

Human Resource Accounting Advantages, Issues And Practices In India: A Literature Review

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Abstract: Human Resource Accounting may be defined as an art of identifying, quantifying, recording, systematically presenting and communicating relevant information regarding human resources of an organization to the interested parties. Traditionally, all the expenses on human resources like cost of recruitment, selection, training and development are taken into consideration and are treated as a charge against revenue because it is assumed that such expenses do not create any physical asset. However there is a change in this concept, now any expense on human resources should be treated as a capital expenditure because such expenses yield benefits for a long time period and should be shown as an asset in the Balance Sheet. The paper aims to review the literature available on human resource accounting. The paper tries to bring into light the companies practicing HRA in India, benefits derived from and issues and challenges faced in practicing HRA.

Keywords: Human Resource Accounting, Valuation, Decision-making, Human Asset, Earning.

I. INTRODUCTION

The growth, success and development of an organization is affected by how efficiently and effectively its organizational resources (both physical and human resources) are utilized. Physical resources comprise of materials, money, land, machines etc which are scarce and are put to use by the human resources in order to attain the organizational goals. Thus, the optimum utilization of the physical resources is dependent on the knowledge, experience, motivation, innovative thinking, skills, quality and other characteristics of human resources. The importance of human resource thus, cannot be ignored and hence, its valuation and communication of the information about the valuation of human resources to the various stakeholders of the organization becomes of immense importance.

Traditionally, according to general accounting principles, only monetary and physical assets are accounted in the books of account and all the expenses on human resources like cost of recruitment, selection, training and development are treated as a charge against revenue as it is assumed that such expenses do not create any physical asset. However there has been a

change in this concept, now expenses on the human resources should be treated as capital expenditure because such expenses yield benefits for a long period of time and should be shown as an asset in the Balance Sheet.

Hence, there is a need to quantify the worth of human resources in terms of knowledge, skills, motivation, experience, creative abilities, innovativeness etc. along with the quantification of various organizational processes like recruitment, training, development etc. which are required to build and support these human characteristics. HRA is concerned with this process of quantifying or measuring human resources in monetary terms. It is an effort made towards identifying, measuring and reporting the investment made in the human resources and the economic value generated by them for the organization. HRA is basically an information system which communicates the management and other interested parties about the changes that occur in the human resources of the organization over time. It is thus, the measurement of the cost and value of the human resource to an organization.

According to Davidson and Roman L Weel, "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 earning process and total assets.”

Human Resource Accounting is the process of assigning, budgeting, and reporting the cost of human resources incurred in an organization. It means accounting for people as the organizational resources. The objectives of HRA are:

- ✓ To provide cost and value information for effective decision-making.
- ✓ To keep record of the changes in the value of human resource.
- ✓ To boost the efficiency of human resource of the organization.
- ✓ To communicate human resource information to the interested parties.

A. BENEFITS FROM PRACTICING HUMAN RESOURCE ACCOUNTING

Human Resource Accounting provides a pool of information about human resource to various interested parties like investors, management, creditors, employees and public. The following are the major benefits derived from HR Accounting:

- ✓ HRA provides cost-benefits information about human resources and thus helps in making better management decisions related to human resource.
- ✓ It helps in determining return on money spent on human resources in forms of recruitment, selection, training and development.
- ✓ Since it considers human resource as a major asset, it projects firm as employee friendly and enhances firm's employer brand.
- ✓ Firms practicing HRA face lower employee turnover as treatment of employees as assets acts as a morale booster for employees and provides a sense of job security.
- ✓ It helps in better evaluation of divisional performance.

B. ISSUES AND CHALLENGES FACED IN ADOPTING HUMAN RESOURCE ACCOUNTING

Despite of the benefits offered by HRA practices, very few companies actually practice HRA. The major limitations of human resource accounting that makes the management of many companies reluctant to implement HRA are as follows:

- ✓ There is no specific standard laid down for valuation and reporting of human resources, thus, there is no objectivity in HRA practices regarding discount rate, future earnings, working life of employees with a firm etc.
- ✓ Implementation of HRA practices involves a huge cost, making it difficult for small businesses to adopt HRA.
- ✓ Trade unions and employees may oppose this idea as it may create divide among employees on basis of skills, compensation, status etc.
- ✓ There is lack of recognition of HRA by tax authorities.

II. OBJECTIVES OF STUDY

The current study has been undertaken with the following objectives:

- ✓ To study how different companies in India have put the concept of HRA to practical use.
- ✓ To determine the benefits derived from applying HRA.
- ✓ To investigate the issues and challenges in implementing HRA.

