



Accounting for Human Resources - An Emerging Concept in Modern Corporate World

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Globalization, Physical Assets, HRCA, HRVA, Corporate, IASB, Amortization, Assets, Acquisition, Investment, Retention, Turnover.

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ABSTRACT Human resource is the most significant part of any organization, as it makes sure that there exist a symbiosis between financial and all other physical resources towards the attainment of organizational objectives and goals. Traditionally, financial assets are accounted in the books of accounts as per the double entry system, but do not include the human asset. Although a lot of efforts have been made by many researchers in this arena, a proper/appropriate and fully reliable method of performance based on accounting in the Indian context is not yet available. The past few decades have witnessed a global transition from manufacturing to service based economies. In order to estimate and project the worth of the human capital, it is necessary that some method of quantifying the worth of the knowledge, motivation, skill, and contribution of the human elements as well as that of organizational processes, like recruitment, selection, training, etc which are used to build and support these human aspects, is properly developed. HRA denotes this process of quantification and measurement of human Resources. The physical assets like land, building, plant and machinery are recorded in the books of accounts at their cost price. Now, depreciation on these assets is considered as the cost for the particular year and debited to profit and loss accounts and the remaining balance is shown in the balance sheet as written down value of the assets. Hence, on similar lines the human resources should also be evaluated, recorded in the books, operated and disclosed in the financial statements. The basic objective of the paper is to study the human resources accounting practices, to identify the issues and challenges, to examine these issues and challenges and lastly, to give suggestions based on the findings.

1. Introduction

Human resource accounting is of recent origin and is struggling for acceptance. Human resource is the vital input of any organization in this era of globalization, as it pulls on all other physical and financial assets and resources towards the achievement of organizational goals. Human Resource Accounting is a process of identifying and measuring data about human resource and communicating this information to interested parties. Therefore, it is an attempt to identify and report investment made in resources of an organization that are not presently accounted for under conventional accounting practices. Moreover, human resource accounting helps to measure the value of employees, which helps the management take vital decisions related to human resources in order to increase production.

2. Methodology of the Study

Human resource accounting identifies, quantifies and reports the amount of expenditure incurred and the capital employed to recruit, train and familiarize and develop the human resources. So, the objective of this paper is to:

1. To study the Human Resources accounting practices
2. To identify the issues and challenges
3. To examine the issues and challenges
4. To give suggestions based on the findings of the study

The current accounting system is not able to provide the actual value of employee's capabilities and knowledge. This indirectly affects future investments of a company, as each year, the cost on human resource development and recruitment increases. The human resource accounting system generates information on various aspects of human resources (such as acquisition, development, allocation, utilization and replacement) in the same manner the financial accounting system is for physical assets.

2.1 Approaches to Human Resource Accounting

Sir William Petty was perhaps the first person to make an attempt to signify the HR accounting in around 1691. He treated the labour as the generators of wealth. Even Adam

Smith had recognized the investment on human resources. Consequently, a number of models or approaches have been developed and suggested for the measurement and valuation of human resources.

These approaches may broadly be classified into two types:

1. HR Cost Accounting (HRCA)
2. HR Value Accounting (HRVA)

HR Cost Accounting (HRCA) may be defined as the measurement and reporting of the costs incurred to acquire and develop people as organizational resources. It deals with accounting for investments made by an organization to the acquisition and development of human resource as well as the replacement cost of the people presently employed.

HR Value Accounting (HRVA) is the concept based on the view that difference in present and future earnings of two similar firms is due to the difference in their human capital or assets. The economic value of the firm can be determined by obtaining the present value of future earnings.

2.2 Major Issues of Human Resource Accounting

The following are the major issues which should be considered for implementation of HR accounting.

1. In the case of HR accounting, it is argued that it lacks symmetry with traditional resource as it cannot be included with in the traditional definition of an asset that of a human
2. There is a little agreement concerning the procedure in accounting for human assets. There are proponents and critics of the various approaches like cost and value approaches.
3. The historical cost approach to develop measures of HRA uses an amortization rate, which provides the figure of amortization to be charged to the profit and loss account every year.
4. Another issue which has not been settled so far is about

the rate at which the prospective stream of contribution is to be discounted or compounded to calculate its present and future value to the organization.

