A human resource audit is a tool for evaluating the personnel activities of an organization. The audit includes one division or an entire company. It gives feedback about the human resources function to operating managers and human resource department. It also provides feedback about how well managers are meeting the human resources duties. In short, the audit is an overall quality control check on human resource activities in a division of company and an evaluation of how their activities supports the organization strategy.

1.1 ORIGIN AND EVOLUTION

The term human resource auditing borrows its title and rationale from accountancy, it also makes use of the system and methods of the social and scientific information. Human Resources Audit can be defined as “a systematic assessment of the strengths, limitations, and developmental needs of its existing human resources in the context of organizational performance” (Flamholtz, 1987)[1]. Human Resources Audit, “measures human resource outputs and effectiveness under the given circumstances and the degree of utilization of the human resources in the best possible manner conducive to the organization” (AbdulAziz Arain, 2001)[2].

The audit of human assets is analytical rather than prescriptive. It aims, “to encourage professional managers and executives to develop their own ways of measuring performance against targets and objections developed from the experience and needs of their own particular unit, department and section. Executives should be encouraged to revise, adapt and apply the various diagnostic methods which are best suited to their own circumstances” (Willion B. Werther & Keith Davis, 1996)[3].
A cost based financial manpower decision can provide a form of scenario analysis whereby various different inputs and outputs can be compared with assistance of the computer spreadsheets. This analysis will organize the numerical and cost dimensions of human resources decisions in such a way which can emphasize contingencies and probability, rather than prescription and certainty. And also this analysis will compel the executives to clarify their own understanding on the way in which human capital are used and their value to the organization assessed (Boudreau & Ramstad, 1997)[4]. Human resource audit “is one of the methods of gathering factual information of management controls and activities based on an unbiased assessment of objective evidences rather than subjective opinion” (Willion B. Werther & Keith Davis, 1996).

Due to expansions and competition in the business trading, and manufacturing cost, the management in particular intend to reduce the cost of production without deteriorating quality, which is possible by eliminating waste, avoiding breakdowns, bottlenecks and by utilizing fully the human resources, along with other factors of production, for which human resource audit can be useful tool and assistance for better and improved management controls. It is an independent appraisal study of various management levels to ensure the fulfillment of the organizational objectives, policies, and procedures. Human resource audit in its scope is beyond the conventional audit. The human resource audit is more clearly defined as “a method to evaluate the efficiency of human resource at all levels throughout the organization, in order to ascertain whether sound management prevails throughout, and to recommend its effectiveness where such is not the case” (Willion B. Werther & Keith Davis, 1996).

The HR manager himself or herself is interested in knowing his or her department’s effectiveness. It is not that the department is infallible. Errors do happen. Policies and practices become outdated. By auditing itself, the department finds problems before they become serious. Done correctly, the evaluation process can build a strong rapport between the department and operating managers, and it can reveal outdated assumptions that can be changed to meet the department’s objectives and future challenges (T.V. Rao & Udai Pareek, 1997)[5]. Systematic
assessment instills discipline in the personnel staff and encourages them to move away from intuitive techniques to more rigorous assessment of the likely benefits to be achieved. Further, “a personnel function must establish credibility with the management by justifying its programs and clearly demonstrating how it contributed to the attainment of organizational goals” (Pareek, 1997)[6].

1.2 PROFILE OF IT FIRMS

The Indian information technology industry has played a key role in putting India on the global map. According to the National Association of Software and Service Companies (NASSCOM), the apex body for software services in India, the revenue of the information technology sector has risen from 1.2 per cent of the gross domestic product (GDP) in FY 1997-98 to an estimated 5.8 per cent in FY 2008-09. India's IT growth in the world is primarily dominated by IT software and services such as Custom Application Development and Maintenance (CADM), System Integration, IT Consulting, Application Management, Infrastructure Management Services, Software testing, Service-oriented architecture and Web services. The exports turnover will touch US$ 80 billion by 2011, growing at an annual rate of 30 per cent per annum, from the earlier few million dollars worth exports in early 1990s.

Indian IT-BPO sector grew by 12 per cent in FY 2009 to reach US$ 71.7 billion in aggregate revenue (including hardware). Of this, the software and services segment accounted for US$ 59.6 billion. IT-BPO exports (including hardware exports) grew by 16 per cent from US$ 40.9 billion in FY 2007-08 to US$ 47.3 billion in FY 2008-09. Moreover, according to a study by Springboard Research, the Indian IT services market is estimated to remain the fastest growing in the Asia-Pacific region with a CAGR of 18.6 per cent. Despite the uncertainty in the global economy, the top three IT majors- Infosys, TCS and Wipro-have seen revenue growth from all important sources of income: from the North American and European regions, in the financial services vertical and from application maintenance and development (ADM) offerings between fiscal years 2008 and 2009. The Indian Software and services industry is export driven. In 2008-09, the
total value of software and services export is estimated at Rs. 2,16,300 Crores (US$ 47 billion).

**Outsourcing:** A research by Gartner forecasts India as the undisputed leader in the outsourcing space in the year 2008. India's most prized resource is its readily available technical work force. India has the second largest English-speaking scientific professionals in the world, second only to the US. It is estimated that India has over 4 million technical workers, over 1,832 educational institutions and polytechnics, which train more than 67,785 computer software professionals every year. The enormous base of skilled manpower is a major draw for global customers. According to NASSCOM software and services exports (including exports of IT services, BPO, engineering services and R&D and software products) reached US$ 47 billion in FY 2008-09, contributing nearly 78 per cent to the total software and services revenue of US$ 59.6 billion.

**Domestic Markets:** India's domestic market has also become a force to reckon with, as the existing IT infrastructure evolves both in terms of technology and depth of penetration. According to NASSCOM, domestic IT market (including hardware) reached US$ 24.3 billion in FY 2008-09 as against US$ 23.1 billion in FY 2007-08, a growth of 5.3 per cent. India Inc's demand for IT services and products has bolstered growth in the domestic sector with deal sizes going up remarkably and contracts worth US$ 50 million-US$ 100 million up for grabs.

**Future Outlook:** Services and software segments are estimated to cross USD 1.2 trillion by 2012. This is more than the 5.2 per cent growth expected in the total IT spending. The huge potential for global sourcing is further highlighted by an addressable market size of USD 500 billion in 2008, which is more than five times bigger than the current market.

**Road Ahead:** According to a report prepared by McKinsey for NASSCOM, the exports component of the Indian industry is expected to reach US$ 175 billion in revenue by 2020. The domestic component will contribute US$ 50 billion in revenue by 2020. Together, the export and domestic markets are likely to bring in US$ 225
billion in revenue, as new opportunities emerge in areas such as public sector and healthcare, and as geographies including BRIC and Japan opt for greater outsourcing.

**Why Tamilnadu:**

The largest pool of technically qualified high class IT manpower in India - Out of annual Turn-out of 136,000 Engineering Graduates from 355 Engineering colleges in Tamil Nadu, 37% are with Computer Science or IT or Electronics & Communication discipline. Tamil Nadu enjoys a cost advantage of around 60-70 per cent as compared to source markets. Additional productivity improvements and the development of tier 2/3 cities namely Coimbatore, Tirunelveli, Madurai, Salem, Trichy and Hosur as delivery centers, is expected to enhance Tamil Nadu's cost competitiveness. Enormous skilled human resource compared to developed countries leading to lower manpower cost nearly one tenth of those in developed nations, thus giving Tamil Nadu a big comparative advantage.

In addition and value additions are:

- Offers a wide range of services from support / data processing to sophisticated software systems etc.
- Rich experience of working with large global companies and enjoy high credibility.
- Expertise on a wide variety of platforms.
- 1683 Software Exporting units with an export performance of Rs.36680 Crores (US $ 8120 million) employing about 285,000 Software professionals.
- Tamil Nadu had the highest Growth rate in software exports in India: 29.04%.
- Tamil Nadu exported 58% of its total IT exports to USA followed by UK (12%).
Government Support

**Income tax exemption:** Section 10A of the Income-tax Act, 1961 provides for 100% deduction of profits and gains derived by an undertaking from export of articles or things or computer software manufactured or produced by it. This facility is available till the to assessment year 2010-11.

- Government of Tamil Nadu has introduced an Innovative ICT Policy 2008. Under this Policy, the Government offers attractive incentives.
- TIDCO and ELCOT had promoted TDEL IT Park in 2000-01 with a built-up space of 1.28 million which became an iconic facility.
- SIPCOT has promoted an IT Park at Siruseri in an area of 756 acres which has some big names like TCS, Cognizant, Xansa, Syntel, Hexaware, Patni, Polaris, etc.
- TIDCO and ASCENDAS have jointly promoted another IT Park at Taramani in Chennai.
- At present, 28 operational IT SEZs in Tamil Nadu.
- 234 IT Parks in pipeline in Tamil Nadu with a built-up space of 131 million sq. feet in Tamil Nadu.
- Chennai has the largest bandwidth in India - 13.52 tbps through two submarine OFC cables linking Chennai with the rest of the World.
- ELCOT is currently developing IT SEZs in Tier II cities namely Coimbatore, Madurai, Thirunelveli, Salem, Trichy and Hosur.
- TIDCO is implementing a state-of-the-art ITES SEZ with about 4.00 million sq.ft. built up space on 26.64 acres of land in Thiruvanmiyur village in Chennai District and, Kottivakkam Village in Kancheepuram District. The project is being
implemented through a joint venture with M/s. DLF Limited. The estimated cost of the project is Rs.1500 Crores. The project is expected to provide employment for about 50,000 persons.

