

# A Study on Human Resource Accounting Practices in India

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## ABSTRACT

**Human Resource Accounting (HRA)** is the process of identifying and reporting investments made in the human resources of an organisation that are presently unaccounted for in the conventional accounting practice. It is an extension of standard accounting principles. Measuring the value of the human resources can assist organisations in accurately documenting their assets. In other words, human resource accounting is a process of measuring the cost incurred by the organisation to recruit, select, train, and develop human assets. The human resource process in India was established to fulfill a number of objectives within the organization. These include:

1. To furnish cost value information for making proper and effective management decisions about acquiring, allocating, developing, and maintaining human resources in order to achieve cost effective organizational objectives.
2. To monitor effectively the use of human resources by the management.
3. To have an analysis of the Human Asset, i.e. whether such assets are conserved, depleted, or appreciated.
4. To aid in the development of management principles and proper decision making for the future, by classifying the financial consequences of various practices.

Approaches to human resource accounting were first developed in 1691. The next approach was developed from 1691 to 1960, and the third phase was post-1960. There are two approaches to HRA. Under the cost approach, also called the "human resource cost accounting method" or model, there is an acquisition cost model and a replacement cost model. Under the value approach, there is a present value of future earnings method, a discounted future wage model, and a competitive bidding model. Considering the pros and cons of various models, Chennai-based CA Lakshminarayanan Ramanujam has worked out a simple to use and easy to adopt, unique model titled Give GET, for the Human Resource Valuation and Accounting, while accounting for PEACE.

**KEYWORDS:** *human resource accounting, India, value, cost, management, standard, organization*

## INTRODUCTION

Cost approach in India is also called an acquisition cost model. This method measures the organization's investment in employees using the five parameters: recruiting, acquisition, formal training and familiarization, informal training and informal familiarization, and experience and development. This model suggests that instead of charging the costs to profit and loss statement (p&l) accounting, it

should be capitalized in the balance sheet. The process of giving a status of asset to the expenditure item is called capitalization[1]. In human resource management, it is necessary to amortize the capitalized amount over a period of time. So, here one will take the age of the employee at the time of recruitment and at the time of retirement. Out of these, a few employees may leave the organization

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before attaining the superannuation. This method is the only method of Human Resource Accounting that is based on sound accounting principles and policies.

**Limitations of HRA in India:**

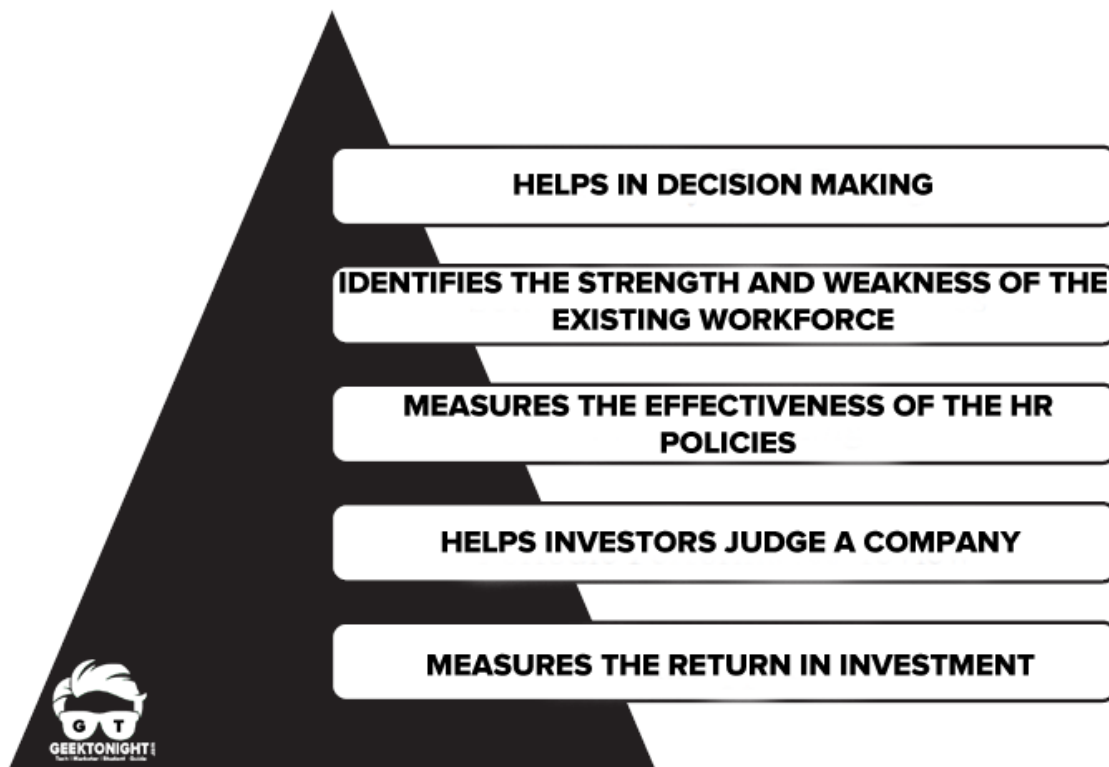
- The valuation method is based on the false assumption that the dollar is stable.
- Since the assets cannot be sold there is no independent check of valuation.
- This method measures only the costs to the organization, but ignores completely any measure of the value of the employee to the organization.
- It is too tedious to gather the related information regarding human values.
- it may be possible that the employee is already fully trained and there is no need to incur any development, training, or recruitment costs. It will create difficulty for a company to find out CTC according to acquisition model.
- Does not account for software which can reduce the overall cost of human resources by having integrated software completing the tasks of staff.[2]



