

## Human Resource Accounting its Reporting Practices

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**Abstract :** The present study has indicated some major proposals for the use of HRA namely, capitalizing salaries, capitalizing cost of hiring of the employees, capitalizing startup costs of the organization, behavioral variables approach, economic value approach, opportunity costs of employees, present value method, etc. Some major problems have also been identified in this study. These are qualification of human resources, inability of human resource manager to understand accounting function, lack of legislation, standard norms and amortization of human costs, dominance of financial accounting etc. The study has also put forward suggestions to overcome the problems. Proper human resource accounting and reporting would undoubtedly improve the productivity and, in turn, profitability of the organization.

**Key words:** Human Resource, accounting and reporting practices

**Concept and significance:** Human Resource (HR) is the most precious asset in an organization. HR plays an important role in the development of an organization. Human Resource Accounting (HRA) is concerned with measurement and reporting of the cost and value of people as organizational resources. HRA is basically an information system that tells management what changes are occurring over time to the human resources of the organization. It involves accounting for investment in people and their replacement costs and also the economic value of people in an organization. In 1973, the American Accounting Association's Committee on Human Resource Accounting defined HRA as the process of identifying and measuring data about human resources and communicating this information to interested parties<sup>[1]</sup> Matz and Usry defined HRA as the process of developing financial assessments of people or groups of people within organizations and society and of monitoring these assessments over time.<sup>[2]</sup>

An organization may determine the cost of acquiring and developing its employees. This includes cost of recruitment, selection, hiring, placement, orientation and job training. These costs benefit the organization for more than a year. These costs become the investment by the organization. So the management will prefer to capitalize and amortize the costs over the useful life of the asset involved. A human resource accounting system attempts to identify incurred human resource costs that are to be separated from the organization's other costs.

Every one recognizes that good employees (human resources) are an organization's most valuable assets<sup>[3]</sup>. Many customers are turned-off and do not come back to a business where employees have been incompetent, inefficient, discourteous or have given other bad impressions. Competent human resources of an organization can do much to ensure the objective that the

customers are the life blood and as such their continued patronage is essential to achieve the firm's goals and objectives. In a manufacturing organization, the use of physical assets namely, plant and machinery, land and building, equipment, etc. is mandatory. Without the use of these assets, the organization can not think of its production. Like these physical assets, human resources as assets also contribute a lot to the productivity and, in turn, profitability of the organization. Here lies the importance of HRA in any kind of organization. Therefore, every organization whether manufacturing, trading or service rendering, has to recognize the utility of human resources and their accounting as well.

**Proposals for the utilization of HRA:** A number of proposals have attempted to utilize HRA. These proposals are as follows:

- Capitalizing salaries of employees-whereby a firm assumes that what the employees are doing will be of some future benefit to the firm and that appropriate rate of capitalization can be determined.
- Capitalizing the cost of acquiring the employees- a plan that would require collecting the costs of acquiring, hiring and training.
- Capitalizing startup costs-involves not only capitalizing startup costs but goes one step further by considering the synergistic components of cost and time required for members of a firm to establish effective cooperative working relationship.
- Behavioral variables approach-involves periodic measurements of the key causal and intervening variables for the corporation as a whole. Statistical variation in leadership styles and technical proficiency levels (causal variables) and the resulting changes in subordinate attitudes, motivations and

behavior (intervening variables) can establish relationships between such variables. These changes would produce changes in the end-result variables such as productivity, profitability innovation and human resource developments. Trends in earnings could then be predicted. These forecasts are discounted to find the present value of the human resources.

- Opportunity costs- suggest that investment center managers are encouraged to bid for any scarce employee they desire. The winning manager includes the bid in the investment lease. The division's benefit is the increased profit produced by the new employee.
- Economic value approach-compares differences in present and future earnings of similar firms in the same industry. Since economic value approach is related to Economic Value Added (EVA), it is essential here to explain the concept of EVA. Basically, EVA is the residual income a company earns after capital costs are deducted<sup>5</sup>. More specifically, it is operating profits as reduced by capital expenditures. EVA is another way of expressing company earning more than the financial markets require. Ostensibly, the differences are due to human organization. Future earnings are forecasts and discounted to find their present value. A portion thereof is allocated to human resources based on their contribution.
- Present value method-involves determining wage payments over perhaps a five-year period and then discounting these payments at the rate of return of owned assets in the economy for the most recent year. This calculation yields the present value of the future five-years' wage payments based on this year's return.
- Stochastic rewards valuation model-involves a stochastic process defined as a natural system that changes in time in accordance with the law of probability. To measure an individual's value to an organization requires:
- An estimate of the time interval during which an individual is expected to render services to the organization and
- A measure of the services expected to be derived from the individual during this interval. The resource's expected value is then multiplied by a discount factor to arrive at the present value of expected future services.

