Human Resources Accounting

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Literature Review

This Literature Review will seek to explain the concept of Human Resources Accounting (HRA) it's relevance and the models that make up this term as well as the criticisms that may hinder worldwide acceptance.

Defining Human Resource Accounting

This theoretical concept is based primarily on the assumption that employees are Human Being with varying goals and needs, therefore, they should not be thought of as basic physical business resources like machinery or vehicles. In other words, this concept is built on the term of "Soft HRM" which looks at the association with the human relations movement, the utilization of individual talents and McGregor's Theory Y perspective on individuals' developmental humanism (Truss, C., et al 1997). The concept of HRA was coined by Sir. William Petty in 1691, however, indebt research into the topic did not commenced until the late 1960 by Renis Likert. In 1967 Renis Likert and others made a significant contribution in defining and the developing the term of HRA. Published work by (Young and Jung, 2003; Myers, 1976; Lau and Lau, 1978; Friedman and Lev, 1974) reveled HRA as a method for systematically measuring both the asset value of labor and the amount of asset creation that can be attributed to employees' activities. These publications reflect the contribution aspect of human resources and incorporates the economic benefit attributable to human capital in recognizing their cost inference.

In defining the concept of HRA the American Accounting Association Committee (1973) stated that it is "the process of identifying and measuring data about human resources and communicating all this information to interested parties. Therefore, it does not only involve measurement of all cost / investments associated with recruitment and selection, placement, training, and the development of employees, but also the quantification of the economic value of the people in an organization." Ericic Flamholz (1971) definition of the concept of HRA is "accounting for people as organization resources and it involves measuring the costs incurred by organizations to recruit, select, hire, train and develop human assets. It also involves measuring the economic value of people to the organization. While, (Bouderau and Berger, 1985; Sackman et al., 1989) both shared a similar definition of the concept HRA, they stated that it is "the measurement of the cost and value of the organization which makes a significant contribution in solving numerous personnel selection problems by using the information in carry-out the decision-making process.

Additionally, the literature offers other definition on the concept of HRA which primarily states that " there are core competencies which are embodied in people and that are essential for the employees in an organization to facilitate new ideas and innovativeness of a firm (Tsou et al., 2016: 33). In the late 1990s to 2000s organizations such as the European Centre for the Developing of Vocational Training (CEDEFOP) and European Commission (EC) provided disclosure and guidelines on Human Resources Accounting. Outline (2001) stated that "this is one aspect of accounting which has received significant attention is the area of human capital." The money that enterprises spend on human resources had traditionally been reported in the finances as a cost rather than as investment (Shreelatha and Shruthi, 2019, pp. 2). Although there is amply room to discuss the precise meaning of HRA, it is evident in an organization "skill" predict "performance", this is because it is the employees who add value to the workplace (Spender & Marr, 2006). However, Flamholtz (1974) and Jasrotia (2004) definition of the concept of HRA is widely accepted generally thought out the literature as this concept is being considered as a critical resource to most companies and the attributes of HRA affects operating outcomes (Wu and Chen, 2016: 127).

Relevance of Human Resources Accounting

Furthermore, the literature goes on to demonstration the relevance of the concept HRA by expounding on the fact that the fundamental functions of this term provides value/cost of acquiring, developing, allocating, conserving, utilizing, evaluating and rewarding the human resource in an appropriate way. Abubakar (2006) identifies getting the best human brain, achieving the pre-determined objectives of the organization, commanding respect in the eyes of Stakeholders, gaining a competitive advantage, becoming the pace setter and maker are some of the reasons why organizations invest a lot of its financial resources on their human capital. Moreover, HRA is a management tool which is designed to assist the senior management leaders in understanding the long-term cost and benefit implications of their HR decisions, which enables better business decisions (Newman, 1999; Jasrotia, 2004). HRA supports removing the misrepresentation in the financial statements which arise due to treating human resource investment as expenditure, by treating human resource investments as expenditures, the income statements tends to be similar in treating human resources as an expense during the year rather than capitalization and amortization of their expected service life.