- TIDCO is implementing a state-of-the-art SEZ for IT-ITES with an Integrated International Convention Center on 25.27 acres of land in Kanagam village and Thiruvanmiyur Village in Chennai District. The consortiums led by M/s. TATA Reality & Infrastructure Limited are the joint venture partner for implementing this project. The project is estimated to cost Rs.3000 Crores and provide employment to over 50,000 persons.

- TIDCO is establishing a IT-ITES SEZ at Sholinganallur, Tambaram Taluk, Kancheepuram district through a joint venture with Nuziveedu Seeds Limited (NSL), Secunderabad, to build about 73 lakh sq.ft. for ITES Space, residential, retail and a 150 room hotel in an area of 66 acres of land; at an estimated cost of about Rs.1500 Crores. This project will generate employment for about 25,000 persons.

1.3 AUDIT OF HUMAN RESOURCE FUNCTION

This involves audit of all HR activities. For each activity, the auditors must (i) determine the objective of each activity, (ii) identify who is responsible for it performance, (iii) review the performance, (iv) develop an action plan to correct deviation, if any between results and goals, and (v) follow up the action plan.

Evaluation of HR function “is useful to justify the existence of the department and the expenses incurred on it” (Pareek, 1997). If the department fails to contribute to the company’s bottom line, it has no reason to function. Similarly, if the expenses incurred on the HR department far exceed its benefits to the organization, they must be pruned drastically to make the department economically viable.
1.4 AUDIT OF MANAGERIAL COMPLIANCE

This involves audit of managerial compliance of personnel policies, procedures and legal provisions. How well are these complied with, should be uncovered by the audit so that corrective action can be taken. Compliance with the legal provisions is particularly important as any violation makes the management guilty of an offence.

1.5 AUDIT OF THE HUMAN RESOURCE CLIMATE

The HRM climate has an impact on employee motivation, morale and job satisfaction. The quality of this climate can be measured by examining employee turnover, absenteeism, safety records and attitude surveys.

1.5.1 Employee Turnover

Employee turnover refers to the process of employees leaving an organization and requiring to be replaced. High turnover involves increased costs on recruitment, selection and training. In addition, high labor turnover may lead to disruption of production, problems in quality control, and difficulty in building teamwork and morale. Certain percentage of labor turnover is unavoidable. Resignation, retirement, death and transfers do take place-causing displacement in work force. Similarly, business expansion necessitates hiring of people. What should cause concern to the HRM is the avoidable turnover. Avoidable turnover gives an excellent measure of the HR climate as it direct attention to that, will help minimize employee turnover. What is significant is that a low turnover rate is worse than a high turnover if the top performers are not retained. Therefore, quality of turnover is more important than the quantity of people leaving and people joining an organization.

1.6 ABSENTEEISM

Absenteeism refers to the failure on the part of employee to report to work though they are scheduled to work. In other words, unauthorized absences constitute
absenteeism. Absenteeism is computed and is expressed in terms of percentages. In a research study (muhsen A. makhamreh, 1985)[7] found out the size of firm, the number of disputes which occurred in the firm and the workers annual, wage increase significantly affect absenteeism rates. It was also found that the size of the firm, the, number of disputes which occurred, the workers annual wage increase and the employees average years of employment in the firm are related to the turnover rate, explaining 74 percent of the variance in the rate. Moreover, absenteeism is found as a precursor to turnover in Jordanian business. Absenteeism costs money to the organization, besides reflecting employee dissatisfaction with the company. Like employee turnover, there is avoidable and unavoidable absenteeism. Absenteeism is unavoidable when the employee himself or herself falls sick, his or her dependants at home suddenly become unwell or there is an accident inside the plant. Unavoidable absenteeism is accepted by managers and is even sanctioned by labor laws. Avoidable absenteeism arises because of night shifts, opportunities for moonlighting and earning extra income, indebtedness, lack of job security, job dissatisfaction and unfriendly supervision. This absenteeism needs intervention by the management. Managers must create a work environment, which will make the employees realize that it makes sense to work in the factory rather than staying at home and waste their time.

1.7 ACCIDENTS

Organizations maintain records relating to accidents. Accidents do cost money to the organization. They also reflect the prevailing organizational climate. The management must have a safety plan, implement it and evaluate its effectiveness.

1.8 ATTITUDE SURVEYS

Attitude surveys are probably the most powerful indicators of organizational climate. Attitudes determine an employee’s feeling towards the organization, supervisor, peers and activities. Attitude surveys may be conducted through face-to-face interviews but are usually done through anonymous
questionnaires. The resulting information from the survey provides an invaluable insight into what employees are feeling and thinking. It can also be used to specifically address business problems associated with productivity, turnover, absenteeism, tardiness, work-group effectiveness, and industrial relations.

1.9 CONCEPTUALIZATION OF HR AUDIT

Auditing has evolved, becoming increasingly specific, until the term functional audit has emerged. The objective of a functional audit is to diagnose, analyze, control, and advise within the boundaries of each functional area of the company. The HR audit is a type of functional audit. Thus, as a first approach, one could say that HR auditing consists of diagnosing, analyzing, evaluating, and assessing future lines of action within the framework of HRM. HR auditing is a basic tool for the management of a company. Its objective is not only the control and quantifying of results, but also the adoption of a wider perspective that will aid in defining future lines of action in the HRM field. Thus, HR auditing must perform two basic functions (Cantera, 1995)[8]. First, it must be a management information system whose feedback provides information about the situation in order to facilitate the development of managing processes or the development of HR. On the other hand, it must be a way of controlling and evaluating the policies that are being applied, as well as the established processes.

It can be understood that in order to secure the operative efficiency and user or client satisfaction, an appraisal of the results of the HR function is necessary. According to this approach, the results obtained can be valued from certain HR policies (an external type of measurement), or from the results of the policies or the policies themselves. The results can be valued through their cost (a measurement internal to the function) (Walker, 1998)[9]. This would lead the company to consider some basic questions. Are adequate HR policies being developed? Are the desired results being obtained? To what extent do they add value to the company?
1.10 APPROACHES TO HR AUDITING

HR auditing has evolved in recent years to the point that it has ceased to be a mere instrument of control and has become a necessary decision making tool in personnel related matters according to the global objectives of the company. As a result, all of the functions and competencies of HR auditing are being progressively expanded. This is creating a distinction between its component elements and the different types of HR audits. In this way, Walker [1998] differentiates between two approaches relative to HR auditing: those centered in the functions internal aspect, and those centered on the external aspect.

From an internal perspective, as in any staff function, there is a trend of valuing its actions as a result of the activities undertaken and its costs. In this way, the department’s capability would be judged on its ability to supply certain services to the organization at the lowest possible cost. Under this approach, the operational measurements traditionally used are those which refer to quantity, quality and reliability, or cost and speed, therefore placing the focus on activities, costs, or productivity ratios. From an external perspective, if it is understood that the ultimate appraisal of the effectiveness of HR is based on their impact on the company’s results, then the measurements should include results obtained outside the function. Another well-known classification of HR audit approaches, which is used to structure the present work, is the difference between three focuses, which are the legal audit of performance or conformity, the operative or efficacy-based audit, and the strategical audit.

1.11 THE LEGAL APPROACH IN HR AUDITING

This first concept of HR auditing is based on a legal outlook. According to Antona, 1993[10], the audit of performance or conformity consists of making an inventory of the social situation of the company, considering the labour law norms and regularly verifying the company’s compliance with the applicable regulations. Thus, this concept is centered on the verification that the current labour laws are being fulfilled. The audit should verify if the firm’s policies, practices, and
documents regarding employee hiring, retention, discipline, termination, and post-
employment are both fair and legal (Higgins, 1997)[11]. These practices and policies
must prohibit discrimination by offering equal employment opportunities; protect
the employment seeker from being discriminated against on the basis of age; carry
out minimum wages; and contain provisions regarding mental disabilities and
reasonable accommodations for disabled workers.

According to Nevado (1998)[12], the basic functions of the audit of
conformity or of performance as an element of HR auditing are threefold. The first
function is examining to see if the firm is fulfilling all its administrative social
obligations, as well as those relative to the collective rights of its personnel. The
second is to study the relationship between the employees and the firm based on the
legal statutes. The final function is verifying if the firm fulfills its financial
obligations (for example, social security payments), as well as its informative ones.

Concern about labour risks has created a function within HRM with the
purpose of altering working conditions by identifying the risks that could stem from
them and implementing necessary preventive measures. Such preventive activity
could fit perfectly into the legal approach of HR, although the effort that the
company can make in this sense can go beyond the application of the existing risk
prevention laws. The requirement for labour security and hygiene is a part of the
search for quality of life in the workplace, which is becoming increasingly
demanded from companies.

