



An insight on new paradigm shift and changing trend in the era of globalization- Human resource accounting

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Abstract

Today one of the most vital parts of any organization is human resource, as it makes sure that there exists a symbiosis between physical and all other financial resources towards the achievement of organizational goals and objectives. Conventionally, financial assets are certainly accounted in the books of accounts as per the general principles of accounting, but it does not count the human asset. Although, many efforts have been made by many of the thinkers in this arena, a proper/appropriate and a fully validated model of performance based on Human accounting in the Indian context is not yet completely available. The past few decades have witnessed a global transition from manufacturing to service based economies. Human resource accounting (HRA) started gaining popularity in India recently, even though it was introduced way back in 1980's. In order to project and estimate the worth of the human capital, it is very much necessary that some method of quantifying the worth of the knowledge, skills, motivation and contribution of the human elements as well as that of the organizational processes like recruitment, selection, training etc which are used to support and build these human aspects is properly developed and nurtured. In this aspect HRA denotes this process of quantification/measurement of Human resources. Major physical assets like building, land, plant and machinery are recorded in the books of accounts at their purchase price. Now, depreciation of these particular assets is considered as the cost incurred for the particular year and debited to profit and loss accounts and the remaining balance is shown in the form of balance sheet as written down value of the assets. Hence, on similar lines the human resources should also be recorded, evaluated in the books, operated as well as disclosed in the financial statements. The paper tries to elaborately discuss about the objectives and process of HRA in the Indian context. The major basic objective of this particular paper is to study the Human Resources Accounting principles and practices, to identify the major issues and challenges, to examine the issues and challenges and lastly to give effective suggestions based on the findings of the study conducted.

Keywords: human resource accounting (hra), financial assets, physical assets, quantification, human capital, goals and objectives

Introduction

As of today a suitable and fully validated model of performance based accounting in Indian context is not available even though many efforts have been made by the thinkers in this field. Past few decades have certainly witnessed a global transition from manufacturing to service based economies. Human resource accounting is a concept of recent origin and is also struggling for existence and acceptance. In this era of globalization human resource is the vital input of any organization, as it pulls on all other physical and financial assets/resources towards the achievement of organizational goals. Conveniently as per the general principles of accounting except human asset financial assets are accounted in the books of accounts. Human resource accounting (HRA) started gaining popularity in India recently, even though it was introduced way back in the 1980's. Human resource accounting is a term applied by the accountancy profession to quantify the value and cost of their employing organization. The concept of Human resource accounting was necessarily established primarily for the service sector, which has now started gaining so much relevance that now companies in all the sectors are applying HR accounting and a good weightage is also given to these reports when making any company analysis. Generally Globalization means, "Integration of business activities across organizational and geographical

boundaries. It is the capacity to treat the whole world as one market while dealing with many culturally diverse merchants. It is a process by which markets expands to include competitors for customers as well as productive inputs without regard to national boundaries". Physical assets such as land, building, plant and machinery are recorded in the books of accounts at their purchase price. Depreciation on these assets are necessarily considered as the cost for the particular year and debited to profit and loss accounts and the remaining balance is shown in the balance sheet as written down value of the assets. Hence, human resources should be recorded, evaluated, recorded in the books, disclosed and operated in the financial statements. Human resource accounting in general parlance is the process of measuring and identifying data about human resource and also communicating the information to interested parties. Therefore, HRA is an attempt to identify and report investment made in resources of an organization that which are not presently accounted for under conventional accounting practices. Moreover, in order to increase production human resource accounting helps to measure the value of employees which helps the management to take vital decisions related to human resources. It requires the optimum use of the available resources and the measurement of the performances of an organization under the direct and indirect control. Hence,

the overall valuation is very much important for decision making in order to achieve the organizational objectives and improve the output.

Major objectives and methodology of the study

Human resource accounting necessarily identifies, quantifies and reports the total amount of expenditure incurred and also the capital employed to recruit, train, familiarize and develop the human resources. Taking this into consideration the objectives of this paper is to:

1. To study approaches to Human resource accounting principles
2. To know and identify the major issues and challenges
3. To critically examine major issues and challenges in HRA
4. To give some suggestions based on the findings of the study
5. To know the major objectives of human resource accounting

The current accounting system which is practiced today is not able to provide the actual value of employee's knowledge and capabilities. This in turn indirectly affects future investments of a company, as each year the cost on human resource development as well as recruitment increases. The human resource accounting system certainly generates information on various aspects of human resources (such as acquisition, allocation, development, utilization and replacement) in the same manner the financial accounting system is for the physical assets. Hence the value of human resources to the organization is measured in terms of monetary units.