**Problems involved in the application of HRA:** The problems involved in the application of HRA are as follows:

**Quantification of human resources:** It is difficult to quantify the capabilities of human resources. Despite the contribution of each people to the organization may be measured. But such measurement may not be accurate and reliable cent percent. Future benefits derived by the employees may also be uncertain, since the productive future life of employee is uncertain.

**Inability of resource managers to understand the accounting function:** Resource managers in the vital areas of business functions namely, human resource, marketing, production, planning and development are unable to fully understand and recognize the accounting as well as finance functions of an organization. But the case is different in case of human resources in the areas of finance and accounting. These human resources fully understand, realize and recognize finance and accounting functions and do accordingly. But these human resource managers have little knowledge on HRA.

**Lack of legislation regarding HRA and reporting:** Not only in Bangladesh but also in any of the countries of the world, there is no legal binding on HRA and reporting the same on the financial statements of an organization. Even the International Financial Reporting Standards (IFRS) have provided no standard for HRA and reporting.

**Dominance of financial accounting:** It is seen that it is the financial accounting which dominates over all other accounting and other functions of the business. As a result, the interest of HRA and reporting in an organization is low, thereby resulting in poor performance in the area of HRA and reporting.

**Lack of standard norms:** In the literature of finance and accounting as well as in the professional word, there are some standard norms or industry norms for the various financial ratios. These may act as the basis of comparison of the actual performances. But in case of HRA, there is no standard norm or industry norm for the relevant ratios with which actual performances can be compared. As a result, the measurement of human resources may be at fault.

**Amortization of human resource costs:** The human resource costs are in the nature of capital expenditures. Hence capitalization of these costs need to be amortized over the useful life of the human resource asset. Such costs are the basis of individual personnel expected life with the specific department or the useful life of the investment. At this stage questions may arise as to the determination of the effective useful life of individual employee and also of the investment with more reliably

and accurately. As a result, proper and accurate amortization of human resource assets is not possible.

**Suggestions to overcome the problems involved in the application of HRA:** The probable suggestions to overcome the aforesaid problems are as follows:

- Qualification of human resources problem may be solved by applying economic value approach.
- Resource managers' ability may be enhanced by imparting proper education and training to them.
- Legislative problem regarding HRA may be solved by enacting law. International Accounting Standards Board should develop and issue standards regarding HRA.
- Dominance of financial accounting problem may be solved by giving more emphasis on HRA
- Every organization should develop its own standard norms with a view to compare with actual performances.
- The period of amortization of human resource assets may be taken as the certain percentage of effective useful life of the individual personnel of the organization.

**Summary and policy implications:** The present study is on HRA- its reporting practices which is wholly based on desk research. The study has highlighted as many as eight proposals for the use of HRA. These are capitalizing salaries of employees, capitalizing the cost of hiring the employees, capitalizing startup costs, behavioral variables approach, opportunity costs of employees, economic value approach, present value method and stochastic rewards valuation model. The study has also identified the major problems involved in the application of HRA. These are quantification of human resources, inability of resource managers to understand the accounting

function, lack of legislation regarding HRA, dominance of financial accounting, lack of standard norms and amortization of human resources costs. The probable suggestions to remove the aforesaid problems have also been put forwarded in this study.

As regards the policy implication, it can be said that the application of HRA will undoubtedly improve the quality of financial accounting. Without the inclusion of human resource assets in the balance sheet of an organization, the true financial position is not reflected. In this context, for the popularization of HRA various researches, seminars, symposiums may be undertaken. Various efficiency studies examining the ways in which human resource variables affect the efficiency of the firm should be conducted by the concerned researchers, academicians and professionals. Moreover, some indicators studies ie problem oriented studies with the indicator approach across the countries and industries need to be undertaken. Lastly, there should be legal binding to use HRA and present the same in firms reporting system. For this, proper law may be enacted by the appropriate authority.

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