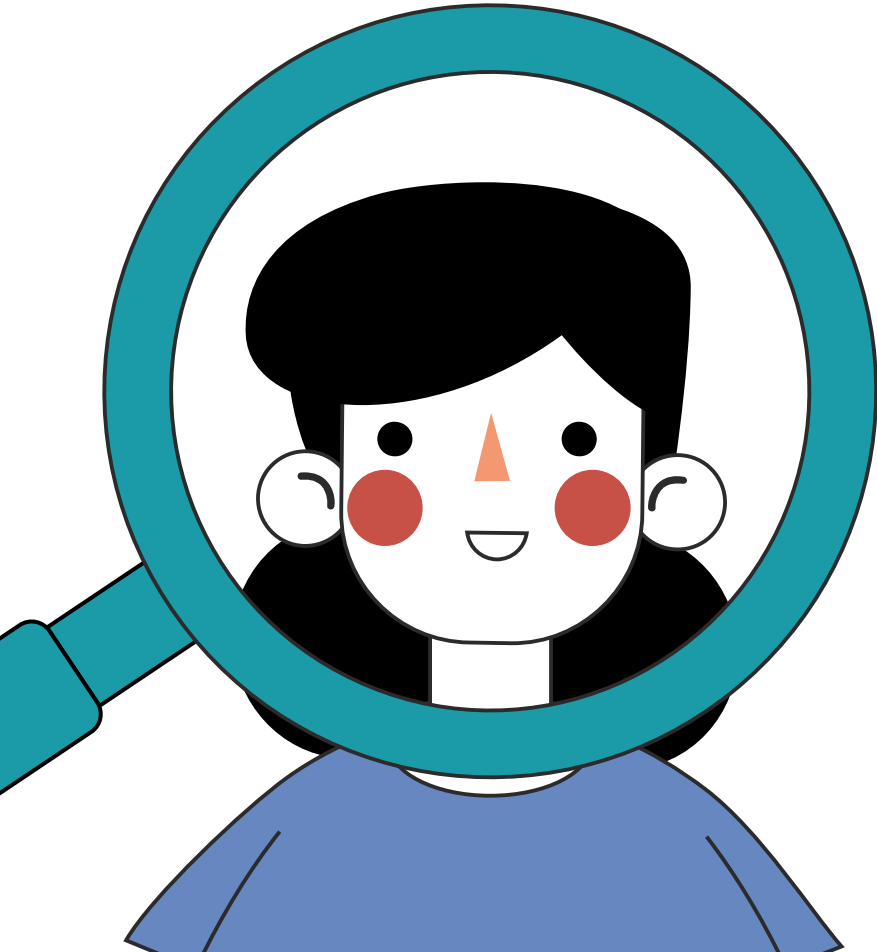
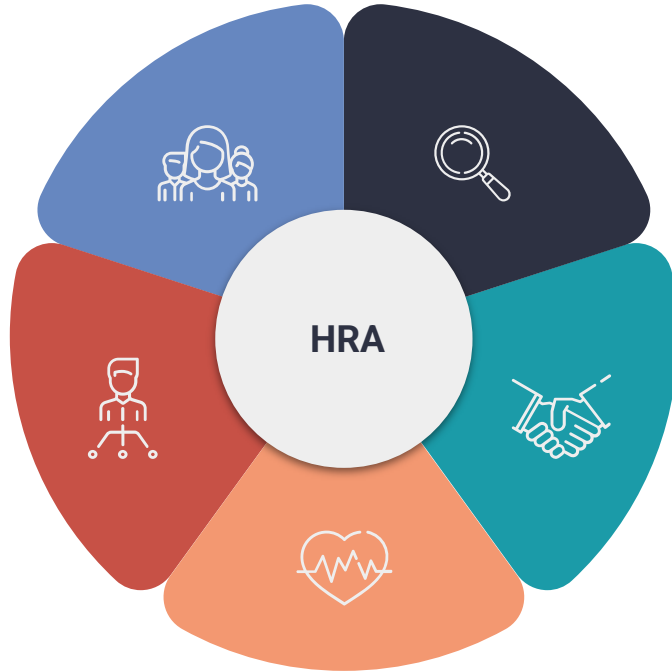




