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HUMAN RESOURCE ACCOUNTING: BASIC INTRODUCTION

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ABSTRACT

The American Accounting Association's Committee on Human Resource Accounting (1973) has defined Human Resource Accounting as "the process of identifying and measuring data about human resources and communicating this information to interested parties". Now human resources accounting is as new branch of accounting. As per tradition accounting system all expenditures viz. recruitments, selection, training, development etc. for human capital formation treat as charge against the revenue. Due to which no physical asset could be created in terms of human resources in the balance sheet. Whereas the concept of human resource accounting states that the expenditure incurred in acquiring any human resource such as the cost of recruitment, selection, training, development etc. should be capitalized. Because it provides measurable benefits in monetary terms. In this paper we will study about the objectives, importance, methods and limitations of human resource accounting.

Keywords: *Human Resource Valuation, Return on Investment & Knowledge, Investment Yields*.

Introduction

In the traditional accounting system, physical resources (Tangible and intangible) are shown in the financial statements, whereas physical resources have no importance without human resources. Thus the success of any business depends on the strength of the Skill of its employees and they are not included as assets in the financial statements.

Human resource accounting is done to overcome this limitation of the traditional accounting system. Thus, human resource accounting is a process in which human resources are financially measured in numbers and addressed to the concerned parties related to the information received.

Objectives of HRA

- Measuring the value of the of human resources quantity devoted to the task/work in the enterprise.
- To identify such factors that motivates the human resources to work and make them dedicated to the enterprise. and measuring them
- Measuring the cost and benefits of human resources working in the enterprise. And accounting them and disclose them in the financial accounts.
- The main objective of human resource is to recognize the employees as an asset.
- Communicating the information to interested parties related to human resources.

Importance of HRA

Human resource accounting provides scientific and realistic basis to the enterprise by which effective decisions can be taken for planning and development of human resources in the enterprise. Human resource accounting has many benefits but in brief, the importance of human resource accounting can be understood from the following points.

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- Information about how much investment has been made on the employees in the enterprise can also be easily obtained from human resource accounting
- Considering the information received from human resource accounting, the investment decisions taken in relation to the enterprise can be more practical and realistic.
- Cost benefit analysis of human resources can be done and through this analysis schemes related to bonus facilities, rewards and punishments can be implemented.
- External parties like banks, financial institutions, government etc. can also get important information from human resource accounting. Therefore, human resource accounting is also important for external parties.

Method of Human Resources for HRA

There are total 9 methods of valuation of human resources in human resource accounting, which can be made in two parts. The first one in which the present value factor is not considered which includes four methods. And the second in which the present value factor is considered, which includes five methods.

(A)Methods that do not consider	**(B) Methods that consider**
The present value factor	**The present value factor**
• Historical cost approach • Replacement cost approach • Opportunity cost approach • Standard Cost method	• Present value of future earnings model • Reward valuation model • Net benefit model • Certainty equivalent net benefit model • Aggregate payment approach

Methods that do not Consider the Present Value Factor

- **Historical Cost Approach:** Historical cost approach was developed by Brummet, Flamholtz and Payle. In this method the actual cost incurred on recruitment, selection, hiring, training and development of human resources in the organization is capitalized (add incurred cost and record in balance sheet).And the same is written off (amortized) over the expected useful life of the human resources. In a way, the valuation of human resources is done in the same way as the valuation of any physical assets. Therefore, if later any expenditure is made on the training and development of human resource, then the value of human assets is increased like other physical assets and capitalized in a similar manner. If human assets expire before its expected service life period, then it will be charged against revenue for that year. If useful life of human assets to be longer than the expected, amortization is appropriately rescheduled.
- **Replacement Cost Approach:** Replacement cost approach was developed by RensisLikert and Eric. G. Flamholtz. In this method, if the exiting employee is replaced by the same experienced, talented and qualified employee, the expenditure that will be spent on the recruitment, selection, hiring training and development of that new employee will be the value of human resource. These methods are also similar to the historical cost method; the only difference is that instead of historical cost, value of human assets is computed on the basis of current cost.
- **Opportunity Cost Approach:** Opportunity cost approach was developed by Hekimian and Jones. This method based on competitive bidding. This method states that if an employee is removed from one department, then the value of that employee will be determined in different departments (on base of bidding) of the same organization, out of which the department in which the highest value of that employee will be determined. That would be the value of human resources. In short, in this method, the value of the employee is determined on the basis of his alternative use. If there is no alternative use for an employee then the value of that employee will be zero.This approach suggested competitive bidding process for the scarce employee in the organisation and excludes those type of employees who can be hired readily from outsides.
- **Standard Cost Method:** Standard Cost method was developed by David Watson. In this method, the valuation of the post is done in place of the person. Whatever employee will be on that post, its value will also be the same. In this method, year after year standard cost is determined for recruitment, selection, training and development for per grade of employees. This method is very easy to explain. And since the standard cost is known, the technique of variance analysis can be used to calculate the actual cost for control purposes.

