

MANAGING EMPLOYEES THROUGH HUMAN RESOURCE ACCOUNTING

V.K. Shrotryia

ABSTRACT

Human Resource (HR) is none the less important asset than any physical asset. It has been a point of discussion that how to show this asset in the Financial Statement (FS). Quite a few number of models have been suggested by different researchers, accountants and academicians. The basic concept of showing physical asset in FS has also been compared and studied by keeping in view the HR.

There are some 15-20 companies, both in public and private sector, in India, which have started valuing their HR and showing it their FSs. Lev and Schwartz model has been adopted by most of these companies as it is or with certain modifications. In this paper, the author suggests some modifications and unveils certain areas of interest for Human Resource Accounting (HRA). It is also talked about in the paper that how the modifications can be given worth.

In the present paper, the management's perspective has been given more importance and the author feels that HRA can provide best information to manage employees in an organisation. On the other side, from the point of view of employees, if HR is shown in FS as an asset, they will feel motivated which will result in their satisfaction and subsequently in qualitative production.

Introduction

Management has been defined as an art of getting things done through and with people. This definition shows the important role of people in the life of an organisation. It is a matter of common acceptance that without active participation of people, i.e. employees, an organisation can not perform for qualitative and quantitative production. The aim of management is getting things done at minimum cost so as to result in maximum profit.

The physical assets like land, building, furniture etc. play a major role in achieving the goal of the organisation. But at the top without active role of employees, physical assets are of no use. Land can not

maximize profit at its own, building needs workers to work in, furniture needs employees to sit and work for the organisation. Investment does not increase itself automatically, it needs lot of brain work before taking decision to invest or not. The acquisition cost of all such asset are depicted in organisation's FS. But what about the HR ?

The concept behind showing the value of physical asset is that of historical cost, acquisition cost, replacement cost etc. Can't these concepts be used for valuing HR and subsequently depicting its worth in the FS ?

Assumptions

The employees are valuable organisational resources. The more qualitative employees are the more profitable it is. It is this HR

which matters much to minimize the cost for maximizing the profit. A good team will yield good amount of profit in the years to come i.e., the life of the organisation. The employees are capable of providing current and future services to the organisation and these expected future services have economic value to the organisation. The potential of HR needs to be valued and depicted accordingly.

It is also assumed for the case of HRA that the value of workers (employees) depends on the attitude of management. It is management which seems to be most interested in managing men. Therefore the value of HR can be brought up by providing them good training on-the-job or off-the-job, giving them good amount of motivation to improve productivity which in long run will result into the target of the management i.e. minimizing cost and maximizing profit. Such enhancement in the value of HR can be depicted in the books of account or FS in the way of addition to the worth of HR. This argument gets more weightage when Rensis Likert says that HR comprises the value of the productive capacity of firm's human organisation.

HR information is a necessity to give worth to the HRs to an organisation. For taking effective decision and for running the organisation efficiently, HRA data helps and gives a base to it. The recognition of HR as non-financial asset would not show true and fair picture of the organisation. It should get its place in the FS (Balance Sheet) in the way of any other physical asset. Financial Reporting would be incomplete in the absence of any mention of HR. When HR data is used in the financial reporting, it would certainly help the management to take effective and

sound decisions and to manage the employees with more database and bases.

The *Objectives of HRA* can very well be laid down as :

- Applying the Accounting concepts, practices and principles for acquisition cost and development cost,
- Evaluating HR worth after matching cost against revenue,
- Providing necessary information of HR to management and other interested parties for decision making.

Accounting Concepts, Practices and Principles , and HRA

The American Institute of Certified Public Accountants (*AICPA*) has defined accounting as an art of recording, classifying and summarizing in a significant manner and in terms of money transactions and events which are in part at least of financial character and interpreting the result thereof. This definition of accounting has passed a long way and has been a point of modification time and again. And that is why it is now regarded as the process of identifying, measuring and communicating economic information to permit informed judgment and decision by users of the information (American Accounting Association). Accounting has become a service activity. It provides information to the interested parties. Hence becoming an Information System. Management takes decisions on the basis of accounting information. Therefore, accounting becomes a tool of decision making.

When accounting is prefixed with Human Resource, it becomes a branch of Accounting like Cost Accounting, Management Accounting, Corporate Accounting, etc. This special branch of

Accounting deals in the valuation and depiction the worth of the HR of an organisation in the Annual Financial Statements. *The American Accounting Association Committee on Human Resource* has defined *HRA* as under :

HRA is the process of identifying and measuring data about human resources and communicating this information to the interested parties.

