

# Human Resource Accounting in Indian Companies – Importance and Challenges

V. Kalpana

Assistant Professor, New Horizon College

**Abstract:** *“Great vision without great people is irrelevant” Any business entity or institution strives hard for achieving profits, reputation in the society, customer retention and loyalty, business expansion, overcoming and eliminating competition. All these goals can be made possible majorly by the employees of such organisations. It is an undeniable truth that a well managed and highly cohesive work force is the back bone of any organisation. Hence it becomes important for any organisation to contemplate on the quantity and quality of its workforce which involves a thorough analysis and understanding of the time and capital invested on its human resources. This is commonly referred to as human resources accounting. Even though, researches have been going on since 1691 in this field, many organisations were merely considering their employees as paid workers. However, post 1960 it has gained momentum and many organisations have started practicing human resource accounting.*

**Keywords:** Human Resource Accounting, Human Resources, Human Capital, Objectives, Limitations,

## 1. Introduction

Human Resource Accounting is the process of reporting the investment made in the human capital of an organization. The main purpose of this is to account for the human resources of the organization as they are unaccounted for in the financial statements. The financial statements show only the financial transactions and the financial soundness of the business and have nothing to do with the human resources of the organisations. Hence human resource accounting is practiced in order to account for the human capital of the organisation.

## 2. Definitions

- 1) The American Association of Accountants (AAA) defines HRA as follows: ‘HRA is a process of identifying and measuring data about human resources and communicating this information to interested parties’.
- 2) Flamhoitz defines HRA as ‘accounting for people as an organizational resource. It involves measuring the costs incurred by organizations to recruit, select, hire, train, and develop human assets. It also involves measuring the economic value of people to the organization’.
- 3) According to Stephen Knauf, ‘HRA is the measurement and quantification of human organizational inputs such as recruiting, training, experience and commitment’.

## 3. Objectives

- 1) To furnish cost value information for making proper and effective management decisions about acquiring, allocating, developing, and maintaining human resources in order to achieve cost effective organizational objectives.
- 2) To monitor effectively the use of human resources by the management.
- 3) To have an analysis of the Human Asset, i.e. whether such assets are conserved, depleted, or appreciated.

- 4) To aid in the development of management principles and proper decision making for the future, by classifying financial consequences of various practices.

## 4. Importance of Human Resource Accounting:

Human Resource Accounting provides useful information to the management, financial analysts and employees as stated below:

- 1) Human Resource Accounting helps the management in the identification and employment of human resources in the organization
- 2) It provides a basis for man power planning and recruitment.
- 3) It helps in deciding the maintenance and development of human resources through proper training, promotion and compensation strategies.
- 4) It assists in evaluating the expenditure incurred for imparting further education and training in employees in terms of the benefits derived by the firm.
- 5) It helps to identify the causes of high labor turnover, absenteeism and issues related to change management and stress management at various levels and formulating strategies and measures to control them.
- 6) It helps in locating the real cause for low return on investment, like improper or under-utilization of physical assets or human resource or both.
- 7) It provides valuable information for persons interested in making long term investment in the firm.
- 8) It helps employees in improving their performance and bargaining power. It makes each of them to understand his contribution towards the betterment of the firm vis-à-vis the expenditure incurred by the firm on them.

The following are the reasons why Human Resources Accounting has been receiving so much attention in the recent years.

- There is genuine need for reliable and complete management of human resources.

- A traditional framework of Accounting is in the process to include a much broader set of measurement than was possible in the past.
- The people are the most important assets of an organization but the value of this asset yet to appear in financial statements. It does not get included in management information systems too.
- Conventional accounting of human resources took note of all expenses of Human capital formation which does not seem to be correct or meeting the actual needs.

## 5. Methods of Human Resource Accounting

There are two approaches to HRA. The cost approach, also called the "human resource cost accounting method" and the value approach.

### a) Cost Approach

This approach is also called an acquisition cost model. Under this method, the organization's investment in employees is measured using the five parameters: recruiting, acquisition, formal training and familiarization, informal training and informal familiarization, and experience and development. Here it is suggested that instead of charging the costs to Income statement, they should be capitalized in the balance sheet. The process of giving a status of asset to the expenditure item is called capitalization. In human resource management, it is necessary to amortize the capitalized amount over a period of time. So, here one will take the age of the employee at the time of recruitment and at the time of retirement. Out of these, a few employees may leave the organization before attaining the superannuation. This method is the only method of Human Resource Accounting that is based on sound accounting principles and policies.

### Limitations

- The valuation method is based on the false assumption that the currency is stable and hence does not give importance for time value of money.
- Since the assets i.e the human resources cannot be sold there are no independent checks of their valuation.
- This method measures only the costs to the organization, and does not take into consideration the value of the employee to the organization.
- It is too tedious to gather the related information regarding the human values.
- It may be possible that the employee is already fully trained and there is no need to employ any development, training, recruitment cost. It will create difficulty for a company to find out CTC according to acquisition model.

### b) Replacement cost approach

This approach measures the cost of replacing an employee. According to Likert (1985) replacement cost includes recruitment, selection, compensation, and training cost (including the income foregone during the training period). The data derived from this method could be useful in deciding whether to dismiss or replace the staff.

### Limitations

In practice, the cost of replacement of employee is quite tedious and expensive process. Moreover, frequent replacement of employees shows the poor management and retention of human resources.

### c) Value Approach

#### 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. It considers the time value of money and helps in determining what an employee's future contribution is worth today.

### Limitations

- The measure is an objective one because it uses widely based statistics such as census income return and mortality tables.
- The measure assigns more weight to averages than to the value of any specific group or individual.