Methods that Consider the Present Value Factor

In this section we will study all the methods in a certain order. Because each next method is an improvement of the previous method.

- **Present Value of Future Earnings Model:** This model was developed by Lay and Schwartz in 1971. According to this model the value of human resource will be computed as follows:
  - Will classify all the employees into specific groups on the basis of their age and their skills.
  - Average annual earnings is determined for various ranges of age.
  - The total income get till the age of retirement of each group will be calculated.
  - The total earnings calculated as above are discounted at the rate of cost of capital.
  - The value thus obtained will be the value of human resource.

The main drawback of this model is that the employee's status is considered unchanged during the entire service period, as well as it ignores the skills, bargaining power etc. and assumes his salary as constant, which is never possible.

- **Reward Valuation Model:** As an improvement over the previous model this model was developed by Lay and Flamholtz in 1971. It takes into consideration the possibility and probability or an employee's movement from one role to another in his career and also of his leaving the firm earlier , than his death or retirement. In this method, the salary is not assumed to be constant. rather that

According to the status of the service, it increases progressively. This model suggests a five step approach for this purpose.

  - Determine the expected period for which the employee will continue to serve in the organization.
  - Identify the 'service states' (i.e. Posts or roles) of the employees where they will reach during their service period in the organisation.
  - Compute estimate of the probable period for which a employee will occupy each possible service state in future in the organisation.
  - Then determine the estimated salary to be given by the organization to the employee according to his service state.
  - The total value of the service derived by the organisation by different employees or group of employees is determined. The value thus arrived is discounted at a pre-determined rate to get the present value of human resources.

The main drawback of the models so far is that value of human resources have been evaluated on the basis of how much they will be paid (salary, cost incurred etc.) by the organisation. Whereas the value of any employee will be properly assessed only when it is done on the basis of how much net benefit the employee will bring to the organization.

- **Net Benefit Model:** This model was developed by Morse in 1973. In this model, the value of human resource is computed as the present value of the net benefits that the organizations will aquired from the employee during his entire service life. The method involved the following steps:
  - First of all it will be determined that what is the estimated benefit from the employee to the organization throughout his service. That is, how much benefits (earnings) will the organization get from the employee.
  - The value of future estimated payments to the employees is determined.
  - Thereafter, determined excess of the benefits to be acquired from the employee by the organization (as per point 1) during the entire period of his service over payment made to him (as per point 2). i.e. net benefit.
  - The present value of net benefit is determined by applying a pre-determined discount rate. This amount represents the value of HR to the organisation.

The main drawback of this model is that the net benefit cannot be computed accurately.

- **Certainty Equivalent Net Benefit Model**: Model was developed by Pekin Ogan in 1976.This model is extension of net benefit model. The model requires determination of the followings:

- Compute net benefits as per morse's net benefit model.
- Certainty factor at the benefits will be available (Certainty equivalent factor is a factor that shows the probability of getting net profit.).
- The net benefits from all employees multiplied by their certainty factor will give certainty equivalent net benefits. This amount represents the value of HR to the organisation.

- **Aggregate Payment Approach:** The aggregate payment approach in human resource accounting was developed by S. K. Chakraborty. The value of human resources is the function of the average salary of the employees and their average employment tenure in the organization. This is the essence of the aggregate payment model. It is the only Indian model of value measurement of human resources for human resource accounting.

Limitations of HRA

- The major limitation of human resource accounting is that there is no universally accepted method for valuation human resources.
- Estimating the life span of a physical asset is easy but the life span of human assets is very uncertain. And it seems unrealistic to valuate them in this uncertainty.
- There is no clear and specific procedure and guidelines for determining and valuating the cost of human resources in any organization.
- When an organization adopts human resource accounting, it fears that HRA may dehumanize and manipulate employee.
- Human beings are not yet recognized as assets by tax laws.

Conclusion

In the current competitive environment, human assets play an important role in the success of any organisation. Although human assets are different from physical assets, they have their own specific importance. Human resource accounting provides useful information about their cost and value. The best utilisation of human assets in an organization is possible only with help of HRA. Human resource is still in the developing stage, there is a need to make standards at the national and international level to reach it in the developed stage.

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