INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE, ECONOMICS & MANAGEMENT

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HUMAN RESOURCE ACCOUNTING: AN OVERVIEW

KAINAT SIDDIQUI
RESEARCH SCHOLAR
DEPARTMENT OF BUSINESS ADMINISTRATION
D.D.U. GORAKHPUR UNIVERSITY
GORAKHPUR

ABSTRACT

Despite the technological advancements and the increasing importance of computerization, human resources continue to play a dominating role in the effective use of physical and financial resources. The value of human resources is invaluable and cannot be measured accurately. In knowledge driven economies it becomes essential that human resources are recognized as an integral part of the total worth of an organization as they are the key elements of the knowledge economy. Management of human resources in any organizations is very much important from accounting point of view. Valuation of human resources, recording the valuation in accounts and fair disclosure of such information in financial statement are the demand of the stakeholders to enhance managerial performance and employees' productivity. Investment in developing human resources is not revenue expenditure. Its impact on developing the capability of employees provides benefits for a long period. There is a genuine need for reliable and complete information that can be used in improving and evaluating human resource management. In present paper an attempt has been made to bring out the significance of Human Resource Accounting (HRA). The study also presents the likely benefits that reporting human resource as assets will have to different users of companies' corporate financial reports and how it will be helpful for different users of accounting information for their day to day decision making. Finally, the paper will conclude by presenting a critical assessment of the concept of HRA thereby unveiling its strengths and weaknesses and recommendations will be made as to what steps should be taken by government and companies to make effective use of HRA in management of human resources.

KEYWORDS

accounting information, decision making, employees' productivity, human resources, human resource accounting.

INTRODUCTION

Human Resource Accounting (HRA) involves accounting for the company's management and employees as human capital that provides future benefits. In the HRA approach, expenditures related to human resources are reported as assets on the balance sheet as opposed to the traditional accounting approach which treats costs related to a company's human resources as expenses on the income statement that reduce profit. HRA is actually a part of social accounting in which accountants need to apply their specialized abilities to help find solutions to the social problems of employees. We know that accounting is a science of measurement, analysis and communication. The designing of proper accounting system for providing information to the stakeholders is also a difficult task. The information concerning human assets is more relevant to a great variety of decisions made by external and internal users. Accounting for human asset constitutes an explicit recognition of the premise that people are valuable organizational resources and an integral part of a mix of resources. The basic premises underlying the practices of human resource accounting are:

- People are valuable physical resources of an organization.
- The usefulness of HR as an organizational resource is determined by the management; and
- Information on investment and value of human resource is useful for decision making in the organization.

Objective of human resource accounting is to facilitate the management to get information on the cost and value of human resources which will enhance the quantity and quality of goods and services. It provides data to the interested persons about the cost of human resources and correspondingly comparing it with the benefit obtained out of its utilization. The human resource accounting is used to furnish cost value information for making proper and effective management decisions about acquiring, allocating, developing and maintaining human resources in order to achieve cost effective organizational objectives.

Further, it helps the organization in decision making in the various areas like Direct Recruitment vs. Promotion, Transfer vs. Retention, Retrenchment vs. Retention, Impact on budgetary controls of human relations and organizational behavior, decision on reallocation of plants, closing down existing units and developing overseas subsidiaries etc. It helps in evaluating the expenditure incurred for imparting further education and training in employees in terms of the benefits. It helps an organization to take managerial decisions based on the availability and the necessity of human resources. When the human resources are quantified, it gives the investors and other client true insight into the organization and its future potential. Proper valuation of human resources helps an organization to eliminate the negative effects of redundant labour.

LITERATURE REVIEW

Various researches have been done on Human Resource Accounting in India and abroad. A brief review of literature is presented below:

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 effect 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.

Batra (1996) calculated the HRA and auditing practices in selected public enterprises like BHEL, SAIL & CCI up to the period 1991-92. Primary and secondary data were collected for the purpose of study. This study suggested a model for measuring the value of human assets of these enterprises and found that HR valuation and audit activity could be helpful in improving the efficiency of human resources in the changing business scenario.

