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# "HUMAN resource ACCOUNTING: a strategic approach to corporate excellence"

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***Abstract:**In the era of Globalization of economy, organizations are considering their employees as "Human Capital' 'Human Capital' (HC) refers to the features such as knowledge, skills, attitude, creativity, aptitude, and commitment possessed by employees of an organization. Thus, employees become as key success factors of competitive advantage and long term sustainability. According to resource-based as well the knowledge-based theory, success of contemporary organizations is no longer attributable exclusively to material capital but rather to intangible assets such as human capital. Hence, human capital is the core driving force for sustainable competitive advantage .Their skills, creativity, and ability cannot be replaced by machines. The Companies can lose efficiency in work in the absence of quality people. Thus companies must learn to recognize and appreciate the value of their employees. Human Resource Accounting gives information regarding inner strength of organization and helps in making decisions regarding long-term investment in that organization. It is the measurement of the cost and value of people to organizations. It involves measuring costs incurred by private firms and public sectors to recruit, select, hire, train and develop employees and judge their economic value to the organization. The present study highlights the significance of Human Capital valuation and methods to measures human assets value. The paper also describes Emerging Practices across Organizations Globally as well in India and how they have tried to implement human capital accounting*

***" people are now realizing that their intangible assets are worth much more than their tangible ones. Now an attempt is being made to put a value to these intangibles, and to bring these hidden values to book."***

***(Yezdi H. Malegam, managing director, S.B. Billimoria & Company)***



## INTRODUCTION

The success of any organization, to a great extent, depends upon the quality and caliber of the people working in it. . The advent of scientific management emphasizes on quantitative methodology to make the most efficient use of all resources. It also includes the computation of the people working in the organization as Human Resource Capital. High performing organizations in order to keep performing on a continuous basis must treat their human capital as the most important and valuable asset. When service sector started major contribution to the country's economy the significance of human assets got prominence. In the Knowledge sectors like Information Technology(IT), Banking, Teleservices and the others, the intangible assets especially human capital contributed enormously to the building of shareholder`s value. Intellectual power of employees and their contributions are the major inputs in these sectors. The critical success factor for any knowledge based company is its skilled and intellectual work force.

Human Capital Accounting is the activity of ascertaining the cost invested in the employees towards their recruitment, training, payment of salaries & other benefits and in return evaluate their contribution to organization towards it's turnover and profitability.

Vol. 2 Issue V, May 2014
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INTERNATIONAL JOURNAL FOR RESEARCH IN APPLIED SCIENCE AND ENGINEERING TECHNOLOGY (IJRASET)

When the human resources were quantified, it gave the investors and other client's true insights into the organization and its future potential. Proper valuation of human resources helps organizations to eliminate the negative effects of redundant labor. This, in turn, helped them to channelize the available skills, talents, knowledge and experience of their employees more efficiently. Human Resource Accounting gives information regarding inner strength of organization and helps in making decisions regarding long-term investment in that organization. It is the measurement of the cost and value of people to organizations. It involves measuring costs incurred by private firms and public sectors to recruit, select, hire, train and develop employees and judge their economic value to the organization.

The present study highlights the significance of Human Capital valuation and methods to measures human assets value. The paper also describes Emerging Practices across Organizations Globally as well in India and how they have tried to implement human capital accounting

By implementing HCA in an organization, the following important information could be obtained:

- Cost per employee
- Human capital investment ratio
- The amount of wealth created by each employee
- The profit created by each employee
- The ratio of cost to the total revenue generated
- Average cost of each employee
- Employee absenteeism rates
- Employee turnover rate and retention rate...

## REVIEW OF LITERATURE

To measure human value as a part of the goodwill various research were conductedsome are given as follows, HRA was introduced in the accounting literature in the 1960s (Flamholtz, 1985). In 1968 Brummet, Flamholtz & Pyle used the term "human resource accounting" for the first time. In 1973 the American Accounting Association's Committee on Human Resource Accounting defined HRA as "the process of identifying and measuring data about human resources and communicating this information to interested parties. It provides information about human resource costs and values, serves to facilitate to decision making, and motivates decision makers to adopt a human resource perspective (Sackmann et al., 1989,).

Research into true human research accounting began in 1960s by Rensis Likert (Bowers, 1973). Likert defends long-term planning by strong pressure on human resources' qualitative variables, resulting in greater benefits in the long run. Support for the idea of accounting for human resource values can be found much earlier (Sacmann et. al., 1989). In 1965, Cronbach & Glaser (1965) and Naylor & Shine (1965) developed models for estimating the financial utility of personal selection. To embrace both HRA and UA (Utility Analysis), Grojer & Johanson (1996) use the concept Human Resource Costing and Accounting (HRCA). Grojer & Johanson (1996) express the management orientation of HRA even more clearly in the assertion that HRA concerns the management of human resources.

