

HUMAN RESOURCE ACCOUNTING (HRA) – MEANING AND RELEVANCE

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Abstract:

This paper attempts to highlight the need of accounting for human resource and depict the same in the financial statements of an organization. The distorted narratives on human resource accounting have led to the serious issue of measuring the value of human resource and recognizing the value of human resource in the balance sheet of an organization. The paper also highlights the growth and development made in the domain of human resource accounting during the last five decades and accentuates the importance of measuring the value of human resource highlighting the various benefits of HRA. This paper is an attempt to explore the horizons of accounting for human resource which has been streamlined over the past many decades due to the cryptic nature of human resource accounting.

Keywords: Human Resource Accounting (HRA), Balance Sheet, Financial Statements, Human Resource

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1.1 Introduction:

Human Resource is the most important asset for any organization. The success and failure of an organization is significantly dependent on the nature of human resource that an organization is heading with. Inevitably the composition of the human resource and its management is the most difficult task to grapple by a manager in any organization (Lama, 2012). There is no apprehension that success of an organization in the contemporary world is ubiquitous aphorism to the value of human resource. Accentuating this fact, HRA rose significantly to the upper echelon of the research agenda during the last five decades among the western countries.

Accounting for human resource have gained considerable momentum since the early 1970s when the first attempt towards measuring the human resource was made by a foot ware manufacturing company R. G. Barry Corporation of Columbus, Ohio with the help of Michigan University in 1967. Human Resource Accounting also known as Human Asset Accounting involves identifying, measuring, capturing, tracking, and analyzing the potential of human resources of an organization and communicating the subsequent information to the various stakeholders in an organization. Scholars across the world have been trying to solve the dilemma of HRA since last many decades but the enigmatic nature of human resource accounting and the failure of the national and international accounting standards board to enforce a detailed standard on mandatory compliance norms have resulted into the dismal compliance of HR Accounting in the contemporary times. The importance of human resource is evident from the famous saying, “If you wish to plan for a year, cultivate flowers; if you wish to plan for ten years, plant trees; and if you wish to plan for eternity, develop men”. This adage highlights the importance of human resource for any entity, if it so desires to sustain in a market for a long term, it cannot do so unless it develops its human capital. The importance of human resource for the organization in the modern management layout therefore depends on the intricacies of the value of the human resources. The reason why HRA has been receiving a reasonable amount of attention in the recent years is:

- Firstly, there is a genuine need for reliable and complete management of human resources for both the management and the external parties.

- Secondly, the conventional framework of accounting is in the process to include a much broader set of measurement than was possible in the past.

The literature on HRA aptly points out that the end result of all accounting typology is to provide reliable, value-based judgments on the basis of which decisions can be taken. Human Resource Accounting, by definition tends to summarize the entire hotchpotch of human resources in an organization. However, the dilemma on the measurement aspect of HRA has left the accountants and the experts on human resource valuation in the midst of nowhere. While accounting methodology has addressed current trends in the economy regarding non-capital assets, with a general change toward a “mark-to-market” approach, it has not examined the adequacy of the current model to measure intellectually based economic activity (Stovall, 2001).

Basic premises of HRA:

- People are the most valuable resources of an enterprise.
- The usefulness of manpower as an organizational resource is determined by the way in which it is managed.
- Information on investment & value of human resource is useful for decision making.
- Resources that can be measured can be controlled.

The basic premises of Human Resource Accounting highlights the dire need to measure the value of human resource and showcase the valuation in the financial statements of the organization. The various approaches to measure the human resources and the existing literature contributed mainly by the western researchers in this field highlight the grave concern on the issue and importance of HRA. The inefficiency of the various national and international standard boards clearly underlines the fact behind the subtle growth and development in the field of human resource accounting.

1.2 Human Resource Accounting – Meaning and Relevance

Human Resource Accounting is an attempt to identify and report the investments made by organizations on human resources that are currently not accounted for under conventional accounting practice. Essentially, HRA is an information system in an organization that helps the organization to take a rational decision on investment of human resources. Human Resource Accounting has been defined by various scholars and reputed institutions in different ways. American Accounting Association's Committee (1973) on HRA defined "HRA is the process of identifying and measuring data about human resources and communicating this information to interested parties". R. L. Woodruff Jr., Vice President, R. G. Barry Corporation (1960) defines HRA as—"human resource accounting is an attempt to identify and report investment made in resources of the organization that are not presently accounted for under conventional accounting practice". Woodruff further considers it to be an information system that tells management what changes over time are occurring to the human resources of the business. Brummet et al. (1968) defined "Human Resource Accounting is the process of identifying, measuring, and communicating information about human resources to facilitate effective management within an organization." Knauf (1983) defined HRA as "The measurement and quantification of human organizational inputs, such as recruiting, training, experience, and commitment". Prakash (1993) defined human resource accounting as a scaling tool that generates and reports quantitative control information about the contribution of human resources for promoting industrial productivity. Chandran (2007) succinctly points out HRA as a method by which a cost is assigned to every employee when recruited and the value that employee generated during the tenure he/she worked for the company. Prof. 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".

