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Human Resource Accounting: A Study on Advances in Concepts, Methods and Applications of Human Resources Accounting

P. Bastin Arockia Raj¹

Assistant Professor (M.Com. M.Phil., MBA., SET)
Department of Business Administration
St. Joseph's College(Autonomous)
Tiruchirappalli, India

S. Arputharaj²

Assistant Professor (M.Com. M.Phil., NET)
Department of Business Administration
St. Joseph's College(Autonomous)
Tiruchirappalli, India

Abstract: Accounting is a man-made art and its principles and procedures have been evolved over a long period to aid business in reporting for the management and public. Of the four factors of production, viz., man, money, material and land, the last three of them are amenable to conventional accounting, but the first one, i.e., the human resource has not been subject to such accounting. Over the last two decades the idea of accounting for human resources is gaining active consideration. Basically, it is an information system that tells the management what changes overtime are occurring to the human resources of the business, and the cost and value of the human factor to the organization. The system may serve both the internal and external users, providing management with relevant data on which to base recruiting, training and other development decisions and supplying investors, lenders and other external users of financial statement with information concerning the investment in and utilization of human resources in the organization. Management of any concern continuously strives hard for obtaining maximum efficiency. In order to measure the effectiveness of any firm the normal method is to examine financial statements. These statements include balance sheets in which physical assets such as cash accounts receivables, inventory and plant are recorded. These statements normally do not mention the productive capacity of the workers or goodwill of the company. HRA is the art of valuing, recording and presenting systematically the work of human resources in the books of accounts of an organization. In this paper we would like discuss objectives, approaches, significance and various aspects Human Resource Accounting.

Keywords: Human Resource Accounting, Objectives, Approaches and Significance.

I. INTRODUCTION

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 day this concept has changed and the cost incurred on any asset should be capitalized as it yields benefits measurable in monetary terms. In 1960's the behavioral scientists attacked the conventional accounting practice for its failure to value the human resource of the organization along with other productive resources. They pointed out that the failure of accountants to value human resources was a serious handicap for effective management. As a consequence, valuation of human resources has received widespread recognition. In the course of time a number of accounting models have been developed to value and report human resources of an organization. In the management terminology this is called as Human Resource Accounting. Advocates of HRA consider the importance of the human element in organizations and the failure of conventional

accounting in dealing with it as an asset. Human Resource Accounting 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 day this concept has changed and the cost incurred on any asset should be capitalized as it yields benefits measurable in monetary term. Human Resource Accounting is the process of assigning, budgeting, and reporting the cost of human resources incurred in an organization, including wages and salaries and training expenses. Management of any concern continuously strives hard for obtaining maximum efficiency. In order to measure the effectiveness of any firm the normal method is to examine financial statements. These statements include balance sheets in which physical assets such as cash accounts receivables, inventory and plant are recorded. These statements normally do not mention the productive capacity of the workers or goodwill of the company. HRA is the art of valuing, recording and presenting systematically the work of human resources in the books of accounts of an organization

II. CONCEPT OF HUMAN RESOURCES ACCOUNTING

Human Resource Accounting means accounting for people as the organizational resources. It is the measurement of the cost and value of people to organizations. It involves measuring costs incurred by private firms and public sectors to recruit, select, hire, train and develop employees and judge their economic value to the organization.

“Human Resource Accounting is the process of identifying and measuring data about human resources and communicating this information to interested parties.”

“American Accounting Society Committee on HRA”

"Human resource accounting in the measurement of the cost and value is a term used to describe a variety of proposals that seek to report and emphasizes the importance of human resources knowledgeable, trained and loyal employees in a company's earning process and total 'assets'".

“Davidson”

“Human Resource Accounting is an attempt to identify and report investments made in human resources of an organization 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”

III. REVIEW OF LITERATURE

Herman Theeke, John B. Mitchell (2008) discussed how reporting under a human resource liability paradigm fits into the traditional accounting framework of contingent liabilities; examine the financial effects of such reporting on market valuation and internal planning; and explore measurement of human resource liabilities. From reviews of financial effects of human resource liability reporting the research logically extends those results to support the proposed paradigm. The paper provides support for the feasibility and need to adopt a human resource liability paradigm for valuing, reporting and managing human resources.

