CHAPTER III

HUMAN RESOURCE ACCOUNTING – AN OVERVIEW

3.1 Introduction

3.2 Meaning and Definition of Human Resource Accounting

3.3 Historical Development of Human Resource Accounting

3.4 Models of Human Resource Accounting

3.5 Objectives of Human Resource Accounting

3.6 Benefits of Human Resource Accounting

3.7 Reporting on Human Capital at National Level

3.8 Disclosure on Human Capital at International Level

3.9 Limitations of Human Resource Accounting

3.10 Summary
CHAPTER III

HUMAN RESOURCE ACCOUNTING – AN OVERVIEW

3.1 INTRODUCTION

“The success of any organization comes out of its human capital”.

In this chapter, the concept of Human Resource Accounting, the various approaches and models for the valuation of Human Resources and the terms used for computing Human Capital are presented. Besides the model of Reporting on Human Capital at the national level and disclosure status at the International level have been given.

Organizations spend more money to recruit, select, hire and train employees and this money represents an investment in people. Organizations often spend more on investments in people than on investments in equipment. Yet under the present accounting system, the purchase of a micro computer would be treated as an asset while the investment made in hiring an executive would be treated as an expense
and charged against current year's revenues. This is clearly a distortion of income measurement because no firm would make such substantial investments in a person unless he or she represented “human capital” – an asset with expected future benefits.  

In the case of manufacturing firms where physical or financial assets predominate, the traditional accounting systems have been tailored to the needs of the firms. In the case of growth firms such as information technology companies, service providing firms, higher educational institutions and entertainment agencies, human resources might be more important than physical or financial resources. If the value of human resources is reflected in their financial statements, the reporting could be more effective.

It is recognized that human resources are costly to acquire and develop, and that substantial investments are required in order to build an effectively functioning human organization. During the past decade, there has been a growing interest in the idea of accounting for people as organizational resources. This interest has led to an emerging interdisciplinary field of research known as “Human Resources

---


Accounting. Human resource accounting is of recent origin and is struggling for acceptance.

3.2 MEANING AND DEFINITIONS OF HUMAN RESOURCE ACCOUNTING

Human Resource Accounting (HRA) involves accounting for the company’s employees as human capital that provides future benefits. In the HRA approach, expenditures related to human resources are reported as assets on the balance sheet as opposed to the traditional accounting approach which treats costs related to a company’s human resources as expenses on the income statement that reduce profit. HRA suggests that the process of measurement has relevance in decision-making involving organizations. Although the origins and early development of HRA occurred mostly in the United States, interest and contributions to growth in the field have been evident in a number of other countries.

Peter F. Drucker pointed out that “It is human being who converts resources of production into production. This income generating aspect of human resources should get not only due recognition but proper recording also”.

---

68 Maria L. Bullen, Clayton State University, Kel-Ann Eyler, Wesleyan College, Journal of International Business and Cultural Studies, p.1
According to Likert (1971), “HRA is a management tool which is designed to assist senior management in understanding the long term cost and benefit implications of their human resource decisions so that better business decisions can be taken”.

According to E.H. Caplan and Landekith, “People are the most important assets of an organization and yet the value of this asset does not appear in the financial statements”\(^7\)

Eric Flamholtz (1971) has defined HRA as “Accounting for people as an organizational resource. It involves measuring the costs incurred by organization to recruit, select, hire, train and develop human assets. It also involves economic value of people to the organization”.\(^7\)

Eric Flamholtz has also pointed out that HRA is “the measurement and reporting of the cost and value of people”. Woodraff Jr. R.L., Vice President. R.G.Barry Corporation, has defined human resource accounting as “An attempt to identify and report investment made in human resources of an organization that are presently not accounted for under conventional practices. Basically, it is an information system that

\(^7\)N.P.Agarwal, SheikhaAgarwal, R.K.Tailor, SunithaAgarwarl (2009), Human Resource Accounting, Prateeksha Publications, Jaipur, p-1

\(^7\)V.S.P.Rao, (2005), Human Resource Management, Excel Books publication, New Delhi, chapter-28
tells the management what changes over time are occurring to human resources of the business.”  

Sidney Davidson has defined Human Resource Accounting as “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.”

According to Thomas W. Mc Rae, HRA describes the process of measuring the cost or value of an organization's personnel and recognizing those amounts as capital investments. Human Resources Accounting has been defined by the American Accounting Association’s Committee on Human Resource Accounting (1973) as “the process of identifying and measuring data about human resources and communicating this information to the interested parties.”