The various definitions highlighted above by different scholars and institutions vividly interpret the various parameters of HRA and the loopholes attached therewith. If accounting is the language of business, for a layman, the language which records, communicates and interprets human resource is human resource accounting. In other words HRA is a

sub-system of the total accounting system which, in turn, is a part of total management information system". The absence of standards on HRA and in the national and international arena has fostered more complexities in the measurement of human resource. Even in India the Companies Act, 1956 does not demand furnishing of HRA related information in the financial statements of the companies. The Institute of Chartered Accountants of India (ICAI) too, has not been able to bring any definite standard or measurement in the reporting of human resource costs.

Accounting for human resource is essential and relevant for any organization. The overall profitability and sustainability of an organization is largely dependent on the strength of the organization to retain competent and skilled human resource/work force. The various intricacies of human resource which starts from recruitment till retirement need a thoughtful analysis and accounting in order to prevent any future untoward incident. Experts in the field of HRA comments, "things that can be measured can be controlled" which indicates that in order to have proper control of human resource, an organization should take necessary steps to measure the value of human resource. Accounting for human resource is inevitable in the modern management era.

1.2 Historical Perspective of Human Resource Accounting – An Overview

Human Resource Accounting may still be considered as a new terminology in the field of accounting and management studies but its origin dates back to the late seventeenth century when economist, Sir William Petty first attempted to estimate the monetary value of population of England in 1681. The quest for the external corporate reporting on human resource accounting has mesmerized the HR professionals since the late 1960s, when the R .G. Barry Corporation, a leisure footwear manufacturer, Columbus, Ohio (USA) included human resource as assets for the first time in their balance sheet. Since then, numerous scholars have contributed on the different aspects of human resource accounting. The history of HR accounting and the different value based models for determining the value of human resource can be traced from a scholarly article by Roger Hermanson conducted at Michigan State University (Hermanson, 1964). Eric Flamholtz and William Pyle contributed vehemently to the literature of HR Accounting during the late 1960s and 1970s. They worked on a series of research projects

designed to develop concepts and methods of accounting for human resources. The major outcome of this research (Brummet, Flamholtz & Pyle, 1968) was a paper representing one of the earliest studies dealing with the measurement of human resource. Scholars like R. Lee Brummet and Rensis Likert involvement and contribution in the field of HR accounting cannot be undermined. Flamholtz & Pyle (1968) also published another article in which they assessed the impact that HRA can have on management. Flamholtz's (1969) Ph. D. dissertation, an exploratory study in the area of HRA, developed a theory of an individual's value to an organization and how it could be measured through HRA. The extensive research in the field of HR accounting since the late 1960s till date attributes to the fact that human resource measurement is one of the most difficult and challenging aspect in the entire accounting arena (Lama, 2012). The recent research in this area attempts to distinguish economic values attributable to the human resources of a firm from the values attributable to other components of goodwill (Spiceland and Zaunbrecher, 1976).

The development of HRA as a systematic and detailed academic activity, according to Eric G Falmholtz (1999) began in sixties. He divides the development into five stages. These are:

First stage (1960-66): This marks the beginning of academic interest in the area of HRA. However, the focus was primarily on deriving HRA concepts from other studies like the economic theory of capital, psychological theories of leadership- effectiveness, the emerging concepts of human resource as different from personnel or human relations; as well as the measurement of corporate goodwill.

Second stage (1966-71): The focus here was more on developing and validating different models for HRA. These models covered both costs and the monetary and non-monetary value of HR. The aim was to develop some tools that would help the organisations in assessing and managing their human resource/asset in a more realistic manner. One of the earliest studies here was that of Roger Hermanson, who as part of his Ph.D. studied the problem of measuring the value of human assets as an element of goodwill. Inspired by his work, a number of research projects were undertaken by the researchers to develop the concepts and methods of accounting for human resource.

Third Stage (1971-76): This period was marked by a widespread interest in the field of HRA leading to a rapid growth of research in the area. The focus in most cases was on the issues of application of HRA in business organisations. R.G. Barry experiments contributed substantially during this stage.

