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Human Resource Accounting

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Abstract:
Human resource accounting - Assumptions of human resource accounting - Objectives of human resource accounting - Human resource accounting in india - Resource accounting problems - Capitalization of human resources costs - Amortisation of human assets - Adjustment of human asset accounts - Presentation of human assets in financial statements - Manipulation of earnings - Human resourse accounting prospects - Resource accounting for effective use of manpower - Methods of valuing human resource - Acquisition cost - Replacement cost - Standard cost - Present value of future earnings method - Herman son's unpurchased goodwill model - Hermanson's adjusted discounted future wages model - Economic value method - Competitive bidding method

1. Human Resource Accounting

Human resource accounting is intended basically as an information system, which reflects the charges in human resources over a time. Such information is vital to management in the planning and control of human resources and budgeting of personnel. It is the measurement of the cost fan d value of people to an organization and involves measuring the costs incurred by private firms and public sector enterprises to recruit, select, hire, train and develop employees and judge their economic value to the organization. Thus, human resource accounting aims at accounting for people as organization resources. In fact, human resource accounting is primary an information system that keeps the management abreast about the changes that are taking place in the human resources of the organization.

The American Accounting association's Committee on Human Resource Accounting defines H.R.A. as follows:

"Human Resourses accounting are the process of identifying and measuring data about human resources and communicating this information to interested parties".

In the words of "Geoffrey M. N. Bekar",-Human resources accounting is the term applied by the accountancy profession to quantify the cost and value of employees to their employing organization.

2. Assumptions of Human Resource Accounting

The human resource accounting makes up the deficiencies of the conventional accounting and is based on the following assumptions.

1. Human resources are similar to financial and physical resources in the matter of providing benefits to an organization.
2. An asset is defined as 'the right to receive future economic benefits'. In this sense, human resources can appropriately figure as accounting assets.
3. Human resources can be acquired only at a cost. An organization incurs an outlay in the acquisition of such resources because of the expected future economic benefits, which are measurable.
4. It is theoretically possible to identify and measure human resource costs and benefits within an organization.
5. Information regarding human resources is useful for the internal management in planning, controlling evaluating and predicting organizational performance.

3. Objectives of Human Resource Accounting

The primary purpose of Human Resource Accounting is to facilitate the managements of people as organizational resources. It can also be called a Human Resource Management Accounting i.e., the application of accounting to the Management of Human resources. The objectives of Human Resources Accounting system are:

1. To furnish human resource cost and value information for making management decisions about acquiring, allocating, developing and maintaining human resources in order to attain cost effective organizational objectives.
2. To allow Managerial personnel to monitor effectively the use of human resources.
3. To provide a determination of asset control, i.e., whether assets are conserved, depleted or appreciated.
4. To aid in the development of management principles by clarifying the financial consequences of various practices.
5. To help the persons interested in the organization to know whether the human resources are producing a return equivalent to their worth or not.

Thus the objective of Human Resource Accounting is not just the recognition of value of all resources used are controlled by a business entity but it also includes the improvement of the management of human resources so that the quantity and quality of goods and services are increased. The basic objective underlying human resource accounting is to facilitate the effective and efficient management of human resources.

4. Human Resource Accounting in India

Under Section 217 (2A) of the companies Act, 1956, companies are required to give the particulars of employees earning Rs.72,000 or more per annum. However, companies like BHEL, MMTC, ONGC, SAIL and SPIC have been giving information about human resources on their own in there published accounts. The method of valuation adopted by these companies is the value-based model developed by Lev and Schwartz. But the discount are varies from on e organization to another. While SAIL applies 14% rate, MMTC has chosen 12% to arrive at the present value. In case of ONGC the earnings are discounted at 12.25%., i.e., the rate at which Government of India is advancing loans to ONGC. According to the category of employees such as managers, supervisors, skilled workers, unskilled workers etc., the present value of the future earnings is shown. It represents the value of human resources to the organization on the assets side and on the liabilities side as social equity representing employee's contribution.

The information such as the ratio human to nonhuman resources, ratio of turnover/human resource sand value added-per employee of human capital is also provided in the reports. HRA information if properly developed will be useful to managers at all levels regarding costs of turnover and inefficient utilization of human resources which will lead to better decisions regarding personnel. Such information also helps these organizations to understand the costs involved in fulfilling social responsibilities such as training to the unemployed persons Data could also be useful to investors to judge the future performance of the enterprise.

5. Resource Accounting Problems

The decision to report human assets in financial statements has been taken, there are five major human resource accounting problems to be resolved which are as under:

5.1. Capitalization of Human Resources Costs

This is a problem of classifying human resource costs into expense and asset components. The basis criterion to decide whether a cost is an asset or an expense is related to the notion of future service potential. Costs should be treated as expenses in the period in which their benefits are derived. If expected benefits relate to future period, they should be treated as assets.