Human asset is the total value to an enterprise of its employees, plus the value of any other assets owned by the company for

---

72 J.MadeGowda (2001), Management Accounting, Himalaya Publishing House, Mumbai, p-677
73 ibid
the exclusive benefit of the employees. Human capital is the equivalent of the total value to an enterprise of its employees.  

3.3 HISTORICAL DEVELOPMENT OF HUMAN RESOURCE ACCOUNTING

The concept of considering human beings as an asset is an old one. The importance which Emperor Akbar gave the gifted nine jewels (courtiers) is a strong evidence for it.

Sir William Petty was the pioneer in this direction. The first attempt to value the human beings in monetary terms was made by him in 1691. Petty considered that labour was “the father of wealth and it must be included in any estimate of national wealth without fail”. Further efforts were made by William Far in 1853 and Earnest Engle in 1883. The real work started only when behavioral scientists vehemently criticized the conventional accounting practice of not valuing human resources along with other resources. As a result, accountants and economists realized the fact that an appropriate methodology had to be developed for finding the cost and value of the people to the organization. For a long period of time, a number of experts worked on the methodology and produced certain models for evaluating human resources. Important among them

76 Dr. Jim Otter, Article- “Putting the People component of the Business Entity on the Balance Sheet” from website
are R. Likert and Associates, Eric Flamholtz, Lev and Schwartz, Jaggi and Lau, and Roger Hemanson.\textsuperscript{77}

Eric G Flamholtz divides the development of HRA into five stages as follows:

**First Stage (1960-66)**

This marks the beginning of the academic interest in the area of HRA. The focus was primarily on deriving concepts from other studies like the economic theory of capital, the psychological theories of leadership–effectiveness relations.

**Second Stage (1966-71)**

The focus was more on developing and validating different models of HRA. Theses models include both the monetary and the non-monetary value of HRA. Roger Hemanson as part of his Ph.D. studied the problem of measuring the value of human assets as an element of goodwill. Inspired by his work, a number of research projects were undertaken by researchers to develop the concepts and the method of accounting for human resources.

**Third Stage (1971-76)**

This period was marked by the rapid growth of research in the area. The focus was on the issue of the application of HRA in business.

\textsuperscript{77} E-Book on Human Resource Accounting - Unit-I, p.4
organizations. R.G. Barry’s experiments contributed to HRA during this stage.

**Fourth Stage (1976-1980)**

This was a period of decline in the area of HRA due to complex issues that needed empirical research, and the organizations did not find much use in pumping in large sums or investing a lot of time and energy in supporting the research.\(^{78}\)

**Fifth Stage (1980 onwards)**

There was a sudden renewal of interest in the area of HRA. Due to the shifting of manufacturing to servicing economy, the organisations began to realize the value of intangible assets since the survival, growth and profits of the organizations were perceived to be dependent more on intellectual capital than on physical assets. The shifting to knowledge based industries gave importance to the valuation of human resources in financial accounting practice.

The International Accounting Standards Committee (IASC) has issued International Accounting Standards to harmonize diverse accounting practices prevalent in the different member countries. As far as the inclusion or exclusion of human resource information in the Balance Sheet and Profit and Loss Account of a Company is concerned,

so far, no definitive accounting standards have been brought. The “Framework for Preparation and Presentation of Financial Statements” issued by the IASC clearly states that financial statements are aids to economic decision making and puts a case for Human Resource Accounting and its inclusion in financial statements. IAS-30 (International Accounting Standards-30) pertaining to the Disclosures in the Financial Statements of Banks also support the adoption of Human Resource Accounting by business entities to provide a true and fair disclosure of the financial position of the business and its profitability.  

3.4 MODELS OF HUMAN RESOURCE ACCOUNTING

The various Models of Human Resource Accounting are discussed here.

The models of human resource accounting are broadly classified.

3.4.1. Cost Based Models:

3.4.2. Economic Value Models:

A. The cost based model is further classified into two categories namely historical cost, capitalization and replacement cost.

