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**Human resource accounting: A new paradigm in the era of globalization**

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**ABSTRACT**

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. Conventionally, financial assets are accounted in the books of accounts as per the general principles of accounting, but does not count the human asset. Although many efforts have been made by many thinkers in this arena, a proper/appropriate and fully validated model of performance based on accounting in the Indian context is not yet available. The past few decades have witnessed a global transition from manufacturing to service based economies. Though, Human Resource Accounting (HRA) was introduced way back in 1980s, it started gaining popularity in India recently.

In order to estimate and project the worth of the human capital, it is necessary that some method of quantifying the worth of the knowledge, motivation, skill, and contribution of the human elements as well as that of organizational processes, like recruitment, selection, training, etc which are used to build and support these human aspects, is properly developed. HRA denotes this process of quantification/ measurement of Human Resources. The physical assets like land, building, plant and machinery are recorded in the books of accounts at their purchase price. Now, depreciation on these assets is considered as the cost for the particular year and debited to profit and loss accounts and the remaining balance is shown in the balance sheet as written down value of the assets. Hence, on similar lines the human resources should also be evaluated, recorded in the books, operated and disclosed in the financial statements. In this paper the author has elaborately discussed about the objectives and process of HRA in the Indian context. The basic objective of the paper is to study the Human Resources Accounting practices, to identify the issues and challenges, to examine these issues and challenges and lastly, to give suggestions based on the findings of the study.

**Key words:** Globalization, Physical Assets, Human Resource Accounting (HRA)

**1.Introduction**

Even though many efforts have been made by thinkers in this field, a suitable and fully validated model of performance based accounting in the Indian context is not available. The past few decades have witnessed a global transition from manufacturing to service based economies. Human resource accounting is of recent origin and is struggling for acceptance. Human resource is the vital input of any organization in this era of globalization, as it pulls on all other physical and financial assets/resources towards the achievement of organizational goals. Conveniently

financial assets are accounted in the books of accounts as per the general principles of accounting except human asset. Though Human Resources Accounting (HRA) was introduced way back in the 1980s, it started gaining popularity in India recently. In order to estimate and project the worth of the human capital, it is necessary that some method of quantifying the worth of the knowledge, motivation, skill and contribution of the human elements as well as that of the organizational processes like recruitment, selection, training, etc which are used to build and support these human aspects is developed.

Globalization means, “Integration of business activities across geographical and organizational boundaries. It is the capacity to treat the world as one market while...dealing with many culturally diverse merchants. It is a process by which markets expands to include competitors for customers and productive inputs without regard to national boundaries”

Physical assets are such as land, building, plant and machinery. It is recorded in the books of accounts at their purchase price. Depreciation on these assets are considered as the cost for the particular year and debited to profit and loss accounts and the remaining balance is shown in the balance sheet as written down value of the assets. Hence, on similar lines the human resources should also be evaluated, recorded in the books, operated and disclosed in the financial statements.

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 decision-making in order to achieve the organizational objectives and improve the output.

## **2. Methodology of the study**

Human resource accounting identifies, quantifies and reports the amount of expenditure incurred and the capital employed to recruit, train and familiarize and develop the human resources. So, the objective of this paper is to:

1. To study the Human Resources accounting practices
2. To identify the issues and challenges
3. To examine the issues and challenges
4. To give suggestions based on the findings of the study

The current accounting system is not able to provide the actual value of employees capabilities and knowledge. This indirectly affects future investments of a company, as each year, the cost on human resource development and recruitment increases. The human resource accounting system generates information on various aspects of human resources (such as acquisition, development, allocation, utilization and replacement) in the same manner the financial accounting system is for

physical assets. So, it also measures the value of human resources to the organization in terms of monetary units.

## **2.1 Approaches to Human Resource Accounting—**

Sir William Petty was perhaps the first person to make an attempt to signify the HR accounting in around 1691. He treated the labor as the generators of wealth. Even Adam Smith had recognized the investment on human resources. The post 1960's witnessed a significant development of business people joining hands with the academics to evolve suitable methods to account for human resources. Consequently, a number of models or approaches have been developed and suggested for the measurement and valuation of human resources. These approaches may broadly be classified into two types:

1. HR Cost Accounting (HRCA)
2. HR Value Accounting (HRVA)

Now let us discuss each of the above types individually.

