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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 are different from human assets in the sense that physical assets are things as thus do not have feelings and emotions and human assets include humans who have feelings and emotions. Human Resource Accounting (HRA) defines accounting for people as actual resources. It is used to measure the cost and value of people for an organization. Human Resource Accounting lays emphasis on human resources and considers human resources equally important as other resources. Human resources include personality, self-control, devotion, quality, skills, talents, and loyalty. In financial statements, the human resources are calculated, recorded and disclosed. The valuation of human resources is extremely important these days. In the course of time, various accounting models have been developed to evaluate the human resources of an organization. Most of the Indian firms use Lev and Schwartz Model.

This paper elaborately discusses the concepts of Human Resource Accounting. 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 resources in their balance sheets.

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

Introduction

The process of identifying and measuring data related to human resources and later communicating this information to the stakeholders is called Human Resource Accounting. It is an attempt to identify and report the investments made in Human Resources of an organization that is presently not accounted for the Conventional Accounting Practices. Human Resource Accounting (HRA) is an emerging branch of accounting that is being used extensively by various firms. This newly emerged branch of accounting relies on the traditional idea 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. However, this concept has changed.

The new perspective is that cost incurred on any asset as human resources need to be capitalized as it provides advantages which can be made quantifiable. Calculation of cost and value of human resource in organizations is highly significant, costs incurred in recruitment, selection, training, and development of employees, and their economic values are strongly applicable for Human Resource Accounting.

Definitions :

1. "Human Resource Accounting 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. "Human Resource Accounting 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 organization that is 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 organization."

   - Eric Flamholtz of University of California, Los Angeles

Research Methodology

Research Type: Descriptive

Research Database: 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 the 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 study the models related to 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 the mismanagement of human resources.
- It helps the efficient allocation of resources.
- It increases human asset productivity.
- It provides a sound and effective basis for 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 on changes in the structure of manpower to the management.
- To provide qualitative information on human resources.
- To evaluate the return on investment in human capital.
- To provide the cost value information to make effective management decisions related to acquiring, allocating, developing, and maintaining human resources. This can be used to achieve cost-effective organizational 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.

- Human Resource Accounting provides valuable information and a platform to conduct SWOC analysis as regards Human resources.
- It provides useful information for Manpower Planning and Decision Making.
- This type of accounting provides useful information for making suitable personnel policies about promotion, favourable working environment, job satisfaction of employees, etc.
- Human Resource Accounting helps the organization to make the optimum utilization of human resources.
- It facilitates the organization to place “the right man in the right place in the right time in the right manner”, depending on his qualifications, skills, and abilities.
- It shows that the organization focuses on employees and their welfare. This increases their confidence and it encourages them to work hard and attain the objectives of the organization.
- Human Resource Accounting helps the company to assess the ROI it has made on human resources.

- 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 has been created by Hekimian and Jones. It is slightly different from the 'Historical Cost Model'. It calculates HR at their current replacement cost instead of the cost of acquisition (i.e. historical cost). It is one of the several techniques of calculating the value of an insured item. There are two kinds: a) Individual placement cost and b) positional replacement cost. For example: When the employee moves from one organization to another by leaving his present position, the cost of vacancy and other related costs are positional cost.
2. **Historical Cost Method:** This method was initiated by William C.Pyle and practiced 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 the human resource. Historical cost does not generally reflect the current market valuation. The unexpired costs are considered to be an investment in HR. Due to the death or retirement of an employee, the 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 economists, 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." Calculating HR value is difficult under this method.
4. **Stochastic Rewards Model:** This model was founded by Eric G.Flamholtz. He identified major variables which help to find the value of an individual to the organization. He defined the movement of employees from one organization to the other organization as a Stochastic Process. Eric G.Flamholtz suggested various methods to calculate the value of Human resources of the company in this model. In order to measure human resource value the period of any employee work in the organization, the role of employee, and the value of the present position are determined and discounted expedited service rewards. Flamholtz has measured the expected realizable value of an individual as :

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

Where

E(RV) = expected realisable value

R_t = Value derived by an organisation in each possible sate

$P(R_t)$ = Probability that the organisation will have R_t

t = time

n = state of exist

r = discount rate

i = 1,2,3,….

5. **Jaggi & Lau Model:** This model is based on the valuation of groups rather than individuals. A group means 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 organization 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 periods or to be promoted to higher levels. The model requires the calculation of the Rank Transitional Matrix and the expected quantities of services for each rank of service. The matrix can be made from the historical personnel records of the employees available in the organization. For the purpose of measurement of quantities of services, certain service or performance criterion is used. The equation for the computation of the value of human resources of an organization 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 organization 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 was constituted in 1971 by Lev and Schwartz for valuing human resources. Lev & Schwartz expressed 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 on the future earnings of an employee until 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

V_r= value of an individual or r years old

I(t)= the individual's annual earnings up to retirements age

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T= retirement age

r= discount rate specific to the person

t= active year of service

Limitations / Challenges of Human Resource Accounting

- There are no rules differentiating the "cost" and "value" of human resources. The existing valuation system has a lot of demerits. After valuing human resources in a specific way, many of them may leave the organization.
- While calculating the human assets, demand for rewards and compensation might be more.
- There is a possibility that Human Resource Accounting may lead to dehumanizing 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 has not been considered in the system of accounting. The traditional accounting methods have overlooked the value of human factors in the organization and treated it as a cost. It is still extremely difficult to determine the actual value of the human resource of the organization through the different methods and accounting techniques that have already proposed for human resource accounting. Valuation and assessment of human resources is extremely important in the present structure of organizations. Plans to practice the valuation of human resources are at a beginning stage. So companies should concentrate on both, theory and practice.

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