

The Needs for Human Resource Accounting: Prospects & Challenges

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Abstract— *Human resource accounting is a very vital aspect that provides efficiency in an organization. It helps an organization in proper utilization, planning, controlling and accounting for people as the organizational resources as well as measurement of cost and value of people to the company. This paper aims to justify the needs for Human Resource accounting, its benefits and objectives as well as different approaches for valuation of Human resource. It also elaborates some limitations that hinder the effective and efficient operations of HRA in a firm. The data used in this research is solely from secondary source . At the end of this paper a policy recommendation was suggested.*

Keywords: *Human resource accounting, Human assets, Valuation.*

1. INTRODUCTION

“Our main asset is our people” How true is this often repeated statement made by management of organizations? The success or otherwise of an organization depends on how best the scarce physical resources are utilized by the human resource. What is important here is that the physical resources are being activated by the human resources as the physical resources cannot act on their own. In spite of the important role played by human resources in organizations, accounting is still based on an industrial paradigm in which only physical and tangible property is considered asset. It is in the light of the above that accountants began research into the area of Human Resource Accounting (HRA). Although, it is relatively a new field, its development has already passed through several stages. The first stage of development from 1960 to 1966 was marked by interest in human resource accounting and the derivation of the basic HRA concepts from related bodies of theory. The initial impetus for the development of HRA came from a variety of sources including; the economic theory of human capital, organizational psychologists’ concern for leadership effectiveness, and a concern for human assets as components of corporate goodwill. It is believed that the human resource is the most vital part of any organization, as it makes sure there exists a symbiosis between financial and all other physical resources towards the achievement of organizational objectives and goals. Conveniently, financial assets are accounted in the books of accounts as per the general

principles of accounting, but does not account for the human asset. Although many efforts have been made by many thinkers in this area, proper/appropriate and fully validated model of performance based on human resource accounting is not yet available. However, some authors have been able to put writings in the area. Human Resource Accounting is a process of identifying and measuring data about human resource and communicating this information to interested parties. Therefore, it is an attempt to identify and report investment made in resources of an organization that are not presently accounted for under conventional accounting practices. Moreover, human resource accounting helps to measure the value of employees, which helps the management take vital decisions related to human resources in order to increase production. It requires the measurement of the performances of an organization and the optimum use of the resources under the direct and indirect control. Hence, the overall valuation is important for decisionmaking in order to achieve the organizational objectives and improve the output. This traditional practice could again influence the financial position of an organization. The current accounting system has not been able to provide the actual value of employees’ capabilities, knowledge and experiences. This seems to indirectly affect future investments of a company as each year the cost on human resource development and recruitment increases. Haven’t the Accounting Standard Setters seen the need to legislate HRA or do they see it as lacking symmetry with traditional resource.

2. AN OVERVIEW OF HUMAN RESOURCE ACCOUNTING (HRA)

Financial accounting has developed various tools that largely measure activities and their results in such areas as profits, costs, production, etc. These tools also measure the value of various physical assets (land, building and machinery, etc.) as well as of various intangible assets (goodwill, patent, brand, etc.). However, financial accounting does not measure the value of human resources which can be 4 to 20 times of the value of physical and financial assets of an organization. In

order to bridge this gap, behavioral scientists have made attempts to measure the value of human assets. An early attempt was made by LIKERT and BOWERS. This attempt was further extended by others to give some concrete shape which has generated human resource/assets accounting. FLAMHOLTZ who has done considerable work in the area of human resource accounting, has defined it as follows:

“Human resource accounting is accounting for people as an organizational resource. It involves measuring the costs incurred by business firms and other organizations to recruit, select, hire, train and develop human assets. It also involves measuring the economic value of people to the organization”.

Like any other terminological conflict in HRM, many people have started using human capital accounting in place of human resource accounting. Human capital accounting has been defined as an attempt to place a financial figure on the knowledge and skills of an organization’s employees or human capital. In fact, in both the nomenclatures, approaches and techniques are same. Therefore, we shall use the more common term human resource accounting.

According to American Accounting Society Committee on HRA “Human resource accounting is the process of identifying and measuring data about human resources and communicating this information to interested parties”.

Also **Stephen Knauf** “HRA is the measurement and quantification of human organizational inputs such as recruiting, training, experience and communication”.

