HUMAN RESOURCE ACCOUNTING: AN OVERVIEW

Josep Palulungan[1]

Faculty of Economics and Business, Catholic University of De La Salle Manado

Email: jpalulungan@unikadelasalle.ac.id

ABSTRACT

Human resource accounting is considered one of many studies with a lot of potential. Especially because this study could solve a few problems in valuating the employee's quality and their "value" to the organization or company. Review of literature is the method used in this study. Human resource is one of the biggest active elements in organization or corporation that could make a significant difference whether is activities or in production. Even with its own potential, there are several limitations that could prevent this study to go any further. A proper system of human resource accounting, in theory, could be essential for organization real performance and result.

Keywords: Human resource, value, accounting

INTRODUCTION

Human productivity is a growing concern regarding the quality of organizational working life. Human resource has been taken increased attention for its crucial impact on human organization. Human productivity then has its own indicators, which in turn could become the subject to theoretical and empirical studies. These provide researchers to measure every accountable data related to human organization. Likert (1961) defined this term as Human Resource Accounting (HRA). Much of the HRA literature begins by attesting to the importance of human resources to the organization (Likert, 1967).

Human resource accounting is the process of identifying and reporting investments made in the human resources of an organization that are presently unaccounted for in the conventional accounting practices. It is an extension of standard accounting principles. Measuring the value of human resources can assist organizations in accurately documenting their assets. Human resources are considered as important assets and are different from the physical assets. Physical assets do not have feelings and emotions, whereas human assets are subjected to various types of feelings and emotions. In the same way, unlike physical assets human assets never gets depreciated.

What is important here is that the physical resources are being activated by the human resources as the physical resources cannot act on their own. Therefore, the efficient and effective utilization of inanimate resources depends largely on the quality, caliber, skills, perception and character of the people, that is, the human resources working in it.

TEORETICAL REVIEW

Human Resource Accounting means accounting for people as the organizational resources. It is the measurement of the cost and value of people to organizations. It involves measuring costs incurred by private firms and public sectors to recruit, select, hire, train and develop employees and judge their economic value to the organization. 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". HRA, thus, not only involves measurement of all the costs/investments associated with the recruitment, placement, training and development of employees, but also the quantification of the economic value of the people in an organization.

According to Likert (1967), the objectives of HRA are to:

1. Provide cost value information about acquisition, development, allocation and maintenance of human resources so as to achieve organisational goals in an effective manner.
2. Enable management of the organisation to effectively monitor the use of human resources.
3. Ascertain whether human assets are conserved, appreciated or depreciated during a given period of time.
4. Assist in the development of effective management practices by classifying the financial consequences of various practices followed by the organisation.

Over the years, there have been significant developments in finding ways to measure knowledge, skills and other variables related to human resource. A number of methods or approaches have been developed for the valuation of human resource. These approaches to HRA may be classified into following categories:

1. Monetary Approaches: The approaches which take into consideration the monetary aspects are known as monetary models. The monetary models are classified into:
   a. Cost Based Approaches: Some of the cost based models of human resource valuation are acquisition cost model, replacement cost model, opportunity cost model, standard cost model etc. which focuses on the expenses incurred on human resource for its valuation.
   b. Value Based Approaches: Some of the value based approaches are adjusted discount future wages model, present value of future earnings model, stochastic rewards valuation model, net benefits method etc. which focuses on the value derived by an organization from its human resource for its valuation.
2. Non-Monetary Approaches: The approaches which focus on the behavioral aspects of human resource are classified as non-monetary approaches. Likert's Casual, Intervening and End result variables model of human valuation is one such approach.

RESEARCH METHOD

Review of literature is the method used in this study, divided into two parts to cover the basic aspects of Human Resource Accounting, which are first, the historical aspects of human resource accounting as well as the need of usage of human resource accounting leading to the emerging of human resource accounting concepts, and secondly, studies that develop the valuation models for the measurement of human resource accounting.

RESULT AND DISCUSSION

This part of this study focuses on the evolution of concept of human resource accounting which is majorly the limitations of the conventional accounting concepts and principles.

Brummet et al. (1968) aimed to focus on the need for Human Resource Accounting. The financial statements prepared as per the conventional accounting principles and conventions are not adequate to answer questions relating to human resources like its value, changes, conditions, profitability, earnings capability etc. The trends in human asset investment ratio (human assets to total assets) can be useful predictor of future profit performance. There is a positive correlation between the investment in human resource and profitability of firm. Information about cost incurred from personnel turnover would be helpful to take appropriate remedial actions. HRA information is important for evaluation of alternatives, in taking capital budgeting decisions involving HR and evaluating investments in HR. HRA provides timely, relevant, verifiable and quantifiable information about HR to help taking informed decisions.

