



Editorial

There were days where there was no accounting, then slowly numbers were invented. As the human conscious evolved the accounting profession also evolved.

What is an asset?

An asset for some may look like an expense for another. A luxury car for a leader might look as a wasteful dead asset to another human being. A spend in a holistic life development course might look like a life time investment for some, while for others it might look like a entertainment expenses

The perspective of accounting is changing, time and again, new innovations are coming.

We were taught the historical costing, but with advent of new business models, accounting has got a new dimension.

Little did one realize that one day we will be valuing human beings. Human beings are most invaluable, they are the creation of the 'lord'. However is there a scientific way to value them. Read on.....

Editorial team of Batgach

HUMAN RESOURCES ACCOUNTING



Introduction

In 21st century being globalization of business and service, Human forces are becoming more important for the success of a concern. Every business concern require physical assets as well as human resources for its success. Without human resources and efforts physical assets like building, plants, machines, offices, computers are unproductive. All the activities, plans, strategies of a concern are initiated, performed, executed, implemented, managed and controlled by the man power who make the concern.

Knowledge or Skills based companies are much richer than the physical or financial bearing companies because intellectual, experience, know-how, attitude, education, behavior and value system of employees improve the efficiency of production or services and create more wealth of an organization. Human are the creative and innovative force which strives to secure maximum results. The concept of human resource accounting is in the early stage of development in developing countries like India.

It has become a separate section of annual accounts or reports of public or Indian companies like:

- Steel authority of India Ltd.
- Bharat Heavy Electricals Ltd.
- Minerals & Metals Trading Corporation Ltd.
- Oil India Ltd.

- National Thermal Corporation Ltd.
- Infosys Technologies Ltd.
- Hindustan copper Ltd.
- Wipro
- Satyam Computers

Human resource or Human capital valuation refers to **identifying and measuring the value of Human resources of an entity**. Unlike other resources, **human beings are not owned by organizations** and hence they are relatively free to supply or withhold their services. There is a debate as to determine whether human capital is an organizational asset as conventionally defined Assets. But there should be no doubt that **they are indeed a huge and major source of revenues for the entities** existing today. Accordingly whether or not human capital is reported in external financial statements, **it is a critical Economic Resource** and it needs to be managed.

The entities in the past have not given due consideration to this important asset working in the enterprise. In traditional accounting practices, the heavy amount incurred on the recruitment, placement selection, training and development of the personnel is generally treated as revenue expenditure and hence it is debited to profit and loss account of the period during which such amount is incurred. But today, it is argued that these expenditures incurred by an enterprise to get the benefit of the services of its manpower force in future, is against the accounting principle to treat them completely of a revenue nature. In fact, such expenditure should be capitalized and be shown as an Asset in the Balance Sheet. The failure of professional accountants to treat human resources as asset just like physical and financial assets has led to the evolution of the concept of Human Resource Accounting, which emphasizes that human resources should be treated like physical assets and should be shown in the balance sheet of the enterprise.

Need for HRA

Human Resource Accounting is necessary because:

- ✓ People are **valuable resources** for an enterprise.
- ✓ To find out the **productivity of investment on human beings** in organization.
- ✓ It can be used as a **scaling tool** that generates and reports Quantitative Information about the contribution of human resource for promoting industrial productivity.
- ✓ The usefulness of manpower as organizational resources is determined by the **way in which it is managed**.
- ✓ Information on investment and value of human resources is
- ✓ Useful for **decision-making** in an enterprise.



- ✓ It helps in developing **financial assessments** for the people
- ✓ Within the organization and monitoring of these assessments
- ✓ in the light of net accounting policy of the concern from time to time.

On balance sheet: Organisations can actually find out how much they can earn from an individual, as the intellectual assets of a company are often worth three or four times the tangible book value. Human capital also provides expert services such as consulting, financial planning and assurance services, which are valuable, and very much in demand.

The purpose of HRA is to **improve the quality of human resources decisions** made both internally and externally concerning and organization. The following may be outlined as the objectives of HRA

- To provide information regarding work forces.
- To focus on human resource as assets.
- To attract and support investment in organization.
- To identifying appropriate person for particular job or work.
- To improve human resource management.
- To retain experienced or qualified work force.
- To overcome problems arising from valuation of intangible assets.
- To improve the image or goodwill of enterprises.
- To attract future skilled work force.
- To classifying revenue and capital nature expenditure of human resource assets.
- To provide information to investors and other interested parties.
- To focus on the role of work force on profitability of organization.
- To provide information about productivity of the organization.



