



Human Resource Accounting and Auditing

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HUMAN RESOURCE ACCOUNTING AND AUDITING

*(As per the Revised Syllabus 2018-19 of Mumbai University
for T.Y.BMS, Semester – VI)*

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First Edition : 2019

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- Published by** : Mrs. Meena Pandey for **Himalaya Publishing House Pvt. Ltd.**,
"Ramdoot", Dr. Bhalerao Marg, Girgaon, Mumbai - 400 004.
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- DTP by** : Pravin
- Printed at** : Rose Fine Art, Mumbai. On behalf of HPH.

PREFACE

This book will help HR students of T.Y.BMS to understand the subject in simple language as per the syllabus given by the University of Mumbai.

We would like to take this opportunity to express our sincere gratitude to Mr. S.K. Srivastava and his entire team of Himalaya Publishing House Pvt. Ltd. We would like to thank the management and colleagues of our colleges for their continuous support and encouragement.

Lastly, a heartfelt thanks to our family members Mr. Shivram and Mrs. Bharati Shelke, and Mr. Rajendra and Mrs. Vaishali Galadagekar for their blessings and making us what we are today.

Authors



SYLLABUS

Modules at a Glance

Sr. No.	Modules	No. of Lectures
1	Human Resource Accounting: An Overview	15
2	Methods and Human Resource Accounting Practices in India	15
3	Human Resource Audit: An Overview	15
4	HR Audit for Legal Compliance and Safe Business Practices	15
Total		60

Objectives

Sr. No.	Objectives
01	To understand the value of human resource in organisations
02	To understand the importance of Human Resource Accounting at National and International level
03	To familiarise with the Human Resource Accounting Practices in India
04	To familiarise the learners with the process and approaches of Human Resources Accounting and Audit
05	To understand the significance of Human Resource Auditing as a Tool of Human Resource Valuation

Sr. No.	Modules/Units
1	Human Resource Accounting: An Overview <ul style="list-style-type: none"> ● Human Resource Accounting – Meaning, Need and Objectives of HR Accounting ● Historical Development of Human Resource Accounting ● Cost of Human Resource – Acquisition Cost, Training and Development Cost and Additional Cost ● Benefits and Limitations of Human Resource Accounting ● Reporting of Human Resource Accounting at National Levels ● Disclosures at International Level

2	<p>Methods and Human Resource Accounting Practices in India</p> <ul style="list-style-type: none"> ● Methods of Human Resource Accounting: <ol style="list-style-type: none"> 1. Cost of Production Approach – Concept <ol style="list-style-type: none"> i. Historical Cost Model – Meaning, Advantages and Limitations ii. Replacement Cost Model – Meaning, Advantages and Limitations iii. Opportunity Cost – Meaning, Advantages and Limitations 2. Capitalised Earnings Approach – Concept <ol style="list-style-type: none"> i. Economic Value Model – Meaning, Advantages and Limitations ii. Capitalisation of Salary – Meaning, Advantages and Limitations ● Statutory Provisions Governing HR Accounts ● Human Resource Accounting Practices in India
3	<p>Human Resource Audit: An Overview</p> <ul style="list-style-type: none"> ● Human Resource Audit – Meaning, Features, Objectives of HR Audit ● Benefits and Limitations of HR Audit ● Need and Significance of HR Audit ● Process of HR Audit ● Approaches of HR Audit ● Principles of Effective HR Auditing ● Role of HR Auditor ● Methods of Conducting HR Audit – Interview, Workshop, Observation, Questionnaire ● Components of HR Audit ● HR Audit and Workforce Issues: Workforce Communication and Employee Relations, Performance Management, Compensation System, Teambuilding System
4	<p>HR Audit for Legal Compliance and Safe Business Practices</p> <ul style="list-style-type: none"> ● Areas Covered by HR Audit – Pre-employment Requirements, Hiring Process, New-hire Orientation Process, Workplace Policies and Practices ● HR Audit as Intervention – Introduction, Effectiveness of Human Resource Development Audit as an Intervention ● Human Resource Audit and Business Linkages ● Human Resource Auditing as a Tool of Human Resource Valuation: Introduction, Rationale of Human Resource Valuation and Auditing, Valuation of Human Resources, Issues in Human Capital Measurement and Reporting

PAPER PATTERN

Maximum Marks: 75

Questions to be Set: 05

Duration: 2½ Hours.

All questions are compulsory carrying 15 Marks each.

Question No.	Particulars	Marks
Q.1	Objective Questions (A) Sub-questions to be asked (10) and to be answered (any 08) (B) Sub-questions to be asked (10) and to be answered (any 07) (*Multiple Choice/True or False/Match the Columns/Fill in the Blanks)	15 Marks
Q.2	Full Length Question OR	15 Marks
Q.2	Full Length Question	15 Marks
Q.3	Full Length Question OR	15 Marks
Q.3	Full Length Question	15 Marks
Q.4	Full Length Question OR	15 Marks
Q.4	Full Length Question	15 Marks
Q.5	(A) Theory Questions	08 Marks
Q.5	(B) Theory Questions	07 Marks
	OR Short Notes To be asked 05 To be answered 03	15 Marks

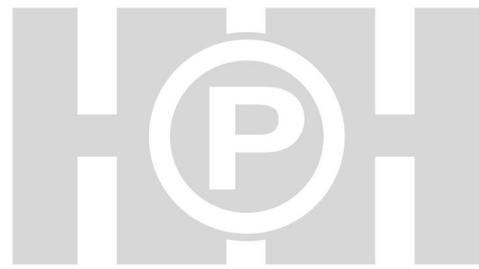
Note:

Theory questions of 15 Marks may be divided into two sub-questions of 7/8 and 5/10 Marks.

