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HUMAN RESOURCE ACCOUNTING:
A SUGGESTED APPROACH FOR PRACTICE

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ABSTRACT

There can hardly be any difference of opinion about the fact that human beings are the most important asset of an organization. However, this important asset is not reflected in the balance sheet of a concern. There is neither any universally accepted valuation model of human resource nor any accepted accounting method of it. The study attempts to find out a suitable human resource valuation model and its accounting in the books of the concern. For accounting purpose cost related to human resource are classified into human resource expenses and human resource investment.

KEYWORDS: *Human Resource Investment, Human Resource Valuation, Government Accounting.*

Introduction

It is now unanimously accepted view that the human being is the most important input in an organization. The success or failure of an organization depends largely upon the qualities and productivity of its human resource (HR). Other resources, i.e. non human resources can only be properly used through human resource. Therefore, HR is regarded as the most important resource of management. Human resources are the energies, skills, talents and knowledge of people which are potentially applied to the production of goods or rendering of useful services. More precisely, human resources of an organization comprise the value of the productive capacity of its people. In spite of its recognition as the most important and valued element of an organization, it is neither shown in the Balance Sheet of an organization nor any portion of cost on HR regarded as an investment. In conventional accounting practice, human workforce, a core element, is yet to find its place.

Definition and Concept of HRA

The committee on Human Resource Accounting of the American Accounting Associations defined human resource accounting as “the process of identifying and measuring data about human resources and communicating this information to interested parties”.

Stephen Knauf defined HRA as “the measurement and quantification of human organizational inputs, such as recruiting, training, experience, and commitment”.

Eric G. Flamholtz explained human resource accounting as accounting for people as organizational resources. It is the measurement of the cost and value of people for the organization.

Review of Literature

With an objective of identifying the fundamental reasons for undertaking the present study, an endeavour has been made to survey the various studies carried out in the field of human resource accounting. The following are some of the major studies in this field:

Gupta (1988) conducted a study on human resource accounting. The study showed various methods of measuring HR, limitations and benefits of HR. The study suggested that the accountants along with social scientist should take initiative to develop a system of measuring value of HR to the organization.

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Milost (1999) in his study has given an insight about the attitude of accountant and directors of various companies towards human resource accounting. The study revealed that very few accountants believed to be acquainted with the main of idea of human resource accounting. While accountant showed the negative attitude, the reverse attitude showed by directors.

Verma (1999) carried out a study on human resource accounting practice in public undertakings in India. He proposed a valuation model for measuring value of human resources.

Flamholtz (1999) conducted a study to develop valid and reliable method of measuring the value of HR of an organization. The study examines the concepts and methods of accounting for people. The study shows the accounting for HR costs.

Prakash (2000) under took a study on disclosure pattern of human resource accounting information in public enterprises in India. The study also revealed the limitations of human resource accounting practices of the companies selected under study.

Kolay (2000) carried out a study on accounting for human resource managers. It was observed that human resource cost classified into two category viz. Human resource expenses and human resource investment.

Saha (2000) conducted a study on accounting for human resources in non profit seeking organization. The study revealed the proposed balance sheet of non profit seeking organization where human assets showed in the balance sheet.

Narayanankutty (2001) made a study on measurement of cost of human resources. The study showed a productivity linked human resource cost model. The study suggested that the HR of any organization seems to be properly used in generating income if the rate of return on HR is equal to or more than the cost of capital.

Kumar & Awasthi (2018) carried out a study on human resource accounting and organizational performance. The purpose of the study was to establish the relationship between them. The study revealed that the performance of the organization is affected by its human resources.

A large number of studies have so far been conducted to develop models for valuation of HR of an organization. But every model has its own limitation. There is neither any generally accepted valuation model nor generally accepted principle for recording and presenting HR information in the financial statement. Absence of HR as an asset in the balance sheet violet the accrual principle, discards matching principle, defies the principle of discloser and under rates the firm’s net worth and current income. The profit & Loss account and Balance Sheet are not reflecting the true and fair view of the business enterprise. At this backdrop the present study aims at to develop a new HR valuation model and treatment of HR information in the books of account.

