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Human Resource Accounting - A Conceptual Framework
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HUMAN RESOURCE ACCOUNTING- A CONCEPTUAL FRAMEWORK

In the first chapter an attempt was made to introduce the entire research project including the review of various researches done in the field of HRA in India and abroad also. The present chapter is a study of conceptual framework of human resource accounting.

Introduction

Accounting is the language of business and its principles and procedures have been evolved over a long period of time. It aims at providing aid to business by reporting the results for decision making by management and also furnishes to public an insight into the financial health of the enterprise. Most of the literature in the discipline of accounting is so far concentrated on the aspects of physical and financial resources, which are well accounted universally with accepted standards of preparation and presentation. Very recently, the idea of accounting for human resources attracted the minds of many scholars. It is now acknowledged that HRA will represent one of the major innovations in behavioural aspects of accounting and control system in the decades to come.¹
In order to understand the concept of human resource accounting in proper perspective, it is pertinent to discuss the concept of human resource separating it from accounting. Thereafter, the concept of human resource accounting, its meaning, definition, objectives, importance, usefulness, limitations and its practical approach for corporate business world as a whole would be discussed at length. This background discussion will pave the way for articulate explanation and understanding of the human resource accounting practices in Indian companies.

The term ‘Human Resource’ means and includes all the living human beings of all sexes, all age-groups and all races and description living in a country from macro-view point. However, from micro view-point, it has a restricted meaning. It includes all the human beings having any direct or indirect transaction or contact with an organisation/enterprise. Human resource of an enterprise may be classified into various categories on the basis of the nature of transactions or contact. Thus, share holders, debenture-holders/depositors, suppliers, customers, employees may be the major human resource groups dealing with the organisation. However, from the view-point of human resource accounting it is felt pertinent to further restrict the meaning of the term ‘human resource.’ Excluded from the term are, therefore, the
external human groups like shareholders, debenture-holders, suppliers and customers. Thus for the purpose of human resource accounting, the term ‘human resource’ shall mean and include employees of all the categories (internal human-resources) working in an enterprise.

**Human Resource in Action**

It is well known that Human Resources constitute the core element of an organisation. They are the most sensitive, reactive and pro-active resource. There is growing awareness of the importance and role of HR in defining an organisation’s cutting edge. It is mainly due to the fact that HR is the mother resource of all other resource because it is only the human being who produces all the other means of production such as machinery, material, money and finally the management. Success of any organisation or business depends, to a great extent, on the quality, calibre and character of the people working in an organisation having vast physical resources. Thus, inspite of all technological developments, the importance of human resource has in no way diminished. Every business organisation depends for its effective functioning not so much on its materials or financial resources as on its pool of able and willing human resources.

These resources by themselves can not fulfill the objectives of an organisation. They need to be united into a team. It is
through the efforts of people that material and money resources are effectively utilized for the attainment of common objectives. Without united human efforts no organisation can achieve its goals. Therefore, people are treated as the most significant resource of an organisation popularly called human resources.

They (HR) consist of a large number of individuals each having unique personality, different needs, attitudes and values. Each has his own physical and psychological traits. Hence, most of the problems of an organisation are people related problems. These problems arise from the mistaken belief that people are alive and they can be treated identically. In order to make effective use of its human resources, an organisation must recognize and pay attention to differences between individuals so that each person can maximize his potential. Thus, human resource is the most important element in an organisation. The effective utilisation of all other resources depends on the quality of human resources. The human resources have the greatest potential to develop and grow. An organisation can survive and grow if it has the right people at the right time working at right job.²

This is the only resource which can generate unlimited wealth through better ideas. There is no apparent limit to what people can accomplish when they are motivated to use their potential to create new and better ideas. No other resource can do
this. This resource is animate, active and living. It is man alone who, with his ability to feel, think, conceive and grow, shows satisfaction or dissatisfaction, resentment or pleasure, resistance or acceptance for all types of managerial actions. All other resources are inanimate, inert and passive and do not act in this way.

Similarly, it is the only resource which appreciates in value with the passage of time. As time passes people become experienced and skilled. It is not so with other resources which generally depreciate with the passage of time.

Thus, the human resources are assuming increasing significance in modern organisations. Obviously, majority of the problems in organisational structure are in the nature of human and social rather than physical, technical or economic. The failure to recognize this fact causes immense loss to the nation, enterprise and the individual.5

HR Accounting Need

The greatest assets of an organisation are the human resources and not the buildings, plants, machinery, equipments, furniture etc. it owns. Hence, amount invested in human beings can give a better result to a business unit. However, it is unfortunate that the balance sheets do not exhibit this most vital asset, while capital invested in other assets is shown. This
information has not even been included as a part of internal accounting and reporting for management purpose so far.

It is pertinent to note that the expenditure incurred on the services of persons working in an organisation is charged to profit and loss account as an item of revenue expenditure in the form of wages and salaries. During these days companies are investing huge amounts of money on their employees for the training and development and also for developing the human organisation. It is assumed that these trained persons will continue to work in the organisation as organisation is a going concern. Thus, the training will be of great use to the organisation in future years. Though certain benefits will accrue to the organisation in future due to expenditure that is incurred on human resource yet it is not treated as an asset. It is a fact that success of an organisation depends on its managerial, scientific and technical personnel. The results of application of physical resources are reported in various financial statements under conventional or traditional system of accounting, but this system of accounting fails to incorporate the value of human resources.

