

# Human Resource Accounting Practices in India: A Study into Significance of HRA for Strategic HRM

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**Abstract-** *The people working in and for any organisation make the human resource of it. Human resources of an organisation hold the major contribution in its growth and productivity. It is the human resources who with its intelligence, skills, knowledge and competence contribute towards the augmented transformation of all other related resources into value added products and services. Not just a high level production system but also, it is the human resource which leads to technology creation and up gradation, enhancement of production channels and methods with its innovation and proficiency. This study is descriptive in nature and covers the analysis of emerging human resource accounting practice, and also its contribution in strategic workforce management. The study also highlights the challenges that come forth in the implementation of the HRA system.*

**Indexed Terms-** *HR Policies, HR Strategies, Human Resource Accounting, Performance Management, Strategic Human Resource Management.*

## I. INTRODUCTION

Human resources are considered to be the most crucial and vital asset of any progressive organization. It is the human resource of the organization that can ensure the effective and efficient employability of all other resources, leading to mending ways towards higher profitability of the concerned organisation. When it comes to making the optimum utilization of all other natural and capital resources, it is skills, knowledge, efficiency and intelligence of the personnel that direct the entire process. Human resource accounting refers to quantifying the value of human resources within an enterprise. It is the evaluation of the overall investment made on any employee in the form of expenses incurred in its recruitment, selection, hiring, compensation, training and development, and the

returns earned in the form of the employee's worth and productivity that are taken into account under a human resource accounting system. Thus, human resource accounting is the method through which economic value of human resources can be determined.

India is a labour-intensive country, i.e. the production units in India require larger labour input to carry out production activities in comparison to capital input. Despite of this fact, human resource accounting was nonexistent in conventional accounting practices in India, but with the spreading enlightenment about HR accounting and its significant role in determining the actual economic worth of the organization in terms of its personnel assets, several public and private sectors in India are promoting the HR accounting practices in their working. Valuation of human being in monetary terms started way back in the 16th century, by Sir William Petty. He considered human beings as key role players in every sector of the economy, and treated them as an element of national wealth. Years later his concept was modified in terms of calculating the cost and value of people in the organization through certain set of procedures and methods. Over the last two decades the concept of capitalization of each and every asset has emerged rapidly within the accounting practices, after the practice of assigning zero value to any of the assets including human asset was criticized by the American Accounting Association.

Strategic human resource management is another emerging trend introduced in the concepts of human resource management that provides a complete new approach to link personnel management and development practices to strategic business goals. Strategic human resource management holds five key components i.e. HR strategy, HR policy, recruitment and selection, employees training and development, and performance management and compensation. All

these components contribute towards linking the workforce of any organization to its core strategies. What plays as a catalyst in this process is the practice of human resource accounting. HRA provides information regarding cost and value of human resource, contributing towards better human resource planning. It also helps in strength and weakness analysis related to human efforts and workforce cost resulting to effective decision making. It also helps to evolve better HR policies about selection and training program, Job satisfaction, employee assessment etc. by providing appropriate database in context of the required information. Right from human resource planning to justified compensation determination, human resource accounting has been an effective tool for the proper implementation and functioning of strategic human resource management.

## II. REVIEW OF LITERATURE

K S (2022) in his paper, "human resource accounting practices and its impact on managerial performance- a study" showed significant impact of human resource accounting on managerial performance contributing to high level of organizational efficiency. The paper also stated that human resource accounting gives a clear picture of the true business value. [1]

Anil S, Sudharani R, Dr. Suresh N (2020) in the paper discussed the significant impact of employment benefit cost on the firms profitability and total return on assets. The study concluded that there is a positive relation among the stated variables. [2]

Dhar, Mutalib and Sobhani (2017) in their study investigated about the impact of the factors including human resource accounting on the organizational performance. The paper highlights a conceptual framework that focuses on how the intellectual capital accounting effects organizational efficiency along with employees performance and management support. [3]

Mukesh Kumar and Dr. Umesh Kumar Agrawal (2023) in the paper discussed about the need of human resource accounting practices and its awareness in Indian organisations. Also, the paper discussed on how different factors such as HR costs, values and

outcomes help in effective human resource accounting. [4]

Rahaman, et. al. (2013) in their study discussed about the strengths and weakness of HRA. They mentioned the importance of accounting of human as an asset to the organisation. However the study criticizes the current models of human resource accounting used at present, and calls it inefficient to be used worldwide. [5]

Dasari Pandurangarao, et. al. (2013) in their paper titled "A study on human resource accounting methods and practices in India," highlighted the advantages organizations gain from adopting human resource accounting. Moreover, the study examines specific companies that have implemented this practice to gain a deeper understanding of the positive effects of HRA on their operations and performance. [6]