1.12 FOCUS OF THE FUNCTION AUDIT

The function audit centers on observing if the procedures applied are the
adequate ones and if they function correctly. That is, checking to see if the
relationship between objectives and procedures is a satisfactory one and if this has
been achieved in the most cost effective manner. [Nevado, 1998,]. The function of
this level of the HR audit is to study and analyze each one of the specific areas of
HRM. The analysis should center on the planned measures, the method of
implementation, and the results obtained. In order to carry this out, the areas that are
to be studied must first be identified. Afterwards, a list of the indicators that will serve to analyze each of them must be made. These indicators can be either quantitatively (absolute numbers or ratios) or qualitatively derived from the responses given by the people involved (management, employees, or external experts). A list of the indicators corresponding to the different areas of the HR function could contain some of the following.

1) **Description of the Company’s Staff**

   The complete staff can be described by: hierarchic levels, years of service, qualification, sex, and nationality; the number of permanent and temporary employees, interns, and physically or mentally challenged employees; and indexes of personnel rotation and absenteeism.

2) **Job Analysis**

   Job analysis can include: the number of described posts and occupants per post; the degree to which the job description cards have been updated; the degree of detail in the job description cards; and the methods used to analyze and describe the jobs.

3) **HR Planning**

   Planning includes the methods employed to plan personnel needs, the measures adopted to cover future personnel needs, and the temporary planning horizon.

4) **Recruiting and Personnel Selection**

   This includes: the number of days needed to fill a vacant post; the number of applications received by work place categories; the average amount of days between the reception of the application and the final answer; the average cost of recruitment and selection per job post; the degree to which internal and external sources of recruitment are used; the average number of candidates that do not pass the selective tests; a study of the reliability and validity of the selection tests; and the degree to which the recruiting efforts fit the company’s business plan.
5) **Training**

The training indicators are: the procedures followed and the frequency with which personnel training needs are analyzed; the criteria followed to define the content of the training programs; the evaluation criteria of the efficacy of the training programs; the percentage of the HR budget dedicated to training; the average number of hours of training per employee; and the percentage of employees that participate in training programs by work place categories.

6) **Development of Professional Careers**

These indicators include: the percentage of people promoted per number of employees; the percentage of vacancies covered internally and externally; and the average time per employee it takes to receive a promotion.

7) **Retribution**

Retribution can be measured by: the average wage per employee and wage difference among employees; the fixed and variable components of retribution; the percentage of remuneration linked to the employee’s yield; and the internal equity and external competitiveness of the retribution system.

8) **Performance Evaluation**

Evaluation indicators include: the level of usage for promotion or career; the level of feedback of results to the company’s personnel; and the degree to which poorly performing employees are assisted in improving their performance.

9) **Work Conditions**

Work conditions can be assessed by the frequency and index of the graveness of work related accidents and by the labor accident and sickness prevention policies that are in place.

In searching for adequate measurements, the use of financial references to evaluate the costs and benefits of HR programs has become commonplace (Parsons,
Financial analysis models applied to HR development programs are increasingly being seen in the literature (Head, 1995; Swanson and Gradous, 1998; Mosier, 1990). Grossman (2000) proposes a three-pronged approach for the measurement of the HR function. First, according to this model, there should be efficiency measurements that help to determine the way in which the resources are being used. Within this group are the measurements of turnover, quits and discharges as a percentage of total employees, average tenure of employees in various jobs, absenteeism, employee productivity, and intellectual capital. After calculating the measurements of efficiency, they must be compared to the results obtained in previous periods. Nevertheless, this is not sufficient, and it is critical to benchmark against others in the same industry or profession. When inefficiencies are revealed, careful analysis of the problem should follow before expenditures are slashed. These cover the efficiency side, but one must also look at the value-creation side. Thus, it is necessary to develop a new set of strategic measurements that connect directly with the mission and strategies of the company.

The creation and selection of these ratios is more difficult, given that they depend greatly on the specific company of which one is talking about. Fitzenz (1999) proposes a measurement that includes quality, efficiency, and service. He suggests using a ratio constructed around five factors that can be applied to anything that one chooses to measure. These five factors are cost, completion time, quantity, quality, and the human reaction. This system concludes with the calculation of measurements of the HR activities, which try to demonstrate their financial viability. These measurements are based on the idea of the ROI ratio, which is calculated by dividing the monetary value of a HR program by its costs. For this, the cost of the program that is being measured must first be determined, then it must be translated into monetary terms.
1.13 THE STRATEGIC AUDIT APPROACH

Nevado [1998] considers that the audit should also analyze if the personnel policies are in alignment with the general objectives and the global strategy of the company. It must also translate the HR strategy into plans and programs. Thus appears a new element of the audit of HR, the strategical audit. Dolan, Schuler, and Valle (1999, p. 390)[17] define it as the evaluation of the adaptation of the HR policies and practices in their support of the company’s general strategy.

The strategical audit of HR helps assure that the HR programs are aligned with the company’s long-term objectives. In this way, the HR function is becoming a source of competitive advantage and is ceasing to be considered as a specialized and unrelated function that incurs high costs to the company. When performing this evaluation, the auditor must identify the company’s global strategy before designing the HR policies that will contribute to its achievement. These policies are then compared to the HR practices that are currently being applied, which leads to the modification of some policies to better conform to the firm’s strategy.

The employee-client-benefit model that was developed and applied at Sears and other companies illustrates this complete alignment of the business and HR measures. This alignment approach presents greater challenges, since the impact of certain actions on the results is frequently not clear. Many HR professionals find it easier to look inside than to connect their results to organizational measures. Yet, with relatively little effort, HR leaders can identify the keys to their business and the actions to apply on the people related to them as well as their results. The main change involved for those responsible for HR is to leave behind their comfort zone and dedicate more time to finding ways of integrating HR into the business.

With this approach, the measurements applied must be useful in identifying if the HR activities are being developed adequately, if the correct results are being obtained, and if such actions add value to the business. As Welbourne and Andrews (1996)[18] highlight, the importance that management gives to its human
capital is one of the most important factors that investors look for when assessing the attractiveness of a company. Recognizing the strategical importance of HR for any organization, the measurements of results can lead to measuring the impact on business through the extraordinary benefits generated as a result of a better trained and motivated work force.

Brown 2000[19] considers that the measurements used to evaluate the company’s personnel reflect neither its value nor its performance. This is why he proposes an alternate procedure that consists of creating a human capital index based on four elements that must be carefully studied considering their relative importance to the company: the number of years in the business or field, the level in the company (by job grade or organizational chart level), the number and variety of positions or assignments held, and the performance rating, which is subjective. It is the result of an evaluation of an employee’s performance, which should include an evaluation by a superior and another of objective aspects such as sales, benefits, or other factors. Through the use of this index, the value that each employee has for the company would be obtained over a total of 100 points. This index is easy to calculate and interpret, and it is fair since it is based on a larger number of objective factors. Yet, it is very simple and does not supply information about the knowledge, abilities, values, managing experience, or other factors of each employee. To overcome this inconvenience, Brown has created a second index that attempts to measure the employee’s level of experience and aptitudes.

Some companies, on the other hand, have developed and applied a balanced scorecard approach to the HR function and treat it as a business unit in and of itself. HR leaders must use four different techniques to measure client attitudes, financial impacts, operative efficiency, and strategic capability. Given that the human factor is a prime strategical element, which explains a company’s differentiation capacity, it is logical that a measurement effort of the way this function is undertaken in the company is made. That is the content of the HR audit, which goes beyond the simple investigative function, and is an extension of the traditional concept of the accounts audit.
The existing literature describes different approaches to HR auditing, including the legal approach, the function-based approach, and the strategic approach. All of them have been analyzed in this work. The legal approach centers on finding out if the company is complying with the current labor laws. Presently, it focuses mainly on the evaluation of the company’s efforts in the prevention of work-related risks. The function approach analyzes the application of different HR policies. Several measurement systems have been presented with the same basic ideas, which include the study of planned measures, the method of implementation, and the results obtained. Yet, these two approaches are limited to the operational and tactical fields, and do not evaluate if HRM supports or aids in the achievement of the company’s strategy. This is why the strategical approach has been developed as a means of determining if the HR function is a source of competitive advantage for the company. This third approach, through the use of several systems such as the client-employee-benefit model or Brown’s human capital index, can make the company’s management aware of the true importance of its employees by identifying them as a key resource worth optimizing. This idea can lead to mistakes when the employees come to be considered as property of the company. The correct interpretation would be to think of personnel not as human capital, but as the owners and investors of human capital Davenport, 2000[20].