If management wants to know the total amount invested in human resources, the conventional accounting does not provide this information. This is one of the severe limitations of the
present day financial statements and incapacitates the user of these statements from making full use of them.

The accounting theory clearly spells out that for proper accounting, expenses and assets should be distinguished. When heavy expenses are incurred in one year and their benefits accrue to the business for many years to come, they are treated as assets and amortized over the period of their benefits to the business. Charge for each year should be treated as an expense while the unamortized portion should be treated as an asset. When any expenses is incurred on training and development of human resources, the concern stands to benefit for more than one year and, as such, expenses should also be treated as asset. It is rightly observed that "the human resources are also the assets of the organisation because when the employees are appointed the organisation acquires a claim on future service of the appointed employees." When total expenses on human resource development are charged in the same year in which these are incurred, profit of that year is reduced and balance sheet does not show the true picture. Therefore, treatment of human resources as assets is necessary for matching periodic costs and benefits.

Some experts of accounting are of the view that the practice of recording all costs incurred on human capital as 'expired cost' is conceptually wrong and inconsistent with the treatment given to
the similar expenditure on physical capital or physical assets. This treatment is in practice because investment in people seems more tenuous than investment in machines, and because there are special difficulties involved in distinguishing between the future benefits of such expenditures and the portion consumed currently. It is difficult in thinking of people individually as assets since they are not legally owned by the firm and because of cultural constraints or taboos on the nation of valuing an individuals in monetary terms.\(^9\)

At the same time some people argue that man is mortal and employees can leave job any time so how can it be treated as an asset? In addition to it, it is not permitted by law. Such arguments are not correct because if once an atmosphere of efficient working is created, it is long lasting. All employees are not leaving job at a time, when new employees are recruited, they are learning from old experienced employees and they are also required to work hard for their survival and growth as a 'work culture' is developed. Contrary to it, if there is no work culture as mostly observed in government sector, new employees will also become inefficient by seeing other employees. Thus, every expenditure on human resource development is creating work culture which should be recognized as an asset. If law is not enforcing to show it as an asset and if no amortization is allowed on it, at least such
expenditure should be shown as by way of foot note below the Balance Sheets.

Inspite of the technological advancement and increasing importance of computerisation, human resources continue to play a dominating role in the effective use of physical and financial resources. The value of human services in any organisation is invaluable and it can not be measured accurately. In some organisations like trading and technical services human assets continue the real and major earning base. As such, there has been much emphasis on treating human resources as assets. Today, it is widely recognized that human resources are as good as other assets. Objections to this treatment of people as assets in accounting sense have been, by and large, overruled. Since efficiency in any organisation stems from the human beings. Gaining the HR for their worth is a difficult task and has to be handled with care. Human resource accounting is a method developed in recent times with which such task is sought to be achieved. Now, an attempt will be made to discuss the origin and background of human resource accounting in the following pages.

**Origin and Background of Human Resource Accounting**

It is believed that human factor largely contributes to the achievements of organisational goals. In order to ensure that their contribution in productivity does not go unreflected in financial
statements of the companies, several attempts have been made by people at various points of time to assign money values to HR. Though the concept of human resource accounting is of recent origin, eminent economists like Adam Smith talked about human resources as early as in eighteenth century. He described the contribution made by human capital as one of the major functions of production in the economic world. It is worth recalling what Alfred Marshall commented long ago that, "the most valuable of all capital is that is invested in human beings." 

Historically, Sir William Petty was the first economist who attempted to value human labour in a systematic manner. He applied the new concept of human capital for the purpose of determination of the wealth of nation as a measure of its potential power at the macro level. To value the national labour, he first capitalized the national income and subtracted the value of the non-human capital from it. He did not, however, define the term capital or the specific aspects of human ability as capital.

Many other economists have made use of human capital concept for solving various problems pertaining to macro economy over a substantially long period of time. So far as the micro level is concerned, Bruch Lev and Aba Schwartz developed models to value human resources of an enterprise on the basis of present value of future earning concept. The economists have been mainly
concerned with the economic value rather than costs of human resources and that too in terms of present value as they considered economic present worth concept as a better measures of value.

It was "Rensis Likert,"\textsuperscript{15} one of the proponents of human resource accounting, who suggested that an organisation's human resources should be capitalised like other assets and a system of accounting for human resources and their changes in value over the years be developed. In 1967, Hekiman and Jones\textsuperscript{16} emphasised the possibility of considering human resource as asset and of quantifying their asset value. In 1968 McCowen and Brummet\textsuperscript{17} reemphasized the case for human resource accounting. They proposed that human assets value should be calculated for profit centre within a company and the return on these investments be regularly calculated.

In the United States of America, William Pyle\textsuperscript{18} at Michigan took a different view point rather than attempt to impute some asset value to total remuneration. He attempted to identify those costs that a company expended in improving the performance of its force in the long term i.e., recruitment, training and development of labour force.

Giles and Robinson\textsuperscript{19} attempted to develop a tool to get a more accurate picture of the value of the human resources with
total remuneration together with multiplier derived from the price earning of the company.  

Practical Application of Human Resources Accounting

The credit for initiating the first practical application of human resource accounting goes to R.G.Barry Corporation of Columbus (Ohio U.S.A.)

