CHAPTER – I

HR AUDIT – AN OVERVIEW
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1.1 INTRODUCTION

Popular perception in industry circles is that an organization’s continuous success, improved performance and long term sustenance depend more on the way the HR Function is handled. The Corporate World has recognized this fact long ago and the basis for this is the kind of new HR interventions that they took up based on research conducted in this field. Despite of the focused attention on HR activities, there are still many such organizations where HR Function has not lived up to the expectations. In some organizations, the scenario is not at all clear to the people due to lack of role clarity.

Against this backdrop, a thorough evaluation of HR Function becomes the need of the hour, to give a new life and thereby rejuvenate the whole gamut of HR activities. In this process, it needs to be kept in mind to what extent these activities are actually business driven. This is where HR Audit comes in handy as it dissects and deciphers HR Systems, HR Competencies, Organizational Culture and a host of other pertinent parameters to unearth the performance hindering factors. By taking up such systematic evaluation through HR Audit at regular intervals, the organizations would be in a position of strength to handle all possible challenges that keep arising every now and then posing a big threat.

To get the best out of human resource, there should be a good alignment of the function, its strategies, structure, systems, and styles with business and its goals. It should be aligned with both the short-term goals and long-term strategies. If it is not aligned, human resource could become a big liability to corporations. Besides this alignment, the skills and styles of human resource staff, the line managers and the top management should synergise with the human resource goals and strategies. Human Resource audit is an attempt to assess these alignments and ensure the same irrespective whichever model or approach an organization adopts for human resource audit.
1.2 RESEARCH EVIDENCE RELATING GOOD HR PRACTICES TO BUSINESS IMPROVEMENT

Recent researches worldwide have shown that good HR practices and policies can go a long way in influencing business growth and development. The research indicates the following HR practices that effective firms adopt (Pfeffer, 1994):

- Financial incentives for excellent performances.
- Work organization practices that motivate employee effort and capture the benefits of know-how and skill
- Rigorous selection and selectivity in recruiting
- Employee share-ownership plans
- Extensive information sharing
- Decentralization of decision making and empowerment
- Work organization based on self-managing teams
- High investment in training and skill development
- Having people do multiple jobs and job rotation
- Elimination of status symbols
- A more compressed distribution of salaries across and within levels
- Promotion from within
- A long-term perspective
- Measurement of HR practices and policy implementation
- A coherent view of employment relation.

Yeung and Berman (1997) point out that HR practices can play three major roles. These are:

1. Building critical organizational capabilities
2. Enhancing employee satisfaction
3. Improving customer and shareholder satisfaction
The following studies summarized by Yeung and Berman (1997:323-324) can help us understand the linkages.

Manduffie and Krafcik (1992) studied 70 automotive assembly plants representing 24 companies and 17 countries worldwide. This study indicated that manufacturing facilities with ‘lean production systems’ are much higher in terms of both quality and productivity than those with ‘mass production systems’. For example, those with lean systems took 22 hours to produce a car and with a quality benchmark of 0.5 defects, while those with mass systems took 30 hours and 0.8 defects for 100 vehicles. The HR strategy of a mass production system was to create a highly specialized and de-skilled workforce to support a large-scale production process, while that of the lean system was to create a skilled, motivated and flexible workforce that could continuously solve problems. The study concluded that the success of the lean production system depended on high commitment of employees, decentralization of production responsibilities, broad job classification, multiskilling practices, profit/gain sharing, a reciprocal psychological commitment between firm and employment security and a reduction of status barriers.

Ostroff (1995) developed an overall HR Quality Index based on the aggregate ratings of all HR activities of a firm. On the basis of this index, firms were grouped into four categories. The firms that scored higher on the HR Quality Index consistently outperformed than those with a lower index on four financial measures: market/book value ratio, productivity ratio (i.e., sale/employees), market value and sales.

Preffer (1998) has more recently reviewed considerable evidence on the effectiveness of good HR practices on business performance.

Macduffie (1995, cited by Pfeffer, 1998:32) observed from his studies that innovative HR practices are likely to contribute to improved economic performance only when:

1. Employees possess knowledge and skills managers lack.
2. Employees are motivated to apply this skill and knowledge through discretionary efforts.
3. When employees contributes to such an effort.

Huselid (1995) used two scales - one to measure employee skills and organised structure and the second to measure employee motivation, the first scale included a broad range of practices intended to enhance employee knowledge, skills and abilities and provide mechanisms to use those for performing the roles. The second scale measured how well linked to comprehension and merit decisions in the corporation.

Huselid (1995) found that in a sample of 3,452 firms representing all kinds of industries, one standard deviation increase in management practices was associated with increases in sales, market value and profit. A subsequent study by Huselid and Becker (1997) found and profits. A subsequent study by Huselid and Becker (1997) found that a one standard deviation improvement in HR system index was associated with an increase in shareholder wealth of $41,000 per employee.

Similar results were found in Germany by Bilmes et al. (1997). This study found a strong link between investing in employees and the stock market performance of the corporation. Companies that laced workers at the core of their strategies produced higher long-term returns than those who did not.

Welbourne and Andrews (1996) studied the survival rate of 136 non-financial companies that initiated public offerings in the Us stock market in 1988. The firms studied were drawn from various industries ranging from food service retailing to biotechnology and varied in size from less than 110 people (about 50 per cent of them) to 700 or more (about 20 percent of them). They developed and used a scale to measure the value the firm placed on human resources. This scale used five items.

1) Whether the company’s strategy and mission statement cited employees as constituting a competitive advantage.

2) Whether the company’s initial publicity material mentioned employee training programmes.

3) Whether a company’s official was charged with the responsibility for human resource management.
4) The degree to which the company used full-time employees rather than temporary or contract workers.

5) The company’s self-rating on office-employee relations.

A second scale measured how the organisation rewarded its people, whether through stock options, gain sharing, profit sharing etc. The study indicated that with the other factors, such as the size, nature of industry and profits controlled, the human resource scale and the rewards scale were significantly related to the probability of survival.