Human Resource Accounting

Presented by: Ms. Vishva Mehta

Human Resource Accounting



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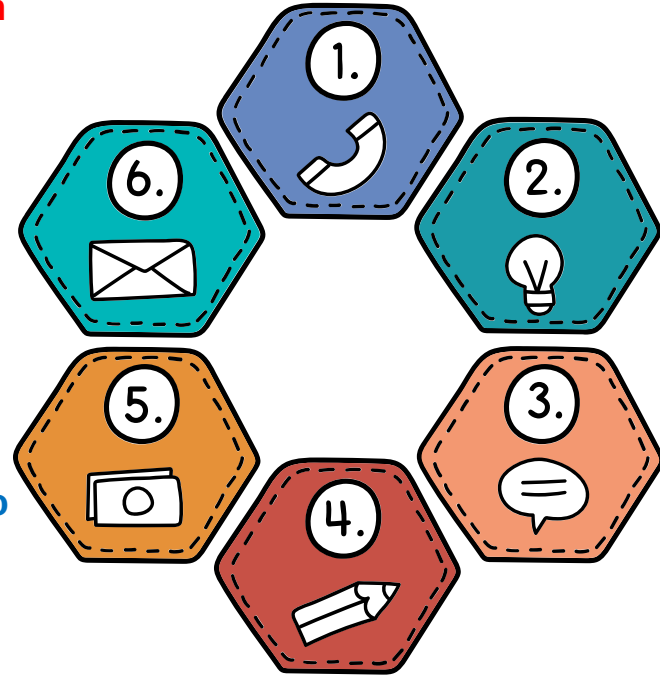
Human Resource Accounting in India

Human Resource Accounting Concept

The **American Accounting Association's Committee on Human Resource Accounting (1973)** has defined Human Resource Accounting as **"the process of identifying and measuring data about human resources and communicating this information to interested parties"**.

Flamholtz (1971) too has offered a similar definition for HRA. They define HRA as **"the measurement and reporting of the cost and value of people in organizational resources"**.

Mr. Woodruff Jr. Vice President of R. G. Batty Corporation defines it as: **"Human Resource Accounting is an attempt to identify and report investments made in human resources of an organization that are presently not accounted for in conventional accounting practice. Basically it is an information system that tells the management what changes over time are occurring to the human resources of the business."**



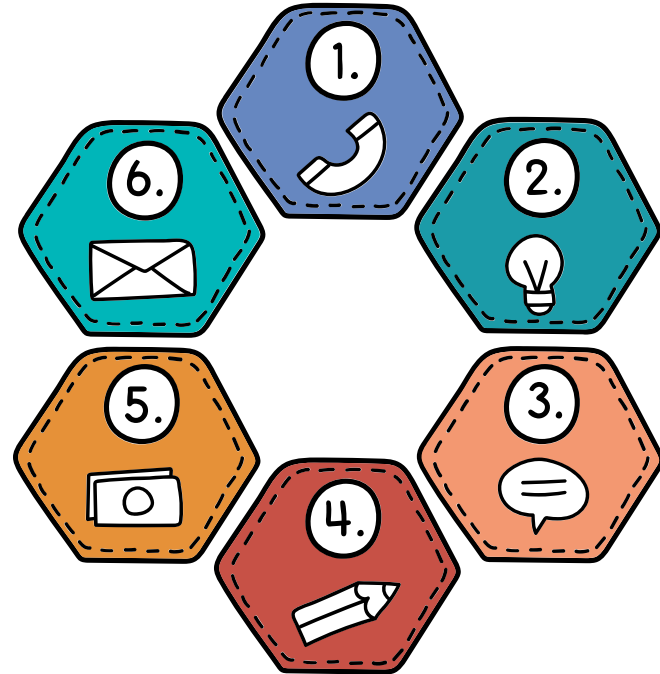
Human Resource Accounting Concept

M.N. Baker defines Human Resource Accounting as:
"Human resource accounting is the term applied by the accountancy profession to quantify the cost and value of employees to their employing organization"

Another management consultant **Stephen Knauf** has defined HRA as: "The measurement of quantification of human organization inputs such as recruitment, training, experience and commitment"

In simple words, human resource accounting is the art of, valuing, recording and presenting systematically the worth of human resources in the books of account of an organisation. Thus, there are three important aspects of human resource accounting:

- i. **Valuation of human resources.**
- ii. **Recording the valuation in the books of account.**
- iii. **Disclosure of the information in the financial statements of the business.**

