

# Human Resource Accounting – as a Modern Method of Performance Appraisal

**Abstract**

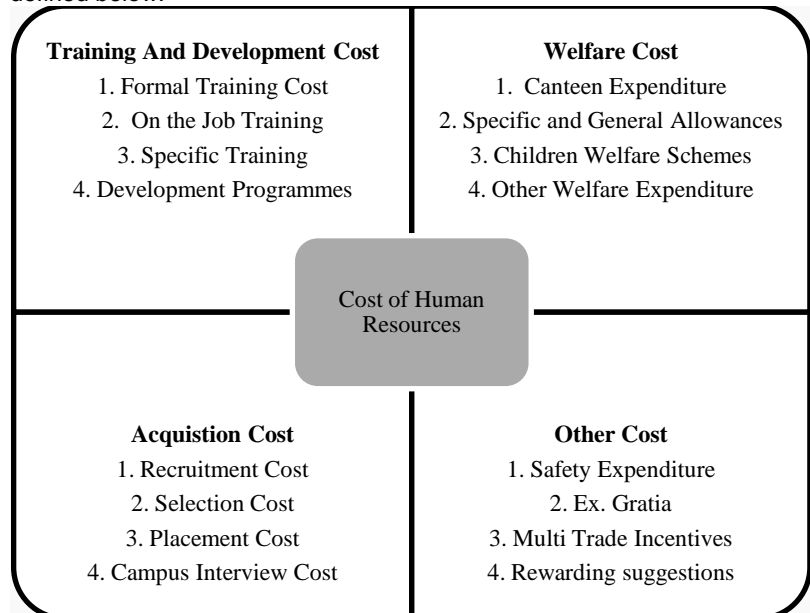
Human resources or human assets are valuable assets for every organization. Human resource accounting method tries to find the relative worth of these assets in the terms of money. In this method the Performance appraisal aims to find out the net contribution of employee to the company in monetary terms. The cost of employee is calculated by adding the expenses incurred on the employee like his compensation, cost of recruitment and training and development. After this, the monetary contribution of employee is found out. The difference between contribution and cost of employee indicates the performance of employee. Ideally, the contribution of the employees should be greater than the cost incurred on them.

The article highlights the significance of Human resource accounting method in relation to performance appraisal. The article finds out the organizations that have implement human resource accounting method. At last, the article depicts the advantages of human resource accounting method.

**Keywords:** Human Resources Accounting, Human Resource Valuation, Cost, HRA, Investment, Performance Appraisal Etc.

**Introduction**

This type of performance appraisal is used by the organizations, who want to evaluate the net contribution of an employee to the company in terms of monetary aspects. This method is used for assigning, budgeting and reporting the cost of the human capital in an organization which includes the salaries, wages and different types of training expenses. This method assesses the cost of workforce and their contribution to the company, in an ideal world, the contribution part should be greater than the cost incurred. The difference between this represents the performance of the employees. The classification of cost of human resources is been defined below:



Source: compiled from book "Human Resource Planning and Development" by Ghosh.

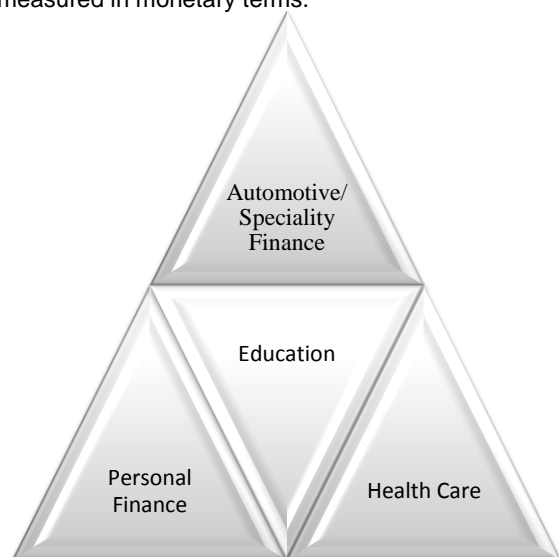
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Human resource accounting is the method of identifying and reporting investments which are made in the human capital of an organization that are unaccounted at the moment. Measuring the worth of human resources can assist in exact documenting of organizational assets. It is the activity of knowing the cost invested in human capital for their recruitment, training them, payment of salaries & other benefits which are paid and knowing in return their input towards the organisation profitability.

