AN OVERVIEW OF HUMAN RESOURCE ACCOUNTING AND REPORTING

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Abstract—Success of an organization depends on quality, caliber, and character of the people working in it. Employees are the important asset of an organization and the success or failure depends on the skill and the performance of the employees. Inspite of the vast physical resources and the latest technology, an organization finds itself in the midst of financial crisis if it does not have the right people to manage and conduct its affairs. In a business enterprise a well organized and loyal personnel may be much more asset than a stock of merchandise. But it is unfortunate that, accountants, till now, could not evolve a generally accepted system to value and record this important asset i.e. Human Resources. So this article aimed at proposing an approach to Human Resource Accounting and its reporting in Financial Statements. It ensures treatment of human resources like other elements involved in financial accounting and the inclusion of human resources not only from expenditure perspective but also from investment point of view. It also describes views of authors and depicts the advantages of human resource valuation.

Keywords-Human resource accounting, Valuation, Cost model, Investment perspective.

I. INTRODUCTION

Human resource is one of the most important back office operations of any organization or business. Their skills, creativity, ability, can’t be replaced by machines. At all levels and areas of business or firm human efficiency is required with machine efficiency. Valuation of this resource is necessary and information about valuation must be given all the stakeholders of business through financial statements. Conventionally, financial assets are accounted in the books of accounts as per the generally accepted accounting principles (GAAP), but it doesn’t count the human asset. Although many efforts have been made by many thinkers in this area, a proper and fully validated model of performance based on accounting is not yet available. Though Human resource accounting was introduced way back in 1980’s, it started gaining popularity in India recently.

Human resource accounting is a new branch of accounting. It is based on the traditional concept that all expenditure on human capital formation is treated as a charge against the revenue of the period as it does not create any physical asset. But now a day this concept has changed and the cost incurred on any asset, as human resources should be capitalized as it yields benefits measurable in monetary terms.

Human resource accounting is the process of assigning, budgeting and reporting the cost of human resources incurred in an organization, including wages and salaries and training expenses. It is an art of knowing the cost invested for employees towards their recruitment, training them, payment of salaries and other benefits and in return knowing their contribution to organization towards its profitability. It gives information regarding inner strength of organization and helps in making decisions regarding long term investment in that organization.

Recognizing human being as asset as old one. From the observation of Indian History, it is evident that Emperor Akbar gave importance to the nine jewels (courtiers), Freedom fighters in India like Mahatma Gandhi, Shri Moti Lal Nehru, Sardar Vallabh Bhai Patel, Pandit Jawahar Lal Nehru, and Sarojini Naidu cannot be forgone from the history of freedom movement of India. But no one made efforts to assign any monetary value to such individuals in the Balance Sheet of India.

There were considerable views both for and against viewing Human Resource as asset. However majority of human resource management practitioner and management scholars have advocated that Human Resources should be viewed from investment perspective. As early as in 19th century itself thrust was made to introduce incentive payments by thinkers like, F.W.Taylor, Merrick, Rowan, Halsey and Bedux etc. for betterment performance of human resources. Actually, unlike
other assets the value of human resources increases with passage of time with gaining expertise.

It is the fact that the 21st century is the era of human demand. Countries like China and Japan forerunners in technology advancement, is the result of their human workforce performance. Hence whole world realized that human resource is real investment into business ventures that should only catch and stick the success waves.

Human Resource Accounting not only involves measurement of all cost or investment associated with the recruitment, placement, training and development of employees but also the quantification of the economic value of the people in an organization. Therefore, it is an attempt to identify and report investment made in resources of an organization that are not presently accounted for under conventional accounting practices. Moreover, human resource accounting helps to measure the value of employees, which helps the management take vital decisions related to human resources in order to increase production.

A. OBJECTIVES
The main objective of this paper is to make an idea about human resource accounting. The work also makes an attempt to disclose the various approaches in the valuation of human resources. It also focused on shifting the firms focus from cost perspective to investment perspective on human resource.

II THEORETICAL FRAMEWORK
American Accounting Association has defined “Human Resource Accounting is the process of identifying, measuring data about human resources and communicating this information to interested parties” (1973). R.L. Woodruff (1989) defined “Human Resource Accounting is an attempt to identify and report investment made in human resources of an organisation that are presently not accounted for in conventional accounting practice”.

Management Scholar Edward Lawler (1992) described human resources from investment perspective as “to be competitive, organizations in many industries must have highly skilled, knowledgeable workers. They must also have a relatively stable labour force since employee turnover works directly against obtaining the kind of coordination and organizational learning that leads to fast response and high quality products and services.”