Objectives of the study

The present study attempts:

- to develop an alternative model to measure the value of HR,
- to identify a rational and acceptable method of recording the value of HR in the books of accounts and
- to exhibit value of HR in the balance sheet of an enterprise.

Methodology of the Study

The study is based on the literature review related to HR valuation models published in different journals and books.

Assumptions of HRA

HRA is based on the following assumptions:

a) Like non-human resources, HR provides benefits to an organization in a similar manner.
b) The benefits associated with both conventional assets and HRs has value to the organization because benefits contribute in same way to accomplishment of the organization goal.

- Human assets are categorized as also accounting assets as it can also provide economic benefit in future.
- Acquisition of HRs involves an economic cost and the benefits associated with such resources can personally be expected to contribute to the economic effectiveness. It follows, therefore, that these benefits are essentially economic in nature and are subject to measurement in financial terms.
- It is theoretically possible to identify and measure HR costs and benefits within an organization.

- HR costs are classified as HR expenses and HR investment.
- Information with respect to HR costs and benefits would be useful in the process of managerial decision making and practicing organizational performance.

Major Human Resources Valuation Models

Many models or approaches or methods have been developed by various proponents for valuing human resources of an organization. This may be classified under the following five categories:

- Cost based approaches or models;
- Opportunity cost models;
- Economic models;
- Behavioral based models;
- Other surrogate measure.

In cost based models the historical cost is considered as the basis for valuation of HR. The proponents of this model are Brummet, Flamholtz & Pyle, Woodruff Junior, Gustafson etc. As per cost base models the expenditure incurred for the acquisition, recruitment, selecting, training and development of an employee by an organization is considered to measure the value of HR. An interesting method advocated by Hekimian and Jones in 1967, known as opportunity cost method. The value of HR is determined on the basis of value of an individual employee in alternative use. This method suggests 'competing bidding price' for computing value of HR.

Economic Value models are based on the present value of the set of future services which is expected to provide by an employee during the service period in the organization. Proponents of this model are Hermanson, Lev and Schwartz, Flamholtz, Giles & Robinso, Friedman & Lev etc. Likert proposed the use of socio-psychological measurement technique for the valuation of HR. Periodic measurements are carried out on the behaviour and technical proficiency of the managerial staff, the resulting effect on subordinates in terms of motivation, loyalty and behaviour, communication, decision making and controlling process of the organization. The present value of HR computed on the basis of discounted price forecasts of predicted earnings from employees.

Findings of the Study

The model is basically developed on the valuation model as suggested by Lev and Schwartz in 1971. An attempt was made to modify the approach by taking into consideration the human resource productivity factor and also the expenses like recruitment, selection, training and development etc. it is a comprehensive approach considering the limitations of Lev and Schwartz's model and shortcomings of current Indian practices of human resource accounting. Under Lev and Schwartz's model, the value of future earnings of employees till retirement is found out and then discounted at the rate of cost of capital to arrive at its present value. But this value does not consider the productivity factor which is one of the most important aspects of an organization. Therefore, productivity should be included in the valuation of human resource.

Another notable limitation of this model is the treatment of expenses like cost of recruitment, training, development etc. Actually these expenses are incurred for future benefits. Hence, to consider this cost as revenue expenses is against the matching principle. Such costs should be regarded as human resource investment instead of human resource expenses. Therefore, human resource value (as suggested by Lev and Schwartz) should also be modified by inclusion of expenses like recruitment, development, training etc. here an attempt was made to find out the modified value of human resource by inclusion of productivity factor and also the cost of recruitment, placement, selection, initial training and development etc. as human resource investment for each grade of employees. A productivity index may be prepared for measuring the work performance of employees from their immediate supervisor(s) from each grade of employees. Though productivity of an organization depends on various factors, we may measure it by considering the efficiency level of the employees. A group wise standard output or performance should be fixed by the top-level management and actual performance should be compared with the standard. Thus for the purpose of valuation of HR productivity index may be computed as below:

