

Human Resource Accounting - A New Dimension

Dr. Vedananda Prabhu P G

Assistant Professor

Govt First Grade College, Tarikere Affiliated to Kuvempu University Chikmagalur dist-577228

Abstract—Human resource is an ancient area of research in economics, as reflected by accounting treatments and it is most valuable resources of any organization. Hence every organization has a need to value the human resources for cost control and cost reduction. Human resource accounting (HRA) is an attempt to find measure and report the investment made in Human resources of an organization that are not presently accounted for under conventional accounting system. Organizations which require a considerable creativity or are science-based show an essential difference between market value and net book value. This difference is for intangible assets (including human skills). However, the Human Resources are yet to get recognition in Balance Sheet. It will help to charge human resource investment over a period of time. Organizations considers that human capital is a production cost so it is called an asset to the business. This study is conducted on accounting treatment for human resource accounting in organizations and discussed the efforts done in this field by researchers and models for valuation of human resources.

Index Terms—Human resource, human resource accounting, Human capital, models for valuation of HR, cost control and reduction.

I. INTRODUCTION

The past few decades have witnessed a global transition from manufacturing to service-based economies. Human elements are becoming more important input for the success of any corporate enterprise. It helps the management to frame policies for human resources. Human resource accounting is a process of identifying and measuring data about human resources. It means accounting for people as an organizational resource. Its basic purpose is to facilitate the effective management of human resources by providing information to acquire, develop, retain, utilize, and evaluate human

resources. and also involves measuring the economic value of people in the organization.

American Accounting Association (1980) has defined human resource accounting as follows: “Human resource accounting is the process of identifying and measuring data about human resources and communicating this information to interested parties”

This definition brings out the following important characteristic features of human resource accounting:

1. Valuation of human resources
2. Recording the valuation in the books of account
3. Disclosure of the information in the financial statements of the business.

Furthermore, some considers Human Resources as part of the intangible assets that are defined as either 'assets' or 'skills'. Assets include the intellectual property rights of patents, trademarks, copyright and registered designs, as well as contracts, trade secrets and databases. Intangible resources, which are skills or competencies, include the expertise of employees, suppliers, distributors and the culture of the organization, enabling it to cope with change, put the customer first, etc. In addition to being categorized as assets or skills, intangible resources may be categorized as being people dependent and people independent.

According to the Dictionary of economy Ed. Economics, Bucuresti, 1999, Resources are "all human, material, real and monetary elements that can be drawn and used in the production of economic goods to satisfy social needs" Human capital refers to a set of knowledge and competence, skills and training, innovation and capabilities, attitudes and skills, learning ability and motivation of the people who form the organization.

II. OBJECTIVES OF THE STUDY

There following summarize the most important objectives and purposes of HRA

- To review the available models of HRA and focus their appropriateness.
- To highlight the major characteristics of HRA along with the practical difficulties in implementations.
- To understand the needs and significance of HRA in the context of business performance measurement.
- To provide suggestions for developing such accounting practices in our business enterprises.
- It provides companies with information about the cost and value of its human resources.
- It provides companies with a guide for human resource decisions about acquiring, allocating, developing, and maintaining human resources to attain cost-effectiveness.
- It motivates managers and decision makers to look at decisions through a human resource point of view.
- It helps in the development of management principles by classifying the financial consequences of various practices (Sharma & Shukla, 2010).

III. METHODS AND PROCEDURES OF THE STUDY

The study is exploratory in nature based on extensive review of relevant studies done earlier and comparative pictures of the various aspects of HRA have been discussed to arrive at concluding remarks.

THE PREREQUISITES OF HUMAN RESOURCES ACCOUNTING

To apply HRA effectively in an organization, some resources and aspects must exist such as:

1. Management support from all levels to facilitate the process.
2. Time and both financial and human resources are needed for data collection, setting criteria, monitoring employees and going on in the process of HR valuing.

3. multi-functional team to work around in the process, as it needs variety of skills and way of thinking, and the process of measuring HR value is complicated.

4. Modern style HR team that embrace new changes and help other adapt with it.

5. Awareness campaigns from HR team to all employees about the valuation and to understand that they aren't going to be treated as objects, instead it's for their own sake.