[bookmark: _Hlk32735247]Gupta (1991) reinforced the argument that HRA information aids HR experts in the management of human resources efficiently and effectively and that it provides quantitative information about the value of human asset, which in turn helps the top management to make the best decisions regarding the adequacy of human resources. He continued by say that HRA information is relevant for performing the HR functions of acquiring, developing, allocating, conserving, utilizing, evaluating and rewarding the human resources as well as allows senior management to monitor effectively the use of human resources. However, Jawahar Lal, (2009) stated that "HRA is not primarily for senior management only but it could be a valued asset in the assessment of information within the decision-making process of human capital." The inclusion of appropriate human resource information in published financial statements could make such statements more meaningful in predicting future performance which is the prime concern for investors (Jawahar Lal, 2009). Micah, Ofurum, & Ihendinihu, (2012) statistically, "expressed that there is an inverse relationship between "Return on Assets" (ROA) of a firm and its level of HRA disclosure. They explained that ROA measures company's overall profitability, whereas investments in human capital is an expense which will result in the understatement of both assets and earnings, consequently companies tend to justify the investments made in human resource, which is not explicitly stated in the balance-sheet."

[bookmark: _Hlk32905654]Subsequently, the balance sheet becomes distorted because it presents the total assets as well as the net income therefore affecting the rate of return incorrectly. Nevertheless, the adequate use of HRA shows the amount of contribution made by the organization towards human capital by way of investing in its development (Leffingwell (2002). According to (Aljamaan, 2017) there are several reasons why the use of HRA is relevant, this is because 1) it provides a basic platform of planning the objectives, aims and methods for acquiring human resources which are crucial to the success of the firm, 2) it provides various assistance to the management team in relation to the employment and utilization of human resources and 3) there are benefits in evaluating the expenditure incurred for imparting further education and training of employees in terms of benefits derived by the organization (Aljamaan, 2017). Studies conducted by Harmanson (1964), Brummet, Vroom and MacCrimmon(1968),Flamholtz (1971 &1974), Lev and Schwartz (1974), Sadan and Auerbach (1974), JaggiandLau (1974), Strauss (1976), Lau and Lau (1978), and Schmidt, Hunter and Pearlman (1982) added that the used HRA can contribute to the process of efficiently measuring the value of human resources. Countries such as India, Scandinavia, United Kingdom, Australia, New Zealand, India, China, Portugal, Germany, Canada and Greece all engage in the practice of HRA, which only demonstrates the growing importance of the concept (Bullen & Eyler, 2010).

Human Resources Accounting and Decision Making

In addition, Managers are more likely to make decisions that treat the company's employees as long-term investments of the company when they go through the process of HRA measurement treating human resources as capital assets. Flamholtz et al (2002) use the psycho-technical systems (PTS) to explain the HRA concept. He argued that the "(PTS) approach play a role in HRA by providing numerical measures and even more important role is the measurement process itself." The HRA measurement process as a dual function attempts to increase recognition that human capital is paramount to the organization short and long-term productivity and growth. Moreover, with in process of measuring human resources managers are more likely to focus on the human side of the organization and may consider human resources as valuable organizational resources to be managed, control and motivated (Bullen, 2007). HRA views human resources as assets or investments which must be maintained for long-run productivity.

Bullen and Eyler, (2010, p.5) explained if management quantified the costs of downsizings, management might be less inclined to use redundancies to eliminate costs and boost short-term profits at the expense of long-run productivity and profits. However even if human assets are not reported on the external financial statements, HRA can play a crucial role in internal managerial decision-making, and HRA measures can be used to show that investments in a company's human resources may result in long-term profit for the company.

