# CHAPTER 1

## HUMAN RESOURCE ACCOUNTING

- **AN INTRODUCTION**

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CHAPTER 1

HUMAN RESOURCE ACCOUNTING
- AN INTRODUCTION

1.1 INTRODUCTION:

Up to 1960, the management believes that labor is one of the factors of production, just as materials, money etc. are. But Robert Owen pointed out boldly that it is in the interest of business itself to give special treatment to its employees. Mrs. Mary Parker Follet stressed the need to realize and accept the importance of human element in industry. Pigors and Myers highlighted the importance of human elements when they stated, 'Good management means securing more concrete results from the employees. The President of the American Break Shoe company once remarked,' the future of any business depends more on employees engaged in it than on anything else. One of the leading industrialists of India, Late Shri J.R.D. Tata stated, “well experienced, imaginative and sincere employees are the most valuable assets of a business.”

Now the world economy is undergoing a fundamental change from industrial to service dominated economy. It means there would be change in the composition of labor force or employees from manual laborers to service oriented employees. The economy therefore requires change in labor force from types and levels of skill needed. Formerly manual workers had hardly elementary education and were semi skilled and unskilled workers. But now the business enterprises require people who are highly educated and skilled people like engineers, Lawyers, Accountants etc., who are all high tech service personnel. This suggests that now instead of physical assets, emphasis will be on human capital.

Business people invest now more in people than in physical assets. For example, if a businessman wants to purchase one more computer, he will have to invest say ₹ 50,000 to ₹ 80,000. But if he wants to hire an experienced and skilled marketing manager, he has to make a nation wide search and give advertisement. He has to spend on his traveling and interview by experts; thus he will have to spend nearly 3 to 5 lakhs of rupees. Thus he has to spend a lot of money on human capital, yet in present accounting the computer will be shown in the balance sheet as an asset, while expenses spent on acquiring marketing manager will be treated as revenue
expenditure and will be charged to profit and loss account. Thus this is a breach of fundamental principle of accounting in which human capital which gives future benefits to business is not treated as an asset.

But now the accountants have recognized the importance of human capital, accept in India where still the concept of HRA is completely ignored except a few companies like Infosys, Bhel etc. In 1962 W.A. Paton said, “in business enterprise a well organized and loyal personnel may be a much more important asset than stock of merchandise; At present, there seems to be no way of measuring such factors in terms of the dollars; hence they cannot be recognized as specific economic assets. But let us accordingly, admit the serious limitations of the conventional balance sheet as a statement of financial condition.” However after 1962, there has been development in quantifying the human resource and now it is possible to value the human resources.

Prof. Flamholtz defined HRA as, “accounting for people as an organizational resource. It involves measuring the costs incurred by the business firm and other organizations to recruit select hire, train and develop human assets. It involves measuring the economic value of people to organizations.”

This definition implies that HRA is concerned with measurement of cost and value of people to the organization. Rensis Likert observed, “Human Asset Accounting refers to the activity devoted to attaching dollar estimate to the value of firm’s human organization and its customers’ goodwill.

1.2 Objectives of HRA:

The following objectives of HRA were stated by the American Accounting Association:

(1) to develop valid and reliable models for measuring cost and value of people to organizations. This should include research on development of both monetary and non monetary measures.

(2) To design operational systems of HRA for implementation in actual organizations and

(3) To determine the behavioral impact of HRA measurement on human resource decisions and performance.”
1.3 Development of HRA:

Before 1960, nobody thought seriously about HRA, except few authors who propagated Human approach of management theory like Mary Parker Follet, Robert Owen, Hugo Munsterbeg, Pigors and Myers, Peter Drucker, and many others.

As Prof. Flamholtz has stated after 1962 the idea of HRA caught the attention of accountants and HR professionals.

(1) The first stage starts from 1960 upto 1966. During this stage there was interest in HRA. There were many reasons for interest in HRA during the first stage. It was economic theory of human capital, the people’s interest in human resource, and the concern for human assets as components of corporate goodwill.