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Unit 4: HR AUDIT FOR LEGAL COMPLIANCE AND SAFE BUSINESS PRACTICES	72 – 92





Unit

1

HUMAN RESOURCE ACCOUNTANCY – AN OVERVIEW

Unit at Glance

- 1.1 Human Resource Accounting
 - 1.1.1 Meaning
 - 1.1.2 Definition
 - 1.1.3 Features
 - 1.1.4 Needs
 - 1.1.5 Objectives
 - 1.1.6 Scope
- 1.2 Historical Development of Human Resource Accounting
- 1.3 Cost of Human Resource
 - 1.3.1 Acquisition Cost
 - 1.3.2 The Training and Development Cost
 - 1.3.3 Additional Cost
- 1.4 Benefits and Limitations of Human Resource Accounting
 - 1.4.1 Benefits
 - 1.4.2 Limitations
- 1.5 Reporting of Human Resource Accounting at National Levels
- 1.6 Disclosure at International Levels
- 1.7 Questions

1.1 HUMAN RESOURCE ACCOUNTING

1.1.1 Meaning

Modern Human Resource Management has changed the overall perspective of the way work force is to be treated. There has been a massive change in the psyche of the employer: from the Mao government's Communist Approach to the Google's innovative Employee Centric Approach. Thus, the trend could be seen to be more

focused on productivity rather than amount of time spent in the office. As we can see now that pregnant women are preferring to work from home even during pregnancy, their husbands being given a paternity leave to take care of their newly born and flexible working hours, rotational holidays etc.

As we progress in the corporate offices, we can see each employee is being designated a specific role, task and position. He is empowered with certain perquisites and also allowances. If you compare to the government employees of 1960s, you can only see the amount of salary drawn by them. However, nowadays, the add on perquisites that are showered by the employer on the employee over and above basic salary are quite extensive. Unlike the government employees who take a fixed salary each month irrespective of their performances, they seem to enjoy a little or no growth at all. However, a person working in private firm can based on his performance can obtain a fixed salary and flexible incentives like bonus, commission, ESOP, travel leave allowance, fully sponsored foreign tours etc.

Now, to maintain record of all such expenses incurred by the HRD, a separate segment is formed. Such Specialises in the Accounting aspect of the employee and treats each employee as a cost station; meaning all the expense incurred to acquire, train and develop and retain the employee are being recorded, summarised, classified, analysed and reviewed by this particular department. Such a practice of maintaining accounting file of an employee is called as Human Resource Accounting (HRA).

HRA involves accounting for expenditure related to human work force. Such cost should be treated as an investment and the human should be considered as an asset and not an expense or a liability. With changing times, the methodology for valuation of the human resource is taking a drastic change. Several psychological and motivational scientists are developing ways and means to calculate the cost and return relationship of Human Resources. They are deriving various formulae to efficiently ascertain the various costs related to manpower planning, appraisals, HR development programmes, identify training needs, cost reduction techniques, budgetary controls measures, facilities allocation, rewards and motivations, morale of employees etc.

There are two reasons to quantify the HR into financial terms: one being to quantify and arrange them as per their value or performance or return with regard to investment and secondly to ascertain the way in which they are being put to use. It may also be a way to let members of the staff know with complete transparency the methods used by the organisation to evaluate the employees.

1.1.2 Definition

Behavioural Scientist Brummet, Flamholtz and Pyle (1968) defines HR Accounting as, “Human resource accounting is the process of identifying, measuring, and communicating information about human resources to facilitate effective management within an organisation”.

According to Stephen Knauf, “HR Accounting is measurement and quantification of human organisational inputs such as recruitment, training, experience and commitment”.

1.1.3 Features

- (i) It facilitates the formulation of strata or parameters for HR policies.
- (ii) Controlling, directions, recruitment and selection, cost budgeting and costing analysis regarding workforce and its planning and development is a key role of HR Accounting.
- (iii) Several of statutory bodies like ICAI, ICSI, CMA/ICWAI etc. are working hard to make parameters of the workforce environment universally uniform.
- (iv) Human Resource could not be placed in any formats of Financial Statements, but their work or presence could affect any Financial statements of company in very adverse manner; hence proper monitor and controlling is essential. It is done by HR accounting.
- (v) With effective and systematic reporting system at regular intervals the stakeholders are also kept in the loop for the decisions pertaining to the human resource management.
- (vi) Human Resource is an expensive and risky investment which should be undertaken with heavy precautions. A single simple error or lack of judgement could lead to a chaos and mismanagement in the entire organisation.

- (vii) It is the logic or rationality behind HR developmental decision making.