In October 1966 a research project was initiated under the joint efforts of Brummet and his associates and a top management team from R.G. Barry Corporation. The aim of the research was to develop an accounting system for human resources and the system so evolved became operational on January 1, 1968. They capitalised the direct and indirect costs of personnel recruitment, training and development as a framework of analysis. Ninety five managers were initially included in the system. The managers were classified into four categories, namely, (i) Line supervisors, (ii) Engineers, (iii) Middle Managers and (iv) Top level Managers. It was reported that an amount of $3000 is invested on a first line supervisor, while that of a top level executive stands at $35,000. In 1969, they extended the system for 155 management people. The company developed a Proforma Balance Sheet in which resource investments were reported during the period of its operation starting from 1969. In 1974, they discarded the system. The Vice President in charge of human resources at Barry Corporation had observed that the benefits of
the system are not encouraging when compared to the cost of the system. The president of the Barry corporation also commented that the maintenance cost of such system was heavy for a company of their size. So they discarded the system as it was not economical. It was also reported that many companies in U.S.A. are trying to develop HRA system for accurate and specific information.  

**Human Resource Accounting Practices in India**

Since 1978-79 trend of valuation of HR was started on a minor scale. Infosys Technologies became the first software company to value its human resources. The concept of HRA was not new in India. HRA was pioneered by public sector companies like Bharat Heavy Electricals Ltd. (BHEL) and Steel Authority of India Ltd. (SAIL) way back in the 1970s. The concept did not gain much popularity and acceptance during that time. It was only in the mid 1990s, after Infosys started valuing its employees, that the concept gained popularity in India.  

The concept of human resource accounting is struggling for its acceptance even in the west. It is said that this concept does not hold good to labour surplus economies of developing countries like India. An analysis of present day situations prevailing in India makes it clear that this concept is of paramount importance here than perhaps in the west.
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The Accounting Standards Board of the Institute of Chartered Accountants of India has issued several Accounting Standards on most of the areas in accounting. But it has not formulated any specific Accounting Standard on measurement and reporting of cost and value of human resources. The Indian Companies Act, 1956 has also not formed any rules regarding the valuation of human resources and presentation of significant information about them in the financial statements of companies. In practice, however, a few companies which presently report valuation of human resources include BHEL, SAIL, MMTC, ONGC, ACC, HMT, CCI, Hindustan Shipyard Ltd., Oil India Ltd., EEI, Electrical India Ltd., Cochin Refineries Ltd., Madras Refineries Ltd., TELCO Project and Equipment Corporation of India, Southern Petrochemical Industries Corporation, NTPC Ltd., Satyam Computer Services Ltd. etc.  

In India, HRA has not been introduced as a permanent system. But recently its application in Indian companies has gained momentum. So, if research is undertaken to demonstrate the feasibility and potentiality of HRA system, as an aid to manpower planning and its development, it may not take long time for the HRA system to be introduced as permanent system in India in every concern.
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Definition of Human Resource Accounting

Human resource accounting is a system of treating the investment made by an enterprise in human resources as an asset. It is similar to principles of accounting system which is in practice. Just as financial accounting reflects the cost of capital assets like machinery and buildings, HRA reflects the cost invested in HR. This concept demonstrates that, the expenses of capital nature, like recruitment, training, welfare, amenities, etc., incurred by an organisation on human resources, are an asset instead of an expense and should therefore, be considered as a part of the total assets of an organisation. Thus human resource accounting shows the investment of the organisation on its people and how the value of these people changes over time.

HRA is an art and science of evaluating the worth of human resource of a business organisation as a whole in a systematic manner and recording them for presenting the information in the financial statements to communicate their worth to the readers of financial statements. It is that branch of managerial accounting which involves the application of accounting concepts to the area of personnel management. It is the process of recognizing, measuring and communicating useful information relating to human resources.
The American Accounting Association Committee on Human Resources Accounting has defined it as the process of identifying and measuring data about human resources and communicating this information to interested parties. Hence, human resource accounting is nothing but the process of collecting and developing financial assessment of people within organisation and report the same. The data about human resources is not only identified and measured but this information is also communicated to those who are interested in such information. Thus, according to this definition there are three functions of HRA namely (i) identification (ii) measurement and (iii) communication of information about human resources.

This definition has some drawbacks also, such as what type of data about human resources should be collected has not been pointed out. The process of communication has also not been pointed out in this definition. Human resources is an asset which appreciates with the passage of time while other fixed assets like plant and machinery etc. depreciate. The fact of treatment of this appreciation has also not been focussed in it.

Eric G. Flamholtz defines human resource accounting as accounting for people as an organisational resource. It involves measuring the cost incurred by business firms and other organisations to recruit, select and hire, train and develop human
assets. It also includes measuring the economic value of people to organisation.

This definition also suffers from certain limitations like the method of reporting the measurement of cost and value of people has not been disclosed in this definition. Measurement of cost and value of people is done for organisation only. Again, use of the word 'people' is vague in this definition. Whether it refers to the people of the organisation or the people of the country as a whole is not clear.