HR Cost Accounting (HRCA) may be defined as the measurement and reporting of the costs incurred to acquire and develop people as organizational resources. It deals with accounting for investments made by an organization to the acquisition and development of human resource as well as the replacement cost of the people presently employed.

HR Value Accounting (HRVA) is the concept based on the view that difference in present and future earnings of two similar firms is due to the difference in their human capital or assets. The economic value of the firm can be determined by obtaining the present value of future earnings. A number of valuation models have been developed for determining the present value of future earnings.

## **2.2 Major Issues of Human Resource Accounting—**

The following are the major issues which should be considered for implementation of HR accounting. They are as follows:

1. The traditional accounting procedures, which have been practiced since long have come to stay as acceptable norms. As a result, whenever a new accounting system is developed, it is pitted against the strengths of the traditional system, which is considered to be comparatively objective and free from any bias. Similarly, in the case of HR accounting also, it is argued that it lacks symmetry with traditional resource as it cannot be included with in the traditional definition of an asset that of a human
2. There is little agreement concerning the procedure in accounting for human assets. There are proponents and critics of the various approaches like cost and value approaches. This factor has become responsible for the slow development of the concept of HRA.
3. The historical cost approach to develop measures of HRA uses an amortization rate, which provides the figure of amortization to be charged to the profit and loss account every year. But it is very difficult to develop norms in this regard. Physically and

mentally, individuals grow and deteriorate at different rates. Some grow more capable as a result of their work experience, others do not. Given the difficulty of predicting such changes, it is even more difficult to develop a means of writing off an individual's value. So far, precise measures for amortization of human assets have not been developed.

4. In the recent past, it has been observed that the value-based measures of HRA are finding more acceptances with Flamholtz approach being progressively used. However, this approach depends heavily on the measurement of an individual's or a group's contribution of valuation. But, measurement of contribution, especially at the managerial levels, is quite a difficult task. As a result, this factor proves to be a hindrance in the development of the concept of HRA.
5. Another issue which has not been settled so far is about the rate at which the prospective stream of contribution is to be discounted or compounded to calculate its present and future value to the organization. A number of applications are available in this process.
6. If an individual is to be valued normatively, the model given by Flamholtz expects that the career path of individuals should be plotted over the span of his probable stay with the organization in the light of the current promotion, and retirement policies of the organization. But such exercise is tedious.
7. It is possible that apprehension regarding the effect of HRA on human behavior may have forced the organization to be reluctant to use this system. HR accounting may lead to alienation as the people might feel that they have been reduced to as industrial input commodity. Publicizing of human resource data could have disastrous effect on the attitudes of employees.
8. The physical assets can be owned and traded by an organization but the human assets cannot and can be only utilized in this regard. The physical assets have some realizable value of retirement but the human resources do not have any such value. They may involve payments of retrenchment, compensation, gratuity and other benefits. Human resources is an appreciating asset since manpower improves with time, with due regard to their ageing constraint, but for physical asset its increasing value at the time of its installation, starts immediately depreciating.

### **2.3 The Challenges of Human Resource Accounting**

1. The ownership of human resources is practically impossible, therefore, it cannot be considered at par with other assets.
2. The measurement of Human Resources is subjective as different firms will use different methods for this purpose. Till date there is no model for valuation of Human Assets, which is widely acceptable and used worldwide.
3. It is not economical for small business units as it involves heavy costs if the firms desire to install the HR accounting package in their organization.
4. The concept of human resource accounting is not recognized by Tax authorities and therefore, it has only academic utility. If the accounting standards board makes it mandatory to disclose the values of Human capital or Human Assets, then only the Direct or Indirect Tax Authorities will take into concern of HR Accounting.

5. There are a number of specific objective procedures for the selection of the factors to be included in the valuation of human resources. Therefore the subjective approach of the value in their regard makes it less reliable.
6. Employees and unions may not like the idea, because HRA may lead to division among the ranks of employees. A group of employees may be valued lower than their real worth owing to reasons beyond the control of management. The employees may resist the idea of being treated like second class citizens, despite their contribution over a period of time.
7. There is no empirical evidence to support the idea that HRA is an effective tool to measure the economic value of people to their organization. There is very little data to support the contention that it facilitates better and effective management of human resource.
8. Measuring Intellectual Capital---
  1. Keep it simple
  2. Measure what is strategically important
  3. Measure activities that produce intellectual wealth

Measuring of intellectual capital can help managers and investors by providing a more accurate estimate of true value of the company than would a single accounting of its physical holdings.

