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Human Resource Accounting – An Indispensable Aid to Improve Quality of Management

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Abstract

In general sense, human resource means the energies, skill and knowledge of people which are, or which potentially can or should be applied to productive activities. More specifically, human resources comprise the value of the productive capacity of a firm's human organisation. In other words, human resource refer to the aggregate of employees attributes including knowledge, skill, experience and health which are presently and potentially available to an organisation for the achievement of its goals. The system of HRA would no doubt, pave the way for increasing productivity of the human resources, because, the fact that a monetary value is attached to the human resources and that human talents, devotion and skills are considered as valuable assets and allotted a place in the financial statements of the organizations, would boost the morale, loyalty and initiative of the employees, creating in their mind a sense of belonging towards the organization and would act as a great incentive giving rise to increased productivity. Moreover the adoption of the system of HRA discloses the value of human resources. This helps in proper interpretation of Return on Capital Employed. Such information would give a long-term perspective of the business performance which would be more reliable than the Return on Capital Employed under the conventional system of accounting. Thus through this conceptual paper the researcher tries to justify why human resource accounting is an indispensable aid to improve the quality of management in the organization.

Key Words: Assets, Appreciation, Human Resource Accounting, Management, Quality

Introduction

Human Resource Accounting is the process of identifying and measuring data about human resources and communicating this information of interesting parties. It is the process of developing financial assessments for people within organisation and society and the monitoring of these assessments through time. It deals with investments in people and with economic results of those investments. Thus, it essentially involves; (a) measurement and valuation of human resources, and (b) communicating the relevant information to management and external users. Stephen Knauf defined HRA as "the measurement and qualification of human organisational inputs, such as recruiting, training experience and commitment." Eric Flamholtz explained human resource accounting as accounting for people as organisation resources. It is the measurement of the cost and value of people for the organisation. Human Resource Accounting may also be defined as the measurement and reporting of the cast and value of people as organisational resources. It involves accounting for investment in people and their replacement of the costs, as well as accounting for the economic values of people to an organisation

Literature Review

This section presents review of related and relevant available literature at home and in abroad to find out the research gap, formulating research questions and to limit the scope of the present research. The outcome of the review of literature is summarized below keeping an eye on the above needs. HRs are truly the most valuable resources because effective utilization of physical and financial resources depends on quality of HR (Makwana, 2016). The resources aboundly available in South Asia is their human capital which could be transformed into a precious asset through reforming existing education and technology (Almas, 2016). The HRs are an indispensable but often neglected element is thus to be fore grounded into the educational area for the betterment of the society. Society has high expectations from educational institutions, which cannot be met without the development of efficiency and behavioural patterns of those working in these institutions (Arora, 2016). HRA is viewed as the process of identifying, measuring and communicating information about HR to facilitate effective management within an organization where, the various decisions relating to hiring, training, developing, conservation, recruiting, allocation and selection of employees have to be made by the top management of any organization (Ijeoma et al., 2017). Skilful and specialized HR is of vital importance for an organization just like its physical properties and investments. Managers of the organizations spend a lot of money for training and educating their workers and employees to increase the efficiency of the organization under their control, but HRA system which should be used for HR information processing have not been used practically by any organization in Iran (Avazzadehfath and Raiashekar, 2015). HRA is a tool that can be used for reporting people as organizational resources in both financial and managerial accounting terms (Steen and Welch, 2013). HR is one of the most important back office operations of any organization or business. Their skills human cannot be replaced by machines. We can lose efficiency in work if no qualitative people. At all levels and areas of the business or firm human efficiency is required with machine efficiency. Human can work without machine but machine cannot (Pandurangarao et al., 2017). Over the last two decades, the idea of accounting for HR is gaining active consideration. Hence, HRA is not a new issue in economics. Economists consider human capital as a factor of production, and they explore different ways of measuring its investment in education, health, and other areas. Accountants have recognized the value of human assets for at least 70 years (Avazzadehfath and Raiashekar, 2015). HRA is an attempt to identify, quantify and report investment made in HRs of an organization that is not presently accounted for under conventional accounting practice (Alam and Kanti, 2014). HRA system can be used to take a variety of decisions in the area of HR management. However, the number of organizations that have adopted HRA system in India is low as it is not compulsory for the Indian organizations to value HRs (Makwana, 2016). The major benefits of such accounting are that it develops effective managerial decision making, quality of management, prevents misuse of HRs, increases human asset productivity, improves morale, job satisfaction, and creativity, etc. The constraints involved are that uncertainty of HR creates uncertainty in valuation of HRs. Nature of amortization is another difficulty; valuation of HRs, their accounting treatments is also difficult as there is no specific IAS/IFRS for such treatment (Islam et al., 2017). However, the importance of HRA has long been recognized by the accounting profession because the aim of HRA is to contribute to the management of the organization by optimizing the value of its human assets (Steen and Welch, 2011. p. 57-58). Ripoll and Labatut (1994, cited in Mamun, 2013. p. 36) identified two reasons for including HRA; first, people are a valuable resource to a firm so long as they perform services that can be quantified, and second, the value of a person as a resource depends on how he is employed. So management style will also influence the HR value. Business enterprises often proclaim that their labour force is their most important asset, while at the same time they fail to recognize it in managerial planning, decision-making and in published annual reports (Avazzadehfath and Raiashekar, 2014). Accounting and finance managers do not agree with the HR evaluation proposals. As a result, HRA asset supporters have failed in terms of implementing HR practices. The main reason for their objection is that the proposed HRA practice is extremely varied from the known HR evaluation techniques, and thus it is difficult to show that employees meet two tests of an asset (Cherian and Farouq, 2017).

