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A Study on HR Accounting Practices in Selected Companies

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Abstract:

Since the beginning of globalization of business and services, human elements are becoming more important input for the success of any corporate enterprise. It helps the management to frame the effective policies of human resources. HRA provides quantitative information about the value of human asset, which will help them to channelize the available skills, talents, knowledge and experience of their employees more efficiently. Therefore, HRA has very high significance not only for the management, but also for analyst. It is now followed by most of the medium and large scale companies in India as there is awareness of the benefits in terms of revenue, productivity, flexibility in skill development.

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. An attempt has been made in this paper to evaluate the HRA practices of Infosys Technologies Limited (ITL) and BHEL along with its usefulness in HR decisions. Some suggestions have also been provided to improve the HRA practices, which will ultimately contribute to ensure the bright future of HRA in India.

Keywords: Human resource accounting practices, valuation of human resources, future potential, value of human asset, skill development.

1. Introduction

With global downturn & economic slowdown two major sectors generating funds mostly were affected. Suddenly within a couple of months the organizations throughout the world started looking at their employees as liabilities & not assets. In this context, the concept of HR Accounting has greater applicability to the various problems which are rising as a result of economic recession. All the processes of the organization are operated by human resource, hence valuation of this resource is very necessary and information about the valuation should be given to the investors, the management and others through financial statements. HRA is a management tool which is designed to assist senior management in understanding the long term cost and benefit implication of their HR decision so that better business decision can be taken. If such accounting is not there, then the management runs the risk of taking decision that may improve profit in the short run but may also have severe repercussions in future. Human Resource Accounting is basically an information system that tells management what changes are occurring over time to the human resources of the business. It is an attempt to identify and report investment made in the human resource of an organization that are not presently accounted for under conventional accounting practice. When service sector started major contribution to a country's economy the significance of human assets got prominent.

2. Literature Review

"Human Resource Accounting is the measurement of the cost and value of the people for the organization" -Eric Flamholtz of University of California, Los Angeles.

"HRA is a measurement and reporting of the cost and value of people as organizational resources". - Jasrona (2004). This definition regards employees more than any other tangible asset because of their knowledge and intellectual capabilities.

"Human Resource Accounting is the process of identifying and measuring data about human resource and communicating this information to interested parties". - American Accounting Society Committee on HRA.

"Human resource accounting is an attempt to identify and report investments made in human resources of an organisation that the presently not accounted for in conventional system that tells the management what changes over time are occurring to the human resources of the business"- Woodruff and Barry Corporation (1969)

Petty (1691) was of the opinion that labour was "the father of wealth" and it must be included in any estimate of national wealth. Further efforts in this connection, were made by William far in 1853, Earnest Engle in 1883.

"Human resources accounting is an attempt to identify and report investments made in human resources of an organization that are presently not accounted for in conventional accounting practice. Basically, it is an information system that tells the management what changes over time are occurring to the human resources of the business". Human Resources Accounting as a method for systematically measuring both the asset value of labour and the amount of asset creation that can be attributed to personnel activities Friedman and Lev (1974) and Lau and Lau (1978).

"HRA is seen as the wealth of the employees' knowledge and intellectual capabilities added to the organization thereby making it to earn profit and to succeed"- Newman (1999).

"HRA is an information system that tells management what changes are occurring overtime to the human resources of the business"- Gupta (1991)

"Real assets will not appreciate much as businesses get commoditized; Innovation and Intellectual power are going to be the key to the future" (Mohandas Pai, CFO, INFOSYS).

"Human Resource Accounting is a term used to describe a variety of proposals that seek to report and emphasize the importance of human resources-Knowledgeable, trained and loyal employees in a company's earning process and total assets"- Prof. Sidney Davidson

2.1. Objectives of the Study

1. To evaluate the HRA practices of Infosys Technologies Limited (ITL) and HPCL.
2. To give suggestions for improving HRA Practices in Selected companies in India.

2.2. Origin of HRA

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. . 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 properly developed. 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 account 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.

2.3. Need for HRA

Human Resource Accounting is very much needed to provide effective and efficient management within the organization. If there is any change in the structure of manpower, it is HRA which provides information on it to the management. It also provides qualitative information and also assesses the cost incurred in personnel. It gives a platform to the management by providing factors in better decision making for future investment. The Return on Investment on human capital is best evaluated through HRA. It communicates to the organization and public about the worth of human resources and also its proper allocation within the organization.