Guy Ahonen. Johanson (1999) propose that decision making and learning by investors and managers are influenced when managers hold positive attitudes towards HRCA. Jones (2000, p. writes that "Financial reporting systems need to account for people.

Various approaches to Human Resource Valuation followed by companies

One of the first attempts to estimate the money value of human beings was made around 1691 by Sir William Petty [10]. Petty considered labor the "father of wealth" and thus felt that labor must be included in any estimate of national wealth. In this attempt human asset valuation estimated the value of the stock of human capital by capitalizing the wage bill in perpetuity at the market interest rate; the wage bill being determined by deducting property income from national income.Ernst Engel's writings around 1883 recommended a cost-of-production procedure for estimating the monetary value of human beings. . Brummet, Flamholtz & Pyle (1969) focused on HRA as a tool for increasing managerial effectiveness in the acquisition, development, allocation, maintenance, and utilization of its human resources. The authors' work represented one of the first attempts to develop a system of accounting for a firm's investments and studied the application of HRA in R.G. Barry Company, a public entrepreneurial firm. The early work in HRA provided inspiration for the next phase of early HRA development, basic academic research developing measurement models. These Attempts have resulted in the development of many different concepts and measurement models.

Vol. 2 Issue V, May 2014

ISSN: 2321-9653

INTERNATIONAL JOURNAL FOR RESEARCH IN APPLIED SCIENCE AND ENGINEERING TECHNOLOGY (IJRASET)

In order to quantify the talent, skills and knowledge of employees or workforce various models were suggested.

Some of the models for valuation of Human Resources are:

HISTORICAL COST METHOD

This method was developed by William C.Pyle and adopted in 1969 by R.G.Barry Corporation, a Leisure footwear company in USA. The historical cost of human resources is very similar to the book value of the other physical assets. In this approach, actual cost incurred on the human resources of the organization are capitalized and amortized over the expected useful life of the human resources.

REPLACEMENT COST MODEL

According to this model the value of employee is estimated as the cost of replacement with a new employee of equivalent ability and efficiency. Cost of recruiting, selecting, training and development and familiarization cost and cost of filling different position in an organization accounts replacement cost. This approach is more representative and logical as it incorporates the current value of company's human resources in its financial statements prepared at the end of the year but suffers from limitation that it is difficult to find identical replacement of the existing human resource in actual practice.

OPPORTUNITY COST MODEL

This model assigns value to an employee based on what each department would be willing to pay him. Quantifying HR value is difficult under this method. Because alternative use of HR within the organization is restricted .

LEV AND SCHWARTZ COMPENSATION MODEL

This model developed in 1971 by Lev and Schwartz for valuing human resources. The model advocated the estimation of future earnings during the remaining service life of the employee and then arriving at the present value by discounting the estimated earnings at the cost of capital.

STOCHASTIC REWARDS MODEL

The Model was developed by Eric G.Flamholtz. According to Flamholtz, the value of an individual is the present worth of the services that he is likely to render to the organization in future. As an individual moves from one position to another, at the same level or at different levels, the profile of the services provided by him is likely to change.
The present cumulative value of all the possible services that may be rendered by him during his/her association with the organization is the value of the individual.

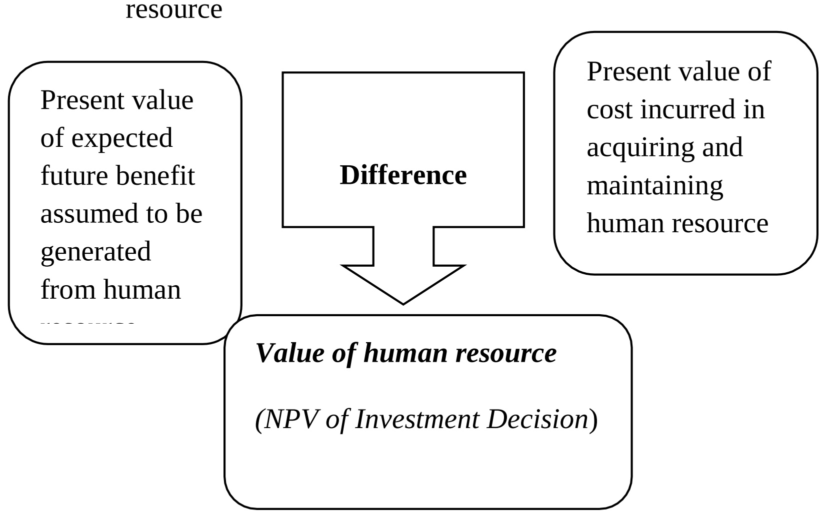
CHAKRA BORTY MODEL

Sk. Chakraborty of Indian institute of management Calcutta was the first Indian to attempt at valuation of resources. The cost of recruiting ,learning, selection, training and development of each employee should considered and be treated as deferred revenue expenditure, which is gradually written off over a tenure of employment of employee .The balance, not the written off amount, should be shown separately in the balance sheet under the head of investment.