1.1.4 Needs

Human Resource Accounting is required for:

1. To increase the target employability in size, segment, sectors, specialisations etc. and make it to optimum levels.
2. To facilitate the spread of knowledge of human empowerment.
3. Strategy optimal level of workforce to maintain desired level of cost and efficiency ratios.
4. Change the perception of the organisation towards the employees.
5. Attract crucial skills at manageable costs.

Many a times it is seen that the employees are being retained for unnecessary purposes. Let us consider few examples.

CASE 1: Suppose SBI, being a nationalised bank has a workforce of 1000 employees who have several drawbacks.

- (i) *They are at age of retirement*
- (ii) *Not that effective in modern day's work*
- (iii) *Not that tech savvy*
- (iv) *Not up to date with upcoming trends*
- (v) *Have lot of unutilised leaves and often take Casual Leaves causing a workload burden on rest employees.*

While such employees draw a salary of ₹ 1,00,000 per month causing total ₹12,00,000/- unproductive expense to the employer.

Now had this being a case of a private sector undertaking, the management would have removed such employee with immediate effect and replaced with younger and more qualified and dynamic employees. In case of legal trouble; offered a Golden Handshake or a VRS. The goal of which would have had being to reduce inefficiency and unproductive expenses.

1.1.5 Objectives

Since none of the law provides for any statutory mandate to report the HR accounting practices followed by the organisation. The business is not asked to furnish any employee details of any nature to any agencies.

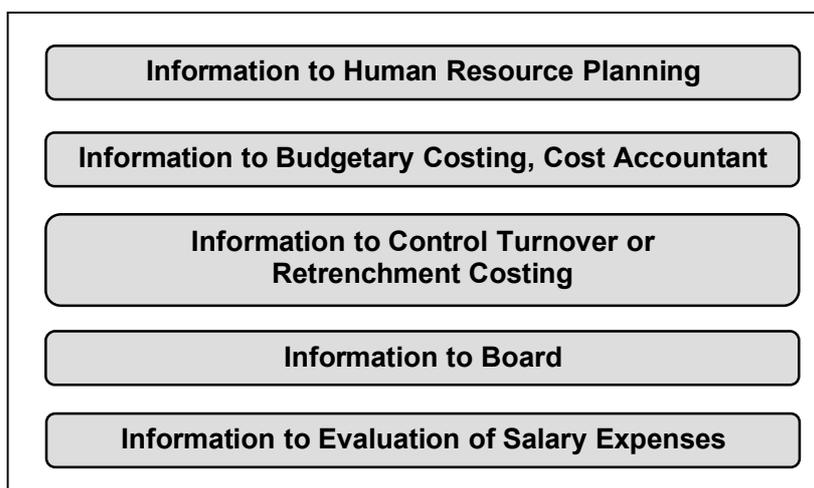
Moreover, the Institute of Chartered Accountants of India has prescribed several standards for the measurement and monitoring of labour cost in manufacturing concerns with mindset of taxation, but no fixed parameter is being dedicated from employee's perspective.

No organisation decides to voluntary disclose to the public the HR budgets or Accounting Principles. The budgeting decisions are being sealed in the board room in tight secrecy.

- (i) HR manager can take relevant decisions based on this monetary valuation of the employees.
- (ii) Any change in the organisation structure could be planned based on the HR accounting decisions on budgeting.
- (iii) Provides base for statistical and numerical values ascertained to each employee.
- (iv) Help to monitor and control all levels of employees and decide increment and perquisite suitable as per performance.
- (v) Performance evaluation is being carried in unbiased manner.
- (vi) Ascertain a standard or yardstick for the management to rate the employee on scales and also to provide basis for promotion and transfers.
- (vii) Data is being constantly being quantified into segments as per employer's convenience and optimum team could be picked and nurtured. Due to recognition of Key Performing Employees the retribution rate also is significantly low.
- (viii) Remedial measures.
- (ix) Psychological aspects and accounting formulas are used simultaneously to achieve goals of developing human resource.
- (x) It is a justification to the stakeholders regarding the decisions for the managerial decision regarding the human asset of the organisation.

1.1.6 Scope

The chart below shows key points of scope of HR accounting.



1. Information to Human Resource Planning

Suppose, a company want to hire new executives for sales department and is being allocated a budget of ₹ 10,00,000. It may have several alternatives. One being to hire 2 experienced personnel for salary 5 lakhs per year to each OR to hire 8 fresh graduates at a salary of 1.25 lakhs each per year. Now the decision to determine the appropriate workforce would be decided by the cost constraint imposed by the Human Resource Accounting department.

Option	No. of Employees	Salary per employee	Total Cost
A	2	5,00,000	10,00,000
B	8	1,25,000	10,00,000

As we can see in the table, Option B being hire 8 employees at the same cost that could hire 2 experienced. Now the decision is in the hands of the management to select alternative that is in synchrony with the organisation's goals.

2. Information to Budgetary Costing, Cost Accountant

Sometimes it occurs to the management to consult with the finances of the company first before taking any of the hiring decision. So, the

manager consults with the accountants for the financial aspects and then take his decision.

Such a case occurs with the manufacturing concerns. In factory, the workers are paid wages on weekly basis and in cash. Hence the manager has to keep an adequate amount of working capital especially on weekend so as to pay off the labourers on time. Failure to do so would cause various labour issues and may escalate to strikes and riot in the factory.

