HUMAN RESOURCES ACCOUNTING-SOME BASIC ISSUES

Ravinder Kumar*

ABSTRACT

Human resources are the key to the growth and success of an organization. To understand, develop, and utilize the potentials of this intellectual capital in the right perspective, the organizations are in a greater need to measure its value. 'Human Resources Accounting' (HRA) is a powerful tool in the hands of the employers in this direction. Basically it is an information system that tells management what changes over time are occurring to the human resources of the business. Though, HRA attempts to assign cost and value (monetary as well as non-monetary) figures to human assets using different methodologies, monetary value-based approach has found greater acceptability in India and abroad. However, the issue of accounting for human creativity is still at its infancy stage, which needs to be explored to gain and sustain competitive advantage. This paper tries to highlight the actual state of affairs of HRA practices in Indian corporate sector among some other basic issues concerning the topic.

Introduction

To an organization, human assets are the greatest well above the equipment, technology and the capital and should be viewed as one of the investments for future planning and growth. But it is ironical that the human resources that create wealth, utilizing money, machinery and material, do not find a place in the asset column of a firm's balance sheet.

Development of human resources enables an organization to meet the challenges of the ever-changing business environment. While most organizations maintain elaborate accounts of their tangible assets, like land and buildings, plant and machinery, and transport and office equipments, there is often no record of the investment in employees. Human Resources Accounting (HRA), also termed as Human Capital Accounting, Human Capital Valuation, Human Asset Accounting, and Manpower Accounting, is an attempt to recognize the human resources of an organization, quantify them in monetary terms, and show them on the organization's balance sheet. Though in Indian context efforts to incorporate the figures of human assets into the standard financial statements are immature, interest is growing in establishing a system of accounting for human resources. It is high time to think of a system of HRA at the macro level. Significance of the need of accounting for human assets can be highlighted by the following question:

* Dr. Ravinder Kumar is Senior Lecturer in the Department of Commerce and Business Studies, Jamia Millia Islamia, New Delhi, 110025

Supposing tomorrow a major catastrophe wipes out all of the human resources in an organization, how long would it take and how much would it cost to replace them with equivalent talent and competence? Typical estimates of such costs range from three to five times the present payroll.

Genesis and Concept of HRA

HRA is not a recent development. Rensis Likert, veteran social psychologist, equated human beings to assets in the organization and coined the term "human asset accounting" (a term later replaced by 'human resources accounting'), in the late sixties. In his view, the traditional procedure of accounting largely ignored a substantial proportion of the income-producing assets of the firms. He emphasized the importance of long-term planning of human resources' qualitative variables that result in greater benefits in the long run. Milwaukee Braves Inc. of the USA was the first organization to experiment with the concept of HRA in 1963, by treating its investments in future team development as an asset to be capitalized and amortized over its expected useful life, rather than as an expense in the relevant period. Since then, many thinkers have attempted to develop the subject by formulating models to assign cost or value (monetary as well as non-monetary) figures to human resources for various decision-making situations but still it is at a developing stage.

HRA is simply the process of assigning cost and value to human resources. The American Accounting Association (AAA) defines HRA as the process of identifying and measuring data of human resources and communicating this information to the interested parties.

Flamholtz offered a simpler definition of HRA. According to him, HRA is accounting for people as organizational resources and is the measurement of the cost and value of people in the organization.

The above definitions regard human beings as a resource in an organization and the focus is on its measurement and onwards reporting to the interested parties (i.e., the shareholders, managers, government, and any other agency) with a view to facilitating the decision-making.

HRA, as a matter of fact, is an extension of the accounting principles of matching costs and revenues and of organizing the data to communicate relevant information in financial terms. The accounting for human resources has an internal as well as external role to play. The internal role comprises providing requisite information to assist the managers in planning, organizing and controlling the human resources in the most efficient way. As regards the external role, HRA processes the data required to produce information that would enable the potential investors and other parties interested in evaluating the human resources in the firm for making relevant decisions.

Rationale of HRA

HRA makes a scientific attempt to measure the value of human resources of an enterprise and presents the information in the financial statements in order to communicate the change in their value.

