

ACCOUNTING TREATMENT OF HUMAN RESOURCE AS AN ASSETS IN THE COMPANIES

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Abstract

History of civilization and economic development is a proof to the fact that human resource is the most precious capital resource of any organization. With the overall transition from manufacturing to service sector, most of the economies in the world have felt need of evaluating the economic value of human assets. The academic application of HRA finds its roots in sixties. Later in eighties, a number of organization started applying various models of human resource accounting in their regular accounting practices. This paper focuses on the brief history and the popular models of evaluating the value of human resource in the organization.

Keywords: human resource accounting, human assets, human capital, intellectual capita.

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Introduction

Human resource accounting as important assets of the business enterprise and since they play a vital in the development activities and good decision making process of the enterprise, the need for the accounting of the human resource has arisen. In current practice,

Concept of HRA

According to the American Accounting Association's Committee on Human Resource Accounting (1973), "It is the process of identifying and measuring data about human resources and communicating this information to interested parties." Thus, HRA involves measurement of all the costs related with the employees such as expenses incurred for recruitment, placement, training, development etc. Moreover, it includes the quantification of the economic value of the employees. RansisLikert, who is famous for his contribution in the field of leadership and management, says that the role of HRA in any organization can be described as follows:

- It provides the information regarding cost of recruitment, selection, placement, training etc. which helps management in decision-making.
- The analysis of the information provided by HRA can help in attaining cost-effectiveness.
- It provides the strong basis for controlling the human-assets.
- It helps in the development of management principles by classifying the financial consequences of various practices.

Thus, HRA can be said a technique that assists management for the effective human resource management as well as in achieving the desired goals of the organization.

The current environment having wide acceptance of International Financial Reporting Standards (IFRS) have encouraged the consideration of non-traditional approach towards the human resources. There is a possibility that future financial reports may include more and more non-traditional measurements such as value calculated of human resources using various HRA models.

History of HRA

The development of HRA ha passed through five stages a follow:

1960-66	Derivation of basic HRA concepts from related bodies of theory.
1967-70	Basic academic research developing measurement models.
1971-77	Rapid growth of interest in HRA
1978-80	Period of declining interest in academia and corporations
1981 onwards	Renewed international interest in HRA theory and practice

Stage-1: (1960-1966)

In this period, the HRA concepts were primarily derived from other management studies such as psychological theories of leadership, economic theory of capital, the concepts of human resources etc. This was the beginning of the academic interest in HRA.

Stage-2: (1966-1971)

During this era, the main concentration was on developing the various models of HRA. There was a need of HRA models, which could help the management bodies in assessing and managing the human resources of their respective firms. Especially, a number of research projects were undertaken to develop the methods and models of HRA, by the researchers being inspired by Roger Hermanson.

Stage-3: (1971-1976)

There was a rapid growth of research in the field of HRA during these years. The prime focus was on the problems of application of HRA in various organizations

Stage-4: (1976-1980)

The issues related to application of HRA were being more and more critical and needed much wider and deeper researches in this field. Though the organizations were impressed with HRA, they didn't find it needful to invest big amounts in this type of researches. So, the progress of this concept was slow during these years.

Stage-5: (1980 onwards)

After 1980, more and more economies were shifting from manufacturing to service economies. They felt the need for having consideration towards human assets. This change was obvious because the growth and profits of most of organizations was being more and more dependent on the intellectual assets than on the physical assets. So there was a sudden zoom in attention towards the HRA after 1980.

This resulted in the shift of focus from the academic application to the greater application of HRA to management. Today, the intellectual capital is believed to be the strategic resources and therefore, the clear estimation of their value is now very important. The increased pressure of ethical issues and codes of conduct demanding for transparency in accounting have helped the need to develop the methods of measuring value of human assets.

In india reporting practices of HRA is very low. Some companies do report in their annual reports in chairman's report or Directors report. The reporting of HRA is some sentences. Some companies give information about No. of employees working in the organization, how many working hours have lost.

It has been revealed by the researchers conducted from time to time in some public sector companies and private sector companies that there is systematic approach for HRA and reporting in their annual reports.

- ❖ Bharat Heavy chemicals Ltd (BHEL)
- ❖ Oil India Ltd (OIL)
- ❖ Steel Authority of India Ltd (SAIL)
- ❖ Hindustan Lever Ltd (HLL)
- ❖ TELCO Ltd
- ❖ Infosys

Techniques of HRA evaluation/ Models

Human resource valuation models can be explained in two ways:

1. Monetary Models
2. Non-Monetary Models

1. Monetary Models

The models which are constructed with monetary variables are called monetary models. These are a number of approaches have been developed and suggested for the measurement and valuation of human resource. These approaches may broadly be classified in to two types.

- (A) Cost based model
- (B) Value based model
- (A) **Cost based model**

There are two type costs that are of special importance in HRA fist one is Historical cost and second is replacement cost. The monetary approaches to the measurement of human resource cost may be based upon either historical cost or replacement cost or opportunity cost. These approaches are discussed as below.

I. Historical cost Approach

According to this approach the actual cost incurred on recruiting, selecting, training, placing and developing the human resource of an enterprise are capitalized and written off over the expected useful life of human resource.

II. Replacement cost approach

The replacement cost means the cost that would have to be incurred if present employees are to be replaced. If an employee leaves the organisation, various costs of recruitment, selection, placement, orientation and training would have to be incurred in order to replace him. In the sense, replacement costs can be viewed as reprenting a bridge between historical cost approaches and economic value approaches and economic value approaches.

