

Human Resource Accounting- Role and Challenge for Accountants'

Juhi Chatterjee, Partha Chatterjee

Post Graduate M.Com

Assistant Professor

Assistant Professor of MBA(Finance) in Dr. B.C.Roy Engineering College, Durgapur.

Correspondence Author: Juhi Chatterjee

ABSTRACT: *Thanks to globalization, we are now passing through knowledge based economy where human resource has a significant contribution for the growth and success of the businesses and the society. Shifting from physical asset to knowledge based intangible asset proves that it is only the human resources who can bring the success of business and it is their endeavour to create more wealth for the firm and the society by proper using the physical assets like land & Building, Plant & Machinery, Infrastructure etc.*

Presently, any growth and success story of corporate are due to the efficiency, creativity, Intellectuality, behavior, attitude, knowledge and skill of the intangible asset i.e. human beings. Human resources are the engine or talent for sustainable growth of any business corporate. Wealth maximization, value maximization, growth in market share, efficiency, competitiveness, good management, vision, mission, achievement of goal, corporate image, corporate governance, brand management, supply chain management, reputation, developed research and development, value management, time management, continuity of success all depends on human talents.

Human resource accounting is the process of identifying and measuring value and benefit arises for human resources and communicating this information to the interested parties for the purpose of relevant decision making.

Date of Submission: 04-06-2018

Date of acceptance: 21-06-2018

In spite of leading contribution made by the human resources, there is no effort made by the business firms to show their value and contribution in the annual report of the company. Many researches has been made so far regarding valuation of human resources but in no case human resource has been shown in the balance sheet as asset i.e. long term investment.

Traditional accounts which records all the tangible assets and to some extent intangible assets like goodwill, patent etc but altogether ignore to show the value of human resources in the balance sheet. As a result the shareholders do not get the real picture regarding contribution made by the human resources for the success of the company. Traditional accounts cannot give a clear vision unless it takes into consideration the value of human resources out of total value of the firm.

At this juncture, the qualified accountants have a leading role to find out the methods of valuation of human resources and also how it is to be shown in the balance sheet.

In this paper, effort has been made

1. Importance of human resources in today's business scenario
2. Concept of HRA and its benefits
3. Problems for valuing Human resources
4. Different valuation model introduced so far
5. Position of Human Resource Accounting in India
6. Role of Professional Accountant in this perspective
7. Recommendations and suggestions.



Human Resource Accounting- Role and challenge for Accountants

Juhi Chatterjee

M.Com

Partha Chatterjee

M.Com, FCMA

Assistant Professor, Dept. of MBA

Dr. B.C.Roy Engineering College, Durgapur.

Importance of human resources in today's business scenario

Often we see in Director's report 'Our employees is our greatest asset for being a fantastic success of our company. We have to retain them at any cost'.

If you look at auditor's report of a company, the statement given by an auditor is 'We have audited the annexed Balance Sheet of ABC Ltd., as on 31st March 2018 and also the annexed Profit and Loss Account. In our opinion and to the best of our information and according to the explanations given to us, the said accounts give the true and fair view of the state of affairs of the business and that profit and loss account reflects a true and fair view of profit or loss for the financial year'.

In the first case, directors are not able to give contribution of the employees in terms of money.

In the second case, auditor gives his audit report without giving state of affairs regarding human resources.

Owners of any business have some positive expectations be it is a sole proprietorship or partnership or Joint Stock Company or any other profit seeking entity. They are interested to know that profit is the main driver or key for success and growth. They are also interested to know that how their hard capital are utilized for earning maximum profit and maximization of wealth.

But behind the scene of growth and success there is an interesting fact i.e. human resources and their role which is almost neglected in the annual report of the corporate. Human resources are the engine or talent for sustainable growth of any business corporate. Wealth maximization, value maximization, growth in market share, efficiency, competitiveness, good management, vision, mission, achievement of goal, corporate image, corporate governance, brand management, supply chain management, reputation, developed research and development, value management, time management, continuity of success all depends on human talents. Like all other resources of the company, the employees possess value because of providing future services.

Intangibles i.e. human resources are more valuable than tangibles e.g. land, building, plant and machinery, computer etc. You may have good infrastructure, centrally air conditioned building, highly developed many number of computers, high technology machine, many number of cars but in absence of good talents that may failed to give a substantial growth. Employees are the drivers whose efforts, mentality, imagination, belongingness, morale, leadership, creativity, co-operation, group efforts can boost up success.