Benefits of HRA

1. 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.
2. The maintenance of detailed record relating to internal human resources (i.e. employees) improves **managerial decision-making** especially institutions like:
 - ✓ Direct Recruitment versus Promotions
 - ✓ Transfer versus Retention
 - ✓ Retrenchment or Relieving versus retention
 - ✓ Utility of cost reduction programs in view of its possible impact on human relations.
 - ✓ Impact of budgetary control on human relations and organizational behaviour.
 Thus, the use of HRA will definitely **improve the quality of management**.
3. The adoption of the system of HRA serves **social purposes by identification of human resources as a valuable asset** which will help prevention of misuse and under use due to thoughtless or rather reckless transfers, demotions, layoffs and day-to-day maltreatment by supervisors and other superiors in the administrative hierarchy; efficient allocation of resources in the economy ;efficiency in the use of human resources; and proper understanding of the evil effects of avoidable labour unrest / disputes on the quality of internal human resources.
4. The system of HRA would no doubt, pave the way for increasingly **productivity of human resources**, because, the fact that a **monetary value is attached to human resources** and that human talents devotion and skill considered as valuable assets and allotted a place in the financial statements of the organization, 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.



Human Capital Valuation

A concern incurs two types of expenditure on human assets.

- A) Capital Expenditure:** Acquisition, Development, Retention, update or upgradation and hiring cost, recruitment & training cost.
- B) Revenue Expenditure:** Wages, Salaries, Bonus, Commission, perquisites, allowances and short term motivation & efficiency maintenance cost.

The biggest challenge in HRA is that of assigning monetary values to different dimensions of HR costs, investments and the worth of the employees. The two main approaches usually employed for this area:

- 1. The cost approach-** The basis for valuation of human resources is the *costs incurred by the company with regard to an employee*.
- 2. The Economic Value Approach-** The basis for valuation of human resources is the *economic value of the human resources and their contribution to the company's growth*. These approaches perceive human resources as assets and estimate the benefits that will be generated from the human resources.



Cost Approach

Cost is a price paid to obtain some anticipated benefit or service. Two types of costs are of special importance in HRA. These are original or historical cost and replacement cost.

- 1. Historical Cost Approach-** The cost associated with the acquisition and development of human resource of an organization. This includes recruiting, selection, hiring, placement, orientation, job training, etc.

While some of the costs like salaries are direct costs, other costs. E.g. the time spent by the supervisors during induction and training, are indirect costs.

Limitations:

- The valuation method is based on false assumption that the currency is stable.
- Since the assets cannot be sold, there is no independent check of valuation.
- This method measures only the costs to the organization, but ignores completely any measure if the value of the employee to the organization.

2. **Opportunity Cost Approach-** This approach focuses on the calculation of what would have been the returns, if the money spent on HR was spent on some on other alternatives.

Example: As an example, let us suppose that oracle applications development business unit's target ROI is 16% and it has a capital base of Rs.1,00,00,000 but its profit is only Rs.13,00,000 which is Rs.3,00,000 short of the target. It is felt by the unit that if it can acquire the services of a particular executive, its profit improves by Rs.4,00,000. The profits will be Rs.17, 00,000, i.e., Rs.100, 000 more than Rs.16, 00,000 (the target ROI). Rs.100, 000 capitalised at 16% comes to Rs.6, 25,000 and the unit can bid upto Rs.6, 25,000 for the services of the executive.

Limitation:

- This method does not fulfill the objective and not a perfect method to value HR. So, it is limited to internal reporting and assessment only.

3. **Replacement Cost Approach-** This approach focuses on the cost associated to replace the present employees. The costs can be classified as costs of recruitment, selection, hiring, placement, orientation, job training, loss in revenue due to unavailability of particular employee that will occur in order to replace them.

Limitation:

- Substitution of replacement cost method for historical cost method does little more than update the valuation, at the expense of importing considerably more subjectivity into the measure. This method may also lead to an upwardly biased estimate because an inefficient firm may incur greater cost to replace an employee.





APPLE - “Think Different”

Economic Value Approach

1. **Lev & Schwartz** advocated the estimation of future earnings during the remaining life of the employee and then arriving at the present value by discounting the estimated earnings at the employee's cost of capital.