5.2. Amortisation of Human Assets

This involves the measurement of the portion of the assets service life consumed during an accounting period. For physical assets such as machines this process is known as depreciation but for intangible assets and human assets it is known as amortization. The principal objective of amortising human assets is to match the consumption of an asset's services with the benefits derived. Some human assets may have a service life equivalent to a person's expected organizational tenure while others may have a service life equivalent to the period a person is expected to occupy a certain position in the organization. The organization should use both individual and group amortization i.e., group amortization, for factory workers and clerical employees and individual amortization for managers.

5.3. Adjustment of Human Asset Accounts

There may e circumstances under which human assets accounts may have to be adjusted/e.g Human assets may have tobe written off as a result of employee turn over or changes in service life estimates. Employee turnover may occur either voluntarily or through lay off, termination etc., and a person's expected service life may change because of ill health. Premature retirement and technological obsolescence. In each case, the-unamortized asset balance must be treated as a loss in the period it is incurred. This right sown of human assets in analogous to a write down of physical assets.

5.4. Presentation of Human Assets in Financial Statements

There is a problem of incorporating degree of uncertainty or realizing human services into accounts while presenting human resources investment in financial statements. This problem can be resolved by providing an allowance for expected turnover costs as on offsets i.e., contra entry to gross investment in human assets. This technique is analogous to the methods of creating reserve for ad and doubtful debts in respect of sundry debtors in conventional accounts.

5.5. Manipulation of Earnings

This problem is concerned with the possibility of earnings manipulation. The potential for manipulation of earnings exists not only if the investment s in people are capitalized but also if one fails to capitalize them. The decision to capitalize and investment in human asset depends on the degree of uncertainty in the specific situation. Under certain circumstances it may not be useful to capitalize human assets because the future benefits may be too tenuous but such circumstances should be viewed as the exception and not as the general rule.

6. Human Resourse Accounting Prospects

The present and potential stock holders of a company and other users of accounting information viz, management, investors, employees, leaders, customers, government and their agencies and public have long been interested in obtaining information about an organization human assets.

Due to conventional accounting treatment of human resource outlays, which consists of expanding all human capital formation expenditures and capitalizing similar outlays on physical capital, the information about human assets of the business entity does not appear in conventional balance sheets. Now there appears to be widespread interest for human resource accounting in future years because of its potential role in facilitating the effective and efficient management of human resources and improving quality of management and investor decisions.

7. Resource Accounting for Effective Use of Manpower

Managers receive a great deal of information about the physical and Financial resources with which they are entrusted but very little information about human resources yet this information is needed as correct decisions are to be made about alternative investments in human resources. Role of human resources accounting as a managerial tool is clear from the following:

1. HRA helps in budgeting human resource acquisition. It provides measurement s of the standard costs of recruiting, selecting an hiring people which are used to prepare human resource acquisition budgets.
2. HRA facilities decisions involving the allocation of resources to human resource development by measuring the expected rate of returns on proposed investments.
3. HRA is useful to management in formulating policy for human resource acquisition and development. It provides estimates of the historical and current costs to acquire and develop people for the various positions.
4. HRA is useful to management in making allocation decisions. Management can apply the linear programming to determine an optimal a solution to the work force allocation problem.
5. HRA can assist management in conserving its human organization by providing as early warning system. It can measure and report certain social, psychological indicators of the condition of the human organization and management can assess trends in these variables prior to the actual occurrence of turnover.
6. HRA provides framework to help managers utilize human resources effectively and efficiently. At present the management of human resources in organization is less effective because it lacks a unified framework guide it. HRA provides the goals and the criterion for the management of human resources.
7. HRA is useful in the valuation process of human resources by developing reliable methods of measuring the value of people to an organization. These methods include both monetary and nonmonetary measurement s and permit human resource management decisions to be based on a cost-value basis.
8. HRA has an impact on the administration of rewards system, which is intended to motivate and reinforce the optimal performance of people in achieving organizational objectives.
9. HRA can be used to evaluate the efficiency of personnel management.
10. HRA furnishes information about the cost and value of people to and organization and is a system of providing management with the information needed to manage human resources effectively and efficiently.
11. HRA is a way thinking about the management of an organisation's human resources based on the notion that people are valuable organisation's human resources based on the notion that people are valuable organizational resources.
12. HRA performs three major functions. Le., it serves as a frame work to facilitates human resource decision making, it provides numerical information about the cost and value of people as organization resources and it motivated line management to adopt a human resource perspective in their decisions involving people.

8. Methods of Valuing Human Resource

In measuring the value of human resources it is difficult to comply with the generally accepted accounting principles. There are two approaches to valuation –on e based on cost which takes into account the costs incurred by an enterprise to recruit, hire, train and develop human assets. In this approach again the cost may be historical cost, replacement cost, standard cost or opportunity cost. The second approach is to measure the economic value of the resource based on capitalization of earnings. Some of these methods are critically discussed below.

8.1. Acquisition Cost

Under this method, the costs of acquisition, namely, the costs incurred in recruitment, hiring and induction of employees are taken into account. The process involves capitalizations of historic costs. The cost so capitalized has to be written off over a period of time for which the employee remains with the firm. If for some reason, the employee leaves the organization prematurely, the unamortized cost remaining in the books has to be written off against the profit and loss account of the particular year.