In a 1980 study by Macduffie (1995) of 70 automobile plants representing 24 companies from 17 different countries, the traditional mass production system with a control-oriented approach to managing people was contrasted with a flexible production system that placed emphasis on people and their participation. In the traditional systems of management practice the emphasis was on the control-oriented approach to manage people, building inventories to maintain production volumes against uncertainties and inspection and control to ensure quality. In contrast, in the flexible system, the emphasis was on teams, employee involvement, and reduction of inventories to highlight production problems that could be remedies. The results revealed that quality and production system and the two systems different substantially on how they managed their people in terms of emphasis on training, use of teams, reduction of status differences and the use of contingent performance related compensation.

Arthur (1994) studied the impact of two different management approaches on the productivity of steel mills. His study of the 30 of the 44 existing steel mills in the US at that time differentiated the ‘control’ approach to human resource management (HRM) from that of the ‘commitment’ approach in the control approach the goal employee compliance with specified rules and procedures and basing employee rewards on some measurable output criteria. In the commitment approach the HR systems are intended to shape desired employee behaviours by forging psychological links between organisation goals and employee goals. The focus is on developing committed employees. After statistically controlling for age, size, union status and business strategy of the mills, the results showed that using a commitment strategy
was significantly related to improved performance in terms of labour hours and scrap rate. Mini-mills using the commitment approach required 34 per cent fewer labour hours to produce a ton of steel and showed a 63 per cent better scrap rate.

A number of studies spanning different organisations operating in various service industries provide evidence for a positive relationship between employee attitudes, customer service and satisfaction and profits’ (Pfeffer, 1998:55). Schneidder and Bowen (1985) reported numbers and quality of people to perform its tasks (called the service imperative) customers reported receiving higher levels of service. In another study Schneidder (1991) found that customer perceptions and attitudes were affected by what employees experienced. Organisational practices that are both service related and human resources related seem to provide cues to customers to evaluate bank’s service.

A study by Johnson, Ryan and Schmit (1994) at the Ford Motor Credit revealed that attitudes concerning work load, teamwork, training and development, satisfaction with the job, and satisfaction with the company were significantly related to measures of employee attitudes about the fairness of pay, whether management was concerned about employee welfare and treated people fairly and whether supervisors attitudes are in turn related to profits. For example, in a study of an eye care company a significant relationship was found between employee attitudes and profit (Moeller and Schneider,1986).

Pfeffer after examining evidence from a large number of studies linking strategy with HR strategy, concludes: I have come to believe that the strategic fit argument is sometimes mustered by managers and organisations that don’t want to acknowledge that the way they manage their people is less than optimal and that they should change they find it easier to say “Even though we aren’t doing what some firms have found to be effective , that’s all right because we are pursuing a different strategy.” This rationalisation should be challenged by asking a simple question: wouldn’t our existing strategy, whatever it is be better implemented if our people were more involved , committed, and better skilled (Pfeffer, 1998:59)?
Delery and Doty (1996) in a study of nearly 200 banks found that differences in HR practices accounted for large differences in financial performance. Huselid concluded that ‘prior empirical work has consistency found that use of effective human resource management practices enhances firm performance (Huselid, 1995:640).

Pfeffer (1998) presents the following rationale to explain this relationship:

- Performance increases because people work harder.
- People put in effort and show greater commitment if they have greater control over their environment, see their effort as related to compensation and pressure activated from self-managed teams.
- Training, job rotation and such other practices help people to work smarter also. High commitment to work also saves direct and indirect costs of labour.
- Trained, multi-skilled, self-managed and motivated employees save on a variety of administrative costs including the cost of management, thus reflecting in profits.

In spite of all this research evidence, as Pfeffer (1998) observes, even in countries like the US and the UK, the spread of the practices is not as rapid as one might expect, Research by Ichniowski (1992) has indicated that only 16 percent of the US businesses have at least one innovative practice in each of the four major HRM policy areas: flexible job design, worker training, pay-for-performance compensation and employment security.

Pfeffer (1998) has identified the following seven practices of successful organisations on the basis of his review of various research studies, related literature and his own personal observations and experience. These seven dimensions seem to characterise most if not all of the system-producing profits through people. These dimensions are:-

- Employment security
• Selective hiring of new personnel.

• Self-managed teams and decentralisation of decision making as the basic principles of organisational design.

• Comparatively high compensation contingent on organisational performance information.

• Extensive training.

• Reduced status distinctions and barriers including dress, language, office arrangements and wage differences across levels

• Extensive sharing of financial and performance information throughout the organisation.

1.3 EMERGENCE OF HUMAN RESOURCE DEVELOPMENT AUDITS

While Human Capital Accounting (HCA) looks at human resource from economic point of view, Human Resource Development Audits views human resource more from behavioral point of view without neglecting economic dimension of human value addition in the business process.

According to Werther and Davis (1993) Human Resource audit evaluates the personnel activities, give feedback about the function to operating managers and human resource specialists. In brief it is an overall quality control exercise on human resource activities in a division or an organization on low HR activities support organization's strategy (Biles & Schuler (1986).

The purpose of evaluation of human capital and the HRD function at the organizational level is to provide data and to give a balance sheet of strengths and weaknesses of the same in a systematic framework and period. According to Pareek (1997) following are the purposes by which HRD evaluations taken up: to benchmark HRD systems against some standards, to give feedback of internal customers on the HRD function and systems, to provide information on the HRD structure and its adequacy, and to assess the impact of HRD on several aspects like industrial peace, work involvement, team work, productivity, response time in relation to changes etc.
1.4 CONCEPT OF HR AUDIT

HR audit is a method for evaluating the contribution of human resource management activities to current and future organizational objectives, assessed on the basis of value for money. In the present competitive business climate, the firms in various industries try to enhance their competence level to survive in the market. To reach their goals they have to comply with the dynamic pressures such as technology changes and increased competition etc. The performance of an organization could be improved only through improved employee performance which is only possible through proper HR practices like recruitment, training, compensation, conflict management and motivation. All these are common functions of Human resource management. Each one of these functions/activities has to be reviewed and evaluated to be able to ensure the efficient HR policies and management system.

