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Accounting for Human Resources – Accountants Dilemma

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ABSTRACT *An accountant is a person who, among other things, professionally assigns measures (positive numbers) to objects and events in the field of economic activities. This side of the accounting activity is mysterious, scientific, responsible and extremely useful for society. Human Resource Accounting may be considered as a controversial subject. The knowledge economy of today has forced a paradigm shift in its valuation processes.*

In a conventional Balance Sheet, it is irony that the Human Resource that created wealth by utilizing Money, Machinery and Material does not find a place in the asset column of the Balance Sheet. Accountants, however, keeping in their minds the needs of developing the accountability of an economic event space, have to apply their own ways of thinking.

In this paper an attempt is made to focus on the practical difficulties faced by an accountant in Human Resource Valuation and Reporting.

Introduction

An accountant is a person who, among other things, professionally assigns measures (positive numbers) to objects and events in the field of economic activities. This side of the accounting activity is mysterious, scientific, responsible and extremely useful for society. At present financial reporting is a critical component of our capitalistic and democratic system. An accountant always views an asset (including human assets) as something with a value on the Balance Sheet but as yet, HR value does not appear as 'asset'. Applying accounting oriented formula to human resources needs to be explored very seriously. I believe that despite the many changes, in the future in a more intellectual society, an accountant will play an equally important role.

Human Capital

Human capital is the best company asset. The authors use the terms **human capital** and **intellectual capital** interchangeably. The knowledge economy of today has forced a paradigm shift in its valuation processes. Any CEO of the companies if asked, as to what they think provides a cutting-edge for their business. The answer from most of them is their Human Resource. Recently Infosys, Wipro, Reliance, Tata Steel, etc are the companies that have done very well in the stock market. What are these companies greatest asset? It is their Human Resource. In fact a 1999 Business Week article revealed that the valuation of Microsoft was superior to the sum total of the valuations of GM, Ford, Boeing, Deere, etc. And where are Microsoft's assets situated? It resides in the heads of its employee. Hence the traditional methods of valuing the company's assets have given way to valuation of its intangibles but the most prized resource – the company's human assets. Human Capital is increasingly being thought of as 'The foundational asset of the organization". In fact, the financial analysts give around one third of their estimates based on non-financial data.

To illustrate a common approach as applied by many authors, I first refer to a well known publication entitled intellectual Capital" by W.I. Hudson who also reported on Stewart's beliefs.

Let us refer to the author in order to show the dilemmas appearing in his consideration and

the issues he came up with. W.I. Hudson refers to the article by T.A. Stewart which appeared

in the June 3rd (1991) issue of *Fortune*. The article is entitled, Brain Power: How Intellectual

Capital Is Becoming America's Most Valuable Asset". Stewart says, Every *company depends increasingly on knowledge-patents, processes, management skills, technologies, information about customers and suppliers, and old-fashioned experience. Added together, this knowledge is intellectual capital. First, I wondered whether the word ,,sum" would be further clarified. I agree with Stewart that the intellectual capital of a firm is the sum of its individual parts, but the important question is how exactly is this sum to be taken?*

Second, as Hudson points out, a principal component is left out of Stewart's definition; the

missing element is one on which tactical enhancement of intellectual capital mainly depends.

In his definition intellectual capital is the combination of (a) genetic inheritance, (b) education, (c) experience, and (d) attitudes about life and business.

Each individual, according to Hudson, has a unique combination of these four factors.

Whatever total intellectual capital you have is in fact *singular,* its structure is unique.

Intellectual capital cannot be mass produced.

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HR in the Balance Sheet
Ultimate motive of any commercial venture is to earn profit. Profit making entity will definitely survive in any environment. All the interested parties, internal or external always look up the financial statements (profit /loss statement and the Balance Sheet) of the company to know the performance of the business. In a conventional Balance Sheet, it is irony that the Human Resource that created wealth by utilizing Money, Machinery and Material does not find a place in the asset column of the Balance Sheet.

HR Accounting
HR is above the simple number game. Human Resource may be thought of as the total knowledge, skills, creative abilities, talents and aptitudes of an organization's workforce. It is the sum total of inherent abilities, acquired knowledge and skills of the employees.

Attempts to account the HR are not new. It was Rensis Likert (Bowers, 1973) who initiated research into HR accounting in the sixties. He stressed the importance of long-term planning of human resources qualitative variables that result in greater benefits in the long run.

