HUMAN RESOURCE ACCOUNTING - A THEORETICAL APPROACH

Article Particulars

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Abstract

Human resources are most important assets of an organization and the value of this asset yet to appear in financial statement. Human resources are the only assets that appreciate over a period. Accounting of human resource in financial statement is very essential. Human Resource Accounting is the measurement of the cost and value of human resources to the organization. It involves measuring cost incurred by the organizations to recruit, select, hire, train and develop employees and judge their economic value to the organization. With the accelerated growth in science and technology, the value of human capital is gradually increasing. Human resources are required at all levels of the organization. Human resource alone can produce an output larger than the input. No machine can operate without the human input. Like all resources, people possess value because they are capable of rendering future services. Therefore, the value of human resource is treated as valuable assets to the organization. Thus companies must recognize and appreciate the value of their human assets.

This article highlights the concept of human resource accounting and the methods to assess the human assets value and also depicts the phases in design and implementation of Human Resource Accounting System.

Keywords: *Human Resource, Human Resource Accounting, Human Resource Valuation*

Introduction

Human beings are the most important part of an organization. The success or failure of an enterprise largely depends on the people who man the organization. In the word of Alfred Marshall, "the most valuable of all capital is that invested in human beings". From social point of view, an enterprise combines two sorts of resources: a group of human beings and a group of physical assets. Without human resource, the organization does not operate their business process. Hence valuation of this resource is very necessary and information about the valuation should be given to the investors, the management and others through financial statements. Human Resource Accounting is an information system that reports management about human resources of the business, and the cost and value of the human assets to the organization.

The concept of human value is derived from general economic value theory. Like all resources people possesses value because they are capable of rendering future services. Therefore, the value of human resources like other resources can be defined as 'the present worth of their expected future services'. The same way as goodwill is recognized as an asset, the human value is also to be treated as valuable assets to the organization.

Human Resource Accounting

Human Resource Accounting (HRA) is a new branch of accounting. It is based on the traditional concept that all expenditure of 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 should be capitalized as it yields benefits measurable in monetary terms. In 1960's the behavioral scientists attacked the conventional accounting practice for its failure to value the human resource of the organization along with other productive resources. In 1990s industries were recognized the value and importance of human assets. When service sector started major contribution to a country's economy the significance of human assets got prominence.

Human Resource Accounting means accounting for people as the organizational resources. It is the measurement of the cost and value of people to organizations. 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 involves measuring the costs incurred by the organization to recruit, select, hire, train and develop employees and judge their economic value to the organization. American Accounting Association's Committee on Human Resource Accounting defined as "*the process of identifying and measuring data about human resources and communicating this information to interested parties to facilitate effective management within the organization*". The second view is that it involves measuring the cost incurred by the business firms to recruit, select, hire, train and develop human assets and the value of people for the organization. Woodraff Jr. says "*HRA is an attempt to identify and report investments made in human resources of an organization that are presently not accounted for in conventional accounting practice. Basically it is an information system that tells the management what changes over time are occurring to the human resource of the business*". Eric Flamhotz of University of California, Los Angeles viewed that, *"Human resource accounting is the measurement of the cost and value of the people for the organization."* HRA is an art of evaluating the worth of human resources of an organization and the society and them for presenting the information in a significant in the financial statements.

Objectives of Human Resource Accounting

HRA helps in developing financial assessments for the people within the organization. The specific objectives of HRA is,

1. To monitor the effective use of human resources by the management to obtain maximum productivity and profitability.

2. To assist the management in taking suitable decisions regarding investment on human assets.
3. To provide information regarding costs and benefits associated with investment in human assets.
4. To facilitate the valuation of human resources, record the value in the books of accounts and disclose the value of human resource in the financial statement.

Review of Literature

Miller (1989) suggest in his study, Human resource management seeks to ensure a fit between the management of organizations and the overall strategic development of the company.

Sharma and Shukla (2010) carried out a study to analyse the application of Human Resource Accounting in Heaving Industries covering the period 2001-2010 with the case study of the Hindustan Copper Limited, a public sector undertaking. This case study helps to analyse that the value of production per employee is increasing or decreasing.

Pandurangarao. Basha and Rajasekhra (2013) carried out a study to examine the methods and models followed by the Indian firms/ companies for the Human Resource Accounting. The study shows that few firms follow the proper methods of the Human Resource Accounting.