Compbell and Helleloid (2011) conducted a study to analyze the adoption of IFRS in the organization and HRM practices by global accounting firms. Theoretical framework was the base of the study. It was found that there is a need to be part of the discourse surrounding the possible U.S adoption of IFRS. It was suggested that if global accounting regulatory standards are adopted then it would be much easier for staff to work transnationally, and much easier to meet regulatory standards regarding supervision when audit work was performed in different countries.

Dawson (1994) studied the distinction between prescriptive and descriptive approaches with regard to human resource accounting. It was found that both approaches have a useful contribution to make but prescriptive approach should not be confused with low quality descriptive approaches and that while the latter are to be deplored the former have a valuable place in management research.

Elias (1976) attempted to provide framework for analyzing the behavioral aspects of accounting methods. It was found that HRA due to its behavioral impact had a distinct effect on decision making. It had a potential impact for both functional and dysfunctional consequences which were different depending on the circumstances and management philosophy. All expenditures related to HR were considered to have been made for the acquisition and maintenance of human assets and are therefore capitalized. It was suggested to consider sunk cost in the various analysis of the company.

Fleming (1977) assessed the behavioral implications if a value for employee is published as an asset on the balance-sheet. For the purpose of the study a survey was done on faculty members and students, which was based on a questionnaire. It was revealed that 43% of faculty and 38% of students were against the the

TJEstatement that placing a dollar value on human being is an insult to their dignity and an equal percentage of faculty felt that it was not only an insult but also a way treating people as slaves or machines. 85% of students were against the discloser of information publicly related with individual.

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 competencies for applying knowledge and skill for achieving the 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 the competencies.

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.

Kaur et. al. (2014) attempted to evaluate extent of HRA measurement and reporting practices of selected Indian companies. The study was aimed at analyzing these companies and ranks the companies on the basis of the extent of disclosure of HRA information in annual reports of companies. The study was based on exploratory research design and secondary data were collected for this purpose. It was revealed that measurements and reporting are highly subjective and the companies are trying to fit available model for the valuation of HR as per their own requirement.

Ratti (2012) calculated the value of human resources at different levels of organization and determined the human resource efficiency quotient taking the sample of fifteen companies for the measurement of human resources. Primary data were used in the study. It was revealed that the value of human resources did not depend upon the number of persons employed.

Stanko et. al. (2014) examined the history of human asset accounting and its feasibility in current financial reporting environments. Additionally, the importance of human asset accounting, different approaches toward human asset accounting, and how beneficial an accurate method could prove to be in financial reporting was demonstrated. It was revealed that as a foregoer to measurement the development of general quantitative & qualitative human capital disclosures, with real company examples, should be included in a company's sustainability reporting.

OBJECTIVES OF THE STUDY

1. To provide an overview of Human Resource Accounting.
2. To present the likely benefits that reporting human resource as assets will have to different users of companies' corporate financial reports and how it will be helpful for different users of accounting information for their day to day decision making.

RESEARCH METHODOLOGY

Secondary data is used for the purpose of the study by doing in depth literature review which is collected from websites, annual reports, journal and magazines, standard books, newspapers, previous research findings and from different libraries.

MODELS OF HRA

Quite a few models have been suggested from time to time for the measurement and valuation of human assets. Some of these models are briefly discussed below:

(A) COST BASED MODELS

(1) **CAPITALIZATION OF HISTORICAL COSTS**: Rensis Likert and his associates at R.G. Barry Corporation in Ohio, Columbia (USA) developed this model in 1967. It was first adopted for managers in 1968 and then extended to other employees of R.G. Barry Corporation The method involves capitalizing of all costs related with making an employee ready for providing services- recruitment, training, development etc. the sum of such costs for all the employees of the enterprise is taken to represent the total value of human resources. The value is amortized annually over the expected length of service of individual employees. The unamortized cost is shown as investment in human assets. If an employee leaves the firm(i.e human assets expire) before the expected service life period, the net asset value to that extent is charged to current revenue. This model satisfies the basic principle of matching cost and revenues. But historical costs are sunk costs and are irrelevant for decision making.