1.14 INTRODUCTION: THE HUMAN RESOURCES AUDIT

The word “audit” comes from the Latin verb audire, which means, to listen. Listening implies an attempt to know the state of the affairs as they exist and as they are expected/promised to exist. Auditing as a formal process is rooted in this feature of listening. Consequently, it is a diagnostic tool to gauge not only the current status of things but also the gaps between the current status and the desired status in the area that is being audited. Auditing has been a routine exercise in the area of finance, especially because it is a statutory obligation. However, in case of Human Resource, there is no legal binding to adopt auditing. Some of the companies nevertheless prefer to have Human Resource audits.
1.15 NEED AND IMPORTANCE OF HR AUDIT

HR Audit is a process of systematic check on the various aspects of intellectual capital management in an organization. The role of intellectual capital in Information technology firms is very high due to foreign clients and the service quality expectations of the delicate institutional clients. In addition, the costs associated with the projects are huge and irreversible in software projects. A product designed by a firm should be in a position to satisfy many clients in the world in terms of simplicity, compatibility, change, up gradation and flexibility to shift the operating system. All these imbedding in a single product requires multiple skills and all those are supported by the different teams. Co-operation, co-ordination, communication and control are the pillars on which a project runs among the intellectuals of different domains. Any mismatches in this may lead to operational and administrative issues. These issues are due to lack of managerial aspects like Planning, Organizing, Staffing, Directing and Controlling.

An HR audit is an investigative, analytical, and comparative process that attempts to measure the effectiveness of the HR function. Like financial auditing, it involves compiling and analyzing data for an extended period (usually a year) to reveal how well or how poorly HR is performing. It also provides base-line data to improve the performance and productivity of the organization. The use of HR auditing has increased in recent years with the commitment to move HR from a support to a strategic function. HR auditing is vital to the importance of the HR function, but there is little correlation between the information in the audit and the overall effectiveness of the organization. The role of HR function has changed dynamically. However, there is always room for improvement which can’t be ignored. For HR, the diagnosis of improvement areas can be done through one essential tool: the HR Audit. Auditing, in simple terms, is described as a diagnostic tool to gauge the current status of operations and to identify the gaps between what is intended and what is actually being delivered.

An audit process can help in identifying the errors at what level and in which function. This can be a caution notice for the next level planning and
implementation. Error is human but the costs of errors are irreversible in software projects and also lead to waste of productive hours of intellectual capital. Hence, human resources audit is closely associated with the quality of work, design, development of the products with the optimization of time and physical resources of software firms. With this motive, the current research is taken for the study to review, the HR audit environment and climate prevailing among the IT firms located in Chennai. This can pave a way to create awareness among the IT professionals on the importance of HR audit and also its importance in career development. A win-win and mutual understanding on the need and importance of HR audit practice is possible in the years to come. Hence, the present study is relevant and contemporary in nature as explained by Abdul Aziz Arain (2001).

1.16 HUMAN RESOURCE (HR) AUDIT

Human resources are the people in an organization, so a human resources audit is a look at those people and the processes that put them in place to make sure the system is working efficiently. An HR audit also goes beyond looking at the hiring process into areas like employee retention, budgeting, training, employee compensation, management/employee relations and virtually any process or practice within the company that affects its people.

A periodic Human Resource audit can qualify its effectiveness within an organization. Human Resource audits may accomplish a variety of objectives, such as ensuring legal compliance; helping to maintain or improve a competitive advantage; establishing efficient documentation and technology practices; and identifying strengths and weaknesses in training, communications and other employment practices.

1.17 DEFINITION OF HUMAN RESOURCES AUDIT (HRA)

Human Resource Audit means the systematic verification of job analysis and design, recruitment and selection, orientation and placement, training and development, performance appraisal and job evaluation, employee and executive
remuneration, motivation and morale, participative management, communication, welfare and social security, safety and health, industrial relations, trade unionism, and disputes and their resolution. HR audit is very much useful to achieve the organizational goal and also is a vital tool which helps to assess the effectiveness of HR functions of an organization. A complete Human Resources Checkup, including administration, employee files, compliance, handbook, orientation, training, performance management, and termination procedures. The intended outcomes include minimizing your liability exposure and introduction or enhancement of human resource best practices.

An HR audit involves devoting time and resources to taking an intensely objective look at the company's HR policies, practices, procedures and strategies to protect the company, establish best practices and identify opportunities for improvement. An objective review of the company's "current state" can help you evaluate whether specific practice areas are adequate, legal and/or effective. The results can provide decision makers with the information necessary to decide what areas need improvement.

An HR compliance audit generally consists of two main parts:

An evaluation of the company's operational HR policies, practices and processes with a focus on key HR department delivery areas (e.g., recruiting—both internal and external, employee retention, compensation, employee benefits, performance management, employee relations, training and development, etc.).

A review of current HR indicators (e.g., number of unfilled positions, the time it takes to fill a new position, turnover, employee satisfaction, internal grievances filed, number of legal complaints, absenteeism rates, etc.).

An audit usually is conducted by using a questionnaire that asks for the evaluation of specific practice areas. This document helps guide the audit team in scrutinizing all critical areas of a company's HR practices. The audit also may
include interviewing selected HR employees and other department managers to learn whether certain policies and procedures are understood, practiced and accepted.

1.18 RATIONALE FOR CONDUCTING AN HR AUDIT

The changing nature of HR management demands that HR professionals participate and contribute fully to their companies as true strategic business partners. An audit will help a company understand whether its HR practices help, hinder or have little impact on the organization's business goals. The audit also helps quantify the results of the department's initiatives and provides a roadmap for necessary changes. Audits also can help the organization achieve and maintain world-class HR practices.

1.19 TYPES OF AUDITS

Abdul Aziz Arain (2001), explains an HR audit can be structured to be either comprehensive or specifically focused, within the constraints of time, budgets and staff. There are several types of audits, and each is designed to accomplish different objectives. Some of the more common types are:

Compliance: Focuses on how well the company is complying with current federal, state and local laws and regulations.

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

Strategic: Focuses on strengths and weaknesses of systems and processes to determine whether they align with the HR department's and/or the company's strategic plan.

Function-Specific: Focuses on a specific area in the HR function (e.g., payroll, performance management, records retention, etc.).
1.20 WHAT TO AUDIT

Boudreau, J.W. & Ramstad, P.M. (1997) says, deciding what to audit will depend largely on the perceived weaknesses in the company's HR environment, the type of audit decided on and the available resources. Keeping a log of issues that have arisen but are not covered in the company's procedures or policies will help identify areas of potential exposure that can be addressed during the annual review process (if they do not need to be addressed immediately). There are, however, certain areas in which companies are particularly vulnerable. Most lawsuits can be traced to issues related to hiring, performance management, discipline or termination. Some additional risk areas that should be carefully reviewed include:

Misclassification of exempt and nonexempt jobs: Almost every company has job positions that have been misclassified as exempt from overtime eligibility. The complexity of wage and hour laws and regulations makes it easy to err in classifying a job as exempt, thereby exposing the company to liability for past overtime.

Inadequate personnel files: A review of sample personnel files often reveals inadequate documentation of performance—for example, informal, vague and/or inconsistent disciplinary warnings. Performance evaluations may be ambiguous, inaccurate or outdated. Personal health information is often found in personnel files, despite medical privacy laws requiring such data to be kept separate. Accurate and detailed records are essential for employers to defend any type of employee claim, particularly unemployment compensation or wrongful termination claims.

Prohibited attendance policies: Controlling excessive absenteeism is a big concern for most employers. However, the complexity of family and medical leave laws, with sometimes conflicting state and federal protections, has made many formerly acceptable absence control policies unacceptable. Absences affect workers' compensation, family and medical leave, disability accommodations and pregnancy laws. Companies often have attendance policies that either do not comply with relevant laws and regulations or grant employees more protections than required.
Inaccurate time records: Employers typically require nonexempt employees to punch a time clock or complete time sheets reflecting their time worked each week. The records generated by these systems typically are the employer's primary means of defense against wage and hour claims, so it is essential that timekeeping policies and practices be clearly communicated and consistently administered.

1.21 WHEN TO AUDIT

Given the resources required for a full-scale audit, most companies will not want to go through this process more than once a year; however, mini-audits that allow for some course correction can be accomplished without too much departmental pain approximately every six months. Scheduling annual checkups to maintain the discipline of a regular review is preferable to only occasional or panic audits (e.g., those that take place only when a potential problem is brewing). Another strategy is to conduct an audit following any significant event (e.g. new plans, management changes, etc.).

1.22 WHAT TO EXPECT

Flamholtz (1987) a comprehensive audit is a time-consuming and intensely focused project that may require the review of numerous documents and policies, as well as interviewing HR staff, selected employees and managers from other departments. The amount of time involved and the effort required will depend on the size and type of company, the type of information the company hopes to glean, the scope of the audit and the number of people on the audit team. A full-scale legal compliance audit in particular will cover a great deal of territory and will take longer to complete as compared with a best practices audit in which one specific practice is being benchmarked against another company's approach, or a function-specific audit in which only one key area of the company's HR practices is reviewed.

1.23 COSTS OF AN AUDIT

The actual cost of an HR audit depends on the scope of the review, the number of people interviewed and the size of the audit team. Consequently, the
expense will vary greatly from one situation to another. Suffice it to say, though, that the cost of conducting any full-scale HR compliance audit will be far less than defending (let alone losing) even one lawsuit. Some insurance carriers even provide audits as a part of their compliance programs, so it could actually be free.