Thanks to globalization, we are now passing through knowledge based economy where human resource has a significant contribution for the growth and success of the businesses and the society. Shifting from physical asset growth economy to knowledge based growth economy reveals that it is only the human resources (intangible assets) which can bring the success of business and it is their endeavor to maximize wealth of the firm and the society by proper using the physical and financial assets like land & Building, Plant & Machinery, Infrastructure etc. Presently, any growth and success story of corporate are due to the efficiency, creativity, intellectuality, behavior, attitude, knowledge and skill of the intangible asset i.e. human beings.

I. THE IMPORTANCE OF HUMAN RESOURCES IS:

- (i) Like any other physical and financial asset they have value creation ability. The remarkable difference between physical assets and human resources are human resources not only create value but also appreciate over time. A company with its worst situation may revive again only due to the contribution made by human resources.
- (ii) Increase in market value of share as compared to book value is not only due to its physical and financial assets. It is the human resources who are the driver for success.

- (iii) In today's competitive business world where right decision in right time is the key for success it is the human resources who give their best effort for being success of a company.
- (iv) Human resources through its effort and value creation ability can judiciously use physical and financial resources so that market can be retained.
- (v) When we talk about capital employed of a business we calculate it taking fixed assets, current assets and current liability by ignoring the value of human resources. Is capital employed calculated under traditional method reflects the true view of the state of affairs so far as allocation of asset is concerned. Time has come when every organization has to consider the paramount importance of human resources.
- (vi) If two companies have same capital employed and technology it is only with the human resources which may be used as a barometer for comparison.
- (vii) Today, employees are the focus of success story. Development, growth, opportunities, brand name, prosperity all depends on human capital which is the most valuable asset in any organization. When some key employee's leaves organization the loss which arises cannot be filled up. Human resource is floating rather than fixed. To retain employees an employer must understand the need and value of employees due recognition must have to be given so that they can be motivated to get loyalty.
- (viii) Disclosure of HRA makes investors fully aware of the company's human assets. The investors can also judge the return on human capital to make sure that their essence of return on their hard capital are fully managed and utilized by human resources of the entity. HR value reporting are also a very important yardstick for the foreign institutional investors who are not fully aware of the day to day performance of the entity.

Concept and study of human resource accounting and its benefits

According to **American Accounting Association** "Human resource accounting is the process of identifying and measuring data about human resources and communicating this information to the interested parties".

The human capital can be defined as "the knowledge that individuals acquire during their life and use to produce goods or services or ideas in market or non-market circumstances."

HRA is the process of quantifying cost and value of human resources of an organization to know their contribution for the achievement of organizational goal and also to the management for the betterment of their services so as to get their best value till retirement.

The importance and value of human assets started to be recognized in the early 1990s when there was a major increase in employment in firms in service, technology and other knowledge based sectors. In these sectors, the intangibles assets, especially human resources, contributed appreciably to the building of shareholders value.

Increasing growth and future opportunities of business in these competitive business scenario, a major transition from today to tomorrow (due to quick change of customers expectations), continuous research regarding market and technology, maintaining competitive cost and price requires need of intelligent human resources for a success story. Without showing value of human resources in the Balance Sheet how should we conclude that this statement reflects a true and fair view? Companies' law and other Accounting Bodies in India have not made it mandatory to show the value of Human resources in the Balance Sheet. Hence there is no mandatory disclosure policy right now regarding human resource accounting which is a big failure for the accounting professional all over the world when a major portion of success in business contributed by human resources.

II. THE BENEFITS OF HUMAN RESOURCE ACCOUNTING ARE

- (i) HRA provides useful information to the management regarding human resource capital which helps them to take valuable decisions for recruitment, training and development, promotion, retrenchment, remuneration, performance appraisal etc.
- (ii) It is used as a very valuable tool to assess the efficiency of HR policies and practices. The strength and weaknesses of the human resources can be revealed. A feeling of high satisfaction and proud for the companies' employees if they are treated as an asset and not expenses of the firm.
- (iii) It helps to judge the value of human resources utilized by an organization. If two companies are offering the same rate of return on capital employed assuming using same technology, HRA by providing information on their human resources can help the potential investors to judge which one company should be selected to make investment.
- (iv) The information provided by HRA helps management to control various types of human resource costs and as a result, help to improve profitability of the organization. The management can also judge the present value of its future commitment of giving employee compensation.

