Human Resource Accounting in India – Accounting with Personnel Touch.

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Abstract

Human resources are considered as important assets and are different from the physical assets like plant and machinery and land and buildings. Physical assets do not have feelings and emotions, whereas human assets are subjected to various types of feelings and emotions. Human Resource Accounting (HRA) means accounting for people as original resources. It is the measurement of cost and value of people for an organization. Human Resource Accounting lays emphasis on human resource and considers human resources equally important as other resources. Human resources include personality, self-control, devotion, quality, skills, talents, and loyalty. The human resources should also be calculated and recorded and disclosed in the financial statements. The valuation of human resources has received widespread recognition. In course of time, various accounting models have been developed to evaluate human resources of an organization. Lev and Schwartz Model is widely used by many Indian firms.

This paper elaborately discusses on the concepts of HRA. It includes an introduction to the concept of human resource accounting, Core Values, significance, advantages, limitations, and various human resource accounting models, which have been implemented by a number of Indian enterprises to give information for human resource in their balance sheets.

Keywords : Human Resource Accounting, physical assets, feelings, emotions, resources, models.

Introduction

Human Resource Accounting is the process of identifying and measuring data about human resources and communicating this information to Stakeholders. It is an attempt to identify and report the investments made in Human Resources of an organisation that are presently not accounted for the Conventional Accounting Practices. Human Resource Accounting (HRA) is a new branch of accounting. It is based on the traditional concept that all expenditure of human capital formation is treated as a charge against the revenue of the period as it does not create any physical asset. But now a days, this concept has changed.

The modern view is that cost incurred on any asset as human resources need to be capitalized as it provides benefits measurable in monetary terms. Measurement of cost and value of the people in organizations is highly important, costs incurred in recruitment, selection; hiring, training and development of employees, along with their economic values are very much relevant for Human Resource Accounting.

Definitions :

1. ‘HRA is a process of identifying and measuring data about human resources and communicating this information to interested parties’.

- The American Association of Accountants (AAA)

2. 'Accounting for people as an organizational resource. It involves measuring the costs incurred by organizations to recruit, select, hire, train, and develop human assets. It also involves measuring the economic value of people to the organization'.

- Flamhoitz

3. "HRA is the measurement and quantification of human organizational inputs such as recruiting, training, experience and commitment".

- Stephen Knauf

4. "Human Resource Accounting is an attempt to identify and report investments made in human resources of an organisation that are presently not accounted for in conventional accounting practice. Basically it is an information system that tells the management what changes over time are occurring to the human resource in the business."

- Woodruff

5. "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 earning process and total assets."

- Davidson and Roman L Weel

6. "Human resource accounting is the measurement of the cost and value of the people for the organisation."

- Eric Flamholtz of university of California, Los Angeles

Research Methodology

Research Type : Descriptive

Research Data Base : The present study is based on secondary sources of data like books, journals, articles, research papers, and websites. The data collected is further refined and used for present research.

Objectives of the Study

1. To explain the concept of Human Resource Accounting practices in India.
2. To explain the need for Human Resource Accounting.
3. To know what are the models or approaches of Human Resource Accounting.
4. To examine the issues and challenges.

Need for Human Resource Accounting

- Human Resource Accounting system can be put to use for taking a variety of managerial decisions.
- It improves the quality of management.
- It avoids mismanagement of human resources.

- It helps the efficient allocation of resources.
- It increases human asset productivity.
- It provides a sound and effective basis of human assets control.
- It helps the management in the employment, locating and utilization of human resources.

Core Values (Objectives) of Human Resource Accounting

- To help in monitoring the utilization of human resources.
- To help in decision making and implementation of management principles by showing the financial significances of various choices and practices.
- To provide information of changes in the structure of manpower to the management.
- To provide qualitative information on human resources.
- To evaluate the return on investment on human capital.
- 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 organisational objectives.
- To have an analysis of the human assets i.e. whether such assets are conserved, depleted or appreciated.
- To ensure better human resource planning.

Advantages / Benefits of Human Resource Accounting

Human resource is the epicentre of human resource accounting.

- HRA provides useful information about the cost and value of human resources. It shows the strengths and weaknesses of human resources.
- It provides useful information for Manpower Planning and Decision Making.
- Human Resource Accounting provides useful information for making suitable personnel policies about promotion, favourable working environment, job satisfaction of employees, etc.
- Human Resource Accounting helps the organisation to make the optimum utilization of human resources.
- HRA helps the organisation to place "the right man in the right place in the right time in the right manner", depending on his qualifications, skills and abilities.
- HRA shows that the organisation focuses on employees and their welfare. This increases their confidence and it encourages them to work hard and attain the objectives of the organisation.
- Human Resource Accounting helps the company ascertain how much investment it has made on its employees and how much return it can expect from this investment.
- Human resource accounting provides valuable information to investors interested in making long term investments in service sector companies.