NON-MONETARY MODEL

The non-monetary methods for assessing the economic value of human resources also measure the Human Resource by ratings and rankings. The non-monetary methods may refer to a simple inventory of skills and capabilities of people within an organization or to the application of some behavioral measurement technique to assess the benefits gained from the Human resource of an organization

Model for investment decision in human resource



ISSN: 2321-9653

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Whereas,

I. PV of Cost incurred on human resource can be determined as sum of the capital cost and current cost discounted at appropriate rate.

The cost incurred on human resource can be categorized as

1. Capital cost- capital cost includes the costs which are not recurring in nature. It may includes the following items

- Expenditure on advertisement for recruitment
- Cost of selection
- Training and development cost
- Educational tour expenses

2. Current cost- The expenses incurred for the maintenance of human resources are termed as current costs. These cost are recurring and includes the following items

- salary & allowances
- overtime wages, bonus & Medical expense
- Employee's Welfare Fund
- Contribution to provident Fund

II. PV of future benefit can be calculated from expected incremental revenue generated from hiring that humane resource discounted at appropriate rate.

Limitations : *The model will hold only for investment decision of a person at managerial level heading any revenue center, profit center or investment center.*

Indian practices:

With the availability of huge manpower at relatively low cost in India human asset and its valuation was ignored earlier. With the liberalization of the Indian economy and to compete in the global market organization need to be managed effectively and efficiently and achieving corporate excellence in respect of all the factors of production, now the importance of human element in an organization has been realized and Indian companies also started practice of considering human resource factor just like another factor to production.

Indian organizational and Human Resource Dynamics are different from that of other part of the globe. The government report shows that approximately 73 per cent of national income is utilized to compensate employees. In addition to wages and salaries, organizations often make other sizable investments in their human resources

Accounting standards , GAAP and Companies Act, 1956 governs the preparation and disclosure of accounting statements but there is no statutory requirements furnish HRA related information in the financial statements of the companies except the remuneration paid to them and the number of employees getting compensation beyond certain amount per annum, but there are a few organizations, however, that do recognize the value of their human resources, and furnish the related information in their annual reports.

HRA was pioneered in India by public sector companies like Bharat Heavy Electronics Ltd. (BHEL) and Steel Authority of India Ltd. (SAIL) etc. however in early nineties the practice were adopted by some private companies also.

*HRA Model followed by some India PSUs*

Bharat Heavy Electricals Limited (BHEL):

This Company followed the discount rate at 12 per cent considering the weighted average cost of capital. It adopted the model of Lev& Schwartz and categorized employees according to their age, grade and category for the purpose of valuation and reporting information related to human resource accounting. It also disclosed the ratios like Human Resources (HR) / Total Resources (TR), Human Resources/ Fixed Assets (FA), Turnover / Human Resource value, Value added / Total Resource, Profit Before Tax / Human Resource value.

Steel Authority of India Limited (SAIL):

SAIL reports value of its human resources from the financial year 1983-84, and it follows the human resource valuation model suggested by Lev and Schwartz by taking some adjustments given by Flamholtz. SAIL takes the possibility of leaving the job by employees. SAIL has divided its total number of employees into six groups (a) Managers (b) Executives (c) Supervisors (d) clerical staff (e) Skilled workers and (f) Semi skilled workers. It reports number of employees' category wise, age wise and total. It also reports the human resource value of all employees in total as well as category wise. SAIL uses the constant rate of discounting the future expected return at 15 per cent.

National Thermal Power Corporation (NTPC):

ISSN: 2321-9653

INTERNATIONAL JOURNAL FOR RESEARCH IN APPLIED SCIENCE AND ENGINEERING TECHNOLOGY (IJRASET)

NTPC divides total employees into three groups as under (a) Executives (b) Supervisors (C) and Workmen. It also presents some ratios similar to Human Resource Value/ Total Resource Value, Value added / Human Resource Value, Turn over / Human Resource Value.