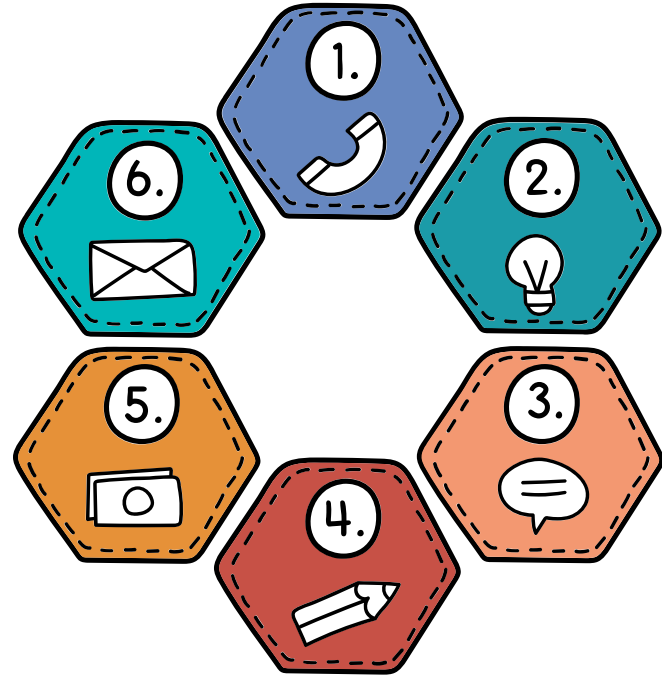


Human Resource Accounting Need & Development

Under conventional accounting, no information is made available about the human resources employed in a organization, and without people the financial and physical resources cannot be operationally effective.

The expenses related to the human organization are charged to current revenue instead of being treated as investments, to be amortized over a period of time, with the result that magnitude of net income is significantly distorted. This makes the assessment of firm and inter-firm comparison difficult.

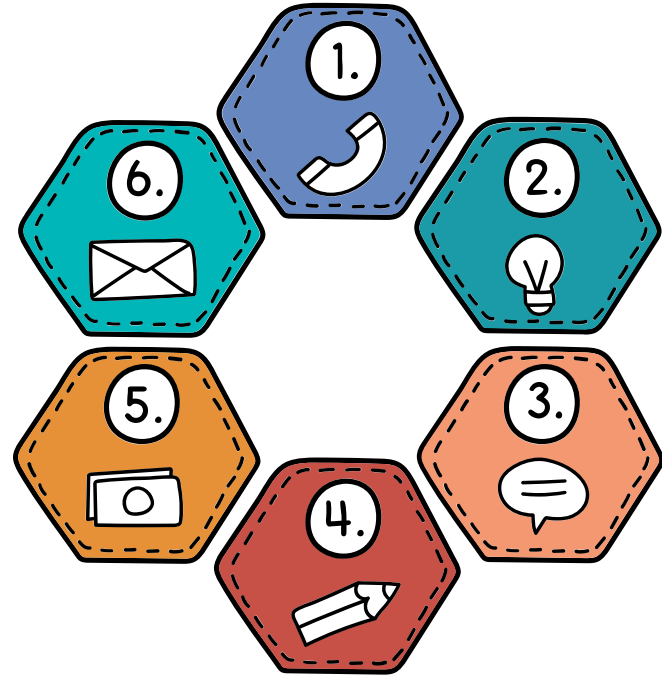
If the value of human resources is not duly reported in profit and loss account and balance sheet, the important act of management on human assets cannot be perceived.



Human Resource Accounting Need & Development

Expenses on recruitment, training, etc. are treated as expenses and written off against revenue under conventional accounting. All expenses on human resources are to be treated as investments, since the benefits are accrued over a period of time.

The productivity and profitability of a firm largely depends on the contribution of human assets. Two firms having identical physical assets and operating in the same market may have different returns due to differences in human assets. If the value of human assets is ignored, the total valuation of the firm becomes difficult.



Human Resource Accounting Valuation

Cost Approach



Historical Cost
Replacement Cost
Opportunity Cost
Standard Cost

Monetary Approach



Lev and Schwartz Model

Eric Flamholtz Model

Morse Model

Non-Monetary Approach



Certainty Equivalent
Net Benefit Model

Aggregate Payment
Approach

Cost Approach

Historical Cost Method

Brummett, Flamholtz and Pyle have developed this method.