HRA is a new branch of accounting based on the concept that all the spending on human capital formation is treated as a charge beside the revenue of the period as it does not create any material asset. But this concept is been changed, the cost incurred on any human resources have to be capitalised as it yields benefits measurable in monetary terms. 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 organisation.

#### Review of Literature

"Human Resource Accounting" is the offshoot of various research studies conducted in the areas of accounting and finance. Human resource is an asset whose value gets appreciated over the period of time provided placed, applied and developed in the right direction. Till the recent past, organizations took few efforts to assign monetary value to human resource in its accounting practice. At present there is a change in this concept and the expenses incurred on any asset (as human resources) should be treated as capital expenditure as it yields benefits which can be derived for a long period of time and could be measured in monetary terms.



Source: compiled from book "Human Resource Planning and Development" by Ghosh

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".

Ripoll and Labatut, 1994, According to both there are two reasons for including human resources in accounting.

Firstly, human resources are valuable resource to a firm so long as they perform services which can be quantified. Secondly, the value of a human as a resource depends on how he/she is employed; therefore management style will also influence the human resource value.

Hosseini (2012) studied the concept of human resource accounting and concluded that the promotion of human capital and its effect on various aspects of organization is extended to economic and social development was not hidden. Promotion of human capital was including a collection of competences for applying knowledge and skill for achieving to better result.

Pandey (2012) analyzed HRA practices of fifty selected companies on the Nifty based of three years of annual reports. Content analysis was used for the study. Study of Co integration between Indian, American and Chinese Stock Markets he found that out of fifty leading companies of India only one (ONGC) company follows the HRA practices.

Kesavan and Dayana (2013) analyzed Human Resource Accounting disclosure in selected Indian companies. Twenty companies were considered for the study, out of which only six companies three public and three private sector companies were following Human Resource Accounting and Independent't test was used to find the difference in the disclosure of Human Resource variables in selected Indian companies concluded that a significant difference had been found between human resource disclosers of public and private sector banks.

Sharma and Kumar (2014) compared the HRA practices adopted by selected public and private sector banks and revealed that public sector banks disclosed more information related to the human resource practices than the private sector banks.

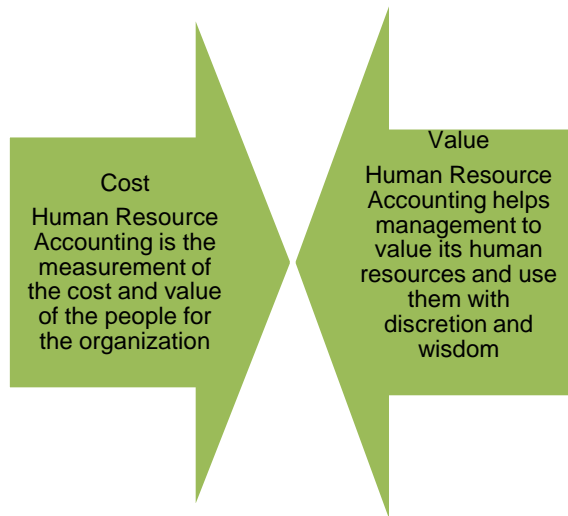
#### Objective of the Study

1. To highlight the significance of Human resource accounting method in relation to performance appraisal.
2. To find out the organizations who have implement human resource accounting method for appraisal.
3. To find out the disadvantages of human resource accounting method.

#### Development of the concept of Human Resource Accounting

The following are the reasons why Human Resources Accounting has been receiving so much attention in the recent years. There is need for reliable and complete management of human resources. Human Resource Accounting is the measurement of the cost and value of people to the organization. It includes measuring costs incurred by the organizations while recruiting, selecting, hiring, training and developing employees and judging their economic value to the organization.