Review of Literature

Akbar Ali (2010) has discussed about the significance of Paradigm shift from traditional and old management concept towards the very innovative concept of leadership.

Anna Mazurkiewicz (2014) has discussed about the talent management as a new HR paradigm. According to author, it is very important to retain and manage as per their caliber and skills. Anil Kumar Singh (2009) has focused on the current HRM practices in the selected private sector organizations of India. The paper has also showed a positive relationship between the HRM practices and organizational culture in the selected private organizations of India.

Dr. Asha Nagendra (2014) has discussed about the social media as a new HR paradigm and how it has shown impact in the Employee life cycle. This research is based on both primary and secondary data. The primary data has been collected from 100 employees working in various IT & ITES companies like- Wipro, Infosys, Ernst & Young, and Deloitte etc. Also 10 HR managers who recruit, induct, train, retain and compensate employees in their organization were also

Interviewed.

Dr.K.Palani (2013) has discussed about the challenges of human resource management in the 21st century. According to author, HRM play a very important role in the success of an organization. In this paper, he throws light on the new HR paradigms which will drive human resource management in future.

Joe Duke *et al.* (2012) have discussed about the effectiveness of new HR practices. According to them, the established HR practices should be combined with new HR

paradigms for more productivity and superior corporate performance.

Poonam Anand *et al.* (2014) have discussed about the innovative leadership. According to them, this new HR paradigm will help organizations to attract, develop and empower innovation leaders. Innovative leaders bring creative ideas which are indeed very useful for the success of an organization.

Priyanka Sharma *et al.* (2010) have discussed about the HRM strategies to counter intensified competition and external conditions like global economic recession, the resultant credit crunch and its impact on employee performance.

Raunak Narayan (2010) has discussed about the new HR paradigm "Human Resource Accounting." The author has tried to discuss about the importance and challenges faced by Human Resource Accounting. According to author, human resources should also be evaluated, recorded in the books, operated and disclosed in the financial statements.

R. J. Masilamani *et al.* (2011) have discussed about the role of Job DSTs in the development of human resource systems that could enable organizations to move towards an ideal business performance environment. The Job DST set consists of an exclusive and exhaustive Job Description that convey to the employee details of all activities to be performed, Job Specifications that incorporate the professional and personal attributes required for the assignment, and Targets that cover the period – specific, quantitative and qualitative aspects of the job.

Robin Kramar *et al.* (2010) have focused on the human resource management. They have discussed about the concept of organizational performance, sustainability and the relationship between organizational performance, sustainability and human resource management.

Shashi Ranjan Kumar Jha *et al.* (2014) have discussed about the importance of HRM practices in Indian banking industry. They have also thrown light on the current HRM practices that are going on in the current banking sector and some suggestive HRM practices for more productivity and efficiency of banking industry.

Approaches to Human Resource Accounting

Sir William Petty perhaps was the first person to make an attempt to signify the HR accounting system in around 1691. He treated the labor as the generators of wealth. The investment on human resources was even recognized by Adam Smith. The post 1960's generally witnessed a significant development of business people who were joining hands with academics to evolve suitable methods to account for human resources. Consequently a number of models or approaches have been suggested and developed for the valuation and measurement of human resources. These approaches may be broadly classified into two major types:

1. HR Cost Accounting (HRCA)
2. HR Value Accounting (HRVA)

Each of the above types has been discussed individually below as follows:

HR Cost Accounting (HRCA) may be defined as the reporting and measurement of the costs incurred to develop and acquire people as organizational resources. It specifically deals with accounting for investments made by an organization to the development and acquisition of

human resource as well as the replacement cost of the people presently employed.

HR Value Accounting (HRVA) is the concept based on the view that the major difference in present and future earnings of two similar firms is due to the difference which incurs in their human capital or assets. The economic value of the firm can be defined and determined by obtaining the present value of future earnings. A number of valuation models have been developed for determining the present value of future earnings.