Annual/quarter/need basis evaluation of HR functions of an organization is referred as HR Audit. Auditing has been a routine exercise. However, in case of Human Resource, there is no legal binding to adopt auditing. Some of the companies nevertheless prefer to own HR audits. Like any audit, the Human Resource Audit can be a systematic formal process, which is made to examine the strategies, policies, procedures, documentation, structure, systems and practices with respect to the organization's human resource management. Consequently, it is just a diagnostic tool to gauge not only the current status of things but also the gaps between the current status and the specified status in the region that is being audited. Also it systematically and scientifically assesses the strengths, limitations, and developmental needs of the existing human resources from the more expansive standpoint of enhancing organizational performance.

The human resource audit is based on the premise that human resource processes are dynamic and must continually be redirected and revitalized to keep responsive to the ever changing needs. Human Resource Audits aren't routine practices aimed at problem solving. Rather than directly solving problems, HR audits, like financial audits, assist in providing insights into possible causes for current and future problems.
HR audit may either evaluate the operational HR policies, practices and processes or review of current HR indicators. An organization’s HR Expertise and experienced person could do the in-house HR audit mostly an outside consultant is required to lessen the biases and prejudices in the auditing process. One can find some typically common types in auditing that are: 1) Compliance with current central, state and local laws and regulations 2) Evaluating the HR policies and practices 3) Targeted on the strengths and weaknesses of the HR system and 4) Evaluate the precise HR functions such as Pay roll, training, documentation, compensation and benefits.

The other characteristic of HR Audit is a linkage between HR and other functional areas such as Production management, Total quality management, Strategic planning and Personnel policies. An audit examines the linkages between HR and the other functions. On the basis of evaluation, HR auditors suggest future HR strategies required by the company. Not only it suggests future strategies, but also it suggests the structure that the company needs to have for developing new competencies, systems that need to be strengthened, ideal managerial styles and work culture in the organization.

HR audit does not always provide solutions to organizational specific problems involving industrial relations, performance and discipline etc. however, it throws insights into the sources of the problem. It is one of the five systems used to measure the effectiveness of HR practices, other being benchmarking, HR accounting, HR Information Systems and HR researches.

The performance information on the HR department is obtained by some sources such as, documents, reports and complaints etc. There are various other methods that are used to audit the HRM systems and these include:

1) Observation
2) Interview method (Individual/group)
3) Questionnaire method
4) 360° review
5) Workshop
6) Assessment center.

The scope of an HR audit can range between an easy review of workplace policies to a thorough examination of practices, policies, procedures and measurements to determine how close the alignment is involving the organization’s strategic goals, direction and HR functions that support their strategy.

The findings of the audits aid decision making in the organization and are usually internal documents that want not necessarily be shared with the public. Moreover, unlike Financial Audits which are routine, regulated and standardized, Human Resource Audits are non-routine and may be built to focus on the unique needs of the organization at a certain point in time. These are actually, studies of a silly nature. The way the Audit is conducted could vary from self-directed surveys to interventions by outside consultants.

The purposes of HR audit is not just assess the grade of existing human resource practices, also tries to identify the gaps in HR system, reduce the difficulties and also helps to accomplish and maintain world-class competitiveness in key HR practice areas.

1.5 HR AUDIT MODELS

HR Audit Model of Werther and Davis (1993)

According to Werther and Davis (1993) following are the four major components that should be addressed in an HR Audits. Audit of corporate strategy: Whether the company stresses on superior marketing channels (ex. State Farm), service (3M), Innovation (3M), Low cost production (Emerson Electric) or any other approach human resource management will be affected and they have a say in it. Understanding the strategy has strong implications for HR activities like manpower planning, staffing, training, compensation, employee relations etc. Therefore in HR audit of the corporate strategy is vital.

Audit of the Human Resource Function: Human resource functions audit should include (i) Human Resource Information system (action plans, sub analysis, compensation administration) (ii) Staffing and development (recruiting, selection, training, career development) and (iii) Organization control and evaluation
(performance appraisal, labour management relations, human resource controls, communication, Human resource audits).

For each of the above dimension the auditor (team) should (a) identify who is responsible for each activity (b) determine the objectives of each activity (c) review the policies and procedures used to achieve these objectives (d) sample the records in the HR information system to learn if policies and procedures are being followed correctly (e) Prepare a report commending proper objectives, policies and procedures (f) develop an action plan to correct areas in various objectives, policies and procedures and follow up on the action plan to see if it solved the problems found through the audit.

Audit of Managerial compliance: Here efforts are made to find out how well managers are able to comply with human resource policy and procedures.

Audit of Employee satisfaction: An effective organization should be able to meet both organizational objectives and employee needs. The audit team collects information relating to wages, benefits, supervisory practices, career planning assistance, employee feedback on performance etc. to determine their satisfaction level.

**Athreya Model (1990)**

Athreya (1990) speaks of an HR audit model which has four components of HR audits. They are:

i) **Strategic Audit:** It refers to annual top management retreats for assessing the organizations competitive positioning and update its strategies and action plans in the light of the findings.

ii) **Organization Audit:** It is an annual comprehensive review of the organization to initiate necessary structural process and climate interventions to fine tune the organization and to meet the emerging challenges.

iii) **HRD Audit:** It is the annual review of HRD systems and practices and to initiate necessary changes for better production and competitiveness.
iv) Systems Audit: Refers to the annual review of the state of the systems like discipline, techniques etc. and to provide inputs to upgrade systems oriented attitudes, knowledge and skills.

**Participative Model of Varadan (1997)**

The model proposed by Varadan (1997) is based on the Total Quality Management (TQM) philosophy and internal customers. A four dimensional framework is used:

i) Human Resources planning: Manpower planning, career planning and succession planning, ii) Human Resource Development: Induction, training, performance and potential appraisal, job rotation, counseling and promotion, iii) Human Resource Maintenance: Wages and salaries rewards and welfare, iv) Organizational Development: Organizational delayering, Climate and staff morale, delegation, decentralization and empowerment through participative mechanisms.

In this approach, the audit is carried out not by HRD experts of HRD function by the internal customers of HRD namely, line executives, who are beneficiaries of the HRD efforts. They evaluate each of the 12 dimensions in the framework facilitated by the HRD expert. The audit should be concluded with a wrap-up discussion with the top executives and action plans to bridge the gap areas and to strengthen the HRD efforts.