## Remarking An Analisation



Source: compiled from book "Human Resource Planning and Development" by Ghosh

### Importance of Human Resource Accounting

Human Resource Accounting provides useful information to the management which are briefly describe below:

1. HRA helps the management in locating and utilization of human resources.
2. HRA helps in deciding the transfers, promotion, training and retrenchment of employees.
3. HRA provides a basis for planning of physical assets v/s human resources.
4. HRA assists in evaluating the cost incurred for imparting education facility and training to employees for the benefits derived by the firm.
5. HRA helps in identifying the reason of high labour turnover at various levels of the organization and taking corrective measures.
6. HRA helps in locating the cause for low return on investment as like under-utilization of physical assets or human resource or both.
7. HRA helps employees in improving their performance and bargaining power and makes each of them to understand their contribution towards the betterment of the organization and expenditure incurred by the organization.

### The Main Objectives of A Human Resource Accounting System are as Follows

1. To provide cost value information for making proper and effective management decisions about acquiring, allocating, developing and maintaining human capital in order to achieve cost effective objectives.
2. To have an analysis of the human asset i.e. whether such assets are conserved, depleted or appreciated.
3. It helps the organization in decision making related to:
  - a. Recruitment vs promotion.
  - b. Transfer vs. Retention.
  - c. Retrenchment vs. Retention
  - d. Impact of budgetary controls of human relations and organizational behaviour.

- e. Assessment on reallocation of plants, closing down of existing units and developing overseas subsidiaries etc.

HR accounting uses several different methods:

#### Standard cost

This method involves the total cost incurred during recruiting and hiring the employees. It includes cost of training and development as well. As per this method, the economic value of employee is the total of these expenditures and the annual value of the entire workforce is equal to the total amount of money spent on recruitment, selection, training and development of the entire workforce during the year.

#### Replacement Cost

This method values the employee in terms of the amount it would cost the company to replace him/her. The method holds that the economic worth of the employee is equal to the estimated cost of recruitment, selection, training and development, replacement or of finding an employee with a similar set of skills and talents.

#### Opportunity Cost

This method is also referred as the competitive bidding model assigns value to an employee based on what department is willing to pay him.

#### Economic Value

This method involves estimating the total inflow of cash that will be produced by an employee over a time period as a course of his service to the company minus the total cost of hiring, training and paying an employee from the estimate of the cash employee will generate for the company at his net worth according to the economic value method.

### Human Resource Accounting by Public and Private Sector Enterprises

The trend towards the measurement and reporting of human assets in company annual report is noticeable among public and private sector enterprises, we find that chairman's reports consistently contain the statements highlighting the significance of human resource. Bharat Heavy Electricals Ltd is a leading public enterprise introduced HRA in its Annual Report of year 1974 – 75 for the first time in India. In the subsequent years more than twenty one organizations belonging to the public sector and seven belonging to the private sector had adopted such a practice. They are as follows:

1. Steel Authority of India Ltd. (SAIL)
2. Hindustan Machine Tools Ltd. (HMTL).
3. Oil & Natural Gas Corporation Ltd. (ONGC)
4. National Thermal Power Corporation Ltd. (NTPC)
5. Hindustan Shipyard Ltd. (HSL)
6. Oil India Ltd. (OIL)
7. Minerals and Metals Trading Corporation of India Ltd. (MMTC)
8. Cement Corporation of India Ltd. (CCI)
9. Engineers India Ltd. (EIL)
10. Electrical India Ltd. (ELIL)
11. Project and Equipment Corporation of India (PEC)

12. Metallurgical and Engineering Consultants of India (MECON)  
 13. Can bank Financial Services Ltd (CFSL)  
 14. Southern Petrochemical Industries Corporation Ltd. (SPIC)  
 15. Cochin Refineries Ltd (CRL)  
 16. Madras Refineries Ltd. (MRL)  
 17. Associated Cement Companies Ltd. (ACC)  
 18. Tata Engineering & Locomotive Co. Ltd. (TELCO) and
19. Infosys Technologies Ltd. (ITL)  
 20. Bharat Heavy Electricals Limited (BHEL)  
 21. Global Tele Limited (GTL)  
 22. Hindustan Petroleum Limited (HPL)  
 23. Hindustan Zinck Limited  
 24. Indian Drugs and pharmaceuticals Limited (IDPL)  
 25. Indian Oil Corporation (IOC)  
 26. Rolta India Limited  
 27. Satyam Computers Limited (SATYAM)  
 28. U.P State Cement Corporation Limited (UPCCI)