B. The economic value model is classified into the Opportunity cost model and the Present value model and the present value model is further classified as the Lev and Schwartz model (Discounted wages

79 E-Book on Human Resource Accounting-Unit-I-pp237-238
and salaries), the Flamholtz model (Stochastic Process with service rewards) and the Jaggi and Lau model (Valuation group basis)\(^8\)

---

**Models of Human Resource Accounting**

- **Cost base**
  - Historical Cost
  - Replacement Cost

- **Economic Value**
  - Opportunity Cost Model
    - Hekimian & Jones model
      - Lev and Schwartz model (Discounted wages & Salaries)
      - Flamholtz model (Stochastic process with group basis)
  - Present Value Model
    - Jaggi & Lau model (Valuation on Service rewards)

### A. Cost based Models:

#### 3.4.1.1 Historical cost:

This model was developed by R. Likert and Associates. The Costs related to recruitment, training, etc for making the employee ready for service are capitalized and amortized over the expected length of service of the employee annually. If the employee quits, the unamortized balance is charged off. The usage of this model is rejected on the following grounds:

1. Historical costs are sunk costs
2. Skilled employees who require less training are valued at lower cost
3. Future training costs are ignored

3.4.1.2. Replacement Cost

This model was developed by Prof. Eric G. Flamholtz. Human capital is valued at the worth of the sacrifice by the enterprise to replace its human resources by an identical one. The Replacement cost is divided into two parts viz., individual replacement cost and positional replacement cost. Individual replacement cost denotes the cost of replacing an individual with another of the same skill set. Positional replacement cost denotes the cost of replacing the set of services delivered by a position. Example – Outsourcing of internal audit.

3.4.2. Economic Value Models:

3.4.2.1. Opportunity Cost Model:

This model was developed by Hekimian and Jones. The value of an employee is equivalent to the value of the employee in alternative use. Example – An engineer in the production department is deputed to the service department. This method is rejected since it is likely to scare employees whose skills are in demand.
3.4.2.2. Discounted Wages & Salaries Model

This model was developed by Lev and Schwartz. The value of an employee is equivalent to the present value of his remaining future earnings from the employment. The Remaining future earnings is equivalent to the estimated salary payable over the remaining estimated working life. This method is widely adopted and it includes the following steps for arriving at the human capital.

3.4.2.3. Steps:

a. Employees are decomposed by age group and skill set
b. Ascertainment of the average earnings of each group and skill set
c. The Present value of the future earnings is arrived at by multiplying the average earnings (b) by the discounting rate
d. The value of human resources is equivalent to the sum of all the present value of the future earnings.

3.4.2.4. Limitations:

a. The Value of employees can also be determined by personal characteristics and their willingness to contribute to the organizational goals.

b. The Retirement/Exit in between service period is ignored

c. The Probability of role change during the career period is not considered
3.4.2.5. Stochastic Process with Service Rewards Model

This model was developed by Prof. Eric G. Flamholtz. The value of the employees is equivalent to the present value of the future benefits. Future benefits is equivalent to the expected quantity of service in each state during the career multiplied by price or income expected to be derived from the use of the services over the period. This method is not widely used because of the following reasons:

a. The estimation of the probability of the likely service status of each employee is highly subjective.

b. The ascertainment of the monetary value of service in each state is quite costly and difficult too.

3.4.2.6. Valuation on Group Model

This model was developed by Jaggi and Lau. This model is similar to the Lev and Schwartz model but recognizes the value of human resources that exists only as a group. This model has got the following steps:

a. Ascertainment of the number of employees in each rank.

b. Estimation of probability that an employee will be in his rank or be terminated or promoted in the next period.

c. Ascertainment of the economic value of an employee in a specified rank during each time period.
d. Present value of an exiting employee in each rank is arrived at by multiplying the number of employees in each rank by the probability period and the economic value viz., ((a)x(b)x(c)).

This model is not widely followed since the exceptional skill of a specific employee can affect the performance of the group and this fact is ignored in this model.

3.5. OBJECTIVES OF HUMAN RESOURCE ACCOUNTING

The objectives of maintaining a Human Resource Accounting System are as follows:

1. To improve the management of human resources from an organizational perspective by increasing the transparency of human resource costs such as recruitment, training and development, promotion, retention and retrenchment.

2. To help the management in giving information on the human capital which is vital for Internal and External decision makers.

3. To improve managerial decision-making specially in situations like direct recruitment versus promotion, transfer versus retention, retrenchment or relieving versus retention.

4. To identify the human resources as a valuable asset which will help the organization for effective utilization and rewarding.

5. To improve the morale, loyalty, initiative and productivity of the employees by attaching monetary values to workforce.
6. To provide cost value information about acquiring, developing, allocating and maintaining human resources so as to meet organizational goals.

7. To have a complete Management Information System in the Organization, etc.

3.6 BENEFITS OF HUMAN RESOURCE ACCOUNTING

The following are the benefits of a Human Resource Accounting System:

1. Human Resource Accounting throws light on the strength and weakness of the existing workforce in an organization. This in turn helps the management in manpower planning whether to hire people or not.