**1.6 NEED FOR HR AUDIT**

Human Resource practices and functions have a far reaching effect on the employee’s morale and performance, which in turn, affects the entire performance of the organization. This is why they're claimed to be closely related to a business's 'balance scorecard' through “productivity, people, and processes” (Ulrich,). Given its criticality, a regular assessment of the HR function, that way of finance function, becomes required for sustaining organizational health and growth. The need for such assessment is increased in today's dynamic and, at times, turbulent, environment, where human resource management needs continuous up-gradation and re-alignment. Moreover, with increased significance of the human contribution to organizations’ competitive advantage, especially in the information driven economy, the human
resource function itself is under transformation. It is gradually moving from the role of a site provider to that particular of a proper business partner. To be able to perform this emerging role effectively, the HR function has to continually assess:

- Whether it's adding tangible value to the organization through its strategies, policies, processes and practices
- Whether it's doing so at a competitive cost; and
- Whether it's doing so in a fashion that's satisfying to its people, acceptable to the society and the law, and sustainable from a long term perspective.

Answers to any or all these questions need regular HR Audit.

Moreover, HR Audit becomes significantly critical in situations of Merger or Acquisition. Often Human Resource is not informed about such transactions till they're complete. However, most often if mergers or acquisitions fail, it is because of the folks related issues. Consequently, it is important that managements spend adequate time and energy to master concerning the human resource part of the target company.

An audit or due diligence before the closure of the offer can have an immediate affect the success or failure of the acquisition. Regulatory Compliance is another section of major concern for most organizations. With increased judicial scrutiny and pressures for compliance with the statutory requirements of the nation, it has become vital that HR continually remains vigilant regarding the legal compliance. It must keep itself abreast with the newest laws and regulations, ensure they are being followed and also get rid of the gaps between what it will and what it says, as that on it's own, carries legal liability.

The purpose of an HR Audit is to recognize strengths and identify any needs for improvement in the human resources function. A properly executed Audit will reveal problem areas and provide recommendations and suggestions for the remedy of these problems. Some of the reasons to conduct such a review include:

- Ensuring the effective utilization of the organization’s human resources.
- Reviewing compliance in relation to administration of the organization.
• Instilling a sense of confidence in management and the human resources function.
• Maintaining or enhancing the organization and the department’s reputation in the community.
• Performing “due diligence” review for shareholders or potential investors/owners.
• Establishing a baseline for future improvement for the function.

1.7 TYPES OF AUDITS

An HR audit could be structured to be either comprehensive or specifically focused, within the constraints of time, budgets and staff. There are several forms of audits, and each was created to accomplish different objectives. A few of the more common types are:

• **Compliance**: Centers around how well the corporation is complying with current federal, state, and local laws and regulations.

• **Best practices**: Helps the corporation maintain or improve a competitive advantage by comparing its practices with those of companies identified as having exceptional HR practices.

• **Strategic**: Centers around strengths and weaknesses of systems and processes to ascertain whether they align with the HR departments and the organization's strategic plan.

• **Function-specific**: Centers on a specific area in the HR function (e.g., payroll, performance management, records retention).

1.8 SCOPE OF HR AUDIT

The actual scope of HR Audit is decided only when audit is taken up. The spectrum of HR audit includes:

1. Performance and potential appraisal
2. Compensation, reward, incentive and salary administration
3. Recruitment and selection
4. Induction, placement, training and development
5. Employee relations and communication
6. Policies and procedures

1.8.1 Auditing HR Practices

All HR departments provide several services that could be clustered into six key domains (Ulrich and Lake, 1990), staffing, training and development, appraisal, rewards, organization governance and communication. For all these six domains, Ulrich recommends four forms of assessments.

The very first is an examination of activity that not only describes the services being given by the HR department but additionally assesses the focus of the HR strategies, the distribution of responsibility, the resource utilization, and the competencies of the HR portfolio.

The second kind of assessment is that of customer value. HR departments might be said to be providing a variety of services to customers, who're the employees of the firm. Customer surveys are conducted to capture the employee’s perceptions in regards to the importance and the grade of the HR services.

Often Cost benefit or utility analyses of HR functions are made to define the value of each of the HR functions. Formulae that may trace the fee and good thing about the services are developed and the outcome compared with time and with the outcome of other companies, to produce an assessment.

Research, involving HR experiments, will also be sometimes conducted by using experimental and control groups. These groups might be formed across sites, or across departments. The purpose of these research studies is to spot the effective HR practices by generating comparative data. This data enables the organization to adopt the most effective HR practices.

1.8.2 Auditing HR Professionals

An audit of HR professionals is basically an assessment of the extent to that the professionals demonstrate competence for HR function. Such an assessment takes a 360 degree feedback, and, in accordance with Ulrich, usually employs the next five steps:
1. Having a Model of Competencies: Before embarking on an assessment of competence, it's necessary to first determine what the competencies that create a successful HR professional are. These competencies usually stem from knowledge of business, knowledge of HR, knowledge of change and finally personal credibility. In addition to determining the competencies that account fully for an effective HR professional, it is also important to find out the behavioral attributes that reflect these competencies. A product that reflects both these aspects may be said to be a thorough model for auditing of HR professionals.

2. Collect data utilizing the Model: Several techniques may be employed to get data in regards to the extent to which an HR professional exhibits the modeled competencies. These generally include interviews, questionnaires and focused groups.

3. Summarizes data and give feedback to the HR professionals: The quantitative and qualitative data that is collected in the aforementioned ways needs to be synthesized and codified so that specific themes emerge. These themes are then used as aids to simply help the HR professionals identify his/her strengths and weaknesses.

One of the key activities of an HR audit is to provide feedback. This needs to be done in a way that protects the confidentiality of the participants. The types of the feedback should take into account the sensitivities of the receiver. The tenor of the feedback should neither be accusatory nor defensive. Additionally, the individual data that is collected may be built-into an audit for the overall HR function.

4. Create action plans: The HR audit goes beyond defining the competencies and inadequacies of the HR function. Additionally, it identifies the measures to produce the competencies at both, the average person and the departmental level. At the institutional level, this could involve doing an ‘HR for HR.’ At the average person level, the action plan will concentrate on creating a tailored set of trainings, readings, assignments and training opportunities.