- (v) HRA helped the management to disclose the value of its human resources. Such information is more valuable and reliable than the conventional system of accounting where 'Return on Capital Employed' is the benchmark for measuring success.
- (vi) If intellectual capitals are legally shown in the Balance Sheet (as per law of the country or Accounting Standard set by Accounting Body like ICAI of India) the scenario of the share market will take a major shift for valuation of securities.

Problems for valuing human resources

In spite of leading contribution made by the human resources, only a few business firms have taken initiative to show their value and contribution in the annual report of the company. Many researchers have been made so far regarding valuation of human resources but in no case human resource has been shown in the balance sheet as an asset i.e. long term investment. The problems of valuing human resources are:

- (i) Like other physical assets, human resources cannot be owned by the organization. Moreover, employees may leave organization when they are getting more monetary and non monetary benefits in other organization.
- (ii) Human resources are not recognized by the Income Tax department.
- (iii) Some qualities of human resources cannot be measured into monetary terms such as leadership quality, praise, honesty, sincerity, motivation, mood, sentiment, loyalty, ego etc.
- (iv) No assurance of certain benefit given by human resources in future time period.

Different valuation model for intangible human resources introduced so far

The important models introduced regarding human resource valuation are:

(i) Historical Cost Method: This method was introduced by **Brummet** to measure the value of firm's investment on human resources. Here investment in human resources reflect the present sacrifice for getting future benefits and hence all expenditure on recruitment, selection, training and development for the employees will be capitalized and to be shown as asset in the balance sheet. Under this method capital expenditure on human assets are amortized over an expected life of human assets. If any employee leaves early then unamortized portion of capital expenditure will be treated as loss and charged to Profit & Loss A/c. However, it is a very difficult task to find out the effective life of human assets and determine the rate at which cost should be amortized.

(ii) Replacement Cost Method: This was developed by **R.Likert** and **E.G.Flanholtz**. Under this method, all the costs of replacement are considered when an employee is replaced (i.e. recruiting, training, placing etc) with a person of same ability. However, it is difficult to determine the replacement cost of an employee and replacement cost does not reveal the competency of an employee.

(iii) Opportunity Cost Method: This method was developed by **Hekimian and Jones**. Under this method human resources are valued on the bidding cost. Only rare work force or employees are considered under this method. The value of human assets is determined by capitalizing the total bid prices of all the scarce employees within the company.

(iv) Rewards Evaluation Model: This model has been suggested by **Flanholtz**. Under this method major variables are identified to determine an individual's value to an organization, i.e. his expected realizable value. The expected realizable value of an individual is the present value of future services he is expected to be given in the service period remain in the organization. Flanholtz presumed that a person's value to an organization depends upon the position to be occupied by him in the organization. The changes in the role of an employee in an organization in different position are a stochastic process with rewards. As people move and occupy different organizational roles, they give services (i.e. rewards) to the organization.

(v) Economic Model (earning approach): **Lev and Schwartz** developed this model which estimates the future earning of an employee during the remaining life of his service and determine the present value by discounting the estimated earnings at the employee's cost of capital. The Lev & Schwartz model shows that the human resource of a company is the summation of value of all the Net Present Value (NPV) of expenditure on employees. The human capital embodied in a person of age r is the present value of his earning from employment. This method has recognized by many companies all over the world. Still this method is not free from limitations such as under this method training expenses, productivity of employees, attrition rate etc has not been considered.

Model-I: Return on Capital Employed (ROCE) -Is it only test?

Details	Company A	Company B
Capital Employed	Rs 200 crores	Rs 220 crores
PBIT	Rs 40 crores	Rs 44 crores
PAT	Rs 20 crores	Rs 22 crores
No. of Employees	10,000	10,000
No. of Shares	100 lakhs	100 lakhs
ROCE (PBIT/Capital employed)	20%	20%
Profit per employee (PAT/No. of Employee)	Rs 20,000	Rs 22,000
EPS (PAT/No. of Shares)	Rs 20	Rs 22

III. FINDINGS

Though ROCE is the same in both the cases, profit per employee of Company B is greater than Company A which may be due to the following reasons.

- (i) Management people of company B have better talents than company A regarding policy formulation and implementation.
- (ii) Employees are more trained and developed, highly motivated, good relation and understanding between employer and employee and as a result low Labour turnover ratio.
- (iii) Sales force is strong enough to capture new markets, projection of market demand is highly successful, and a strong background in market research and supply chain management is very effective.
- (iv) Financial manager and his staff have a strong background in utilization of capital structure; costing department is very effective in cost analysis, for controlling overhead, highly developed standard data for analysis of variance, a sound budgetary control system and overall control on cost reduction programme.
- (v) Projecting brand image of the company to the world in efficient way.
- (vi) Production are very much scheduled, waste management are very effective.
- (vii) Portfolio manager are highly successful in predicting future risk of investment.
- (viii) A strong data base management system developed by highly qualified professionals for IT department.

