

HUMAN RESOURCE ACCOUNTING – AN OUTLOOK

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Abstract

The key strength of an Organization depends upon its human capital. Human Capital plays an important role for organizational success.

In the current business environment, human capital is regarded as a key source of competitive advantage. With the 'knowledge agenda', companies view their employees as an important resource and invest heavily in them. But the value of human capital is not adequately reported to stakeholders because of strict recognition criteria for intangible assets and problems in measurement that do not allow human capital to be valued and reported. Information on human capital and its development is important to financial analysts and fund managers, who need to assess the future direction, potential and values of companies. Adequate disclosure of human capital information is an important matter since it affects not only a firm's ability to recruit and retain the best people, but also conveys a firm's potential to create value. Hence, the objective of this paper is to calculate and report the value of human capital for 2 Units of a company and the future trends of human capital for 10 years.

Since the Automobile Industry plays crucial role in Domestic & Global Market, this study deals with the assessment of human capital of 2 automobile units of TVS & Sons Ltd., situated in Pudukkotai District and Trichy District of Tamil Nadu. This is the first attempt being made to take up a study on human capital investment in these 2 Units for the F.Y.2005-06 to F.Y.2009-10. The valuation of Human Capital is done by applying Lev & Schwartz economic model, taking into consideration the direct & indirect benefits paid to the employees. This calculation is done on the basis of data available in the annual of reports of the Outlets.

This study helps the Corporate to make a report on human capital management as an annexure to Balance Sheet. This research will enable the Industrial Units to improve the Standard of the Corporate reporting, which is very useful to the stake holders.

Key words: Human Capital, Human Asset, Human Resource Accounting (HRA), TVS-PDK, TVS-TRY

1. Introduction

One of the objectives of financial reporting is to provide useful and relevant information to users for their decision making. Corporates tend to fulfill the needs of their primary stakeholders, especially the investment community since it is costly to satisfy the needs of entire stakeholders. The information produced by the traditional accounting system has limited usage for making investment plans. In order to overcome this difficulty,

corporates have started making voluntary disclosure statement along with mandatory financial reports. These voluntary disclosure statements include Report on Human Capital, Social Balance Sheet, Report on Environmental accounting and so on. To enhance the usefulness of corporate reporting, companies are increasingly supplementing mandatory financial reports with voluntary disclosures about intellectual capital, including human capital (Holland 2003)

Human capital has long been recognized as a vital asset and value creator to companies. In Roslender and Dyson (1992), ‘value’ was seen in a broad sense as “enhancing the performance of an organization”. More recently, Swart (2006) refers to “core competence, knowledge creation and innovation ... creating value over and above physical and financial resources”

However the criteria of IAS 38 restrict the recognition of human capital as an intangible asset because companies do not have control over market for managers and other employees as well as the future economic benefits expected to flow from them. Human capital is one of the key non-financial areas of business activity where greater disclosures in the annual report and accounts are likely to be demanded in the future. Since Employee related policies are significant for an understanding of the overall performance, there would be a possibility of disclosures in Operating and Financial Review Statements in future.

2. Review of Literature

A study conducted by Mahalingam (2001) reveals that human capital converts the potential i.e., material, equipment, tools & technology and energizes the creating of wealth. The author suggests the method of arriving at human capital by Net present value approach. The value of competency possessed by the employees together with the value assigned to them, make the Value of human capital.

In a case study conducted by Patra, Khatik & Kolhe (2003) in a profit making heavy engineering public sector company (BHEL), 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.

Morrow (1996 & 1997) investigated the concept of football players in the United Kingdom as human assets and the importance of measurement as a critical factor in asset recognition.

3. Statement of the problem

A study by Graham, Harvey and Rajgopal shows that managers often delay or forego investment in sound projects (projects in which there is a positive net present value) in order to “manage” quarterly earnings and meet market expectations. This behavior occurs for both tangible and intangible investments. It could however, be postulated that intangible investments and human resource investments in particular, may be prone to being viewed as discretionary since they are traditionally viewed as costs.

Even though many efforts have been made by researchers in this field, a suitable and fully validated model of performance based accounting in the Indian context is not available. The past few decades have witnessed a global transition from manufacturing to service based economies.

In these circumstances, Human Resource Accounting is struggling to gain acceptance.

Sir William Petty was perhaps the first person to make an attempt to signify the HR accounting in around 1691. He treated the labor as the generators of wealth. Even Adam Smith recognized the investment on human resources. The post 1960’s witnessed a significant development of business people joining hands to evolve suitable models for measurement of human capital.

Rensis Likert, a Social psychologist and early pioneer of Human Resource Accounting advocated its inclusion in the formal accounting system.

