

HUMAN RESOURCES ACCOUNTING: THE GAME CHANGER

RizwanaKhurshid*

Abstract

The productive utilization of human resources plays a pivotal role in an organization towards the achievement of organizational objectives and goals. Human resources of an organization makes it sure that there exists a symbiosis between the physical resources of an organization and the financial resources it possesses. Conventionally, financial assets are recorded in the books of accounts as per the generally accepted accounting Principles, but the people which are the most important assets of an organization are yet to appear in the financial statements of organization. With the accelerated growth in this era of science and technology, the value of human capital is increasing gradually, and hence becomes imperative for the organizations to reflect the investment made in human resources. The skills, creativity, ability of human resource cannot be replaced by machines because at all levels and areas of business human efficiency is required with machine efficiency. Organization must learn to recognize and appreciate the value of their talented employees. The success or failure of an organization depends on their employee's qualification and performance. The evaluation and assessment of human resource is not done properly because the organizations considers the salaries and wages, actually an investment in the improvement and qualification of the employees, and not as an investment in the most important and valuable asset and resource of the organization. Human resource accounting aims at providing information pertaining to the evaluation of human capital because it is necessary that some method of quantifying the net worth, the motivation and the skills possessed by employees should be estimated, recorded in the books of accounts operated and disclosed in the financial statements because HRA represents a new way of thinking about people as assets.

Keywords: Human assets, human capital, human resource Accounting

* **The business school, University of Kashmir**

Introduction

It was during the early 60's a new concept of human resource accounting came into the limelight in the business world. A new realization that human capital is the potential asset of an organization and just like that of other physical assets of the organization it also needs to be developed. This thought was led by few experts of this period like Hermanson, HC Kiman, Rensis Likert, and Jones.

Human element is the most inevitable input in an organization, as all of the process of the organizations are operated by human resources hence valuation of human resource is necessary and the information pertaining to the valuation of human resources should be provided to the investors, the management and all the stakeholders through financial statements. Human resource accounting is basically the process of identifying and measuring data about human resources and communicating it to all the stakeholders. HRA provides the information to the management which is related to the changes that are occurring over time to the human resources of the business.

Human resource accounting is an attempt to identify and measure the value of employees, which helps the management take indispensable decisions related to human resources in order to increase production which otherwise is not accounted under the conventional practices of accounting. Physical assets, tangible assets, intangible assets, fictitious assets, investments all are recorded in the books of accounts at their particular purchase dates and at their purchase prices. Depreciation on fixed assets are considered as the cost for the particular fiscal year and hence are debited to the profit and loss account and the balance remaining is the written down value of the assets and is shown in the balance sheet for that particular year. Henceforth, on similar lines the human elements should be evaluated, recorded, operated and disclosed in the financial statements of an organization.

With the advent of the new economy, it has been concluded that human capital is extremely important in determining the total value of an organization. Human capital refers to a team of creative, competent, skillful, talented, innovative, devoted, and motivated persons that are capable of converting a sick concern into a successful one.

To quote Prof. Sidney Davidson, “Human resource accounting in the measurement of the cost and value is 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 are earning process and total assets. American Accounting Association defines it “as a process of identifying and measuring data about human resources and communicating this information to concerned parties”. E. Flamholt says “it is the measurement of the cost and value of people for the organization”.

REVIEW OF LITERATURE

Stephenson and Franklin (1982) gave a macro level perspective to human resource accounting by analyzing different HRA models which reinforced the practical implications of HRA in terms of real dollars and common sense for management. It was found that many companies have recognized the need for systematic assessment of the human element of the organization in quantitative terms for internal management purposes. It was invented that in the near future maximum corporations will be recording their human capital in the balance sheet. Flamholtz et. al. (2002) explored the term HRA and implications of measuring human capital for financial capital and managerial use. It was also studied about the Swedish based HRA applications with respect to measuring human assets and intellectual capital including the Skandia Navigator illustrates the intellectual history and developments in business schools. It was revealed that HRA suggests a vehicle for improvement of management as well as measurement of HR. If HRA can demonstrate that improvement in HR management enhances profits, then managers will integrate human capital implications in their decision making to an enhanced degree. Dhade (2005) gave a macro level perspective to human resource accounting for succeeding in highly knowledge driven economy. It was concluded that companies should focus on intangible assets like human resources for future growth.