E H Kohler has defined human capital as *The capitalized value of present and future productive services possessed by individuals.*

And for *HRA* he says

...the effort in HRA was directed towards capitalising items such as employee training, health programs etc. on the supposition this increased their assets value for the employing organisation

The definition of *HRA* given by American Accounting Association does not exclude non monetary measurements and asks for its proper communication to the interested parties. The most interested party in such information has to be the Management. *HRA* information will help the management to manage the men effectively and efficiently by taking proper and sound decisions. Stephen Landekich is of the view that. A good part of the literature on *HRA* deals specifically with the potential management uses of the resulting information.¹

Eric Flamholtz says that

HRA means accounting for people as organisational resources. It is the measurement of the cost and value of people to organisation.

He further states that the primary objective of *HRA* is to help facilitate the

effective and efficient management of people. For making best use of employees in an organisation. *HRA* plays a major role.

HRA provides information for decision making and gives a base for sound decisions. The moment such information is depicted in the organisation's FS, the employees feel their worth and it results in their performance and their satisfaction vis-a-vis the profitability of the organisation. The worth of HR depicted in FS works as a motivating factor. Here, one may argue that *since employees are not slaves or chattel - they are not owned by an organisation and then should not be represented on the Balance Sheets.* One may agree with Brummet who establishes the statement as an unjustified legalistic bias that accountants have reflected over the years. Brummet replies to this argument and says, *Although in certain instances there are legal ramifications to the manner in which a company keeps its books, we should account for and monitor those things which are most significant in an organisation without regard to their legal ownership status. HR met this criterion.* This statement of Brummet clearly shows the relationship of employees with the employer. It should not be a matter of slavery if the worth of HR is depicted in FS. This is the submission here that the employees of the organisation should be given the opportunity and even the right to know their economic values which is done on the basis of broad study, nature of the organisation, categories of the employees etc.

HRA has been under experiment during last three decades in different organisations of different countries. It is a new phenomenon in the vista of accounting. However, whatever history *HRA* has, RG

Barry Corporation's experiment is of great importance. Eric Flamholtz may be considered as father of *HRA* who experimented it in RG Barry Corporation. Flamholtz comments on his experiment in second edition of his book *Human Resource Accounting*:

Unfortunately, the publication of those Financial Statements also had a negative side effect; they led to the wide spread erroneous impression that HRA was concerned only with treating people as financial statements that included human resources was undoubtedly a part of human resource accounting, it was not by far the most significant part. Yet precisely because it was dramatic and innovative became the dominant image of HRA for many people.

This finding of Flamholtz guides us to experiment certain models or the modifications in Indian organisations. Indian companies are no exception for adoption *HRA*. There are quite a number of organisations which has started following it. Among public sector organisations Bharat Heavy Electricals Limited (*BHEL*), Cement Corporation of India (*CCI*), Projects and Development Corporation India Limited (*PDCIL*), Engineers India Limited (*EIL*), Minerals and Metals Trading Corporation (*MMTC*), Electrical India Limited, Oil and Natural Gas Commission (*ONGC*), Hindustan Ship Yard Limited, Steel Authority of India Limited (*SAIL*), Oil India Limited (*OIL*), and National Thermal Power Corporation (*NTPC*) are following certain models as whole or in part or added with modifications. It is noteworthy here that even some private sector organisations like Maruti Udyog Limited (*MUL*), Tata Electrical and Locomotives Company

(*TELCO*), Associated Cement Company (*ACC*) and Southern Petro-chemical Industries Corporation(*SPIC*) are also given economic value to its employees. And the developments in the fields of *HRA* are more speedy since last decades. As management education is getting more and more importance, *HRA* has also become one of the important topic of discussion and acceptance.

In most of these organisations Lev and Schwartz Model is adopted in full or in part. *BHEL* does not consider labour as a cost but as a resource. They are following Lev and Schwartz model. The Indian experience of this concept gives more weightage to this particular model which is based on present value of future earnings.

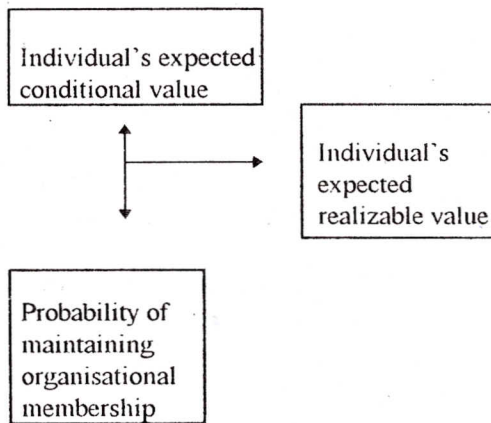
This model was developed by Baruch Lev and Aba Schwartz in 1971. They give a formula to calculate present value of future earnings of an employee :

$$V_{\gamma} = \sum_{t=r}^T \frac{l(t)}{(1+r)^{t-\gamma}}$$

where V_{γ} = the human capital value of a person γ years old
 $l(t)$ = the person's annual earnings up to retirement
 r = rate of discount
 T = retirement age