Human resource accounting is primarily involved in measuring various aspects related to human capital. Its basic purpose is to facilitate the effective management of human resources by providing information to acquire, develop, retain, utilize and evaluate the human resources. The more specific aims of human resource accounting are:

- To provide cost-value data for managerial decisions regarding acquiring, developing, allocating and maintaining human resources so as to attain cost-effective organisational objectives.
- To provide information to monitor the effectiveness of human resource utilisation.
- To provide information for determining the status of human assets whether it is conserved properly; it is appreciating or depleting.
- To assist in the development of effective human resource management practices by classifying the financial consequences of these practices

2.1 VALUATION OF HUMAN RESOURCES

Valuation of human resources can be made on the basis of either the ‘cost of the resource’ or on the basis of ‘economic

value of resource’. Therefore different methods of valuation of human resources can be classified into the following two categories viz;

1. Cost based methods of human resource valuation
 2. Value based methods of human resource valuation
- 2.1.1 COST BASED METHOD OF HUMAN RESOURCE VALUATION

The following are the various methods under this category;

- ❖ Historical cost method
- ❖ Replacement cost method
- ❖ Opportunity cost method
- ❖ Standard cost method
- ❖ Total cost method

Historical cost method: This method of valuing human resources was first developed by William C. Pyle and R. G. Barry Corporation, USA in 1967. Under this method actual costs incurred on recruiting, selecting, hiring, training and developing the human resources of the organisation are capitalised and amortised over the expected useful life of the human resources. Thus a proper record of the expenditure made on hiring, selecting, training and developing the human assets is maintained and a part of it is written off from the income of the next few years during which human resources will provide service.

Replacement Cost Method: This method, first suggested by Rensis Likert, was developed by Eric G. Clamholtz. Under this method, the human resources are valued at their present replacement cost. If a new organization has to be started now, the cost of recruiting, selecting, hiring, training and developing human resources to their present efficiency level which will be considered as the value of human resources of the organisation.

Opportunity Cost Method: This method was first advocated by Kekimian and Jones. Under this method, the value of human resources ascertained on the basis of its alternative use i. e. on the basis of ability of doing other jobs. If an employee has no alternative use, he has no value according to this method. In nutshell, the value of an employee of one department can be determined on the basis of the offers made by other departments of the organization for his service.

Standard Cost Method: This method was propounded by David Watson. Under this method, the standard cost per grade of employee for recruiting, selecting, hiring, training and developing is determined year after year. The standard cost so arrived for all employees of the organization, when aggregated, gives the value of human resources of the organization. The standard costs of recruitment, training and developing individuals, can be developed on the basis of replacement costs. The standard costs for various purposes are also useful to compare the actuals and analyse the variations from standard.

Total Cost Method: This method was advocated by Pro. N. Das gupta. Under this method, the total expenditure incurred by the organization towards education and training of an employee so as to make him efficient in his present level or to make him fit for the organization's requirement, is taken as the value of an employee to an organization such value is to be adjusted every year on the basis of age, experience, seniority, status and performance etc.

2.1.2 VALUE BASED METHODS OF HUMAN RESOURCE VALUATION.

The following are the various methods under this category;

- ❖ Capitalization of super profits method
- ❖ Present value of future earnings method
- ❖ Rewards valuation method
- ❖ Net benefit method

Capitalization of super profit method: This method was developed by Herman son. Under this method, the value of human resources of an organization is measured by capitalizing the earnings of the business in excess of normal earnings earned from similar type of business. The excess or super earnings of the business is assumed to be due to the better resources of the organization and accordingly capitalized as the value of the human resources.

Present Value of future earnings Method: This method was developed by Brauch Lev and Aba Schwartz in 1971. In this method, the future earnings of various groups of employees are estimated up to the age of their retirement and are discounted at a predetermined rate to obtain the present value of such earnings. This method is similar to the present value of future earnings used in the case of financial assets. However, this method does not give correct value of human capital as it does not measure their contributions to achieving organisational effectiveness.

Rewards Valuation Method: This method was suggested by Flamholtz. The method removes the defects of the previous method and value the human resources on the basis of their discounted earnings in the future, taking into account changes in their service and the possibility of early retirement.

Net Benefit Method: This method was suggested by Morse in 1972. Under this method, the value of human resources is equivalent to the present value of the net benefits derived by the enterprise from the service of its employees.

3. SOURCES OF DATA

All the data were sourced from secondary sources which includes next books, thesis and internet.