III. REVIEW OF LITERATURE

The review of literature has been divided into three sections in order to study Human Resource Accounting. Firstly, it studies the companies practicing human resource accounting. Secondly, studies have been taken to know the benefits of implementing HRA. Lastly, a study that aims to determine the issues and challenges faced by companies in implementing the concept of HRA has been taken.

A. HRA PRACTICES IN INDIA

This part gives an idea about the companies practicing human resource accounting, different valuation models used, different discount rates being used, thus showing the limitations of implementing HRA.

Pandurangarao et al. (2013) found that there were 15 companies till the year 2012 valuing and reporting human resource which includes Bharat heavy Electrical Ltd (BHEL), Steel Authority of India Ltd (SAIL), Oil and Natural Gas Commissioning (ONGC), Oil India Ltd, Project and Equipment corporation of India.(PEC), Engineers India limited (EIL), Mineral and Metal trading Corporation of India.(MMTC), Electrical India Ltd., Hindustan Shipyard Ltd., Cement corporation of India. (CCI), Infosys Technologies Ltd. (ITL), Tata Engineering and Locomotive Works, Southern Petrochemicals Industries Corporation Ltd (SPIC), Associated Cement Company Ltd (ACC), National Thermal Power Corporation Ltd (NTPC). Infosys valued their human resource as per Lev and Schwarts Model. HRA helps to determine correct return on investment, developing proper personnel policies and to improve employee efficiency.

Kashive (2012) developed a case study on successful PSUs in India which practice HRA in order to determine the importance of HRA practices and its implications. HRA was first adopted by BHEL using Lev and Schwartz model with discount rate of 12% for human resource valuation. Infosys used Lev & Schwartz (1974), Lev (2001) and Sveiby (1997) models individually and in combination with a discount rate of 11.21% and emerged as a leader among all companies in thorough disclosure of human resource. SAIL follows valuation model suggested by Lev and Schwartz, also accommodating some adjustments suggested by Flamholtz and Jaggi and Lou with 15% discount rate. ONGC declares value per employee calculated using Lev and Schwartz's model with discounting rate of 8%. From the study, a total of 12 disclosure variables for human resource have been identified like valuation model used, total no of Employees, discount rate, Value Added, value of HR, Employee

Remuneration and Benefit, Value of HR per employee, Value Added per Employee, Turnover per Employee, EVA, age wise distribution, group wise distribution. On an average, selected PSUs in study disclose 8 HR variables which indicate good HR practices. HRA practices help in measuring true worth of firm including both tangible and intangible assets and also enhances its employer brand in terms of good workplace.

Shaheen et al. (2016) evaluated the HRA practices of Infosys Technologies Limited (ITL) and Hindustan Petroleum Corporation Limited (HPCL) and how it was useful in HR decisions. ITL, as a standard practice follow Lev and Schwartz's Model for human resource valuation, but they also developed a new model for valuation in collaboration with GIST Advisory called the Infosys GIST-HCX model. According to this model, valuation is present value of future earnings of employees during their working tenure at Infosys. It also takes into consideration human value attrition due to retirement or resignation and thus, quantifies value of positive human capital externality (benefits to society when trained and developed employee leaves the company) generated by Infosys. It uses a discount rate consistent with RBI's long run inflation rate expectations. HPCL as on 31st March, 2014 used Lev and Schwartz's model for valuation of human resource with a discount rate of 9.36% and compensation being taken as CTC (including both direct and indirect benefits).

Sharma and Shukla (2010) developed a case study of Hindustan Copper Limited (HCL) for a period of 2001-2010 to evaluate the application of HRA to heavy industries. HCL gave information about value of production, number of employees, value per employee and value added. It is necessary that firms should value and report human resources to users of financial statements.

Joshi and Mahei (2012) carried out a comparative study of HRA practices of Hindustan Petroleum Corporation Limited (HPCL), Rolta India Limited, Cement Corporation of India (CCI) and Infosys Technologies Limited (ITL) and ranked these companies on the basis of extent of HRA disclosures made by them in their annual reports for a period of five years ranging from 2006-2011. It was found that all other organizations except CCI use Lev and Schwartz model for valuation of HR, CCI adopted the Lev & Schwartz, Flamholtz, Jaggi & Lau model with required modifications. All the organizations used different discount rates while CCI did not disclose it. The basis of earnings is total direct and indirect benefits to the employees while CCI again did not disclose it. A total of 15 HR disclosure variables have been identified and scores are assigned to the organizations from 0-5 on the basis of disclosure of these variables for the study period of five years. Mean scores ($=\text{Total Score}/\text{No. of years}$ i.e. 5) for each of the companies are calculated to ascertain rank. Infosys is ranked first disclosing all the variables while Rolta is ranked fourth giving least amount of HR information. HPCL stood second and CCI stood third.