1.24  WHO SHOULD CONDUCT AN AUDIT

The company's HR professionals can perform an audit in-house if they have the expertise, the time, a willingness to objectively acknowledge inadequacies in current procedures and, most importantly, the clout to make or influence the necessary organizational changes. However, if the audit is conducted with internal resources or even with an outside consultant who is a non-lawyer, everything connected with the audit is subject to discovery in litigation relating to employment practices. If a company has legitimate concerns about what its HR audit may reveal regarding the company's noncompliance with various employment laws and regulations, the company should follow fairly strict audit procedures and protocols and consider hiring outside legal counsel to conduct the audit. In doing so, the company may be able to safeguard the audit results through the application of at least one of the three legal privileges against disclosure. The team that is responsible for the audit should represent a cross-section of the organization's staff, including line staff, middle and upper management and those responsible for HR functions.

1.25  REDEFINING THE ROLE OF HR

The historical role of Human Resources has changed dramatically since its inception in the early 1900s. What began as a primarily clerical function is now a strategic partner in planning and attaining organizational policies and goals. Today's business climate puts the onus on the HR department to accept the challenge of doing more with less, while contributing value toward business objectives. Human resources also has to address the rapidly changing conditions affecting the type of employees required and their changing needs, so the function requires flexible and knowledgeable practitioners. HR strategic planning has become an integral part of doing business and it is important that human resource professionals be both professionals in the field and competent business persons.
Makhamreh, M.A. (1985), explains, in order to walk the talk of being a “business partner,” HR managers have to provide real evidence that they are having a strategic business impact. Management will often appraise, How they were doing? However, this is not always an easy question to answer. This is especially so, when it is difficult to obtain some type of objective measuring tool to determine how well a certain HR function is performing. To legitimize the claim of being “business partners”, HR managers must clearly demonstrate how HR services can accomplish the business objectives set forth by the organization. The HR function is often overlooked for audits /measurement tools, to assess its effectiveness and legal regulatory compliance. However, the HR Audit is a process that sets the stage for a true transformation in HR strategy and services. It links HR systems and services to organizational objectives while focusing on the business needs of internal customers.

1.26 PURPOSE OF HR AUDITING

Parsons, J.G. (1997), says, the purpose of the HR Audit is to conduct a more in depth analysis of the HR function to identify areas of strength and weakness and where improvements may be needed. Conducting an audit involves a review of current practices, policies, and procedures, and may include benchmarking against organizations of similar size and/or industry. Areas that should be audited include, but are not limited to:

- Legal compliance
- Record-keeping Compensation/pay equity
- Employee relations
- Performance appraisal systems
- Policies and procedures/employee handbook
- Terminations
- Health, safety and security (OSHA compliance, Drug-Free Workplace, AIDS in the workplace, etc.)
Legislation affecting all aspects of Human Resources is constantly evolving and the legal ramifications of noncompliance impact the HR department, the organization, and its employees. An HR Audit can help to ensure legal compliance while measuring the effectiveness of HR programs. There are many reasons why an HR Audit should be conducted, and the results can be used for multiple purposes. At a minimum, the results of an audit help you to determine what needs to be done, how these changes will impact the bottom line of your organization, and how to prioritize problem areas in terms of significance.

It is hoped that this manual will demonstrate how to position your HR plans to support and enhance your organization’s goals. Step confidently into your role as a strategic business partner.

1.27 THE AUDITING PROCESS

Cantera, J. Del (2000), views, auditing involves the regular and systematic examination of organizational practices and accomplishments vis-a-vis organizational objectives, company policies, legal requirements, and/or professional standards. Effective audits pinpoint the gaps between “what is” and “what should be” or “what could be.” By removing or reducing the size of the gaps, an organization can increase legal compliance, ensure conformance to established professional standards, and/or contribute to the quality improvement process. In finance and accounting, auditing is routine. Financial audits are regularly performed and their findings submitted to senior management and the board of directors. The audit typically involves a review of an organization's financial policies and practices against established accounting standards and recommended practices. The annual reports of public organizations include a statement from an independent certified public accounting firm verifying that the financial statements are truthful and comply with normally accepted practices and standards. Stakeholders rely on the independent financial audit to oversee the fiduciary role of management and the board of directors. Larger organizations rely on internal auditors to review, on a continuous basis, the operational and financial performance of the operating departments, divisions, and subsidiaries.
1.28 SUCCESS FACTORS AND OTHER ISSUES: A QUESTION OF ‘OWNERSHIP’

The very idea of an audit generates fear. In the typical scenario, an auditor, internal or external, comes in at senior management's request to examine and look for discrepancies between management practices and applicable policy or legal requirements. A formal written report to senior management usually follows. If some major discrepancy is found, remedial action, including the possible removal of the offending manager, is recommended. Here, auditors appear to act as “agents” for senior management—the client—and, as a result, are responsible primarily for performing “due diligence.” Their role is to satisfy their client's predefined needs, no more and no less. The role of the target audience—functional or operating management—tends to be somewhat passive. Fear of reprisal, real or imagined, that uncovered gaps will result in career derailment or termination becomes a strong motivator for doing things to pass the audit, and to impress upper management.

1.29 SUCCESS CRITERIA

Often, when launching an audit, the reasons for the audit are not well understood and its “success criteria,” which help identify the factors that will be used to evaluate the audit's relative merits, that is, its usefulness in improving individual and group performance, are not fully articulated. Since an audit can have multiple goals, the purposes and associated success criteria must be clearly defined and communicated up-front.

Specific purposes for an audit are:

- To examine an organization's compliance with established regulations and/or company policies.
- To explore how to better serve the needs or satisfaction of the relevant users or constituencies—management, employees, or the community.
To streamline the work processes used to carry out functional work, such as recruiting, compensation, training, benefits, etc.

- To establish an “early warning system” to spot problems or identify issues before they become crises.

- To measure continuous improvement by asking whether things have gotten better or worse as a result of a functional initiative.

Essential elements to success are:

- Clear objectives, established up-front.

- Appropriate resources, that is, staff skills, budget, and tools and materials required to plan and execute the audit.

**HR Auditing: Matrix Illustrating Relationship of Substantive or Procedural Issue to Strategic or Operational Focus**

Source: [http://www.ipma.hr.org](http://www.ipma.hr.org)

*Continuous improvement auditing* is the systematic process of identifying gaps in functional or organizational performance between what is and what could be or what should be. The output of the audit is a list of opportunities for increased effectiveness and efficiency. Service quality auditing is a specific example of
continuous improvement auditing. In this type of audit, the focus is on the alignment of the human resources unit’s response to internal customer (management or employee) demands. Alignment is defined in terms of customer satisfaction vis-a-vis the perceived importance the customer attaches to the target service. The matrix that follows illustrates the relationship of a substantive or procedural issue to a strategic or operational focus of a human resources audit.

1.30 DESIGN CONSIDERATIONS

Compliance and service quality audits are relatively easy to design and implement because they are comparative. Continuous improvement audits are more difficult to design and implement because they attempt to measure organization performance. Designing a continuous improvement audit, therefore, requires that certain precautions be taken:

- The focus of the analysis should not be arbitrary. Rather, it should follow an underlying frame of reference that is, in itself, appropriate to and derived from management practice and research.

- Given that organizational problems may come from and occur in any part or aspect of a system, the audit should comprehensively address the entire organization's “properties,” that is, the performance variables, including, for example, strategy, structure, goals, technology, and systems.

- The audit should focus on events and conditions taking place early in the causal sequence. This approach implies less emphasis on outputs (results) and more concentration on inputs (plans and resources) and throughputs” (the processes).

- The audit should be directed at areas that can yield some tangible results, as opposed to areas that are difficult or impossible to influence or change.
Objectives of HR Audit

- To find out the effectiveness of performance of HR Department
- To study about the implementation of HR policies, procedures;
- To find out the reasons for low productivity and improve HRD Strategies;
- To Evaluate the HR staffs & employee;
- To modify and Review HR system & challenges
- And to seek answers to: What happened? Why did it happen? Why did it not happen?

1.31 BENEFITS OF HR AUDIT

- Identification of contributions of HR department
- Helps identify the gaps between the current state and the standard, thereby streamlining HR work processes
• Encouragement of greater responsibility and professionalism among HR members
• Clarification of HR duties and responsibilities
• Stimulation of uniformity of HR policies and practices
• Ensuring timely compliance with legal requirements
• Reduction of HR costs through more effective personnel procedures
• A thorough review of HR information systems.

1.32 FREQUENCY OF HR AUDIT

It is best to have a HR audit once in a year. The HR audit, if conducted continuously and regularly, then it becomes a fairly managed process. The chances of drastic corrections become lower if it is conducted regularly. Usually, the frequency of the audit being conducted depends on the company. An ideal audit can be conducted every 18 months but the management must see to it that a well efficient audit is done on yearly basis. The HR audit is primarily concerned with the way the HR department is carrying out the activities assigned to it. It also assesses the competency levels of the staff of the HR department by assessing how well or how badly they performed their tasks and the net result of their actions. An HR audit at this level generally focuses on the design and development of various human resources policies and procedures and proper functioning of the human resources department.