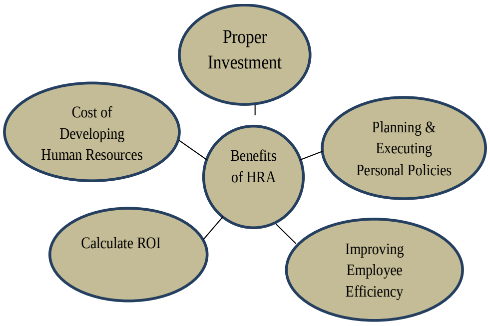
Kesavan and Dyana (2013), carried out a study to analyse the Human Resource Accounting disclosures in selected Indian Companies. 20 companies were selected for the study, out of that only 6 companies were following Human Resource Accounting.

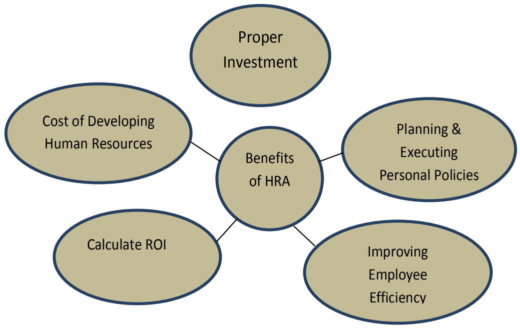
Rao (2013) conducted a study to know how much the Indian firms are disclosing the human resource related aspect in their financial reports and also study the method they used for that purpose.

Benefits of Human Resource Accounting

Human resource accounting helps to know whether human asset is being built up in the organization or not. An executive may show good result in producing well, and so on but he might not have built the human resources properly. A good manager keeps the morale of his subordinates high so that they contribute the maximum in achieving the organizational objectives. The figure 1.1 clearly depicts the benefits of Human Resource Accounting.

Figure 1 Benefits of Human Resource Accounting





Cost of Developing Human Resources: Human Resource Accounting will give the cost of developing human resources in the business. This will enable the management to ascertain the cost of labor turnover also.

Proper Investment: It can be seen whether the business has made proper investment in human resources in terms of money or not. If the investment is in excess, efforts should be made to control it.

Planning and Executing Personal Policies: It will help the management in planning and executing personal policies. The management also makes use of its help in taking decisions regarding transfers, promotions, training, retirement and retrenchment of human resources.

Improving Employee Efficiency: It helps in improving the efficiency of employees. The employees come to know of the cost incurred on them and the return given by them in the form of output, and so on, which will motivate them to increase their worth.

Calculate Return on Investment (ROI): The return on investment can realistically be calculated only when the investment on human resources also is taken into account. The ROI is may be good because there is an investment on human beings.

Methods of Valuation of Human Resource

There are various approaches of Human Resource Valuation and Accounting. These can be classified into two categories: The monitory measures and non-monetary measures.

Monetary Measures

Historical Cost Approach

William C. Pyle and R.G. Barry Corporation, a leisure footwear manufacturer based on Columbus, Ohio (USA) in 1967 developed this approach. Under this approach, the actual cost incurred on recruiting, hiring, training and development of the human resources are capitalized and amortized over the expected useful life of the human resources. Thus a proper recording of the expenditure made on hiring, selecting, training and developing the human assets is maintained and a portion of it is written off to the income of the next few years during which human resources will provide service. If the human assets are liquidated prematurely, the whole of the amount now written off is charged to revenue of the year in which such liquidation takes place. The historical cost of human resources is very similar to the book value of the other physical assets. When an employee is recruited by a firm, he is employed with the obvious expectation that the returns from him will far exceed the cost involved in selecting, developing and training in the same manner as the value of fixed assets is increased by making additions to them. Such additional costs incurred are also capitalized and are amortized over the remaining life.

It suggests capitalizing the expenditure of the firm incurred on recruitment and selection, training and development of the employees and treats them as the assets of the organization for the purpose of HR accounting. This method suffers from a limitation that the capitalization of costs does not reflect its true value. The total performance has to be judged in relation with the total cost associated with the HR to reflect its value.

Replacement Cost Approach

Initially replacement cost approach was suggested by Rensis Likert, and was developed by Eric G. Flamholtz on the basis of concept of replacement cost. Human resources of an organization are to be valued on the assumption that a new similar organization has to be created from scratch and what would be the cost to the firm if the existing resources were required to be replaced with other persons of equivalent talents and experience. It takes into consideration all cost involved in recruiting, hiring, training and developing the replacement to the present level of proficiency and familiarity with the organization.

Opportunity Cost Approach or Market Value Approach

This approach was first advocated by Hekiman and Jones for a company with several divisional heads bidding for the services of various people they need among themselves and then include the bid price in the investment cost. Opportunity cost is the value of an asset when there is an alternative use of it. There is no opportunity cost for those employees that are not scarce and also those at the top will not be available for auction. As such, only scarce people should comprise the value of human resources.