5. Continuous Improvement: Auditing of HR professionals isn't an onetime Human Resource Audit activity but a continuing continuous process by which HR professionals are able to constantly build on their HR competencies and strengthen the HR functions in the organization.
1.8.3 Auditing HR Function or Department

Auditing HR function and the HR department may be an integration of individual HR competencies. However, at the same time, there are additional overall indicators of HR functions, such as ratio of total employees to HR professionals, the performance of the department against the master plan, the ratio of expenditure on HR to total sales, general costs and other such measures. Temporal and spatial analyses of these could provide an overall assessment of the HR department. Comparisons against benchmarks are also a technique often utilized in HR audits.

1.9 THE FREQUENCY OF HR AUDIT

There's no uniform norm regarding how the HR Audits ought to be conducted in an organization. Generally, it differs in case of different organizations depending upon.

1. The objective of the Audit. For instance, if the point is to learn the extent of compliance with the organization policies, Audit might be an annual exercise. Whereas if the point would be to gauge the cultural shift as a result of a planned HR intervention, the Audit might be undertaken once in three or five years.

2. The periodicity of changes in the external business environment. The faster and the more discontinuous the changes, the higher should be the frequency of the audits in order that timely actions could be initiated where gaps exist between expectations and the reality.

3. The frequency of changes in the strategies, policies, and personnel within the organization.

4. The rapidity of technological changes which are anticipated to impact the psychology of men and women and,

5. The speed of change in the legal, socio-economic and political conditions

1.10 COSTS OF AN AUDIT
The specific cost of an HR audit depends upon the scope of the review, the number of individuals interviewed and the size of the audit team. Consequently, the expense varies greatly from one situation to another. Suffice it to express, though, that the expense of conducting any full-scale HR compliance audit will be far significantly less than defending (let alone losing) even one lawsuit. Some insurance carriers even provide audits as part of their compliance programs, and so the audit could actually be free.

1.11 DESIGNING AND CONDUCTING HR AUDITS

The Audit can be carried out internally or with assistance from an external consultant. Where it's conducted internally, four things are really important:

1. Unless the scope of the Audit is limited, the Audit ought to be conducted by way of a team and not an individual;
2. The team should represent a cross-section of the organization's staff, including, the line personnel, middle and upper management, and those responsible for HR functions;
3. The team ought to be trained in survey techniques and data analysis; and
4. The organizational culture ought to be trust based and open. Otherwise, the information given is going to be distorted and the entire diagnosis will end up inaccurate.

Many firms prefer to have independent consultants to conduct the audit. This is done primarily with a view to acquire greater objectivity and impartiality in diagnosis and reporting. Moreover, consultants are expected to have wider experience and specialization in the field. They, therefore, have a tendency to possess an uncanny eye for details and data that could otherwise be looked as insignificant by the internal personnel. Their audits, thus, are allowed to be both without any prejudice and more professional and accurate.

While an organization's size, industry, financial health, commitment to becoming a “best destination for a work,” and business objectives and imperatives affect the scope and urgency of the HR audit process, we have noted some common features, attributes, and objectives in HR audits recently conducted.
Since HR audits are becoming increasingly complex and multi-dimensional, the following aspects need to be borne in mind while designing the audit.

- Ensuring alignment of HR management and employment practices with the organization's business objectives.
- Assessing the outcomes of the organization's employment processes, policies, practices, and outcomes.
- Developing the best human capital measurements and HR metrics to allow the organization to calculate and measure the worth added by human resources, to determine the ROI and the return on the human capital asset, to measure the outcomes of employment policies and practices and the achievement of EEO and diversity goals, and to benchmark best practices.
- Ensuring due diligence, including: uncovering hidden liabilities and assets, identifying vulnerabilities to be corrected, and identifying opportunities to be attacked.
- Developing HR auditing procedures that become an ongoing and sustainable element of the organization's internal controls.
- Assessing and managing employment related fraud.
- Developing HR auditing procedures that become an ongoing and sustainable element of the organization's risk management program. HR audit reports are increasingly being used to report audit findings to wider audience. The distribution of the report on auditing findings is no more limited to senior management.

As noted above, an increasing number of third parties are expressing fascination with the organization's human resources management. This set of external stakeholders includes not only investors, major stockholders, and venture capitalists, but in addition governmental agencies, NGOs, civil rights groups, and plaintiff attorneys. Since HR audits findings include proprietary and confidential information and in many cases produce discoverable information, the implications of non-management stakeholders reviewing HR audit finding are significant and produce a potentially serious problem for organizations. As a result, organizations are spending more time considering the format, content, and the impressions produced by their HR audit reports.
1.12 AUDITING PROCESS: ESSENTIAL STEPS

The Auditing process is a function of the objectives and the scope of the Audit, the nature of the organization and the amount of involvement of the very best management.

Though this technique may vary from organization to organization, it essentially follows the stages described below.

1) Briefing and orientation: This is a preparatory meeting of key staff members to:
   i. discuss particular issues considered to be significant
   ii. chart out audit procedures, and
   iii. develop plans and programme of audit

2) Scanning material information: This involves scrutiny of all available records and documents related to the personnel as well as personnel handbooks and manuals, guides, appraisal forms, material on recruitment, computer capabilities, and all such other information considered relevant. Human Resource Audit could be the critical analysis of the existing human resource management within the organization. In order to do that, the audit will have to be served with the data that is quantitative, authentic as well as comprehensive. Quite simply, the success of the stage of human resource planning solely rests upon the way personnel records and other information are maintained. Hence, the quality of the HRIS becomes critical.

3) Surveying employees: Surveying employees involves interview with key managers, functional executives, top functionaries in the organizations, and even employees representatives, if necessary. The purpose is to recognize and enumerate issues of concern, present strengths, anticipated needs and managerial philosophies on human resources.

4) Conducting interviews: The main element issue listed here is to list the pertinent and probing questions. Your decision on these questions depends upon the scope and purpose of the Audit as well as on the culture of the organization. The skill of the interviewer lies in getting relevant and correct information without threatening the interviewees.
5) **Synthesizing:** The data thus gathered is synthesized to provide the:

   i. current situation
   ii. priorities
   iii. staff pattern, and
   iv. issues identified

Similarly, future needs are identified and appropriate criteria developed for spotlighting the human resource priorities and specific recommendations made.

