Session objectives

Human Resource Accounting

- Explain the meaning of HRA
- Global trends in HRA use
- State the objectives and importance of HRA
- Apply the Models of HRA
- Explain the limitations of HRA
Meaning

- Organization’s resources can be broadly divided into three;

  - Financial resources,
  - Physical resources and
  - Human resources (employees).
• At the end of any financial year,
  - the financial and physical resources are reflected as assets in the company’s balance sheet.
  - The only reference made about human resources is usually in the Chairman’s/CEO’s keynote address to the effect that, ‘Before I conclude, I wish to sincerely thank our employees without whose dedication and commitments, we would not have achieved our objectives and they are our most valued resources.
The fact that employees are not reflected in the balance sheet brings into focus the question whether employees are assets or liabilities.

Various studies have been conducted to answer this question.
It has been observed that financial and physical resources are passive factors of production while human resources are active factors because it mobilizes the financial resources, exploit the physical resources and build up a progressive organization. For that reason, it is the most important of the three resources.
Manpower is the largest component of any organization and its proper development is key to success of the organizations' productive efforts.

The success and survival of any organization depends upon the manner in which people are recruited, developed and utilized effectively.
All activities of any enterprise are initiated and determined by the persons who make up that institution. Plants, offices, computers, automated equipment, and all else that a modern firm uses are unproductive except for human effort and direction.
Human beings design or order the equipment; they decide where and how to use computers; they modernize the technology employed; they secure the capital needed and decide on the accounting and physical procedures to be used.

Every aspect of a firm's activities is determined by the competence, motivation and general effectiveness of its human organization.
Lack of human resources of right quality is largely responsible for the backwardness of the otherwise rich nations - Likert Persis Mydral

Productivity through people as one of the important attributes that characterized the most excellent and innovative companies in the United States - Peter and Waterman
Many management would agree that the effectiveness of their organizations would at least be doubled if they could discover how to tap the unrealized potential present in their human resources. - McGregor

Theories that were propounded earlier based on the above studies, it can be concluded that human resources are not only assets but the most valuable of all assets.
However, as assets, they ought to be reflected in the financial statements (balance sheet) like other assets.

For this to be done, they must first be properly valued.

The valuation of human resources is a major challenge that so far, very few organizations have taken up.
Definition

“The process of identifying and measuring data about human resources and communicating this information to the interested parties.”

- American Accounting Association
“the production of information about and/or for employees that can be useful to both employees and other stakeholders.”

- Janice and Ahmed Belkaoui (1995),
“The process of identifying and measuring the value of human resources and reflecting it in the balance sheet”
Evolution of Human Resource Accounting

- Passed through several stages between 1960 and the mid-1980s.
- The initial stage 1960 and 1966—basic concepts were being derived.
- Organizational psychologists—interested in leadership effectiveness and the human resource perspective was emergent as was the economic theory of human capital". 
• In the next stage (1966 to 1971),
  • the models of measuring human resource cost and value were tested.
  • William C Pyle, Lee Brummet and Eric G. Flamholtz developed the historical cost model in 1967.
  - looked at the actual costs incurred in “recruiting, selecting, hiring training and developing”
Lev and Swartz (1971)

- Developed an economic value model that determined the value of the employee as the present value of all future services discounted at an appropriate rate.
Flamholtz (1971)

✓ improved on the Lev and Swartz model
✓ came up with the stochastic reward model.
✓ estimating expected future services based on the post occupied at the time of exit, and the probabilistic estimation of the number of years and positions the employee would have occupied in the organization.
The years 1971 to 1976

- rapid growth of interest in human resource accounting.
- There were many attempts to apply HRA in business organizations like R. G. Barry Corporation. (USA)
- Attention given to the potential impact of HRA on managerial decision-making.
From 1980- onwards

- Move throughout the United States towards the use of HRA to increase productivity,
- Japanese companies were fast becoming a major competition they treated their employees differently from US companies as resources rather than expenses.
- Major companies in India has adopted it
Contribution of HRA to Management

- HRA can help a firm obtain competitive advantage. -Porter (1991)
- Effective management of human resource gives benefits that lead to greater profitability. -Schuler and Macmillan (1984)
- HRA is seen as a strategic factor strongly influencing the economic success of a single company -Pieper (1990)

- role of the Chief Financial Officer in managing human resource is changing, and finance and H.R executives working closer together to address the management of human capital.

- Shift a result of the costs associated with labor (pay, benefits, training etc.) forming about 36 per cent of the American company's revenues.
• About half of the financial executives say that investors are querying them on issues associated with human resource,
• 23 % said their boards are already involved in human resource issues,
• 36 % predicted that the involvement at board level will grow in two years.
• 92% said human capital has a great effect on the company's ability to achieve customer satisfaction, and
• 82 % believe that human resource has an impact on profitability.
Eronen (1999)

- Analyzed 126 companies listed on the Helsinki Stock Exchange during 1983-97 to determine whether H.R information disclosure in their annual reports had any effect on their market-to-book ratios.