It is on the basis of actual cost incurred on human resources. Such a cost may be of two types - acquisition cost and learning cost.

Acquisition cost is the expense incurred on recruitment, selection; entire cost is taken into consideration including those who are not selected.

Learning cost involves expenses incurred on training and development.

This method is very simple in its application but it does not reflect the true value of human assets. For example, an experienced employee may not require much training and therefore, his value may appear to be low though his real value is much more than what is suggested by historical cost method.

Cost Approach

Historical Cost Method

Under this approach actual cost incurred towards recruitment, hiring, training and developing human resources of the organization are capitalized and amortized over the future expected useful life of the human resources. Certain part of costs will be written off in proportion to the income of the future years which those human resources will provide service.

When these human assets are prematurely liquidated, the amount not written off is charged to income of the year in which such liquidation takes place.

When the useful life of the human resource is considered to be longer than originally expected, revisions are to be effected in the amortization schedule. The historical cost of human resource is almost similar to the book value of the other physical assets. The additional costs incurred in training and developing is capitalized and is amortized over the remaining working life of the employee. The unexpired value is investment in human assets.

Cost Approach

Historical Cost Method

Advantages

1. Simple to understand and easily worked out.
2. Cost is related to revenue.
3. It enables to provide a basis for evaluating the company's returns on its investment in human resources.

Disadvantages

1. It takes into account only acquisition costs and does not take into account his potentiality.
2. It is not clear when or up to how many years the amount should be amortized.
3. Amount to be amortized is not fixed.
4. Capital cost decreases with amortization.

Cost Approach

Replacement Cost Method

Rensis Likert & Eric G. Flamholtz propounded it. This is a measure of cost to replace a firm's existing human resources. Human Resources are to be valued on the assumption that a new similar organization has to be created from scratch and the cost to the firm is calculated if the existing resources were required to be replaced with other persons of equivalent talents and experience. It takes into account all costs involved in recruiting, hiring, training and developing the replacement to the present level of efficiency.

As against historical cost methods which take into account the actual cost incurred on employees, replacement cost takes into account the notional cost that may be required to acquire a new employee to replace the present one. Replacement cost is generally much higher than the historical cost.

For example, Friedman has estimated that the replacement cost of an executive in middle management level is about 1.5 to 2 times the current salary paid in that position.

Cost Approach

Replacement Cost Method

This approach is more realistic as it incorporates the current value of the organization's human assets in its financial statements prepared at the end of the year. Costs incurred by an organization in replacing a terminated employee are defined as replacement cost like the following -

- a) Communication of job ability
- b) Pre-employment administrative functions
- c) Interviews
- d) Testing
- e) Staff Meetings
- f) Travel Cost
- g) Employment Medical Examination

Cost Approach

Replacement Cost Method

Limitations

1. There may be no similar replacement for certain existing assets.
2. The replacement value is affected by subjective considerations and therefore the value is likely to differ from one another.
3. It is against conventional accounting practice.

Cost Approach

Opportunity Cost Method

Heckiman and Jones first advocated this approach. This is also known as "Market Value Method". This method of measuring the value of human resources is based on the economist's concept of "opportunity cost"

Opportunity cost is the value of an asset when there is an alternative opportunity of using it. In this method, there is no opportunity cost for those employees who are not scarce. As such only scarce people should form part of the value of human resources. The employee is considered as scarce only when the employment in one division of an individual or group denies this kind of talent to another division. Thus, the opportunity cost of an employee in one department is calculated on the basis of offer made by another department for the employees working in this department in the same organization.

Cost Approach

Opportunity Cost Method

Limitations

1. The total valuation of human resource on the competitive bid price may be misleading and inaccurate. A person may be a valuable person for the department in which he is working and may have a lower price in the bid by other departments.
2. Only scarce employees are included in this method and as a result not scarce employees may lose their morale, as they are not counted.
3. It would be difficult to identify the alternative use of an employee in the organization.

Cost Approach

Standard Cost Method

David Watson has suggested this approach. Instead of using historical or replacement cost, many companies use standard cost for the valuation of human assets just as it is used for physical and financial assets. For using standard cost, employees of an organization are categorized into different groups based on their hierarchical positions.

