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   REVIEW OF LITERATURE

   NEED/IMPORTANCE OF THE STUDY

   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

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HUMAN RESOURCE ACCOUNTING: REDEFINING HUMAN CAPITAL INVESTMENT IN CORPORATE SECTOR

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ABSTRACT

Management of Human Resources (HR) in any organization is very much important from accounting point of view. Valuation of HR, recording the valuation in accounts and fair disclosure of such information in financial statements are the demand of the stakeholders in the context of enhancing managerial performance and employees' productivity. In the field of managerial decision making, the human resource data as part of management information system helps in making meaningful choices between various types of human investments and investments in other assets. By measuring the value of human resources at different points of time, Human Resource Accounting (HRA) can reveal whether the management is building up human resources or depleting them. Human resource accounting (HRA) has been defined by the American Accounting Association (1973) as 'the process of identifying and measuring data about human resources and communicating this information to interested parties'. The information generated through HRA can help the management in formulating policies and programmes for the development of human resources. HRA as a managerial tool can be used for effective management of human resources. The target of this research article is to study present vision on the significance of HRA. This study will also be helpful for understanding the Lev and Schwartz method of valuation of human assets.

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KEYWORDS

American Accounting Association, Human Resources, Human Resource Accounting and Lev and Schwartz method.

INTRODUCTION

Human Resources (HR) are the energies, skills, talents and knowledge of people which are, or which potentially can be applied to the production of goods or rendering useful services. HRA is not a new issue in economics and other disciplines. The basic objective underlying human resource accounting is to facilitate the effective and efficient management of human resources. HRA is the process of identifying and measuring data about human resources and communicating this information to interested parties. It is widely recognized that human resources are no lesser important than other productive resources.

HR factor is very crucial, important and sensitive factor of production. It is a widely accepted fact that success of any organization, to a great extent, depends upon the quality, caliber and character of the people working in it. An organization having immense physical resources with latest technology may suffer financial crises as it does not have right people to manage and to conduct its affairs. Thus, in spite of technological developments, the importance of human resources to ensure the organization's success has no way abridged. Yet accounting has concentrated on the physical and financial resources of an entity, without bringing this vital ingredient of social system into its fold forgetting that the performance of the enterprise itself is the product of human activity and the failure of most of the organizations is due to the poor performance of its people. Realizing the importance of human resources, the accountants and economists all over the world became conscious and this has led to the development and implementation of Human Resource Accounting along with financial statements.

Flamholtz (1971) defined HRA as "the measurement and reporting of the cost and value of people in organizational resources".

Rao (1983) reported that human asset accounting is one of the latest concepts adopted by Indian companies of recent times. Most of the enterprises, which follow human asset accounting, spare a separate section in their annual reports for detail accounts of their human resources. Human resources reporting in India usually include a profile of human assets, the compensation pattern, training and development, human asset productivity, human asset value and the total wealth of the organization.

Loqman, M. (1987) stated that HRA in recent years has been receiving attention for two major reasons. Firstly, developments in modern organization theory have made it clear that there is a genuine need for reliable and complete information which can be used in improving and evaluating the management of human resources. Secondly, the traditional framework of accounting is in the process of being expanded to include a much broader set of measurements than was thought possible in the past.

According to Newman (1999), HRA refers to the measurement of the abilities of all employees of a company, at every level – management, supervisory and ordinary employees – to produce value from their knowledge and the capabilities of their minds. HRA is seen as the wealth of the employees' knowledge and intellectual capabilities added to the organization thereby making it to earn profit and to succeed.

Bhat (2000) provides a definition of "Human Resources Accounting" as depicting the human resources potential in money terms while casting the organization's financial statements. He notes that with global trade and foreign exchange transactions becoming more complex with innovations in derivatives, more uniformity in accounting practices and transparency will emerge. The authors suggests that accounting and financial management issues will soon be integrated in accounting statements facilitating more meaningful use of accounts, as opposed to history and bookkeeping.

REVIEW OF LITERATURE

Elias (1972) conducted the first published research concerning the effect of human resource outlay data on stock investment decisions. For this, he selected two hypothetical companies ABC and XYZ operating in the same industry. Two different sets of financial statements were prepared and supplied to the Chartered Financial Analysts, certified Public Accountants and accounting students asking them to choose the company for their investment based on the analysis of the given financial statements. The choice decision of the respondents varied when the HRA information along with the traditional information was supplied. This shows the importance of providing HRA data in addition to conventional data.