Also, bonus and compensation as per the relevant legal provisions are to be provided to the employees in order to keep the morale of the labourers on high note.

3. Information to Control Turnover or Retrenchment Costing

When company thinks to reduce the workforce, it has to think about the retrenchment benefits that the employees are entitled to receive. Generally, for his dedication to the company, the employee receives, gratuity, bonus, profit sharing, ESOP etc. is very heavy burden on the company and hence needs to be planned well in advance. Let take this example.

BAJAJ PLANT CHAKAN

Renowned automobile manufacturer Rahul Bajaj was facing a severe crisis in his factory held in Chakan, near Pune. It was seen that the plant was in need to be shut down as the local authorities imposed heavy taxes adding a heavy burden on the factory. Hence the management decided to shift the plant further down into interiors of Maharashtra.

In case a company want to shut down its operations completely or downsize the level of employees, it cannot just lay off employees in Chakan Project, it has to pay them dearly for their dedication and loyalty, also their long and continuous services. If the employee is young, they have to provide them with compensation equivalent to the loss of his earning capacity. In case the employee is of age of retirement and it would be difficult for him to fetch a job, then he must be provided with compensation of salary up to his age of retirement. Also, senior and long serving employees are to be paid with statutory compensations as prescribed by the law.

Already in a bad economic shape, the company would have had been facing a severe liquidity problem and it was an evitable end for the scooter tycoon. Instead they came up with a master stroke that got riddance of the unwanted work force and also saved their money.

The management looked into the perspective that instead of removing the employee from the task force, it was better to retain them at wages that are pre-decided. The employees were asked to come to the factory and made to sit idle. The management was paying to the employees for just sitting idle. Many a times companies stick to acts that make the work life of the employees so hopeless that out of monotony, frustration or saturation the employees leave their jobs. Hence the company has a dual benefit of reduced workforce and even no compensation pay-outs.

Here Mr. Bajaj was walking on a very thin line of legal and ethical boundaries and got away unscratched. It is beyond any argument true that Mr. Bajaj did no legal wrong. Yet the particular case is up for debate whether this practice of HR being made to sit idle is ethical?

4. Information to Board

Board is concerned about keeping the expense related to HR asset to least possible extent. In case of being over the budgets, the board need to make amendments and change the structure for the expense. For adequate management of finances up-to-date information to the board is required at regular intervals. HR accountant does this gathering and analysis of information for the board.

5. Information to Evaluation of Salary Expenses

Salary is a core and substantial expense to any organisation. Around 40% of the expense or working capital of the organisation consists of salary and wages components. In case of even a slight increase in the salaries the working capital is affected significantly. Hence adequate reserves should be kept apart for the salary payment in case of contingencies.

1.2 HISTORICAL DEVELOPMENT OF HUMAN RESOURCE ACCOUNTING

Humans should be treated as assets in organisation as contrast to traditional approach which merely treated them as costly incurring affair

to company's financial statements. HRA is sophisticated way to manage and develop the personnel of the company. It was initiated in 1691 by Sir William Petty. However, in 1960, Rensis Likert stated working on a research project to develop patterns and practices for the development of the human resource in an organisation. The development was divided into 5 distinct stages.

First Stage (1960-66) this stage was purely academic research-based process wherein only factors driving the employee to better productivity were being considered. Leadership, personnel relations and corporate goodwill were also key elements.

Second Stage (1966-71) this was a crucial stage for the viability of the various research papers submitted in stage 1. Feasibility analysis of the cost models and employee accountability were also key considerations. Overall this was an acid test to the practical application of the theory.

Third Stage (1971-76) the next five years show a wide acceptability of the theory at international level by several MNC's and also accreditations by various organisations.

Fourth Stage (1976-80) due to lack of must deeper empirical research and also advent of several leading and established theories by eminent industrialists, this stage saw a decline of popularity at international levels.

Fifth Stage (1980 onwards) this stage saw renewed vigour by several economists and capitalist to treat employee as an asset and not a machine. Making several amendments to the original draft of the theory, the basic ideology of 'employee-based accounting' resurfaced in the global dynamics.

1.3 COST OF HUMAN RESOURCE

1.3.1 Acquisition Cost

The cost that is associate with the procurement of employee is called as acquisition cost. It is the only method that records the data associated with the human resource and furnish the same into the books of accounts. All the relevant cost associated with the recruitment, hiring,