The reasons for lack of importance of HRA are:

1. The valuation of human capital, the efficiency and productivity disclosures are not seriously considered since human resources are available in plenty in our Country.
2. No statutory requirement either under Companies Act or under Indian Accounting Standards.
3. There is no requirement for disclosure of human capital under the listing agreement framed by SEBI
4. There is no well defined measurement system for valuation and reporting on human Capital.

In order to address the above difficulties, the researcher has made an attempt to value the human capital of 2 units selected as sample for this empirical study.

4. Concept of Human Resource Accounting

The concept of human resource accounting can be basically examined from two dimensions:

- (i) The investment in human resources (Cost)
- (ii) The value of human resources. (Benefit)

The expenditure incurred for creating, maintaining and updating the human resource quality is known as investment in human resources. Such investment yields fruitful results like higher productivity and higher income to the organization. The yield that the investment in human resources generates will be considered as the basis of human resource value.

The Human Resources Accounting has been defined by the Committee on Human

Resource Accounting of the American Accounting Association as ‘the process of identifying and measuring data about human resources and communicating this information to the interested parties’.

Human asset is also defined as the total value to an enterprise of its employees, plus the value of any other Assets owned by the company for the exclusive benefit of employees. Human capital is the equivalent of the total value to an enterprise of its employees.

5. Historical development of HRA

Eric G Flamholtz divides the development into five stages as follows:

First Stage (1960-66): This makes the beginning of academic interest in the area of HRA. The focus was primarily on deriving concepts from other studies like economic theory of capital, psychological theories of leadership – effectiveness relations.

Second Stage (1966-71): The focus was more on developing and validating different model of HRA. Theses modes include both monetary and non-monetary value of HR. Roger Hemanson, who as part of his Ph.D., studied the problem of measuring the value of human assets as an element of goodwill. Inspired by his work, a number of research projects were undertaken by the researchers to develop the concepts & method of accounting for human resources.

Third Stage (1971-76): This period was marked by rapid growth of research in the area. The focus was on the issue of application of HRA in business organizations. R.G. Barry’s experiments contributed during this stage.

Fourth Stage (1976-1980): This was a period of decline in the area of HRA due to complex issues that needed empirical research and the organizations did not find much use in pumping in large sums or

investing lot of time & energy in supporting the research.

Fifth Stage (1980 onwards): There was a sudden renewal of interest in the area of HRA. Due to shifting of manufacturing to servicing economies, the organizations began to realize the value of intangible assets since the survival, growth and profits of the organizations were perceived to be dependant more on intellectual capital than on physical assets. The shifting to knowledge based industries, gave importance to the valuation of Human resources in financial accounting practice.

In India, though the HRA accounting has not been institutionalized, Many Public & private sector companies have starting adopting the concept of HRA. (Examples: BHEL, ACC Cements, Infosys, MMTC, NTPC, SPIC)

The process followed to assign value to the human resources is similar to the mechanism used in evaluating the physical capital budgeting proposal. The focus is to calculate the present value of the salaries to be paid to an employee throughout his or her association with the organization till his or her retirement. This discounted figure represents the revenue generation potential of the human resources.

6. Applications of HRA

Reports on human capital prepared for 31.03.2010 with regard to sample units TVS-PDK and TVS-TRY are presented below. Tables showing the trends in the human capital values and graphical representation are also presented. Lev and Schwartz economic model has been applied.

It consists of the following 2 Steps:

Step I

It covers the classification of employees by segregating the staff & workmen, age-group wise, ranking skilled & unskilled, calculating the remaining period of service and adopting the direct benefits & indirect benefits of employees as accounted in P&L a/c, for arriving at the yearly earnings.

Step II

It deals with the application of discounting rate of 15% (present value annuity) for calculation of present value for average earnings per employee. Finally Human capital is arrived at by multiplying the no. of employees with present value calculated (refer Appendix for details). This practical approach based on Lev & Schwartz model, will enable the industrial units to improve the standard of corporate reporting, which is very useful to the stake holders.