6) **Reporting:** Like planning meetings for briefing and orientation, the outcomes of the audit are discussed within several rounds with the managers and staff specialists. In the process, the difficulties get further crystallized. On the basis of the findings and the discussion throughout the meetings, then the final report is prepared and presented formally to the Management. This report will include, the “state of the organization” report, the assessment of effectiveness and efficiency of numerous areas included in the Audit, a legal compliance/ aspects of concern report, and critical recommendations for improvement.

1.13 **HR AUDIT MODEL**

Figure 1.1 is a simple model depicting the process of HR Audit usually adopted in the organisations.
1.14 APPROACHES AND METHODS OF EVALUATION OF HR FUNCTION

1.14.1 Evaluation by Research

This methodology proposed by Singh (1997) revolves around social science research methodology and management of change. Here the auditor identify the problem, implement an intervention, evaluate it and then make necessary changes. Seven competencies are essential for the evaluator. Problem identification and diagnosis, development of evaluation plan, design of instruments and data collection, data analysis, developing recommendations report writing and working with significant decision makers to implement recommendations.

Eicher Tractors have been evaluating its various HR activities through various mechanisms from 1984 onwards through employee relation surveys, climate surveys, Total quality management evaluation, HRD systems and HRD function evaluation etc. These assessment were meant to evaluate the effectiveness of various HRD/OD interventions and to provide top management and HRD personnel with information about the success of their interventions and opportunities to launch new intervention, (Sachdeva, & Arora, A R (1989) &Singh (1997).

1.14.2 Social Sensitivity Approach
Mehta (1997) pointed out the need for evaluating the HRD through social sensitivity of managers in organizations and ethical behavior considerations.

1.14.3 Multiple constituency approach of HR Evaluation

According to Tsui (1984) the effectiveness of Human resource department can be measured through a tripartite approach. The activities of the department are mostly responses and reactions to the demand and expectations of the various units of the organizations. As a result different constituencies (units) may have different expectations and they may use different criteria for assessing the department's effectiveness. According to the multiple constituency approach criteria for effectiveness is the extent to which the constituencies’ needs and expectations are satisfied by the HR department. Based on this, appropriate indicators can be developed. For example customer satisfaction can be an important measure of the effectiveness.

1.14.4 Marketing Concept of Evaluation

Here the market situation and the customer is considered as the key factor for evaluation. Very often the customers the internal people themselves are considered. This approach is promoted by Peters and Austin (1985), for customer orientation Kotler (1984) and Kotler and Levy (1969) emphasize service orientation for HR evaluation. In their studies organizations that are reorganized for HRD initiatives Sehgal and Jain (1992) and Dayal et.al (1996) found five approaches most commonly employed to measure the effectiveness of HRD interventions:

1.14.5 Annual survey

An annual survey of the attitudes of employees on various aspects of the job, personnel, supervisory practices, relationships etc., are conducted to assess the HR function. Modixerox uses a questionnaire for this purpose and evaluates the effectiveness of their initiatives. The findings are used to assess the policy and the practices and for planning in the year to follow. In Eicher using the survey data, strengths and weakness of each of the initiatives are analyzed. The assumption is that HRD interventions influences the behavior and attitudes of employees about the job,
conditions of work, relationship etc. The survey besides showing a trend indicates effectiveness of a particular intervention.

1.14.6 Specially designed studies

It is based on personal interviews and assesses low HRD initiatives that influence the behavior of employees and the interactions among people at the work place. For example Life Insurance Corporation has employed such studies (Dayal 1993). Following three methods are used here (i) interviews with managers and subordinates (ii) content analysis of events (iii) the third method was based on the Lewinian concept of dynamic equilibrium indicating whether any change has occurred in conceptualizing problems and issues by managers as a result of HRD interventions. In all the three methods participative approaches were used involving the executives within LIC.
1.14.7 Evaluation by a consultant or an educational institution

Several Birla companies have contracted out evaluation to independent researchers or educational institutions. Here these searchers choose their own methodology keeping in mind the organizational requirements.

1.14.8 Evaluation by periodic intervals

Here the appraisal is done by the HRD specialist in the organization. A report is prepared to discuss with the top management. For example, Indian Oil corporation and Eicher,

1.14.9 CEO initiated evaluation

In some organizations the CEO, along with the operating heads, raises issues about development of people in their regular meetings. For example, CMC Ltd. uses this approach. Managers have to review down the line how development function is being performed. CEO also may ask the HRD department to carry out certain studies or collect data on a systematic manner to aid this process.

1.14.10 Employee profile oriented evaluation

A few scholars and practitioners believe that effectiveness of HRD and its results are very much seen in the profile of the employees in the organization. The bottom line should be made effective and healthier through the intervention of HRD. HRD effectiveness can be therefore measured only from the status of the profile of the employees in the organizations.

1.14.11 Evaluation by the specific objective

According to this view point effectiveness of HRD initiatives should be measured from the primary objective of the program or initiative. If the primary purpose of a program is individual development the measurement should be centered on how the individual has grown in respect of his knowledge, skills, attitude etc. If the purpose of the intervention is role clarity (like in Indian Oil Corporation) the measures of the effectiveness must relate role efficacy and role clarity.
1.14.12 Evaluation through follow up study

Organizations like L&T evaluate the training by a follow up study at the work place. They study how trainees have applied his class room learning on the job.

These are not exhaustive as there are some more approaches coined by the researchers which can be taken up in certain contexts.

1.15 BENEFITS OF HUMAN RESOURCE AUDIT

Several benefits associated with Human Resource audit are listed below. An audit reminds member of HR department and others its contribution, creating a more professional image of the department among manager and specialist.

The audit helps to clarify the department's role and leads to greater uniformity, especially in the geographically scattered and decentralized HR function of large organizations. Perhaps most important, it finds problems and ensures compliance with a variety of laws and strategic plans in an organization. Identifies the contribution of Human Resource department to the corporation

- Improves the professional image of the Human Resource department.
- Encourages greater responsibility and professionalism among member of the Human Resource department.
- Clarifies the HR department's duties and responsibilities.
- Stimulates uniformity of HR policies and practices.
- Finds critical HR problems.
- Ensures timely compliance with legal requirements.
- Reduces human resource cost through far better Human Resource procedure.
- Creates increased acceptance of needed change in the Human Resource department.