3.1 BENEFITS OF HUMAN RESOURCE ACCOUNTING

The concept of human resource accounting cover the people who constitute a valuable resources of an enterprise and

information on the investment and value of such resources is useful for internal and external decision-making. Such accounting is of permanent importance to the nation and also to individual organizations. The following are the main benefits of human resource accounting:

1. **Helpful in proper interpretation of return of capital employed:** The human resource accounting will disclose the value of human resources. This will help in proper interpretation of return on capital employed. Such information will give long-term perspective of the business performance which could be more reliable than the return on capital employed based on net profit only
2. **Improves managerial Decision-making:** The maintenance of detailed records relating to internal human resources(i. e. employees), will improve the managerial decision making especially in situation like direct recruitment versus promotion, transfer versus retention, retrenchment versus retention and decision on relocating plants, closing down existing units or developing overseas subsidiaries etc.
3. **Serves social Purpose:** It will serve as social purpose by identification of human resource as a valuable asset which will help in prevention of misuse and under use due to thoughtless or rather reckless transfers, demotions, layoffs and day to day maltreatment by supervisors and other superiors in the administrative hierarchy.
4. **Increase productivity:** It will have the way for increasing productivity of the human resources because, the facts that a monetary value is attached to human resources and that human talent, devotion and skills are considered as valuable assets and allotted a place in the financial statements of the organization, would boost the morale, loyalty and initiative of the employees, creating in their mind a sense of belonging towards the organization.
5. **Essential where the human element is the prime factor:** HRA is absolutely essential in such organization where human element is the prime factor e. g. , a professional accounting firm, a drama company, a solicitor and attorney firm etc.
6. **Helps in investment decisions:** The value of a firm's human resources is helpful in potential investors and others users in making long-term investment decisions.
7. **Completes MIS:** Human resource data would create a more complete management information system as it can provide information of vital importance for both short-term and long-term decision making as well as performance measurement.

3.2 OBJECTIVES OF HUMAN RESOURCE ACCOUNTING

- To furnish cost value information for making management decisions about acquiring, allocating, developing and maintaining human resources in order to attain cost effective organization objective.

- To allow management personnel to monitor effectively the use of human resources.
- To provide a determination of assets control i. e, whether human assets are conserved, depleted or appreciated.
- To aid in the development of management principles by classifying the financial consequences of various practices. +
- To facilitate the effective and efficient of management of human resources
- To evaluate the return on investment in human resources.

From the above, it is clear that there are three(3) important aspects of HRA as given below:

- I. Valuation of human resources.
- II. Recording the valuation in the books of accounts.
- III. Disclosure of the information in the financial statements of the business

4. LIMITATIONS OF HUMAN RESOURCE ACCOUNTING

No doubt HRA can provide valuable information both for management and outsiders, yet its development and application in different industries and organizations has not been very encouraging. This accounting concept is not popular like social accounting because it may not result in providing immediate and tangible benefits and on account of the facts of lacks of consensus among accountants and other concerned about the basis of measurement of the value of human resources. The reluctance on the part of the organization to introduce the HRA system can be attributed to the followings

1. There are no specific and clear-cut guidelines for finding cost and value of human resources of an organization. The existing valuation system suffers from many drawbacks.
2. The life of human resources is uncertain and therefore, valuing them under uncertainty seems unrealistic.
3. There is a possibility that HRA may leads to dehumanizing and manipulations in employees. For example, a person having a low value may feel discouraged and thus, in itself, may affect his competency in work.
4. The much needed empirical evidence is yet to be found to support the hypothesis that HRA, as a managerial tool, facilitates better and effective management of human resources.
5. Human resources, unlike physical assets, are not capable of being owned, retained and utilized at the pleasure of the organization.
6. There is a constant fear of opposition from trade unions. Placing the value on employees would prompt them to seek rewards and compensation based on such valuation.
7. In what form and manner, should their value be included in the financial statements? Is another question on which there is no consensus in the accounting profession.

5. CONCLUSION ANDRECOMMENDATIONS

In spite of the above problems and limitations, HRA is a most to improve HRM in order to overcome issues arising from valuation of intangible assets and to overcome the difficulties in providing sufficient information to existing and potential investors. However, as more experience is gathered in the use of various models, it is expected that in the years to come corporate reporting practices will ascribe greater importance to this emerging dimension of accounting.

Therefore, going by this research, we recommended that International Accounting standard Board shall consider HRA as the tools for effective HRM, so that consideration should be placed. Managers, accountants and academicians shall combine their efforts together towards eliminating such drawbacks of the HRA.

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