The cost of HR encompasses the following:
Cost of Recruiting: This is recruitment cost. It includes the publicity, mailing, rejected applicants and contracted applicants.

Cost of Selection: This is selection cost. The components are derived from the candidate's interview (travelling, lodging/boarding, organization of exams and selective tests).

Cost of Placing: This is the placement cost of new employee in their job.

Cost of Training: This is training cost of new and old employees.

Cost of Orientation: This is orientation cost generally includes adapting the new person to the organization as a whole and to a specific job.

Cost of Promotion: This is promotion cost of employee.

Cost of Improvement: This cost is for maintaining and improving the potential of every employee.

Cost of Substitution: This includes the exit costs of the leaving employee and recruiting and training of the replacement.

Opportunity Cost: It is the estimate of an asset value that is the target of an alternative use.

Exit Cost: This cost covers the loss efficiency prior to separation, job vacancy cost during the new search and termination pay.

Should HR be Accounted in the Asset Column?
One school of thought emphasizes the need for incorporating the asset value of HR in the balance sheet. Ripoll and Labatut (1994) identified two reasons for including the HR in accounting:

People are a valuable resource as long as they perform services that can be quantified.

The value of a person as a resource depends on how people are employed which is influenced by the management style.

It could be argued that when HR is the 'Creator' of all resources, who dares to quantify the 'Creator'? HR is not only the foundation of the edifice of business, it is the very 'Soul and Body' and 'Blood and Flesh' of the business. When one tries to quantify the HR on par with other resources it amounts to degradation of the HR. HR as an intangible asset changes its value according to the working environment of the business and the management policies.

An Accountant's Dilemma
When no established formula is available, the accountant is in a fix to evaluate the asset value of HR. Accountants, however, keeping in their minds the needs of developing the accountability of an economic event space, have to apply their own ways of thinking. Ways which are appropriate to accounting methodology of research.

Following data could be used for inclusion in the balance sheet:
FTEs: Full Time Equivalent staff

Headcount (H): Total FTEs at month end

Revenues (R): Total operating income in i.e. total sales

Expenses (E) : Operating expenditure excluding tax, interest etc.

Profit: (R – E)

Cash-like Rewards (C): Emoluments i.e. salaries, wages, overtime, bonuses and commissions.

Benefits (B): Other rewards that may or may not be taxed as 'benefit in kind' such as cars, pension, company loans etc.

Staffing Performance Indicators (Carme et al., 1999)
Internal

Sales per Employee: It indicates general employee productivity. Compare SPE this year over last year and with SPEs of rival organizations (benchmarking).

Recovery Rate: Aggregate compensation and benefits then divide by revenue. RR compares staffing cost with revenue delivered. A decreasing RR is desirable.

Utilization Percentage: It can be applied. e.g. to a consultancy company or school whose main business is allocating or selling the time of its staff.

External
Profit per Head: Like RoCE, shareholders and business analysts may use profit per head or profit before-tax-per head to focus on employee related costs and returns.

Compensation per Rupee profit: This evaluats profit against cost/employee rather that headcount. Interpretation can be difficult.

Personnel Services Expenses: It is the total operating expenses of the personnel/4RM section (personnel salaries, cost of facilities/equipment, training and development budgets, research/project expenditure, communications activities etc).

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Personnel Services Headcount: It is total FTE for the personnel/HR section in the calculation period.

Personnel Services Cost%: Divide PSE by total operating expenses (E) to identify trends and to influence budgeting processes.

Conclusion

Human Resource Accounting may be considered as a controversial subject. But the fact is that the inclusion of Human resource value on the asset side of the Balance Sheet is to be focused in the near future. Traditional accounting is no longer a well fitted system describing economic performance of such a firm. Also, the balance sheet does not show a true and fair view of this highly intellectual unit.

Accountants must provide relevant timeline information for decision making. Without appropriate information, risk increases as do demanded returns and the costs of capital. Accountants need to develop a wise accounting system, which we believe is a feasible system to design. But the predicament of the accountant still lingers, as there is no full-proof formula to quantify the omnipresent human resource without which no organization can come into existence .Human Resource Accounting is a new challenge for accountants and a positive response from the accounting world can be expected.

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