Fourth Stage (1976-1980): This was a period of decline in the area of HRA primarily because the complex issues that needed to be explored required much deeper empirical research than was needed for the earlier simple models. The organisations, however, were not prepared to sponsor such research. They found the idea of HRA interesting but did not find much use in pumping in large sums or investing lot of time and energy in supporting the research.

Stage Five (1980 onwards) : There was a sudden renewal of interest in the field of HRA partly because most of the developed economies had shifted from manufacturing to service economies and realized the criticality of human asset for their organisations. Since the survival, growth and profits of the organisations were perceived to be dependent more on the intellectual assets of the companies than on the physical assets, the need was felt to have more accurate measures for HR costs, investments and value. An important outcome of this renewed interest was that unlike the previous decades, when the interests were mainly academic with some practical applications, from mid 90s the focus has been on greater application of HRA to business management.

Different types of models to suit the specific requirements of the organisations have been developed incorporating both the tangible and the intangible aspects. Also, larger number of organisations actually began to use HRA as part of their managerial and financial accounting practice.

1.5 Review of Literature:

Pyle (1970) suggests that primarily the cost approach to HRA is helpful for a manager in planning for the development of human assets and creation of favorable relationships with external parties. The author also highlights that if human resource accounting grows in acceptability to the point where it is incorporated into the audited financial statements, it can help the manager in the same manner as that of conventional financial reporting. Crumbley and Savich (1975) presents a feasible liquidity approach based upon a modification of the Bardahl formula with the use of HRA for use by service organizations. Spiceland and Zaunbrecher (1976) assert that reservation by economists concerning the treatment of humans as assets as being immoral or at least impractical relegated the topic to a dormant position for many years and further states that these reservations expressed in neo-classical economics will likely continue to help confine the effects of HRA to internal rather than external reporting purposes. Dermer and Siegel (1974) suggests that HRA systems should either make use of behavioral measures in accounting for HR or attempt to develop financial surrogates of the behavioral condition of an organization. Dittman, Juris and Revsine (1976) reveal that the greater the specificity of the training provided and the greater the mobility restriction to the human resource, the greater is the likelihood for asset creation. Ansari and Flamholtz (1978) reveal that Human Resource Accounting represents a major development in the adjustment of accounting to what has been called as 'post-industrial society'. Sinclair (1991) examines that the findings of his study support the findings of previous external accounting studies which indicated that human resource accounting information can affect decision making.

Flamholtz and Main (1999) reveal that the core strategic asset of enterprises as well as the foundation of the wealth of nations is human capital. Without the ability to measure these assets, their management is unlikely to be either rational or optimal. Lepak and Snell (1999) exemplify the alternative employment arrangements used by firms in allocating work. Further, the author reveals that human capital theory, transactions cost economics, and the resource based view of the firm all converge on two dimensions, i.e. the value and uniqueness of employee skills as primary determinants of a HR architecture. The author also argues that adopting an architectural perspective may help both academics and practitioners understand

which forms of human capital have the potential to be a source of competitive advantage at present and in the future. Flamholtz (2005) empirical investigation provides support for the notion that culture, or human capital of the third kind, is a significant component of overall financial success. Flamholtz (2009) examines the need for alternative measures of financial performance that can provide a real time indication of what is actually happening in organizations and highlights a framework that provides the context for these alternative measures and related empirical research. Lama (2012) reveal that unless a proactive role is taken by the domestic accounting standard boards and the IASB on the valuation of human resources no particular solution to the measurement problem of human resources can be arrived at.

1.6 Human Resource Accounting in Managerial Reporting and Decision-Making:

Accounting is basically entrusted with the task of providing information to the various users for making various decisions. Accounting for human resource too is done mainly to provide the quantitative information of the human resource in an organization for make decisions by the top level management. Human Resource Accounting provides the quantitative information about the value of the human assets, which helps the top level management to take decisions regarding the adequacy of human resources. (Parameswaran and Jothi, 2005). In order to measure the value of human resource various models have been developed over the past five decades and many of them have been reckoned and accepted by organizations of repute in India and abroad. Organizations like BHEL, SAIL, CCI, Infosys, etc. have accentuated the need and importance of human resource accounting and have depicted the worth of the human resource in the financial statements.