Objections against the Treatment of People as Assets

There are several objections to the treatment of people as assets in accounting sense but they have been by and large over-ruled. They are: The first objection is that the people are not owned by the organisation like other physical properties. It is true that people cannot be regarded as slaves or chattels in a modern society. But, it does not imply that the potential benefits of skilled manpower should not be assessed. There are many organisations where investment in physical non-human capital is negligible, and most of their earnings are derived from the skill and ability of experienced personnel. If the return on investment in any such organisation is calculated on the basis of only physical, non-human capital, the rate of return would be unbelievably high. Take for instance, the organisations or consultants, architects and designers, trading firms. The human assets constitute their real and major earning base. The rate of return on investment in these cases, calculated with only gross fixed assets taken as denominator, would show unrealistic scores if the value of human asset is not included. Another argument is that there is no assurance of future benefits from human resources. This argument is also not tenable. When fixed assets like plant and machinery are procured, the cost incurred is the estimated potential value of the benefits likely to be derived. Uncertainties of changes in technology and production process and premature obsolescence of machinery are taken into account while assigning their potential benefits and service life. There is no reason why human asset should not be amenable to the same treatment. One more objection to human resource accounting is that it may not be recognised by tax laws. This objection again cannot be sustained. In actual practice even now the profit and loss accounts prepared on the basis of existing conventions and concepts have to be redrawn for tax accounting purposes. It should thus be possible to overcome the difficulty of tax laws by incorporating the value of human resources in the financial statements, while accounting for tax purpose may be separately taken care of.

