

REVIEW AND REFLECTIONS ON HUMAN RESOURCE ACCOUNTING – INDIAN PERSPECTIVE

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Abstract: Human Resource Accounting (HRA) is of recent origin and is major issue for research and analysis in management. Human resource has always been taken as a 'soft and light issue' whose contribution generally can not be measured in monetary terms. 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. HRA 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. Even today, when a good deal of work has been done in this field, it is very much unfortunate that there is not only set pattern or generally accepted method either for valuation of human resource or for their recording in books of accounts. Most of the Indian organizations do not value their human resources and plans to implement valuation of human resources are at a very early stage. In order to show greater progress, more needs to be done at both the theoretical and practical level. More search into valuation methods and models, and the practical implication of these, is needed together with the engagement of both human resource and accounting professionals in the debate on valuation and its implementation in practice. The present study focuses on approaches and various Human Resource Valuation models.

Keywords:

IndexTerms - Human Resource Accounting, Model, Approaches, Human Resource, Human Resource Information System.

I. INTRODUCTION

Employees are the most important assets of an enterprise and its success or failure depends on their qualifications and performance. The current accounting system is not able to provide the actual value of employee capabilities and knowledge. This indirectly affects future investments of a company, as each year the cost on human resource development and recruitment increases. Human Resource Accounting (HRA) is a direct part of the social accounting and aims to provide information on the evaluation of one of the most important components of the organization, namely human capital. Human resource thus requires the necessary attention in order to achieve corporate objectives.

Human Resource Accounting (HRA) or human resource valuation is the process of identifying, measuring data about human resources and communicating this information to interested parties. HRA helps to measure the value of employees, which helps management in decision making. HRA has very high significance not only for the management, but also for analyst and even for employees. It helps management in better utilization, planning, management of human resources in the organization.

NEED FOR HR ACCOUNTING -

- HRA communicates to the organization and public about the worth of human resources and also its proper allocation within the organization.
- The return on Investment on human capital is best evaluated through HRA.
- HRA is very much needed to provide effective and efficient management within the organization.
- It gives a platform to the management by providing factors for better decision-making for future investment.
- HR helps the management in developing principles by classifying the financial consequences of the various practices.
- If there is any change in the structure of manpower, it is HRA which provides information on it to the management. HRA provides qualitative information and also assess the cost incurred in personnel.

IMPORTANCE OF HRA -

The basic reason for developing HRA is to overcome problems arising from the valuation of intangible assets. We know that many organizations do not provide sufficient information to invest investors in traditional balance sheet and HRA is a device to overcome this difficulty. HRA provides an insight on employees as assets. HRA provides a profile to the enterprise and thus improves its image. HRA probes to retain intelligent human capital. The very importance of HRA in developing countries like India can be best judged through government report which shows that in India approximately 73% of National Income is utilized to compensate employees. In addition to wages and salaries, organizations often make other sizeable investments in their human resources. Despite all this, the concept of HRA in India is a recent phenomenon and struggling for its acceptance. In India, HRA has not been introduced so far as a system. The Indian companies act does not provide any scope for furnishing significant information in this regard in the financial statement. However, some public sectors like BHEL, Cement Corporation of India, ONGC, Engineers India Ltd, NTPC, MMTC, etc. have started disclosing some valuable information regarding human resources in their respective financial statements. The IT majors like Infosys also has applied HRA in a systematic manner. However until now, the efforts made are to value human resources and to integrate and present their value in the conventional financial

statements. But if the real ability of HRA is to be derived, the whole concept of preparing financial statement have to be prepared with a view which is based on human beings instead of the present view based on capital.

Human Resource Accounting in India

Chronological Order of Human Resources Accounting Introduction in India

Sl. No	Name of the Organization	HRA introduced in Year	Model
1	BHEL	1973-74	Lev and Schwartz Model
2	ONGC	1981-82	Lev and Schwartz Model
3	MMTC	1982-83	Lev and Schwartz Model
4	SAIL	1983-84	Lev and Schwartz Model with some refinements as suggested by Eric.G
5	NTPC	1984-85	Lev and Schwartz Model
6	INFOSYA	1995-96	Lev and Schwartz Model

