

Human Resource Accounting: a frame work for better Financial Accounting and Reporting

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Abstract: Accounting is crossing its boarders since the inception of single and double entry system. The accounting concepts and conventions made a stronger contribution to the field of accounting. However, the conservatism and other principles and concepts of accounting limited the usage and treatment of human resources in right dimension. There were earlier researches with respect to human resources valuation and treatment both from investment and cost perspective. However, still human resource accounting is in infancy due to varied reasons and in one way the present research aimed to rethink and stress the need for further studies in the subject. The present research paper aimed at the treatment of human resources with a true and fair view, like other elements involved in financial accounting and the inclusion of human resources not only from the expenditure perspective but also from the investment point of view is argued to depict the true and fair view of financial accounts and financial reports. Further, it is intended to discuss setting up of an apex body for valuation and treatment of human resources and other concerns which limits the practice of human resource accounting. Finally, it concluded with the future road map for financial accounting to consider it as "Human Resource Financial Accounting".

Key Words: Accounting, Conservatism, Valuation, Human Resources and Investment Perspective

I. Introduction

Ever since the concept of Accounting is introduced it is undergoing significant changes and in one way Accounting is aimed at streamlining the financial processes and elements. However, the major asset, which undertakes this essential element is "Human Resources", is not given proper importance or scope in today's accounting framework. Though, there were considerable arguments both for and against viewing "Human Resources" as assets, the behavioural scientists, who argues, considering "Human Resources" as assets, have to realize the fact, majority of Human Resource Management practioner and management scholars have advocated that "Human Resources" should be viewed from investment perspective. As early as in 19th century itself, thrust was made to introduce "Incentive Payments" by erstwhile social scientists like F.W.Talyor, Merrick, Rowan, Halsey and Bedux etc. for betterment of performance of human resources. Over and above, unlike other assets, human resources value increases with passage of time because of gaining expertise. However, Financial Accounting could not consider "Human Resources" in accounting parlance due its inherent limitations. The Financial Accounting community has to undertake the consideration of "Human Resources" as a compulsory theme. Though, certain firms have already including in their annual returns, human resources as assets both from investment and expenditure perspective, the same is not well accepted either by organizations, employees and employee unions. Now, the time came to consider "Human Resources" as vital limb of financial accounting.

II. Problem Statement

The major problem identified with HR Accounting is estimation of the value of human resources and ensuring effective utilization of the human resources and projecting a consolidated version of Human Resources in the annual returns.

III. Key Objectives Of HR Accounting

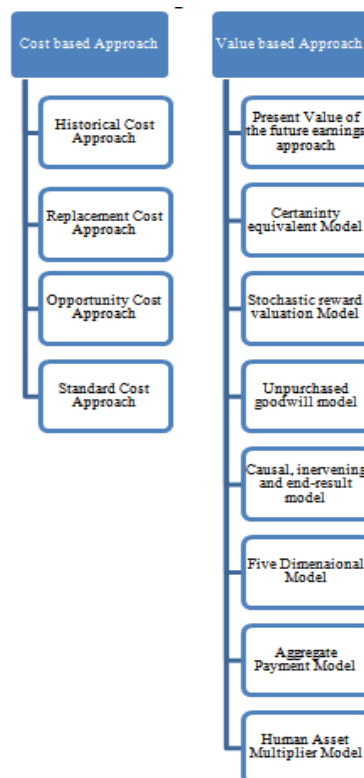
- Assigning quantitative values to qualitative figures like human resources
- Shifting the focus of firms from cost perspective to investment perspective on human resources
- Development of a concrete model for inclusion of human resources in both profit and loss account and balance sheet

IV. Approaches To HR Accounting

Though HR accounting is in infancy, some experts provided logical and accepted approaches to Human Resource Accounting. These approaches are majorly classified either into cost based or value based. The cost based approach focusses on cost of acquisition, training and other costs incurred on human resources and

various value based approach focuses on income-earning capacity of human resources. Some of the approaches prevailed in HR accounting is depicted in chart 1.

Chart 1: Approaches to Human Resource Accounting



Review Of Literature

American Accounting Association has defined “Human Resource Accounting is the process of identifying and measuring data about human resources and communicating this information to interested parties.”