2.4. Importance of HRA

The very importance of HRA in developing countries like India can be judged through Government report which shows that in India; approximately 73% of National Income is utilized to compensate employees. In addition to wages and salaries, organizations often make their sizeable investments in their human resources. The basic reason for developing Human Resource Accounting is to overcome problems arising from the valuation of intangible assets. We know that many organizations do not provide sufficient information to invest investors in traditional balance sheet and HRA is a device to overcome this difficulty. It provides a profile to the enterprise and thus improves its image. HRA probes to retain intelligent human capital.

As recession forces consumers to stop investment, producers are forced to go for employee curtailment. Information generated by HRA can be used for a host of managerial & strategic decisions like recruitment, turnover, personnel advancement analysis, training and capital budgeting. Hence, it is a time for the companies to go for innovative methods to deal with economization of staff costs rather than downright downsizing. HRA also involves accounting for investment in people & their replacement costs.

2.5. HRA Practicing Companies in India

Even though, many benefits have contributed by HRA, yet its development and application in different industries has not been encouraging. Because Indian Companies Act 2013, does not provide any scope for showing any information about human resources in

financial statement. Due to the development of business and industries, some of the Indian companies, both public and private, value their human resources and report this information in their annual report. The companies, who are presently reporting human assets valuation, include:

1. Bharat heavy Electrical Ltd (BHEL).
2. Steel Authority of India Ltd (SAIL).
3. Oil and Natural Gas Commissioning (ONGC).
4. Oil India Ltd
5. Project and Equipment Corporation of India. (PEC).
6. Engineers India limited
7. Mineral and Metal trading Corporation of India. (MMTC).
8. Electrical India Ltd.
9. Hindustan Shipyard Ltd.
10. Cement corporation of India. (CCI).
11. Infosys Technologies Ltd.
12. Tata Engineering and Locomotive Works
13. Southern Petrochemicals Industries Corporation Ltd (SPIC).
14. Associated Cement Company Ltd (ACC).
15. National Thermal Power Corporation Ltd (NTPC).
16. Hindustan Petroleum Corporation Limited (HPCL)

2.6. HRA - Measurements

It is known facts that measurement is the process of representing the properties or qualities of objects in numerical terms. But the biggest challenge in HRA is that of assigning monetary values to different dimensions of HR costs, investments and the worth of employees.

The two main approaches usually employed for this are:

2.6.1. Cost Approach

It involves methods based on the costs incurred by the company, with regard to an employee. Cost is a sacrifice incurred to obtain some anticipated benefit or service. The various methods of measurements of costs and valuation of human resources are Historical cost method, Replacement cost method, and Standard cost method, Present value of future earnings method, Expected realizable value method and Economic value method.

2.6.2. Economic Value Approach

It includes methods based on the economic value of the human resources and their contribution to the company's gains. This approach looks at human resources as assets and tries to identify the stream of benefits flowing from the asset. The value of an object, in economic terms is the present value of the services that it is expected to render in future.

The methods for calculating the economic value of individuals are Lev and Schwartz (1971) model, Eric Flamholtz (1974) model, Jaggi-Lau's model. Of these Lev and Schwartz model become popular. According to this model, the value of human capital represented by a person of age is the present value of his remaining future earnings from his employment. They have given the following formula for calculating the value of an individual. According to this model, the value of human capital embodied in a person who is 'Y' years old, is the present value of his/her future earnings from employment and can be calculated by using the following formula-

$$E(V_y) = \sum_{T=Y}^{T=Y} P_y(t+1) \sum_{T=1}^{T=T} I(T)/(I+R)^{t-y}$$

Where,
 $E(V_y)$ = expected value of a 'Y' year old person's human capital.
 T = the person's retirement age.
 $P_y(t)$ = probability of the person leaving the organization.
 $I(t)$ = expected earnings of the person in period
 $I R$ = discount rate.

Most, companies adapt this model to their practical requirements by making necessary alterations. For instance, different organizations use different discount rates for ascertaining the present value of future cash flows.

2.6.3. Methods of Valuation of Human Assets

There are a number of methods suggested for the valuation of human assets. Many of these methods are based on the valuation of physical and financial assets while others take into account human consideration. Major methods of valuation of human assets are historical cost, replacement cost, standard cost, present value of future earnings, and expected realizable value.

2.6.4. Historical Cost

Historical cost is based on actual cost incurred on human resources. Such a cost may be of two types – acquisition cost and learning cost. Acquisition cost is the expense incurred on recruitment, selection, and placement. While calculating the cost of recruitment and selection, entire cost is taken into consideration including incurred on those who are not selected.