Rao (1983) developed a system of human resource accounting, and illustrated its application in a transport equipment manufacturing concern. He has designed the system, based on the input/output control mechanism. The output variables of the system are described to be the indicators of human resource investment subsystem. To identify the human resource investments, all the human resource costs, whose benefits are expected to effect in future periods, are treated as investments. Then the annual human resource investments are adjusted to the tune of changes due to intake or separation or natural deterioration. The intake of people results, in addition of human resource investments, while separation, necessitates writing off of human resource investments. The human resource deterioration is measured and adjusted with the help of amortization rates in each year under study.

Malik (1990) in his doctoral thesis examined the impact of HRA information on decision making. The study has two dimensions part one is the impact of HRA information on investor's decision while part two includes the research connected with the usefulness of such information for managerial decision making. Therefore, this research confines itself to the study of relationship between the provision of HRA of information and the decision behaviour of the internal (i.e., management) and external users of accounting information (i.e., investors). Major conclusion for this study is that the decisions are affected by the inclusion of HRA information in the financial statements of the companies.

Akhtaruddin, M. (1996) studied that Public sector enterprises in Bangladesh occupy a commanding position in the economy. But in spite of their major contribution in the economy in terms of value added and employment, their overall performance has remained unsatisfactory. The performance of an enterprise depends, to a great extent, on the qualified, trained and experienced human resources. But these key assets are neglected and are given less importance for their development. Development and maintenance of human resources require reliable information and it is HRA which would serve the purpose. The study made an opinion survey regarding the applicability of HRA in public enterprises. Majority of the respondents favoured the introduction of HRA in our public enterprises.

A study by Subbarao & Zehgal (1997) gave a macro level perspective to HRA disclosure in financial statements by analyzing the differences across countries in the disclosure of human resources information disclosure in annual reports across six countries. The authors found differences in disclosures of HR information across countries and provided accounting and financial professional insights on the HR information areas they need to focus on in their country.

Olsson (2001) examined the annual reports of the 18 largest Swedish companies, selected on the basis of market capitalisation in the Swedish stock market. She developed a list of five elements to ascertain the level of Human Capital Reporting: education and development; equality; recruitment; selection of employees; and comments by Chief Executive Officers about personnel. The study found that, in 1998, none of the 18 companies reported more than 7% on human capital information (as a proportion of total information) in their annual reports. Furthermore, the information that was reported was found to be highly deficient in either the quality or the extent of the disclosure.

Flamholtz, Bullen & Hua (2003) utilized the HRA measure of expected realizable value, and found that employees' participation in a management development program increased the value of the individuals to the firm. In addition, the authors noted that the HRA measures provided upper level management with an alternative accounting system to measure the cost and value of people to an organization. Thus HRA represented both a paradigm and way of viewing HR decisions, and the set of measures for quantifying the effects of human resource management strategies upon the cost and value of people as organizational resources.

Patra, Khatik and Kolhe (2003) studied a profit making heavy engineering public sector company which used the Lev & Schwartz (1971) model to evaluate HRA measures. The authors examined the correlation between the total human resources and personnel expenses for their fitness and impact on production. They found that HRA valuation was important for decision making in order to achieve the organization's objectives and improve output.

Culpepper (2005) conducted case study in India, and examined the effect of disclosure of human assets on three companies viz. BHEL, INFOSYS, and SATYAM. The author evaluated the correlation between disclosure of the value of human assets and firm value from 1998 to 2004. BHEL Analysis indicates that as more money is invested in the human asset, the value of the organizations' stock appears to be worth more to the investors. INFOSYS analysis indicates that an increase in human asset value results in a decrease the firm value. SATYAM analysis shows that the correlation of human assets value to firm value is negative. This analysis indicates that the more money invested in Human Assets the lower the value of the firm's stock in SATYAM.

Tang (2005) focused on a measurement of human resource cost in developing a heuristic frame addressing the link between human resource replacement cost and decision making, in a Human Resource Replacement Cost (HRRC) system. The system measures direct and indirect costs of human resources, which is then applied to a company within the metro industry in China. The author includes a suggested measure of learning cost, cost of lost productivity, and cost of job vacancy and discusses the usefulness of the HRRC model in decision making in such areas as employee turnover, separation indemnity, duration of labour contracts, and personnel budgets in monetary terms. The author notes that an increased focus on HRA and improved information technology has led to a saying "what you cannot measure, you cannot manage." He notes that the system of accounting for replacement cost in people is an attempt to improve the quality of information available for facilitating effective human resource management, providing information necessary for a cost benefit analysis and decision making in areas such as employee turnover, separation indemnity, duration of labour contract and personnel budgets in monetary terms.