So, it can be said that return on capital employed is not only the sole driver to measure the growth and success. We have to think behind the scene i.e. the operators or drivers whose efforts and initiatives may reflect a good corporate image to all the interested parties.

Model-II: How to value Human Resources

Details	2016	2017
Profit after Tax	120,00,000	140,00,000
Less: Normal Return on Capital Employed (Rs 1000 lakhs x 10%)	100,00,000	100,00,000
Super Profit	20,00,000	40,00,000
Increase in Earnings (Rs 40,00,000 – Rs 20,00,000)		20,00,000
Capitalized at 10% rate Rs 20,00,000 x 100		
----- = Rs 200,00,000		
10		

From the above calculation it is seen that with the same capital employed a company has earned Rs 20,00,000 more in the year 2017 as compared to 2016 (100% increase) due to training and development of the employees. Capitalized value at 10% normal rate of return is Rs 200,00,000. This reflects the value of human resources and can be shown in the Balance Sheet.

Position of Human Resource Accounting in India

The concept of human resource accounting was not new in India. HRA was introduced by public sector companies like Bharat Heavy Electricals Ltd. (BHEL), Steel Authority of India Ltd (SAIL) way back in the 1970s. However, the concept did not gain much popularity and acceptance during that time. The need of reporting human resource value has geared up amongst the software companies in India after 1990.

In the financial year 1995-96, Infosys Technologies became the first software company to value its human resources in India and disclosed in their Annual Reports as a statement of intangibles (additional notes to the

accounts). The company used **Lev and Schwartz Model** and valued its human resource assets at Rs 1.86 billion. Infosys had always given utmost importance to the role of employee in contributing to the company's success.

Though the concept of human resource accounting is in the early stage of development in our country it has take place in the annual report as a separate section of Indian companies like Steel Authority of India Ltd. (SAIL), Bharat Heavy Electricals Ltd. (BHEL), Minerals and Metals Trading Corporation Ltd., Oil India Ltd. National Thermal Corporation Ltd., Hindustan Copper Limited, TATA, Birla, Wipro, Infosys Technologies, Satyam Computer and other companies.

Role and challenge of Professional Accountants in this perspective

The Institute of Chartered Accountants of India has not issued an accounting standard for the measurement and reporting of cost and value of human resources of an organization. The Indian Company's Act, 2013, is also silent regarding furnishing of any significant information about human resources in the Balance Sheet. According to the money measurement concept of accounting only those transactions can be recorded under double entry accounting system which can be expressed in monetary term. Human qualities (i.e. honesty, loyalty, sincerity, wisdom, skill, attitude etc) cannot express in monetary term, therefore, there is no standard method which can be followed to capitalize the investment on human assets.

At this juncture, the qualified Cost and Management accountants (CMA's) are questionable for not taking their brains to reflect the true picture regarding recognition of human capital and they have to take an active role to find out the clear methods of valuation of human resources and also how it is to be shown in the balance sheet as 'long term investment'.

Recommendations and suggestions based on findings of the study.

Traditional accounts which records all the tangible assets and to some extent intangible assets like goodwill, patent etc but altogether ignore to show the value of human resources in the balance sheet. Due to this insufficient reflection in the annual accounts the shareholders do not get the real picture regarding contribution made by the human resources for the success of the company. Traditional accounts cannot give a clear vision unless it takes into consideration the value of human resources out of total value of the firm.

Accounting Professional bodies of every country must give due attention to find out the way of valuation of human resources of the businesses so that a uniform measurement and accounting policy can be found out all over the world. Time has come when more and more researches are required in this field otherwise the true value of human assets remains unearthed.

BIBLIOGRAPHY-

- [1]. Partha Chatterjee ' The Management Accountant' 'Return on Talent And Its Accounting-Role And Challenge For Cost And Management Accountants' March 2013 Issue.
- [2]. Jasrotia Punita, (2002), "The need for human resource accounting",
- [3]. Flamholtz Eric G, Bullen Maria L, Hua Wei, "Human Resource Accounting: A Historical Prospective and Future Implications", Management Decision.

Juhi Chatterjee." Human Resource Accounting- Role and Challenge for Accountants'." International Journal of Business and Management Invention (IJBMI) , vol. 07, no. 06, 2018, pp. 01-06.