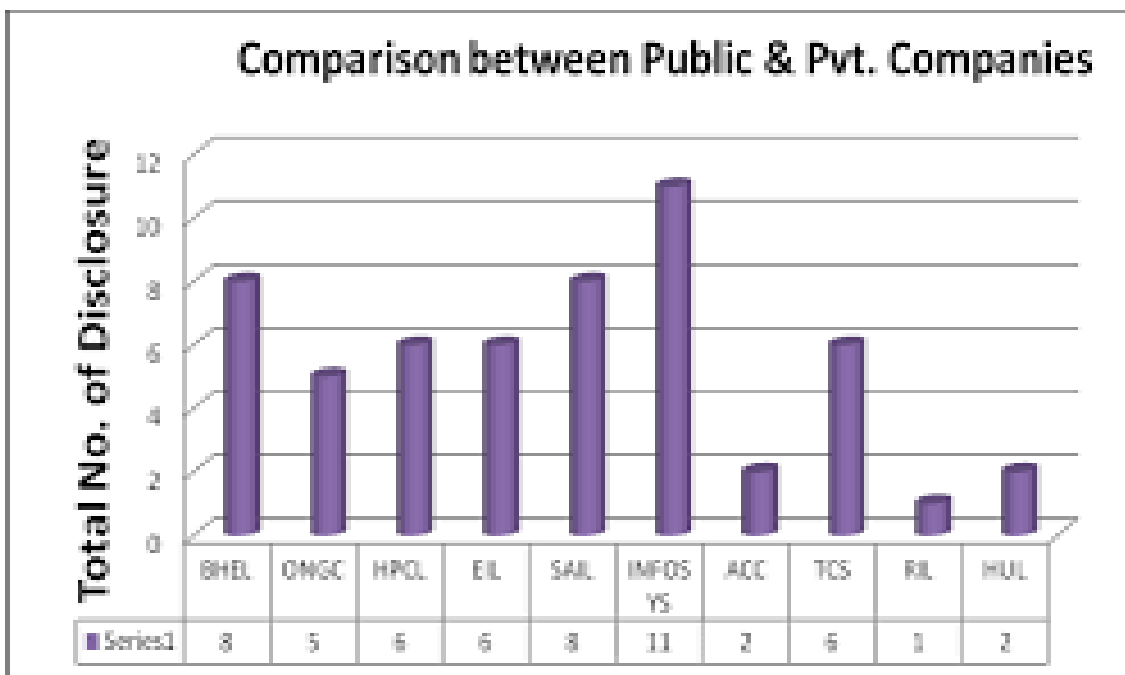
Replacement cost approach measures the cost of replacing an employee. According to Likert (1985) replacement cost includes recruitment, selection, compensation, and training cost (including the income foregone during the training period). The data derived from this method could be useful in deciding whether to dismiss or replace the staff. Substitution of replacement cost method for historical cost method does little more than update the valuation, at the expense of importing considerably more subjectivity into the measure. This method may also lead to an upwardly biased estimate because an inefficient firm may incur a greater cost to replace an employee (Cascio 3–4). Lev and Schwartz (1971) proposed an economic valuation of employees based on the present value of future earnings, adjusted for the probability of employees’ death/separation/retirement. This method helps in determining what an employee's future contribution is worth today. Hekimian and Jones (1967) proposed that when an organization had several divisions seeking the same employee, the employee should be allocated to the highest bidder and the bid price incorporated into that division's investment base. For example, a value of a professional athlete's service is often determined by how much money a particular team, acting in an open competitive market, is willing to pay him or her. According to Mirvis and Mac (1976), this model focuses on attaching dollar estimates to the behavioral outcomes produced by working in an organization. Criteria such as absenteeism, turnover, and job performance are measured using traditional organizational tools, and then costs are estimated for each criterion. For example, in costing labor turnover, dollar figures are attached to separation costs, replacement costs, and training costs.[3]

**Discussion**

The success of any business unit largely depends on the intensive application of skill, creativity and dexterity of the people working therein. Eric Flanholtz defines human resources accounting as, “Accounting for people as organizational resource.