Standard cost is fixed for each category of employees and their value is calculated. This method is simple but does not take into account differences in employees put in the same group. In many cases, these differences may be quite vital.

According to this approach, standard costs of recruiting, hiring, training and developing per grade of employees are determined year after year. The standard cost so arrived at for all human beings employed in the organization are the value of human resources for accounting purposes.

Cost Approach

Standard Cost Method

The approach is easy to explain and can work as a suitable basis for control purposes through the technique of variance analysis. However, determination of the standard cost for each grade of employee is a ticklish issue.

Monetary Value Approach

Flamholtz's Model of Determinants of Individual Value to Formal Organisations

According to Flamholtz, the value of an individual is the present worth of the services that he is likely to render to the organisation in future. As an individual moves from one position to another, at the same level or at different levels, the profile of the services provided by him is likely to change. The present cumulative value of all the possible services that may be rendered by him during his/her association with the organisation, is the value of the individual.

Typically, this value is uncertain and has two dimensions. The first is the expected conditional value of the individual. This is the amount that the organisation could potentially realize from the services of an individual during his/her productive service life in the organization. It is composed of three factors:

Monetary Value Approach

Flamholtz's Model of Determinants of Individual Value to Formal Organisations

1. **Productivity or performance** (set of services that an individual is expected to provide in his/her present position);
2. **Transferability** (set of services that he/she is expected to provide if and when he/she is in different positions at the same level);
3. **Promotability** (set of services that are expected when the individual is in higher level positions.)

These three factors depend, to a great extent, on individual determinants like activation level of the individual (his motivation and energy level) and organizational determinants like opportunity to use these skills or roles and the reward system.

Monetary Value Approach

Flamholtz's Model of Determinants of Individual Value to Formal Organisations

The second dimension of an individual value is the expected realizable value, which is a function of the expected conditional value, and the probability that the individual will remain in the organisation for the duration of his/her productive service life. Since individuals are not owned by the organisation and are free to leave, ascertaining the probability of their turnover becomes important.

The interaction between the individual and organizational determinants mentioned above, leads to job satisfaction. The higher is the level of job satisfaction, the lower is the probability of employee turnover. Therefore, higher is the expected realizable value.

Monetary Value Approach

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Monetary Value Approach

Flamholtz Model (Reward Valuation Method)

This model has been suggested by Flamholtz (1971). This is an improvement on "present value of future earnings model" since it takes into consideration the possibility or probability of an employee's movement from one role to another in his career and also of his leaving the firm earlier, that his death or retirement.

According to this model, the ultimate measure of an individual's value to an organization is his expected realizable value. Expected realizable value is based on the assumption that there is no direct relationship between cost incurred on an individual and his value to the organization at a particular point of time. An individual's value to the organization can be defined as the present worth of set of future services that the expected to provide during the period he remains in the organization.

Monetary Value Approach

Flamholtz Model (Reward Valuation Method)

Flamholtz has given the variables affecting an individual's expected value (IERV): individual conditional values and his likelihood of remaining in the organization. The former is function of the individual's abilities and activation level, while the later is a function of such variables as job satisfaction, commitment, motivation and other factors.

The model suggests a **five-step approach** for this purpose

1. The set of mutually exclusive states that an individual may occupy in the system during his/her career.
2. The value of each state, to the organisation;
3. Estimates of a person's expected tenure in the organisation
4. The probability that in future, the person will occupy each state for the specified time.
5. The discount rate to be applied to the future cash flows.

Human Resource Accounting Valuation

Flamholtz Model (Reward Valuation Method)

The total value of the services derived by the organization by different employees or group of employees is determined. The value thus arrived is discounted at a predetermined rate to get the present value of human resources.

Limitations

The model suffers from nearly all the drawbacks from which the present value of future earnings models suffers. Moreover, It is difficult to obtain reliable data for determining the value derived by an organization during the period a person occupies a particular position. The model also ignores the fact that individuals operating in a group may have a higher value for the organization as compared to individuals working independently.

Monetary Value Approach

The Lev and Schwartz Model

As mentioned earlier, the Lev and Schwartz model is the basic model employed by Indian organisations. According to this model, the value of human capital embodied in a person who is 'x' years old, is the present value of his/her future earnings from employment and can be calculated by using the following **formula**:

$$V_r = \sum_{t=r}^T \frac{I(t)}{(1+r)^{t-r}}$$

Where,

V_r = The human capital value of an employee aged r.

