

## **COST-BENEFIT DRIVEN APPROACH TO HUMAN RESOURCE ACCOUNTING**

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### **Abstract**

*Companies the world over follow the axiom of earning maximum returns on all the investments made in the business. In line with the expectations of the investors and shareholders, all the resources have to be gainfully deployed and optimally utilised so as to maximise profitability as well as wealth-creation. Among all the productive assets, human beings are the most important asset for any organisation. However, seldom do the balance sheets reflect this. The bottleneck is absence of a single universally accepted valuation model of human resource or any widely accepted accounting method to record it. This paper suggests a suitable human resource valuation model and its method of accounting in the books of a company. Human resource expenses and human resource investment have been used to explain the model and to reveal the same in the books of accounts.*

**Keywords:** Human Resource Investment, Human Resource Valuation, Government Accounting.

### **INTRODUCTION**

Judicious use of physical assets is imperative for the success of any business organisation. Over the last few decades, though, there has been a growing realisation that the human being is the most important productive source in an organisation. It is the cornerstone of the success or failure of any modern business organisation. The quality and productivity of its human resource (HR) has a bearing on financial as well as non-financial performance of a business organisation. Even physical assets and all other resources, i.e. non-human resources can also be optimally if the human resource is subject to judicious use. Human resources bring with them knowledge, experience, special skill sets, and innate strengths which are used to their fullest extent to produce goods or services of the highest calibre. To put it more succinctly, human resources represent the value of the productive capacity of the people working in a company or any organisation. In spite of their unparalleled importance, the conventional accounting practice has sordidly ignored the human workforce as a core element and hence it is not shown in the financial statements. There is a very cost involved in imparting training the workforce but it is not reflected as an investment in any part of financial statements nor it is shown in the Balance Sheet as a valued productive asset.

### **CONCEPT OF HRA**

Human Resource Accounting of the American Accounting Associations defined human resource accounting as “the process of identifying and measuring data about human resources and communicating this information to interested parties”. Stephen Knauf defined HRA as “the measurement and quantification of human organisational inputs, such as recruiting, training, experience, and commitment”. Eric G. Flamholtz explained human resource accounting as accounting for people as organisational resources.

### **LITERATURE REVIEW**

There is plethora of research work carried out on the subject work. They have so far remained inconclusive with regard to the method of valuation or method of disclosure in the books of accounts. The following are some of the major studies in this field: Gupta (1988) conducted a study on human resource accounting. The study showed various methods of measuring HR, limitations and benefits of HR. The study suggested that the accountants along with social scientist should take initiative to develop a system of measuring value of HR to the organisation.

Milost (1999) has given an insight into the attitude of accountants and directors of various companies towards human resource accounting. His work revealed that very few accountants believed to be acquainted with the main of idea of human resource accounting. While accountant showed the negative attitude, the reverse attitude was shown by directors. Verma (1999) carried out a study on human resource accounting practice in public undertakings in India. He proposed a valuation model for measuring value of human resources. Flamholtz (1999) conducted a study to develop valid and reliable method of measuring the value of HR of an organisation. The study examines the concepts and methods of accounting for people. The study shows the accounting for HR costs. Prakash (2000) under took a study on disclosure pattern of human resource accounting information in public enterprises in India. The study also revealed the limitations of human

resource accounting practices of the companies selected under study. Kolay (2000) carried out a study on accounting for human resource managers. It was observed that human resource cost classified into two category viz. Human resource expenses and human resource in non-profit oriented organisation. The study revealed the proposed balance sheet of non-profit oriented organisation where human assets are disclosed in the balance sheet. Kumar & Awasthi (2018) carried out a study on human resource accounting and organisational performance. The purpose of the study was to establish the relationship between them. The study revealed that the performance of the organisation is affected by its human resources. A large number of studies have so far been conducted to develop models for valuation of HR of an organisation. But every model has its own limitation. There is neither any generally accepted valuation model nor generally accepted principle for recording and presenting HR information in the financial statement. Absence of HR as an asset in the balance sheet violate the accrual principle, discards matching principle, defies the principle of disclosure and under rates the firm's net worth and current income. The profit & Loss account and Balance Sheet are not reflecting the true and fair view of the business enterprise. In the backdrop of all these studies, this paper suggests a new model for valuation and treatment of HR in the books of account.

## OBJECTIVE

The main objective of the paper is to develop a cogent model to measure the value of human resources and to find a logically sound and acceptable way of recording and measuring human resources and accommodating them in the financial statements.

Research Methodology as delineated in the literature review has been replicated in this paper.

## BASIC PREMISES

HRA like other utopian accounting concepts uses the following assumptions:

1) HR is just like other productive resource and hence provides tangible benefits to an organisation 2) Acquisition of HRs involves an economic cost and the benefits associated with such resources can personally be expected to contribute to the economic effectiveness. It follows, therefore, that these benefits are essentially economic in nature and are subject to measurement in financial terms. It is therefore possible to measure HR expenses and HR investment 3) It is theoretically possible to measure HR costs and benefits within an organisation. 4) Human assets like other accounting assets do provide economic benefits which can be objectively verified and measured.