Learning cost involves expenses incurred on training and development. This method is very simple in its application but it does not reflect the true value of human assets. For example, an experienced employee may not require much training and, therefore, his value may appear to be low though his real value is much more than what is suggested by historical cost method.

2.6.5. Replacement Cost

According to this model the value of employee is estimated as the cost of replacement with a new employee of equivalent ability and efficiency. There are two costs, individual replacement cost and positional replacement cost in this model. Cost of recruiting, selecting, training and development and familiarization cost are account in individual replacement cost. When an employee present position to another or leave the organization cost of moving, vacancy carrying and other relevant costs reflect in individual replacement cost. Positional replacement cost refers to the cost of filling different position in an organization and this model is highly subjective in nature.

2.6.6. Opportunity Cost Model

Opportunity cost is the maximum alternative earning that is earning if the productive capacity or asset is put to some alternative use. Quantifying HR value is difficult under this method. Because alternative use of HR within the organization is restricted and at the same time the use may not be identifiable in the real industrial environment.

2.6.7. Sk. chakra borty Model

Sk. Chakraborty of Indian institute of management Calcutta was the first Indian to attempt at valuation of resources. This model was similar to historical cost model, he noticed the cost of recruiting ,learning, selection, training and development of each employee should considered for acquisition cost method of valuation and be treated as different revenue expenditure, this is subject to gradual written off.

The Chakraborty model basically considered a combination of acquisition method and present value.

$$V = \sum_{i=1}^n \left\{ N_i * \frac{AS_i}{(1+k)^n} \right\} + AC$$

Where V= Value of a category of employee N=Number of employees AS= average annual pay K= after tax return on capital employed i=1, 2, 3.....n years (average tenure of employed).

2.6.8. Lev and Schwartz Compensation Model

This model developed in 1971 by Lev and Schwartz for valuing human resources. Lev and Schwartz model is popular for calculating the value of HR used by public sector like SAIL and BHEL and private sector like Infosys. It is based future earnings of an employee till his retirement. According to the model value of human assets is estimated for a person at a given age which is the present value of his remaining future earning from his employment and this represented by the following:

$$V_r = \sum_{t=r}^T \left\{ \frac{I(t)}{(1+r)^{t-r}} \right\}$$

Where V_r = value of an individual or r years old

$I(t)$ = the individual's annual earnings up to retirements age

T = retirement age

r = discount rate specific to the person

t = active year of service.

The model categorized whole work force in the various homogenous groups such as unskilled ,semi-skilled, technical staff, managerial staff and so on and also into different age groups. By using the formula calculated average earnings for different classes and age groups and present value of HR. Lev & Schwartz also recommended the use of cost of capital of the organizations for the purpose of discounting the future earnings of the employees to arrive at the present value. They recognized individual employee's economic value to the organization.

2.7. Human Resource Valuation by INFOSYS

A fundamental dichotomy in accounting practices is between human and non-human capital is considered as assets and reported in the financial statement, whereas human capital is mostly ignored by accountants. The definition of wealth as a source of income inevitably leads to the recognition of human capital as one of the several forms of wealth such as money, securities and physical

capital. As standard practice, Infosys reports the value of its employees using the Lev & Schwartz model. We have developed a new model quantifying this value, in partnership with GIST Advisory this year.

The INFOSYS GIST-HCX model is based on a present value calculating the increase of future earnings of employees during their employment at Infosys. Unlike conventional model, it also accounts for the impact of attrition on our human capital value, and therefore also quantifies the value of the positive human capital externality being generated by Infosys. Human capital Externality refers to the benefit derived by society when employees whose human capital value is enhanced due to training and employee development at Infosys, leave the company. The model discounts future earnings at an appropriate discount rate, and utilizes a long-run inflation rate consistent with the Reserve Bank of India's target for inflation expectations.

	2013	2012	Annual Change
Employee No.			
Software professionals	147008	141788	3.68%
Support	9680	8206	17.96%
Total	156688	149994	4.46%
Value of human resources			
Software professionals	124867	115900	7.74%
Support	12978	9817	32.20%
Total	137845	125717	9.65%
Value of human capital externality			
Software professionals	6767	6182	9.46%
Support	878	649	35.29%
Total	7645	6831	11.92%
Total value of human resource capital and human capital externality	145490	132548	9.76%
Ratio			
Value of human capital per Employee	0.88	0.84	4.76%

Table 1

Source: Annual Reports of Infosys 2012-13

2.8. Human Resource Valuation by HPCL

Hindustan Petroleum Corporation Limited HPCL considers human dimension as the key to organization's success. Several initiatives for development of human resources to meet new challenges in the competitive business environment have gained momentum. HPCL recognizes the value of its human assets who are committed to achieve excellence in all spheres. The Human Resource Profile given below in table shows that HPCL has a mix of energetic youth and experienced seniors who harmonize the efforts to achieve the Corporation's goals.