Flamholtz (1999) divided the development of HRA in five stages. First stage (1960-66) marked the beginning of academic interest in HRA and focus was on developing HRA concepts from other studies like emerging concepts of HR, leadership-effectiveness theories, goodwill measurement. Second stage (1966-71) focused on developing and validating valuation models for HRA, earliest work done by R. Hermanson followed by other researchers to treat HR value as a part of goodwill. Third stage (1971-76) marked a rapid growth in research in HRA and focused on understanding issues and challenges related to application of HRA in organizations. Fourth stage (1976-80) saw a decline in research in HRA because large sums of money were required for deeper research which organizations were not willing to sponsor. Last stage (1980 onwards) experienced a sudden renewal of interest in HRA as many manufacturing economies became service economies whose growth depends upon intellectual assets of firm. Many firms actually started to adopt HRA practices.

Rao (2014) argued that financial statements without taking into consideration the concept of human asset does not give a true and fair view of firm's position. Employees are the reason that firms develop their competitive advantage. Many organizations like Kodak, P&G, Motorola, IBM, Ford, General Electric, Boeing, Xerox etc. have invested huge amounts of money in training and development of their employees; thus, there is a strong need to establish an investment perspective for human resource, which makes it mandatory to evaluate returns from investment made in human resource. Also, treatment of employees as assets provides them with a sense of job security and hence, it acts as an employees' morale booster.

Monetary Approaches: This is classified into cost based and value based approaches.

Cost Based Approaches

Heckiman and Jones (1967) developed Opportunity Cost Approach and used competitive bidding for human resource valuation. The authors suggested a competitive bidding for only scarce employees within the organization to determine their opportunity cost. Opportunity Cost refers to the value of asset having an alternative use. Hence, only an employee who is scarce i.e. having an alternative use, forms a part of human asset. An employee is considered to be as scarce if its employment in one division deprives the other of the same talent. Various divisions bid for their required scarce employee and the employee is allotted to highest bidding division. The successful bid forms a part of this division's investment base. The opportunity cost of the employee of one division is determined by the offer (bid) made for such employee by other division in the same organization.

Pyle (1970) developed the Historical Cost Approach for valuation of HR and was assisted by R. Lee Brummet & Eric G. Flamholtz. Historical cost or acquisition cost or outlay cost or the original cost refers to the actual cost or expenses that are incurred on human resources in the form of recruitment, selection, training, development. Under this approach, the historical cost is capitalized and to be amortized over the expected useful period of human resource in the organization. In case, human asset leaves the organization before the expected period, the balance acquisition cost which is not amortized is fully charged against the income of current year. If actual useful life of the asset exceeds the expected useful life, the amortization schedule needs to be revised. Any additional cost incurred is also capitalized and written-off over the remaining useful life of human asset. The unamortized value is the value of human asset or the investment in human asset.

Flamholtz (1973) developed Replacement Cost Approach. The approach was first suggested by Rensis Likert. Replacement cost refers to the cost of recruiting, selecting, hiring, that a firm would have to incur to replace its existing human asset with human resource having equivalent experience, capabilities, talents and cost incurred for training and developing the replacement to meet present level of efficiency and familiarity with the organization. The human asset should be valued at its replacement cost to the organization from time-to-time.

Value Based Approaches

Hermanson (1964) gave Adjusted Discounted Future Wages Model for human resource valuation. It is based on the assumption that the differences in the profitability of the firms are due to the differences in the efficiency of the employee. It thus, relates the valuation of human resources with the extra profits the firm earns over and above the normal industry's expectations. An employee's value to the organization is the discounted future wage stream adjusted for the efficiency ratio. The discounted future wage stream is the present value of wage payments to human resource for the succeeding five years using a normal rate of return in industry. Efficiency ratio is the weighted average ratio of actual average earnings of the firm to average normal earnings of all the firms in industry for last five years where weights are given in reverse order, highest weight 5 is given to current year and lowest weight 1 is given to preceding fourth year.

Lev and Schwartz (1971) developed the Present value of Future Earnings Model. The authors developed this model stating that value of human resource is the present value of his earnings in the remaining years of his employment with the organization. It is also called Capitalization of Salary Method. It is assumed that there is significant relationship between employee's salary (earnings) and his value to the firm. The total workforce is divided into homogeneous groups on the basis of age, skills, designation, tasks etc. and average annual earnings stream till their retirement is determined for each group. The earnings of each group are discounted at rate of cost of capital; the total present value of earnings of all the groups is the capitalized future earnings of the firm as a whole which represents the value of human resource. The authors also provided the valuation model in case of employee's death before retirement.

Flamholtz (1971) came out with Stochastic Rewards Valuation Model stating that value of human resource is the present value of the future benefits/services/rewards to the firm that an employee is expected to provide during his working life taking into consideration the fact that his movement from one organizational role to another is a stochastic process and so are the rewards. According to this model, the value of future services expected to be derived from an employee at each role that he is expected to occupy for different time periods in his service life is estimated along with the probability that he will occupy different roles for future periods. The estimated total value to be derived from all the employees is discounted at an appropriate rate to obtain value of human resource. The Flamholtz's model was restated using groups instead of individuals because it is easier to predict the percentage of people in particular group who are likely to leave the organization or get promoted than to predict the same for an individual. The authors make an assumption of constant pattern of career movement and probabilities for one year are extended to future periods.