- 60% of the companies published written information on their personnel exceeding the minimum requirements of the accounting act.
• 38% provided information on training and development, absences, labour turnover and pensions in the form of indicators,

• 20 % on costs in these four fields, and 24 % on efficiency (e.g. net sales or value added per employee).

• Clear differences between industries and the extent of human resource information disclosure was positively associated with the annual net sales of
Objectives of HRA

- R.G. Barry incorporation USA-(1968) while implementing HRA
- Provide managers with additional information to assisting decision making and evaluating employee performance
- Provide managers with specific feedback on their own performance
- Provide organization with more accurate accounting of return on total assets employed
- Aid in development of management principles
- Furnish cost value information to attain
Importance

- Internal Reporting
  - Planning
  - Decision making
  - Capital budgeting
  - Control
  - Performance Evaluation
  - Activity Analysis
Importance ..con’td

☐ External reporting

✓ Investors and shareholders - measure the change in asset value of a period of time thereby reflecting correct measurement of corporate growth

✓ Changes in the value of HR would indicate organizations personnel policies
Importance ..con’td

- Management of human resources
  - Acquisition of human resources
  - Allocation of human resources
  - Maintenance of human resources
  - Evaluation and reward of employees
  - Training of human Resources
  - Helps the personnel to be treated as profit centres
Importance ..con’td

- Human Resource Development
  - Manpower planning
  - Appraisal of HRD programs
  - Identification of training needs
  - Impact of budgetary control on motivation and moral of employees

- Society
  - Society views as cooperative social organization in which interest of different groups mingle
Human Resource Valuation Models

- Historical cost method
- Replacement cost
- Opportunity cost model
- Standard cost model
- Lev and Swartz Model
- Stochastic model
- Jaggi and Lau Model
Excerpts of findings based on a Ph.D study on HRA by Dr. George Achoki
Significance and Potential Benefits of HRA

- Highly useful in manpower planning.
- Likely benefits of would overweigh the cost of keeping such records.
- It would be significant in improving personnel decisions especially those relating to recruitment and voluntary retirement policies.
Significance and Potential Benefits of HRA

- Help in precise valuation on investment made on human resources,
- Help identify and tap the unrealized potential of the human resources, significant in determining the ratio of investment in human resource to the total investment
Significance and Potential Benefits of HRA ...con't

- Help in identifying the employees with the highest expected realizable value and prevent reckless transfers, layoffs, demotions etc;
- Better formulation of performance evaluation policies and reward of employees;
Significance and Potential Benefits of HRA ..con't

- Give an exact idea of the strengths and weaknesses of the organization with respect to human resource potential;
- Ensure more purposeful allocation of expenses being incurred on procurement and development of human resources,
Significance and Potential Benefits of HRA ..con't

- Better utilization of human resources,
- Arrest personnel turnover,
- Reflect the true worth of the firm correctly,
Significance and Potential Benefits of HRA ..con’t

- Employees and trade union leaders:
  - would boost their morale and self confidence,
  - improve job commitment and sense of belonging to the firm,
  - enhance their career prospects of vertical rise in the organization,
Employees and trade union leaders:

- help them in wage negotiations,
- better facilities and faster response from the management,
- make them aware of the expenses incurred on their development.
• Other shareholders

- Would help to improve the productivity and profits,
- Quality of goods and services due to better utilization of human resources; help in social development,
Help to determine the ratio of investment thereby assisting the society in judging human resource development conscious organization, the investors would be able to evaluate the return on investment of human assets and other assets.
The creditors would have full knowledge of creditworthiness of the organization.

The trade union leaders would use the data generated in wage negotiations, and their relationship with the management would improve as determining net worth of the employees improves their motivation, morale and loyalty.
Besides, the determination and appreciation of the real worth of human resources would reduce strikes and lockouts.

Lesser wage disputes would occur as valuation would provide a scientific basis in dispute solving.
Hindrance in HRA

- Absence of any statutory obligation compelling the organizations to adopt HRA.
- Possibility high personnel turnover as the competitive firms would use the values to lure precious human resources.
- The present approaches are inadequate to reflect the gap between the real potential and present value of human resource.
Ways to overcome hindrances

• Made obligatory by the Government and accounting bodies like Institute of Certified Public Accountants of Kenya and Industrial Associations be involved,

• Modification of relevant tax laws to accommodate the assetisation of human resources

• Workshops, Seminars and symposiums
Milestones of HRA

• Football – Christiano Ronaldo – Ksh.10 Billion ($130m)
• Kaka – Ksh.8.4 billion (€65 million)
Thank You