Age	21-30	31-40	41-50	Above 50	Total
No. of employees	1775	1271	3509	4303	10858
Management	1590	932	1383	1385	5290
Non- Management	185	339	2126	2918	5568
Average Age	26	35	47	55	

Table 2

2.9. Accounting for Human Resource Assets:

The Lev & Schwartz model is being used by our Company to compute the value of Human Resource Assets. The evaluation as on 31st March 2014 is based on the present value of future earnings of the employees on the following assumptions:

1. Employees' compensation represented by direct & indirect benefits earned by them on cost to company basis.
2. Earnings up to the age of superannuation are considered on incremental basis taking the Corporation's policies into consideration.
3. Such future earnings are discounted @ 9.36%.

Rs/ Crores		
Value of Human Resources	2013-14	2012-13
Management Employees	14,130	16,791
Non Management Employees	6,716	8,496
Total	20,846	25,287
Human Assets vis-à-vis Total Assets		
Value of Human Assets	25,912	22,549
Net Fixed Assets	10,860	10,627
Investments	10,860	10,627
Net Current Assets	15,861	16,118
Total	73,299	74,581
Employee Cost	2,030	2,526
Net Profit Before Tax(PBT)	2,674	1,361
Ratios (in %)		
Employee Cost to Human Resource	9.74	9.99
Human Resource to Total Resource	28.44	33.91
PBT to Human Resource	12.83	5.38

Table 3

2.10. HRA – Problems

There are certain operational problems in human resource accounting because it attempts to measure intangibles. Therefore, subjective factors may play crucial role. Thus, the major operational problems involved in human resource accounting are of the following types:

1. There is no well-set standard accounting practice for measuring the value of human resources. In the case of financial accounting, there are certain specified standards which every organization follows. However, in the case of human resource accounting there are no such standards. Therefore, various organizations that adopt human asset valuation use their own models. With the result, value of human assets of two organizations may not be comparable.
2. The valuation of human assets is based on the assumption that the employees may remain with the organization for certain specified period. However, this assumption may not hold true in today's context because of increased human resource mobility.
3. There is a possibility that human resource accounting may lead to the dehumanization in the organization if the valuation is not done correctly or results of the valuation are not utilized properly.
4. There is also a possibility that trade unions may oppose the use of human resource accounting. They may want parity of wages/salaries with value of employees. However, many of these problems are of operational nature or if attitudinal nature. These may be overcome by developing suitable organizational climate and culture.

2.11. Suggestions

Suggestion to Government

1. The Government should suggest specific model that is acceptable by all the companies.
2. The Government should make mandatory to value and disclose HR related information in its annual report.
3. To motivate companies for HRA, the Government should provide incentives like Subsidy, Tax exemption etc.

3. Conclusion

To conclude, the HR Accounting system tries to evaluate the worth of human resources of an organization in a systematic manner & record them in the financial statement to communicate their worth with changes in time & result obtained from their utilization to the users of the financial statement. Hence, looking at the importance of HRA, now it is required under the law & government guidelines, for undertakings, to maintain a separate item in their balance sheet about such HR activities undertaken by them.

Hence, the time has come for the organizations to realize that the knowledge of the workforce/human capital is their prime assets and not liabilities.

Human resource accounting provides information about the value of human assets, which helps the top management to take decisions regarding the adequacy of human resources. The concept of human resource accounting is yet to gain momentum in India. For the betterment of the organizations, it is necessary to evaluate the worth of human resources in a systematic manner and record the information related to them in the financial statement of the organization to communicate their worth time to time to the users of the financial statement. When proper valuation and accounting of the human resources is not done then the management may not be able to recognize the negative effects of certain programmes, which are aimed at improving profits in the short run. If not recognized on time, these programmes could lead to a fall in productivity levels, high turnover rate and low morale of existing employees. The HRA

concept itself represents a new way of thinking about people as assets. It has a great potential for future organization to understand the value of human forces and the same should be mentioned in the financial statement.

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