There are two major reasons why HRA has been receiving wider attention of the corporate sector globally in recent years. First, there is a genuine need for reliable and complete information, which can be used in improving and evaluating management of human resources. Second, a traditional framework of accounting is in the process of including a much wider set of measurement than was possible in the past. Watson and Wyatt studied more than 750 companies in the US, Canada and Europe, with at least three years of shareholder returns, 1000 or more employees and minimum of US $ 100 million in revenues or market value. The sample consisted more than 23,10,000 employees. The study revealed:

- There exists a significant correlation between how companies manage their people measured by Human Capital Index (HCI), and the shareholder returns, and
- The HCI predicts shareholder returns much better than the shareholder returns predict HCI.

In a 'hire and fire' relationship, the employer may never realize the creative energy and capacity of his employees. Realizing the benefits accruing from them, the responsibility lies on the employers, as to how much importance they give to their human resources.

Significance of HRA

The organization's capital can be valued in terms of its ownership and legal form, its income, assets, and performance in terms of the products, brands, market share, and the growth. But beyond the conventional factors, the company exists as a group of committed people engaged productively for mutual benefits. The noted classical economist, Alfred Marshall has recognized that the most valuable of all capital is that invested in human beings. Human resources, as a matter of fact, is the only appreciating asset since they can be trained and motivated to develop and acquire higher skills till the very time of their superannuation. The absence of any information regarding the value of human assets in financial statements prepared under conventional accounting system is a serious handicap to decision making both on the part of the managers employing quantitative means to arrive at quantitative decisions and to investors likewise seeking to make rational decisions concerning their investment. Likert rightly cautioned that the non-accounting of human resources and the changes occurring therein, of an organization might provide a jaundiced picture of the profits and profitability of the organization.

Identifying and measuring the value of human capital can be a process worth investing. Realizing the importance of this phenomenon, many companies, the world over, are making HRA as a necessary element on their balance sheets. One of the best examples is of Denmark Government. The Danish Ministry of Business and Industry has issued a directive that with effect from the trading year 2005, all companies registered in Denmark will be required to include in their annual reports information on customers, processes and human capital. In India, efforts in the field HRA have mostly taken place in public sector undertakings that have sought of disclosing human asset values in their published annual reports and financial statements. However, professional accounting bodies have shown little interest in this direction.

Objectives of HRA

The basic objective of HRA is to facilitate the management of an organization plan and control the use of human resources effectively and efficiently and to report on their financial effects. HRA is intended to provide managers the information needed to acquire, develop, allocate, conserve, utilize, evaluate and reward human resources.

Despite a continuing debate about the objectives of HRA, the following objectives of HRA, outlined by the AAA, carry a wider acceptance in the accounting world:

- To develop valid and reliable models for measuring cost and value of people to organizations. This should include research on development of both monetary and non-monetary measures.
- To design operational systems of HRA

for implementation in actual organizations, and

- To determine the behavioral impact of HRA measurements on human resource decisions and performance.

Thus, the objectives of HRA are not confined to the recognition of the value of all resources used by the organization, but also include the management of human resources so that the quantity and quality of goods and services are enhanced.

Human Resources as a Balance Sheet Asset

An accountant sees an asset as something with a value on the balance sheet. Once human asset is valued, it is one of the significant aspects in HRA how it should be shown in the Balance Sheet. It can be shown as some extra information below the Balance Sheet or it can form part of the double entry system. Typical balance sheet of any business concern does not reveal 'human assets'. Employees' costs do feature in the profit and loss account but their "value" does not appear as an asset on the balance sheet. Due to statutory requirement, information pertaining to company's senior executives relating to their salary etc., is appended to the balance sheet. There it is shown as an asset though it is not forming part of accounts. Some treat it as fixed assets while others treat it as current assets or investments but it should form a separate category, as it cannot match with any other categories. Human Resource is an asset forming its own category and, therefore, its merit display under the heading – Human Resources.