Woodruff Jr. R.L., Vice President of R.G. Barry Corporation, U.S.A. is of the view that human resource accounting is an attempt to identify quality and report investment made in human resource of an organisation that are not presently accounted for under conventional accounting practice. Basically, it is an information system that tells management what changes over time are occurring to the human resources of the business. It must be considered as an element of a total system of management not as a separate device or gimmick to focus attention on human resources. It is an attempt for identifying and reporting investment made in human resources of an organisation. It also gives an information to the management about the changes which have occurred in the human resources.
This definition also suffers from certain limitations like, the mode of communication of information has not been pointed out in this definition. The process of identification and investment has also not been made clear.  

Geoffrey M.N. Baker suggests that human resource accounting is the term applied by the accountancy professionals to quantify the cost and value of employees to their employing organisation.

Davidson and Well think that it is the process of measuring and reporting the human dynamics of an organisation. It is the assessment of the condition of human resources within an organisation and the measurement of the change in the condition through time. It involves accounting for people as an organisational resource. It is the process of developing financial assessment for people within an organisation and society and the monitoring of these assessments through time.

In the words of Stephen Knauf, "human resource accounting is the measurement and quantification of human organisation inputs, such as recruiting, training, experience and commitment of human resource. He considers HRA as an approach to value the amount spent on human assets from recruitment to the present situation."
All the above definitions and many others regard human being as a resource in measurement and communication to interested parties. So, in simple words we can say that HRA is the systematic recording of the transactions relating to the value of human resources. It is the measurement of cost and value of people for the organisation. It may be concluded that HRA comprises the following three aspects:

1) Evaluation of human resources.
2) Recording the valuation in the books of accounts.
3) Presenting the information in the financial statement for communication to the interpreted parties.

A Taxonomy of Human Resources Accounting

HRA is developing as a tool to aid managers in their decision making. As has been indicated, the most widely used measure of overall organisational efficiency matches the revenue from the sale of firms product or services with the costs required to produce that revenue. Human resource grows out of the recognition that traditional accounting and management information treat costs associated with the development of long-term human capabilities as expenses which understate revenue in the short term. This new accounting concept is designed to correct this distortion in the measures of business efficiency.
As inputs to these measures of efficiency, accountants have provided information on the acquisition, development, maintenance and utilization of certain capabilities employed by the firm. When physical capabilities, to continue the prior example, expire prematurely, the increase write-off becomes an expense against revenue in the current year. Reported profitability is reduced and the responsible manager is held accountable. Unfortunately, the protection afforded to physical assets has not traditionally been accorded to human capabilities. The focus of human resources accounting is to extend this protection to HR.

The Initial Focus: Investments in Human Capability

The initial focus of human resource accounting has been to determine investments in human capabilities and develop appropriate accounting procedures. The primary effort has been in business with large contributions from human capabilities. The major objectives have been:

(1) providing information pertaining to human resources,
(2) providing feedback on manager's performance with respect to human assets in the organisation, and
(3) Providing a more accurate accounting of the return on total assets employed.

Approaches to these objectives include:

- Human resource inventories.
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- Determination of outlay costs,
- Determination of replacement costs, and
- Determination of the economic value of the human resources employed in the organisation.

Construction of an inventory is, in some ways, the simplest of these approaches, probably the most sensible first step in approaching the utilization of human resources in the firm. The following are typical questions that might be used in developing an inventory of human resource classes and their importance.

Outlay costs are associated with the actual cash outlays for obtaining, maintaining and developing the organisation’s human assets. Large sums are spent each year on recruiting, familiarizing and developing people with the expectation that they will be of benefit beyond these costs. Capitalization of these outlay costs with amortization over the expected employment of the individual which provides a more accurate picture of the firm's overall return on investment that charging them all in the year incurred.

Replacement costs represent the outlay costs that the firm would have to make to replace its employees or to provide a certain level of human resources. This concept introduces the fluctuations of the job market as well as the general increases in cost of living etc. Replacement costs provide better guidelines for forecasting, budgeting and planning extensions. However, since
actual outlays are not involved, the values must include some estimation. Therefore, determination of replacement costs are both more difficult to develop and less reliable than outlay costs.

Both outlay cost and replacement cost of human resources point towards the concept of the economic value of human resources. This value may be defined as 'the present discounted value of their future contributions less the costs of acquiring, maintaining and utilizing those resources in the organisation. The concept obviously involves a large measure of estimation and, therefore, would be difficult to measure reliably.\(^{35}\)

Human resources information is essential for each of the several phases of the management's planning and control functions. Corporate managers generally recognise that employees constitute the most important and the most valuable assets, they often take decisions involving expenditure which may be justified as investment in human resources, traditional accounting requires such expenses to be charged to income without considering the timing of expected benefits. Thus, expenditures made for recruiting, engaging, training and developing people are treated as 'expense', and no attempt is made to formulate rules to distinguish between their asset and expense components. It has been increasingly realised that although outlays for human resources have been traditionally treated as 'expenses' rather than 'assets', it
is the result of conventional boundaries of the concept of an asset, and not because of the real nature and timing of benefit that result from such outlays.

