Human Resources Accounting – Universal Approach

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Abstract: Human Resource Accounting (HRA) involves accounting for the company’s management and employees as human capital that provides future benefits. In the HRA approach, expenditures related to human resources are reported as assets on the balance sheet as opposed to the traditional accounting approach which treats costs related to a company’s human resources as expenses on the income statement that reduce profit. HRA suggests that in addition to the measures themselves, the process of measurement has relevance in decision-making involving organizations. Although the origins and early development of HRA occurred mostly in the United States, interest and contributions to growth in the field have been evident in a number of other countries. This paper provides a brief overview of HRA from an international perspective. In recent years, the financial reporting standards used in Generally Accepted Accounting Principles (GAAP), have been moving toward adoption of more complex measurement methods compared with the traditional historical cost approach to asset measurement. The strong growth of international financial reporting standards (IFRS) is another indication that the environment for financial accounting reporting is one that potentially encourages the consideration of alternative measurement and reporting standards. Accountants and others in the financial reporting environment have become accustomed to using more complex measurement approaches to the financial statement reported amounts. This would lend support to the possibility that future financial reports may include nontraditional measurements such as the value of human resources using HRA methods.

Keywords: Human resources accounting, Accounting standard, Universal practice

1. Introduction

Human resource accounting (HRA) is of topical origin and is struggling for acceptance. It is clearly said that, Human resources accounting is an accounting measurement system and a large body of literature has been published in the last decade setting for the various procedures for measurement. At the same time the theory and underlying concepts of accounting measurement have received generous attention from academicians and a substantial body of literature has been developed. Under conventional accounting system, human resources are not recognized as physical or financial assets.

Human Resources accounting, also known as Human Asset Accounting, is an information system involved in identifying, measuring, capturing, tracking and analyzing the potential of the human resources of a company and communicating the resultant information to the stakeholders of the company. It is a method by which a cost is assigned to every employee when recruited, and the value that the employee would generate in the future. Human Resource accounting reflected the potential of the human resources of an organization in monetary terms, in its financial statements.

Back in mid of 1980’s, behavioral scientists criticized the conventional accounting system for its failure to value the human resources of the organization. In this changing perspective the accountants were also called upon to play their role by assigning monetary value to the human resources deployed in the organization. Furthermore, the sturdy
growth of international financial reporting standards (IFRS) is another indication that the
environment for financial accounting reporting is one that potentially encourages the
consideration of alternative measurement and reporting standards.

2. Objectives

[1] To study the concept and theoretical framework of human resources accounting.
[3] To analyze the international developments in human resources accounting

3. Concept of Human resources accounting

American Accounting Association defines Human Resource Accounting, “HRA is a
process of identifying and measuring data about human resources and communicating this
information to interested parties.” It simply means accounting for people as an
organizational resource. It involves identification and measurement of the cost incurred
by an organization to recruit, select, hire, train and develop human assets. In the same
vein, it measures the economic value of people in the organization. Human Resource
Accounting ensures that expenditures relating to human resources are treated as assets as
opposed to traditional accounting arrangement which treat such costs as operating
expenses. It is not only an effective tool for decision-making but is also widely employed
in framing policies for human resources.

4. Theoretical Frame Work

Human Capital Theory

winner of the Nobel Memorial Prize in Economic Sciences, came up with the Human
Capital theory in 1961. He researched into why post-World War II Germany and Japan
recovered faster than United Kingdom despite the devastation suffered by the former. His
research showed that the speed of recovery in Germany and Japan was due to a healthy
and highly educated population. He discovered that United Kingdom was still rationing
food long after the war.

Gary Stanley Becker (1930 – 2014), an American economist and Nobel Prize winner,
is another foremost exponent of Human Capital Theory. He researched into the impact of
positive and negative habits such as punctuality and alcoholism on human capital. He
employed the different rates of return for different people and the resulting
macroeconomic implications. He equally brought out the difference between general to
specific education and their influence on job-lock and promotions.

According to the theory, Human capital theory contends that education or training
raises the productivity of workers by imparting useful knowledge and skills, thus raising
workers’ future income as well, through increase in their lifetime earnings (Enyi and
Adebawojo, 2014).

For instance, all competitor firms have the potential to accrue equal value by acquiring
employees with knowledge of general management, the ability to apply financial ratios, or
general cognitive ability. On the other hand specific skills, provide value only to a
particular firm, and such skill are of no value to competing firms. An instance of this is
the knowledge of how to use a particular technology used only by one firm, or knowledge
of a firms policies and procedures provided to that firm, but usually would not be valuable
to other firms.
Enyi and Adebawojo (2014) links up the relevance of Human Capital Theory to Human Resource Accounting on the ground that it considered the cost of education, training, development and even workers medical treatment as investments which is expected to reflect in increased or improved productivity of individual workers.