Human Resources Accounting Models

The concept of HRA is comprised of several models with contribute to the decision-making process in relation to controlling, monitoring, motivating and managing human capital;

Present Value Model: this model was conceptualized by Flamholtz et al (2002) who argued that people are valued asset within the organization. Hence, these valued employees are expected to perform their duties during the time they are active employees at the organization (Dawson, 1994).

Original Cost Model: this model explains that the costs of training and development process which are parts of an organization original costs should be capitalized upon. The training and development process are expected to aid the employee and the organization (Paperman, 1977).

Historic Cost Model: The historic cost method calculates an employee 's worth using the total historic costs associated with obtaining an employee. However, with is this method decisions must be made about what costs to expense and what costs to capitalized on. This approach can be used to conclude all the costs associated with recruiting, testing, training, and development of the organization. Also, the decision of whether to capitalize or expense is based on how long the cost will benefit the company. It is necessary to note that the Historic costs do not represent the worth of an employee; they are merely an assessment of past costs (Dawson, 1994).

Replacement Cost Model: This approach was developed by Likert (1967) who suggested that the cost of an employee should be valued based on what the organization would have to sacrifice to replace an employee if they left the organization. This approach embraces the cost attributable to the turnover of a present employee, as well as the costs of acquiring and developing a suitable replacement. It calculates an employee worth using the replacement costs associated with obtaining a new employee. This method is based on solid fact; what is the costs of recruiting and training a new individual.

Total Organizational Model: This approach takes in to account the value of the organization and divides it between the different inputs to the organization, then it divides the amount associated with labour between the different clusters of employees in the company (Dawson, 1994).

A Bidding Model: The literature explains this model as the way in which managers in an organization determine value by bidding for human resources within the organization. This approach suggests competitive bidding for scarce employees in an organization (e.g. opportunity cost of employees linked to scarcity) (Dawson, 1994).

Economic Cost Model: This model stems for capital theories. It refers to appropriately discounted amount of net cash inflows generated by the human resources of a firm over their economic service lives. The economic value method is a present value measuring (Dawson, 1994).

Stochastic Reward Valuation Model: This model is very complex in its focuses on HRA value rather than HRA cost, it calculates the value of an employee as the discounted sum of the values of the service states that the individual will occupy during their career with the organization (Dawson, 1994).

Criticisms of Human Resources Accounting

[bookmark: _Hlk32820992]Nevertheless, like most research carried out on a topic that are always critics. According to Gates (2002) and Akinsoyinu (1992), the problem with the HRA process is that it was highly depended on the companies reporting the process themselves and organization vary in the products and service they deliver. For instance, organizations engaging in the production of goods are different from those providing services therefore it may not be feasible to use the same Human Capital Accounting methods between them. Gates (2002) stated “that organizations do not attach first priority to the measurement of human assets; rather they face more urgent issues like human resource requirement and allocation. Also, Where the Human Resource Manager does not give enough importance to the concept of HRA, the senior management will give it even less importance and resources, leaving no time for measurement.” He continued his argument via his research where he found managers do think that the formal establishment of indicators of performance hardly adds any value to the external stakeholders. In other words, there is no return observed by many managers on the investment and effort required in reporting the human capital. The managers interviewed by Gates mentioned that without an established measurement criterion there would not be value in the reporting of Human Capital Value.

Other critics such as Jasrotia (2004) is of the opinion that strongly the documentation of people as book assets, the argument is that it presents employees as property of an organization. Also based on the evaluation of HRA which requires a lot of estimations of data is vulnerable to manipulation. Critics in the literature ague that management could manipulate figures to suit its interest, and that different countries have different requirements which creates barrier for uniform method (Gebauer, 2003). Countries such as United States Generally Accepted Accounting Policies (GAAP) which stipulates financial reporting guidelines that are different from those of Indians and to some extent Nigerians. These constraints and criticisms hinder the upward progression of HRA (Okpala & Chidi, 2010, p.71). Therefore, management needs to be fully focused when applying HRA, and to consult HRA specialist to coordinate the whole process and design the suitable model for HRA measurement in the organization.

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