1.33 THE EVOLUTION OF HR AUDITS: THE SECOND GENERATION ERA

Evolution is a process of change. Over the last 25 years we have seen significant change in the HR auditing process, the value derived from HR auditing, and the HR audit tools used. HR audits have evolved from a simple checklist of do’s and don’ts or periodic affirmative action plans to a comprehensive, sustainable process that: 1) is an integral part of the organization’s internal controls, due
diligence, and risk management; 2) is a fundamental activity of strategic management; and 3) uses sophisticated auditing products and consulting services. Increasingly HR audits are conducted of HR rather than by HR.

1.34 EXTERNAL AND INTERNAL FORCES

Numerous external forces and factors have had an impact on the demand for and scope of HR audits. First, in the global economy, human capital is becoming the single most important determinant of competitiveness, productivity, sustainability, and profitability. Increasingly, the organization’s human capital is being recognized as the source of innovation and a driver of business success. Thus to be effective in the global economy, HR audits must be diagnostic, predictive, and action oriented.

Second, a confluence of economic, political, and social factors, including corporate scandals, the failure of the financial industry to adequately assess risks, and increasing stockholder initiatives, have resulted in increased statutory and regulatory requirements, a call for greater transparency, and increased internal and external audit activity. Consider:

1) Sarbanes-Oxley requires effective internal controls. While Sarbanes-Oxley specifically requires effective internal financial controls, the financial and organizational costs of employment related claims and litigation can have a material effect on an organization’s bottom line; can have a negative impact on earnings per share and the organization’s valuation; and because employment litigation can negatively affects the organization’s employment brand, can impact the organization’s long-term sustainability.

2) Securities and Exchange Commission Guidelines require management to “… exercise reasonable management oversight.” If human capital is one of the organization’s most important assets — it is certainly one of the organization’s largest expenses — is it not
reasonable to expect that management applies the same level of oversight and due diligence to the management of the organization’s human capital as it does to the management of the organization’s other assets.

3) Venture capitalists, investors, and stockholders are scrutinizing organizations’ human resource management practices, processes, and outcomes and using HR audits to help them properly evaluate an organization’s human capital asset, expose liabilities, and perform due diligence.

4) Recognizing the importance of the organization’s human capital asset and the risks associated with misaligned, mismanaged, and unlawful employment practices, internal auditors and risk managers are assuming a leadership role in developing HR auditing standards and in designing and conducting HR audits.

1.35 THE FIVE CRITICAL COMPONENTS OF THE HR AUDIT PROCESS

Recognized as setting the standard in HR auditing, the new edition of the ELLA, the Employment-Labor Law Audit, the leading HR auditing tool, incorporates the five critical components of an HR audit into the HR audit process. These five critical components, which should be addressed in every HR audit, are shown and discussed below in the HR Audit Model.
1) **Activities**: The starting point of the HR auditing process is a review of the organization’s activities, that is, the tasks and actions that create or implement employment policies, practices, procedures, and programs. Activities include such actions as the promulgation of an EEO policy statement and other employment policies, and the posting of required employment posters. The Activities component of HR audits is typically evaluated by using a “checklist approach,” that is, the item is checked off when it is completed.

2) **Behaviors**: Behaviors in this context are actions and conduct that affect — either positively or negatively — the implementation or effectiveness of the organization’s policies, practices, procedures, and programs, and demonstrate the organization’s commitment to stated goals and objectives. Examples of Behaviors include: the creation of a corporate culture that values and promotes equal employment opportunities, diversity, and compliance; the visible
and unequivocal support by senior management for the organization’s diversity efforts; and the budgeting of sufficient resources to achieve EEO compliance and diversity goals. Behaviors are frequently assessed using qualitative measures, such as culture scan and employee satisfaction surveys.

3) Risk Assessment: Risk assessment is the identification of current and/or future events that have the potential to cause loss, peril, or vulnerabilities, and management’s willingness to accept those risks. Human resource management and employment practices liability related risks include: employment law and regulation compliance failures; lost business opportunities due to the failure to attract, hire, and retain top talent; intangible asset losses due to turnover and the loss of top talent and key employees; ineffective staff development and succession planning; and lower profitability due to the inability to control labor costs. HR auditing activities include assessments of the external and internal factors that impact human resource management and employment practices – including: 1) the economy; 2) legal, regulatory, and litigation trends; and 3) demographic and structural changes in the workplace and work force.

4) Internal Controls: Internal controls are processes, tests, and assessments that help ensure compliance, manage risks, identify fraud, and help ensure the achievement of organizational goals. HR auditing activities include: 1) assessments of the effectiveness and efficiency of HR management processes, policies, practices, and procedures; 2) the reliability and accuracy of HR management reporting; and 3) the level of compliance with: laws and regulations; industry and professional standards; codes of conduct and ethics; organizational policies; and budgets.
5) Outcomes: Outcomes are quantitative and qualitative measurements and metrics that measure and help assess the achievement of organizational goals and objectives. HR auditing activity includes the identification of metrics used by the organization to measure organizational and individual performance; the assessment of results by comparing actual results against projected results, budgets, and internal and external standards; and a description of the activities, behaviors, and internal controls that are needed to maintain or improve future results. The value of the HR Audit Model is that it helps organizations: 1) assess current HR management and employment practices; 2) identify and diagnosis systemic problems; 3) evaluate and predict the impact of corrective measures; 4) develop a plan of action; and 5) determine the ROI of such actions.

1.36 ESSENTIALS OF PERSONNEL (HR) AUDIT

Also in business sector is used term “performance audit”. “Performance audits are directed at organizational goals and their achievement. Author remarks not only goals but also strategies. Brock bank finds that performance is higher when HR departments focus more on strategy [Brock bank, 1999, Lawler et al. 2000, 10][21]. Previously marked can be shown graphically, by adding a Costello’s verity in Figure 1.2.

![Diagram of HR management and strategies](image)

**Figure 1.2 HR management and strategies**
It matches with the theory, which remarks, that realization of individual aims helps to reach the aims of organization. (Alvesson, 2004)[22]. The aim is to focus people on doing the right things in order to achieve a shared understanding of performance requirements throughout the organization. Though in the same is not acceptable that audit depends on questions of HR but not on strategy, goals, objectives etc. of institution. That is why it is important to understand integration of objectives, which is shown in Figure 1.3.

![Figure 1.3 Integration of objectives by Armstrong](Armstrong, 2006, 58)

Each of lower level objectives is integrated in the next level on which ones equally work different external and internal factors. It means that in audit would be necessary to look in direction from establishment strategies to HR, it also matches with the business sector audit approach. But this approach isn’t absolute because we can’t answer to questions, which appear in institution about HR management (Armstrong, 2005, 230)[23].

- Who does what?
- How can different sorts of action can be unified?
- Which communicating ways and expedients must be chiselled?
- How to make people understand what is their role in reaching the aim of organization and what roles do have colleagues?
- Do we do all what we should do and don’t do that what we shouldn’t etc.?
The key word for answering these questions is the systematic thinking [Armstrong, 2005, 230]. The organizations are systems, which as the result of environment’s efficacy get a structure, in which are involved formal and informal elements. Although there isn’t a perfect organization and it isn’t static. The most important what we can do is to optimize the process, also can’t forget that no matter what structure is forming, it is dependent of outside factors and one the aims of organization is to reach the perfect ratio between the institution’s structure and the influence of outside factors. Also without that what is remarked in previous figure, important elements are- structure, culture, systems and personnel. (Aaker, 2001, 414)[24].

![Figure 1.4 Model of analysis organization](image)

Figure 1.4 Model of analysis organization [Aaker, 2001, 414]

All elements must have a connection among them and with the strategy of institution. Systems are called as financial, information, control, planning, motivation and others. Wherewith from Figure 4 we can see, that the personnel is involved in one unified system and that it is necessary to audit in association with other affecting factors – structure, culture, system. In reviewing the organization's structure, auditors should look for red flags such as first-line supervisors with spans of control too great to be practical; middle managers with lines of authority over only one other manager, and chains of command that are not clearly designated or that reflect multiple, conflicting reporting relationships(Vito, 2008, 84)[25] A number of changes in structure and process have been advocated in order to increase business responsiveness of staff functions Mohrman, et al., 1998[26].
In the same time auditing has evolved becoming increasingly specific, until the term functional audit has emerged. The objective of a functional audit is to diagnose, analyze, control, and advise within boundaries of each functional area of the company. The Human resource (HR) audit is a type of functional audit (Olalla and Castillo, 2000, 58)[27]. Author remark, that there are two words- first function, second functional. Although there is a chance that in several cases can be meant different words, though, as both words have common origin- Latin word function, which meaning is accomplishment, action, then we can suppose that they aren’t meant as two different sorts of audits (Bouvier’s Law Dictionary)[28].

Although it is said about business sector, must be remarked that now in Latvia there are performed function audits in government. They were started because the number of employees in government is too big. In Latvia, in public sector are 31.9% of working population (This figure includes employees of all levels and types of administrative institutions). The average number of public sector employees of other countries shown is 22.4%1 (LABORSTA, 2010)[(29]. In fact in Latvia would be necessary to perform HR audit but it can’t be performed without evaluating the state’s functions and the definite functions for institution.