**Learning Curve Theory**

Learning Curve Theory, according to Akintoye (2012), is concerned with the idea that when a new job, process or activity commences for the first time it is likely that the workforce involved will not achieve maximum efficiency immediately. Akintoye (2012) further states that repetition of the task is likely to make the people more confident and knowledgeable and will eventually result in a more efficient and rapid operation.

Learning curve is basically a measures of the experience gained in production of an article or product by an individual or entity. The more a product is produced, the more efficient the worker becomes. Thus, each subsequent unit consumes fewer man-hours to produce.

The theory is built on the belief that as the quantity produced of a given product doubles, the cost of that product decreases at a fixed rate. Initially, the time required to carry out a task declines and finally stabilizes when efficiency is maximized. Cumulative average time refers to the average time per unit for all units produced so far, from and including the first one made (Akintoye, 2012).

The Model of unit curve is denoted as: \( Y_x = K x \log_2 b \)

Where

- \( K \) is the number of direct labour hours to produce the first unit
- \( Y_x \) is the number of direct labour hours to produce the \( x \)th unit
- \( x \) is the unit number
- \( b \) is the learning percentage

### 5. Human Resource Accounting and International Financial Reporting Standards

There is no accounting standard on treatment of Human Resource Accounting either from the International Accounting Standards Board or the Financial Reporting Council of Nigeria. Meanwhile, (Badiyani, 2012) identifies the growth and wide acceptance of International Financial Reporting Standards (IFRS) as a trigger for the necessity of considering human resources as an asset of the firm.

Scholars have predicted that there would be recognition of Human Resource Accounting by International Accounting Standards Board going by the current wave of adoption International Financial Reporting Standards and the desire to improve on economic information provided by financial statements.

Akintoye (2012) notes that from the very hot debate going on the adoption of IFRS since 2004 in many countries, it thus appear to us that the issue of human resource accounting may soon find a prominent place in international reporting, as the failure of so many enterprises is now pin down to human behaviour/failure rather than failure of known traditional /conventional assets. He points to the Enron’s case which is still fresh in our minds.
Badiyani (2012) supports this position when he observes that the current environment having wide acceptance of International Financial Reporting Standards (IFRS) have encouraged the consideration of non-traditional approach towards the human resources. He further asserts that there is a possibility that future financial reports may include more and more non-traditional measurements such as value calculated of human resources using various HRA models.

Economic information in financial statements is incomplete without the inclusion of non-financial metrics such as human resources, customers, technology and internal processes. Kashive (2013) underscores the importance of non-financial metrics as the value drivers of the organization, representing the value of the company’s work force, its customer relations and its ability to innovate.

The current treatment of Goodwill under IFRS 3 and growing clamour for measurement of the time value of money of assets in financial statements have opened a new vista of opportunity for inclusion of Human Resource Accounting in financial statements. Under International Financial Reporting Standards, certain assets are now reported at their fair market value at each balance sheet date, & many items on the balance sheet that are noncurrent are measured at the present value of the estimated future cash flows.

IAS-38 on Intangibles Assets & IFRS-3 on business combinations allows for the recognition of the intangibles assets -Goodwill.

The accounting standard IAS 19 on Employee benefits merely sets out the accounting treatment and disclosure for employee benefits. It does not specify how human asset should be treated in financial statements. The standard classifies four (4) types of benefits as follows:

i. Short-term employee benefits, such as wages, salaries, vocational holiday benefit, sick pay, profit sharing, or bonus plans paid within 12 months of the end of the period, and non monetary benefits, such as medical care and so on, for current employees.

ii. Postemployment benefits, such as pensions, postemployment medical benefits, and postemployment life insurance.

iii. Termination benefits, such as severance pay.

iv. Other long-term employee benefits including long service leave or sabbatical leave.

Classifying some of the aforementioned benefits as post-employment benefits indicates sufficient justifications for capitalization of such benefits as assets to finance the future liabilities, also IAS 19 includes planning for some employees benefits as plan assets, this may be considered as a declared statement for capitalization some of employees benefits, these plan classified in IAS 26 into two categories: defined contribution plan , depending on these plans, an entity pays a fixed contribution into a separate entity (fund) and will have no legal or constructive obligation to pay further contributions if the fund does not have sufficient assets to pay employee benefits relating to employee service in the current and prior periods (Jaarat, 2013).

6. International Developments in Human Resource Accounting

Interest in HRA related reporting has grown in a number of countries across continents. In discussing “HR metrics,” 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. Some research has focused specifically on the authors’ country, on the implications for the international development of HRA are as follows.