The human resource accounting has thus an important role to play in management functions bearing on planning and control. Measurement of the value of human resources, is maintainable, can assist the management in recognizing and defining problems connected with the people at work. Trends in the human-asset investment ratio (i.e. the ratio of investments in human assets to total assets) may be a useful predictor of future profit performance. Charges in the value of human resources may indicate the cost of turnover of employees. Certain leadership styles may result in long run liquidation of human assets, while showing immediate increase in earnings. Managers, who put pressures on employees for cost reduction, may experience increases in current net income as measured by conventional practice; but it may also result unmeasured deterioration of employee-attitude, motivation and other psychological variables adversely affecting the level of profits in future periods. If the accounting system incorporates the value of a firm's human resource and its changes over time, the 'net income' (as conventionally defined) might be adjusted to reflect changes in the value of human resources, so as to avoid the illusion of 'profits'
derived from the liquidation of human resources. The adjusted figure would give a more realistic measurement of managerial effectiveness. Besides, the trends in the adjusted net income figures would also provide an improved basis for the projection of future of earnings.36

Managerial planning involves search for alternative solutions to problems and evaluation of alternatives in decision-situation the search for alternatives requires an awareness of the critical nature of all human resources. A conscious recognition of this factor in the development of alternatives can be possible with a regular assessment of the value of human resources. Likewise, the impact of capital budgeting decisions on human assets is often considered to be a qualitative factor and its critical significance, if not ignored, is not given due importance. Measures of the values of human resources are expected to make a lot of difference in capital budgeting decisions. Human assets are not included in the asset-base used to calculate the rate of return on investment. Human as well as physical assets have opportunity costs associated with their use. This cost needs to be quantified and considered in the evaluating alternative proposals.

Evaluation of investments in human capital generally is based on a qualitative assessment of the alternatives. Moreover, investments in human assets are often made without evaluating the
expected pay-off or return on such investments. The value of managerial training and development programmes is usually taken on faith and expenditure on these accounts is incurred by firms which can afford it with ease, given a high level of profits. Systematic programmes of employee-training and executive development obviously need evaluation of the yield or return on the expenditure involved in such programmes.

In the decision models used in the process of selecting among alternatives, human resource information and changes in the value of human resources over time are important ingredients of decision-making. For example, if the management has to choose among alternative locations for a new plant, it involves transfer of existing employees, it is necessary that a survey of employees attitude should be undertaken towards the alternative locations and attempt should be made to determine the expected turnover, associated with each location, and the expected cost of turnover calculated. This may be a critical factor in the choice of location for the new plant.

The use of human resource accounting for reporting on actions taken and results achieved may also be of crucial significance in the management control system. Human resource data may include information about the composition of investments in human resources and analysed to determine
standard costs of recruiting, hiring, training and developing employees to bring them up to a desired level of competence. Besides, these data may be useful to estimate the replacement costs of filling up various positions. replacement costs, in turn, can be used to make budget allocations for investment in manpower planning and development. In other words human resource data may provide the basis of setting up a standard cost accounting system for human resource costs, similar to that for manufacturing costs.\textsuperscript{37}

**Objectives of Human Resource Accounting**

The primary purpose of human resource accounting is to facilitate the management of people as organisational resources. It can also be called as accounting i.e. the application of accounting to the management of human resources. The objectives of human resource accounting can be summarised as under:

(i) To furnish human resource cost and value information for making management decisions about acquiring, allocating, developing and maintaining human resources in order to attain cost effective organisational objectives.

(ii) To allow managerial personnel to monitor effectively the use of human resources.

(iii) To provide a determination of asset control i.e. whether assets are conserved, depleted or appreciated.
To aid in the development of management principles by clarifying the financial consequences of various practices.

To help the persons interested in the organisation to know whether the human resources are producing a return on investment to their worth or not.

Hence, the objective of human resource accounting is not just the recognition of all resources used or controlled by a business enterprises but it also includes the improvement of the management of human resources so that the quantity and quality of foods and services are increased. The basic objective underlying human resource accounting is to facilitate the effective and efficient management of human resources.

Significance of Human Resource Accounting

The benefits of adopting HRA are manifold. It helps an organisation to take managerial decisions based on the availability and the necessity of human resources. When the human resources are quantified, it gives the investors and other clients true insights into the organisation and its future potential. Proper valuation of human resources helps organisations to eliminate the negative effects of redundant labour. This, in turn helps them to channelise the available skills, talents, knowledge and experience of their employees more efficiently. By adopting and implementing HRA
in an organisation, the following important information could be obtained:

- Cost per employee,
- Human capital investment ratio,
- The amount of wealth created by each employee,
- The profit created by each employee,
- The ratio of salary paid to the total revenue generated,
- Average salary of each employee,
- Employee absenteeism rates, and
- Employee turnover rate and retention rate.

Firstly, HRA helps in identifying the right person for the right job, based on the person's specialised skills, knowledge, capabilities, experience, etc. Valuation of human assets could also be effectively used to motivate employees to achieve best results, using the best of their abilities. Valuation of human capital also ensures continuous evaluation and follow-up of various human policies associated with recruitment, selection, training, development and retention.

Secondly, HRA gives the cost of developing human resources in the business. This enables the management to ascertain the cost of labour turnover also. There may be a high labour turnover and management may not take it seriously in the absence of cost figures of human resources. Though it is not
possible to eliminate labour turnover but in case the cost of labour turnover is high then management should try to reduce it as far as possible.