In all levels of function audit is involved the evaluation about personnel or HR audit. There is analyzed all possible information, which is believable and
which can be used in the time of performing audit. At first level of function audit the biggest accent is put on law analysis to appraise if the accordant institution accomplishes its functions, it also evaluates the number of employees in program level and estimates at human resource’s using in every function. The next levels are colligated with evaluation of institutions work through the prism of functions and one of the main aspects is personnel evaluation in linked with previously described systemically approach. Regardless of that in truth, performance auditing is more subjective, more like the social sciences, where constants are few, variables are many, and terms are often ambiguous (Costello, 1997, 30). Four our purposes, therefore, the „auditee” or auditee organizations” is that organizational activity mot directly responsible for achieving the performance goal under audit, and for fixing the performance problem identified in the audit”, (Costello, 1997, 30)[30]. It can’t be done by auditing only HR problem without enterprises problem. It is also approved by author’s performed functional audit in State police, where, without HR management audit, also was performed the analysis of institution’s culture outside factor influence on the institution, function and others. In the result was ascertained that, for example, can be saved up a sum of Ls1 476 804 (EUR 2 101 303) a year which is spent for indirect functions (at minimum salaries paid), (Magone and Vorončuka, 2010)[31].

The necessity of performing audits in state administration has been discussed for a long time, because the costs of government employees’ high salaries always have been the object of discussions, (McBrayne, 1990,375)[32]. However, not less important is question how to balance salaries and work productivity in business sector too. There is no point to do good the things which aren’t necessary for anyone, that means to perform functions which aren’t needed or to perform functions that, how their performing is unprofitable. About functional approach is discussed since start of previous century, when F.Taylor laid the foundations of functional approach (Taylor, 1911)[33] (Kane el.at, 2009,159)[34]. What was followed by many other authors’ views about functional approach? H.Fayol [Fayol, 1916][35], M.Porter (Porter, 1980)[36], W.E.Deming (Deming, 1982)[37] and others.
Despite, that new management methods all the time are getting improved and developed, in general about F.Taylor’s approach P.Drucer has remarked that: in time of the last 100 years every new method is based on F.Taylor approach principles. [Кане et.al, 2009,160].

From this figure, it is that visible how functional evaluation is performed in business sector. The general evaluation of institution aren’t touched, that means, by speaking in images, to evaluate the taste of a cake, is offered to taste one layer of the cake. Author remarks that by tasting one layer of cake and to compare it with its decoration, can’t reason about the cake in general. Also the same in this case about HR audit. If HR audit is performed, without evaluating other elements and it is compared visually with the institution’s strategy, can’t agree that auditor has valuable information, on which basis auditor will give correct conclusion.

No matter what apportionment of audit would be performed, the main attention must be put on audit’s systemic approach, where isn’t heeded only one audit’s object but it is reviewed with the aims of institution, also with inside and outside factors and together with other critical points of institution. One of these is institution’s or enterprises doable functions. For further discussion is worth question about audit performing in after-crisis circumstances information won’t be usable.
because the situations in before-crisis, in time of crisis and after crisis, are very
different.

1.37 Tools of HR Audit

In a Comparative Approach, another company or unit that has more
developed practices or results is chosen as the model. The audit team audits and
weighs against the audited firm’s results with the best practices of the model
organization. This approach is normally used to match the results of some certain
activities or programs. This approach is usually used for comparing the results of
turnover, absenteeism, salary data and staffing levels. It helps to identify areas for
improvement. It also makes sense to compare where a procedure is being used for
the first time (Blaird & Meshoulam, 1998)[38].

In the Outside Authority Approach, standards set by a consultant or taken
from published research findings are used as the benchmark for the audit team. The
consultant or research findings may help to diagnose the cause of troubles (Werther
& Davis, 2000). The Statistical Approach depends on performance measures drawn
from the company’s existing information system. From existing records, the audit
team creates statistical standards against which activities and programs are
appraised. With the mathematical standards as a base, the team may discover errors
while they are still minor. For example, by tracking and managing turnover and
absenteeism rates from one period to another, the team can compare and analyze the
data to see how well Human Resource and operating managers control these
problem areas. Often this approach is supplemented with comparative data from
external sources such as other firms, or industry association surveys. The
information is usually expressed in ratios or formulas that are easy to compute and
use (Martocchio, 2001)[39].

With the Compliance Approach, the auditor reviews past practices, to
determine if actions taken followed legal requirements and company policies and
procedures. The audit team here often examines a sample of employment,
compensation, discipline and employee appraisal forms. The purpose of the review
is to ensure that the field offices and the operating managers have complied with internal rules and legal regulations, such as minimum wages and equal employment opportunity laws. By sampling elements of the Human Resources information system, the audit team looks for deviations from laws and company policies and procedures. The team can then determine the degree of compliance achieved (Wright, Gardner, Allen, 2005)[40].

In the MBO (Management by Objectives) Approach, managers and specialists set objectives in their area of responsibility. Then they create specific goals against which this performance can be measured. The audit team investigates actual performance and compares it with the previously set objectives. They can then evaluate the trends in this area (Werther & Davis, 2000). In actual practice, audit teams normally use several of the above strategies, depending on the specific activities under consideration. Feedback is then given to senior management, the operating managers and the employees. Unfavorable feedback leads to remedial action and development in the contribution of the Human Resource department (Wright et al, 2005). The audit team uses a combination of several information-gathering tools to collect data about the firm’s Human Resource activities. These tools include interviews, surveys, historical analysis, external information, Human Resource experiments and international audits. Each tool provides partial insights into the firm’s activities. By using these tools skillfully, the audit team can get an insight into the effectiveness of the organization’s Human Resource activities (Noe, 2002)[41].

Interviews of employees and managers often provide audit teams with a powerful tool for collecting information about Human Resource activities and identifying areas that need improvement. Interviews can be conducted on both sides to determine the reasons for problems like turnover or absenteeism. Comments and criticisms from interviewees can help pinpoint perceptions and causes that will then form the basis for corrective action. Suggestions by interviewees may reveal ways of better dealing with the issues. Where criticisms are valid, changes should be made. Where the Human Resource department is correct however, employees may have to
be educated and trained by explaining the reasons for the procedures in place that are a cause for concern (Werther & Davis, 2000).

Exit interviews are conducted with departing employees to learn their views and experiences with the organization. Questions asked along these lines are reviewed later to find out if there is a major cause for turnover, absenteeism, dissatisfaction etc. The Human Resource department must take an active interest in exit interviews. Some employees may be hesitant to pass judgment on and speak their mind. Reasons must be studied to determine if trends exist among employees of the organizations. The scope for taking interviews is however time consuming and limited, therefore there is a trend among Human Resource departments to use questionnaires to widen the scope of their research. Survey Questionnaires may lead to more honest answers than face-to-face interviews. Attitude survey feedback can find answers to concerns (Werther & Davis, 2000).

An analysis of historical records can also reveal important trends. Compliance with laws and company policies and procedures can also be determined, as well as the success of action plans to remove points of concern. Specific areas that may be covered include employee safety and health, grievances, compensation, affirmative action, programs and policies. There may be a conflict between these laws and the organization’s practices, however a proper study and analysis is helpful to level out these discrepancies and meet the organizational goals (Grip & Sieben, 2005)[42].

External information can also be helpful in giving the audit team a perspective against which the firm’s activities can be judged. Such information can be available from various public and private agencies and government departments. Examples include wages and salary surveys, employee turnover rates, workforce projections, future employment opportunities, and accident rates by professions that can serve as benchmarks for comparison purposes. Workforce demographics such as age, sex, education and racial composition are useful in evaluation of affirmative action programs. Some information may also be provided from consultant studies and research bureau’s (Florkowski & Schuler, 1994)[43].
Another tool available to the Human Resource audit team, especially in evaluating new programs and trends on which there is no available data for comparison purposes, is to themselves conduct a field experiment. In using the field experiment, the Human Resource audit team compares an experimental group with a control group, under realistic conditions. Such experimentation is usually employed in researching absenteeism, turnover, compensation, job satisfaction and safety activities. For example, in checking the effectiveness of a job safety program, the audit team may implement a safety-training program to half the supervisors (the experimental group). The other group (control group) contains supervisors that have not been given this training. The accident rates and safety records of both groups can be compared at a later stage, some months after the safety program has been concluded. If results reveal that the experimental group has a considerably lower accident rate and better safety record, there is evidence that the safety program was effective (Martocchio, 2001).

A cost benefit analysis will also be conducted to compare the costs of the training program with the benefits to the workers and the company. However the field experiment method can have some drawbacks. Managers may be hesitant to experiment with workers because of morale problems and potential dissatisfaction among those who were not selected. On the other hand, employees involved in the experiment may feel influenced. The experiment itself may be bewildered by changes in the work environment or simply by the two groups talking to each other about the experiment. Once the audit has been concluded, the Human Resource audit team leader will compile the findings and recommendations of the audit team into a Human Resource Audit Report. This report is a comprehensive definition of the Human Resource activities and includes both commendations for effective practices and recommendations for improving practices that are less effective. Recognition of both good and bad practices is more balanced and makes room for wider acceptance of the report (Werther & Davis, 2000).
1.38 IMPORTANCE OF HUMAN RESOURCES AND IMPLICATIONS

Human resource management is a system, a philosophy, policy and practices that can influence individuals working in an organization. An effective and competitive human resource is the key strength of organizations in facing the challenges of business today. HRM is the part of an organization that is concerned with people working in an organization. Successful organizations recognize the significance of human element in the organizational success and emphasize on their development, satisfaction, commitment and motivation in order to attain desired objectives. Sustainable development of a company depends upon effective management of human resources.