**United Kingdom**

Morrow (1996 & 1997) investigated the concept of football players in the United Kingdom as human assets and the importance of measurement as the critical factor in asset recognition. In another publication Wagner (2007) suggested that human capital (people and teams) is one of the intangible assets that investors look for in valuing a company, along with structural capital (processes, information systems, patents) and relational capital (links with customers, suppliers, and other stakeholders). However, according to an analysis of more than 600 manufacturing and service companies in research led by Dr. Chris Hendry, Centenary Professor of Organizational Behaviour and Human Resource Management at the Cass Business School, City University of London, Wagner notes that annual reports now overemphasize the role of relationship capital in company performance and minimize the role of human capital, giving a skewed view of companies’ future performance. A conclusion was that the long-term value of innovative workers is not getting enough attention from companies preparing annual reports for investors, according to research for Britain’s Economic and Social Research Council. Although the annual reports provide glowing accounts of R&D spending and numbers of patents, including those generated by the innovators have left the company, the reports are less likely to focus on the numbers of innovators that have left the company and have thus reduced the company’s future prospects for innovation.

**Australia and New Zealand**

Gusenzow and Tower (2006) note that the Australian Football League (AFL) is Australia’s premier spectator sport involving millions of people across a wide range of communities, and that it is not surprising that the most valuable assets as regarded by AFL clubs and the AFL hierarchy are the players, the organization’s biggest revenue drivers. However in the authors’ survey of 79 AFL-linked individuals and 58 accountants and accounting academics to assess whether key stakeholders considered putting the value of players on a balance sheet a plausible idea, findings showed that the majority of respondents disagreed with the concept of showing the value of AFL players in their clubs’ balance sheet. However it is interesting to note that the results from the logistic regression analysis and ANOVA analysis show there is a significant relationship between the concept of valuing AFL players, and both the type of respondent and their knowledge of accounting. Gusenzow and Tower note that although player valuation is a plausible and arguably important idea, a reason for the resistance by AFL respondents could be that AFL has a salary cap to limit amounts paid to players and no transfer fee system. Although the evidence from study did not demonstrate a need to implement player valuations, a move towards financial statement player valuation may be needed if AFL clubs emulate other overseas sporting codes and list on the stock exchange.

Other Australian authors Whiting & Chapman (2003) also investigated the merits of HRA in a professional sport—rugby. The authors comment that the Australia and New Zealand rugby union is a combination guaranteed to stir patriotic feelings across the Tasman. The authors raise the question that since rugby players are the team’s most valuable assets, should their value be placed on the balance sheet, and does doing so make any difference to decisions made by financial statement users. They comment that professional sport has been prevalent in the United Kingdom and the United Stated for nearly 200 years, but arrived much later in Australia and New Zealand. In the United
Kingdom and the United States, professional sports teams’ financial accounts often incorporate HRA, in which a value for the employees is placed on the balance sheet and is amortized over a period of time, instead of expensing costs. The authors refer to the big question being whether HRA information is more useful to the decision-maker than the alternate expensing treatment, and that past research has shown that sophisticated users of financial information do make significantly different decisions with the different presentations.

The outcome was tested in New Zealand in a survey questionnaire responded to by 64 members of the professional body Institute of Chartered Accountants of New Zealand. On an overall basis, the study shows that generally accountants will make the same investment decisions regardless of whether human resource information is expensed or capitalized. The authors noted, however, that their exercise only explored one type of decision-making process, and that prior studies may have been of a wider nature, thus explaining the differing result. They then suggest that if HRA is to follow the international trends emerging in intangibles reporting, capitalized human resource information may become more prevalent.

**China**

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 labor contracts, and personnel budgets in monetary terms. Tang (p. 2) notes that an increased focus on human resource management and improved information technology has led to a saying “what you cannot measure, you cannot manage.” The author adds that since the time when China espoused an open policy of reform there have been many brave attempts to seek new ways for handling organization and management. Tang (p. 14) also suggests that HRA information can aid in budgeting of human resources recruitment and development. The hard costs in human resource replacement cost are the actual investments in human resources which reflect the historical direct costs of recruiting, orientating, and training people. Combining these hard costs with human resource demand can help a company budget its personnel activities more reliably. Tang (p. 15) 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 labor contract and personnel budgets in monetary terms. Care should be taken to recognize that high human resource costs should not be viewed as negative and low costs as positive in that, for example higher costs could indicate higher-quality training.

Although the HRRC system developed was based on a pilot study and still requires refinement and extensions, it does represent a meaningful contribution to the practice of HRA, and an expected result is a new awareness by management of the high costs of turnover. Ng (2004, p. 26) further comments on the benefits of HRA related information and notes that measuring and managing human capital is not rocket science, but is (p. 26) “simply a defined framework to maximise the only real competitive advantage companies have in the knowledge economy—their human capital assets.” Ng notes that to derive and quantify value from this human asset requires human capital analytics—an entirely new class of systems that aggregates HR data financial, customer and supplier information for exploration, analysis and presentation. According to the author, human capital analytics
supports rapid decision backed by quantifiable, accurate information and defensible forecasts, and in addition helps identify essential insights that allow organizations to proactively apply strategic human capital initiatives to meet corporate objective.