1.15.1 A RESEARCH EFFORT WHICH HIGHLIGHTS THE BENEFITS

TV Rao (1999) has presented in the book titled ‘HRD Audit’ (Evaluating the Human Resource Function for Business Improvement), a detailed analysis of four different companies which have immensely benefitted after conducting HR Audit and
utilising the suggested interventions. The study was conducted quite comprehensively by M G Jomon over a period of four years during 1995 – 98.

1. A Metal Manufacturing Company

Introduction

This company was established about 40 years ago and is one of the biggest Indian manufacturers of the product. It has about 6,000 employees at the time of this study. The organizational structure is hierarchical and the management style is participative and consultative.

The HRD department initiated in 1962 is a rare mix of personnel, industrial relations, HR, welfare and safety functions. The HRD team alone consists of 13 members and is headed by the Vice President – HRD.

The HRD audit exercise was started in 1995, with the aim of facilitating the formal take-off of the HRD function. The chairman was also keen on finding out how HRD could help the organization become globally competitive.

The Situation in 1995

In 1995, the organizational climate was conducive to experimentation and encouraged people to try out new ideas. However some of the weaknesses pointed out by the audit were:

- There was considerable subjectivity in the process of potential appraisal and promotions and these decisions were not based on substantial data.
- The promotion policy was not shared with everyone.
- The career paths were not laid out for each employee.
- There was no individual planning of work.
- There was poor pre-training preparation.
- Information about the company, the market and the changes in the environment was not provided to the employees.

Post-audit Scenario
Soon after the audit, a number of meetings were held by the management and a final action plan was formulated. Though the action plan covered the HRD function at the policy-making, operational and departmental levels and contained a joint action plan for the HRD/Training department, the report as well as the plan was kept confidential. The following changes were brought about as a result of the audit exercise:

- A well-established system to assess the potential of higher level people based on key competencies
- The promotion policy is now shared with everyone
- Each employee is aware of his career path
- Mechanisms to help employees plan their work efficiently have been set up and employees are helped by their supervising officers to plan their work effectively
- Employees now go for training with a clear understanding of the knowledge and skills they are expected to acquire from training
- Regular circulars and notices and bulletins give adequate information to the employees about the company, market situation, changes in the environment, etc.

2. A Gas Distribution Company

Introduction

Established in 1988, this natural gas distribution company had 627 employees and a turnover of Rs.1,050 million at the time of the study. Having already diversified into LPG, power, LNG, IT and financial services, this company has distribution operations in three different towns.

The organizational structure is semi-hierarchical. The management style prevalent is team-centred and democratic. The company does not have any unions. It is highly conscious of its social responsibility and has entered into collaborations with various institutions. It provides good infrastructure to its employees and has allocated 0.5 per cent of its total budget for employee development.
The HRD department headed by a manager and looked over by the Vice-President consists of 10 professionally qualified members. The HR department has a HR vision in line with the corporate vision and a corporate HR strategy.

The HRD audit was conducted in 1994 with the aim of streamlining the HRD function and to examine how HRD as a tool can be used to give a competitive edge to the business. The top management was also keen on finding out how appropriate HR strategies can be evolved to get closer to the people.

The 1994 Scenario

To start with, the top management was committed towards people development and the organization was characterized by a learning environment. However, some of the weaknesses which were pointed out by audit are listed below:

- Unclear personnel policies
- Teamwork not considered effective
- No proper system in place for potential appraisal and development
- Unclear and ambiguous roles
- Quality not taken into account while sending employees for training
- Lack of research competence among the HRD staff

Post-audit Scenario

This company seems to have come long way since 1994. The situation today is indicated by:

- Clear personnel policies including a promotions policy, communication policy, reward and recognition policy and many more
- Team spirit at this company was of a high order as conveyed by the employees themselves
- PPRDS have been revamped. A well-structured feedback mechanism is in place now
- KPAs provide role clarity and direction to the employees in terms of their work and role clarity is very high among employees
- External training programmes are chosen carefully after collecting enough information about their quality and suitability.
- Action-oriented research is very well established and taken seriously and acted upon.
3. A Fertiliser and Chemicals company

Introduction

This company started production in 1988. At the time of the study, it had 14 departments and a total of 1,250 employees of which 437 belonged to the managerial cadre. The emphasis on quality is evident from the fact that it was one of the earliest to earn the ISO 9002 certification.

It has an autonomous HRD department with a fairly flat structure headed by the vice-President – HRD. This is another organization which is aware of its social responsibilities and participates in many welfare projects. It has collaborations with BITS Pilani for distance learning programmes for self-development of employees.

Initiated at the behest of its Chairman who along with the senior managers wanted to know if the organization was going on the right track, the HRD audit programme in 1993 was meant to address a high turnover problem in the light of various emerging projects.

The Picture in 1993

Marked by unclear personnel policies and a low sense of security, the results of the audit are briefly given below:

- No systematic projection of manpower recruitment needs
- Key competency requirements not considered during potential appraisals
- KPAs being handed over to the employees, without any scope for participation from their side
- Low level of role clarity
- Low level of role efficacy as perceived by the employees
- OD initiatives lacking
- Research orientation absent
- No communication, empowerment and reward systems in place
- Inadequate HRD staff, who are perceived to have a low level of professional competency
Post-audit Scenario

A management council meeting was organized to discuss the strengths, weaknesses and recommendations of the audit. Strategic issues related to the HRD function were also considered at this juncture. The status in 1997 is presented below:

- Manpower requirements for each department are identified well in advance
- Key competencies have been identified and a system is in place for assessing the potential of people for higher level responsibilities
- Employees also participate and contribute to the annual performance plans
- KPAs provide role clarity and direction to the employees in terms of their work
- A very high level of role efficacy as stated by the employees themselves
- OD initiatives, research orientation, communication, empowerment and reward systems are yet to be established
- The HRD staff, though inadequate in number, was considered to be highly competent

4. A Glass Manufacturing Company

Introduction

Established in 1992-93, this is a multinational company. It has a flat structure with two levels at the executive cadre and two levels at the non-executive cadre, which were occupied by 19 managers and 365 workers at the time of the study.