In today's competitive business environment, company workforce is in a continual state of flux- skill sets and job requirement as well as the regulatory environment changes at such a rapid pace that the staff needs of tomorrow are very different to those of today. In the past decades, the HR manager has evolved significantly. The previous functional approach has been substituted for a strategic one. Human resource management is mainly focused on leadership (getting ready for tomorrow) agenda and closely integrated with the business.

HR manager now typically has a much deeper understanding of key organizational challenges, play a proactive and more strategic role and no more consigned to a reactive and administrative role. This is more desirable than what is perceived to be personnel's traditional administrative role. Ulrich even goes so far as to suggest that personnel department should be abolished if they fail to become more strategic. Now what is strategic role of HRM in an organization? Within the literature on strategic HRM, HR functions that play a strategic as opposed to a “tactics” or “administrative” role tend to be distinguished by focus on the long term, linking business and HR strategic objectives and forward planning. The presence of the HR director on the board is also regarded as significant. For HR function to be involved in strategic business decisions it needs to be at centre of power and influence within an organization.
David Ulrich (1987) has distinguished between strategic and non-strategic role. He describes four corresponding roles for HR to play within a business: a) as a strategic partner working to align HR and business strategy, b) as an administrative expert working to improve organizational processes and deliver basic HR services, c) as an employee champion, listening and responding to employees' needs, and d) as a change agent managing change processes to increase the effectiveness of the organization. One of unique things about Ulrich's approach is that it includes all of the ways that HR can deliver value to an organization, rather than shifting focus from one area to another.

Now the question arises that what are the internal and external challenges/factors that impact on the role of HR in an organization and how these factors affect HR. In today’s intensely competitive and global marketplace there are a lot of internal and external factors that affect the role of HR department in an organization. These factors are discussed below.

1.39 INTERNAL AND EXTERNAL FACTORS THAT IMPACT ON THE ROLE OF HR

Internal and external environmental influences play a major role in HRM. Organizational climate and culture, work organization and management style help to shape HR policies and practices, which, in turn, have an impact on the quality of candidates that a firm can attract, as well as its ability to retain desired workforce. The economic environment, labour market conditions and unions play a role in determining the quality and variety of employees that can be attracted and retained. There are external challenges that are dramatically changing the environment of HRM. These challenges include demographic trends and increasing workforce diversity, trends in technology, increasing government involvement in the employer-employee relationship, globalization, and changes in nature of jobs and work. After briefly describing the ongoing internal and external influences, first we will focus on the internal factors that are having the most significant impact on HRM.
**Internal challenges/factors**: In the internal environment the factors that have the most direct impact on role of HR in an organization, includes organizational culture, organizational climate, work organization, management style, staff/management relations and budget process. Organizational culture consists of the core values, beliefs and assumption that are widely shared by members of an organization. It serves a variety of purposes including communicating what the organization “believe in” and “stand for”, providing employees with a sense of direction and expected behaviour, shaping employee’s attitudes about themselves, the organization and their role. Culture is often conveyed through an organization’s mission statement, as well as through stories, myths, symbols, and ceremonies. Being aware of an organization’s culture at all levels is important because the culture defines appropriate and inappropriate behaviour. In some cultures, for example, creativity is stressed.

In others, the status quo is valued. The accessibility of management and the ways in which decisions are made are reflections of an organization’s culture as well. Having a positive culture earns critical acclaim, and has a positive impact on both retention and recruitment.

Organizational climate, defined as the way in which organizational members perceive and characterize their environment in an attitudinal and value-based manner. Organizations have personalities, just like people. They can be friendly or unfriendly, open or secretive, rigid or flexible, innovative or stagnant. The major factors influencing the climate are management’s leadership style, HR policies and practices, and amount and style of communication. The type of climate that exists is generally reflected in the level of employee motivation, job satisfaction, performance and productivity, and thus has a direct impact on the role of HR department in an organization. The positive organisational climate has a direct and positive impact on employees and organization’s performance.

Within the internal environment management style especially towards employees is another factor affecting HR role in an organization. Effective management style provides leadership that uploads the values of and creates
commitment to organization, builds the capacity for improved productivity and creates an environment that brings out the best in the staff and recognizes the value of multiculturalism. Staff-management relation serves a critical role in development and maintenance of trust and positive feelings in an organization. To establish good staff-management relation is another challenge for HR in an organization.

**External challenges/ factor:** The external environmental factors that have direct or indirect impact on the role of HR department in an organization includes economic environment, labour market condition, trade unions, demographic trends and workforce diversity, technology and legal regulations. To be effective, HR managers must monitor the environment on an ongoing basis; assess the impact of any factor and be proactive in implementing policies and programs to deal with such factors.

The economic environment has a major impact on business in general and the management of human resources in particular. Economic conditions affect supply and demand for products and services, which, in turn, have a dramatic impact on the labour force by affecting the number and types of employees required, as well as an employer’s ability to pay wages and provide benefits. When the economy is healthy, companies often hire more workers as demand for products and services increases. Consequently, unemployment rates fall, there is more competition for qualified employees, and training and retention strategies increase in importance.

The labour market is the geographic area from which an organization recruits employees and where individuals seek employment. The labour market is often different for various employee groups within an organization. While clerical and technical employees are generally recruited locally, the labour market for senior managers and highly specialized employees is often national or even international in scope. Many factors motivate candidates to seek employment with a particular organization, including type of business/industry, reputation, opportunities for advancement, compensation, job security, working condition, location, climate and other aspects of firm’s physical surroundings can help or hinder a firm’s ability to attract and retain employees. The labour market affects role of HR, because, the
labour market is not controlled or influenced by any one factor, it is unstructured and often unpredictable.

A trade union is an officially recognized association of employees, practicing a similar trade or employed in the same company or industry, who have joined together to present a united front and collective voice in dealing with management, with the aim of securing and furthering the social and economic interests and well-being of their membership. Although both an internal and external challenge, we have listed unions as an external factor because they become an additional party in the relationship between the company and employees. The company is required by law to recognize the union and with it in good faith. Trade unions affect role of HR in several ways. Management has less discretion and flexibility in implementing and administering HR policies, procedures and practices when dealing with unionized employees.

Another external factor that has an impact on role of HR in an organization is the demographics trends and increasing workforce diversity. Demographics refer to the characteristics of the work force, which include age, sex, marital status, and education level. Demographic changes are very important for HRM strategy. Different tools have to be applied to motivate older and women workforce. Similarly the lack of educated and skilled employees also affects the role of HR in an organization. Diversity refers to any attribute that human are likely to use to tell themselves, ‘that person is different from me,’ and thus includes such factors as race, gender, age, values and cultural norms. Workforce diversity has a direct impact on HR in an organization. Policies and practices must be adapted to embrace the diversity of the dominant values represented in an organization’s workforce.

Technology’s impact on HR cannot be ignored. The overall impact of technological changes is that labour-intensive blue collar and clerical jobs are decreasing, while technical, managerial and professional jobs are increasing. This shift in employment opportunities has many implications for organizations. Jobs and organization’s structures are being redesigned; new incentive and compensation
plans are being instituted; revised job descriptions are being written; and new programs are being instituted for employee selection, evaluation and training/retraining – all with the help of HR specialists.

Various laws enacted by governments have had and will continue to have a dramatic impact on employer-employee relation. Some of the employment-related legislation is aimed at prohibiting discrimination in various aspects and terms and conditions of employment, such as human rights, employment equity and pay equity. Of course these legal changes complicate life for HR professionals by imposing demanding and detailed burdens on employers.

1.40 HR AUDIT EFFECTIVENESS IMPROVEMENT PRACTICES

In today’s global competition companies focuses on profits, productivity, employee turnover, and human resource practices more than before. Most organizations devote considerable attention to human resource management, which can be defined as the process of acquiring, training, developing, motivating, and appraising a sufficient quantity of qualified employees to perform the activities necessary to accomplish organizational objectives, and developing specific activities and an overall organizational climate to generate maximum worker satisfaction and employee efficiency.

However, there is an important relationship between good HR practices, reduced turnover of employees and increased employee productivity. Further, those practices enhance high profitability and high value of the firms nowadays. A high quality, highly motivated workforce is tough for competition to replicate. To gain improvements in organizational performance is an advantage and this is mainly succeeded through effective HR management.

1.41 CHAPTER SUMMARY

The current chapter presented the information on the focused area of research Human Resources Audit and its implications in the firm’s performance, growth and development. In addition, the HR audit practices, factors influencing and
the evolution of the HR audit practices is presented in a clear manner. It also presented the detail information about profile of IT firms. With this back ground the researcher moved on to review the literature on the focus are and the studies conducted and the research gaps available to it further in the second chapter.