Table-1 Report on Total value of Human Capital as on 31.03.2010 in Sample Unit-PDK

AGE GROUP	UNSKILLED		SEMI SKILLED		SKILLED		GRAND TOTAL
	NO.	HUMAN CAPITAL	NO.	HUMAN CAPITAL	NO.	HUMAN CAPITAL	HUMAN CAPITAL
LESS THAN 25	3	2555859	0	0	1	1382999	3938858
25 TO LESS THAN 30	2	1701586	0	0	2	2762232	4463818
30 TO LESS THAN 35	3	2526468	2	1944822	2	2734191	7205481
35 TO LESS THAN 40	1	824753	8	7618534	2	2677691	11120978
40 TO LESS THAN 45	2	1579639	3	2735938	3	3846408	8161985
45 TO LESS THAN 50	0	0	3	2493022	3	3504896	5997917
50 TO LESS THAN 55	0	0	2	1335744	3	2816849	4152593
55 & ABOVE	0	0	1	339815	1	477741	477741
TOTAL	11	9188304	19	16467875	17	20203007	45859186
Total No. of Employees	47						
Total value of Human Capital		Rs.4,58,59186					

Table-2 Report on Total Value of Human Capital as on 31.03.2010 in Sample Unit-TRY

AGE GROUP	UNSKILLED		SEMI SKILLED		SKILLED		GRAND TOTAL
AGE	NO.	HUMAN CAPITAL	NO.	HUMAN CAPITAL	NO.	HUMAN CAPITAL	HUMAN CAPITAL
LESS THAN 25	5	4659808	1	1167731	1	1501148	7328687
25 TO LESS THAN 30	8	7445539	3	3498422	10	14991042	25935004
30 TO LESS THAN 35	8	7369956	1	1154303	8	11871088	20395347
35 TO LESS THAN 40	6	5413245	2	2260900	10	14532225	22206370
40 TO LESS THAN 45	4	3455971	2	2165135	4	5566674	11187779
45 TO LESS THAN 50	2	1574562	3	2959347	4	5072423	9606333
50 TO LESS THAN 55	0	0	4	3171196	4	4076655	7247851
55 & ABOVE	0	0	1	403379	0	0	403379
TOTAL	33	2,99,19081	17	16780413	41	57611256	104310750
Total No. of Employees	91						
Total Value of Human Capital		Rs.10,43,10750					

Table-3 Trends in human capital & sales-sample unit-PDK

Sl.No.	YEAR	Trends in the Value of Human Capital (in crores)	Trends in the Value of Sales (in crores)
1	2011	4.82	15.43
2	2012	4.70	16.12
3	2013	4.59	16.80
4	2014	4.47	17.48
5	2015	4.35	18.17
6	2016	4.23	18.85
7	2017	4.12	19.54
8	2018	4.00	20.22
9	2019	3.88	20.90
10	2020	3.77	21.59

Findings of Trend Analysis-Sample Unit-PDK

Trends in value of human capital & in Sales have been arrived at using least square method and presented in Fig.1. It is observed that there is a continuous decline in human capital and a continuous growth in sales. The decline in human capital may be due to reduction in staff cost & the increase in sales may be due to hike in prices of products & services and increase in the volume of sales.

Graphical representation

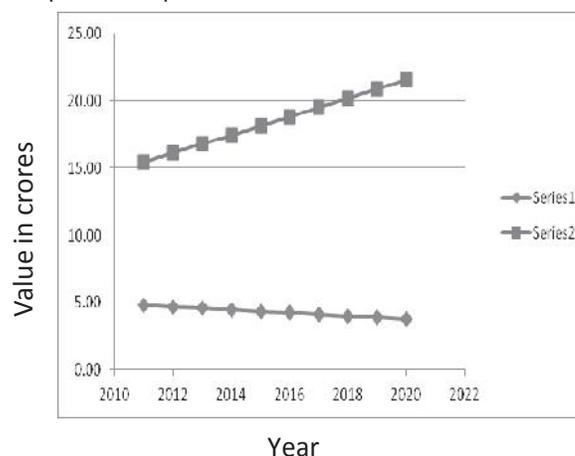


Fig.1: Trend in human capital and sales

Table-4 Future Trends in the value of Sales & in the value of Human capital
- Sample unit -TRY

YEAR	Trends in the Value of Sales (in crores)	Trends in the Value of Human Capital (in crores)
2011	68.05	12.21
2012	74.72	13.02
2013	81.39	13.83
2014	88.05	14.64
2015	94.72	15.45
2016	101.39	16.25
2017	108.05	17.06
2018	114.72	17.87
2019	121.39	18.68
2020	128.05	19.49

Findings of Trend Analysis-Sample Unit-TRY

Trends in value of human capital & in Sales have been arrived at using least square method. It is observed that there is a continuous increase in human capital and a continuous growth in sales. Both the curves move in same direction. Hence it is assumed that there is a relationship between human capital and sales.

Conclusion

This is an era of globalization and cost cutting. Though the concept of HRA and its usefulness have been illustrated in number of presentations and articles at National and International levels, the application of HRA has not flourished through the world. In future, there is a possibility of valuing and reporting of intangible assets because of strong growth of International Financial Reporting Standards.

It is hoped that this study will be very useful to TVS & Sons Ltd, Pudukkottai and Trichy Units, to incorporate such details of human capital in their annual reports.

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