Productivity (P_i) = $\frac{\textit{Actual output or perfomance of the group}}{\textit{Standard output or performance of the group}}$

For implementation of the alternative model for valuing human resource HR costs must be classified as HR expenses and HR investment. Salaries, wages, other benefits and allowances etc.

related to current services should be categorized as HR expenses. On the other hand cost of recruitment, selecting including placement, initial training and development etc. related to future services should be categorized as HR investment. Therefore, it should be considered for valuation of HR as an asset. The modified model by including productivity factor and considering HR investment cost may be as below:

Value of Human Resource = $\left\{ \sum_{t=x}^{T} \frac{I(t)}{(1+r)^{t-x}} \times P_i \right\} + D_i$

Where,

T = Employee's retirement age,

x = Age when a person join the service or the year first valuation,

I(t) = Employee's annual earnings up to retirement considering the probability of death,

r = Discount rate (it may be cost of capital for profit seeking concern or market rate of interest on fixed deposit for non-profit seeking or financial institution) to capitalise the earnings of the individual,

P_i = Productivity index,

D_i = HR investment cost.

D_i may be increased in each period and at the same time be decreased by the process of amortization. HR investment cost may be amortized equally throughout the average service life of employees. Accounting entries for HR costs and HR investment irrespective of the valuation model:

The value of human asset may be shown in the balance sheet by following accounting entries irrespective of valuation models if the costs relating to human resources are classified into HR expenses and HR investment.

- For raising the value of HR in the books of account for the first time:
  Human Asset Account Dr.
  To Human Capital Account
- In each subsequent years:
  - For elimination of HR cost included in the value of Human Asset:
  Human Capital Account Dr.
  To Human Asset Account
  - A portion of HR investment cost which are included in the value of human asset may be eliminated over the length of service or the expected benefit period of such cost outlay by the following entry:
  Human Capital Account Dr.
  To Human Assets Account

The above entries are to be passed to complete the double entry system and balancing.

- If any further HR investment is made for recruitment, selection, training and development etc. it may again be debited to Human Asset Account by crediting Cash or Bank Account. It is also assumed that fresh cash always to be brought for HR investment.
  - Cash/ Bank Account Dr.
  To Human capital Account
  - Human Asset Account Dr.
  To Cash/ Bank Account

In this way HR accounting may be considered as an integral part of accounting. At the same time it can be put in conventional Balance Sheet. The Balance Sheet of a profit seeking concern may be modified and redesigned as below:

Particulars	Note on	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
I. Equity & Liabilities			
(1) Shareholders' Funds			
(2) Share application money pending allotment			
(3) Non-current liabilities:			
a. Long term borrowings			
b. Deferred tax liabilities			
c. Other long-term liabilities			
d. Human capital			
e. Other long term provisions			

(4) Current Liabilities Total **II Assets** (1) Non Current Assets a. Fixed Assets i. Tangible Assets ii. Intangible assets iii. Capital work-in-progress iv. Intangible assets under development b. Non-Current Investment c. Deferred tax assets(net) d. Long term Loans and advances **e. Human assets** f. Other non-current assets (2) Current Assets Total			

Conclusion

The suggested model does not compete with the other human resource valuation models, rather it aims to make the human resource valuation process more effective and acceptable. The suggested accounting approach can be followed by the conventional accountants easily in the books of accounts. The accounting equation and double entry system would not be disturbed by incorporating the suggested entries. Accountants may follow these accounting entries relating to human resource irrespective of human resource valuation model followed by them. The suggested accounting approach may also helps to comply fully the accrual principle, the matching principle and the principle of disclosure.

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