Theeke and Mitchell (2008) in a study made an attempt to explore the implications of HR liability accounting paradigm including effects on financial statements, ratios, risk and management behaviour. It was found a relationship between a firm value and the present value of HR expenses and recognizing HR expenses will tend to depress asset turnover and return on

assets while inflating estimates of risk in the form of a higher debt ratio, lower cash flow coverage and higher degree of operating leverage. Tracy (2008) directed at analyzing the types and adoption of HR policies, practices and programs in the hospitality industry of Kenya that may be linked to a firm's overall business strategy & helps to drive performance in the hospitality industry of Kenya. It was proclaimed that there is a need to develop a clear and strong alignment between the overall business plan and the HR function. Seth (2009) studied the concept of human resource accounting and various human resource accounting models, which have been adopted by a number of Indian enterprises to give information about human resource in their balance sheets, steps involved in calculation of human value using Lev and Schwartz model and its critical aspects, and lastly, concludes with suggestions for improvement in the field. It was revealed that the measurement and reporting of HRA in Indian Industry were in growing trend. Further, it was found that most of the Indian companies and corporations have followed Lev & Schwartz model for determining the value of human resources & HRA should have been flourished throughout the nation. Avazzadehfath (2011) checked the impact of human resource accounting information on the investment decisions and explored the factors that could interfere in the effect. Further, it was examined that which evaluation method of human resource was the most appropriate method consistent with Iranian companies in terms of qualitative characteristics of accounting information. It was revealed that human resource accounting (HRA) information disclosures in financial statements were relevant and affect on the optimal investment decisions. Original cost method was found to be the most effective and appropriate evaluating method of human resource consistent with current status of Iranian companies and institutions. Hosseini (2012) in a research studied the concept of human resource accounting and found that the promotion of human capital and its effect on different aspects of organization operation and in more extended level on economic and social development was not hidden for everybody. Promotion of this capital was found including a collection of competences for Applying knowledge and skill for achieving to results of programs. Creativity, flexibility, capability of conducting, solving problem and making creative relation with others, job making and complex skill such as knowledge of manner of learning were the features embracing in the competences.

OBJECTIVES OF PAPER

The main objective of present study is to explore the significance of HRA in business entities.

RESEARCH METHODOLOGY

This study is descriptive in nature. Secondary data is used for the purpose of the study, which is collected from websites, published books, related research findings, journals and articles.

APPROACHES TO HUMAN RESOURCE ACCOUNTING

Sir William Petty was the first person who made an attempt to signify the importance of HR accounting in the year 1661. He considered labor as wealth generators. Adam Smith also recognized the importance of investment on human elements. A number of models or approaches have been devised for the measurement and valuation of human resources.

These approaches may broadly classify into two types:-

1. **Human Resource Cost Accounting:** -It is the measurement and reporting of the costs that have been incurred for the acquisition and development of people as resources. Further, it deals with the replacement cost of the people which are currently being employed.
2. **Human Resource Value Accounting:** -It is based on the concept that the economic value of the firm can be determined by obtaining the present value of future earnings. The difference in present value and future value earning of two similar firms arise due to the difference in their human capital or assets. A number of models have been developed for the valuation of present value of future earnings.

MAIN OBJECTIVES OF HUMAN RESOURCE ACCOUNTING

1. To provide cost value information for the proper and effective decision making pertaining to the acquisition, allocation, development, and maintenance of human resources in order to achieve cost effective objectives of the organization.
2. To assess and monitor effectively the use of human resources by the management.
3. To analyse the human assets in terms of conservation, depletion, or appreciation.
4. To succor in the development of management principles, proper decision making for future and classification of financial consequences.