- The physical assets can be owned and traded by an organization but the human assets cannot and can be only utilized in this regard. The physical assets have some realizable value of retirement but the human resources don't have any such value.

2.3 The Challenges of Human Resource Accounting

- The ownership of human resources is practically impossible, therefore, it cannot be considered at par with other assets.
- The measurement of Human Resources is subjective as different firms will use different methods for this purpose. Till date there is no model for valuation of Human Assets, which is widely acceptable and used worldwide.
- It is not economical for small business units as it involves heavy costs if the firms desire to install the HR accounting package in their organization.
- The concept of human resource accounting is not recognized by Tax authorities and therefore, it has only academic utility.
- There are a number of specific objective procedures for the selection of the factors to be included in the valuation of human resources. Therefore the subjective approach of the value in their regard makes it less reliable.
- Employees and unions may not like the idea, because HRA may lead to division among the ranks of employees. A group of employees may be valued lower than their real worth owing to reasons beyond the control of management.
- There is no empirical evidence to support the idea that HRA is an effective tool to measure the economic value of people to their organization. There is very little data to support the contention that it facilitates better and effective management of human resource.

2.4 Valuation Models

The basis of valuation is quite complicated. It requires use of assumptions regarding probable stay of the employee with the firm at different stages of his service. Three important models have been developed in this regard.

- Lev and Schwartz Model It is based on the assumption that the employee will stay with the firm till retirement.
- Eric Flamholtz Model It is based on the assumption and the probability of expected stay with the firm at different stages of services of each employee.
- JaggiLau's Model This model introduces "Group" as the basis of such calculation based on historical data regarding employee turnover patterns.

2.5 Practices and Perceptions

It is true that worldwide, knowledge has become the key de-

terminant for economic and business success but Indian companies focus on 'Return on Investment' (ROI), with very few concrete steps being taken to track 'Return on Knowledge' i.e. is measurement of abilities of all employees in a company, at every level, to produce value from their knowledge and capability. Infosys became the first software company to value the human resources in India. The company used the Lev & Schwartz model and valued its human resource assets at Rs 1.86 billion. Narayana Murthy, the Chairman and Managing Director of Infosys, said: "Comparing this figure over the years will tell us whether the value of our human resources is appreciating or not. For a knowledge intensive company like ours, that is vital information".

By adopting and implementing HRA in an organization, the following important information could be obtained:

- Cost per employee
- Human Capital Investment Ratio
- The amount of wealth created by each employee
- The profit created by each employee
- The ratio of salary paid to the total revenue generated
- Average salary of each employee
- Employee absenteeism rates
- Employee turnover rate and retention rate

The concept of HRA was not new in India. HRA was pioneered by the public sector companies like Bharat Heavy Electricals Ltd. (BHEL) and Steel Authority of India (SAIL) way back in the 1970s. However, the concept did not gain much popularity and acceptance during that time.

The ICAI has so far not formulated any specific accounting standard on measurement and reporting of cost and value of HR. The Indian Companies Act, 1956, also has not explicitly provided for disclosure of HR values in the financial statements of the companies.

3. Conclusion

In today's time of globalization and cost cuts, HRA would give an organization a correct vision towards the way forward. In the ultimate analysis it must be said that the concept of HRA has been appreciated by the accounting professionals and by and large its usefulness has also been acclaimed in the literature but unfortunately, its application has not flourished throughout the world. The International Accounting Standards Board (IASB), and the Accounting Standards Board (ASB), has not been able to formulate any specific accounting standards on measurement and reporting of cost and value of HR of an organization. Hence, considering the paramount importance of HRA, proper initiation should be taken by the Government as well as Professional Boards at the National and International levels in respect of formulation of specific accounting standard and suitable valuation models on the measurement and reporting of the value of HR.

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