Hansen (2007) notes that two thirds of the 250 largest companies in the world now issue sustainability reports along with their financial reports in order to capture the full value of the organization. Global standards for sustainability reporting require the disclosure of workforce data that reflect the potential for future performance and profitability. Sustainability reporting has been formalized under guidelines by the Global Reporting Initiative, an international network of business, labour investors and accountants.

Moore (2007) suggests that the value of human capital should be more fully considered when making decisions about the acquisition and disposal of people and notes that the accounting practices currently employed by companies can have an undue influence in driving the strategic decisions of these companies. Moore notes that there are parallels between the process of acquiring an employee (a human capital asset) and that of acquiring a fixed capital asset. However while most companies acknowledge the contributions of its employees, they do not think of the acquisition or disposal of human capital assets in the same way or with the same thoughtful planning or strategic thinking as they do fixed capital assets.

Dalvadi (2010) examined Human Resource Accounting practices in 4 selected companies in India for five year commencing from 2003-04 to 2007-08.The author gave some suggestions to sample companies and government to improve Human Resource Accounting practices within Indian accounting system.

OBJECTIVES OF THE STUDY

The following objectives are formulated for the present study:

1. To appraise the effectiveness of valuation and reporting of human resources on the information contents of financial statements.
2. To review the conceptual framework of HRA adding utility to the investors and other stakeholders.
3. To conceptualize the Lev and Schwartz method of valuation of human assets.
4. To make financial statements more transparent and creditworthy by adequately disclosing HR related costs
5. To providing appropriate recommendations to create an effective model for measuring Human Resources Value.

HUMAN RESOURCE ACCOUNTING INTRODUCTION IN INDIA

HRA is a recent phenomenon in India. Leading public sector units like BHEL, NTPC, MMTC, SAIL etc. have started reporting 'Human Resources' in their Annual Reports as additional information from late seventies or early eighties. The Indian companies basically adopted the model of human resource valuation advocated by Lev and Schwartz (1971). This is because the Indian companies focused their attention on the present value of employee earnings as a measure of their human capital. BHEL applies Lev and Schwartz model with the following assumptions:

i) Present pattern of employee compensation including direct and indirect benefits;
ii) Normal career growth as per the present policies, with vacancies filled from the levels immediately below;
iii) Weightage for changes in efficiency due to age, experience and skills;
iv) Application of a discount factor of 12% per annum on the future earnings to arrive at the present value.(ICAI)

HUMAN RESOURCE ACCOUNTING INTRODUCTION IN INDIA

S. NO	NAME OF THE ORGANISATION	YEAR	MODEL
1	BHEL	1973-74	Lev and Schwartz Model
2	ONGC	1981-82	Lev and Schwartz Model
3	MMTC	1982-83	Lev and Schwartz Model
4	SAIL	1983-84	Lev and Schwartz Model with refinements as suggested by Eric G.
5	NTPC	1984-85	Lev and Schwartz Model
6	INFOSYS	1995-96	Lev and Schwartz Model

Source: A Report on HRA from http://www.indiamba.com

LEV AND SCHWARTZ MODEL OF HUMAN RESOURCE VALUATION

Lev and Schwartz model has been the most widely used for its ease of use and convenience. The Lev and Schwartz Model states that the human resource of a company is the summation of value of all the Net Present Value (NPV) of expenditure on employees. The human capital embodied in a person of age 'r' is the present value of his earning from employment. Under this model, the following steps are adopted to determine human resource value:

(i) Classification of the entire labour force into certain homogeneous groups like skilled, unskilled, and semi-skilled and in accordance with different classes and age.

(ii) Construction of average earning stream for each group.

(iii) Discounting the average earnings at a predetermined rate in order to get present value of human resources of each group.

(iv) Aggregation of the present value of different groups which represent the capitalized future earnings of the concern as a whole.

Vr = I (t)/(I + r)t-r

Where, Vr = the value of an individual r years old;

1(t) = the individuals annual earnings up to retirement;

t = retirement age;

r = discount rate specific to the cost of capital to the company.

The Lev and Schwartz Model suffers from the following limitations:

1. This model ascertained the earnings on the basis of skills but ignores the concepts of productivity of employees. Skills can not be in directly proportional to earnings unless the skills are properly utilized for productivity.