HRA proponents have offered many models as to how accounting may measure and report intellectually based investments as assets rather than expenses. One way to classify HRA models is the model's consistency with (1) an exchange value accounting based model, such as historical cost HRA (Flamholtz, 1985), versus (2) a less traditional, more institutional notion of the firm, such as defining the human resource asset as the discounted value of employees' future wages (Friedman & Lev 1974; Lev & Schwartz, 1971) (Stovall, 2001). The use of different models primarily the value-based models like the

Lev and Swertz Model, Hermanson's Model, etc. provides the general understanding on the value of human resource of an organization in a particular time frame. HRA can play a crucial role in internal managerial decision making, and HRA measures can be used to show that investments in a company's human resources may result in long-term profit for the company (Bullen, 2007). Some scholars also hold the view that the presence of skilled human resources adds to the goodwill of the company that facilitates the profitability and growth of a company. To measure human value as a part of goodwill, HRA was introduced into the accounting literature in the 1960s (Flamholtz, 1985). Human Resource Management decisions such as recruitment, selection, training, promotion, retirement, etc. can be easily forecasted using the value based models which primarily deal with finding the present value of all the future earnings and losses. Consistent and systematic HR accounting provides the necessary information to managers for making all kinds of decisions related to Human Resource. It has been felt during the last few decades that Companies are giving due importance to "intangible assets" and human capital and its various dimensions has been extensively explored during the last few decades. The critical success factors for many knowledge-based companies were a substantial presence of its highly skilled and intellectual workforce. Notwithstanding the fact that intangibles cannot be measured and assessed, Companies like Microsoft, Amgen and Intel that came into existence in the 1980s relied almost entirely on intellectual capital for their survival and profit and hence succeeded. Many Indian companies like Infosys, NIIT, CCI, etc. also attribute its successes mainly to the human capital it possesses and understands the need to value the most important asset in their financial statements. Infosys Technologies Limited is one of the largest Indian IT companies in India. At Infosys, employees are considered as the most important assets. The company strongly believes that the quality and level of service that its professionals deliver are among the highest in the global technology services industry. Infosys uses the Lev and Schwartz model to measure the value of human resource. Table 1.1 depicts the presentation of human resource by Infosys in the financial statements:

Table 1.1

Balance Sheet (Including Intangible Assets) of Infosys (March 2003 – March 2009)							
As on March 31 (In Cr.)							
Particulars	2003	2004	2005	2006	2007	2008	2009
Source of Funds							
Share Capital	33	33	135	138	286	286	286
Reserves and surplus							
Capital Reserves – intangible assets	17,905	32,541	42,487	69,552	89,069	1,30,684	1,34,478
Other reserves	2,827	3,216	5,182	6,828	10,969	13,509	17,968
Minority interest / Preference share	-	93 (pre.sh)	0.14	68	4	-	-
	20,765	32,668	47,806	76,586	1,00,328	1,44,479	1,52,732
Applications of Funds							
Fixed Assets	772.72	1,031	1,574	2,226	3,771	4,777	5,354
Intangible assets							
Brand value	7,488	8,185	14,153	22,915	31,617	31,863	32,345
Human Resources	10,417	21,139	28,334	46,637	57,452	98,821	1,02,133
	17,905	29,324	42,487	69,552	89,069	1,30,684	1,34,478
Investments	33	945	1,210	755	25	72	---
Deferred tax assets	36	39	44	65	92	119	126
Current assets, loans and advances	2,721	3,233	3,922	6,334	9,521	13,018	16,646
Less: current liabilities and provisions	703	1,907	1,432	2,346	2,150	4,191	3,872
Net current assets	2,018	1,326	2,490	3,988	7,371	8,827	12,774
	20,765	32,668	47,806	76,586	1,00,328	1,44,429	1,52,732
Source: Annual Report of Infosys 2002-03 to 2008-09							

1.7 Objectives of Human Resource Accounting:

Table 1.2

Internal Objectives	External Objectives
1. To provide quantitative information on human resource for managerial decision making regarding acquiring, developing, allocating, and maintaining human resources so as to attain cost-effective organizational objectives.	1. To communicate the worth of human resources to the organization & the society at large.
2. To identify the various skills, competencies and expertise of human resource available within the organization.	2. To provide information to investors and potential investors about the capabilities of the organization.
3. To identify the most appropriate person/s for doing a particular tasks.	3. To enhance the credibility of an organization in order to attract more business, customers and clients
4. To determine the return on investment on human resources.	4. To keep a close watch with the competitors.
5. To highlight the limitations of gap in skill and competency level of the human resource in an organization	5. To attract more efficient and competent human resource from the market/industry.
6. To assist in planning for career progression, succession, training or development and knowledge management.	6. To assist the different external users to make decisions by highlighting the worth of human resource.