**Table 1.1: HR Accounting in Some of The Indian Enterprises is Detailed Below**

Name of the Enterprise	HRA introduce in the year	Model adopted	Discount rate(in percentage) applied	Category wise no. of employees	Age wise and category wise no. of employees	Category wise human resource values	Productivity & performance ratios
BHEL	1974-75	Lev and Schwartz model	12	Yes	Yes	Yes	Yes
SAIL	1983-84	Lev Schwartz model with refinement as suggested by Flamholtz and Jaggi and Lau	15	Yes	Yes	Yes	--
MMTC	1982-83	Lev and Schwartz model	12	Yes	Yes	Yes	Yes
EIL	1980-81	Not reported	10	Yes	--	Yes	--
HMTL	1986-87	Not reported	Not reported	Yes	Yes	--	--
ONGC	1981-82	Not reported	12.25	Yes	--	Yes	--
NTPC	1986-87	Lev and Schwartz model	12	Yes	Yes	Yes	Yes
ELIL	1983-84	Lev and Schwartz model	12	Yes	--	Yes	--
PEC	1980-81	Lev and Schwartz model	Not reported	Yes	--	Yes	Yes
MECON	1984-85	Lev and Schwartz model	14	Yes	--	Yes	Yes
CFSL	1989-90	Lev and Schwartz model with certain modifications	Not reported	Yes	--	Yes	--
SPIC	1983-84	Lev and Schwartz model	Not reported	Yes	--	Yes	--
CRL	1987-88	Lev and Schwartz model	15	Yes	--	Yes	Yes
MRL	1985-86	Lev and Schwartz model	15	Yes	--	Yes	Yes
ACC	1983-84	Lev and Schwartz model	Not reported	Yes	--	Yes	--
CCI	1979-80	Lev and Schwartz model with refinements as suggested by Flamholtz and Jaggi and Lau.	15	Yes	--	Yes	--
OIL	1982-83	Lev and Schwartz	10.5	Yes	--	Yes	Yes
ITL	1995-96	Lev and Schwartz	17.17 to 27.97	--	--	--	Yes

**Source:** Annual Reports of the enterprises.

**Limitations of Human Resource Accounting**

Human Resource Accounting is used to describe the accounting methods, system and techniques, which unit with knowledge and ability and assist personnel management in the valuation of personnel in financial terms.

It presumes that there is immense difference among the personnel in their knowledge, ability and motivation in the same as well as from other organization. HRA facilitates decision making about the personnel either to keep or distribute their services or to provide training. There are numerous limitations which make the management unwilling to introduce HRA practices some of them are as follows:

1. There is no proper and specific procedure or guidelines for finding cost and value of human resources of an organization.
2. The existence period of human resource is uncertain and hence valuing them under uncertainty in future seems to be unrealistic.
3. The much needed empirical evidence is yet to be found to support the hypothesis that HRA as a tool of effective management of human resources.
4. In what structure and manner, their value is to be included in the financial statement is the question yet to be classified.
5. Human resources are not capable of being owned, retained and utilized, unlike the physical assets so there is problem for the management to treat them as assets in the strict sense.
6. There is regular fear of from the trade unions as placing a economic value on employees would make them claim rewards and compensations based on such valuation.
7. In our country human resource accounting is still at the developmental stage. Much additional research is necessary for its effective implementation.

**Conclusion**

At a large level organizations do not value their human resources and not even plan to implement valuation of its human resource at a very early stage. In spite of the interest in appraisal there will be moderate progress in the area over the next five to ten years. In order to get greater progress, it needs to be done at the theoretical and practical level both. More search into valuation methods and models, and the practical implication of these, is needed together with the engagement of both human resource and accounting professionals in the debate on valuation and its implementation in practice.

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