Morse (1973) developed Net Benefit Model and valued human resource as present value of net benefits derived from employees by an organization. It involves determining gross value of services expected to be received from employees in individual and collective capacity and of and the future payments to him. Net benefit derived from an employee is excess of benefits over payments. The present value of net benefits is determined by discounting it at a pre-determined rate usually the cost of capital. Such present value for all the employees of the organization represents the HR value.

Non-Monetary Measure

Likert and Bowers (1968) developed HR valuation model in which measurement of human resource value is done as a group to the organization. The authors have classified human variables into three categories namely, Casual variables, intervening variables and end result variables. The casual variables are independent variables that can be altered by management like organizational structure, leadership styles, managerial behavior etc. The intervening variables reflect internal performance capabilities and health of the organization like motivation, perceptions, loyalty, commitment etc. required for effective decision-making, communication. The end result variables are dependent variables that reflect the results achieved by an organization like productivity, revenue, costs, earnings, market share etc. The authors argued that a change in casual variables result in changes in intervening variables that produce change in end result variables.

Based on literatures previously explained it is possible to provide a few limitations or constraints in implementing human resource accounting. First, determining of human resources "cost" and "value". In general, there is no guidelines in how to determine and differentiate the cost and value of human resources. Any specific way of determining human resources cost and value could make organization of corporation to face many drawbacks. Human life itself is uncertain and hence valuing the asset under such "foggy" conditions is not proper. Like physical assets, human assets cannot be owned, retained and utilised at the sweet will and pleasure of an organisation (Soni, 2016).

Second, the dehumanising human resources. Human resource accounting methods put a person to a certain degree of "cost" and "value". This could lead a person with a lower "value" to feel discouraged in doing their activities. This might be affecting his/her quality of work.

Third, the measurement problem of human resource accounting methods. All the methods in human resource accounting are using assumptions to determine the cost and value, which could go wrong at any time. This could lead to misunderstanding of total quality of work that could be provided by any person. There is no agreement among the accountants and financial professionals regarding the measurement process.

Fourth, the valuation of human resource lifespan cannot be estimated, which could make the valuation result unrealistic. Fifth, the reliability of valuation could differentiate each time the method conducted, that could result in the unreliability of data.

CONCLUSION AND RECOMMENDATION

Human resource accounting is a new branch of study with a lot of potential discussions and methods available. Using the right concept would create so many points of view that would lead to the popularity of this study. Human resource is one of the biggest active elements in organization or corporation that could make a significant difference whether is activities or in production. Even with its own potential, there are several limitations that could prevent this study to go any further. A proper system of human resource accounting, in theory, could be essential for organization real performance and result.

REFERENCES

Brummet, R.L., Flamholtz, E.G. and Pyle, W.C. (1968). Human Resource Measurement-A Challenge for Accountants. The Accounting Review, Vol. 43, No. 2 (Apr.,1968), 217-224.

Flamholtz, E. (1999). Human Resource Accounting: Advances, Concepts, Methods and Applications, Boston, MA: Kluwer Academic Publishers.

Flamholtz, E. G. and Likert, E. (1973). Human Resource Accounting: Measuring positional replacement costs. Human Resource Management 12(Spring), 8-16.

Flamholtz, E. G. (1971). A Model for Human Resource Valuation: A Stochastic Process with Services Rewards. Accounting Review, 46(2), 253-267.

Hermanson, R. H. (1964). Accounting for Human Assets. Occasional Paper No. 14, Graduate School of Business Administration, Michigan State University, 1-69.

Jain, R. (2017). Human Resource Accounting Methods: A Literature Review. International Education & Research Journal Vol. 3 Issue: 6. E-ISSN No: 2454-9916.

Lev, B. and Schwartz, A. (1971). On the use of the Economic Concept of Human Capital in Financial Statements. Accounting Review, 46(1), 103-112.

Likert, R. and Bowers, D.G. (1968). Organizational Theory and Human Resource Accounting. American Psychologist.

Morse, W.J. (1973). A Note on the Relationship between Human Assets and Human Capital. The Accounting Review, Vol. 48, No. 3 (Jul., 1973), 589-593.

Pyle, W. C. (1970). Human Resource Accounting. Financial Analysts Journal, September-October, 1970, 69-78.

Rao, Dr. A.L. (2014). Human Resource Accounting: a frame work for better Financial Accounting and Reporting. IOSR Journal of Business and Management, Volume 16, Issue 4, 86-90.

Soni, D. (2016). Human Resource Accounting: An Overview. International Journal in Management and Social Science Vol. 04 Issue-04. ISSN: 2321-1784.