This method is simple to understand by all concerned. It is also easy to implement. But the most important drawback of this system is that historic costs are not relevant for decision-making and are useless. The data may be of some use to managers in calculating ROlin human resource development activities etc., but will be of no use to investors because this method does not give a correct value of human resources under this method merely represents the unamortised balance of the costs and does not give any indication of the potential benefits that accrue to the organization from the use of such resources.

8.2. Replacement Cost

While in the case of acquisition cost, past costs are considered, under this approach one takes into account how much it costs to replace a firms existing resources and thus represents a current market conditions. But it is a difficult exercise as in many cases the replacement may not be exactly similar.

Replacement costs can be positional or personal. Positional replacement costs are typical in nature and related to the position, but not the individual who occupies it. Personal replacement costs are related to a particular person.

8.3. Standard Cost

This is an application of standard cost principles to costs associated with recruitment, hiring, training and development of human resources. The standards set for various components are also helpful to compare the actual and analyse the variations from standards.

8.4. Present Value of Future Earnings Method

This model is developed by lev and Schwartz and is very popular in India. It is also known as capitalization of salary methods. Under this method, the future earnings of an employee or grades of employees are estimated up to the age of retirement and are discounted at a rate appropriate to the person or the group in order to obtain the present value. The model may be symbolically expressed as follows:

$$Vy= \frac{T \qquad 1(t)}{T=y\ (1+r)t\text{-}y}$$

Where

Vy	=	The human capital value of a person y years old.
T	=	The person’s annual earnings up to retirement.
R	=	Discount rate specific to the person.
T	=	Retirement age.

When the calculation is made for a group, values are arrived at on the basis of average earnings for each category of employees. Human capital calculated in this manner is useful since comparison with non-human capital will give an idea about the degree of labour intensiveness.

Although this method is simple to understand, it suffers from many drawbacks. They are:

1. It is very difficult to estimate the future earnings as some for the persons may occupy higher posts than the ones anticipated by acquiring further qualification and skills.
2. Since human capital is taken as equal to present value of total earnings, any over or under-dilution of Salary results in arriving at a wrong value of human capital.
3. The sum of the human capital values of individual employees does not add to the human capital value of the organization, since it ignores the synergistic effect. Teamwork is something more than the sum of the values of individuals.

9. Herman Son’s Unpurchased Goodwill Model

This is the earliest model developed in 1964. Hermanson was the first to suggest that human resources will come under the category of attritional assets although an organization does not legally own the. Hermanson has developed two valuation methods both of which are based on economic concept value.

Under the unpurchased goodwill method Hermanson has suggested arriving at the value of human resources by capitalizing the profits in excess of normal earnings. Normal earnings are based on the normal rate of return to the economy as a whole. The computation would be as shown below:

Average value of owned assets:	Rs. 30,000
Average net profit (after tax) @ 15%	Rs. 4,500
Net income at normad rate say 12%	Rs. 3,600
Excess earnings over normal rate	Rs. 900

Value of human assets by capitalizing the excess earnings.

$$\frac{Rs.900*100}{12} = Rs.7500$$

This method also suffers from demerits. They are:

1. It is based on historic cost and therefore of little value of decision marking.
2. It is not right to assume that the human resources are the only unowned assets and that the excess profits are entirely attributable to human resources.
3. This method assumes zero value to human resources when the earnings are normal.

10. Hermanson's Adjusted Discounted Future Wages Model

This is basically similar to the Lev and Schwartz model in discounting the future compensation to determine the value of an individual. However, the value so arrived is adjusted by using an efficiency ratio. The efficiency ratio is found by dividing the actual average earnings of the firm by the normal earnings of all the firms. The ratio of 1 indicates that the firm's average rate of return is equal to the average rate of return for the economy. If the ratio is more than 1, higher than normal earnings are indicated. Conversely when the ratio less than 1, the firm's earnings are less than the normal earnings of all the firms.

11. Economic Value Method

The economist's concept of the value of an asset is equal to the present worth of its estimated future economic benefits. This approach has a strong theoretical appeal. This method involves the following steps:

a. Estimation of future benefits
b. Ascertaining the present value of such benefits by using an appropriate interest (discount) rate.

It is very difficult to estimated the flow for future benefits unless the organization has a single employee. It is equally difficult to establish the discount factor although cost of capital suffices for practical purposes.

In view of the measurement problems, resort is made to use substitute measures such as replacement costs, opportunity costs etc.,

12. Competitive Bidding Method

This is also known as the opportunity costs method. To overcome the deficiencies or replacement cost, Hekimian and Jones have suggested the use of opportunity cost. It is defined as the measurable value of benefits that could be obtained by choosing an alternative course of action. In the case of HRA, opportunity cost is determined by a process of competitive bidding in which various divisions and departments bid for the services of various officers. This method can be applied only to resources that are scare. This system is not suited to top management, which is not available for action.

13. References

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