2. HRA provides valuable feedback to the management regarding the effectiveness of HR policies and practices. For example, high training cost may warrant a change in policies. Additional recruitment expenses in respect of a particular category of employees may indicate the need for formulating a better compensation package.

3. HRA helps the management to look at the return on investment in human capital over a period of time.
4. HRA helps the investors to judge a company better on the strength of the human assets utilized therein.

5. HRA provides for the classification of the employee costs under different heads such as recruitment cost, training and development cost, transfer cost, separation cost, which helps the management to take appropriate decisions, keeping in mind the impact on the long run profitability.

6. Nowadays, firms spend a lot of money on training and development of the workforce. Hence, it becomes imperative to catalogue the nature and role of this expenditure.

7. The HRA System gives value to human resources, which enables the employees to realize their value to the organization. These values boost the morale of the employees for better productivity.

3.7 REPORTING ON HUMAN CAPITAL AT NATIONAL LEVEL:

The practice of identifying and measuring data about human resources has been developed in many Indian companies. There is a growing trend towards the measurement and reporting of human assets in corporate annual reports by various public sector and private sector companies. Though there is no statutory requirement either under the Companies Act or under the Indian Accounting Standards for the disclosure of statistical information regarding human resources, the valuation and disclosure of human capital is gaining importance.
The following are some examples of reporting patterns in the Indian Corporate scenario.

3.7.1 Bharat Heavy Electricals Limited

The BHEL has been valuing and reporting its human assets in its annual reports since 1978-79. The company adopts the Lev and Schwartz model and the application of a discount factor of 12% per annum on the future earnings of employees to arrive at the human capital.

<table>
<thead>
<tr>
<th>HUMAN RESOURCES</th>
<th>1987-88</th>
<th>1986-87</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive</td>
<td>4744</td>
<td>3960</td>
</tr>
<tr>
<td>Superiors</td>
<td>3841</td>
<td>3121</td>
</tr>
<tr>
<td>Artisans</td>
<td>5850</td>
<td>5169</td>
</tr>
<tr>
<td>Supporting Technical Staff</td>
<td>74</td>
<td>698</td>
</tr>
<tr>
<td>Clerical and Office supporting</td>
<td>1106</td>
<td>1036</td>
</tr>
<tr>
<td>Staff</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unskilled and Semi-skilled Staff</td>
<td>1982</td>
<td>1899</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>18265</strong></td>
<td><strong>15883</strong></td>
</tr>
</tbody>
</table>

Source: Annual Report 1987-88

3.7.2 Steel Authority of India Limited (SAIL)

The SAIL adopts the economic value model advocated by Lev and Schwartz while evaluating the human capital. It also incorporates refinements as suggested by Eric Flamholtz and Jaggi and Lau with
modifications suitable to the circumstances of the SAIL. It adopts a discount factor of 14% per annum.

### TABLE-3.2

**SAIL HUMAN RESOURCE VALUE**

As on 31.03.1986 (Rs. In crores)

<table>
<thead>
<tr>
<th>Age Groups</th>
<th>Below 25</th>
<th>25-35</th>
<th>35-45</th>
<th>45-50</th>
<th>Above 50</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Managers</td>
<td>-</td>
<td>9.12</td>
<td>90.56</td>
<td>57.99</td>
<td>30.63</td>
<td>188.00</td>
</tr>
<tr>
<td>Executives</td>
<td>96.34</td>
<td>395.44</td>
<td>466.90</td>
<td>165.99</td>
<td>59.27</td>
<td>1183.93</td>
</tr>
<tr>
<td>Supervisors</td>
<td>30.34</td>
<td>333.46</td>
<td>1050.53</td>
<td>737.44</td>
<td>175.20</td>
<td>2326.97</td>
</tr>
<tr>
<td>Clerical Staff</td>
<td>20.44</td>
<td>261.64</td>
<td>292.91</td>
<td>57.75</td>
<td>9.59</td>
<td>642.33</td>
</tr>
<tr>
<td>Skilled Workers</td>
<td>131.35</td>
<td>889.20</td>
<td>1382.10</td>
<td>525.68</td>
<td>103.30</td>
<td>3031.63</td>
</tr>
<tr>
<td>Semi Skilled/ Unskilled Workers</td>
<td>202.67</td>
<td>987.32</td>
<td>792.93</td>
<td>196.52</td>
<td>35.88</td>
<td>2215.63</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>481.14</td>
<td>2876.18</td>
<td>4075.93</td>
<td>1741.37</td>
<td>413.87</td>
<td>9588.49</td>
</tr>
<tr>
<td><strong>Previous Year-1985</strong></td>
<td>515.21</td>
<td>3008.56</td>
<td>4065.40</td>
<td>1656.44</td>
<td>335.52</td>
<td>9581.13</td>
</tr>
</tbody>
</table>