Human resources accounting is measurement of the cost and value of people for organizations.” It is clear from this definition that the human resources accounting is useful for both general managers and personal managers since human resources information influences the planning and controlling functions of the management and various operative function of personal management. It helps the management to utilize human resources most economically and efficiently. It also helps the managers in making sound decisions in personal matters by providing required information. HRA helps management review its strategy of investment in human assets. The accounting concept helps as certain effectiveness of the entire gamut of human resource management. HRA is of permanent importance to the nation and also to individual organizations. It is all too easy to see a company in abstract terms of balance sheets, technologies and organization charts. Such a view overlooks the fact that the most valuable assets are the commitment and skills of individuals who make the system work and lay the foundations for future growth. Apart from laying stress on training, companies offers a host of facilities to its employees to maintain a congenial working environment. Among those given at the factories: houses/tenements for a large number of workers and staff, cooperative societies, crèches, dispensaries/hospitals, canteens, rest halls and so on. Benefits are liberally subsidized by the company. They also care of employees’ families through merit scholarship, tuition fee reimbursement, medical treatment etc. [4]



**The following are the main benefits of HRA:-**

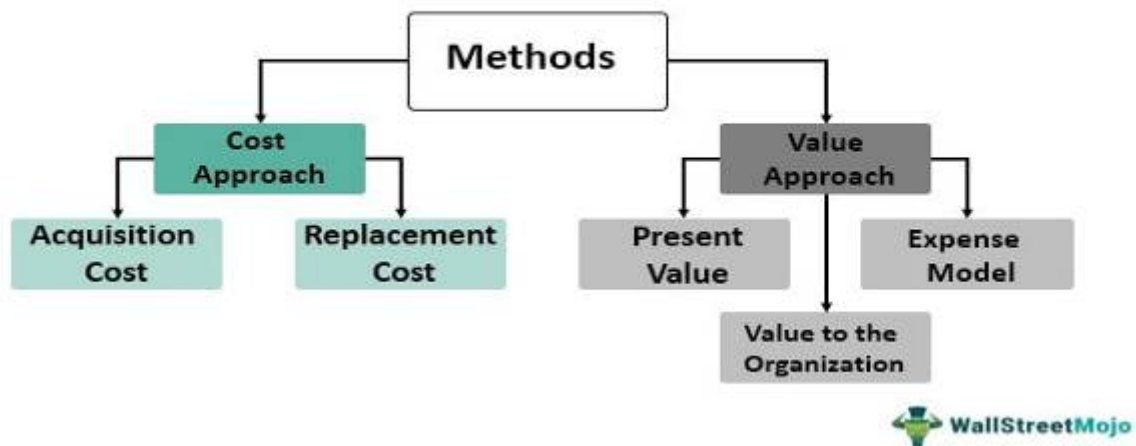
**The adoption of the system of HRA discloses the value of human resources.**

- Improves managerial decision making.
- Helpful in proper interretation of return on capital Employed.
- Adoption of HRA will help increasing productivity of human resources.
- It will serve social purpose by identification of human resources as a valuable asset.
- HRA is absolutely essential in such organization where human element is the prime factor like a professional accounting firm, a drama company etc.

The success of an organization very much depends on the build-up of quality workforce at all levels. If this vital asset is not shown in the balance sheet, to the extent the public and investors are handicapped.

HRA reports give useful information to the company management, employees and investors. In India, very few companies use HRA.[5]

## Human Resource Accounting



It is not compulsory in India. Infosys Technologies and BPL are the leading companies in India, which use HRA. It is fact that the 21st century is era of Human demand, countries those have labor quality ruling the world with dominant technology. Countries like china and Japan forerunners in technology advancement, is all result of work force performance. Hence whole world realized that human resource is the real investment into business ventures that should only catch and stick the success waves. It can be say that INFOSYIS, Bharat heavy Electrical Ltd (BHEL), DR.REDDY`S and Steel Authority of India Ltd (SAIL) are ever profit generators because recognized value of quality of labor and ordered peak priority so as company`s yields ripped fruits with assistance of ripped force (quality employees) and can stand against any business storm and cope up effectively. Even though, many benefits have contributed by HRA, yet its development and application in different industries has not been encouraging. Because Indian companies act 1956, does not provide any scope for showing any information about human resources in financial statement. Due to the development of business and industries, some of the Indian companies, both public and private, value their human resources and report this information in their annual report. The companies, who are presently reporting human assets valuation, include:

1. Infosys Technologies Ltd.
2. Steel Authority of India Ltd (SAIL)
3. Bharat heavy Electrical Ltd (BHEL)
4. Oil and Natural Gas Commissioning (ONGC)[6]
5. Oil India Ltd.
6. Project and Equipment corporation of India.(PEC)
7. Engineers India limited
8. Mineral and Metal trading Corporation of India.(MMTC)
9. Electrical India Ltd
10. Hindustan Shipyard Ltd xi. Cement corporation of India. (CCI)
11. Tata Engineering and Locomotive Works
12. Southern Petrochemicals Industries Corporation Ltd SPIC)
13. Associated Cement Company Ltd ACC)
14. National Thermal Power Corporation Ltd (NTPC).

**Results**

**Future of human resource accounting**



Historically, human resources accounting and costing focused on how much employees cost an organization, without evaluating the value of the employee to the business. As the world moves into the information age, intellectual knowledge as a business asset is becoming increasingly important. Recording, evaluating and assigning value to this intangible asset is one of the primary focuses of the evolution of human resources accounting. Until recently, the “value” of an enterprise as measured within traditional balance sheets, e.g. buildings; production plant etc. was viewed as a sufficient reflection of the organization or enterprise assets. However, with the growing emergence of the knowledge economy, this traditional value has been called into question due to the recognition that human capital is an increasingly important part of an enterprises total value. This has led to two important questions.

1. How to assess the value of human capital in addition to an enterprise’s tangible assets
2. How to improve the development of human capital in enterprises.

The emergence of methods for accounting human resources aimed at measuring, developing and managing the human capital in an enterprise, can thus be said to reflect the need for improving measuring and accounting practices as well as human resource management.

The concept of Human Resource Accounting in India is a recent phenomenon and is struggling for its acceptance. [7]



In India, Human Resource Accounting has not been introduced so far as a system. The Institute of chartered accountants of India has not issued an accounting standard for the measurement and reporting of cost and value of human resources of an organization. So far as the statutory requirement is concern, the Indian company Act 1956 does not require the furnishing of any significant information about human resources in the balance sheet or final account of the companies. According to the money measurement concept of accounting only those transactions can be recorded under double entry accounting system which can be expressed in monetary term. Human attributes (i.e. honesty, sincerity, loyalty, wisdom, skill, attitude etc.) cannot be expressed in monetary terms; therefore, there is no standard method which can be followed to capitalize the investment on human assets. In recent years some public undertakings have started to disclose information about their work force along with the financial statement. Finally every organization should be understood the value of human force and same should be recognized in accounting books.

### Benefits of HRA

Human resource accounting helps in knowing whether human asset is being built up in the business or not. An executive may show good result in producing well, and so on but he might not have built the human resources properly. A good manager keeps the morale of his subordinates high so that they contribute the maximum in achieving the organizational objectives. [8]



1. HRA will give the cost of developing human resources in the business. This will enable the management to ascertain the cost of labor turnover also.
2. Proper investment: It can be seen whether the business has made proper investment in human resources in terms of money or not. If the investment is in excess, efforts should be made to control it.
3. Planning and executing personal policies: It will help the management in planning and executing personal policies. The management also makes use of its help in taking decisions regarding transfers, promotions, training, retirement and retrenchment of human resources.
4. Improving employee efficiency: It helps in improving the efficiency of employees. The employees come to know of the cost incurred on them and the return given by them in the form of output, and so on, which will motivate them to increase their worth.
5. Calculate Return on Investment (ROI): The return on investment can realistically be calculated only when the investment on human resources also is taken into account. The ROI is may be good because there is an investment on human beings[7]

## Conclusions

Overall, even valuing human resources appear to be important to Indian organizations, most organizations do not value their human resources and plans to implement valuation of human resources are at a very early stage. Despite the interest in valuation there will be little or moderate progress in the area over the next five to ten years. In order to show greater progress, more needs to be done at both the theoretical and practical level. 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. Therefore whatever the tool or approach to HRA, much of the potential for developing human resource accounting capability and gaining its advantage depending upon the availability of and accessing to the required data. In those organizations, where the data is not readily available or routinely maintained, the first step towards human resource accounting (HRA) will have to be Human Resource Information System (HRIS).[8]

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