(2) **REPLACEMENT COST:** The Flamholtz model (1973): Replacement cost indicates the value of sacrifice that an enterprise has to make to replace its human resource by an identical one. Flamholtz has referred to two different concepts of replacement cost viz. 'individual replacement cost and positional replacement cost. The individual replacement cost refers to the cost that would have to be incurred to replace an individual by a substitute who can provide the same set of services as that of the individual being replaced. The positional replacement cost, on the other hand refers to the cost of replacing the set of services required of any incumbent in a defined position. Thus the positional replacement cost takes into account the position in the organization currently held by an employee and also future positions expected to be held by him.

(B) ECONOMIC VALUE MODELS

(1) **OPPORTUNITY COST:** The Hekimian and Jones Model (1967): This model uses the opportunity cost,that is the value of an employee in his alternative use, as a basis for estimating the value of human resources. The opportunity cost value may be established by competitive bidding within the firm, so that in effect, managers must bid for any scarce employee. A human asset will therefore have a value, only if it is a scarce resource, i.e. when its employment in one division denies it to another division.

(2) **DISCOUNTED WAGES AND SALARIES:** The Lev and Schwartz Model (1971): This model involves determining the value of human resources as the present value of estimated future earnings of employees (in the form of wages, salaries etc) discounted by the rate of return on investment (cost of capital). According to Lev and Schwartz, the value of human capital embodied in a person of age n is the present value of his remaining future earnings from employment. Their valuation model for a discrete income stream is given by the following:

(i) $\mathbf{Vn} = \sum_{t=n}^{T} \frac{I(t)}{(1+r)^{r-n}}$

Where,

Vn = the human capital value of a person n years old.

I(t) = the person's annual earnings upto retirement.

r = a discount rate specific to the person.

T = retirement age.

However the above expression is an ex-post computation of human capital value at any age of the person, since only after retirement can the series I(t) be known. Lev and Schwartz therefore converted their ex-post valuation model to an ex-ante model by replacing the observed (historical) values of I(t) with estimates of future annual earnings denoted by I*(t). Accordingly, the estimated value of human capital of a person years old is given by:

(ii) $V_n^* = \sum_{t=n}^{T} \frac{I*(t)}{(1+r)^{t-n}}$

Lev and Schwartz again pointed out the limitation of the above formulation in the sense that the above model ignored the possibility of death occurring prior to retirement age. They suggested that the death factor can be incorporated in the above model with some modification and accordingly they recommend the following expression for calculating the expected value of a person's human capital:

(iii) $E(V_n^*) = \sum_{t=n}^{T} P_n(t+1) \sum_{t=n}^{T} \frac{I_i^*}{(1+r)^{t-n}}$

Where P(t) is the probability of a person dying at age 't'.

(3) **STOCHASTIC PROCESS WITH SERVICE REWARDS:** Flamholtz (1971) advocated that an individual's value to an organization is determined by the services he is expected to render. An individual moves through a set of mutually exclusive organizational roles or service states during a time interval. Such movement can be estimated probabilistically. The expected service to be derived from an individual is given by:

(iv) $E(S) = \sum_{i=1}^{n} S_i P(S_i)$

Where S_i represent the quantity of services expected to be derived in each state and $P(S_i)$ is the probability that they will be obtained. However, economic valuation requires that the services of the individuals are presented in terms of a monetary equivalent. This monetary representation can be derived in one of the two ways:

(a) By determining the product of their quantity and price, and
(b) By calculating the income expected to be derived from their use.

The present worth of human capital may be derived by discounting the monetary equivalent of expected future services at a specified rate (e.g. interest rate).

(4) **VALUATION ON GROUP BASIS:** Jaggi and Lau Model: Jaggi and Lau realized that proper valuation of human resources is not possible unless the contributions of individuals as a group are taken into consideration. A group refers to the homogeneous employees whether working in the same department or division of the organization or not. An individual's expected service tenure in the organization is difficult to predict but on a group basis it is relatively easy to estimate the percentage of people in a group likely to leave the organization in future. This model attempted to calculate the present value of all existing employees in each rank. Such present value is measured with the help of the following steps:

(i) Ascertain the number of employees in each rank.
(ii) Estimate the probability that an employee will be in his rank within the organization or terminated/promoted in the next period. This probability will be estimated for a specified time period.
(iii) Ascertain the economic value of an employee in a specified rank during each time period
(iv) The present value of existing employees in each rank is obtained by multiplying the above three factors and applying an appropriate discount rate.