Source: Annual Report 1985-86
# TABLE 3.3
SOCIAL BALANCE SHEET OF SAIL AS ON 31.03.1986
(Rs. In Crores)

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>As on 31st March, 1986</th>
<th>As on 31st March, 1985</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organization Equity</td>
<td>268.85</td>
<td>242.52</td>
</tr>
<tr>
<td>Social Equity (Employees’ Contribution)</td>
<td>9588.49</td>
<td>9581.13</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>9857.34</strong></td>
<td><strong>9823.65</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Assets</th>
<th>As on 31st March, 1986</th>
<th>As on 31st March, 1985</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social Capital Investments:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>7.42</td>
<td>7.21</td>
</tr>
<tr>
<td>Residential and Other Buildings</td>
<td>198.94</td>
<td>175.00</td>
</tr>
<tr>
<td>Roads and Bridges</td>
<td>16.82</td>
<td>16.06</td>
</tr>
<tr>
<td>Electrification</td>
<td>11.66</td>
<td>10.99</td>
</tr>
<tr>
<td>Water supply and sewages</td>
<td>26.87</td>
<td>26.11</td>
</tr>
<tr>
<td>Furniture and Fittings</td>
<td>1.23</td>
<td>1.18</td>
</tr>
<tr>
<td>Other Equipments</td>
<td>5.91</td>
<td>5.97</td>
</tr>
<tr>
<td>Human Resources</td>
<td>9588.49</td>
<td>9581.13</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>9857.34</strong></td>
<td><strong>9823.65</strong></td>
</tr>
</tbody>
</table>

Source: Annual Reports of SAIL
3.7.3 Cement Corporation of India Limited (CCI)

The CCI has made an attempt to value its human resources, taking into consideration the anticipated future earnings on the basis of the present pay scales and promotion policies. The computation has been made based on the guidelines and principles enunciated in the economic models by Lev and Schwartz, Eric Flamholtz and Jaggi and Lau with appropriate modifications.

**TABLE 3.4**

**VALUATION OF HUMAN ASSETS IN CCI**
(Rs. In Million)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Managers</td>
<td>157</td>
<td>115</td>
<td>85</td>
<td>70</td>
<td>51</td>
</tr>
<tr>
<td>Supervisors</td>
<td>106</td>
<td>88</td>
<td>64</td>
<td>43</td>
<td>54</td>
</tr>
<tr>
<td>Skilled Workers</td>
<td>207</td>
<td>175</td>
<td>114</td>
<td>78</td>
<td>61</td>
</tr>
<tr>
<td>Semi-Skilled workers</td>
<td>130</td>
<td>101</td>
<td>68</td>
<td>49</td>
<td>42</td>
</tr>
<tr>
<td>Clerical and other</td>
<td>96</td>
<td>86</td>
<td>59</td>
<td>49</td>
<td>44</td>
</tr>
<tr>
<td>supporting Staff</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unskilled Workers</td>
<td>108</td>
<td>100</td>
<td>76</td>
<td>69</td>
<td>55</td>
</tr>
<tr>
<td>Total</td>
<td>804</td>
<td>665</td>
<td>466</td>
<td>358</td>
<td>307</td>
</tr>
</tbody>
</table>

Source: Annual Report of CCI

3.7.4 The Associated Cement Companies Ltd (ACC)

The ACC evaluates its human assets by computing the net present value of the anticipated future earnings of the employees based on the guidelines enunciated in the economic models of the HRA developed by Lev and Schwartz, Eric Flamholtz, Jaggi and Lau with
appropriate modifications as considered necessary. The ACC discloses in its annual report the value of the human resources as “Total Inventory of Human Resources” and “Age-wise and the Category-wise Inventory of Human Resources”. It is the only company in the Private Sector which has received the award “Plaque” for the best presentation of annual accounts and reports from The Institute of Chartered Accountants of India, for the year 1983-84