Flamholtz et al. (2003) utilized the HRA measure of expected realizable value, and found that employees' participation in a management development program increased the value of the individuals to the firm. In addition the authors noted that the HRA measures provided upper level management with an alternative accounting system to measure the cost and value of people to an organization. Thus HRA represented both a paradigm and way of viewing human resource decisions, and the set of measures for quantifying the effects of human resource management strategies upon the cost and value of people as organizational resources.

Chris Dawson (1994) indicated relationship between two prescriptive models of HRA – the replacement cost model (RCM) and the stochastic rewards valuation model (SRVM). Investigates not only the operationalization of the two models, but also the reasoning used by managers in determining or arriving at the data. Goes on to discuss the general benefits and limitations of simulation methodologies and how they relate to prescriptive and descriptive approaches to the study of management.

IV. PURPOSE OF HRA IN AN ORGANIZATION

According to Likert (1971), HRA serves the following purposes in an organization;

- It furnishes cost/value information for making management decisions about acquiring, allocating, developing, and maintaining human resources in order to attain cost-effectiveness;
- It allows management personnel to monitor effectively the use of human resources;
- It provides a sound and effective basis of human asset control, that is, whether the asset is appreciated, depleted or conserved;
- It helps in the development of management principles by classifying the financial consequences of various practices.

V. OBJECTIVES OF HUMAN RESOURCES ACCOUNTING

HRA helps in developing financial assessments for the people within the organization. However, the specific objectives of HRA may be outlined as under:

- 1) To assist the management in taking suitable decisions regarding investment on human resources; and
- 2) To provide information to all people concerned regarding the earning potential of human resources of the organization.

VI. RESEARCH METHODOLOGY

Data and information were gathered from secondary published sources viz., for accomplishing the objectives of the study secondary data were collected. Data published by various institutions such as books, journals, newspapers, websites, research studies, etc are used for the purpose of the present study.

Methods of Valuation of Human Resource Accounting

Historical Cost Approach: This approach was developed by William C. Pyle and R.G. Barry Corporation, a leisure footwear manufacturer based on Columbus, Ohio (USA) in 1967. In this approach, actual cost incurred on recruiting, hiring, training and development the human resources of the organization are capitalized and amortized over the expected useful life of the human resources. Thus a proper recording of the expenditure made on hiring, selecting, training and developing the employees is maintained and a proportion of it is written off to the income of the next few years during which human resources will provide service. If the human assets are liquidated prematurely the whole of the amount not written off is charged to the income of the year in which such liquidation takes place. If the useful life is recognized to be longer than originally expected, revisions are effected in the amortization schedule. The historical cost of human resources is very similar to the book value of the other physical assets. When an employee is recruited by a firm, he is employed with the obvious expectation that the returns from him will far exceed the cost involved in selecting, developing and training in the same manner as the value of fixed assets is increased by making additions to them. Such additional costs incurred in training and developing is also capitalized and is amortized over the remaining life. The unexpired value is investment in human assets. This method is simple to understand and easy to work out. It meets the traditional accounting concept of matching cost with revenue. It can provide a basis of evaluating a company's return on its investment in human resources.

Replacement Cost Approach: This approach was first suggested by Rensis Likert, and was developed by Eric G. Flamholtz on the basis of concept of replacement cost. Human resources of an organization are to be valued on the assumption that a new similar organization has to be created from scratch and what would be the cost to the firm if the existing resources were required to be replaced with other persons of equivalent talents and experience. It takes into consideration all cost involved in recruiting, hiring, training and developing the replacement to the present level of proficiency and familiarity with the organization. This approach is more realistic as it incorporates the current value of company's human resources in its financial statements prepared at the end of the year. It is more representative and logical.