III. Opportunity cost approach

This approach has been suggested by Hekimian and Jones. It values human resource on the basis of the economic concept of opportunity cost. The opportunity cost is linked with scarcity. A human resource asset has a value only when it is scarce i.e. its employment in one division is possible and not in another division. “The investment center manager will bid for the scarce employees they need to recruit. These “scarce” employees come from within the firm and include only those who are the subject of recruitment request made by an investment center manager. In other word, employees not considered “scarce” are not included in the human asset base of organization”

- (B) **Value based model**

Another important approach to the evaluation of human resource assets is to calculate their economic values. This concept is based on the view that difference in present and future earnings of two similar firms is due to the difference in their human organization. The economic value of the firm can be determined by obtaining the present value of future earnings.

There are several models given by experts to assess the value of an individual.

I. Flamholtz's model of determinants of individual value to formal organisations:

Flamholtz says that the value of an individual is the present worth of the services that he is likely to extract to the organization in future. The present cumulative value of all the possible services that he may be render during his association with the organization is the value of that individual. This value has two dimensions.

The first is the expected conditional value of the individual. It means the amount that the organization could potentially realize from the services of the individual during his productive service life with the organization.

The second one is the expected realizable value. It means the expected conditional value of the probability that the individual will remain in the organization during his productive service life.

II. Flamholtz's stochastic rewards valuation model

Stochastic process means the progress of an individual through organisational roles during his service life. This model directly measures an individual's conditional value and expected realizable value. This model assumes that an individual generates value as he takes different roles in the organisation. An individual's expected conditional value and expected realizable value will be equal, if he is certain to remain in the organisation in the predetermined roles throughout his expected service life.

III. Lev and Schwartz model

This model is also known as compensation model and capitalization of salary model. They suggest the use of a person's future compensation as a suggorgate of his or value. Accordingly, "the value of human capital embodied in a person of age x is the present value of his remaining future earning form employment." This valuation model is expressed as:

$$V_Z = \sum_{t=2}^T \frac{I(t)}{(1+r)^{t-z}}$$

Where V_Z = the human capital value of a person Z year old

$I(t)$ = the person's annual earning up to retirement.

r = A discount rate specific to the employee

t = retirement age.

Because V_Z is an ex-part value, given that $I(t)$ is obtained only after retirement and because V_Z ignore the possibility of death before retirement age they refined the valuation model as follows:

$$E(V_T) = \sum_{t=Z}^T P_Z(t+1) \sum_{i=2}^t \frac{I_i}{(1+r)^{t-z}}$$

Where I_i = the future annual earnings

$E(V_T)$ = the expected value of a person's human asset

$P_Z(t)$ = the probability of a person dying at age t

2. Non-Monetary Models

There are several non-monetary measures that assess the economic value of human resources, but not in terms of money. They depend on various ratings and rankings. Below are given the non-monetary measures:

- (a) **The skills inventory:** It is a listing of the education, skills and experience of human resources.
- (b) **Performance evaluation:** It includes ratings and rankings which reflects an individual's performance.
- (c) **Assessment of potential:** It measures an individual's capacity of promotion and development. 'Trait approach' is used here to assess the potential of the individual.

(d) **Attitude measurement:** It assesses the individual's attitude towards the job, work and organization and determines the job-satisfaction or dissatisfaction.

The field of Human Resource Accounting is still developing and the new models are being created to fulfill the need of having a better approach of assessing the value of human resources.

COMPARISON OF HRA MODELS

The cost models of HRA fail to recognize the factors which determine the economic value of human resources. Also no serious effort is made in these models to identify factors which can enhance the value of human resources. The historical cost model resources on the basis of capital cost incurred to acquire and develop these resources. Since this model fails to recognize the economic value of human resources of an organization, the data generated through this model is too little significance for making decisions regarding matters relating to human resource development. The replacement cost model seeks to incorporate the current value of company's human resources in its financial statements. However this model cannot be used in practice as it is really difficult to find identical replacements of existing employees. The opportunity cost model is based on the economist's concept of opportunity cost. This method can be used for computing the value of those employees only who can be employed on alternative jobs. This method fails to measure the value of those employees who are specialists in certain fields. From the above analysis it can be said that cost models of HRA are of little use in the process of Human Resource Development.

Among the present value models, the Lev and Schwartz Model and the Hermanson's Model do not make any serious attempt to identify factors determining the value of human resources. At the same time these models also fail to explain the factors which can improve the value of human resources. Both these models suggested using the future wages and salaries of employees of an organization as a surrogate of the value of its human resources. Both these models assume that wages and salaries paid to the employees fairly represent the contribution made by them to their organization. However in actual practice the things might be quiet different; as there are evidences that employees sometimes are not fairly compensated. Therefore the information

generated by the above two models cannot help the management in making HRD related decision to a significant extent.

The Flamholtz's Stochastic Rewards Valuation Model and Jaggi and Lau's model explain the factors determining the value of human resources to a considerable extent. These models also explain the factors which can improve the value of human resources. The Flamholtz's model focuses on individual employees for the measurement of human resources whereas Jaggi & Lau suggest the use of homogeneous groups of employees as the basis for the same. However there are a number of computational problems which make the practical use of these models a difficult proposition. An organization desirous of using these models for human resource valuation must create facilities for estimating the reliable value of variables determining the value of human resources. If this could be done the information so generated could be of considerable importance for making HRD related decisions.

A discussion of the HRA models reveals that there is not even a single model which fulfills all the requirements of a model which could help in the process of HRD. Certain models fail to recognize the factors determining the value of human resources whereas others have computational problems. Therefore, there is a need for great deal of research which could be of considerable help in the process of human resource development.

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