$I(t)$ = The expected annual earnings of the person in period t.

r = A discount rate specific to the person (typically the company's cost of capital).

t = The person's retirement age.

Monetary Value Approach

The Lev and Schwartz Model

The basic theme of Lev, Schwartz model is to compute the present value of the future direct and indirect payments to their employees as a measure of their human resource value. While doing so, the common assumptions set by the Indian companies are the pattern of employee compensation, normal career growth, and weightage for efficiency. Moreover, companies adapt this model to their practical requirements by making necessary alterations. For instance, different organisations use different discount rates for ascertaining the present value of future cash flows.

This method of accounting is basically oriented towards measuring changes in the employees' value rather than employers' gains from the employees. Unless the employees' payments are directly linked to employee productivity or the company performance, the changes in the value of employees will not reflect the changes in the employees' contribution.

Monetary Value Approach

The Lev and Schwartz Model

As pointed out by Prabhakara Rao (1993) under the Lev, Schwartz model, the value of human resources will be more or less increasing, even if the organisations continuously incur losses/decrease in profitability. The attitude and morale of the employees, the contribution of the employees to the organisation, and such other factors are out of the purview of the Lev, Schwartz model.

Disadvantages

1. This model implies that the future work condition of the employee will not change over the span of his working life, but will remain the same as at present.
2. The approach does not take into account the possibility that the employee will withdraw from the organization prior to his death or retirement. It is therefore not realistic.
3. It ignores the variability of the career movement of the employee within the organization. An engineer will be an engineer throughout his career in the organization.

Monetary Value Approach

The Lev and Schwartz Model

4. It does not take into account the role changes of employees. A Personnel Manager may become Chief Legal Officer.

However, this method does not give correct value of human assets as it does not measure their contributions to achieving organizational effectiveness.

Monetary Value Approach

Morse Model (Net Benefit Model)

This approach has been suggested by Morse (1973). According to this approach, the value of human resources is equivalent to the present value of net benefits derived by the organization from the service of its employees.

The method involves the following steps -

1. The gross value of services to be rendered in future by the employees in their individual as well as their collective capacity is determined.
2. The value of future payments (both direct and indirect) to the employees is determined.
3. The excess of the value of future human resources (as per 1 above) over the value of future payments (as per 2 above) is ascertained. This, as a matter of fact, represents the net benefit to the organization on account of human resources.
4. The present value of the net benefit is determined by applying a predetermined discount rate (generally the cost of capital). This amount represents the value of human resources to the organization.

Non – Monetary Value Approach

The non-monetary methods for assessing the economic value of human resources also measure the Human Resource but not in dollar or money terms. Rather they rely on various indices or ratings and rankings. These methods may be used as surrogates of monetary methods and also have a predictive value. The non-monetary methods may refer to a simple inventory of skills and capabilities of people within an organization or to the application of some behavioral measurement technique to assess the benefits gained from the Human resource of an organisation.

1. The skills or capability inventory is a simple listing of the education, knowledge, experience and skills of the firm's human resources.
2. Performance evaluation measures used in HRA include ratings, and rankings. Ratings reflect a person's performance in relation to a set of scales. They are scores assigned to characteristics possessed by the individual. These characteristics include skills, judgment, knowledge, interpersonal skills, intelligence etc. Ranking is an ordinal form of rating in which the superiors rank their subordinates on one or more dimensions, mentioned above.
3. Assessment of potential determines a person's capacity for promotion and development. It usually employs a trait approach in which the traits essential for a position are identified. The extent to which the person possesses these traits is then assessed.
4. Attitude measurements are used to assess employees' attitudes towards their job, pay, working conditions, etc., in order to determine their job satisfaction and dissatisfaction.

Non - Monetary Value Approach

Pekin Ogan (Certainty Equivalent Net Benefit Model)

This approach has been suggested by Pekin Ogan (1976). This, as a matter of fact, is an extension of "net benefit approach" as suggested by Morse.

According to this approach, the certainty with which the net benefits in future will accrue should also be taken into account, while determining the value of human resources. The approach requires determination of the following -

1. Net benefit from each employee as explained under "net benefit approach".
2. Certainty factor at which the benefits will be available
3. The net benefits from all employees multiplied by their certainty factor will give certainty equivalent net benefits. This will be the value of human resources of the organization.