(2) During the second stage (which covered a period from 1966 to 1971) of development of HRA, there developed academic interest in researcher. They wanted to assess the validity of models for the measurement of human resource cost and value. There was also an attempt to develop new measures of human resource value. A study in HRA was conducted by Hermanson, who was a Ph.D. student. He tried to find how to measure the value of human assets as an element of goodwill. During the same period, a research team of researchers carried out a series of projects to develop concepts and methods of accountancy for human resources. During this second stage, an attempt was made by William Pyle to measure historical cost of human resources at the R.G. Barry Corporation.

(3) During 1971 to 1976 which is the third stage of development of HRA, there was a rapid growth of interest in HRA. During this period a great deal of research was carried out in HRA. Many small and medium organizations, including R.G. Barry Corporation tried to apply HRA in their annual accounts. R.G. Barry Corporation was not a very big company but it made the first attempt to develop the accounting system for the historical cost of human resources. As it was the first company to incorporate the value of human assets in its proforma financial statements, it received a great deal of recognition in the accounting world. Although the inclusion of human assets in financial statements was not the most
significant part, yet as it was innovative, HRA was treated as putting people on the balance sheet.

The third stage was also known for the continued interest of academicians and accountants in developing concepts and models for measuring and accounting for human resource cost and value. Number of papers were published by researches during this period and there were a hectic seminar activity. Even the research during this stage involved thinking about potential impact of HRA information on decision by human resource professionals. During this period even the accounting bodies began to take interest in HRA. The American Accounting Association appointed two committees on HRA in 1971-72 and 1972-73. These committees published their detailed reports. The committees on HRA defined HRA as follows. It is the process of identifying and measuring data about human resources and communicating this information to interested parties.

(4) There was declining interest in HRA among academicians and accountants during the fourth stage from 1976 to 1980. This situation arose because during the third stage the preliminary research was achieved and it was a difficult task to further develop HRA. This could be done by a few intelligent researchers who were few in number. Thirdly, it required the cooperation of such organizations who are willing to serve as research centres. There were very few scholars who had the required skills or qualifications required to do such research. Cooperation from corporate world was also not forthcoming to cooperate in allowing research. Hence no major research work was undertaken during this stage. The corporations believed that the cost of promoting such research would be very significant and the benefit of such research would be available to the whole business world and not to the company alone which sponsored the research. In such circumstances it was not possible for HRA to develop to the extent it needed.

(5) The fifth stage of development of HRA started in 1980 and it was the beginning of interest in the theory and practice of HRA. During this period there had been a number of research studies carried out by research scholars in HRA. Not only that but even some large business enterprises tried to apply human resource accounting. The major reason for revival of
interest in HRA during this stage was the decision of U.S. office of Naval Research to sponsor a research project on HRA.

It wanted to see whether it is feasible to apply HRA to naval human research management. Prof. Flamholtz carried out this research project. It was a major research project and it was not possible for any private sector enterprise to undertake such a project as it involved a huge cost.

Other factors that contributed to the revival of interest in research about theory and practice of HRA may be stated as follows.

(1) There was a growing interest in the corporate world about increasing productivity against fierce competition in the international markets. Here human resource is the only resource which can contribute toward increased productivity and also HRA.

(2) The second important factor was the emergence of Japan as a world class competitor. The US industrialists found that Japanese entrepreneurs treat their employees differently from what the US employers are doing. The US employers would dismiss the employees on the pretext of taking more leaves than what is granted beforehand by employers. While major Japanese companies give lifetime employment to their employees and treat them as their fixed assets. They realized the importance of human resources as compared to other factors of production. In USA big giants like General Motors frequently laid off their staff and treated their employees not as assets but as expenses. Japanese businessmen treated their human resource as asset and not as expense, the people working with them had high morale and were greatly motivated to work hard and had corporate loyalty which led to higher productivity. This led the HR professionals and also academics to undertake research in HRA.

(3) The most important factor that led entrepreneurs to believe the human resource as a great and precious asset is that most countries are now converting their economy from industrial to a high tech service economy. Naturally in such a situation, human capital becomes a precious asset.

As Flamholtz wrote, "It is my judgment that human resource accounting has entered a new period of rapid growth in its applications. Human resources accounting
is being developed and used in a variety of ways by accountants, lawyers, human resource professionals and senior managers. The most exciting impact of human resource accounting is people increasingly discovering new uses for its measurement technology and conceptual framework.... HRA can contribute to an organizational culture in which the belief that people are valuable organizational resources is manifested in decision and actions rather than merely being given lip service....”

