

## THE CONCEPT OF HUMAN RESOURCE ACCOUNTING: PROSPECTS AND CHALLENGES.

**Amar Jyoti Borah**

M.Phil Research Scholar, Department of Commerce, Assam University.

### Abstract

The idea of Human Resource Accounting (HRA) has been a debatable issue by academicians, accountants and standards setters universally. This study critically assesses the concept of Human Resource Accounting in order to unveil its prospects and challenges. It is generally accepted that human capital are important resource of the firm. The achievement and development of any firm depends on its human assets. Without human capital, the other assets cannot be functionally successful. Unless an organization has correct man, human assets, to manage its happenings sometimes it may badly fail even though it possessed with plentiful physical assets. Thus, the significance of human assets cannot be neglected. Sadly, till today universally accepted accounting principles of this important asset, viz., the human assets has not been adapted. Therefore, at this moment, it becomes crucial to give due attention on the proper development of such a significant resource of a firm. The study recommended that a universal model/approach for reporting human capital measurement should be agreed upon, while campaigns and similar publicity given to International Financial Reporting Standard (IFRS) should also be given to the application of HRA in the valuation of human capital in different organizations.

**Key Words:** Human Capital, Human Resource Accounting, IFRS, Organization, Prospects, Challenges etc.

### Introduction

The proficiency of persons must be improved in the correct direction in order to assure the rise and blooming of any firm. The person's behavior variables, like group allegiance, expertise, inspiration and capacity for fruitful interaction, transmission and decision taking showed the real strength of the institutions. It is generally accepted that human capital are important resource of the firm. The achievement and development of any firm depends on its human assets. Without human capital, the other assets cannot be functionally successful. The resources required for a firm are human, substance, tools, capital and techniques. These resources are usually divided into two parts, viz., animate and inanimate (human and physical) resources. The men, is known as the human capital, are known to be animate resources. Other resources, like, substance, tools, capital and techniques are known as inanimate or physical resources. The achievement and development of an institution depends on how best use of the scarce physical assets by the human capital. As the physical assets cannot act on their own, it is necessary here that the physical assets are being utilized in the best possible way by the human assets. Hence, the productive and fruitful employment of inanimate assets relies heavily on the standard, excellence, talent, discernment, nature and personality of the man, that is, the human capital operating in it. The meaning of Human Capital at macro level signify the overall value of all

the element such as capability, innovative skills, creative judgment, instinct, vision, perception, knowledge and practical experience of all the man. Unless an institution has correct man, human assets, to manage its happenings sometimes it may badly fail even though it possessed with plentiful physical assets. Thus, the significance of human assets cannot be neglected. Sadly, till today universally accepted accounting principles of this important asset, viz., the human assets has not been adapted. Therefore, at this moment, it becomes crucial to give due attention on the proper development of such a significant resource of a firm.

### **About Human Resource**

Human Resource refer to the individuals or personnel or workforce within an organization responsible for performing the tasks given to them for the purpose of achievement of goals and objectives of the organization which is possible only through proper recruitment and selection, providing proper orientation an induction, training, skill developments, proper assessment of employees (performance appraisal), providing appropriate compensation and benefits, maintaining proper labor relations and ultimately maintaining safety, welfare and health concern of employees, which is process of the human resource management.

### **About Human Resource Management**

Human resource management involves developing and administering programs that are designed to increase the effectiveness of an organization or business. It includes the entire spectrum of creating, managing, and cultivating the employer employee relationship.

For most organizations, agencies, and businesses, the human resources department is responsible for:

- Managing job recruitment, selection, and promotion
- Developing and overseeing employee benefits and wellness programs
- Developing, promoting, and enforcing personnel policies
- Promoting employee career development and job training
- Providing orientation programs for new hires
- Providing guidance regarding disciplinary actions
- Serving as a primary contact for work-site injuries or accidents

### **The Concept of Human Resource Accounting**

In order to get more insights into the theory of HRA, one needs to look at the few important definitions stated by the some proficient researcher in the related area. In economics we find Men, materials, land, money and the entrepreneur is the main elements of production. The financial statement or annual reports of every undertaking recorded land and capital however they did not give much importance to the men and entrepreneur and hence, they only represent a charge against the profit made by the organization. The two factors, labor and entrepreneur, are the human assets or resources organizations have.

From another point of view, HRA is an expansion of the existing “Expense recognition principle” or “Matching Principles” that requires revenue to be matched with expenses incurred to earn that amount of revenue and of organizing data to communicate relevant information. This effort to quantify Human Assets value assists the management to deal with the changes in

its quantity and standard in order to achieved balance between the needed resources and the benefit derived from such resources. The American Accounting Association in their report **(The Accounting Review, 1973)** defined Human Resource Accounting as the method of determining, quantifying and reporting information's relating to human assets so as to promote productive management within a firm. Human capital can be stated as the knowledge which the employees obtain during the course of their service life and use to manufacture services, goods, skills or ideas in different situations. This definition taken into consideration the HRA as the method of identifying and valuation of human capitals in order to help the firm for effective and efficient management. The concept is however incomplete because it is not distinct as to what constitute the Cost of Human Capital and how to identify it.