2. This model ignores the productivity of promotion of employees except retirement or death.

3. Expenses of 'training and development' incurred by the company are not considered.

ILLUSTRATION

From the following information in respect of ABC Ltd., calculate the total value of human capital by following **Lev and Schwartz model**:

Distribution of employees of ABC Ltd.

Age	Unskilled		Semi-skilled		Skilled	
	No.	Average Annual Earnings (Rs.)	No.	Average Annual Earnings(Rs.)	No.	Average Annual Earnings(Rs.)
25-34	50	2000	40	3000	20	4000
35-44	10	3000	10	5000	10	6000
45-49	5	4000	8	6000	5	7000

Apply 12% discount factor

SOLUTION

The present value of earnings of each category of employees is ascertained as below:

(A) Unskilled employees

AGE GROUP 25-34.ASSUME THAT ALL EMPLOYEES ARE JUST 25 YEARS OLD	
	Present Value(Rs.)
Rs 2,000 p.a. for next 10 years	11,300
Rs 3,000 p.a. for years 11 to 20	5,457
Rs. 4000 p.a. for years 21 to 25	1,496
	18,253

Age group 35-44.Assume that all employees are just 35 years old:	
	Present Value(Rs.)
Rs 3,000 p.a. for next 10 years	16,950
Rs. 4,000 p.a. for years 11 to 15	4,644
	21,594

Age group 45-49.Assume that all employees are just 45 years old:	
	Present Value(Rs.)
Rs. 4,000 p.a. for next 5 years	14,420
	14,420

(B) Semi-Skilled employees

Age group 35-44.Assume that all employees are just 35 years old:	
	Present Value (Rs.)
Rs 5,000 p.a. for next 10 years	28,250
Rs. 6,000 p.a. for years 11 to 15	6,966
	35,216

Age group 25-34.Assume that all employees are just 25 years old	
	Present Value(Rs.)
Rs 3,000 p.a. for next 10 years	16,950
Rs 5,000 p.a. for years 11 to 20	9,095
Rs. 6,000 p.a. for years 21 to 25	2,244
	28,289

Age group 45-49.Assume that all employees are just 45 years old:	
	Present Value(Rs.)
Rs. 6,000 p.a. for next 5 years	21,630
	21,630

(C) Skilled employees

Age group 25-34.Assume that all employees are just 25 years old:	
	Present Value (Rs.)
Rs 4,000 p.a. for next 10 years	22,600
Rs 6,000 p.a. for years 11 to 20	10,914
Rs. 7,000 p.a. for years 21 to 25	2,618
	36,132

Age group 35-44.Assume that all employees are just 35 years old:	
	Present Value (Rs.)
Rs 6,000 p.a. for next 10 years	33,900
Rs. 7,000 p.a. for years 11 to 15	8,127
	42,027

Age group 45-49.Assume that all employees are just 45 years old:	
	Present Value (Rs.)
Rs. 7,000 p.a. for next 5 years	25,235
	25,235

	Total Value of Human Capital								
Age	**Unskilled**		**Semi-Skilled**		**Skilled**		**Total**	
	No.	Average Annual Earnings (Rs.)	No.	Average Annual Earnings (Rs.)	No.	Average Annual Earnings (Rs.)	No.	Average Annual Earnings (Rs.)
25-34	50	9,12,650	40	11,31,560	20	7,22,640	110	27,66,850
35-44	10	2,15,940	10	3,52,160	10	4,20,270	30	9,88,370
45-49	5	72,100	8	1,73,040	5	1,26,175	18	3,71,315
	65	**12,00,690**	**58**	**16,56,760**	**35**	**12,69,085**	**158**	**41,26,535**

In the hypothetical illustration given above we have adopted the model of human resource valuation advocated by Lev and Schwartz. This is because the Indian Companies have focused their attention on the present value of employee's earnings as a measure of their human capital. Measuring and Reporting the value of human assets in financial statements would prevent management from liquidating human resources or overbooking profitable investments in human resources in a period of profit squeeze.

RECOMMENDATIONS FOR FUTURE RESEARCH

The present research paper focuses on the theoretical framework behind Human Resource Accounting and its related valuation technique. The author recommends for future research on the following lines:

1. To study the impact of adequately measured and disclosed Human Resource Cost in the financials of companies in terms of improved EPS and related market capitalization.
2. Introducing mandatory Accounting Standard on Human Resource Accounting.
3. To corroborate the impact of Human Resource Accounting on employees morale and productivity of select listed Companies.
4. Evaluating various Human Resource Accounting techniques to meet the expectation of employees and external agencies.

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