Opportunity Cost: This method was first advocated by Hc Kiman and Jones for a company with several divisional heads bidding for the services of various people they need among themselves and then include the bid price in the investment cost. Opportunity cost is the value of an asset when there is an alternative use of it. There is no opportunity cost for those employees that are not scarce and also those at the top will not be available for auction. As such, only scarce people should comprise the value of human resources.

This method can work for some of the people at shop floor and middle order management. Moreover, the authors of this approach believe that a bidding process such as this is a promising approach towards more optional allocation or personnel and a quantitative base for planning, evaluating and developing human assets of the firm.

Present Value of Future Earnings: Lev and Schwartz (1971) proposed an economic valuation of employees based on the present value of future earnings, adjusted for the probability of employees' death/separation/retirement. This method helps in determining what an employee's future contribution is worth today. According to this model, the value of human capital embodied in a person who is 'y' years old, is the present value of his/her future earnings from employment and can be calculated by using the following formula:

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

Where $E(V_y)$ = expected value of a 'y' year old person's human capital T = the person's retirement age $P_y(t)$ = probability of the person leaving the organization $I(t)$ = expected earnings of the person in period I R = discount rate.

Phases in the Design and Implementation of Human Resource Accounting System: There are five phases in the design and implementation of human resource accounting system:

- 1) Identifying human resource accounting objectives,
- 2) Developing human resource accounting measurements,
- 3) Developing a data base for the system,
- 4) Pilot testing the system for validity, and
- 5) Implementing the system.

HR Accounting Objectives: The objectives of the human resource accounting system should basically stem from the management's requirements from human resource information. These requirements must be defined explicitly. As a part of the detailed study and analysis of the organization's human resource management process, each organizational unit should be responsible for human resource management, should define its functions, and indicate the kinds of decisions made, their relative frequency and information needed to make those decisions. These information needs must be analyzed in relation to the present information flow and the new information to be developed must be made specific. Once this analysis is done, the basis of the human resource accounting system in terms of its scope and objectives can be defined. The objective may be a total HRA

system, a problem oriented system, a partial system, such as, a budgeting system for human resource costs, or setting of standard costs.

Developing Human Resource Accounting Measurements: The first step is to select the types of HRA measurements desired. The choice needs to be exercised between: (a) single measurement or a set of measurements, (b) monetary or nonmonetary measurements, and (c) measurements of costs or value, or both. In the next step, before these measurements selected can be translated into useable forms, their validity and reliability must be tested.

Developing Human Resource Accounting Database: The inputs required for human resource accounting constitute the database. These include cost data, timesheets, psychological measurements, etc. In typical cases, it will become necessary to restructure the organization's accounting classification with a view to ensuring that all personnel related costs are classified separately. Otherwise these cost elements are 'buried' covered in one single classification "administration and general expenses". The accounting classification should be organized in relation to responsibility centers, such as, recruitment, training, management development, etc. In addition to restructuring the accounting classification, the database must also include non-financial information, such as, employee attitude survey feedback as a standard ongoing basis. Similarly, the probabilistic estimates of employee mobility compiled in the human resource planning process must be taken into account form measuring human resource value.

Pilot Testing the System: After the objectives have &defined, measurements developed, and necessary database is made available, the-next step is to pilot test the system. Care should be taken that the test is not influenced by extraneous problems and that the management's support and cooperation is available throughout the processes of design and development of the stem. In the light of the feedback from pilot testing, the system should be reviewed for its utility, efficiency, cost, etc .aspects and suitability modified, if considered necessary.

VII. IMPLEMENTING THE HUMAN RESOURCE ACCOUNTING SYSTEM

The final phase is their implementation process. It involves essentially, standardizing the input output documents, forms, etc., and familiarizing the personnel with the new system. Staff orientation as to the uses, purposes, uses and methods is a key activity in order to operate the human resource accounting system without many hassles.