#### **A review on Human Resource Accounting Models**

According to **(Lev & Schwartz, 1971)** Present Value of Future Earnings Model, assist to calculate the present value of future earnings of human assets. The process of valuing human assets is based on the current worth of the future incomes, adjusted for the likelihood of human capitals demise/retirement/disconnection.

The development and advancement of the present value of future earnings model is called as the stochastic rewards valuation model. This model is developed by **(Flamholtz, 1971)**. It is based on estimates of expected future services which was a major constraint of the earlier model. This model focuses on measurement of a person's value to a specified institution. It is acknowledged that a teaching faculty creates value for an establishment as he takes over and performs separate character and provides services to the academic establishment. The worth of human capital of the establishment is calculated by gathering the value of anticipated future earnings of all the academicians for the particular time period.

The Flamholtz's model of stochastic rewards valuation recognizes the main elements which ascertained the worth of a person to the firm. By using this model we can see how an individual creates value for a firm as the individual engaged and perform various duties and renders services to the establishment. The transfer of individuals from one organizational job position to a different job position is called as stochastic process. Based on the above mentioned theory, an individual's expected realizable value for a firm considering the probability of his remaining service life in the firm, can be ascertained as the discounted mathematical expectation of the monetary value of the future services.

To calculate the value of a person to the firm, this model proposes a five step approach.

- Prediction of the duration of time an individual may stay in that particular firm i.e., the expected service life remains.
- Identify the position that the individual may occupy in future and the time when he may exit the firm i.e., identification of his service states.
- Assess the value extract by the firm when an individual takes over any specific service state for particular time duration.
- Assess the probability of occupying all possible mutually exclusive particular position at prescribed time period.
- Discounting the expected service benefits to their current value at a specific predetermined rate.

The model proposed by Flamholtz is the best scientific model theoretically as it focuses more on the future oriented economic worth of human resources. But practically, to adopt this model and collect required data is a very challenging task as the information required to calculate the HR value to the organization like service state value, expected service life remains of the individuals and probability of takes over any particular service state in future course of time is a very difficult job.

The Jaggi & Lau (1974) proposed a model for Human Assets valuation which advocated the estimation of Human Assets bases on groups. According to this model group means the team of homogeneous employees. In the case of academic institution it may be the group of faculty members, who are in the same position. It is hard to forecast a person's expected service life remains at a specific place or designation; on the other hand it is much easier to determine the amount of individual in a specific group who are probably leave the organization in coming days or may got promotion to higher designation.

The Model on Human Resource Accounting prescribed by **(Ravindra, 2010)** prescribes Human resource accounting parts model as aggregate value of the following;

1. Expense of actual capital
2. Current value of future earnings
3. Performance assessment

The Value to the organization Model Proposed by **(Hekimian & Jones, 1967)** revealed that where an institution had various sections searching for the same individual, the individual must be allocated to the topmost bidder and the offer amount included in the same sections investment foundation.

Hermansons un purchased Goodwill Model describes the value of human assets of an institution possibly evaluated by maximizing salary and wages in excess of normal incomes for companies of which the organization is a part.

Moreover Hermenson (1964) has proposed a model know as adjusted discounted future wages model through which the value of the employees is measured by using efficiency ratio by discounting the future earnings with an adjustment.

**(Hekimian & Jones, 1967)** have advanced a model for human valuation which is known as Competitive Bidding Model, by which the managers of profit bid for the services of worthy workers of their different sections. The highest bid amount has been taken as the value of the worker because it would show the estimated present identical of the optimal utilization of the workers services between the profit centers.

The economic value model of Brummet, at al (1968), recommended several measures of human assets comprises of an economic value notion including various elements like predicting future rewards, the discounting of these predicting future incomes and collaboration of this nearly with all other assets including human assets according to the calculated share.

(Likert, 1967) a behavioural scientist, has proposed a new model of HRA which is based on group methods or bilateral methods between HR, known as causal, intervening and end-result model. The Likert's model is focuses on calculating associations between three group variable called as casual, intervening and end result variables. The phrases suggested long term cause and effect association which was recorded in detail through his study.

Yet in another model, in which he researcher taken into consideration both expense and reward aspects of the worth of the human assets to a firm. This model can work fruitfully when rewards or benefits of the employees are willingly estimated or determined. Still so application of this model may create some serious difficulties in various circumstances where the rewards to the institution relating to particular persons are hard to estimate and quantify.