## MODELS OF HUMAN RESOURCES VALUATION

Many experts have suggested different models to measure, value and record HR which have been briefly furnished here to set the research process in proper perspective. They may be broadly divided into the following five categories: Cost based approaches or models, Opportunity cost models, Economic models, and Behavioural based models apart from other models using more or less the same method or approach for measuring HR.

In cost based models the historical cost is considered as the basis for valuation of HR. The proponents of this model are Brummet, Flamholtz & Pyle, Woodruff Junior, Gustafson etc. As revealed by the cost based models, the expenditure incurred for the acquisition, recruitment, selecting, training and development of an employee by an organisation is taken into consideration to measure the value of HR. Likert proposed the use of socio-psychological measurement technique for the valuation of HR. Periodic measurements are carried out on the behaviour and technical proficiency of the managerial staff, the resulting effect on subordinates in terms of motivation, loyalty and behaviour, communication, decision making and controlling process of the organisation. An interesting method advocated by Hekimian and Jones in 1967, known as opportunity cost method. The value of HR is determined on the basis of value of an individual employee in alternative use. This method suggests 'competing bidding price' for computing value of HR. Economic Value models are based on the present value of the set of future services which is expected to provide by an employee during the service period in the organisation. Proponents of this model are Hermanson, Lev and Schwartz, Flamholtz, Giles & Robinso, Friedman & Lev etc. The present value of HR computed on the basis of discounted price forecasts of predicted earnings from employees. Findings of the Study The model is basically developed on the valuation model as suggested by Lev and Schwartz in 1971. An attempt was made to modify the approach by taking into consideration the human resource productivity factor and also the expenses like recruitment, selection, training and development etc. it is a comprehensive approach considering the limitations of Lev and Schwartz's model and shortcomings of current Indian practices of human resource accounting. Under Lev and Schwartz's model, the value of future earnings of employees till retirement is found out and then discounted at the rate of cost of capital to arrive at its present value. But this value does not consider the productivity factor which is one of the most important aspects of an organisation. Therefore, productivity should be included in the valuation of human resource. Another notable limitation of this model is the treatment of expenses like cost of

recruitment, training, development etc. Actually these expenses are incurred for future benefits. Hence, to consider this cost as revenue expenses is against the matching principle. Such costs should be regarded as human resource investment instead of human resource expenses. Therefore, human resource value (as suggested by Lev and Schwartz) should also be modified by inclusion of expenses like recruitment, development, training etc. here an attempt was made to find out the modified value of human resource by inclusion of productivity factor and also the cost of recruitment, placement, selection, initial training and development etc. as human resource investment for each grade of employees. A productivity index may be prepared for measuring the work performance of employees from their immediate supervisor(s) from each grade of employees. Though productivity of an organisation depends on various factors, we may measure it by considering the efficiency level of the employees. A group wise standard output or performance should be fixed by the top-level management and actual performance should be compared with the standard.

In order to facilitate implementation of the alternative model for valuing human resource HR costs must be classified as HR expenses and HR investment.

Wages and salaries related to current services should be taken as HR expenses, whereas as all expenses incurred on recruitment, selection, placement, initial training and development etc. related to future services should be categorized as HR investment. Therefore, it should be considered for valuation of HR as an asset.

The value is measured by the use of the following formula:

$$V_r = t$$

$$\sum I(t)$$

$$t = r(1+r)^t - r$$

Where,  $V_r$  = the human asset value of a person  $r$  years old

$I(t)$  = the person's Annual earnings up to retirement

$r$  = A discount rate specific to a person

$t$  = Retirement age. Alternatively,

$$\sum_{i=1}^t P(S_i) = 1$$

Where,  $SI$  = Services expected from the individual on each service state.  $P(S_i)$  = The probability that the individual will occupy a particular service state.

After factoring in the necessary changes and suitable revisions, a new model which also includes productivity factor as well as investment in HR can also incorporate the following variables:

$T$  = Employee's retirement age,

$x$  = Age when a person join the service or the year first valuation,

$I(t)$  = Employee's annual earnings up to retirement considering the probability of death,

$r$  = Discount rate ( it may be cost of capital for profit seeking concern or market rate of interest on fixed deposit for non-profit seeking or financial institution) to capitalise the earnings of the individual,

$P_i$  = Productivity index (measured comparison of performance)

$K_i$  = HR investment cost.

HR investment cost may be amortized equally throughout the average service life of employees.

## CONCLUSION

The suggested model does not compete with the other human resource valuation models. Its main aim is to make the human resource valuation process more accurate, comprehensible, effective and acceptable. The suggested accounting approach can be followed by the conventional accountants easily in the books of accounts. The accounting equation and double entry system would facilitate disclosure of human resources more transparently provided proper model is identified and implemented based on congruent objectives and premises. The suggested approach may also help to comply fully with the accrual principle, the matching principle and the principle of disclosure.

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