VIII. SIGNIFICANCE OF HUMAN RESOURCE ACCOUNTING

HRA as a managerial tool can be used for effective management of human resources. In the field of managerial decision-making, the human resource data as part of management information system helps in making meaningful choices between various types of human investments and investments in other assets. By measuring the value of human resources at different points of time, HRA can reveal whether the management is building up human resources or depleting them. The information generated through HRA can help the management in formulating policies and programmes for the development of human resources. Such information can be of utmost help for making decisions in the following areas:

- a) Man power planning.
- b) Appraisal of human resource development programmes.
- c) Identification of training needs.
- d) Usefulness of cost reduction programmes in view of their possible impact on human relations.
- e) Studying the impact of budgetary control on motivation and morale of employees.
- f) Facilitating allocation, conservation and reward of human resources.

IX. ADVANTAGES OF HUMAN RESOURCE ACCOUNTING

Human Resource Planning anticipates not only the required kind and number of employees but also determines the action plan. The major benefits of HR accounting are:

- It checks the corporate plan of the organization. The corporate plan aiming for expansion, diversification, changes in technological growth etc. has to be worked out with the availability of human resources for such placements or key positions. If such manpower is not likely to be available, HR accounting suggests modification of the entire corporate plan.
- It offsets uncertainty and change, as it enables the organization to have the right person for the right job at the right time and place.
- It provides scope for advancement and development of employees by effective training and development.
- It helps individual employee to aspire for promotion and better benefits.
- It aims to see that the human involvement in the organization is not wasted and brings high returns to the organization.
- It helps to take steps to improve employee contribution in the form of increased productivity.
- It provides different methods of testing to be used, interview techniques to be adopted in the selection process based on the level of skill, qualifications and experience of future human resources.
- It can foresee the change in value, aptitude and attitude of human resources and accordingly change the techniques of interpersonal management.

X. LIMITATION OF HUMAN RESOURCE ACCOUNTING

Human Resource Accounting is the accounting methods, systems, and techniques, which coupled with special knowledge and ability, assist personnel management in the valuation of personnel in their knowledge, ability and motivation in the same organization as well as from organization to organization. It means that some employees become a liability instead of becoming a human resource. HRA facilitates decision making about the personnel i.e. either to keep or to dispense with their services or to provide mega-training. There are many limitations which make the management reluctant to introduce HRA. Some of the Attributes are:

1. There is no proper clear cut and specific procedure or guidelines for finding costs and value of human resources of an organization. The systems which are being adopted have certain drawbacks.
2. The period of existence of Human Resource is uncertain and hence valuing them under uncertainty in future seems to be unrealistic.
3. The much needed empirical evidence is yet to be found to support the hypothesis that HRA as a tool of management facilitates better and effective management of human Resources.
4. As human resources are incapable of being owned, retained, and utilized, unlike the physical assets, there is a problem for the management to treat them as assets in the strict sense.
5. Jealousy to see the high value of other employee can decrease the efficiency of any employee because he can think why my price is so low and other employee's price is so high.
6. From human resource accounting, we cannot get short period benefits like general historical accounting system.
7. Indian company law 1956, Indian Income tax law 1961 and other legal laws are no rule for showing human resource assets in the balance sheet.

XI. CONCLUSION

Human beings are the dynamic elements of every organization. The success of any organization, to a great extent, depends upon the quality and caliber of the people working in it. In other words, human resources are the most important asset of an organization. Thus, in spite of all technological developments, the importance of human resources has in no way diminished. 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. Human Resources Accounting not only involves measurement of all the costs/ investments associated with the recruitment, placement, training and development of employees, but also the quantification of the economic value of the people in an organization. Human Resource Accounting gives information regarding inner strength of organization and helps in making decisions regarding long-term investment in that organization. HRA helps to identify the causes of high labor turnover at various levels and taking preventive measures. By keeping limitations and negative aspects of human resource accounting, it plays important role in the organization growth. It helps in locating the real cause for low return on investment, like improper or under-utilization of physical assets or human resources or both. HRA helps the employees in improving their performance and bargaining power and makes each employee understand his contribution towards the betterment of the firm and the expenditure incurred by the firm on him. Human Resource Accounting helps the management in employment and utilization of Human Resources.

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