6. Development of knowledge-based Methodologies for measuring.

7. The Company's size should be large, because it is not economical for small firms to apply it as it involves heavy costs (Narayan, 2010).

IV. HUMAN RESOURCE VALUATION METHODS AND MODELS

Human resources have been given much priority in the present service sector since identifies importance. In order to quantify the talent, skills and knowledge of employees or workforce various models were suggested. Some of the models to valuation of Human Resources are:

1.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. Historical cost method calculates actual cost incurred on recruiting, selecting, hiring and training and development of human resource (HR) which is equal to the value of workforce. The economic value of HR increases overtime and they gain experience. However, according to this model, the capital cost of HR decreases through amortization.

2. REPLACEMENT COST MODEL

According to this model the value of employee is estimated as the cost of replacement with a new employee of equivalent ability and efficiency. There are two costs, individual replacement cost and positional replacement cost in this model. Cost of recruiting, selecting, training and development and familiarization cost are account in individual replacement cost. When an employee present position to another or leave the organization cost of moving, vacancy carrying and other relevant costs reflect in

individual replacement cost. Positional replacement cost refers to the cost of filling different position in an organization and this model is highly subjective in nature.

3. STANDARD COST METHOD

This method has been developed by David Watson. Instead of using historical or replacement cost, many companies use standard cost for the valuation of human assets just as it is used for physical and financial assets. For using standard cost, employees of an organization are categorized into different groups based on their hierarchical positions. Standard cost is fixed for each category of employees and their value is calculated. This method is simple but does not take into account differences in employees put in the same group. In many cases, these differences may be quite vital.

4. PRESENT VALUE OF FUTURE EARNINGS

In this method, the future earnings of various groups of employees are estimated up to the age of their retirement and are discounted at a predetermined rate to obtain the present value of such earnings. This method is similar to the present value of future earnings used in the case of financial assets. However, this method does not give correct value of human assets as it does not measure their contributions to achieving organizational effectiveness.

5. EXPECTED REALIZABLE VALUE

The above methods discussed so far are based on cost consideration. Therefore, these methods may provide information for record purpose but do not reflect the true value of human assets. As against these methods, expected realizable value is based on the assumption, and this is true also. That there is no direct relationship between costs incurred on an individual and his value to the organization at a particular point of time. An individual's value to the organization can be defined as the present worth of the set of future services that he is expected to provide during the period he remains in the organization. Flam Holtz has given the variables affecting an individual's expected realizable value (IERV): individual conditional values and his likelihood of remaining in the organization. The former is a function of the individual's abilities and activation level, while the

latter is a function of such variable as job satisfaction, commitment, motivation, and other factors.

6. OPPORTUNITY COST MODEL

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. Because alternative use of HR within the organization is restricted and at the same time the use may not be identifiable in the real industrial environment.

7. STOCHASTIC REWARDS MODEL

Stochastic Rewards Model was developed by Eric G. Flam Holtz. This model identified some major variables that are help to determine the value of an individual to the organization. He determined the movement of employees from one organization to another as Stochastic Process. Eric G. Flam Holtz suggested different approaches to assess the value of HR of the company in this model. In order to quantify 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. To be precise an employee value is the product of individual conditional value and the profit that the individual offers to the organization in his/her service life. The conditional value comprises of productivity, transferability and prompt ability, skills and activation levels are also the determinants of an individual's conditional value. Flamholtz has measured the expected realizable value of an individual

8. SK. CHAKRA BORTY MODEL

Sk. Chakraborty of Indian institute of management Calcutta was the first Indian to attempt at valuation of resources. This model was similar to historical cost model, he noticed the cost of recruiting, learning, selection, training and development of each employee should considered for acquisition cost method of valuation and be treated as different revenue expenditure, this is subject to gradual written off. The balance, not the written off amount, should be shown separately in the balance sheet under the head of investment. To derive the present value of HR average feature tenure of employment of employee's and average future salary should discounted at an appropriate rate, it is shown as investment in the asset

side of balance sheet which is to be added to the capital employed in the liability side. Separate valuation can be made for managerial and non-managerial employee. The discount calculates the present value should take as expected average after tax return on capital employed, taken from the conventional balance sheet. The Chakraborty model basically considered a combination of acquisition method and present value.