HRA Disclosure Practices in Indian Corporate Sector

Though HRA is a recent phenomenon in Indian scenario, there seems to be a rising trend amongst Indian corporate sector towards the measurement and reporting of human assets during the last one decade. Bharat Heavy Electricals Ltd. (BHEL), the largest engineering and manufacturing enterprise in India in the energy-related and infrastructure sector, has been pioneer in introducing HRA in its Annual Report of the financial year 1974-75, as a factor of image projection. Subsequently in the interest of displaying 'true and fair' view of the assets and liabilities and to ensure better management control, as many as thirteen public sector undertakings and six private sector entities have started reporting 'Human Resources' through their respective Annual Reports as supplementary information since early eighties but on a limited scale. They are: (1) Steel Authority of India Ltd. (SAIL), (2) Hindustan Machine Tools Ltd. (HMTL), (3) Oil and Natural Gas Corporation Ltd. (ONGC), (4) National Thermal Power Corporation Ltd. (NTPC), (5) Hindustan Shipyard Ltd. (HSL), (6) Oil India Ltd. (OIL), (7) Minerals And Metals Trading Corporation Of India Ltd. (MMTC), (8) Cement Corporation Of India Ltd. (CCI), (9) Engineers India Ltd. (EIL), (10) Electrical India Ltd. (ELIL), (11) Projects and Equipment Corporation of India Ltd. (PEC), (12) Metallurgical And Engineering Consultants of India (MECON), (13) Canbank Financial Services Ltd. (CFSL), (14) Southern Petrochemical Madras Refineries Ltd. (SPIC), (15) Cochin Refineries Ltd. (CRL), (16) Madras Refineries Ltd. (MRL), (17) Associated Cement Companies Ltd. (ACC), (18) TELCO (now christened as Tata Motors), and (19) Infosys Technologies Ltd. (ITL).

For evaluation of human assets, most of the above organizations have adopted the "Economic Evaluation Method" and the basic model as conceived by Lev and Schwartz incorporating certain refinements as suggested by Flamholtz and Jaggi and Lau.

However, HRA has not been adopted systematically by the Indian corporate sector as yet, though its significance has been acknowledged in recent years. A perusal of annual reports of leading public sector undertakings and some of the private sector MNCs which claim to have practicing HRA viz., BHEL, NTPC, MMTC, HMT Ltd., and Tata Motors, has revealed that they contain hardly any worthwhile HRA information though, in a few cases like ONGC, SAIL, and ITL, HRA disclosure practice does appear to be in existence. Furthermore, a personal visit of the corporate office of BHEL unveils that no integrated system of HRA is available with the enterprise, as a result of various factors and a package of problems. Similarly during a survey of the Standing Conference of Public Sector Enterprises (SCOPE) in this behalf to get the first hand information on HRA practices by various PSUs, the concerned officials expressed their utter ignorance about the subject.

Conclusion

The idea of HRA has gained a good deal of interest, but in actual practice it has proved to be considerably difficult to actually assign monetary value to the intellectual capital. In most of the cases HRA systems is in operation with the aim to project the totality of the contribution of human element towards the growth of the organizations. But they can't be referred as methods of HRA without implementing an integrated system of HRA. Lack of an industry standard and extensive research (that it entails) seem to be the main hindrances. Another obstacle in implementing HRA is the dearth of awareness and acceptance of the concept amongst corporate sector. "In terms of awareness and acceptance, the level is still low as many companies take little initiative to make the numbers public to shareholders, despite having the data", says P K Gupta, the director of strategic development-intercontinental operations, of Legato Systems India. As a result, HRA has really developed at a slower rate than was originally hoped.

It appears that the accountants are not favorably disposed towards the idea of HRA. Two principal reasons seem to be responsible for this state of affairs while the first, is the lack of awareness about this accounting approach; the second, is that the accountants already have to deal with heavy task of accounting records. Introducing new dimension of HRA would mean increasing their burden.

Nonetheless, the issue of accounting for human creativity is undoubtedly a challenging area but is still at its infancy stage, where researchers could explore the link between human worth accounting and strategic human resource management in order to gain and sustain competitive advantage. It is suggested that the accounting bodies like Indian Accounting Standard Board, Institute of Chartered Accountants of India (ICAI), and Institute of Cost and Works Accountants of India (ICWAI), as also the International Accounting Standards Committee in collaboration with industry bodies like Federation of Indian Chambers of Commerce and Industry (FICCI), Confederation of Indian Industries (CII), and NASSCOM should help formulate guidelines and set a standard for implementing HRA practices in Indian corporate sector.

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