In India however, no research studies have been undertaken so far to determine the usefulness of HRA and to find methods of HR cost and Value or models to value human resources. Of course, Shri D.P. Rao has undertaken a study for designing, application and usefulness of HRA in Hindustan Vishakhapatnam.

But the conclusions of the study have been useful to only the company for which it was undertaken. However, it is a useful contribution to the study of HRA in Indian corporate world.

However, some Indian companies have voluntarily taken up computing value of their human resource and publish them in their annual reports as an annexure to their statutory financial statements. It was Bharat Heavy Electricals Ltd. (BHEL) which started the practice of valuing their human resource. Some other companies in public sector are MMTC, Indian Oil Corporation (IOC), Engineers India Ltd, Cement Corporation Ltd., State Trading Corporation (STC) and Southern Petrochemical Industries Corporation Ltd. Followed BHEL example.

1.4 Objectives of the study:

It is accepted by one and all that without the help of human beings nothing can be achieved in any business organization. If the human capital is efficient the firm can reach its goal of maximum profits. Materials, money and machinery are of no importance if not handled by human resources. But that is not reflected in conventional accounting. In the USA and other industrially advanced countries of the West and also in Japan, HRA has gained importance and many companies have adopted the practice of presenting supplementary financial statements in their annual accounts showing value of their human resources.

But in India and particularly in Gujarat the management of human resource is unscientific and its importance is ignored. No company in Gujarat has ever tried to find out the value of their human resources. We have selected two companies of
Gujarat, namely Torrent Power Ltd. In private sector and Gujarat Electricity Board (GEB) in public sector. They are completely blank in respect of HRA. Looking to the importance of HRA in recent years and the contribution of human resources to increased efficiency and productivity, we have undertaken this study to know whether:

1) Companies in Gujarat in the public sector as well as private sector can adopt HRA, which they have ignored so far.

2) Whether the companies in Gujarat have benefited due to efficient human resources.

3) Whether they can motivate their employees and increase their productivity by reporting value of their human capital, so that employees feel assured that the management has recognized their importance.

4) Whether the companies can formulate their personnel policies based on the human resource value information.

If these questions are replied in affirmative, the manager can proceed with its future plan of development with certainty in his mind that he has an efficient human capital and would be successful in his plan of future development. At present Gujarat State has become the hub of automobile industry and many world famous automobile companies are establishing their plants in Gujarat. Many of them are American companies with modern look towards their human resource. The industrialist of Gujarat are very conservative, family owned businessmen who never believe in adopting modern methods of management. The other objective is to see that they look to their human resource with respect and value them and present them in their financial statements.

1.5 Research Methodology:

So far no study has been undertaken in Gujarat on HRA in the corporate sector. Hence we have concentrated our study on the valuation of human resources on the basis of Lev & Schwartz model, so that extremely conservative and family owned companies of Gujarat may be interested in HRA. We have received no data or figures from any of the two corporates on labor turnover and recruitment which have selected and so we could not come to any conclusion on these two points.
The main method of research was to obtain data on human resource value, selection, turnover etc. was to send questionnaire to various Indian Companies. But very unfortunately not a single company in India has responded to our questionnaire which we have given at the end of this work. We tried to obtain necessary data by personal interviews of accountants and even CEOs of these two corporates, but they were not prepared to part with any information or data relating to their employees. However, with great efforts we have obtained some scanty figures on the basis of which we have valued the human resources of Torrent Power Ltd. And Gujarat Electricity Board.

The conclusions that we have reached are thus based on scanty information collected by us, they must be taken in that perspective. As almost 100% of the Gujarat companies are careless about HRA and do not care for their human capital as foreign companies do, we have restricted our study to only two power generating companies. It must be remembered that these power generating companies invest heavily in plant and machinery and its dependence on human resource is very much less. Hence, they ignore them and so do not care to incorporate value of their human resources in their financial statements.

We must bring to the notice of the readers that whole exercise of human resource valuation in power generating companies is conceptual. The work does not intend to develop any new theory or modify what work has been done so far on the subject. The purpose of the study is only to see whether HRA in companies in Gujarat can lead to increased productivity and whether the owners (as the businesses are family-owned) realize that HRA can lead to high efficiency and high morale among the employees.