9. LEV AND SCHWARTZ COMPENSATION MODEL

This model developed in 1971 by Lev and Schwartz for valuing human resources. Lev and Schwartz model is popular for calculating the value of HR used by public sector like SAIL and BHEL. 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. The model categorized whole work force in the various homogenous groups such as unskilled, semi-skilled, technical staff, managerial staff and so on and also into different age groups. By using the formula calculated average earnings for different classes and age groups and present value of HR. Lev & Schwartz also recommended the use of cost of capital of the organizations for the purpose of discounting the future earnings of the employees to arrive at the present value. They recognized individual employee's economic value to the organization.

V. CRITICISM ON HRA METHODS

Of all these methods, no single approach satisfies all organizational and professional interests. Firms engaging in the production of goods are different from those providing services and it may not be feasible to use the same Human Capital Accounting methods for them. For example, in an auditing firm a member of staff may be measured by the number of bills he/she generates in a month, while in a manufacturing industry, an employee cannot be directly associated with finished product, because such products pass through several hands and units. There is also the fear that Human Capital Accounting may be used by management to manipulate financial statements. With the collapse of Enron, WorldCom

and many others, due to the so-called creative accounting, many are of the view that Human Capital Accounting will give avenue to management to manipulate financial statements. Assigning value to employees could become very low motivator for some employees that thinks highly of their jobs than the value assigned by management.

VI. CONCLUSION

The central problem in HRA is recognition time and procedure of recognizing human resources. In this aspect proposed model provides some reasonable basis for recognition time and methodology to recognize it in books of account. Apart from that there is performance evaluation part which boosts morale of employee to show extra performance than normal one. This model also provides from Profit for unforeseen contingencies which protect company from unforeseen contingencies. This model does not discard Lev & Schwartz model but as a further step it provides entry for accounting for valuation of that model in books. In this model capital cost related to employees has been written over expected service life of employee which is one of the basic concepts of accounting. In this model whole of salary paid to employee has been charged in profit and loss A/C (Some part of it has been charged as depreciation/amortization of Human Asset, but this model is also having some limitations such as procedure for calculation can be cumbersome for each employee. While valuing human assets one should not lose sight of the fact that human beings are highly sensitive to external forces and human skills in an organization do not remain static. Skill formation, skill obsolescence or utilization may take a continuous process. Model proposed by me considers the fact that skills of employee are directly reflected in revenue of organization so why should not be Human Resource capitalized on this basis? In this method subjectiveness has been tried to avoid to the extent possible as actual sales figures has been taken but whole subjectiveness cannot be removed for Human Resource Asset.

Human resources are the energies, skills and knowledge of people which are applied to the production of goods or rendering useful services. It is the method of identifying and measuring data about human resources and communicating the information

to interested persons. While valuing human resources, emphasis can be given on acquisition costs, substitution costs, opportunity costs, replacement costs, economic value models, standard cost method, non-monetary measures etc. As per accounting standards disclosure of human resource accounting information follows historical cost approach to human asset valuation but this fails to show current cost. This is why economic value approach is more relevant. Still true cost of capital for discounting the net cash flows related to human assets is also difficult to find out. As a result, replacement cost valuation method and non-monetary behavioral approach might be suitable for valuation of human resources of an organization. Our Companies Act 1994 does not provide for valuation of human resources. As result disclosure of such information has become voluntary to our business management. There is need to prescribe the specific provisions for valuing human resources and disclosing the details of investment in human assets in the form of training and development expenses, salaries and other allowances etc. through annual reports.

REFERENCES

- [1] Sharma, S., & Shukla R.K. (2010). Application of human resources accounting in heavy industries. A Journal of Physical Sciences, Engineering and Technology, Retrieved from <http://www.smsitlucknow.com/journals/issue12.html>.
- [2] Narayan R. (2010). Human resource accounting: A new paradigm in the era of globalization, University of Calcutta, Kolkata, India. The Asian Journal of Management Research.
- [3] American Accounting Association, 1980, Terms and Concepts in Accounts, New York
- [4] Flam Holtz E. G., Kannan N. R. & Bullen, M.L. 2004, Human Resource Accounting today: Contributions, controversies and conclusions. Journal of Human Resource Costing & Accounting,
- [5] Dr. S Anilkumar, Dr. V Rajesh Kumar Dr. B mariyappa-2015, Advanced corporate accounting.
- [6] Various Websites