Srimannarayan (2009) undertook the study with the purpose to identify the measures of human resource activities in India. The major domains of HR activities include recruitment, selection, training & development, performance management, employee relations and compensation which could be evaluated using HR measures. In order to determine the effectiveness of all the domains of HR, 56 possible HR

measures were identified based on earlier research work and existing literature like applicants per recruitment source, applicants selected per recruitment source, number of candidates moved to selection process, the new employee performance on the job, number of employees trained in training programmes, number of training days, training cost, performance appraisals completed on time, accuracy of appraisal process to judge individual performance, average salary increase, average of current salary against industry average, percentage of grievances settled, average length of time to settle grievances etc. A questionnaire was developed containing 56 HR measures which was responded by 109 HR professionals working in manufacturing, services and IT sector with a minimum experience of two years, representing public, private and joint venture sectors of India during September-October 2008. A four-point scale ranging from not measured; measured to a limited extent; measured to a significant extent; to measured and reported to the top management; was used. The study found that compensation related activities were measured by the organizations to a significant extent. At second place, training and development activities were measured followed by employee selection, performance management, employee relations and recruitment respectively. The measurement of HR activities by organizations in India varies from limited extent to significant extent. Also, such measurement is not reported to top management for action but only confined to HR professionals. Indian companies focus on measurement of traditional HR measures and not on business driven measures like impact of training on employees' productivity, performance improvements due to proper performance evaluation etc. Thus, HR professionals should focus on measures showing business improvements.

B. BENEFITS DERIVED FROM HRA PRACTICES

This area focuses on why companies should implement Human Resource Accounting.

Okpako et al. (2014) determined the relationship between human resource accounting and firm's performance through a survey on seven companies in Nigeria for a period 2006-2010. Questionnaire was designed on a 5 points Likert scale to solicit responses from the staff of Human Resource, Accounting, and Audit/Internal Control departments. Principle Component Analysis was adopted to quantify the responses. Return on Equity (ROE) was adopted as Firm's performance indicator to study the impact of human resource accounting on firm performance. It was found that human resource accounting significantly affects firm's performance. Human resource accounting variables like training and development, providing shelter, safety and health benefits to employees contributed positively to the level of firm performance.

Hendricks (1976) examined the effects of HRA information on stock investment decisions by investors. In the experiment, HR was valued at historical cost. Ninety-one students of a graduate finance course were experimented to know how the investment decision of Rs. 100000 between two hypothetical companies (either A or B) was affected, when they were supplied only traditional accounting information (Treatment 1) and when they were supplied with HR

information along with traditional accounting information (Treatment 2). It was found that additional HR information had an effect on investment decision using difference of means t-test (difference in mean amount invested in Company B under the two treatments) at a significance level of .0005 level. The author also investigated the correlation between background variables (like age, experience, employment status, number of courses completed in accounting field etc.) and the degree to which HR information affects the investment decision. Result was that experience was the only background variable that is correlated (positively) with the difference in mean amount of investments (correlation coefficient significant at .018 level). Also, whether the degree of openness of belief system (degree of dogmatism) is correlated to the degree to which HRA affects investment decision was also examined at significance level of .099. It was revealed that degree of openness does not explain the differences in investment decision. Pearson product-moment correlation was used as a measure of correlation for the experiment.

Tomassini (1977) examined how HRA cost data affects personnel layoff decision. In randomized, control group, post-test-only research design, fifty-two accounting students were divided into two groups and were asked to give their relative preferences for the four alternatives available in a hypothetical case related to personnel layoff decision in which one group had access to conventional accounting information only and other group had access to both conventional accounting and HR information. Numerical values were allotted by the students to express their relative preferences for the four alternatives. In order to determine if there were differences in the decision preferences of the two groups, t-statistic was calculated to compare means of both groups for each preference. There was supportive evidence to conclude that there were significant differences in the preferences of the two groups for the four alternatives regarding personnel lay off decision with p -value $< .02$.