Ratti (2012) through her paper examined 15 companies practicing HR accounting. The paper also describes various stakeholders affected by the practice. The study elaborates how the accounting shall be done at different segments and levels of organisation. [7]

Gupta (2021) in his paper discussed that human resource accounting proves to be an essential tool for putting the right person at the right place in an organisation. He also stated that human resource accounting not just computes the economic value of the employees but also discloses the strengths and weaknesses of each human resource. [8]

Poonam Agrawal & Dr. Shikha Goyal (2022) in their paper discussed about the relation of human resource analytics with strategic human resource management. They stated that anything that can be measured, can be managed effectively. They also discussed how HRA helps in appropriate decision making and guides in resistance free change management. [9]

## II. OBJECTIVES OF THE STUDY

1. To understand the concept of human resource accounting.

2. To understand the existing methods of human resource accounting practiced in Indian accounting system.
3. To analyze the significance of human resource accounting in strategic human resource management.
4. To analyze challenges in adopting of human resource accounting practices.

### III. RESEARCH METHODOLOGY

The study holds a qualitative and theoretical approach to elaborate the concept of human resource accounting. The study follows a descriptive research to record the existing methods of HRA being practiced in India and the challenges faced in the same. Findings have been collected to depict the impact of an effective human resource accounting system upon strategic HRM. Secondary data has been collected through various journals, research articles and manuscripts.

### IV. DISCUSSION AND ANALYSIS

- Origin and growth of human resource accounting: As stated by Dasari.Pandurangarao, Dr.S.Chand Basha & Devarapalli Rajasekhar(2013) “The suitable work was started to determine the cost and value of human beings by behavioral scientists from 1960 onwards. The experts in this field were Shultz (1960), William Pyle(1967), Flam Holtz(1973), Kenneth Sinclare (1978) and Dr Roa (1983), etc who contributed appropriate methodology and correct methods for finding out the value of the employee to the organization.” [6]

Talking about the growth of the idea of valuation of workforce, it has been observed that, there has been a dramatical change following the shift of major portion of contribution by services sector in a country's economy. The services sector has been seen contributing heavily to the overall growth of a country. Areas of information technology, banking, advertising, finance, healthcare etc work on the efforts of its workforce majorly. Hence, to compute the actual valuation of input in such sectors it is highly important to compute the value of human resource. Human resource accounting is not just done for the financial statements of the firm but to provide a clear picture to

the management about the changes in the productivity of human resources over time.

- Methods of human resource accounting practiced in India:

Historical cost method: this method was initially developed by William C Pyle and later adopted by R G Barry Corporation in the year 1969. In this method, the actual cost of recruiting, selecting, training and developing and experience of the employee is taken into account to compute the economic value of that particular employee.

One of the problems with this method is that decisions must be made about what costs to expense and what costs to capitalize. One way of deciding what to expense or capitalize is to classify human resource costs as either training or educational. With this approach, training cost would include anything associated with the current job, and it would be expensed. Educational costs would be anything associated to the preparation or advancement, and these costs would be capitalized. Another approach that could be used includes all the costs of recruiting, testing, training, and development. The decision of whether to capitalize or expense is based on how long the cost will benefit the company. If the cost will lead to a benefit for longer than twelve months, then the cost will be capitalized. [10]

Replacement cost method:in this method, the value of an employee is considered to be equal to the replacement cost incurred in hiring another employee with the same expertise and experience as the previous employee.This includes the expenditures associated with staff turnover and hiring and developing a replacement.[6]

Opportunity cost method: opportunity cost is the earning received out of the best alternative chosen for once productive capacity. However, this method is not of significant use as alternative placement of human resource within the organisation is mostly restricted at many places.

Lev and Schwartz compensation method: this method was developed by Lev and Schwartz in the year 1971, and is currently used in Indian companies such as BHEL and SAIL. In this method, the present value of

future earnings received from the employee is taken into account. It is one of the value based methods practiced in India.

**Present Value model:** In his present value method, Flamholtz et al (2002) suggests that people should be valued at the present value of expected future services to be rendered to the organization. Thus, they define individual 's value to organization as the present worth of the set of future services the person is expected to provide during the period he/she is anticipated to remain in the organization. [11]

**Original Cost model:** Brumment suggests that costs of training and development which are parts of original costs should be capitalized. The argument is that training and development are expected to have ongoing benefits to the employee and to the organization and as such would provide future benefits over years. On the other hand, he suggests that other costs associated with recruitment should be expensed as the period costs. The original cost method has been implemented by few companies like R. G. Barry. Others include Atlanta Braves, Flying Tigers Corp., Upjohn Co., and Touche Ross & Co. (Paperman, 1977). [12]

**Stochastic Reward Valuation model:** The Stochastic Reward Valuation model poses a significant challenge as it requires evaluating the worth of disordered rewards with a random probability distribution or pattern. While these rewards can be statistically analyzed, their precise prediction remains elusive. This approach places emphasis on the value derived from Human Resource Accounting (HRA) over costs, calculating an employee's value as the discounted sum of their service states throughout their tenure with the organization.