Present value of human resource can be calculated as under:

$$PV(r) = \frac{RC+FC+DC+JC+P(Le+Og)}{ESP}$$

PV(r) = Present value of human asset.

RC = Recruitment Cost.

FC = Familiarization Cost.

DC = Development Cost

JC = Job Cost

ESP = Expected Service Period

P(Le+Og) = Probability for loss of efficiency of human resources and for outgoing of the employees.

2. **Flamholtz** proposed HR value on par lance with the roles the employees perform which is in accordance with the service state they occupy. The model also considers the present value of the future services at different service states and takes into consideration the migration of an employee from one service state to the other. However, the

KING FISHER - “Fly the Good Times”

estimates of the employees occupying different service states in his/her career in the organization can be highly probabilistic and unreliable.

3. **Harmonson** advocated the HR value as the present value of the future wages payable for the next five years discounted at the adjusted rate of return. The adjusted rate of return is the average rate of return on the owned assets of all firms in the economy multiplied by efficiency ratio of the organization. This method attempts to bring into question the effectiveness of ROI of the industry on the assumption that there are no extraneous factors and that the results were due to efforts of the employees.

Each model has its own negatives and positives when it comes to practical application. ***In an Indian context, the Lev & Schwartz model has an edge over the other models.*** Since the method has been widely adopted by ***Indian companies*** such as ***Infosys, DSQ Software Ltd., Satyam Computers, BHEL and SPIC***, it enables the company to benchmark the performance and the efficiency of their human resources with others. The assumptions in this model are realistic and scientific. The method has practical applicability when availability of quantifiable and analyzable data is concerned.

The Institute of chartered accountants of India has not issued an accounting standard for the measurement and reporting of cost and value of human resources of an organization. So far as the statutory requirement is concerned, The Companies Act, 1956 does not require the furnishing of any significant information about human resources in the balance sheet or final account of the companies.

According to the money measurement concept of accounting, only those transactions can be recorded under double entry accounting system which can be expressed in monetary term. Human attributes (i.e. honesty, sincerity, loyalty, wisdom, skill, attitude etc.) cannot be expressed in monetary term, therefore, there is no standard method which can be followed to capitalize the investment on human assets.



DELL - "Leap Ahead"

HRA Reported by Infosys

Human Resource Valuation -Infosys

A fundamental dichotomy in accounting practices is between human and non-human capital. As a standard practice, non-human capital is considered as assets and reported in the financial statements, whereas human capital is mostly ignored by accountants. The definition of wealth as a source of income inevitably leads to the recognition of human capital as one of the several forms of wealth such as money, securities and physical capital.

We have used the Lev & Schwartz model to compute the value of human resources. The evaluation is based on the present value of future earnings of employees and on the following assumptions:

- a) Employee compensation includes all direct and indirect benefits earned both in India and overseas.
- b) The incremental earnings based on group / age have been considered.
- c) The future earnings have been discounted at the cost of capital of 10.60% (previous year – 12.18%).

LG - "Life's Good"

Conclusion

In the absence of Human Resource Accounting, the management may not realize the negative effects of certain programs aimed at improving profits in the short-run. Such programs may result in decreased value of human assets due to fall in the productivity levels, high labour turnover, low morale, etc. HRA in any organization should be designed to serve mainly two functions. First it should focus more on recognition of human resource as a critical success factor for any organization, as it is the men behind the organization who drive it towards success. The emphasis on the human capital should be increased to remain in the competition in today's economic era. The second aim of HRA is to provide an alternative accounting system designed to measure the cost and value of human assets to an organization.

In the sense, HRA represents both dimensions, a way to view human resources as critical part of the company and a set of measures to quantify the effects of human resources. The methods discussed above are in their infant stages and there is an urgent need to develop a new accounting standard for valuing human resources of the organizations. The application and usefulness of Human Resources Measurement depends on the future efforts and experiments to be made by practicing managers accountants and academicians. The application of HRA also needs support from the professional bodies and Government.





WIPRO - “Applying
Thoughts”

Light House

This news letter we have been talking about Human resources valuation. I never imagined that at some point of time human beings would be valued, and it would be an important asset. It is a new phenomenon in accounting parlance. However, considering the human perspective, how much have we worked towards ourselves to be valued more. Read this article, are you the “emperor with out clothes”. If you are the emperor without clothes, you are not valuing yourself properly

Nah Nah

The negotiation was done, the deal was signed. The elated boss came out of the room with all of us, and walked ahead. It resembled as if a cricketing legend had hit a century and the rest of the players walked back to the pavilion with the leader.