Thirdly, the investment on the development of human resources can be compared with the benefits and results derived. There may also be a wasteful expenditure on human beings which could have been avoided. Efforts should be made to control avoidable expenditure. The company can develop its own managerial cadres by recruiting and training executives. It can also hire already trained persons. The cost of both the methods can be compared and suitable alternatives can be adopted. This type of analysis will be possible only if expenditure on human resources is treated as an asset. So, HRA allows the analysis of expenditure on human asset.

Fourthly, the Return on Investment (ROI) can realistically be calculated only when investment on human resources is also taken into account. The ROI may be good because there is an investment on human beings. On the other hand, a low investment may be the reason of low investment on human asset. So, ROI can give accurate results only when expenditure on employees is treated as an asset.

Fifthly, it helps management in planning and executing personnel policies. The management will be helped in taking
decisions regarding transfers, promotions, training, retirement, retrenchment of human resources, etc.

Finally, it can be seen whether the business has made proper investment in human resources in terms of money or not. If the investment is excessive, attempts should be made to control it. Moreover, human resources accounting helps in improving the efficiency of employees. They come to know of the cost incurred on them and the return given by them in the form of output etc. It motivates the employees to increase their worth.

**Human Resource Accounting and Human Resource Development**

HRA as a managerial tool can be used for effective management of human resources. In the field of managerial decision making the human resource data as part of management information system helps in making meaningful choices between various types of human investments and investments in other assets. By measuring the value of human resources at different points of time, HRA can reveal whether the management is building up human resources or depleting them. The information generated through HRA can help the management in formulating policies and programmes for the development of human resources. Such information can be of utmost help for making decisions in the following areas:
1. Manpower planning standard,

2. Appraisal of human resource development programmes,

3. Identification of training needs,

4. Usefulness of cost reduction programmes in view of their possible impact on human relations,

5. Studying the impact of budgetary control on motivation and morale of employees,

6. Facilitating allocation conservation and reward of human resources,

7. It helps the management in the decision making process about employment resources,

8. It helps the management in measuring standard cost of recruitment, selection, hiring and training people and the organisation can select a person with highest expected realisable value,

9. It also helps the information seekers to know whether human resources are giving adequate return in comparison to payment made to them and whether they are overpaid or underpaid,

10. Valuation of human resource is absolutely essential in such organisation where the human element is the prime factor, e.g., professional accounting firm, drama company, solicitor and attorney firms, educational institutions etc.
11. The inclusion of relevant human resource data would create a more complete management information system,

12. Human resource data provides a more adequate basis for decisions on allocation of resources for short and long term decision making, and

13. The value of a firm's human resources is helpful to potential investors and other users in making long term investment decisions.42

Human Resource Accounting and Management

Flamholtz has specifically underlined the primary role of human resource accounting as that of providing information essential for management to perform the functions of acquiring, developing, allocating, conserving, utilising, evaluating and rewarding human resource.43 The first step in human resource acquisition is to forecast manpower requirements; the management must then translate the manpower forecast into a 'manpower acquisition budget', which is essentially a process of cost estimation. HRA can provide measurements of the standard cost of recruiting, selecting and hiring people, for estimates of amounts to be incorporated in the manpower acquisition budget. Again, in making selection decisions, managers need measurements of the value of candidates for particular jobs, so that the person selected is one who possesses the greatest future value to the organisation.
Instead of using non-monetary measures of potential abilities derived through qualitative tests, the potential economic value of candidate may be a better criterion for selection. Using monetary measurements of the expected value of people, decision rules may be designed to optimise the expected value of the firm’s human resources.

Budgeting for training and development programmes for employees involves assessment of the value of a proposed investment in such programmes and estimating the cost of such programmes. HRA can be helpful for decision-making, involving the allocation of resources to training and development programmes by measuring the expected rate of return on the proposed investments. By providing estimates of the historical and current costs to acquire and develop people for various position, HRA can also help management to assess the trade-off between the costs of recruitment from outside and development from within.

Allocation of resources, i.e. assigning people to various organisational roles and tasks, needs to be decided on the basis of the efficiency of the employees, opportunity of self-development and job-satisfaction expected to be derived by the employee. HRA can help quantify the variables required to be considered in the process of allocation expressed in terms of the common denominator of monetary units. The management may, thus, be
enabled also to apply linear programming for an optimal solution of the manpower allocation problem. Otherwise, allocation decisions may be costly to individuals as well as to the organisation.

Conservation of human resources is yet another area in which HRA can be of great assistance to management. Conservation of human resources is the process of maintaining the capabilities of people as individuals and the effectiveness of the human system developed by an organisation. This needs monitoring the effectiveness of the human organisation to assess the extent to which it is being maintained or depleted. Measures of employee turnover rates, traditionally used to assess the conservation of human resources, are inadequate, firstly, because these are historical figures and secondly because they do not fully reflect the economic impact of turnover. Through monetary measures and reporting of socio-psychological indicators of the condition of human organisation, HRA can help management by providing an early warning system to take care of human resource conservation. HRA can further help management in the utilisation of human resources effectively and efficiently by providing a conceptual framework, so as to develop strategies with respect to acquisition, development, allocation and conservation, designed to influence the value of people. Human resource evaluation involves
the measurement of productivity and promotability of people. HRA can be useful in the evaluation of human resources by developing appropriate methods, including both monetary and non-monetary measurements. Moreover, human resource valuation can be used for organisational rewards to be administered in relation to an employee's value to the organisation. Further, the efficiency of personnel management function per se can also be assessed through human resource accounting. The standard costs of acquiring and developing people may be compared with the actual costs incurred for the purpose, and the variances from the standard may be analysed to identify the possible lapses in the personnel management functions.

