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Human Resource Accounting: An Exemplary Case Study

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Abstract

Human resource is the most important asset for any company in the present competitive environment. The present article reviews the quantitative aspect of human resource and identifies its value to an organization, using the Lev and Schwartz model on a case study basis in one of the leading software firms in India, Infinity Technologies Ltd¹. There is new branch of accounting popularly known as human resource accounting (HRA) which measures data about human resources and communicate this information to the interested parties. It is found that measuring the economic value of people to organizations is a win-win situation both for employees and corporate in utilizing their real potential in the long run.

Keywords: Human resource accounting, software, asset, earnings, value

1. Introduction

Human resource is the most important resource (asset) who acts as a key player in the entire value chain of a company starting from idea generation, planning, execution stage and even beyond that. An organization may have abundant supply of financial and physical resources but may not utilize them effectively if it doesn't have valuable work force with it. Until few years back, human resource was a qualitative concept and there was no method to check the value of human resource to any organization. But due to its increasing importance over time, companies are realizing the necessity of keeping proper record and information about their human resource.

Financial statements are the primary source of information from where the performance and position of the resources held by an organization can be analyzed. Traditional accounting system only provides the financial information about the organisation and not about its human elements, which resulted into incomplete presentation of financial statements. This serious limitation of traditional accounting system was noticed in the late 1950s by behavioral scientists, economists and scholars in the area of accountancy. Their collective efforts have resulted into a new stream of accounting, called as human resource accounting (HRA).

Human Resource Accounting (HRA) has been defined by the Committee on Human Resource Accounting of the American Accounting Association as *"the process of identifying and measuring data about human resources and communicating this information to interested parties"* Basically, it involves measuring the cost incurred by business firms and other organizations to recruit, select, hire, train and develop human assets, and thereby deriving their economic value to organizations.

¹ The name of the company is disguised for data reasons.

HRA has not been introduced so far as a legal mandate in India. The Indian Companies Act 1956, or new Companies Act 2013 which govern the preparation of financial statements of companies in India are silent about the disclosure of human resource accounting in the statements and annual reports. However, few enlightened companies in India have voluntarily begun to include a statement of HRA in their annual reports. A leading public sector enterprise Bharat Heavy Electricals Ltd. had introduced HRA in its annual reports of the financial year 1974-75 for the first time in India. In the subsequent years, some public enterprises, such as ONGC, NTPC, MMTC, SAIL, EIL, PEC, HSL, MECON, OIL etc. and private companies, like TELCO, ACC, SPIC and ITL adopted HRA practice.

2. Lev and Schwartz Model

In Indian context present value of future earnings models (the Lev and Schwartz model) has an edge over the other models. This model has been widely adopted by Indian Companies, such as Infosys, DSR software Ltd., Satyam Computers, BHEL and SPIC. Some companies such as SAIL and CCI had adopted Lev and Schwartz model with refinement. For the computation of the value of human resource of an organization Brauch Lev and Aba Schwartz suggested the following formula:

$$V_T = I(t) / (1+r)^{t-T}$$

Where V_T = human capital value of a person T years old

$I(t)$ = person's annual earnings up to retirement

r = discount rate specific to person

T = retirement age

As per this formula the value of a person can be computed only after his retirement. Moreover, it ignores the possibility of death, occurring prior to retirement age. They refined their formula taking these aspects and presented in the following form:

$$E(V_y) = \sum P_y(t+1) \sum I(T)/(1+R)^{t-y}$$

where $E(V_y)$ is the expected value of a person human capital and P_y is the probability of a person's dying at age t .

The following are the steps followed in calculating the HRA value by Lev and Schwartz model:

- Classification of the entire labor force into certain homogeneous groups based on software professionals & support staff etc.
- Construction of average earning stream for each group.
- Discounting the average earnings at a predetermined rate in order to get present value of human resources of each group.
- Aggregation of the present value of different groups which represent the capitalized future earnings of the concern as a whole

An assumption that employees will not make role changes during their service in the enterprise is also followed in this model. The merit of this model is its objectivity in valuing HR value because it depends upon the present value of future earning capacity of an employee.