This model envisages the computation of monetary value and the allocation of people to the most promising activity and thereby assesses the opportunity cost of main employees through competitive bidding among the investment centre.

Economic Value Approach

The value of human resource is evaluated on the basis of contribution they are likely to make in the organization during their stay with the organization. The payments made to the employees in the form of salary, allowances and benefits are estimated and discounted appropriately to arrive at the present economic value of the individual.

Non-monetary measures

Expected Realizable Value Approach

The elements of expected realizable value like the productivity, transferability and promote-ability are measure using personal research, appraisal techniques or other objective methods. The productivity is measured by objective indices and managerial assessment. The promote-ability and transferability are measured in terms of potential using psychometric tests and subjective evaluations.

Discounted Present Value of Future Earnings Approach

Lev and Schwartz proposed an economic valuation of employees based on the present value of future earnings, adjusted for the probability of employees' death/separation/ retirement. This method helps in determining what an employee's future contribution is worth today. According to this method, the value of human capital embodied in a person who is 'y' years old, is the present value of his/her future earnings from employment and can be calculated by using the following formula:

E(Vy) = Py(t+1) I(t)/(I+R)t-y

Where E (Vy) = expected value of a 'y' year old person's human capital

T = the person's retirement age

Py (t) = probability of the person leaving the organization

I(t) = expected earnings of the person in period I

R = discount rate.

This method was use by Rencis Likert who proposed three sets of variables-casual, intermediate, output. These helped in measuring the effectiveness over a period of time. Casual variable include leadership style and behaviour, the intermediate variable are morale, motivation and commitment to goals, and these in turn affect the output variables like production, sales and profit.

Phases in the Design and Implementation of Human Resource Accounting System

There are five phases in the design and implementation of human resource accounting system:

1. Identifying human resource accounting objectives,
2. Developing human resource accounting measurements,
3. Developing a data base for the system,
4. Pilot testing the system for validity,
5. Implementing the system.

Identifying Human Resource Accounting Objectives

The objectives of the human resource accounting system should basically stem from the management's requirements from human resource information. Each organization should responsible for human resource management, define its functions, indicate the kinds of decisions made and their relative frequency and information needed to make those decisions. These information needs must be analyzed in relation to the present information flow and the new information to be developed mast be made specific. The objective may be a problem oriented system, a partial system such as, a budgeting system for human resource costs, or setting of standard costs.

Developing Human Resource Accounting Measurements

The first step is to select the desired types of Human Resource Accounting measurements. The choice to be exercised between: (a) single measurement or a set of measurements, (b) monetary or nonmonetary measurements, and (c) measurements of costs or value, or both. In the next step, before these measurements selected can be translated into useable forms, their validity and reliability must be tested.

Developing Human Resource Accounting Database

The inputs required for human resource accounting constitute the database. These include cost data, timesheets and psychological measurements. In typical cases, it will become necessary to restructure the organization's accounting classification with a view to ensuring that all personnel related costs are classified separately. Otherwise these cost elements are 'buried' covered in one single classification "administration and general expenses". The accounting classification should be organized in relation to responsibility centers, such as, recruitment, training and management development. In addition to restructuring the accounting classification, the database must also include non-financial information, such as, employee attitude survey feedback as a standard ongoing basis. Similarly, the probabilistic estimates of employee mobility compiled in the human resource planning process must be taken into account for measuring human resource value.

Pilot Testing the System for Validity

After the objectives have defined, measurements developed and necessary database is made available, the-next step is to pilot test the system. Care should be taken that the test is not influenced by extraneous problems and that the management's support and cooperation is available throughout the processes of design and development of the system. In the light of the feedback from pilot testing, the system should be reviewed for its utility, efficiency and cost.

Implementing the Human Resource Accounting System

The final phase is the implementation process. It involves essentially, standardizing the input/ output documents, forms, etc., and familiarizing the personnel with the new system. Staff orientation as to the purposes, uses and methods is a key activity in order to operate the human resource accounting system without many hassles.

Conclusion

Human beings are the dynamic elements of every organization. The success of any organization depends upon the quality of the people working in it. Human Resources Accounting not only involves measurement of all the costs/ investments associated with the recruitment, placement, training and development of employees but also the quantification of the economic value of the people in an organization. Human Resource Accounting gives information regarding inner strength of organization and helps in making decisions regarding long-term investment in that organization. HRA helps to identify the causes of high labor turnover at various levels and take preventive measures. HRA facilitates the valuation of human resources and disclose it in the financial statement. Human Resource Accounting helps the management in selection and utilization of Human Resources.

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