Boss looked at us with a thumbs up and everybody cheered. We had struck a deal which was very good for the firm. We all congratulated him, and may be that is why we called him “Boss”.

He was the director of the company, and it appeared that he knew everything. He was a true all rounder, he was good the businessman, he was a superb HR guy and technically very sound. His taste for music was above par, an art lover, a friend for everybody and could lend a shoulder to a stranger too. A compassionate sole with a liberal mind. He knew – a

BBC - “Nation Shall Speak Peace
Unto Nation”

healthy body would mean a healthy mind. We wondered “How can he do everything at the same time”. Our boss was liked by all, adored by all and he was our role model.

As time rolled by, I got quite close to him and learnt a lot of things. We traveled together, and I learnt how to pack, how to dress, how to deal in business situations, how to keep in touch with family and how to party too. He used to work hard and party harder. His life was rocking, and I wished mine would reach there soon. As I saw him with envy, pride, awe and reverence almost 3 years passed by. These 3 years were one of the most defining years of my life. I observed in these 3 years, there was not a single instance he was not in control. He could solve every situation. We were around 100 people in our office and not one of them could out beat him in solutions, situations, and he always maintained calm. In the 3 years, I felt, the song was on, there was not a single situation, which could challenge him; there was not a single incident that shook him up. He was amidst accolades, claps, appreciation and was a role model. He knew it, that we all kept him in highest alter at office.

I asked him once “How does it feel to be like you”. He replied in a shot “quite boring” I was shocked at his reply. He went on to explain, “I am a role model to every one of you, but I hardly have any competition. If there are not many challenges it makes growth slow and difficult. I always look forward for healthy criticism; I don’t have a devil’s advocate at work or home”. “I do not enjoy being the Mr. Right every time”.

As I walked back I realized several issues in our office. Our boss would only give instructions, and we had no discussions. Decisions were taken and there were no deliberations. His wrong was also right, and his right could have been more right. We were only looking at what is right and wrong, but we had to look at what is right, and what is more right? He wore high heels and there were no one to talk to him, there were everyone to listen to him. It was one-way traffic, and that is why the speed had come down. He had no body to race with him.

I am sure lot of us would have seen such situations in our offices, family, friends circle, and life. Now I will go a next step in my thought process, which I realised after 3 years at my office.

‘The boss was always right’. There was no questioning him. I recollected instances where he had performed much less than his best, but still it looked the best in our eyes. There were decisions that were wrong, but he proved them right. There were selections & choices that could be better, but we did not have a better alternative. There could be more creativity, but we were only listeners and not contributors. Now I looked back and realized that we could have actually done better in many situations.



I remembered a party we had been. The cocktails & mock tails with starters was the beginning and the deserts preceded the dancing and fun. As we had the starters, the boss had the first bite and he proclaimed “superb”. As soon as the dictum was given, everyone started with their own adjectives of good to great. I recollect the taste, and it had too much of salt, the salt still lingers on my tongue even now when I think of these pakodas. So every activity was “superb” or “not good” depending on what he proclaimed.

He wore a bright blue suit with a bright pink shirt. The first person told it was lovely, this spread and every one had appreciated his bright blue suit; pink shirt and the tan shoes. If I see the picture today, it looks so comical, but why did I tell, “It was great”, I should have shouted, “The emperor has no clothes”.

How many families and organisations, friends, dancers, musicians are in this trap. Are we having enough people to give constructive, healthy, meaningful criticism? Are we surrounding ourselves with people who say “wah’s” or do we have some trusted people who also tell “nah”. The wah wah people are required but so are the nah nah people.

It would take a good heart to take meaningful criticism, but it would take a mind to identify who is a good critic and who is a faultfinder. We should not surround ourselves with people who are faultfinders, but we should have critics who matter to our growth, our rise. The critics should be mature people, who think about our growth. It would be useful to have association with people whom we look up to, than always surround ourselves with people who look up to us. A faultfinder would only go about finding mistakes in everything one does, but a critic would discuss what could be better. *A fault finder is a thinking pessimist but a critic is a growing optimist.* The number of critics should be far and few, but should be people who know our good. They might not be people who are more learned than oneself, but people who can view the situation from a different perspective.

Can we have someone to shout “Boss does not have clothes, you are not the best, but you can be”?