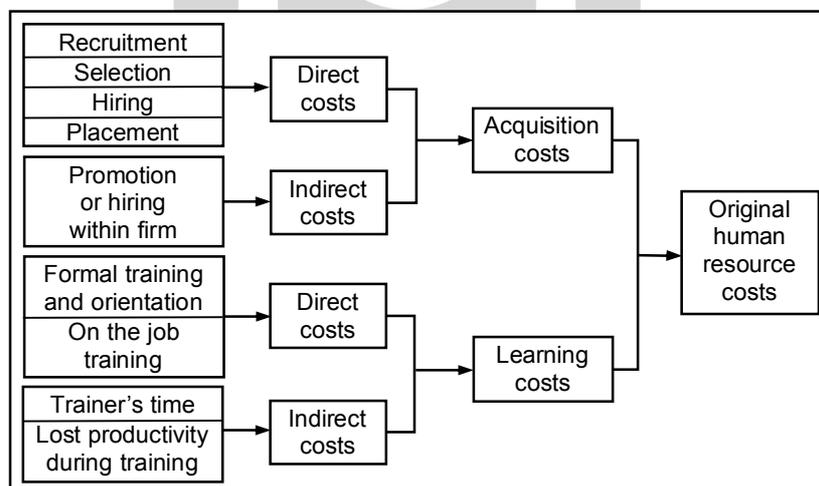
training and development, socialisation and induction, outsourcing or inhouse maintained of HR records are capitalised and written off for the period the employee is associated with the organisation. In case, due to any reason the employee cannot complete the pre-decided tenure with the organisation, then the unabsorbed value is charged to the current net earnings of the firm. Acquisition cost is capitalised as it may be a one-time cost to acquire, train the employee etc. but the expected returns from such investments exceed over more than one year, and hence as per accounting policies such expense is a capital expenditure.

For e.g., M/s ABC Ltd. procured a regional sales manager and incurred following expense for transfer and induce into the organisation. Signing Bonus ₹ 10,00,000, Induction Expense ₹ 75,000, legal expenses ₹ 50,000. The contract stated a term of 5 years, hence each year ₹ 2,25,000 (11,25,000/5) should be capitalised from the HR accounting department.

The capitalisation should be in such a way that the costs are being appropriated in following manners:

Legal costs, Induction costs, Bonus being indirect costs and the salary package offered to him would be a direct cost.

Model for Measurement of Original Human Resource Costs



Source: Flamholtz, E.G., "Human Resource Accounting: Measuring Positional Replacement Cost", Human Resource Management.

In the following chart, a clear distinction is being provided for the cost associated with human resource and its classification into direct cost and indirect cost. Direct cost is those which are directly resulting into the productivity or profitability. For e.g., Recruitment of employee who will work for organisation and would result into direct profitability. While indirect costs are those which are added expense and could be avoided by proper preventive steps. Such cost does not lead to productivity and are to be treated as loss and ascertained to the total production of the organisation as a whole and not to a particular employee.

1.3.2 The Training and Development Cost

Mere acquiring an employee is not a sufficient task. The employee needs to be groomed into the organisational culture in a way that would make efforts of the employee in synchrony with the operations of the organisation. Such new employee is then asked to undergo certain amount of training activity for reconditioning. Many organisations have internal training and development centres or few prefer to hire outside consultants to take the developmental activities. The main benefit of external agency for developmental activity is that they provide a clear vision of the external factors that the employee has to face during his employment tenure; as opposed to the internal agency that is biased only towards the organisational point of view. The organisation has to be more concerned about the cost and budget of the developmental activities.

1.3.3 Additional Cost

Additional cost attracted by the employee include any cost that are over and above the normal pay scale of the peer of the employee. For e.g., Legal burdens, bonus, signing bonus, gratuity, compensation, Medi-claim, PF, vacations, travel allowance, frequent miles, dining coupons, game passes, petrol allowance etc.

1.4 BENEFITS AND LIMITATIONS OF HUMAN RESOURCE ACCOUNTING

1.4.1 Benefits



1. Information for Manpower Planning

The relevant information about HR policy, principles and relevant cost of concerned acquisition are to be evaluated by HRA and recommendation provided to the management. Such recommendations are very crucial as the wrong decisions of the hiring and nurturing doubtful employees could lead to excessive burdens on the organisation.

*CASE 1: A company was about to gain a new contract which required roughly 900 manhours per week to meet the requirement of the client. The company at present had a workforce of 15 employees. So currently it could employ 840 (15*8*7) manhours per week. So, for remaining work it has to employ additional labour which comes to 2 labourers. At the beginning of the week it has to procure the required man force. In case it fails to do so, the work won't get completed or it has to put overtime burden on the present employees. In such manhour planning, information regarding the workload comes handy.*

CASE 2: Into the recession the company was in verge of bankruptcy, the management was not ready to face the issues of weakness or reduce workforce. This led to adding cash expenditure on the unrequired staffing policies. The creditors of the company led the matter to court. Court appointed a liquidator, whose first observation was that if the workforce was reduced 6 months ago, the company would not have gone bankrupt.

CASE 3: In a leading law firm litigation department was weak and overburdened. The client could face the tension and many left the firm and joined their competitors. The managing partners yet were adamant to hire new lawyers. When it came to the point that there was only one lawyer left in concerned department that the firm hired extra hands to help. With extra lawyers came new clients and the firm acquired its initial diversified clientele. Had the partners looked into the staffing matters seriously at the first issue itself the troubles might not have aggravated and firm not lost its business to its competition.

Now the students have to ascertain the criteria for selection of one organisation and make a report of its findings whether they are adequately staffed or under staffed? In case of over staffing what would be appropriate measures. Also, from what avenues could they get the information required for personnel selection.

In all the cases we saw that the appropriate hiring and training policies, staffing practices and appropriate planning and inter departmental communication had led to make or break of the corporate empire.