The purpose of HRA is derived from the above prognosis of the usefulness of human resource information for managerial decision-making. The primary purpose of HRA is to help management plan and control the use of human resources effectively and efficiently. In short, the objective is to improve the quality of financial decisions of management on the promise that the availability of quantitative data on human resources would result in a widening of the scope of managerial decision-making by permitting consideration of a larger set of variables, or improving the basis on which these variables are currently considered. According to the American Accounting Association
(AAA) Committee on HRA, the purpose of HRA is to improve also the quality of decision-making to external users, particularly the investors, who could benefit from HRA through the provision of information to the extent to which the human assets of the organisation have been increased or have diminished during the period.\textsuperscript{45}

The usefulness of human resource data for external users has been alluded to by different writers. According to Likert, "Bankers making loans, investment houses and others, who are interested in the earnings and success of the enterprise, should be just as interested as Boards and Senior Officers in having these periodic measurements of the causal and intervening variables available."\textsuperscript{46} External reporting of human resource data has been suggested, considering the benefits of the same to external users.\textsuperscript{47} One of the arguments in favour of external reporting is that it will increase comparability and completeness of financial statements as well as a closer tie-in-between financial statements.\textsuperscript{48}

We have already referred to the conventional accounting treatment of investments in human resources being treated as expenses rather than assets, which results in distorted income statements and balance-sheets. It leads to an artificially lower net income during the period in which there is investment in human resources since the whole amount is expensed in the income
statement for that period. Correspondingly, a higher income results during the subsequent period. This could be avoided through the HRA approach as the AAA Committee in preparing a Statement of Basic Accounting Theory has observed:

"A conversion is a recombination of asset-services, reflecting the production of new utility. Expenditures and other costs, devoted to such activities as research and development, personnel recruitment and training and marketing campaign, often involve an element of future usefulness, and are examples of conversions that would be recognised if quantifiable and verifiable."^49

Since the rate of return is the ratio of net income to total assets, the rate which is conventionally calculated does not reflect the real position because of the distortion in its components. Investors, who base their investment-decisions on a firm's rate of return, should, therefore, adjust the rate of return for investments in human assets. They should also be aware of and concerned about any unintended, dysfunctional result of the accounting treatment of investments in human assets. Specifically, conventional accounting tends to motivate management to disregard the long-term interest of the organisation and emphasises short-term interests. If the expenditure incurred to build human assets is treated as an expense, the reported current
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earnings will show relatively lower amounts. Thus, management may appear to be doing poorly when it is actually doing well. As a result, an enlightened management may be required to make decisions that are in the interest of the organisation but may be detrimental to their personal interests. In periods of profit squeeze, or when management wants to show higher current earnings, it may simply avoid or postpone necessary investments in human resources.\textsuperscript{50}

Limitations of Human Resource Accounting

HRA suffers from the following limitations: Firstly, it is not easy to value the human assets in an organisation there are no guidelines differentiating the ‘cost’ and ‘value’ of human resources. After valuing HR in a specific way, many of them may leave the organisation. Human life itself is uncertain and hence valuing the asset under such ‘foggy’ conditions is not proper. Like physical assets, human assets cannot be owned, retained and utilized at the sweet will and pleasure of an organisation. The so called ‘asset’ after getting enriched within a company-may simply disappear, causing irreparable loss to the company almost suddenly.

Secondly, HRA is full measurement problems. There is no agreement among the accountants and finance professionals
regarding the measurement process. In what form and manner the human assets are to be included in the financial statement? To compound the problems further, there is the question of deciding the recovery rates. How should the HR costs be amortized? Should it be increasing constants or decreasing? Should it remain same or different for different classes of employees?

Thirdly, employees and Unions may not like the idea, because HRA may lead to division among the ranks of employees. A group of employees may be valued lower than their real worth owing to reasons beyond the control of management. The employees may resist the idea of being treated like second-class citizens, despite their useful contribution over a period of time. Unions may fight such manipulative practices or the part of management. They may even demand higher compensation better rewards when things turn rosy and employees are valued at a 'premium' and

Finally, there is no empirical evidence to support the idea that HRA is an effective tool to measure the economic value of people to the organisation. There is very little data to support the contention that it facilitates better and effective management of human resources.
In conclusion, it can be observed that though the need for HRA has been recognised globally only recently, the aims, objectives, functions and role of HRA in an organisation are quite significant. The various concepts and theories of HRA have been summarized so that they can be utilized for enhancing profit which is an ultimate objective of any business organisation.

It is in this backdrop that the next part of this chapter deals with the viewpoints of executives and accountants regarding the desirability of human resource accounting.