There is an almost universal belief among business executives, investment managers and other stakeholders that consistent human metrics would be valuable. Moreover, investors would take human capital data into consideration if it could be provided on a reliable basis that would enable intelligent comparison (Scott-Jackson 2006). Flamholtz (1979) describes the human resource paradigm in terms of psycho-technical systems approach to organizational measurement. According to this approach, the two functions of measurement are: 1) process functions in the process of measurement and 2) numerical information from the numbers themselves. Pro. Sidney Davidson defines human resource accounting as a term used to describe a variety of proposals that seek to report and emphasize the importance of human resources- knowledgeable, trained and loyal employees- in a company’s earnings process and total assets. “Pundits of today assert that while other forms of capital including material, equipment, tools and technology, only present inert potentialities, it is the human capital that converts this potential and energizes the creation of wealth” (Mahalingum, 2001). According to him, each person has a set of competencies and a value is assigned to each, with summation of these values making up the value of the employee and the value of the entire employee making up the human capital of the organization, which together with customer and structural capital produces the revenue.

III HRA MEASUREMENT MODELS
A number of models or approaches have been developed for valuation of human resources. It can be broadly classified into two types:

1) Human resource Cost Accounting, and
2) Human resource Value Accounting

A. Cost based approaches
William C. Pyle was first developed Historical Cost approach in 1967 and it was assisted by R. Lee Brummet and Eric G. Flamholtz. According to this method, the actual cost incurred on recruiting, selecting, training, placing and developing the human resources of an enterprise is capitalized and written off over the expected useful life of human resources.

Rensis Linkert and Eric G Flamholtz developed replacement cost model. Under this method cost of replacing employees is used as the measure of company’s human resources. There are two costs, individual replacement cost and positional replacement in this model. Human resources have to be valued on the assumption that what it will cost the concern if existing human resources are required to be replaced with other persons of equivalent experience and talent.

Hekimian and Jones suggested the use of opportunity cost method which determines the value of human resources on the basis employees value in alternative uses. Accordingly value of an employee is based on his opportunity cost i.e., the price other divisions are willing to pay for the services of an employee working in another division of an organization. This
method can work for some of the people at shop floor and middle level management.

David Watson developed standard costing approach. According to him human resource data is used for setting standard costs for various human resource functions like hiring and training.

B. Value based approaches

Lev and Schwartz model or Present value of future earnings model was developed by Brauch Lev and Aba Schwartz in 1971. According to them the salaries payable to employees during their stay with the organization may be used as a replacement for the value of human resources, as there is relationship between employee compensation and their value to the organization. They have divided the whole labour force into certain homogeneous groups in accordance with different classes and age group. Average annual earning of each group has determined and aggregate of present value of different group represents the capitalized future earnings of the firm. The authors of the model recommended the following formula:

\[ V_r = \frac{I(t)}{(1 + r)^{t-r}} \]

Where, \( V_r \) = value of an individual r years old
\( I(t) \) = the individuals annual earning up to retirement age
\( t \) = retirement age
\( r \) = a discount rate specific to the cost of capital of the company.

Dasgupta (1978) suggested a total cost approach. According to him the total cost incurred by an individual, the state and the organization to bring that individual upto the present position should be taken as the value of a person on the day when he starts serving the organization. Both employed and unemployed persons should be brought in its purview for determination of the value of human resources. It will include not only expenses incurred by the individual for his education and training but also by the organization on recruitment, training, familiarizing and development of human beings. The valuation can be done in group wise, if number of employees is large.

Stochastic Rewards Model was developed by Eric G Flamholtz. This model identified some major variables that are help to determine the value of an individual to organization. He determined the movement of employees from one organization to another as stochastic process. He suggested different approaches to assess the value of human resources of the company. In order to quantify human resources value the period any employee work in the organization, role of employee and value of present position are determined and discounted expedited service towards. To be precise an employee value is the product of individual conditional value and the profit that the individual offers to the organization in his/her life. The conditional value comprises of productivity, transferability and promotability, skills and activation levels are also the determinants of an individual conditional value.

Morse model (1973) suggests that, the value of human resources is equivalent to the present value of net benefits derived by the organization from the service of its employees. Net benefit is the difference between the gross value of services to be rendered in future by the employees and the value of direct and indirect future payments to the employees.

Pekin Ogan (1976), suggested certainty equivalent net benefit model which is an extension of Morse model. Under this model the value of human resources is determined by taking into consideration the certainty with which the net benefits in future will accrue to the enterprise. It has to calculate net benefit from the employee, certainty factor at which benefits will be available in future and finally the certainty equivalent benefits will be calculated by multiplying the certainty factor with the net benefits from all employees.

S. K. Chakraborthy Model (1976), valued human resources in aggregate and not on an individual basis. He suggested that managerial and non managerial manpower can be valued separately. The value of human resources on a collective or group basis can be is multiplied by average tenure of employment of the employees in that group and is the investment in human resources. He noticed the cost of recruiting, learning, selection, training and development of each employee could be recorded separately and be treated as deferred revenue expenditure which is subject to gradual written off. In order to disclose in financial statements, he suggested to include human asset under investment and it is not wise to shown it as either fixed asset or current asset.

IV HR FROM INVESTMENT PERSPECTIVE

Human capital refers to the human knowledge, their inner capabilities and creativity. People and their development only can meet the needs of globalization and liberalization. The human capital in the organization should be rightly assessed and developed through motivation, training and perceptual needs of the organization. The computer technology offers greater precision but demands different skills. The owners of these new skills are both technically educated and trained on the job.