Oil India Limited (OIL):

This company reports total resources including Human Resources at current costs. It uses the Lev and Schwartz model with suggestions given by Flamholtz . It categorized all employees into two groups. (i) Technical, (ii) Administrative and Commercial. Company further classifies them into three groups (i) Managers (ii) Executives and (iii) Work men. The discount rate varies from 10.5 per cent to 15 per cent.

Oil and Natural Gas Corporation Limited (ONGC):

This Company considers the rate of interest, at which the Government of India advances them loans, as the discount rate. It divides total employees into four categories as under (a) Managerial and Supervisory (b) Clerical (c) Skilled Workers (d) Unskilled Workers.

*HRA Model followed by some Indian Private sector companies*

Associated Cement Companies (ACC):

Categorized total employees age wise and designation wise like (a) Senior executives (b) Managerial (c) officers (d) clerical and other (e) supporting staff (f) skilled workers (g) semi skilled workers (h) unskilled workers to asses the value of human resources and it has been disclosed from the financial year 1983 -84 by using Lev & Schwartz model with adjustments suggested by Flamholtz, Jaggi and Lau. ACC reported in its annual report information under the head human resources accounting. This company not depicted human resources accounting information from the year 1987.

Global Tele Limited (GTL):

This company reports human resource value in the section ‘‘people first’’. GTL follows the Lev and Schwartz model and divided the total employees into two groups as under: (i) Operation Staff and (ii) Support Staff / Other. GTL also reports some ratios, Total HR value to total turn over, value added to total value of human resource.

Reliance Industries Limited

Reliance Industries limited company is no. one private sector Company. It provides the information regarding No of Employee and employee cost, earning per share and total assets. Company had not reported the discount rate, value added, EVA, value added per Employee value model and also turnover per employee.

Satyam Computers Limited :

It uses the Lev and Schwartz model to asses the value of human resources. It considers the weighted average cost of capital for the past five years as the discount rate; employees are divided into two categories: (a) Development associates, (b) and support associates. It also reports associates cost i.e. cost of employees in rupees and also as a percentage of human resource value, percentage share of development associates human resources value and support associates human resources value in total human resource value.

Infosys Technologies Limited

In Infosys, the Lev and Schwartz model has been used to measure the value of human resources. The company has valued its HR based on certain assumptions, which include: (a) Employee compensation includes all direct and indirect benefits earned both in India and abroad, (b) The incremental earnings based on group/age are considered, and (c) The future earnings are discounted at the rate which is equivalent to the weighted average cost of capital of the last five years. The discount rate varies from year to year. The employee strength along with the category, gender and age-wise classification, have been specified in the annual reports under the Section ‘Additional information to shareholders’.

## GLOBAL SCENARIO

The International Financial Reporting System (IFRS) do not currently have standards requiring HRA but they are moving closer to providing more flexible approaches to accounting measurements and reporting. For example, the international standards IAS 38 Intangible Assets and IFRS 3 on Business Combinations allows for the recognition of the intangible asset goodwill, which indicates willingness to allow for valuation of assets that are not traditional tangible assets, such as human resources. The valuation of goodwill often involves complex assessments of fair values as well as periodic reassessments to determine whether the fair values have become impaired. These more difficult and challenging measurements of goodwill and other fair values are similar to some of the challenges documented in the past related to the measurement of human resources, particularly when using the value approach to HRA.

ISSN: 2321-9653



Thus, the movement toward fair value accounting seen in recent years for both U.S.GAAP as well as for international accounting standards IAS, indicates a more sophisticated approach to the measurement of assets, tangible as well as intangible. This is assumed their willingness to recognize the need for, and consider the measurement and use of HRA in future external financial reporting is strong.
In the United Kingdom and the United States, professional sports teams' financial accounts often incorporate HRA, in which a value for the employees is placed on the balance sheet and is amortized over a period of time, instead of expensing costs.

## CONCLUSION

In today's time of globalization and cost cuts, HCA would give an organization a correct vision towards the way forward. . The profitability of the organization depends a lot on its ability to attract, develop and nurture a cadre of competent professionals because they, like any other optimally used input, play a major role in increasing the turnover and profitability of the firm. Thus valuation of this intangible asset should be done not just in cost but also in the tangible and intangible returns it brings to the organization. Therefore The Human capital is not just the cost but also revenue for the organization and like any other asset needs proper accounting. The study has shown that many top companies of the world and also in India are practicing HCA and they have grown and maintained a good position in the market. There have been instances in the corporate history where leaving of an individual from the company has plummeted its share prices. This once again proves the capital value of the individual .Rationalizing it and giving accounting standards is the need of the hour.