Jaggi and Lau tried to simplify the process of measuring the value of human resources by considering a group of employees as valuation base.

BENEFITS OF HRA

All the valuation methods above have certain disadvantages or limitations. Nevertheless, accounting for human resources can be of great importance to the organization and its stakeholders. Craft & Bimberg, despite their apprehension on Human Resource Accounting explained the benefits of HRA under three headings:

IN PERSONNEL MANAGEMENT: HRA could help the personnel manager make better use of the resources entrusted to him, in developing measurements of cost of hiring and training new employees which is ordinarily not shown in conventional financial reporting system.

IN LINE MANAGEMENT: HRA could also be used to inject additional inputs e.g. personnel costs and perhaps social-psychological data into the organizational internal planning and control systems.

BY INVESTORS: HRA could be integrated into reports designed for external use in evaluating economic condition of the firm (Craft & Bimberg, 1980). Gogo itemized some of the benefits of HRA to include:

- Proper integration of Return on Capital Employed (ROCE) in disclosure of the value of human resources in the long-term perspective of the business performance,
- The maintenance of detailed record relating to internal human resources will improve managerial decision-making process in Recruitment Vs Promotion, Transfer Vs Retention, Retrenchment Vs Retention,
- Identification of Human Resources as a valuable asset will prevent underuse and misuse through thoughtless and reckless transfers, demotions, lay-off and day-to-day maltreatment by supervisors and other superiors.
- Help in efficient allocation of resources in the economy
- Help in efficient use of Human Resources
- Help in proper understanding of the evil effects of avoidable labour unrest or disputes on the quality of internal human resources (Gogo, 1 987)

LIMITATIONS OF HRA

It is generally accepted that human resources are the most important to the success of every organization. However its inclusion in the balance sheet has been strongly denounced by certain authors. These people are usually regarded as non-advocates of HRA. Also certain authors, who even consider the feasibility of HRA, do so, however not without mentioning the limitations. According to Craft & Bimberg, many accountants have always been concerned about capitalizing on the balance sheet excessive amounts of outlays for intangibles, because many firms have had large," amount of these "assets" turning to be worthless. They caution accountants from considering an innovation which will increase the intangible assets on the corporate balance sheets, and that HRA should be considered only for internal use rather than for external purposes (Craft & Bimberg, 1980).

CHALLENGES IN THE ADOPTION OF HRA

It would have been much better if we could have such a well-developed and highly accepted model to recognize and report Human Resource in the Balance Sheet of an organization. Even though gradual development has been witnessed in this field, still the new approaches and models are being given. There are several methods and models currently in use to determine the value of an individual such as cost approach and the economic value approach. But none of these models is free from sizable limitations. Valuing human resource is not so easy rather it is very tough task because of various reasons like-There is no proper clear cut and specific procedure or guidelines for finding costs and value of human resources of an organization. The systems which are being adopted have certain drawbacks. Models so far developed reveals that without considering the regular pay amount no model for valuing human capital is yet possible. So any model adopted for computing human value will give the scope of fraudulently reporting moderately skilled persons as highly skilled by offering them a higher regular pay package. The period of existence of Human Resource is uncertain and hence valuing them under uncertainty in future seems to be unrealistic. The much needed empirical evidence is yet to be found to support the fact that HRA, as a tool of management facilitates better and effective management of human resources. Management can take their decision on performance measurement. As human resources are incapable of being owned, retained, and utilized, unlike the physical assets, there is a problem for the management to treat them as assets in the strict sense. There is a constant fear of opposition from the trade unions as placing a value on employees would make them claim rewards and compensations based on such valuations. In spite of all its significance and necessity, the Tax Laws don't recognize human beings as assets. There is no universally accepted method of the valuation of Human Resources. Owing to the rapid change in technology, human being may be replaced by technology to a large extend. For taking decisions we have Management Information System, Decision Support System, Executive Support System, Artificial intelligence. Self-created goodwill also brings benefit to the organization, but we don't show this goodwill as assets in the balance sheet. Employees of an organization are its resources or not are reflected in the statement of financial performance trough earning profit or incurrence of loss. The output of human skill is the research and development; costs incurred in relation to this are currently capitalized as per IAS 38. In case of operating lease, we use the capital assets of others and pay the charge for using it. Similarly, we are hiring the employees and paying for their skills. Evidence are there because of fraudulent activities of humans deployed which resulted in the collapsing of the organization. So how such human can be an asset to be recognized in the balance sheet? To apply HRA it is required to be backed by Human Resource Auditing.