There are two schools of thought regarding whether the human resource of an organization to be considered as an asset or not. One says that human resource is an asset and other doesn’t agree with it. An asset is anything which is owned by the entity to derive service in future and should have legally
enforceable claim. As such there is no guarantee of deriving benefits from the existing human resources in future and has no sales value like other assets, legally human resource is not an asset.

But other school is of the opinion that, human resource is an asset. They puts forth following contentions in favour of their opinion:

i) There is a legal ownership on human resources, which prevent him/her from joining other organizations unless properly relieved by complying with some formalities

ii) Deriving future benefit is a common problem for all assets, not only with human resources.

iii) Generally an asset needs maintenance and development supports the organization, so as to derive benefits over a long period of time. Similarly human resource as an asset also is in need of training and development in order to maintain the service potential for the employer.

R. L. Woodruff observed that treating people as asset and accounting them is logical and satisfactory to the expectation of future economic benefits.

Thus the view that human resource is an asset as they are valuable resource to an organization and investment in such asset will help organization to improve.

Some of the Indian companies, value their human resources and report this information in their annual report like, BHEL, SAIL, ONGC, Oil India Ltd, PEC, Cement corporation of India, Infosys Technologies Ltd, Tata Engineering and Locomotive Works, etc. they have invested on employee training considering human resource as an investment. However, some of the organizations still view their employees as variable cost of production, while physical assets are treated as investments. The organizations, which view their employees as variable costs, there is little recognition of the firms contribution towards training or costs of recruitment, training and employee replacement.

The Human capital asset majorly consists of outstanding depth in human skills, logistics capabilities, knowledge bases, or other service strengths that the competitors lack. Therefore the organizations, which realized the fact that a firms competitive advantage majorly derives from human resources are adopting in investment perspective on recruitment, training, management development, prevention of skill obsolescence, reductions in career plateauing and employee health etc. instead from cost perspective. Over and above strategic management thinkers view is that considering employees from investment perspective acts as a morale booster and better job security provides a meaningful contribution from the bottom line. Management thinkers another view is that firms, which not considers from investment perspective will face high cost of employee turnover. Therefore in order to establish a solid “HR accounting framework” an investment perspective provides a valuable guide for better evaluation of human resources real value.

V TRENDS AND CHALLENGES IN HRA

The physical assets can be owned and traded by an organization but the human assets cannot and can be utilized in this regard. The measurement of human resources is subjective as different firms will use different methods for this purpose. Till date there is no model for valuation of human assets, which is widely acceptable and used worldwide. The concept of human resource accounting is not recognized by tax authorities and therefore, it has only academic utility. If the accounting standards board makes it mandatory to disclose the values of human capital or human assets, then only the direct or indirect tax authorities will take into concern of human resource accounting.

Measuring of intellectual capital can help managers and investors to give a true and accurate view of value of the company. Human capital, structural capital and customer capital comprise of companies intellectual capital. Even though all the three are intangible, they can be measured for targeted investment. Every country, every company, and every individual depends increasingly on knowledge, patents, processes, skills and technologies, information about customers and suppliers and experience. This has bought up a new way of strategic thinking about “how to put people on the balance sheet”. Traditional financial statements are less disclosing with respect to the assets that create wealth than they were in past. Intangible assets such as brand name, patents, copy right, etc. now generate an increasing amount of wealth for firms.

A large number of human resource parameters are expressed in accounting such as employee leave account, provident fund account, gratuity account, conveyance account, medical reimbursement, etc. All these are managed through special software. The total cost incurred for entire human resource gives the entire picture of cost of total human resources.

In addition to the above, there are a number of human resource software versions available for quantification of human resource performance. The total sum derived for the entire organization can be regarded as the benefits derived or accrued from the total of human resources. Therefore, the most complicated element in human resource quantification is no longer an issue and it is high time to re-organize the outdated principles as per advancement in technology.

Further there are a large number of associations established for concerning human resources. Unfortunately, the International Accounting Standards Board, and the Accounting Standards Board, has not been able to formulate any specific accounting standards on measurement and reporting of cost and value of human resource of an organization. These associations or institutions have to take steps for setting up an apex body concerning the human resources at each and every country.
level and concerned ministries of human resource development have to give necessary supports also.

Every organization must be equipped with a human resource department and human resource managers must have to update their knowledge in understanding human resource accounting theme and philosophy. They must give active participation and involvement in bringing the concept of human resource accounting into practice.

VI CONCLUSION

Human resource accounting provides quantitative information about the value of human assets, which helps the top management to take decisions regarding the adequacy of human resources. Based on these insights, further steps for recruitment and selection of personnel can be taken. Outside the organization, it has an impact on the decisions of the investors, clients and potential staff of the company. When proper valuation and accounting of human resources is not done then the management is not able to recognize the negative effects of certain programmes, which are aimed at improving profits in the short run. If not recognized on time, these programmes could lead to a fall in productivity levels, high turnover rates and low morale of existing employees.

References


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