R.L.WoodruffJr (1989) defined “Human Resource Accounting is an attempt to identify and report investment made in human resources of an organization that are presently not accounted for in conventional accounting practice.”

Management Scholar Edward Lawler(1992) described human resources from investment perspective as “to be competitive, organizations in many industries must have highly skilled, knowledgeable workers. They must also have a relatively stable labor force since employee turnover works directly against obtaining the kind of coordination and organizational learning that leads to fast response and high-quality products and services”.

Lee Brummet, Eric Flamholtz and William C.Pyle(1968) developed Historical Cost Approach, according to them, the cost incurred for recruitment, training and developing the employees should be capitalized (converting the expenses into capital investment or asset) and total amount capitalized is then amortized (gradually reduced) over the estimated useful life of the human resources.

Hekimian and Jones (1967) developed Opportunity Cost Approach, according to them “an opportunity cost exists for all human resources that are in short supply and basically any decision that involves a choice from more than one alternative has an opportunity cost”.

David Watson developed Standard Costing Approach according to him “human resource data is used for setting standard costs for various HR functions like hiring and training”

Brauch Lev and Aba Schwartz (1971) developed Present Value of Future Earning Model and according to this model, the value of human resources depends on the present value of the future earnings to be made from a person’s employment.

PekinOgan(1976) developed The Certainty Equivalent Model and this Model consist of two major components (a) the net benefit and (b) the certainty factor, which provides the means of determining the net present value of the human resources.

W.J.Giles and D.F.Robinson (1972) developed The Human Asset Multiplier Model and according to them, the valuation of human resources is normally made in the same way as other business assets are valued on a “going concern concept” basis.

Roger H. and Hermanson (1964) developed “The Unpurchased Goodwill Model” according to this model, the organization must ascertain its actual earnings and average it for the past few years.

RenisLikert and David G.Bower(1973) introduced “The Causal, Intervening, and End-result Model and according to them, the development of participative approach requires the introduction of new organizational structure and style of management behavior and these views as causal variables.

Myers and Flowers (1974) developed a “Five Dimension Model” according to this model five dimensions of the employees like knowledge, skills, health, availability and attitudes have to be considered.

V. Methodology Of The Study

The present study is made based on secondary sources of data like books, journal articles, research papers, web based sources and other sources of unpublished data. The data collected is further refined and used for present research.

VI. Weaknesses Of Financial Accounting In Treatment Of Human Resources As Assets

Organizations have realized the importance of human capital and they are moving from financial capital concept to intellectual capital concept. However, Generally Accepted Accounting Principles (GAAP), which issue the standard framework of guidelines for financial accounting, does not recognize human capital in the financial books. It continues to treat the expenses on employees as expense only and not as capital. This majorly happened due to some of the accounting principles and concepts.

Accounting has certain principles like **conservatism and prudence**, which in one way limits the consideration of human resources in right dimension. The conservatism principle takes into consideration all possible expenses and liabilities but not all possible gains unless they are realized in cash or kind.

The prudence concept in accounting governs the recording and reporting of financial transactions, “such that the assets or income are not overstated and liabilities or expenses understated”. The prudence concept creates a proper platform for accounting standards and reinforces the fundamentals of financial reporting—such as the principle of Fair Presentation, which dictates that financial reports should fairly reflect the financial position and cash flows of an organization.

VII. Weaknesses Of Human Resource Accounting

The Generally Accepted Accounting Principles (GAAP) has declined to treat the expenses on human resources as capital investment for certain reasons. They are:

- Violation of conservatism concept
- Uncertainty about the future benefits
- Absence of initial investment in the acquisition of human assets
- Lack of real ownership of employees physically by the employer
- Lack of guiding principles, concepts, conventions and regulatory body
- Lack of recognition by tax authorities
- Trade union opposition
- Lack of awareness and adequate research