### **Prospects of Human Resource Accounting**

From the point of advertisement for a particular post to the point of departure, organizations do commit some financial resources to the employee. Many reasons culminated into the spending nature of organizations on their human resources. (Abubakar, 2006) identifies that getting the best human brain, achieving the pre-determined objectives of the organization, Commanding Respect in the Eyes of Stakeholders, gaining Competitive Advantage, Becoming the Pace Setter and Market Leader are some of the reasons why organizations do invest a lot of financial resources on their human capital. However, (Lau & Lau, 1978), (Steffy & Maurer, 1988), (Roslender & Fincham, 2001), and (Williams & Leffingwell, 2002) also revealed areas through which organizations invest money relative to their human resources. The identified areas are Advertisement, Recruitment and Selection, Familiarization and Training, Training and Development, Medical and Entertainment. (Sveiby, 2017), argued that organizations acquire Human Resources to generate future revenues, and therefore Human Resource must be take into consideration at the time of measuring a firm by taking advantage rather expensing them in the present financial year. According to him human capital, intellectual capital and structural capital concepts are similar to other assets. Human resources is largely seen as an integral part of the firm's value – creating processes as well as creating and maintaining competitive advantage. In today's dynamic business environment, firms invest heavily in human capital assets. The problem however, is that these investments are either immediately expensed in the financial statement or arbitrarily aromatized and therefore are not fully reflected in the balance sheet. Consequently, the book values of firms with significant amounts of human capital investments are unrelated to the market values. The chartered institute of management accountants noted that all drivers of performance and value should be provided to investors including the non financial ones such as intangibles. The financial Accounting Standard Board (FASB) addressed this issue by encouraging business to voluntarily disclose information regarding their intangibles and intellectual capital.

### **Challenges of Human Resource Accounting**

The following are the hurdles which make it hard to report and disclose the values of human assets by the organizations.

(a) The foremost barrier for reporting human assets outside of the company is that the data shared might be sympathetic to the organization and considered as anything which shouldn't be reported to the outside of the business because it may create a unfavorable image on the

minds of the stakeholders or the data shared might provide significant information's to the rivals.

(b) As stated by **Gates (2002)** the businesses did not give initial preference to the interpretation of the value of the human resources instead they give more importance to the crucial matters like HR requirement and allocation.

(C) Further from **Gates (2002)** point of view about the acceptance of HRA practices is the absence of generally accepted method to measure and reporting the same accordingly outlining the norms that might agree to valuable, significant and relevant comparisons. As presently there is a lack of generally accepted definition of HRA, the businesses that are sufficiently provident to calculate, accomplished it in their own method.

From another perspective, **(Josrotia, 2004)** focused at the recent trends in the HRA area and developed few element which discourage the progression in the field and the implementation of the concept are low level of awareness and acceptance of HRA, absence of an industry standard, Extensiveness of the Research Involved, Strength and passion of few businesses like the IT is extremely dynamic because of repeated invention and technological development. On another viewpoint, human resources, according to **(Kodwani & Tiwari, 2007; Abubakar, 2006; Josrotia, 2004; Flamholtz, 1974; Roslender R. , 2004)**, have certain notable quality, which leads to construct their measurement very different. These qualities include the uncertainty of the service life because the free movement of the human assets at any time they accordingly want. An HR can leave his work for a different job at any moment without any intimation. They also identified some special attributes of human resources which make their valuation so peculiar and problematic. These attributes include:

- i. Uncertainty of the service period- because of the free mobility of employees, an employee can leave a job for another one at anytime without notice.
- ii. Uncertainty of the contribution level of employees- an employee's contribution level is too difficult to be estimated and forecasted with much reliability because employee productivity fluctuates and depends on many factors.
- iii. In valuing human resources, the payments in terms of salaries and/or wages count to a large extent. An employee that is valued in terms of the future salaries and wages determined today may have his value affected whenever the government changes policy affecting his reward system, or whenever there is an action from the workers union regarding the reward system.

### **Conclusion and Recommendations**

Human Capital at macro level signify the overall value of all the element such as capability, innovative skills, creative judgment, instinct, vision, perception, knowledge and practical experience of all the man. Unless an organization has correct man, human assets, to manage its happenings sometimes it may badly fail even though it possessed with plentiful physical assets. Thus, the significance of human assets cannot be neglected. Sadly, till today universally accepted accounting principles of this important asset, viz., the human assets has not been adapted. Therefore, at this moment, it becomes crucial to give due attention on the proper development of such a significant resource of a firm therefore, the study recommends that campaigns and similar publicity given to International Financial Reporting Standard (IFRS)

should be given to HRA application by the appropriate bodies. As a way forward, there is need for more empirical studies to examine the impact of HRA information on investors' decision making, and also the utility of HRA as a managerial tool for decision making on human resource acquisition, utilization, development, and retention.

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