Sinclair (1991) aimed to determine that whether differences in accounting treatment of HR expenditure will affect evaluator's assessment of performance of an investment centre. It also aimed to determine that if there are differences in assessment of divisions, then what factors influenced the decision. The author aimed to find whether background factors like industry type, company size, position of respondent etc. and the evaluator's attitude towards importance of HRA in the evaluation process of divisions affect the ranking of divisions. A sample of ninety-seven individuals at different positions; from nine different companies (both manufacturing and non-manufacturing with different levels of sales volume) having knowledge about responsibility accounting; were surveyed. They were given hypothetical information about assets, operating profits and HR expenditures for two divisions under three different formats (first, information as per traditional accounting; second, detailed information on HR expenditures were also included; third, traditional and capitalized HR expenditure information were disclosed) and were asked to evaluate the performance of the divisions. They were also asked the degree of emphasis they placed on various factors (operating profit, assets, human resource expenditures etc.) during the evaluation process in order to determine their attitude towards importance of HR information for evaluation

of division's performance. Chi-square test at a significance level of .05 was computed to test the differences in ranking and the factors that affected the decision. The study found that there were significant differences in the ranking when subjects used capitalized format and when they used other two formats (format one and 3, p -value $< .0022$; format two and three, p -value $< .0459$). It was found that background variables individually did not affect the ranking but the evaluator's attitude towards the importance of HRA in evaluation has an impact on the ranking of divisions. Thus, the study shows immense relevance of HRA in managerial decision-making.

C. ISSUES AND CHALLENGES IN THE IMPLEMENTATION OF HRA PRACTICES

This part of the study aims to determine what issues and challenges have been identified by the existing studies in implementing HRA.

Narayan, R. (2010) identified various issues and challenges of human resource accounting. Major issue identified is that there is greater subjectivity involved in adopting any of the human resource valuation models in terms of rate of discount, expected working life of employees with the organization, amortization rate, measurement of the contributions made by employees etc., so there is no agreement concerning which valuation model should be adopted. Acceptance of the idea of valuation of employees by labour unions and public is difficult as they may think that HRA practices may lead to division of employees. Even companies especially small businesses would be reluctant to adopt HRA practices as it would be a costly affair. Considering the importance and benefits derived from HRA, government and professional bodies at both national and international level should take necessary steps to formulate accounting standard for HRA giving details regarding methods for measurement and reporting of human resource.

Islam and Sarker (2016) argued that human beings cannot be treated same way as physical assets. Humans cannot be owned, valued, utilized or retained like physical assets. Even tax authorities do not recognize human resource as asset. A lower value to human resource may discourage him and affect his competency at work. A solution suggested by the authors involves capitalization of cost of acquisition and development, its amortization over service time period and its adjustment for any material changes in the organization.

Dean et al. (2012) explored view point of individuals in accounting field on whether human resources should be accounted for in the balance sheet. A questionnaire containing eight multiple choice questions and one free response question about demographics and view points of the respondents about HRA was e-mailed to approximately 500 individuals related to accounting area and 180 responses were received. The study revealed that 13% of the people who responded were in favor of reporting HR in the balance sheet. 4% of those who were in favor said that HR should be recorded as a current asset, 71% said as an intangible asset, 12% said as investment and remaining 13% said as other asset. While 87% of the respondents were not in favor of HRA giving varied reasons like difficulty in measurement, involves subjectivity, difficult to maintain consistency, easy manipulation of HR value in

balance sheet will distort balance sheet, switching of jobs and inherent HR value in financial performance of firm. The authors suggested that since there is no specific way of valuing and reporting HR, so it would be better to not to include HR value in financial statements but to prepare separate human capital report.

IV. CONCLUSION

On the basis of this review of literature, following conclusions can be drawn:

- ✓ Most of the companies follow Lev and Schwartz's model for valuation of human resource.
- ✓ Different companies use different discount rates; different basis of compensation etc. which provides information that is not comparable.
- ✓ There is a need to spread awareness about the implementation and benefits derived from HRA practices among both the employers and employees.
- ✓ HRA provides benefits in terms of better performance, employee efficiency, better decision making, improved employer brand, true reporting of worth of firm.
- ✓ Governmental and professional bodies should take steps to establish specific rules and regulations for valuing and reporting human resources.

V. IMPLICATIONS FOR FURTHER RESEARCH

- ✓ To develop appropriate valuation model for human resource including appropriate discount rate, basis of measurement of future earnings, employees' working life with firm etc.
 - ✓ To evaluate valuation model developed by Infosys called Infosys GIST-HCX in terms of its applicability and usefulness.
 - ✓ To determine the relationship between HRA practices and employee performance, firm performance, firm's goodwill, EPS, market capitalization.
 - ✓ To undergo a cost-benefit analysis from practicing HRA.
- The present review of literature provides a theoretical base for conducting research in the future regarding Human Resource Accounting and to contribute towards this area.

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