### TABLE 3.5

**VALUATION OF HUMAN ASSETS IN ACC AS ON 31.03.1986**

<table>
<thead>
<tr>
<th>CATEGORY</th>
<th>EMPLOYEES</th>
<th>VALUE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>%</td>
</tr>
<tr>
<td>Executives</td>
<td>56</td>
<td>0.21</td>
</tr>
<tr>
<td>Managers</td>
<td>287</td>
<td>1.05</td>
</tr>
<tr>
<td>Officers</td>
<td>1949</td>
<td>7.15</td>
</tr>
<tr>
<td>Skilled Workers</td>
<td>9977</td>
<td>36.60</td>
</tr>
<tr>
<td>Clerical and other supporting Staff</td>
<td>4527</td>
<td>16.61</td>
</tr>
<tr>
<td>Un skilled Workers</td>
<td>6695</td>
<td>24.56</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>27258</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

Source: Annual Reports of ACC (1985-86)

In the financial year 1995-96, Infosys became the first software company to value human resources in India. The company used the Lev and Schwartz model and valued its human resource assets at Rs 1.86 billion. Infosys had always given the utmost importance to the role of the employees in contributing to the company’s success. The Analysts felt
that human resource accounting (HRA) was a step further in the Infosys’ focus on its employees. Narayana Murthy, the then Chairman and Managing Director of Infosys, said: “Comparing this figure over the years will tell us whether the value of our human resources is appreciating or not. For a knowledge intensive company like ours, that is vital information”

3.8 DISCLOSURE ON HUMAN CAPITAL AT INTERNATIONAL LEVEL

The following are some examples of reporting patterns in the International Corporate scenario.

Australia:

It has been found by Trotman and Pand that 79% of the top 100 Australian companies voluntarily provide information on their social responsibility in the areas of community development, environment, human resource development and product improvement.

New Zealand:

In New Zealand, there is voluntary disclosure of social responsibility accounting and human assets value information in the financial statements and annual reports of the companies, which is also supported under Section 153 of the Companies Act, 1953 and under the

---

various accounting standards issued by the New Zealand Society of Accountants. This shows their concern for the use of such information in the decision making process.

3.9 LIMITATIONS OF HUMAN RESOURCE ACCOUNTING

1. Problems in Valuation:

It is not easy to value the human assets in an organization. There are no guidelines for differentiating the cost and the value of the human resources. There is a possibility of some employees leaving the organization due to separation i.e., resignation or retirement or death after valuation. This may cause serious problems in the valuation of human capital. Since the employees are not owned by the entity and the ownership of human resources rests with the employees, the employees could not be treated as assets.

2. Problems in Measurement:

Human Resource Accounting is full of measurement problems. There is no uniformity among the accountants and finance professionals regarding the measurement process of human capital. Questions may arise as to in what form and manner are the human assets to be included in the financial statements. How should the Human Resource cost be amortized?

3. Dissatisfaction among Employees:
Employees and Union representatives may not like the idea of human resource valuation. HRA may lead to division among the ranks of employees, valuing one group in a higher rank and another group in a lower rank. This may cause dissatisfaction among the employees. Moreover, employees may demand higher payouts and better reward, when they are valued at a “Premium”.

4. Lack of Support to Management:

There is no empirical evidence to support the idea that Human Resource Accounting is an effective tool to measure the economic value of the people to the organization. This creates a lack of support in generating information to the Management.

3.10 SUMMARY

Every one agrees that the only real long lasting asset which an organization or a society or a nation possesses is the quality and caliber of the people. Human Resource Accounting facilitates the valuation of the people and provides valuable information to the management for decision making. There are two approaches broadly classified as the cost model and the economic model which suggest methods for valuing the invaluable (Human Resources). Very few corporates value and report
the human capital using economic models to their own convenience and modifications. It is hoped that a uniform (standardized) valuation model to be built would enable the Corporate Sector to make the disclosure on human capital very constructive and logical.

The Lev and Schwartz Economic Model

Formula:

\[ V^*t = T \sum_{t} \frac{I(t)}{I = t (I+r)^{i-t}} \]
V_t = the human capital value of a person t years old

I(t) = the person's annual earnings up to retirement

r = a discount rate specific to the Person

T = retirement age.

**Steps:**

a. Employees are decomposed by age group and skill set

b. Ascertainment of the average earnings of each group and skill set

c. The Present value of the future earnings is arrived at by multiplying the average earnings (b) by the discounting rate

d. The value of human resources is equivalent to the sum of all the present value of the future earnings.
REFERENCE


11. Dr. Jim Otter, Article- “Putting the People component of the Business Entity on the Balance Sheet” from website
12. E-Book on Human Resource Accounting-Unit-I-p.4