IMPORTANCE AND IMPLICATIONS

The micro level (within organization) perspectives are directly linked to HRA, which, again, could be developed both for internal and external use, a tool for profiling the enterprise/organization. It is obvious that there is a strong connection between external and internal functions. They are not mutually exclusive; sometimes one may even be a prerequisite for the other. Below are some reasons why HRA is been considered as important aspect for decision making.

1. Acquisition and allocation of human resource and overcome the difficulties in providing sufficient information to investors with traditional financial statement.
2. Development and improvement of human resource and profile the enterprise and improve its image.
3. Acquisition & Development policy formulation and Branding among future employees.
4. Focus on employees as assets and redistribute social responsibilities between the public & the private sectors.
5. Retain qualified employees and rewarding them.
6. Overcome problems arising from the valuation of intangible assets.

HRA can be helpful for allocation decision by quantifying variables involved in this allocation and express them in monetary units. Assessing the value of a proposed investment (Resource allocation) and then estimating the cost of the proposed expenditure (Cost estimation). HRA can address the decisions by measuring expected rate of return on proposed investment. For policy formulation estimates of historical and current costs required, HRA can help management assess the tradeoffs between buy-produce, develop policy of personnel acquisition and assist them in conserving its human organization by providing an early warning system. It measures the productivity (performance) and ability of promotion of the people. Such decisions may include overall reward system i.e. compensation, promotion, performance appraisal etc. It can also measure the performance of human resource management by comparing actual cost with standards.

RECOMMENDATIONS

The findings of this study are of immense importance to both standard setters and organizations. The movement toward fair value accounting seen in recent years for international standards indicates a more sophisticated approach to the measurement of assets, tangible as well as intangible. The valuation and disclosure of human resource related information in the annual reports should be made mandatory by the government. Also a specific model acceptable to all companies should be developed and motivations for the same should be given to the companies in the form of tax exemptions and subsidies etc.

CONCLUSION

To overcome the difficulties in traditional balance sheets lot of work are being done at present by accounting, financing, investors' and others. Organizations such as the International Accounting Committee (IAS) and Federation do Experts Computable Europeans (FEE) are vigorous in this area. Assets are resources from which future economic value will flow to the entity. As an employee of an organization will not merely work for a single year, it seems rational to account for employee as an asset in the balance sheet on the ground that they will provide future economic benefit to the entity. Moreover, charging the cost of recruiting, training and development of the employee in the profit and loss account for a single period goes in contrary to the expense recognition principle of accounting. Like other physical assets as the incurrence of these costs gives benefit through more than one fiscal period, amortizing these costs over the benefit deriving period is highly accepted. So until and unless a sophisticated and accepted model for valuing human capital is developed, it will be worthwhile to capitalize and amortize the cost of recruiting, selecting, formal and informal training and, formal and informal familiarization. The amortization will be over the expected service period. This solution is in line with the existing historical cost approach. Given the view expressed by both academicians and policy makers that the traditional financial reporting system are insufficient to provide investors with value- relevant information, it may well be that in the future, the reporting of information related to Human resource accounting in the financial statements may be mandatory. Hence, the focus for policy should be to develop preeminent model for valuing Human capital; establish guidelines for reporting and encourage compliance with said guidelines.

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