2. Information for Personnel Policies

HRA informs management about the ongoing market policies concerning trends of the employability conditions. Also, the working conditions that are to be implemented in the organisation are to be drafted with consultation with the HRA. It also consists of several legal consultants so as to avoid unnecessary legal complications.

3. Optimum use of Human Assets

HRA helps to analyse and evaluate human resource into the best, efficient and optimum utilisation of the available resources. Sometimes

the organisation does not have the essential resource to carry out the job, it may have several options to acquire the task force. One being, it may recruit the employee itself; or outsource the requirement to some external agency, or recruit on temporary basis. The entire thing needs to be taken care very diligently or else it may add unwanted and overrated expenses. Hence the selection of employee for the organisation is to be recommended by HRA.

A firm wants a manager to overlook production department all over the country. Now the manager needs to be well experienced and qualified. Further to maintain the function all across the country he also needs some assistant managers. He also needs office space in all the plants. So hiring a single manager will not serve the purpose, he should be provided with his complete team to facilitate complete and efficient working culture.

4. Proper Selection and Placements

Right man for the right job, is the mantra for any successfully executed HR programme. Now we all know that Recruitment is mere collection of relevant candidature pool and selection is the negative function that removes unsuitable candidates. As we have seen earlier that wrongful selection can lead to a large legal mess up for the organisation; but even more it would lose precious time for the organisation. Any particular task would lead to delay in the overall project operation. Hence selecting proper man for the proper job would save precious time and cost of the organisation.

Sometimes it may happen that the particular HR manager has certain amount of bias towards a particular sector, gender, race etc. it is the duty of the HR department that such an incident does not occur as the organisation would be subject a severe legal law suit.

5. Increase Morale and Motivation

Once the HR accountant has ascertained the salary for the employees, he would forward it to the management who would sanction the same and pass on to the finance department to vouch and transfer it into the employee's bank account. This is a simple way to keep the employees motivated; pay the salary on time.

Not only money but several other non-monetary things can also increase the morale of the employees and add as a motivational factor.

Work from home reduces the stress of the employees to an extent that their productivity increases to a next level. They are in their comfort zone at home, their travelling time and efforts are saved. They can work in flexible way. Overall, they can work to their fuller capacity with no distractions.

In corporate having a 5 - day week culture, several of the firms brought in an initiative to offer a Mid-week off. Wherein employees have the liberty to take any 2 days of the week as holiday and not necessarily a Saturday or Sunday.

Office vacations for high performing employees could lead to a strong message that the organisation keeps high regard to those who perform. It acts as a stimulant for others to improve their standards of performances.

Festivals, Birthdays and Events should take a significant place in the corporate culture. Since these are the times when interdepartmental communication can take place. Corporate harmony and unity could be foster. Such parties could even act as a stress buster.

Sometimes, lack of motivation also may cause severe troubles to the management, as we will see it in following example:

A bangle making factory refused to give wages to the employees on the grounds that the company suffered a significant loss in the month. It is general expectation of the management that the employees will go on a strike and take a violent form and cause damage to the entire stock of bangles. The employee was counting on that. Since the entire stock would be damaged by event beyond reasonable control, he would be entitled to be paid for damages by the insurance company. Further he could also remove the trouble making employees without any notice period or severance pay.

However, the union leader of the labourers took a drastic innovative action. The employees came to work on the designated time and started the task of production. The only difference being, a lot of mistakes were committed by them resulting into heavy wastage of

material. The entire stock was consumed and no single saleable bangle was produced.

Here the management's own designated weapon backfired on them as now they were compelled

- (i) To pay the employees for previous work undertaken by them.*
- (ii) To pay for the current day's work.*
- (iii) To honour their agreement towards labourers.*
- (iv) Cannot remove the labourers for the wastage caused as it was nature of the industry to cause wastage during production. No legal action can be taken against workers for losses suffered.*
- (v) Also, the waste is not covered by the contract of insurance and hence there will be no liability of the insurance company to pay.*

All these factors require a systematic recording, analysis and budgeting of expenses to incur for the activities. The management has to take a decisive stand in assigning the proportion of cost dedicated to each segment. It also must see that none of the activity is being over compensated and none of it is ignored. Because motivation factor works as a combination of several factors. Company providing all the facilities but ignoring single part may lead to overall negative motivation. People want 100% satisfaction. Hence this portion of accounting is crucial.

6. Attract Better Human Capital

Once employee get the hint that the organisation is taking good care of its employees through various policies and also the implementation is immaculate, the employees feel more than obliged to work with full vigour.

7. Policy and Structure Framing

Many a times accounting of human resource creates a structure and framework for the effective implementation by the operation department.

8. Valuable Information to Stakeholders

When the information of accounting policies related to the Human Resource is being reported to the stakeholders of the company, it increases the confidence amongst the stake owners. They believe that the

philosophy of the organisation is more people centric rather than profit orientation.