Major issues of Human resource Accounting

The following points given below are the major issues which should be considered for implementation of HR Accounting. They are as follows:

1. The traditional accounting principles and procedures, which have practiced and preached since long, have come to stay as acceptable norms. As a result, whenever a new accounting system is developed, it is pitted against the strengths of the traditional system, which is considered to be comparatively free and objective from any bias. Similarly in the case of HR accounting also, it is argued that it lacks symmetry with traditional resource as it cannot be included within the traditional definition of an asset as that of a human
2. Concerning the procedure in accounting for human assets there is little agreement. There are critics and proponents of the various approaches like value and cost approaches. This factor has become very much responsible for the slow development of the concept of human resource accounting
3. The historical cost approach to develop the measures of HRA uses an amortization rate, which also provides the figure of amortization to be charged to the profit and loss account each and every year. But it is very much difficult to develop norms in this regard. Physically and mentally, individuals do grow and deteriorate at different rates. As a result of their work experience some grow more capable, others do not. Given the difficulty of predicting such changes, it is even more difficult to develop a means of writing off an individual's value. But so far, precise measures for amortization of human assets have not been developed.
4. It has been observed in the recent past that the value based measures of HRA are finding more acceptances with flamholtz approach being progressively used. However, this approach depends heavily on the measurement of an individual's or a groups contribution of valuation. But especially at the managerial level measurement of contribution is quite a difficult task. As a result of this, this factor proves to be a hindrance in the development of the concept of Human resource accounting.
5. Another major issue which has not been settled so far is about the rate at which the prospective stream of contribution is to be compounded or discounted to calculate its future and present value to the organization. A major number of applications are available in this process.
6. If an individual is to be valued normatively, the model which is given by Flamholtz expects that the career path of individuals should be very essential to be plotted over the span of his probable stay with the organization much in the light of the current promotion

and retirement policies of the organization. But such exercise is very much time consuming and tedious.

7. It is very much possible that apprehension regarding the effect of HRA on human behaviour may have forced the organization to be reluctant to use this type of system. HR accounting may also lead to alienation as the people might feel that they have been reduced to as industrial input commodity. Publicizing and showcasing of human resource data could have disastrous effect on the attitude and behaviour of employees
8. Physical assets can be owned and traded by an organization but human assets cannot be utilized in this regard. Physical assets surely have some realizable value of retirement but the human resources do not have any such value associated with them. They may involve the payments of compensation, retrenchment, gratuity and certain other benefits. Human resource is an appreciating asset since manpower improves with time, with due regards to their ageing constraint but especially for physical asset its increasing value at the time of its installation starts immediately depreciating.

Major Challenges of Human Resource Accounting

Some of the major challenges of Human Resource Accounting are as follows:

1. Ownership and having an absolute majority or imposing power on human resources is practically impossible, therefore it cannot be necessarily considered at par with any other assets
2. Measurement of human resources is subjective as different methods will be used by different firms for this purpose. Till date there is no model for valuation of human assets, which is very widely acceptable and also used worldwide
3. Small business units do not find HRA as economical as it involves heavy costs if the firms desires to install the HR accounting package in their organization
4. The concept of Human resource accounting is not recognized by the tax authorities and therefore it has only academic utility. Direct or Indirect tax authorities will take into concern of Human resource accounting if the accounting standards board makes it very much mandatory to disclose the values of Human assets or Human Capital
5. In the valuation of human resources there are a number of specific objective procedures for the selection of the factors to be included. Therefore the subjective approach of the value in their regard makes it less reliable
6. At times Human resource accounting may lead to division among the ranks of employees; hence employees and unions may not necessarily like the idea. A group of employees may be valued lower than their real worth owing the reasons beyond the control of the management. The employees may certainly resist the idea of being treated like second class citizens, despite their contribution over a period of time
7. There is no empirical evidence to support the idea that HRA is an effective tool to measure the economic value of people to their respective organization. Also there is very little idea to support the contention that it facilitates effective and better management of human resource

8. Measuring intellectual capital can be done by”
 1. Keeping it simple
 2. Measure what is strategically important
 3. Measure the activities that which produce intellectual wealth

Thus measuring of intellectual capital can surely help managers and investors by providing a much more accurate estimate of the true value of the company than would a single accounting of its physical holdings. Hence measuring of intellectual capital can be measured by:

1. Putting people on balance sheet: “Every country, every company and in turn each and every individual depends increasingly on patents, knowledge, skills, processes, technologies and information about customers, suppliers and experience”. This has certainly brought up a new way of strategic thinking about “how to put people on the balance sheet”.
2. Intellectual capital: Today traditional financial statements are less illuminating with respect to the assets that which create wealth then they were in the past. Intangible assets such as patents, copyrights, brand names, intellectual capital and expenditures for development and research now generate an increasing amount of wealth for firms. Soft assets are not recognized in financial statements.

Valuation models

The basis of valuation is certainly quite complicated. It also requires use of assumptions regarding probable stay of the employee with the firm at different stages of his service. Three very important models have been designed and developed in this regard:

1. Lev and Schwartz model: It is generally based on the basic assumption that the employee will certainly stay with the firm till retirement
2. Eric flamholtz model: It is based on the underlying assumption and the probability of expected stay with the firm at different stages of service of each employee
3. Jaggi-Lau’s model: This particular model introduces “Group” as the basis of such calculation based on the historical data regarding an employee’s turnover patterns

Practices and perceptions

It is true that worldwide today that knowledge has become the key determinant for business and economic success that Indian companies do focus on ‘Return on Investment’(ROI) with a very few concrete steps being taken to track ‘Return on knowledge’.