The objective that is to be achieved through this study: To develop a deep understanding of the HRA practices adopted by corporate, with case of ITL.

Valuation discussion

ITL adopted LEV and Schwartz Model for valuing its human resources on the following assumption:

- (i) Employee compensation includes all direct and indirect benefit earned in India and abroad.
- (ii) The incremental earning based on group/age have been considered
- (iii) Future earnings have been discounted at the cost of capital of 14.97%, 13.32%, 12.18%, 10.60% and 11.21% in the accounting year 2015-16, 2016-17, 2017-18, 2018-19, 2019-20.

1. It was given that in the year 2016 the total number of employees was 72,241 employees which increased to 130,820 in 2020 i.e., an increase to 181.09 % during the last five years. The number of software professional and support staff has increased to 181.66 % and 171.58 % respectively. It is clear that the number of HR has been continuously increasing.

2. Total employee cost has increased form Rs. 7,112 crores in 2016 to Rs. 14,856 crores in 2020 while the cost per employee was found Rs. 0.098 crore, Rs. 0.097 crore, Rs. 0.109 crore, Rs. 0.106 crore, Rs. 0.114 crore in the accounting years respectively. It is obvious that though total employee cost has increased by 208.89 % during the last five years, cost per employee has an increasing trend. There is an increase of about 15.35 % in cost per employee in the period of study.

3. As far as total human resource value is concerned, it has increased from Rs. 57,452 crore to Rs. 1,35,105 crores during the year 2016 to 2020, i.e., an increase of 235.16 %. Similarly the value of software professional and support staff has increased by 228.65% and 325.54% respectively. The value of human resources in each category shows continuous increase.

The Total income to human resource value ratio has shown a decline from 0.24 to 0.20 during the year 2016 to 2020 while value added to human resource value ratio has decreased from 0.21 to 0.19 during the same period. Similarly, return on human resource value has also a decline from 6.72% to 5.05 % in the period of study.

Table: Statement Showing Human Resource Accounting as per (Lev & Schwartz model)

Particulars	2020	2019	2018	2017	2016
Employees (no.)					
Software professionals	123811	106864	97349	85013	68156
Support	7009	6932	7501	6174	4085
Total	130820	113796	104850	91187	72241
Value of human resources					
Software professionals	122539	106173	95600	92331	53592
Support	12566	7114	6533	6490	3860
Total	135105	113287	102133	98821	57452
Rate Of Discounting	11.21%	10.60%	12.18%	13.32%	14.97%
Total income(1)	27501	22742	21693	16692	13893
Total employee cost(1)	14856	12093	11405	8878	7112
Value-added	25031	20935	19073	14820	11879
Net profit(1)	6823	6219	5988	4659	3861
Ratios					
Value of human resources per employee	1.03	1.00	0.97	1.08	0.80
Total income / human resources value (ratio)	0.20	0.20	0.21	0.17	0.24
Employee cost / human resources value (%)	11.00%	10.67%	11.17%	8.98%	12.38%
Value-added / human resources value (ratio)	0.19	0.18	0.19	0.15	0.21
Return on human resources value (%)	5.05%	5.49%	5.86%	4.71%	6.72%
Cost Per Employee (In Crores)	0.114	0.106	0.109	0.097	0.098

Conclusion

The rate of discounting future earnings of employees should be kept constant. However, if the discount rate has to be changed due to some reason, should be shown at the it new rate to make the data compatible and more useful for HR decision. Auditing of the information about HRA is essential and central to maintain the trustworthiness of the HR data. Also, while valuing human resources, various variables like human resources amortization, idle time, loyalty of employees should also be included and the information should be disclosed likewise.

In nutshell, the standards of valuation, disclosures and accounting of human resources should be standardized and clearly established by the ASB of the ICAI and it should be made mandatory to disclose the HRA practices.

