employee provides through his service to the company. If the human asset leaves the company prematurely then the whole of the amount not written off is charged to the income of the year in which the human asset left. On the other hand if he serves the company for a period more than what was expected of them proper revisions is done accordingly. This method is very easy to calculate and apply but it suffers from certain limitations such as it doesn't take into account the aggregate value of the potential services of the employee and it is also very difficult to calculate the time period for which the capitalized expenditure to be amortized etc.

- **Replacement Cost Model**

This model was developed by Rensis Likert, and Eric G. Flamholtz on the basis of concept of replacement cost. According to this model the value of employee is estimated as the cost of replacement with a new employee of equivalent ability and efficiency. Flamholtz divided the replacement cost in two parts i.e. individual replacement cost and positional replacement cost. Individual replacement cost includes the cost of recruiting and selecting the new employee; providing him training and

development to make him as much capable as the employee who is leaving.

Positional replacement cost meant the loss of production caused to the company due to the replacement of the leaving employee, the set of jobs which was expected to be performed by the employee of the present position and the cost of recruiting and developing the employee to make him so much capable as will justify the present position as that of the leaving employee.

This method is considered as more realistic as compared to historical cost method as it is taking the current value of the human asset. But its limitation is that it is very difficult to find two persons of same caliber and to compare the caliber of the new entrant with the leaving one is very subjective.

- **Opportunity Cost Model**

This method was first advocated by **He Kiman and Jones**. Under this method the cost of a human asset is equal to the benefit which he can provide if been put to some alternative work.

Opportunity cost is the maximum alternative earning that is earning if the productive capacity or asset is put to some alternative use. It is very difficult to calculate the value of Human resource by this method because alternative use of HR within the organization is restricted and at the same time the use may not be identifiable in the real industrial environment.

- **Standard Cost Method**

This method was coined by David Watson. According to this method the value of human resource is equal to the total of the standard costs incurred in recruiting, hiring, training and development per grade of service.

- **Stochastic Rewards Model**

This model was developed by Eric G. Flamholtz. This model considers both the factors that are the probability of promotion of an employee and also the rewards generated by him during his period of service.

Flamholtz has measured the expected realizable value of an individual as

$$E(RV) = \sum_{i=1}^n y \left[\sum_{i=1}^n \left(R_i * \frac{P(R_i)}{(1+r)^i} \right) \right]$$

Where

E (RV) =expected realizable value

Rt =Value derived by an organization in each possible state

P (Rt) =Probability that the organization will have Rt

t= time

n= state of exit

r= discount rate

i = 1, 2, 3.....

- **S.K. Chakraborty Model**

Chakraborty model divided the human assets in two groups i.e. managerial group and non managerial group. To calculate the value of human asset the average turnover of group of employees is multiplied with average salary drawn by them and discounted by the expected average turnover period.

- **Lev and Schwartz compensation model**

Lev and Schwartz developed this model in 1971 for valuing human resources. Most of the Public sector companies like BHEL, SAIL etc. are using this method for valuation of their human resources. This model takes the future earnings of an employee till retirement as the basis of this model.

According to the model the value of a human resource is equal to his remaining future earnings. In other words, it is equal to the estimated salary payable over remaining estimated working life.

$$V_r = \sum_{t=1}^T \frac{I(t)}{(1+R)^{(t-1)}}$$

Where

V_r= value of an individual or r years old

I (t) = the individual's annual earnings up to retirement age

T= retirement age

r= discount rate specific to the person

t= active year of service

The model categorized whole work force in the various homogenous groups on the basis of their age groups and

income levels. Then the present value of different groups is ascertained by discounting the average earnings of different groups by using the above formula. By using the formula calculated average earnings for different classes and age groups and present value of HR. This model also suffers from certain limitations such as it doesn't consider the early leaving of organization by an employee, effect of seniority and change of role.

Present Status of Human Resources Accounting in India

Human Resource accounting has not been made compulsory in India by any legislation till now. Even the New Companies Act 2013 does not made any provision regarding compulsory disclosure of Human resources in the Annual report of the company. Some of the companies are introducing and following the concept of Human resource accounting.

In India Human Resource Accounting was first introduced by Public Sector Companies. Bharat Heavy Electricals Limited was the first company to adopt the concept of valuation of Human resources. But the concept of human resource accounting does not gain much importance at that time.

Infosys Technologies was the first software company who had valued its human resources in India. The company valued its human resources at Rs. 1.86 billion by using Lev and Schwartz Model. In spite of many advantages of HR Accounting, it has not been developed and encouraged in different industries. Presently around twenty-eight companies are doing the practice of Human Resource Accounting .The name of those companies are ,Steel Authority of India Ltd. (SAIL),Hindustan Machine Tools Ltd. (HMTL),Oil & Natural Gas Corporation Ltd. (ONGC),National Thermal Power Corporation Ltd. (NTPC),Hindustan Shipyard Ltd. (HSL),Oil India Ltd. (OIL),Minerals and Metals Trading Corporation of India Ltd. (MMTC),Cement Corporation of India Ltd. (CCI),Engineers India Ltd. (EIL),Electrical India Ltd. (ELIL),Project and Equipment Corporation of India (PEC),Metallurgical and Engineering Consultants Of India

(MECON) Canbank Financial Services Ltd.(CFSL), Southern Petrochemical Industries Corporation Ltd. (SPIC), Cochin Refineries Ltd.(CRL),Madras Refineries Ltd. (MRL),Associated Cement Companies Ltd.(ACC),Tata Engineering & Locomotive Co. Ltd. (TELCO) ,Infosys Technologies Ltd.(ITL) ,Bharat Heavy Electricals Limited (BHEL),Global Tele Limited (GTL),Hindustan Petroleum Limited (HPL),Hindustan Zinc Limited,, Indian Drugs and pharmaceuticals Limited (IDPL),Indian Oil Corporation (IOC), Rolta India Limited, Satyam Computers Limited (SATYAM) and U.P State Cement Corporation Limited (UPCCI)

Criticisms of Human Resource Accounting

- Dehumanizing Human Resources- One of the major limitation of Human resource accounting is that if the report is not prepared with accuracy or if the results of the report are not used properly then it will lead to demonizing of human resources.
- No Uniform Standards- Financial performance of two organizations can be compared as there is uniformity in the preparation and presentation of the accounts .This is due to the fact because they follow the uniform standards laid. But in case of Human resource accounting there is no uniform standards due to which the results of one organization can not be compared with other.
- Mobility of Human resources- The valuation of human resources is done on the basis that they will remain in the organization for a long time. But this is unrealistic as the human mobility is very high.

CONCLUSION

Human Resources are an asset which has the ability of value creation like any other physical and financial asset. There are various methods which can be followed for computation of human resources. Many organizations have already adopted the process of accounting for human resources others are also expecting.

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