Non - Monetary Value Approach

S. K. Chakraborty Model (Aggregate Payment Approach)

Indian author Prof. S.K. Chakraborty in 1976 advocated this model. He has valued the human resources in aggregate and not on an individual basis. He suggested that managerial and non-managerial man power can be evaluated separately. The value of human resource on a collective or group basis can be multiplied by the average tenure of employment of the employees in that group and is the investment in human resource.

The average annual salary payments for the next few years could be found out from the salary grade structure and promotion schemes of the enterprise. The recruitment, including selection, development and training costs of each employee could be recorded separately and considered as deferred revenue expenditure to be written off over the expected average tenure of the employee in the organisation. The deferred portion should be shown in the financial statement of the organisation.

Non - Monetary Value Approach

Barry Corporation Method

The subject of approach to measurement of human resources through human resource accounting has tempted personnel specialists and academics alike. The early development of human resource accounting was carried out by a team of researchers from the University of Michigan's Institute for Social Research under the guidance of Rensis Likert. Likert felt that the failure to show the human resources of the firm as an asset on the firm's books caused management to undervalue these resources in its decision-making. Early development work by the research team at the R.G. Barry Corporation at Columbus, Ohio emphasised the capitalising of expenditure on employee recruitment and development, using the approach. The money spent on recruiting and training of employees was treated as a capital investment to be amortized over several years, since the benefits were presumed to continue over that period. R.G. Barry Corporation presented the human resource historical cost approach. The money spent on recruiting and training of employees was treated as a capital investment to be amortized over several years, since the benefits were presumed to continue over that period. R.G. Barry Corporation presented the human resource accounting information as an addendum to its regular financial statements in its report to stockholders. However, the primary use of information is for managerial control and decision making.

Non - Monetary Value Approach

Barry Corporation Method

The **objectives** behind such human resource accounting are as under:

- (1) To check the quality of profit activity.
- (2) To know whether the company acquires enough human resource to accommodate business unit objectives.
- (3) To know whether HR is developed continuously or not.
- (4) How much is HR maintained.
- (5) Is HR used in the interest of business or not.

This method is the only method of human resource accounting which is based on sound accounting principals and policies.

Non - Monetary Value Approach

Barry Corporation Method

Limitations

- (1) The valuation method is based on false assumption that the dollar is stable.
- (2) Since the assets cannot be sold there is no independent check of valuation.
- (3) This method measures only the costs to the organization but ignores completely any measure of the value of the employee to the organization.
- (4) It is too tedious to gather the related information regarding the human values.

Importance of Human Resource Accounting

-  Human Resource Accounting helps the management in the Employment, locating and utilization of human resources.
-  It helps in deciding the transfers, promotion, training and retrenchment of human resources.
-  It provides a basis for planning of physical assets vis-à-vis human resources.
-  It assists in evaluating the expenditure incurred for imparting further education and training in employees in terms of the benefits derived by the firm.
-  It helps to identify the causes of high labour turnover at various levels and taking preventive measures to contain it.
-  It helps in locating the real cause for low return on investment, like improper or under-utilization of physical assets or human resource or both.

Importance of Human Resource Accounting



It helps in understanding and assessing the inner strength of an organization and helps the management to steer the company well through most adverse and unfavourable circumstances.



It provides valuable information for persons interested in making long term investment in the firm.



It helps employees in improving their performance and bargaining power. It makes each of them to understand his contribution towards the betterment of the firm vis-à-vis the expenditure incurred by the firm on him.

Human Resource Accounting in India

In India, HRA is still in the early stage of development. Even though HRA was introduced before 1980s, it started gaining popularity in India after it was adopted and popularized by Neyveli Lignite Corporation (NLC) and Bharat Heavy Electricals Limited (BHEL). The Indian Companies Act does not provide any scope for furnishing any significant information about human resources in financial statements. HRA has not been introduced so far in any legislation and thereby Human Resources are not yet recognized as "assets" neither in the Balance sheet or in the Annual Report of many of the Public or Private companies in India.

Even in the new Companies Act 2013, there is no specific provision regarding the accounting and reporting requirement of Human Resource in Annual Report of Indian Companies. The Institute of Chartered Accountants of India (ICAI) has issued Accounting Standard (AS) on various aspects of accounting but it is not possible for ICAI to bring any exact accounting standard for measurement and reporting of human resource of an organisation. This was the greatest drawback relating to HRA.