1.8 Advantages of Human Resource Accounting:

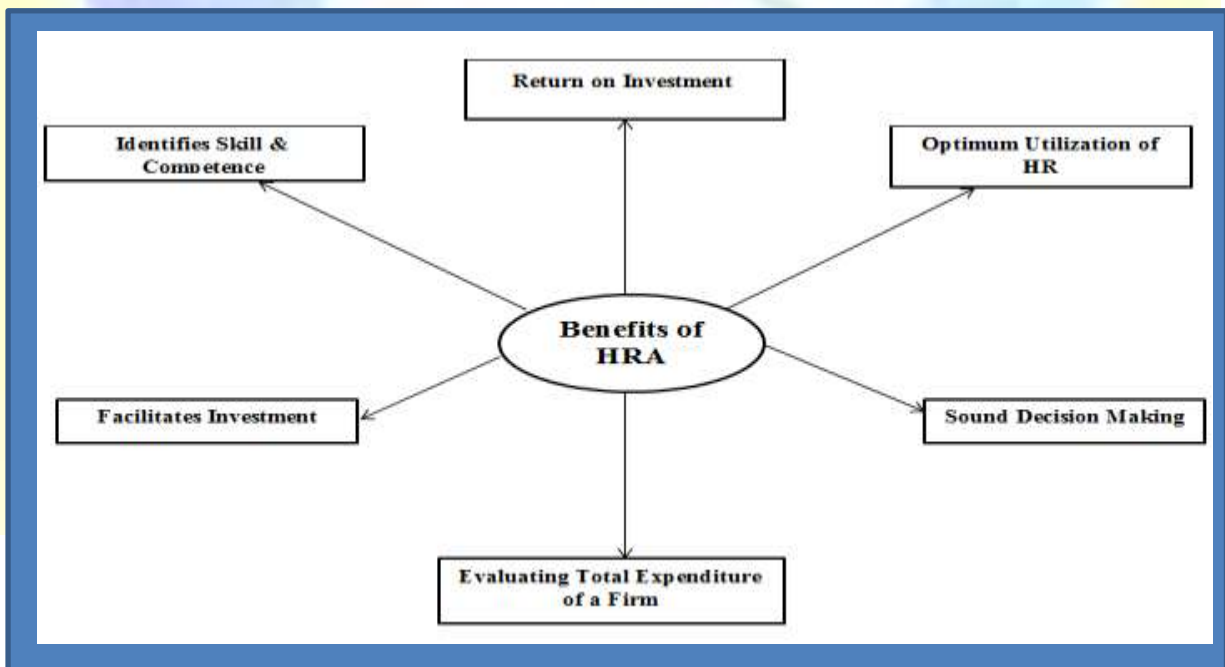
- Human Resource Accounting helps the management in the optimum utilization of human resources.
- It helps in planning, supervising, directing and staffing the human resource. It assists in

taking sound decision with regard to recruitment, selection, training, promotion and retrenchment of human resources.

- It assists the firm in evaluating the total expenditure that the firm has incurred for training and development schemes for its employees in terms of the benefits derived by the firm.
- It helps to reveal the gap in skills and competence among the employees in an organization and identifies the most appropriate person for particular tasks.
- The return on investment can realistically be calculated only when the investment on human resources is taken into account.
- It facilitates investment by providing information to investors about the achievements and capabilities of an organization. HRA is also helpful in presenting a sound image of the company facilitating and attracting new faces and increasing the retention of existing staff.

Fig. 1.1

Benefits of Human Resource Accounting



1.9 Limitations of Human Resource Accounting:

- Human being is mobile. They cannot be owned or retained like other physical assets. Hence valuing human resource seems to be unrealistic.
- There is no proper clear-cut and specific procedure or guidelines for finding cost and value of human resources of an organization.
- There is no generally accepted principle which makes it mandatory for companies to disclose its human resource in the balance sheet.
- There is no consensus among the professionals with regard to the valuation of human resources as the valuation depends on a large number of abstract factors not measurable in precise monetary terms. Hence, the valuation lacks objectivity and preciseness.
- In spite of all its significance and necessity, tax laws do not recognize human beings as asset. Hence, human resource accounting remains merely as a theoretical concept.

1.10 Conclusion:

Human Resource Accounting being a relatively new area in accounting has a great potential for further research. Many issues related to the HRA need further analysis and deliberations. The measurement aspect of the HRA is one area which needs a thoughtful attention. This paper has only highlighted the meaning, relevance, historical background, and the prospects and challenges of human resource accounting. One of the intriguing issues in accounting for human resource is the valuation of human resource. Indeed the of human resource is important for controlling the human resource and making proper decisions by the organization but the measurement of human resource is spurred by the plethora of complexities. The recent developments of valuation models have failed to give the proper justification of measurement of human resource, and hence more research and universal applicability of accounting for human resource is to be facilitated.

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