Portugal

Bras & Rodrigues (2008) analyzed two competing approaches to accounting for a firm’s investment in staff-training activities: the accounting and labour economics approach which argues that no asset should be recognized from training activity and the human resources management approach, espoused by HRA that advocates recognition of an asset. The authors used document analysis and interviews in their attempt to understand the training phenomenon from the company’s point of view. The paper provided a case-based empirical analysis of accounting and human capital and asset recognition arguments, and clarifies the situation in which assets should be recognized as generated by training expenditures.

Germany

Schmidt & Minssen (2007) explored to what extent human resource practitioners value and account for international assignments, and to relate these findings to the human resources cost accounting context. The authors drew on data from a quantitative survey among German chemical companies and expert interviews with human resource managers from eight chemical companies. They found that human resource managers appreciate the positive effect of overseas assignments on personal development, but often underestimate the long-term benefits of an international assignment for the company.

Canada

Jones (2000, p. 9) writes that “Financial reporting systems need to account for people. The author indicates that the issue of providing bottom line worth for training, wellness programs or employee satisfaction surveys remains an ongoing struggle with HR executives in Canada, and laments why one is required to make the business case for something that is intrinsically known to be important to financial importance. The author refers to the International Accounting Standards Committee (IASC) recently published standard on Intangible Assets (IAS 38) and comments on reports that investment and awareness of the importance of intangible assets have increased significantly in the last two decades. Furthermore the author notes that while the standard is expected to have no direct impact on how Canadian chartered accountancy firms report and file (unless the firm is multi-national with offices in countries required to comply with IASC standards) it does give a global definition to intangibles. Jones (p. 2) called for researchers to team up with practitioners to create the knowledge base required for the development of a whole new measurement system for value creation that would operate in parallel with the existing value realization measurement system. The author noted how the Canadian Performance Reporting Initiative Board is being established to advance knowledge in the intellectual capital management and other areas critical to performance measurement, providing a golden opportunity for HR leader to work together to ensure that people count.

Greece

Andrikopoulos (2005) attempted to bridge the gap between traditional financial theory and intellectual capital (IC) reporting by proposing a model where organizational priorities were set as the solution to a portfolio selection problem. The solution to this problem provides priorities for organizational change. The author notes that the quantitative approach in the paper requires extensive use of data on organizational
performance found in IC statements, and that when it comes to human capital IC reporting, works on results from HRA, which have been extensively applied in the academic and business communities. Andrikopoulos found that that the model helps discover corporate strengths and uses them to set organizational priorities for IC value creation.

India

Interest in measuring human capital has also been apparent in India. Mahalingam (2001, p. 19) notes that “Pundits of today assert that while the other forms of capital, including material, equipment, tools and technology, only represent inert potentialities, it is the human capital that converts this potential and energizes the creation of wealth.” This author suggests a human resource value approach based on a person’s skills and the returns these skills are expected to return over the next five years, with future years discounted to arrive at the current value.

Mahalingam notes that each person has a set of competencies and a value is assigned to each, with the sum total of these values making up the value of the employee and the value of all the employees making up the human capital of the organization—which together with the customer and structural capital produces the revenue. In a case study conducted in India, Patra, Khatik & 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. Bhat (2000, p. 1) provides a definition of “HUMAN resources accounting” as depicting the human resources potential in money terms while casting the organization’s financial statements. The author refers to several measurement models including the Brummet et al. model (1968a, 1968b, 1969) based on historical cost method with provisions for appropriate depreciation and replacement cost of acquiring, training and developing the entire human resources, and competitive bidding proposing the capitalizing of the additional earning potential of each human resource in the organization. The author also mentions the Jaggi & Lau (1974) model estimating the human resources worth on a human resource groups basis with the groups accounting for productivity and performance, and Hermanson’s (1964, 1986) unpurchased goodwill method in which the marginal higher earning potential of human resources in comparison with similar industries is capitalized. Bhat 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.

7. Conclusion

International contributions made to the field of HRA have resulted in growth of both the field HRA and the wider study of human capital, human resource metrics, intellectual capital, and organizational management. Along with advances in HRA theory, it is encouraging to note that some studies have been based on empirical research, case and field studies. Both the process and inclusion of HRA measures in human resource decisions are expected to have implications from the standpoint of providing measures that can compete with other investment proposals for the firm’s resources, and demonstrate that the long-term benefits from such investments can be positive. The movement toward fair value accounting seen in recent years, for both ICAI as well as for international standards, indicates a more sophisticated approach to the measurement of
assets, tangible as well as intangible. This might suggest a willingness to recognize the need for, and consider the measurement and use of HRA in future external financial reporting.

8. References

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