Eric Flamholtz commented on this model. He gives an argument that during the life of an organisation the employees leave the organisation before their death or retirement. Since Lev & Schwartz model is based on present value of an employee's future earnings, it is attacked by a limitation which ignores the possibility and

probability of leaving the organisation before death or retirement. Eric suggests that 'expected realizable value' of an employee is an important as his 'expected conditional value'. He further explains 'expected realizable value' as the present work of services actually expected to be derived during the individual's anticipated tenure in the organisation.



In his realization, the most important part is the stay of an individual in the organisation. The anticipation for his satisfaction and outdoor opportunities have to be given worth to reach at the more significant result. One or the other happening in the organisation may effect the tenure of an employee. The change in leadership, collaboration, place, environment, salary package, perks etc. may result in the established tenure of an employee. It has to be given worth.

The personal file of an employee will provide the basic details where as the day-to-day behaviour and activities will provide the information to anticipate his expected tenure in the organisation. Such details, behaviour and activity has to be given economic value. It is suggested here that the organisation may put certain points for

certain activities and set the standard at one point. The economic worth can be given depending on different point levels and subsequently be shown in the financial statement.

Conclusion :

Though, HR valuation has been a topic of debate among academicians and accountants, its importance has always been getting recognition. Indian companies are getting aware of the developments in the field of accounting vis-a-vis Human Resource Accounting. Among all the models proposed by different researchers and academicians, Lev and Schwartz model has gained more importance. I feel that this model in itself is not complete and neglects a very important happening in the life of an organisation which is the stay of an employee in the organisation. Therefore, the above mentioned amendment is suggested. Further, depending on the working environment in an organisation, it can be adopted by giving worth to the points which will be calculated after going through the information relating the concerned employee.

While giving final comments on the use of economic concept of human capital in FS, Eric Flamholtz states that -

The task of measuring the value of an organisation's human resources is quite formidable. At this stage, none of us can claim to have the answer, and our proposed solution will inevitable have defects.

Hence, until unless HRA reaches to a mature stage, one or the other change is bound to be suggested by different people. And since it is still in its childhood it needs such discussions and exposures to reach at

an uniform model to be adopted by the organisations. But, even if it does not get common acceptance in near future, HRA would be one of the most effective tool of managing employees in the organisation.

References

1. American Accounting Association. 1966 , *A Statement of Basic Accounting Theory* (ASOBAT) .
2. American Institute of Certified Accountants, New York, *Accounting Research and Terminology Bulletin*.
3. Brummet , B. Lee.1970, Accounting for Human Resources *The Journal of Accountancy*, Dec 1970.
4. Batra ,G. S. and Bhatia,B.S.1994 , Human Resource Valuation (A study of Indian Corporate Sector) *Journal of Accounting and Finance*, Vol VIII No. 1, April, 1994.
5. Cooper, W. W. and Yuji Ijiri, *Kohler's Dictionary of Accountants* 6th Edition.
6. Flamholtz, E.1974, *Human Resource Accounting* Dickenson Publ. Co. San Francisco .
7. Flamholtz, E. 1985, *Human Resource Accounting* Dickenson .Publ. Co. San Francisco, 2nd Edition .
8. Flamholtz, E.1972, On the Use of Economic Concept of Human Capital in Financial Statements - A Comment *The Accounting Review*, Jan 1972.
9. Hermanson ,R.1986, Accounting for Human Assets *Research Monograph No. 99,1986* GSU, Atlanta, Georgia.
10. Landekich Stephen ,Accounting for Human Resources and Social Costs *The Modern Accountants Handbook*.
11. Baruch, Lev and Schwartz, Aba .1971 On the use of the Economic Concept of Human Capital in Financial Statement *The Accounting Review*, Jan 1971.
12. Likert, Rensis 1960, *New Pattern of Management* McGraw Hill, New York, 1960.
13. Likert, Rensis 1967, *The Human Organisation ; its management and value*. McGraw Hill, New York .
14. Report of the committee on HRA, the Accounting Review Supplement to Vol. 48, 1973.
15. Roslender R and J R Dyson,1992, Accounting for the worth of employees : A new look at an old problem, *British Accounting Review*, 24