### Value to the organisation

Hekimian and Jones (1967) proposed that when an organization had several divisions seeking the same employee, the employee should be allocated to the highest bidder and the bid price incorporated into that division's investment base. For example, a value of a professional athlete's service is often determined by how much money a particular team, acting in an open competitive market, is willing to pay him or her.

### Limitations

The soundness of the valuation depends wholly on the information, judgment, and impartiality of the bidder

### Model on human resource accounting

This model prescribes the human resource accounting approach for two categories of employees:

- Employees, who are at strategic, key decision-making positions such as MD, CEO (Top Executives)
- Employees, who execute the decision taken by Top Executives

Model arrives value of human resources as sum of below-mentioned three parts:

- 1) Real capital cost part
- 2) Present value of future salary/wages payments
- 3) Performance evaluation part

### Limitations

- 1) Calculation process is lengthy and cumbersome.
- 2) Lev and Schwartz valuation principles have been used at one point of time, so this model contains a weakness from the Lev and Schwartz model.

## 6. Future of HR Accounting

Historically, human resources accounting and costing focused on how much employees cost an organization,

without evaluating the value of the employee to the business. As the world moves into the information age, intellectual knowledge as a business asset is becoming increasingly important. Recording, evaluating and assigning value to this intangible asset is one of the primary focuses of the evolution of human resources accounting.

Until recently, the "value" of an enterprise as measured within traditional balance sheets, e.g. buildings; production plant etc. was viewed as a sufficient reflection of the organization or enterprise assets. However, with the growing emergence of the knowledge economy, this traditional value has been called into question due to the recognition that human capital is an increasingly important part of an enterprises total value. This has led to two important questions.

- 1) How to assess the value of human capital in addition to an enterprise's tangible assets
- 2) How to improve the development of human capital in enterprises.

The emergence of methods for accounting human resources aimed at measuring, developing and managing the human capital in an enterprise, can thus be said to reflect the need for improving measuring and accounting practices as well as human resource management.

## 7. Limitations of Human Resource Accounting

Human Resource Accounting is the term used to describe the accounting methods, system and techniques, which coupled with special knowledge and ability, assist personnel management in the valuation of personnel in financial terms. It presumes that there is great difference among the personnel in their knowledge, ability and motivation in the same organization as well as from organization to organization. It means that some become liability too instead of being human assets. HRA facilitates decision making about the personnel i.e., either to keep or dispense with their services or to provide training. There are many limitations which make the management reluctant to introduce HRA. Some of the attributes are:

- There is no proper clear-cut and specific procedure or guidelines for finding cost and value of human resources of an organization. The systems which are being adopted have certain drawbacks.
- The period of existence of human resource is uncertain and hence valuing them under uncertainty in future seems to be unrealistic.
- There is a fear that HRA may dehumanize and manipulate employees. iv) For e.g., an employee with a comparatively low value may feel discouraged and develop a complex which itself will affect his competency to work.
- The much needed empirical evidence is yet to be found to support the hypothesis that HRA as a tool of the management facilitates better and effective management of human resources.

- In what form and manner, their value to be included in the financial statement is the question yet to be classified on which there is no consensus in the accounting profession.
- As human resources are not capable of being owned, retained and utilized, unlike the physical assets, there is problem for the management to treat them as assets in the strict sense.
- There is constant fear of opposition from the trade unions as placing a value on employees would make them claim rewards and compensations based on such valuation.
- Another question is, on value being placed on human resources how should it be amortized. Is the rate of amortization to be decreasing, constant or increasing? Should it be the same or different for different categories of personnel?
- In spite of all its significance and necessity, tax laws do not recognize human beings as assets.
- There is no universally accepted method of human asset valuation.
- As far as our country is concerned human resource accounting is still at the developmental stage. Much additional research is necessary for its effective application.

The concept of Human Resource Accounting in India is a recent phenomenon and is struggling for its acceptance. In India, Human Resource Accounting has not been introduced so far as a system. The Institute of chartered accountants of India has not issued an accounting standard for the measurement and reporting of cost and value of human resources of an organization. So far as the statutory requirement is concern, the Indian company Act 1956 does not require the furnishing of any significant information about human resources in the balance sheet or final account of the companies. According to the money measurement concept of accounting only those transactions can be recorded under double entry accounting system which can be expressed in monetary term. Human attributes (i.e. honesty, sincerity, loyalty, wisdom, skill, attitude etc.) cannot be expressed in monetary terms; therefore, there is no standard method which can be followed to capitalize the investment on human assets. In recent years some public undertakings have started to disclose information about their work force along with the financial statement. Finally every organization should be understood the value of human force and same should be recognized in accounting books.

## 8. Conclusion

In spite of its limitations, a growing trend towards the measurement and reporting of human resources, particularly in the public sectors, is noticeable during past few years. BHEL, Cement Corporation of India, ONGC, Engineers India Ltd., National Thermal Power Corporation, Mineral and Metals Trading Corporation, Madras Refineries, Associated Cement Companies, SPIC, Cochin Refineries Ltd. etc. are some of the organization which have started disclosing some valuable information regarding human resources in their financial statements.

## References

- [1] Human Resource Accounting – A review of Theory and Research by Eric G Flamholtz.
- [2] Human Resource Accounting by Pragnesh B Shah
- [3] [www.whatishumanresource.com](http://www.whatishumanresource.com)
- [4] [www.wikipedia.org](http://www.wikipedia.org)
- [5] [www.CiteHR.com](http://www.CiteHR.com)
- [6] Asian Journal Of Management Research - ISSN 2229-3795