Source: A Report on HRA from <http://www.indiamba.com>

REVIEW OF LITERATURE-

During the two last decades, several advocates of HRA, including Lev and Schwartz (1971), Flamholtz et al. (2003), Pekin Ogan (1988), Chris Dawson (1994), Flamholtz (2004), Elias (1972), Hendricks (1976), Herman and Mitchell (2008) and others have suggested that HRA could benefit external users of financial statements. External decision makers must know the changes in human assets in order to evaluate properly assets and income. The conventional accounting profit may be misstated and the asset base distorted, if the condition of human assets changes during the period (Flamholtz, 1999). Hendricks (1976) performed a study using accounting and finance students as subjects. His simulated investors made two stock investment/capital allocation decisions, one with and one without human resource cost data. In this research, HRA had a meaningful impact on adopted decisions statistically. Nabil Elias (1972) provided 2 groups of financial reports (one, traditional report and another, reports containing HRA information) in his research to the sample including accounting students, financial analysts and accountants. Research results showed that HRA information had meaningful impact on decisions statistically, although the relationship between HRA information and the adopted decisions was not strong. Schwan (1976) considered the effects of human resource cost measures on banker decision-making. He found that the inclusion of HRA data in published financial statements resulted in, one, significantly different ratings of management's preparedness to meet future challenges and opportunities and, two, statistically different predictions of a firm's net income. Tomassini (1977) provided to a sample comprising of accounting students, traditional financial information and information containing human resources accounting. HRA information led to remarkable differences in decision-making.

OBJECTIVES OF THE STUDY -

- To review the available literature on HRA.
- To study the HRA practices in India.
- To understand the needs and significance of HRA.
- To know HRA approaches followed by Indian companies.
- To provide suggestions for developing HRA in Indian context.

HRA APPROACHES -

Assigning money values to different dimensions of HR costs, investments and the worth of employees is the biggest challenge that the HRA is facing. HRA basically has two approaches.

1. The Cost Approach – This method is based on the costs incurred by the company with regard to an employee. Two types of costs are of special importance in HRA: original cost and replacement cost.

* **Original/ historical costs** of human resources are the sacrifice that was made to acquire and develop the resource. These include the costs of recruiting, selection, hiring, placement, orientation and on- the- job training.

* **The replacement cost** of human resources is the cost that would have to be incurred if present employees are to be replaced.

* Other cost methods that may be used are the standard cost method and the competitive method. In the standard cost method, the standard costs associated with the recruitment, hiring, training and developing per grade of employees are determined annually.

2. The Economic Value Approach – This method is based on the economic value of the human resources and their contribution to the company's benefits. The methods for calculating the economic value of individuals are two types- monetary and non-monetary methods.

HUMAN RESOURCE VALUATION APPROACHES FOLLOWED BY COMPANIES IN INDIA

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. 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 calculate 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.

$$V = \sum_{i=1}^n \left\{ N_i * \frac{AS_i}{(1+k)^n} \right\} + AC$$

Where
 V= Value of a category of employee
 N=Number of employees
 AS= average annual pay
 K= after tax return on capital employed
 i=1, 2, 3.....n years (average tenure of employed)

3. 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.

4. 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 a 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.

5. 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 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

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.

6. Stochastic Rewards Model -

Stochastic Rewards Model was developed by Eric G.Flamholtz. 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.Flamholtz 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 promotability, skills and activation levels are also the determinants of an individual`s conditional value.

Flamholtz has measured the expected realizable value of an individual as -

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

Where

E (RV) =expected realizable value
 Rt=Value derived by an organization in each possible state
 P (Rt) =Probability that the organization will have Rt
 t= time
 n= state of exit
 r= discount rate
 i = 1,2,3.....

SUGGESTIONS –

1. The government should made mandatory to value and discloses HR related information in its annual report.
2. To motivate companies for HRA, government should provide incentives like Subsidy, Tax exemption.
3. It is suggested to the company that beside technological up gradations and modernization, The company should also make efforts towards competency development.
4. The company should continue to work for developing capabilities and realization of best potential of its people.
5. The company should also take continuous efforts for active participation by employees, implanting a conducive ambience for exhibiting creativity and innovation by employees and ensuring a climate that reflects synergy and contagious enthusiasm has been at the core of HR initiatives and interventions.

CONCLUSION -

Human resource accounting is of recent origin and is struggling for acceptance. The HR Accounting system tries to evaluate the worth of human resources of an organization in a systematic manner and record them in the financial statement to communicate their worth with changes in time and result obtained from their utilization to the users of the financial statement. Hence, looking at the importance of HRA, now it is required under law and Government guidelines, for undertakings, to maintain a separate item in their balance sheet about such HR activities undertaken by them. Hopefully in future the HR practioners and the budding leaders of future enterprises would work together to use HRA in every organization, which has helped to a great extent in differentiating humans from mere operators of machines to intellectual capital. The journey has thus begun as HRA is in its infancy and there are miles to go. The Lev and Schwartz model was the popular and adopted with a little modification by Indian companies in India. Although, none of the Indian regulatory authorities has issued proper guidelines for valuation and reporting of human resources and its accounting and this might have created obstacles in the development of HRA practices in India.

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