Other models worth noting are Total Organizational model, Bidding model and Economic Cost model. [13]

- Significance of HRA in strategic human resource management:

Strategic human resource management (SHRM) is instrumental in maximizing human capital and efficiently overseeing personnel. Unlike conventional human resource management, which focuses on day-to-day tasks, SHRM adopts a strategic and objective-

driven approach, ensuring HR practices are in line with organizational goals.

When integrated with human resource accounting or analytics, SHRM gains valuable insights into employee performance and value creation. Human resource accounting involves assessing the value of employees to the organization, considering factors such as skills, experience, and potential future earnings. This method helps identify the most suitable roles for employees based on their potential contributions to value.

Through the assessment of employees' future earning potential using human resource accounting, organizations can make informed decisions about talent placement and management. This not only benefits the organization by placing employees where they can generate maximum value but also enhances employee satisfaction and engagement.

The incorporation of human resource accounting or analytics into strategic human resource management provides a comprehensive understanding of an organization's human capital. It enables more effective decision-making regarding talent management and resource allocation.

Human resource accounting not just helps in career planning, but also helps in an effective succession planning. It creates an effectual human resource matrix to identify employees with high potential, so as to determine, who is comparatively holding the maximum worth to replace a current key position.

Effective training and career development initiatives can be taken after recognizing the value of the current workforce.

When talking about employee satisfaction, HRA helps the employees in self evaluation and helping them plan their career accordingly. A company practicing HRA holds a satisfied workforce as they recognize their actual worth.

HRA helps in justifying the roles and responsibilities offered to each personnel. The duties of the employees are delegated as per their worth and thus, the

management holds strong and valid reasons in case of any downsizing taken up.

It also keeps a track on the efficiency of recruitment channels, and helps management keep a check on whether the required group of potential candidates has been pooled up or not.

“With the application of analytics; HR function is able to implement a pragmatic approach to help executives make the right investments based on effective analysis and initiatives. The goal is to assess the past and present to predict the future based on facts and data. With the collection of the right data and using analytics to monitor performance even laggards can become leaders.” [9]

- Challenges in adopting a successful human resource accounting practice:

Computing the value of human resources is of high significance which have been discussed in many studies and papers but on contrary, there are enough challenges faced by companies in adopting an effective human resource accounting system.

The practice of accounting the value of human resource has yet not been recognized by the tax authorities of India and thus no practical implication in accounting practices can be followed.

There is no model or method of HR accounting particularly out of those mentioned above that has been accepted and practiced worldwide hence the computation of the economic value of a person by same company may be different and the value may vary significantly.

The concept of human resource accounting has no evidence in its support to consider it as an effective tool to compute an employee’s worth or its actual economic value. [4]

The entire system of human resource accounting is not just highly technical but also involves huge investment, hence it is not practically possible for small businesses to implement it into their system.

At one side of the coin, the practice of computing the economic worth of the employees might act as a factor

of motivation for one set of employees who are highly skilled, while on the other hand, it may create a sense of conflict and disunion among the employees if a set of employees are valued lower than the others. Also, the value computed might not always show the true value of employees and might account them lesser than their actual worth, this can substantially create conflict and mismanagement.

## V. SUGGESTIONS AND RECOMMENDATIONS

Through the conducted study, it has been observed that, the more the economy is shifting towards service-based works, the more is the need to capitalize the human efforts in any organisation. What comes in the light of concern is the adaptability of the practice nationwide. Efforts shall be made by all small and large business houses to recognize and quantify human efforts in order to gain the benefits of integration of HRA with strategic HRM.

## CONCLUSION

Evaluation of human resource is quite an effective practice that should be practiced in Indian organizations. It provides detailed information about the worth of human capital that makes up the workforce of the organisation. The study reveals that various techniques, encompassing both cost-based and value-based approaches, are employed to measure the economic value of human resources. Yet, the absence of a universally accepted methodology renders the precise value of an employee uncertain.

The study counts on many significant benefits that human resource accounting is providing for an effective strategic human resource management and implementing a resistance free change management within the organization. The study also concludes that still there are a lot of cons that are leading to substandard implementation of the HRA practice within the organisation.

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