5. It facilitates the management in the valuation of human assets, recording their valuation in the books of accounts, and disclosing the information in the financial statements.

BENEFITS OF HUMAN RESOURCE ACCOUNTING

Human Resource Accounting is an offshoot of accounting and finance. Human resources are the assets whose value gets appreciated over a period of time, if applied and developed in the right direction. Human resource accounting enables us to know whether human asset is being built up in the business or not.

The main benefits of HRA are listed below:

1. It helps in the development of cost of human resources thereby enabling the management to ascertain the cost of labour turnover.
2. It helps in the realistic calculation and proper interpretation of return on capital employed.
3. It helps in improving the efficiency of employees. Human element is the prime factor in any organization. If employees are provided with the information about the costs which have been incurred on them and the returns generated by them in the form of output, and so on, they will increase their productivity and will motivate them to increase their worth.
4. It enables the organizations to know whether they have made proper investment in human resources in terms of money or not. If the investment exceeds benefits, efforts are made to control the investments.
5. It helps the management in the planning and execution of personnel policies. It helps out in taking various decisions related to the transfers, promotions, training, retirement, retrenchment, layoff of human resources.
6. It helps in the improvement of managerial decision making.
7. It also serves social purposes of an organization and successful operations of the organization.

METHODS OF HUMAN RESOURCE VALUATION FOLLOWED BY ORGANIZATIONS

In order to quantify the knowledge, the skills, the aptitudes and the talent possessed by the human resources, various models have been suggested till yet. Some of the models used for the valuation of human resources are:-

1. **Historical cost method:** - This method was developed by William C. Pyle (and assisted by R. Lee Brummet & Eric G. Flamholtz). This model was adopted in the year 1967 by R.G Barry Corporation, a leisure footwear manufacture based on Columbus, Ohio (U.S.A). This method is based on conventional accounting. It involves capitalization of costs made on hiring, selecting, placement, training, and learning, which is equal to the value of workforce. It determines the investments made in the human assets.

2. **Replacement cost method:** - It is an alternative method for historical cost method. This approach was first suggested by Rensis Likert, and later was developed by Eric G. Flamholtz. According to this method the value of employees is estimated as the cost of replacement of an existing employee with a new employee of equivalent abilities and efficiency.

As per this method, the value of HR involves two forms of replacement cost.

a. **Individual replacement cost:** - It refers to the cost incurred by an organisation to replace an existing employee with an equivalent substitute in terms of various abilities, skills, knowledge and efficiency.

b. **Positional replacement cost:** - It refers to the cost of replacing different positions in an organisation rendered by the employees at their respective positions and the positions they will render in the likely future.

3. **Opportunity cost method:** - In order to overcome the bottle necks of replacement cost method, HC Kiman and Jones advocated the method of opportunity cost. It determines the value of human resources when there is an alternative use of them, which is to check the maximum alternative earning of human resource when they are put to some alternative use.

4. **Capitalization of salary method:** - The advocates of this method are Baruch Lev and Abaraham Schwartz. They developed this method in the year 1971. According to this model value of human assets is determined/ estimated for a person at a given age, by the salaries payable to them during their stay with the organisation. This can be represented as:

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

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 the whole work force in the various homogeneous groups like skilled, semi-skilled, unskilled, technical staff, managerial staff etc.

5. **Stochastic rewards model:** -Reward valuation model which is commonly known as stochastic reward valuation model was developed by Eric G. Flamholtz. This model identified some major variables that seeks to measure the value of human resource on the basis of an employee's value to an organization at various positions and at various service states (role) that he is expected to occupy during the span of his working life with the organisation. The movement of employees from one service state to another service state is the stochastic process.

Flamholtz has measured the expected realizable value of an individual as:

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

Where $E(RV)$ = expected realizable value

R_t = Value derived by an organization in each possible state

$P(R_t)$ = Probability that the organization will have R_t

t = time

n = state of exit

r = discount rate

$i = 1, 2, 3, \dots$

6. **Return on efforts employed method:** - This approach tries to measure the value of the organisations human assets on the basis of the efforts made by them for the benefits of the organisation.