Executives' and Accountants' Attitude towards Human Resource Accounting: A Survey Analysis

Human resource accounting is passing through developing stage and has become very popular in the last few decades. The extent of popularity is as much as was required. The views of executives regarding different aspects of applicability have already been expressed in the studies conducted by Gupta (1988) and Singh (2003). These researches clearly indicate that majority of executives of public and private sector enterprises of India agree to the desirability of human resource valuation e.g. as per Gupta's study out of 49 executives in private sector companies 40 agree, 5 strongly agree i.e. 91.8 per cent of total executives are in favour of HR valuation. Only 3 executives disagree and 1
strongly disagree i.e. only 4 executives (8.2 per cent of total) are not in favour of desirability of human resource valuation. In case of public sector companies, except 3, all executives expressed a favourable opinion. The number of executives in the public sector who agreed with the proposition, was 36, while 12 strongly agreed i.e. of the total, 94.10 per cent were in favour of HR valuation while 5.9 percent expressed their opinion against HR valuation as per findings of the aforementioned study.

It will not be out of place to review here the views of accountants towards HRA because much will depend on their attitude which is not so far encouraging. In this regard, it is worthwhile to mention that the attitude also depends, to a larger extent, on acquaintance with subject and their view regarding its significance. Moreover, it also depends on age and level of education of accountants. Fortunately, Institute of Chartered Accountants of India and other Institutes have adopted it to some extent but still there is a need to further emphasise the subject. A study was conducted in the year 1999 by Franko regarding accountants' attitude towards HRA taking a sample of 39 companies. The data noted in the following table reveals the reasons for introducing human resource accounting:
Table 2.0
Showing Accountants Attitude Towards Human Resource Accounting Practices

<table>
<thead>
<tr>
<th>Ground</th>
<th>Number of Companies</th>
<th>Share in percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Human resources are the most important element of the business process.</td>
<td>39</td>
<td>100.00</td>
</tr>
<tr>
<td>Investment into human resources are similar to those into (other) assets.</td>
<td>37</td>
<td>94.90</td>
</tr>
<tr>
<td>Human resource information relevant to operating decision making</td>
<td>39</td>
<td>100.00</td>
</tr>
<tr>
<td>The direct inclusion of human resource information into accounting statements would confuse the users</td>
<td>28</td>
<td>71.80</td>
</tr>
<tr>
<td>Including human resource values into accounting statements would have a negative impact on the morale of the employees</td>
<td>14</td>
<td>35.90</td>
</tr>
<tr>
<td>Besides the traditional accounting statements it would be acceptable to draw up parallel statements including human resource data</td>
<td>17</td>
<td>48.70</td>
</tr>
<tr>
<td>The expenses related to the introduction of human resource accounting would considerably exceed the benefit derived therefrom</td>
<td>33</td>
<td>84.60</td>
</tr>
<tr>
<td>Total</td>
<td>39</td>
<td>100.00</td>
</tr>
</tbody>
</table>


It is observed from the above mentioned study that accountants of all the sample companies agree that human resources are the most important element of the business process and human resource information is relevant to operating decision making. 94.9 per cent of the Accountants of the sampled companies feel that investment into human resources are similar to
those into other assets. Similarly, 33 accountants of 39 companies, that is 84.6 per cent of the Accountants feel that the expenses related to the introduction of human resource accounting would considerably exceed the benefit derived therefrom. Whether the direct inclusion of human resource information into accounting statements would confuse the user was the next question posed to the accountants of all 39 companies. It is noted that 71.8 per cent of total accountants agreed to it. Two more questions i.e. including human resource values into accounting statements would have a negative impact on the morale of the employees and besides the traditional accounting statement it would be acceptable to draw up parallel statements including human resource data were put to the Accountants of the sampled companies. While 35.9 per cent of them were in favour of the former, 48.7 per cent of them supported.

The inferences drawn from the above analysis clearly indicate that accountants do not accept the HRA system in totality. Like management they also believe that HR is the most important element of the business process. But at the same time, majority of them feel that the expenses related to the introduction of human resource accounting would considerably exceed the benefit derived therefrom which means that they are not
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wholeheartedly in favour of applicability of HRA in the financial statements.54

Conclusion

The final conclusion from the analysis of viewpoints of executives and accountants and personal queries by the researcher with the executives and accountants of sample companies is that still these is no change in the viewpoints of executives and accountants towards human resource accounting practices in Indian companies. Majority of executives and accountants still feel human resources as a most important element of the business process. They also feel that human resource information is relevant to operating decision making in organisation. Thus, opinions of the executives and accountants are more in favour than against as assessed by researcher. Their views are almost unanimous regarding HR valuation in both the sectors. Even then, most the companies have been identified in which HR valuation has not actually been in practice. Enquiry was, therefore, specifically made to ascertain the reasons why HR valuation was considered impracticable in Indian corporate entities. The answers were more than one like, firstly, there is no legal compulsion on the companies. Secondly, it is an expensive activity involving additional staff and time. Thirdly, they say that HR can not be valued objectively. Fourthly, evaluation may be disputed. Fifthly,
HR itself may develop an attitude of self-importance and above all, employers have a feel that employees union may raise unreasonable demands.

To prove or disprove the above noted argument in favour/against, the best way of presentation of findings would have been to conduct a fresh survey of opinions of executives and accountants. But since there was lack of positive response from all related parties, the desired survey could not be conducted. Moreover, time constraint had been a major factor to conclude the research in its present shape. Howsoever it is, an attempt has been made to make the study exhaustive and extensive in its coverage. In the next chapter we will focus on the presentation of certain models for application in Indian Industries.
References


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44. Flamholtz, Eric G., op. cit., pp. 10-16.


46. Likert, Rensis. op. cit., p. 154.