1.4.2 Limitations

- (i) Human asset is a thing which cannot be compared with one another. Each has one's own distinct traits which can only be revealed under suitable scenarios. No two employees can have similar calibre. Hence, yardstick for measurement is impossible to be uniform.
- (ii) There sometimes maybe personal bias that may come into play while determining key HR policies.
- (iii) When you grade human with respect to the monetary values, you tend to dehumanise them causing treatment of humans as a mere machine or output generating means.
- (iv) You tend to appreciate the human value over the years of experience, however, there is no guarantee that with growing age, humans could become more productive as compared to today. Aging sometimes takes toll on performance.
- (v) Unlike machines, humans don't come with guarantee or warrantee. They do not have a fixed life. Their life is uncertain and could lead to any catastrophic happening.
- (vi) Productivity and Profitability are the key concerns that drive the organisation to achievement of its goals. Organisation without manpower is useless as it is humans that drive it towards the destination.
- (vii) Decisions regarding training and development can be of crucial role as lot of expense is incurred on the employee to procure, train and groom him to organisation's requirement. In case the employee leaves or is not as per expectations, company faces heavy loss of time, efforts and energy.

1.5 REPORTING OF HUMAN RESOURCE ACCOUNTING AT NATIONAL LEVELS

Organisations are operating with a cut throat competition. One competition that requires management to utilise information to make timely, effective and efficient decisions regarding human capital. As is concerned about the actual driving force of that keeps the organisation

alive; the choices should be meaningful. There might be a dissimilarity amongst firms if they often resort to indigenous reporting frameworks. Hence IFRS has been struggling to bring uniformity amongst HR reporting standards. Also, sometimes the information should be made available to the public for sake of general awareness.

1.6 DISCLOSURE AT INTERNATIONAL LEVELS

HR accounting is a globalised concept; it leads to the value creation in business change from mere physical term to financial asset; driver of the evolution of the organisation.

As we can see, standard of Financial Reporting at International Level is not uniform. United States follows GAAP (Generally Accepted Accounting Principles), while India has its own Indian Accounting Standards. Many countries have adopted IFRS. So, in such a diverse and varied reporting framework, it was very complicated to keep uniformity in recording HR accountancy. Few of the problems arise in following areas.

- (i) **Cash flow:** Employees draw salary that is an expense to the firm and also a direct operating expense. Hence as per Accounting Standard 3 proposed by the Institute of Chartered Accountants of India, it is included in the operating expense head of cash flow statement. What we fail to understand is that, any expense incurred on the employee's grooming, training and development is by far a capital expenditure exceeding return for more than 1 year. Hence only a proportionate cost should be added to the cash flow statement of particular year. In practice we add up the net overall expense undertaken to procure the employee.
- (ii) **Current asset:** Employee is in the firm for a period of more than one year. Hence, he is a capital asset to the firm and not a current asset. Current asset has the validity of period less 12 months. We clearly see that employee is retained in the organisation for period more than that hence he becomes a fixed/long term asset. Moreover, Balance Sheet items need to be based on monetary valuation. Still a debate is underway to treat such a human resource a monetary item or not.

- (iii) **Market price:** Market price means, the price at which the seller is willing to sell and the buyer is willing to buy. It all depends on the market conditions. Like in economics we learned the ways in which the price is being determined. More the demand higher the price and vice versa.

We have seen so far that in major sports leagues, players are auctioned like some commodity. In Indian Premier League, each player is being given the base price. Let say, a player Mr. X, who is playing cricket for past 5 years and is performing well consistently is said to have a high base price, say \$ 100,000. Now anyone want to bid for the player has to start at the minimum ask price. However, this price is not the actual price which the player might take home. Sometimes he may even take as high as \$ 10,000,000 (10 times more than his original ask) or might even go unsold.

Thus, it is just theoretical assumption of determining the price at which the human capital is to be judged. It is not a solid foundation to place a price tag. It just depends on economical formulae.

- (iv) **Fair value price:** *Continuing from the previous example, we have another player who has played a single match but has performed beyond anyone's belief. Many of the commentators also have showered praise on him. Suddenly he came in the spot light of the media and newspaper cuttings. So, it is obvious that each team would like to pay a handsome money to bag this player. His initial ask money was \$ 15,000 but due to the press hype the contenders out-bid each other and the player took home \$ 11,000,000. It was way beyond his initial ask and even over and above the player in previous example.*

Now we come to the point where we have to think about why such a thing occurred? That is because market price is just an amount that is determined by economist, while fair value is the actual amount the buyer is psychologically willing to spend.

The question now arises, which of the following amount is to be taken into consideration while budgeting the human assets? The answer to this would be simple compare the market price and the fair value, accept whichever is lower. And in case of any general and major discrepancy, give justifications.

- (v) **Representation in Balance Sheet:** The human resources *per se* have no standing of their own in the financial statements of the organisation especially the balance sheet. Few unpaid items indicated in the profit and loss statement may be seen in the balance sheet as outstanding or prepaid expense, but they are in fact the expense incurred on operating side. They are not expenditure on humans. Hence many countries emphasising on presentation of records in financial statements or annual reports of the company, compliances made to the organisations pertaining to human rights protection are for the fact not legally valid. Arguments are being going on in various courts, forums and international law-making bodies to inculcate the reporting standards and mandatory compliance. None have taken a concluding shape.
- (vi) **Intangible:** Humans being intangible are subject to several of psychological effects that are beyond the scope of machines and other tangible assets. Machines cannot work on their own. You need human to operate them. All the assets would remain idle and unutilised if not for humans. Hence of all the assets, human resource recording and analysis should be made as per the likings of psyche of the employees. The employees should feel like they are wanted. The organisation should foster a caring as one united family and not centralised association of complex etiquettes.
- (vii) **Public knowledge:** The employee spending of the company is not a public knowledge and it should be a private and confidential. In case of leak of employee benefits being leaked it would be very easy for the competitors to poach the employee from rival firms.
- (viii) **Traditional v modern:** As we see in the introductory phase of the chapter, there are two bipolar phases of human consideration. Mao's, Stalin's etc. philosophy as to exploit the human to fullest of the extent. Mao in one of his principles stated.