What is needed necessarily is the measurement of abilities of all the employees in a company, at every level to produce value from their capability and knowledge. “Human resource accounting (HRA) is basically information systems that tell management what are the changes occurring over time to the human resources of the business”. P.K. Gupta, the Director of strategic development-intercontinental operations of Legato systems, India says “HRA also involves accounting for investment in people and also their replacement costs and also the economic value of people in an organization”. The current accounting system in India is not able to provide the actual value of the employee knowledge and capabilities. This surely indirectly affects future investments of the company, as each and every year

the cost on human resource recruitment and development increases.

Infosys became the first and foremost software company in India to value the human resources in India in the financial year 1995-96. The company had used the Levy and Schwartz model and also valued its human resource assets as Rs. 1.86 billion at that time. In contributing to company’s indomitable success and growth Infosys had always given utmost importance to the role played by employees. Analysts also felt that Human resource accounting (HRA) was a step further in Infosys focus on its employees. Narayana Murthy the then Chairman and also Managing Director of Infosys had said “Comparing this figure over the years will tell us whether the value of our human resources is appreciating or not. For a knowledge and innovative company like ours that is vital information”.

The importance and benefits of adapting to HRA were manifold. It certainly helps an organization to take managerial decisions based on the necessity and availability of human resources. When the human resources were readily quantified, it gave other stakeholders and investors true insights into the organization and also its future potential. Proper valuation and importance given to human Resources helped organizations to eliminate the negative effects of redundant labor. This in turn also helped them to channelize their talents, skills, experience and knowledge of their employees more effectively and efficiently. By implementing and adopting Human resource accounting in an organization, the following important information could be necessarily obtained:

1. Major cost per employee
2. Human capital investment ratio
3. Amount of wealth and assets created by each employee
4. The profit created by each employee to the organization
5. The ratio of salary paid to the total revenue and profits generated
6. Average salary of each employee working in the organization
7. Employee absenteeism rates
8. Employee retention and turnover rate

The concept of HRA was not new in India. Way back in the 1970’s itself HRA was pioneered by the public sector companies like Steel Authority of India (SAIL) and Bharat heavy electrical Ltd (BHEL). However, the concept did not gain much acceptance and popularity during that time. The ICAI has so far not certainly formulated any specific accounting standard on particular measurement and also reporting of value and cost of Human Resources. The Indian companies’ act of 1956 also has not explicitly provided for disclosure of HR values in the financial statements of the companies. In spite of an absolute unfavourable environment in India in the various methods of introducing the reporting on HRA, some of the major Public Limited companies are following the HR accounting practices in India. The Levi and Schwartz model probably was the most popular and also adopted with a little modifications by some of the Indian companies. However major companies like SAIL adopted Flamholtz replacement cost model.

Major Objectives of Human resource Accounting

Human resource accounting process was established to fulfill a number of objectives within the organization. Some of the major objectives include:

1. To furnish cost value information for making effective, efficient and proper management decisions about allocating, acquiring, developing and also maintaining human resources in order to achieve cost effective organizational objectives and goals
2. To effectively monitor the use of human resources by the management'
3. To have an analysis of Human Asset as to whether such assets are conserved, appreciated or depleted
4. To aid in the development of management principles and also proper decision making for the future, by classifying the financial consequences of various such practices.

Conclusion

In today's world the accounting of human resources can well be seen as much a question of philosophy as of technique. This probably is one of the major reasons behind the variety approaches and is also further underlined by the broad range of purposes for which accounting of human resources can be used. We are in an era of globalization and cost cuts, where HRA would certainly give an organization a correct vision towards the way forward. In the ultimate analysis it must be certainly said that the concept of HRA has been appreciated by the accounting profession and also by and large its usefulness has also been acclaimed in the literature, but unfortunately its application has not been flourished throughout the world. The Accounting Standards Board (ASB) and the International Accounting Standards Board (IASB) have not been able to formulate any specific accounting standards on reporting and measurement of value and cost of HR of an organization. Hence, taking into consideration the paramount importance of HRA, proper support and initiation should be taken by the Government as well as Professional boards at the National as well as International levels in respect of formulation of specific accounting standards and also suitable valuation models on the reporting and measurement of the value of Human Resources.

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