The top management wanted the auditor to assess the extent to which the company environment reflected the following characteristics: open-door policy, atmosphere of mutual respect, creativity, entrepreneurial spirit, teamwork, etc. It was a time when everyone was confused about the culture since people from different organizations had come together for a common cause. There was no breathing space since everyone had to perform and show results in a short period.

Scenario before the Audit in 1994

The unique feature characterizing this organization was an unusually high emphasis on discipline extending to punishments, performance and self-reliance
(there was no assistance in the form of clerical staff or peons). Unlike the first three organizations where HRD audit questionnaires were administered, being a closely held company, this organization declined the administration of the HRD audit questionnaires. Some of the weaknesses highlighted by the audit were:

- No potential appraisal system and adhoc performance appraisal system
- No career planning system
- Lack of role clarity
- Poor induction procedure
- Absence of mentoring
- High confusion and friction in values and approach
- Lack of initiative and a mechanical approach to work
- Human orientation missing
- Operators treated badly
- Personnel policies not development oriented but discipline oriented

**Post-audit Scenario**

Once the HRD audit report was submitted, the HR chief invited all the managerial staff for dinner and presented the findings. Based on the discussions an action plan was drawn up which after implementation led to the following changes:

- A well-established potential appraisal system and a systematic performance appraisal system
- Career planning is done up to the executive level
- Role clarity brought about through identification of KPAs
- Establishment of a systematic induction and training programme
- Initiation of mentoring
- An increase in the level of trust among employees
- High involvement of employees at all levels
- Human orientation injected into the business process with opportunities for growth and development provided to all employees
- Empowerment of operators through various mechanisms, and efforts made towards improving the management-operator relationship
Integration of all HR-related activities which now support developmental activities

**Major findings and conclusion**

1. There is a direct relationship between the CEOs commitment towards HRD and the effectiveness of the HRD function.

2. An interesting revelation was that in all four organizations, the CEO was rated higher that HRD chief in commitment towards the HRD function. The reason for this could be that many communications announcing new ideas, practices and systems to be put into effect were signed by the CEO. This also ensured greater acceptability of these new systems by the members of the organization.

3. There is however a direct relationship between the ratings of the HRD chief in commitment towards HRD and the effectiveness of the HR function.

4. Management styles also show a high degree of equivalence with HR effectiveness. The companies scoring high on the average best management styles had more effective HR systems. These companies had a dominant participative style with a back-up professional or organic style. An altruistic management style was seen to have an adverse effect on the effectiveness of the HR function.

5. As far as organizational characteristics are concerned, the following organizations were able to embrace change and utilize the HRD audit inputs better, leading to a more effective HR function:
   - Middle-aged organizations (Estb. between 1970 and 1990) as compared to old or young organisations
   - Professionally-run private organizations as compared to family-owned organizations or closely held MNCs
   - Service companies as compared to their manufacturing counterparts
   - Organisations with a flat structure as compared to those hierarchical in nature
   - Medium-sized organization (with 20-40 departments and between 1000 and 2000 employees) as compared to those very large or very small
   - Organisations with a good employee profile, fulfilling the following the criteria:
(i) Managerial profile: A majority of managers are professionally qualified, in the age group of between 30 and 40 years, with more than eight years of work experience.

(ii) Support staff profile: A majority of the support staff are secretarial certificate holders, are in the age group of between 35 and 45 years, with above 10 years of work experience.

(iii) Worker profile: A majority are skilled, with above 10 years of work experience, and have an average age of between 35 and 45 years.

   ▪ Organisations where management systems were in the process of being set up as compared to those with a well-established management system
   ▪ Organisations with participative and proactive unions undertaking developmental activities had better HRD practices for workers
   ▪ Organisations with employee development budgets as compared to those with no such allocation.

However, the following organizational characteristics did not seem to have any relation to the utilization of audit inputs or the effectiveness of the HR function:

   (i) Market positioning
   (ii) Tendency of groupism among employees
   (iii) Linkage with industries
   (iv) Collaborations with institutions
   (v) Social responsibility

6. The utilization of the audit inputs and the resultant effectiveness of the HR department was far better in organizations with the following HRD department profile:

   ▪ Department age of seven to 10 years as compared to those greater than 10 years old and less than seven years old.
   ▪ A separate and independent HRD function and a separate HRD department as compared to those with departments combined with other functions such as personnel.
   ▪ HRD department structurally positioned at a higher level, headed by a Vice-President-HRD.
• A flat structure of the HRD department as compared to a hierarchical structure in the HRD department.
• A decentralized HRD department with the HRD function being considered a line function and the involvement of line managers in the implementation of HRD practices.
• An adequate HRD staff (i.e., around 10 per cent of the total number of managers in the organization.) as compared to having insufficient or the bare minimum number of staff.
• An average age of between 30 and 40 years of the HRD staff this age group was considered good and facilitated better utilization of HRD audit inputs, the age of the HRD chief was also was found to influence HRD effectiveness-company where the HRD chief was relatively young (33 years) has accepted changes better.
• A good professional profile with most of the staff having professional qualifications in human resources and a background in behavioural sciences.
• An experienced HRD staff with many of them having 10 or more years of work experience.
• An HRD staff who were high on initiative, were hardworking and spent extra time at the department ensured a better utilization of the HRD audit inputs.
• An HRD staff who were members of professional bodies and undertook independent research activities.

7. Organisations with a highly competent HRD staff were able to derive much greater benefit from the audit process, resulting in a higher impact on the effectiveness of the HR function. The competency level of the HRD staff was judged by their score on the HRD Competencies Checklist. In fact, in one company, though the HRD department was small and inadequately staffed, the utilization of the HRD audit and its effectiveness on HRD practices were high mainly due to the high competency level of the HRD staff.

1.16 CONCLUSION
Considering the ever changing, highly volatile and dynamic nature of the modern day organisations, it becomes essential and all the more imperative to constantly evaluate the function of Human Resource. HR Audit comes in handy as an effective tool to do this quite effectively. Unless the needed changes are brought out the performance continues to suffer. The four organisations where the audit was conducted are the shining examples of the usefulness of HR Audit.

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