## Suggestions

In the ultimate analysis it must be said that the concept of HRA has been appreciated by the accounting professionals and by and large its usefulness has also been acclaimed in the literature but unfortunately, its application has not flourished throughout the world. The International Accounting Standards Board (IASB), and the Accounting Standards Board (ASB), has not been able to formulate any specific accounting standards on measurement and reporting of cost and value of HR of an organization. Hence, considering the paramount importance of HRA, proper initiation should be taken by the Government as well as Professional Boards at the National and International levels in respect of formulation of specific accounting standard and suitable valuation models on the measurement, disclosure norm and reporting norm for value of HR.

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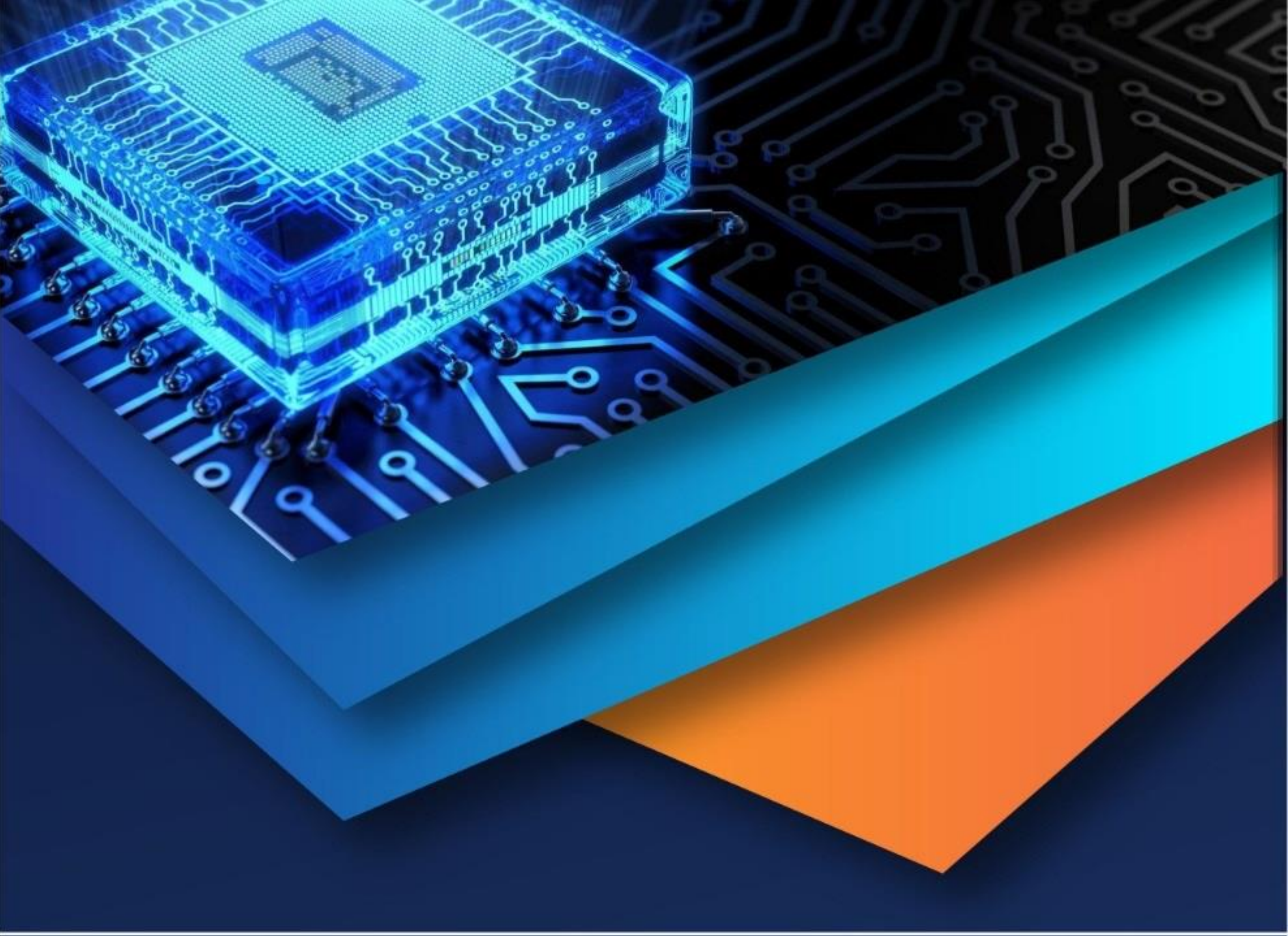

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