Models of Human Resource Accounting

1. **Replacement cost Model :** This model suggested by Hekimian and Jones, a simple variation of the 'Historical Cost Model' values HR at their current replacement cost instead of the cost of acquisition (i.e. historical cost). It is one of the several methods of determining the value of an insured item. It is of two types, individual placement cost and positional replacement cost. When the employee moves from one organization to another by leaving his present position, vacancy carrying and other relevant cost these types come under positional cost.
2. **Historical Cost Method :** This method was developed by William C.Pyle and adopted in 1969 by R.G.Barry Corporation, a leisure footwear company in Columbus, Ohio, USA. This method calculates cost incurred on selecting, recruiting, hiring, training & development of human resource. Historical cost does not generally reflect current market valuation. The unexpired costs are considered to be the investment in HR. Due to death or retirement of employee, human asset becomes useless and the remaining is charged off against the current earnings.
3. **Opportunity Cost Model :** It was first described in 1848 by French classical economist, expressing "the basic relationship between scarcity and choice". Opportunity Cost is not restricted to monetary or financial costs. "The cost of an alternative that must be sacrificed in order to pursue a certain action, the benefits you could have received by taking a substitute action." Opportunity cost is the maximum alternative earning that is earning if the productive capacity or asset is put to some alternative use. Quantifying HR value is difficult under this method.
4. **Stochastic Rewards Model :** This model was developed by Eric G.Flamholtz, recognized some major variables which helps to determine the value of an individual to the organization. He defined that movement of employees from one organization to the other organization as Stochastic Process. Eric G.Flamholtz suggested different approaches to assess the value of Human Resource of the company in this model. In order to measure human resource value the period any employee work in the organization, role of employee and value of present position are determined and discounted expedited service rewards. Flamholtz has measured the expected realizable value of an individual as :

$$E(RV) = \sum_{i=1}^{n} y \left[\left[\sum_{i=1}^{n} \left(R_t * \frac{P(R_t)}{(1+r)^t} \right) \right]\right]$$

Where

E(RV) = expected realisable value

Rt = Value derived by an organisation in each possible sate

P(Rt) = Probability that the organisation will have Rt

t = time

n = state of exist

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r = discount rate

i = 1,2,3

5. **Jaggi & Lau Model :** The model suggested by Jaggi and Lau is based on valuation of groups rather than individuals. A group implies homogeneous employees who may or may not belong to the same department or division. It might be difficult to forecast an individual's expected service tenure in the organisation or at a particular level or position, but on a group basis it is easier to determine the percentage of people in a particular group likely either to leave the firm during each of the forthcoming period, or to be promoted to higher levels. The model required the determination of Rank Transitional Matrix and the expected quantities of services for each rank of service. The matrix can be prepared from the historical personnel records of the employees available in the organisation. For the purpose of measurement of quantities of services, certain service or performance criterion is used.

   The equation for the computation of value of human resources of an organisation using Jaggi & Lau models is given below.

   TV = (N) rn (T)n(V)

   Where

   TV = Column vector indicating the current value of all current employees in each rank.

   (N) = Column Vector indicating the number of employees currently in each rank.

   n = time period

   r = Discount rate

   (T) = Rank transitional matrix indicating the probability that an employee will be in each rank within the organisation or terminated in the next period given his current rank.

   (V) = Column vector indicating the economic value of an employee of rank 1 during each period.

6. **The Lev and Schwartz Model :** This model developed in 1971 by Lev and Schwartz for valuing human resources. Lev & Schwartz advocated the estimation of future earnings during the remaining service life of the employee and then arriving at the present value by discounting the estimated earnings at the cost of capital. The assumptions in this method are realistic and scientific. It is based future earnings of an employee till his retirement. According to the model value of human assets is estimated for a person at a given age which is the present value of his remaining future earning from his employment and this represented by the following.

$$V_r = \sum_{t=r}^{T} \left\{ \frac{I(t)}{(1+r)^{t-r}} \right\}$$

Where

Vr= value of an individual or r years old

I(t)= the individual"s annual earnings up to retirements age

T= retirement age

r= discount rate specific to the person

t= active year of service

Limitations / Challenges of Human Resource Accounting

- There are no guidelines differentiating the "cost" and "value" of human resources. The existing valuation system suffers from many drawbacks. After valuing human resources in a specific way, many of them may leave the organisation.
- While valuing the human assets, demand for rewards and compensation might be higher.
- There is a possibility that HRA may lead to dehumanising and manipulating the employees.
- Tax laws do not recognize human assets and in that sense, it might be theoretical only.
- Human Resource Accounting is full of measurement issues.
- There is no universally accepted method of valuation of human resources.
- The ownership of human resources is practically impossible, therefore, it cannot be considered at par with other assets.

Conclusion

The Indian Companies Act does not provide any scope for providing any significant information about human resources in financial statements. Human Resource Accounting is the process of identifying and reporting the investments made in the Human Resources of an Organization that are presently not accounted for in the conventional accounting practices. The traditional accounting practices simply ignored the value of human factors in the organization and preferred to treat it as an expense and expendable factors. It is still extremely difficult to determine the actual value of the human resource of the organization through the different methods and accounting techniques have already proposed for human resource accounting. Even valuing human resources appear to be important to Indian organizations, most organizations do not value their human resources and plans to implement valuation of human resources are at a very early stage. So they should more concentrate on both theoretical as well as practical.

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