Need for Human Resource Accounting

The need for human resource accounting arose primarily as a result of the growing concern for human relations management in industry since the sixties of this century. Behavioural scientists concerned with the management of organisations pointed out that the failure of accountants to value human resources was a serious handicap for effective management .One of the most important aspects of the business manager's job is the use of resources to achieve the immediate and long run goals of the organisation. This requires resources information of many kinds. The human beings constitute an important asset for an organisation. Without people in an organisation physical and financial resources cannot be operationally effective. But no information about organization's human resources is available to managers in conventional accounting. The measures of the income which are provided in the conventional statements do not accurately reflect the level of business performance. Expenses relating to the human organisation are charged to current revenue instead of being treated as investments to be amortised over the economic service life, with the result that the magnitude of net income is significantly distorted. For that reason conventional balance sheets fail to reflect the value of human assets and hence distort the value of the firm and the rate of return of investment. Distorted measures render assessment of firms and inter-firms comparison difficult. Conventional treatment of investments of human resources may lead to the erosion of investor's interest through management decision harmful to the long run success of an organisation and to the investor's equity. Traditional accounting involves treatment of human capital and non-human capital differently. While non-human capital is represented by the recorded value of asset, there is no record of human asset corresponding to the human capital of the organisation. But the human asset constitute a vital part of the total capital, in as much as productivity and profitability to business firms largely depend on the contribution of human assets. Two firms may be engaged in the same line of business, use identical physical asset and operate under similar market conditions, but the end results in term of growth and profitability may be quite different due to differences in their human assets. Since the value of human capital is ignored in traditional accounting practice, real assessment of the total value of a firm is not possible. Expenses incurred by a firm on recruitment, training and development of employees are treated as current costs and written off against current revenue in-the conventional accounts. Expenses on employee welfare and amenities as well as incentive payments for improving efficiency are similarly treated under the presently system of accounting. But, all these expenses are essentially of the nature of investment as the resulting benefits are more often derived over a period of time beyond one year. The conventional treatment of these expenses lead to a general inclination on the part of managers to keep down expenses on human development on welfare. The immediate saving in costs and the resulting profits are achieved neglecting the long-run impact of such a policy on the motivation and morale of the employees.

Current practices with respect to Human Resource Accounting

The measurement of inter-temporal results of business in terms of profit or loss is primarily based on the classification of all transactions into two groups: (a) Capital, and (b) Revenue. In between these two, some items of revenue nature are treated as "Deferred Revenue Items" to avoid distortions in the periodical results due to inclusion of extra ordinary large sums of revenue nature. On the other hand, some items of capital nature involving relatively small amounts, are treated as "revenue items" as a compliance with the "principal of materiality". The items classified as "capitals" are actually assetised for the time being and they continue to appear on balance sheets of successive years till they are fully written off to profit and loss account through depreciation or amortisation. However, this is only a technique of inter- period allocations and in the long- run all capital items also become revenue items. The current accounting practice, as it relates to human resource, generally treats all cost related to human resource as of "revenue" nature. Typical balance sheet of any business concern does not disclose "human assets". All expenses related to recruitment, training, familiarisation and development of human resources are charged against the revenue of the relevant accounting period in which they are actually incurred. This is done despite the fact that the benefit accruing from such expenses relate to several accounting periods. Accountancy, justifies this obvious violation of the "accrual principle" on grounds of the adherence to the "principle of conservation." They argue that one is never sure about the realisation of future benefits from such benefits due to uncertainly of the tenure of an employee. Hence, it is proper to treat such expenses as revenue expenses. It would be quite pertinent to note that although no separate head like "Human Resources" or "Human Assets", appear on a balance sheet, accountants are not totally unaware of the existence of the value of human resources. They recognise it in the process of valuation of goodwill along with several other factors. However, they do not favour periodic valuation of goodwill and its disclosure in balance sheet as part of the regular valuation process. On the contrary, they favour amortisation of even the cost of purchased goodwill when profits are sufficient to permit it. Thus, the value of human resources is written by amortisation of goodwill when it is actually increasing.

Conclusion

Thus this paper signifies that by charging expenses of recruitment, training and development of human resources to current period's profit and loss account, profits during that period are understated or losses are overstated. By doing so the boundaries of principles of conservatism are stretched beyond its logical limits and even at the cost of ignoring the tenet of accrual. By not capitalising expenses relating to human resources, even when they are substantial, the assets are concealed and net worth is understated to that extent. The combined effect of the foregoing to points would be a blatant negation of the cardinal principal of true and fair disclosure in published accounts. By writing off goodwill when profits are rising, accountings create secret reserves. Though physical assets are fully recorded under the existent system, human assets are ignored in the internal as well as external reports. This leads to faulty evaluation and decisions. By not valuing human resources, depreciation of human assets is also ignored. It is a stark reality that human resource deteriorates in terms of its efficiency and productivity due to several indigenous and exogenous man-made factors. Had there been any attempt to systematically measure and report the "depreciation' or "appreciation" of human resources, the quality of management would certainly improve.

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