VIII. Relevance Of Considering Human Resources From Investment Perspective

The majority of management practioners and human resource scholars have advocated that human resources should be viewed from an investment perspective. Some of the organizations like Boeing, Cummins, Ford, General Electric, IBM, Kodak, Motoroala, Polaroid, Procter & Gamble and Xerox have invested on employee training considering human resources as investments. However, still some of the organizations still view their employees as variable cost of production, while physical assets are treated as investments. The organizations, which view their employees as variable costs, there is little recognition of the firm’s contribution towards training or costs of recruitment, training and employee replacement. The Human Capital Asset majorly consists of outstanding depth in human skills, logistics capabilities, knowledge bases, or other service strengths that the competitors lack. Therefore the organizations, which realized the fact that a firm’s competitive advantage majorly derives from human resources are adopting in investment perspective on recruitment, training, management development, prevention of skill obsolescence, reductions in career plateauing and employee health etc. instead from cost perspective. Over and above, strategic management thinkers’ view is that considering employees from investment perspective acts as morale booster and better job security provides a meaningful contribution from the bottom line. The strategic management thinkers another view is that firms, which not considers from investment perspective will face high cost of employee turnover. HR consulting expert Hay group estimated that finding and training a replacement, costs 50% to 60% of the departed

employee's annual compensation. Therefore, to establish a solid "HR accounting frame work" an investment perspective provides a valuable guide for better evaluation of human resource's real value.

IX. Trends In HR Accounting

A large number of HR parameters are expressed in accounting terminology such as employee leave account, provident fund account, gratuity account, conveyance account, medical reimbursement account etc. all these are managed through special HR software and quantification of HR expenditure is no longer an issue. The total cost derived for the entire HR gives the entire picture of cost of total human resources.

Along with the above dimension, there are a number of HR software versions available for quantification of HR performance. The sum derived for the entire organization can be regarded as benefits derived or accrued from the total human resources. Therefore, the most complicated element in HR "Quantification" is no longer an issue and it is the high time to re-organize the outdated principles as per advancement in technology. It is in one way a technology enabled HR accounting.

Further, there are a large number of associations established throughout the world concerning human resources. However, these associations like accounting standards either GAAP (Generally Accepted Accounting Principles) or ASB(Accounting Standards Board) of India have not prescribed any standards for governing or valuing Human Resources. These associations or institutes have to take steps for setting up an apex body concerning the "Human Resources" at each and every country level. The concerned ministries of HRD have to support in augmenting these standards.

Over and above, the majority of HR managers have to update their knowledge in understanding "HR Accounting" theme and philosophy, their active participation and involvement will really bring the concept to live and last forever.

X. Filling The Gap Between HR Accounting And Financial Accounting

Though Financial Accounting is not showing the "Human Resources" in annual accounts, there are some acceptable facts, which in one way fill the gap and gives scope for inclusion of "Human Resources" in annual accounts. They are:

- The profit/loss shown in profit and loss account without considering value earned by human is not the actual profit, in fact the rest of the things are valued by human only and ignoring the contribution of human is in one way amounts to not showing of annual accounts in true and fair view of the affairs
- In Profit and Loss account the expenditure on Salaries is shown on the debit side, whereas no mention about revenue earned out of the expenditure on credit side can be considered as a human trick to invade taxes vis-à-vis cannibalization of human resources
- In case, if human resources have to considered only from expenditure point of view treat the entire element of human resources separately and consider the only net worth generated through human resources in annual account
- A concrete and universally accepted "Human Resource Accounting" has to be established to provide the "Net Worth or Net Loss" generated through human resources and the same can incorporated in annual accounts to depict the true and fair view of the affairs of the organization
- Employee awareness has to be increased in establishing and realizing the importance of "Human Resources Value" as in the case Performance Appraisal System
- Organizations have to come forward voluntarily in establishing and providing their annual accounts in a pro-active manner, so far only few companies like BHEL, Infosys, NIIT and Reliance Industries etc. have implemented the process of showing their value of "Human Resources" in annual accounts

XI. Conclusion

Human Resource Accounting in fact is not a new discipline in Human Resource Management. However, it has not received wide recognition due to wide variety of factors. Now, it is the high time due to liberalized and globalized environment to provide the necessary impetus to this branch of accounting in general financial accounting. At the end of each financial year there will be thorough feedback analysis on each and every aspect of financial matter, but unfortunately it is the only element, which is window dressed in financial accounts is "Human Resources". The annual accounts are in fact incomplete, if they fail to consider each and every element in providing the end result. The result can be profit or loss/ product or service. Therefore, a concrete research in a standardized fashion in this respect is an immediate requirement from the ambit of organizations, academicians and practioners.

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