However there is a growing trend towards the measurement and reporting of human resources in Indian companies, it could be noticed during the past few years, sensing the benefits from valuing and reporting the human assets, many Public companies have voluntarily disclosed all relevant information related to human resource in their books. In recent years some Private companies also have started to disclose information about their work force along with the financial statement.

Objectives of Human Resource Accounting



To furnish cost value information for making proper and effective management decisions about acquiring, allocating, developing and maintaining human resources in order to achieve cost effective organizational objectives.



To monitor effectively the use of human resources by the management.



To have an analysis of the human asset i.e, whether such assets are conserved, depleted or appreciated.



To aid in the development of management principles, and proper decision making for the future by classifying financial consequences, of various practices.



In all, it facilitates valuation of human resources, recording the valuation in the books of account and disclosure of the information in the financial statement.

Objectives of Human Resource Accounting



Further, it is to help the organization in decision making in the following areas:

- a) Direct Recruitment Vs promotion.
- b) Transfer Vs. Retention.
- c) Retrenchment Vs. Retention
- d) Impact on budgetary controls of human relations and organizational behaviour.
- e) Decision on reallocation of plants, closing down existing units and developing overseas subsidiaries etc.

Advantages of Human Resource Accounting

1. Information for manpower planning:

HRA provides useful information about the cost and value of human resources. It shows the strengths and weakness of the human resources. All this information helps the managers in planning and making the right decisions about human resources. Thus HRA provides useful information for Manpower Planning and Decision Making.

2. Information for making personnel policies:

HRA provides useful information for making suitable personnel policies about promotion, favourable working environment, job satisfaction of employees, etc.

3. Utilisation of human resources:

HRA helps the organisation to make the best utilisation of human resources.

4. Proper placements:

HRA helps the organisation to place the right man in the right post depending on his skills and abilities.

Advantages of Human Resource Accounting

5. Increases morale and motivation:

HRA shows that the organisation cares about the employees and their welfare. This increases their morale and it motivates them to work hard and achieve the objectives of the organisation.

6. Attracts best human resources:

Only reputed organisations conduct HRA. So, competent and capable people want to join these organisations. Therefore, HRA attracts the best employees and managers to the organisation.

7. Designing training and development programmes:

HRA helps the organisation to design (make) a suitable training and development programme for its employees and managers.

8. Valuable information to investors:

HRA provides valuable information to present and future investors. They can use this information to select the best company for investing their money.

Limitations of Human Resource Accounting

1. The valuation of human assets is based on the assumption that the employees are going to remain with the organisation for a specified period. However, this assumption is wrong because employee mobility is very high.
2. The human resource accounting may lead to the dehumanisation in the organisation. If the valuation is not done correctly or the results of the valuation are not used properly.
3. In the case of financial accounting, there are certain specified accounting standards which every organisation must follow. However, there are no standards for HRA. Each organisation has its own standards for HRA. So, there are no uniform standards for HRA. Therefore, the HRA of two organisations cannot be compared.
4. There are no specific and clear cut guidelines for 'cost' and 'value' of human resources of an organisation. The present valuation systems have many limitations.
5. The life of a human being is uncertain. So its value is also uncertain.

FAQ's in University Exams

1. Explain the replacement cost method to evaluate the human resource. (December – 2022, 2024)
2. Give definition of human resource accounting and explain its advantages. (November – 2023, 2024)
3. Give the definition of Human Resource Accounting and its objectives. (December – 2022)
4. Need of Human Resource Accounting (November – 2023)
5. Importance of Human Resource Accounting. (March – 2023, 2026)
6. Explain in detail Lev and Schwartz's Model method for valuation of Human Resources for accounting (March – 2023)
7. Features of Human Resource Accounting (March – 2024)
8. Human Resource Accounting in India (March – 2024)
9. Disadvantages of Human Resource Accounting. (June – 2023)
10. Human Resources as a business asset (June – 2023)
11. Explain Re-establishment cost method Human Resource Accounting method. (November – 2025)
12. Explain the Historical cost approach and present value approach method for valuation of human resource. (March – 2026)
13. State the usefulness and limitations of Human Resource Accounts. (March – 2026)