1. Put people on Balance Sheet—“Every country, every company, and every individual depends increasingly on knowledge- patents, processes, skills, and technologies, information about customers and suppliers and experience”. This has brought up a new way of strategic thinking about “how to put people on the balance sheet”.
2. Intellectual Capital: Traditional financial statements are less illuminating with respect to the assets that create wealth than they were in the past. Intangible assets such as brand names, intellectual capital, patents, copyrights and expenditures for research and development now generate an increasing amount of wealth for firms. “Soft” assets are not recognized in financial statements.

## **2.4 Valuation Models**

The basis of valuation is quite complicated. It requires use of assumptions regarding probable stay of the employee with the firm at different stages of his service. Three important models have been developed in this regard.

1. Lev and Schwartz Model- It is based on the assumption that the employee will stay with the firm till retirement.
2. Eric Flamholtz Model- It is based on the assumption and the probability of expected stay with the firm at different stages of services of each employee.
3. Jaggi-Lau’s Model- This model introduces “Group” as the basis of such calculation based on historical data regarding employee turnover patterns.

## **2.5 Practices and Perceptions**

It is true that worldwide, knowledge has become the key determinant for economic and business success but Indian companies focus on 'Return on Investment' (ROI), with very few concrete steps being taken to track 'Return on Knowledge'.

What is needed is measurement of abilities of all employees in a company, at every level, to produce value from their knowledge and capability. "Human Resource Accounting (HRA) is basically an information system that tell management what changes are occurring over time to the human resources of the business. HRA also involves accounting for investment in people and their replacement costs, and also the economic value of people in an organization", says P.K.Gupta, the director of strategic development-intercontinental operations of Legato Systems, India. The current accounting system is not able to provide the actual value of employee capabilities and knowledge. This indirectly affects future investments of the company, as each year the cost on human resource development and recruitment increases.

In the financial year 1995-96, Infosys became the first software company to value the human resources in India. The company used the Lev & Schwartz model and valued its human resource assets at Rs 1.86 billion. Infosys had always given utmost importance to the role of employees in contributing to the company's success. Analysts felt that human resource accounting (HRA) was a step further in infosys' focus on its employees. Narayana Murthy, the then Chairman and Managing Director of Infosys, said: "Comparing this figure over the years will tell us whether the value of our human resources is appreciating or not. For a knowledge intensive company like ours, that is vital information".

The benefits of adopting HRA were manifold. It helps an organization to take managerial decisions based on the availability and the necessity of human resources. When the human resources were quantified, it gave investors and other stakeholders true insights into the organization and its future potential. Proper valuation of human resources helped organizations to eliminate the negative effects of redundant labor. This, in turn, helped them to channelize skills, talents, knowledge and experience of their employees more efficiently. By adopting and implementing HRA in an organization, the following important information could be obtained:

1. Cost per employee
2. Human Capital Investment Ratio
3. The amount of wealth created by each employee
4. The profit created by each employee
5. The ratio of salary paid to the total revenue generated
6. Average salary of each employee
7. Employee absenteeism rates
8. Employee turnover rate and retention rate

The concept of HRA was not new in India. HRA was pioneered by the public sector companies like Bharat Heavy Electricals Ltd. (BHEL) and Steel Authority of India (SAIL) way back in the 1970s. However, the concept did not gain much popularity and acceptance during that time.

The ICAI has so far not formulated any specific accounting standard on measurement and reporting of cost and value of HR. The Indian Companies Act, 1956, also has not explicitly provided for disclosure of HR values in the financial statements of the companies. In spite of an absolute unfavorable environment in India in the method of introducing the reporting on HRA, some of the Public Limited companies are following the HR Accounting practices now in India. The Lev and Schwartz model was the most popular and adopted with a little modifications by some Indian companies. However, companies like SAIL adopted Flamholtz's replacement cost model.

### **3. Conclusion**

This is an era of globalization and cost cuts, therefore, HRA would give an organization a correct vision towards the way forward. In the ultimate analysis it must be said that the concept of HRA has been appreciated by the accounting profession 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), have 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 and reporting of the value of HR.

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