

HUMAN RESOURCE VALUATION AND ACCOUNTING

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ABSTRACT

Human Resource Valuation is not a new issue in the arena of business. It is true that knowledge is a key determinant of economic and business success, but most companies focus on 'Return on investment (ROI)', with very few concrete steps taken to tract 'Return on Knowledge'. However, what is needed in this concept is a measurement of the abilities of all employees in a company, at any level, to produce value from their knowledge and capability. The concept of human resource valuation can basically examine from two dimensions: the investment in human resources and the value of human resources. The expenditure incurred for creating increasing and updating the human resource quality is known as investment in human resources. Such investment yields fruitful results like higher productivity and higher income to the organization. The yield that the investment in human resources generates will be considered as the basis of human resource value.

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

Introduction

Human Resource Value helps companies to structure and optimise their talent management strategies and to implement global staff review processes and succession plans that are consistent with their performance management policies. The authors have also developed an exclusive method for evaluating the efficiency of employee retention policies. This unique method enables accountants to identify the risks weighing on the key resources and the solutions to limit the volatility of employee's talent. The authors also intervene in mergers and acquisitions to assess the relevance and the quality of the human capital of corporations, and the robustness of their succession plans. Human resource valuation is aimed at depicting the human resources potentials in money terms while casting the organization's financial statements, with the emergence of the knowledge economy, recognition of human capital as an important part of the enterprises, total value has gained importance.

The Concept of Human Resource Value

The belief that individual employee performance has implications for firm-level outcomes has been prevalent among academics and practitioners for many years. Interest in this area has recently intensified; however, as scholars have begun to argue that collectively, a firm's employees can also provide a unique source of competitive advantage that is difficult for its competitors to replicate. For example, Wright and McMahan (1992), drawing on Barney's (1991) resource-based theory of the firm, contended that human resources can provide a source of sustained competitive advantage when four basic requirements are met. Wright and McMahan's (2008) work points to the importance of human resources in the creation of firm-specific competitive advantage. At issue, then, is whether, or how, firms can capitalize on this potential source of profitability. Bailey (2010) contended that human resources are frequently "underutilized" because employees often perform below their maximum potential and that organizational efforts to elicit discretionary effort from employees are likely to provide returns in excess of any relevant costs. Human resource management practices influence employee's skills through the acquisition and development of a firm's human capital.

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Approaches of Human Resources Valuation

The several accounting concepts related to costs defined above have significant applications in human resource accounting. The concept of human resource cost has its roots in the general concept of cost. Human resource costs are costs incurred to acquire or replace people. Like other costs, they have expense and asset components. Similarly, other descriptions of costs, viz., outlay and opportunity costs, direct and indirect costs, actual and standard costs - all fit into the costs framework of human resource accounting. One can measure costs through human resource accounting in two ways: (1) the original or historical cost of human resources, and (2) the replacement costs of human resources. The concept of original cost The original cost of human resources may be defined as the sacrifice that was actually incurred to acquire and develop or replace people. It includes costs of: Recruitment, Selection, Hiring, Placement, Orientation and on-the-job training.

It has elements of direct costs as well as indirect costs. For example, a trainee's salary is ' a direct cost, while the time spent by the supervisor or other employees during training contributes to the indirect cost. For managerial uses of the cost data, it is desirable to - include the opportunity costs incurred in the original costs of human resources. However, since the reliability of the opportunity costs can always be questioned, it should not form part of reporting to investors and external users. The definition of original cost of human resources refers to the sacrifice that would have Resource Development to be incurred to acquire and develop people. This means that any attempt for measurement of original human resource costs essentially requires measurement of acquisition costs and training costs. These costs will include both direct costs and indirect costs of acquiring and developing human resources.

Replacement Cost of Human Resources

The Replacement Cost of Human Resources may be defined as the sacrifice that would have to be incurred today to replace human resources presently employed. It includes the costs attributable to the turnover of a present employee as well as the cost of acquiring and developing the replacement. From individuals, the scope can be extended to include the groups of individuals and the human organisation as a whole. Replacement refers to acquiring a substitute capable of rendering an equivalent set of services for a single specified position, meaning thereby that the context is the positional replacement. There is another notion of replacement cost: personal replacement cost. It refers to the sacrifice that would have to be incurred today to replace a person presently employed with a substitute capable of rendering an equivalent set of services in all the position the former might occupy. Here the context is the person, and the replacement cost is the cost of replacing a set of services provided by one person with an equivalent set of services to be provided by another.

Measurement of Replacement

The context of replacement cost measurement can be positional as well as personal. There are three basic components of positional replacement cost: acquisition costs, learning costs and separation costs. While the first two components 'have been reflected in the earlier model, the separation costs refer to the costs incurred as a result of a position holder leaving an organisation. It may have both direct and indirect components and may include such costs as (i) cost of a vacant position while search for replacement is on, (ii) opportunity cost because of loss of services, and (iii) cost of lost productivity prior to the separation of an individual from the organisation if such tendencies were apparent.

Personal Replacement Cost

Human Resource Accounting The concept of personal replacement cost refers to the sacrifice that would have to be incurred today to replace a person with a substitute capable of providing a set of services equivalent to the individual being replaced. The notion refers to the cost of replacing a person with a functionally equivalent substitute rather than the cost of replacing him with the best available substitute. The notion of personal replacement cost is quite similar to the concept of economic value.

Systems of Human Resource Accounting

Several organisations require different degrees of human resource accounting capability. Flamboltz's Systems I to V are not all embracing or standards to match a specific organisation's human resource accounting needs. Instead, in each case, an appropriate system will have to be tailor made to a firm's particular needs. There are five phases in the design and implementation of human resource accounting system:

- **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, time sheets, psychological measurements, etc. In typical cases, it will become necessary to restructure the organisation'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. The accounting classification should be organised 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 for measuring human resource value.

Conclusion

Thus the final phase is the implementation process. It involves essentially, standardising the input output documents, forms, etc., and familiarising the personnel with the new system. Staff orientation as to the uses, purposes, uses and methods is a key activity in order to operationalise the human resource accounting system without many hassles. Any system, over a period of time, may become out of step either because of inherent constraints or changes in the management needs. A continuing review would make the system more responsive to the changing needs, and modifications required would be easy to carry out either by simple adjustments in the existing system.

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