7. **Adjusted discounted future wages:** - This approach to HRA was developed by Hermanson. This model attempts to measure the value of human resources with the extra profit the firm earns over and above the expectations of business and industry.

HUMAN RESOURCE ACCOUNTING PRACTICING COMPANIES IN INDIA

Although there are numerous benefits that are attributed to HRA, yet its development and application has not been encouraging. Human resource accounting is not accepted widely because of its few serious limitations. However, this system of accounting is trying to gain popularity in India, despite the fact that the Indian Companies Act, 1956, which governs the preparation of financial statements of companies of India, doesn't provide any scope for presenting any information about the human capital. But due to globalization and the development of commerce and industries, few enlightened companies in India have begun to value their human capital and present a statement of HRA in their annual reports. The lists of such companies, who are presently valuing their human assets include:

1. Bharat heavy Electrical Ltd (BHEL).
2. Steel Authority of India Ltd (SAIL).
3. Oil and Natural Gas Commissioning (ONGC).
4. Oil India Ltd
5. Project and Equipment corporation of India (PEC).
6. Engineers India limited
7. Mineral and Metal trading Corporation of India (MMTC).
8. Electrical India Ltd.
9. Hindustan Shipyard Ltd.
10. Cement corporation of India (CCI).
11. Infosys Technologies Ltd.
12. Tata Engineering and Locomotive Works
13. Southern Petrochemicals Industries Corporation Ltd (SPIC).
14. Associated Cement Company Ltd (ACC).
15. National Thermal Power Corporation Ltd (NTPC).

CONCLUSION

The changing economic, political and social environment has introduced and opened up new windows to globalization resulting in increasing greater competition among the business entities. In this era of globalization and cost cuts, it has become imperative for the organisations to realize its human capital as the most precious asset of an organization because it's HRA that gives a correct vision towards the way forward.

To ensure potential growth and development of any organisation, the efficiency of human capital must be augmented in the right perspective. Without human resources, all other resources cannot be effective. The original health of an organization is clearly depicted by the human attributes, like skills, motivation, talents, aptitudes, group loyalty, capacity for effective interaction etc.

The success or otherwise of an organisation clearly depends on how best the human capital utilizes all the other physical resources. The physical resources cannot act on their own, they need to be activated and utilized by the human resources. The effective and efficient utilization of inanimate resources largely depends upon the skills, knowledge, potential, attitude, and character of the human capital.

An organization with abundant resources may sometimes fail miserably to manage its business affairs, if it doesn't acquire and retain right people. The right people helps the management to cope up with the changes in its quantum and quality so that an equilibrium is maintained between the required resources and the provided human resources.

The HRA concept represents a new perspective of thinking about people as assets. HRA has a great potential for future organizations to understand the economic values of people to an organisation. Human resources are the key factors that provide competitive advantage to the organisation over others.

While bearing in mind, the growing importance of the human resources, it has become important for the organisations to develop a process to measure and record data, concerning the human resources. There are undeniable abilities in human resources of an organisations. Human resources are the real contributors to the growth and development of the organisations. Human

resources have become more estimable and valuable in the light of the fact that no other asset can replace human assets, and it is human assets that creates and develops influence over all other assets. Despite offering a number of benefits to the organisations, the organizations seems a bit reluctant to implement HRA. The concept of HRA is yet to gain momentum in India because its development and application in different industries has not been encouraging. For the betterment of the organizations, it is desirable to evaluate the net worth of human capital in a systematic manner and present the information related to them in the financial statements. By doing so, the organisations can communicate the worth of their efficient and effective people to the stakeholders and thus creates a potential for attracting the investing public. Therefore, at this juncture it has become imperative for the business entities to pay due attention on the proper development of such an important resource of an organization because the overall valuation is crucial for decision making in order to achieve the organizational objectives and improve the output.

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