*The employer should support the employee in all aspects like:
Children's education, day care, lunch facility,
Employee's health care, travel facility, home accommodation,
Spousal preference in job.*

Providing all this amenity the employee stays loyal to the employer and is not grumpy to work an hour or so extra every now and then. He is not disheartened if he is not given any promotion or a raise. Also, he sees to find it heartening that he has no travel time to spend and hence he is willing to work an hour or so extra as a compensation for the travel time spared.

Later in the years, it was started to see the employee of the organisation as an asset and not just revenue churning component or machinery.

While the other factors of Google employment are that it is open to employees to work as per their ease and convenience. It has a great ambiance.

- (ix) **Realisable value:** One cannot predict what a man thinks at all the time. Maybe the person has a qualification required.
- (x) **Soft accounting:** Human resource is a soft capital. Hence it cannot be treated as a normal commodity. It has to be treated as a special component. As we have studied.
- (xi) **Working capital budgeting:** Human resource marks the highest proportion in any budgeting decisions, especially working capital management. Any other component of working capital can allow a delay period of 3 months, but employees of the organisation that draw salary are to be paid up each month. A delay of 1 or 2 weeks could be accepted but anything beyond that is not tolerated. People would go on strike can take up violent means to protest and also can cause severe labour dispute over social media and in court of law. This hampers the goodwill, image of the firm and its reputation.

A firm kept on increasing its debts to extent that it was way beyond the line of credit allowed to it by the bank. Creditors kept on visiting the offices and threat were made for liquidation. Overdue bills, lack of revenue, problem in collection of debt from customers all added up to chaos that the employee felt the insecurity regarding jobs and outstanding salaries. In bad economy all those who could find a job, fled. All those who could stay without a job (having a stable family background) did quit. It was left to the helpless souls who couldn't leave as they were having problems finding another job and this job was the only mode of survival. In the end when the firm wound up,

all the creditors got preference into receiving their debt payments and the employee received nothing.

This made many countries to rethink about the standards for protection of rights of its employees. Many recommendations are being submitted, detailed analysis is being concluded, yet final decision regarding any of modifications is yet to come out.

Following are various proactive step undertaken by several countries to determine the right ways to address the ever-increasing issues with the human resource accounting:

New Zealand is one of the first country to understand and address the problems associated with human resource accounting. CPA (certified public accountants) equivalent to Chartered Accountants in India, were asked to draft a proforma or format to have prepared so as the organisations could have a uniformity to reporting. Several amendments are being made into its local laws so as to make it more HR friendly.

Europe and Australia are working on an adequate working model to enhance efficiency and reduce stress. Work life balance is taking driver's seat.

China until recently was not open to the fact to acknowledge the employee beyond the scope of mere production factors. As we can expect of the communist nature of the country's economy. They are yet being influenced by the Mao's theory of socialistic development that they don't open up to the concept of human empowerment. However, with emerging new players like Alibaba, China is also not resilient to change.

1.7 QUESTIONS

(I) Fill in the Blanks

1. The cost to acquire a new employee is called as _____.
(a) Acquisition cost (b) Hiring cost
(c) Selection cost (d) Recruitment cost
2. The cost to make the employee sufficiently competent to work with the peers in the organisation is called as _____.
(a) Training and development cost (b) Replacement cost
(c) Selection cost (d) Additional cost

3. Human resource accounting does an accounting of _____ in the firm.
(a) Human assets (b) Machines
(c) Salaries
4. HRA is an _____ ideology.
(a) Employer oriented
(b) Employee oriented
(c) Employer-employee mutually benefiting
(d) Profit maximising

Answers: 1.- (a); 2. - (a); 3. - (a); 4. - (c)

(II) Match the Following

Development of Human Resource Accounting

1. First Stage (a) 1960-66
2. Second Stage (b) 1966-71
3. Third Stage (c) 1971-76
4. Fourth Stage (d) 1976-80
5. Fifth Stage (e) 1980 onwards

Answers: 1.- (a); 2. - (b); 3. - (c); 4. - (d); 5. - (e)

(III) Answer the Following Questions

1. What is Human Resource accounting and explain its objectives?
2. Explain historical development of Human Resource Accounting?
3. Explain cost of human resource.
4. What are benefits and limitations of Human Resource Accounting?
5. How is HR Accounting reported at National levels?
6. Explain disclosures at International level?

(IV) Short Notes

1. Need of Human Resource Accounting
2. Acquisition cost
3. Training and Development Cost
4. Additional Cost
5. Benefits of Human Resource Accounting.

