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HUMAN RESOURCE ACCOUNTING- INTRODUCTION AND ACADEMIC OUTLINE BY ICAI

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Abstract

Human Resources in any organization are its vital organs with which an organization can flourish and can also flush, so these resources need to be identified with greater importance than just being an expense or a liability. Human resources accounting is the process of identifying and reporting the investment made in the human resources of an organization to the interested parties. The main concept behind Human Resources Accounting is the investment made on each employee and the value generated by them. Though, Human Resource Accounting paved its way back in 1980s but has recently started gaining popularity in India. This paper aims at introducing Human Resource Accounting as a concept covering what it relates to, with its benefits and some challenges being faced in its implementation. Another feather is highlighting the academic outline framed by The Institute of Chartered Accountants of India in its curriculum which is undoubtedly a quality work under the supervision of the highest accounting authority and will be of immense support in grasping the know –how.

Keywords: *Human Resource Accounting (HRA), Investment, Value Generated, Academic outline, Institute Of Chartered Accountants Of India (ICAI)*

Introduction

"Human beings are considered central to achievement of productivity, well above equipment, technology and money. Human Resource Reporting is an attempt to identify, quantify and report investments made in human resources of an organization that are not presently accounted for under conventional accounting practice.

The necessity of Human resource reporting arose primarily as a result of the growing concern for human relations management in industry since the sixties of this century. Behavioral scientists concerned with the management of organizations, pointed out that the failure of accountants to value human resources was a serious handicap for effective management.

Many people pointed out that it is very difficult to value human resources. Some others have cautioned that people are sensitive to the value others place on them. A machine never reacts to an over or under-valuation of its capacity, but an employee will certainly react to such distortion. Conventionally human resources are treated just as any other services purchased from outside the business unit. As a result conventional balance sheets fail to reflect the value of human assets and hence distort the value of the business. The treatment of human resources as assets is desirable with a view to ensuring comparability and completeness of financial statements and more efficient allocation of funds as well as providing more useful information to management for decision-making purposes.

The committee on HRA of the American Accounting Association defined HRA as "the process of identifying and measuring data about human resources and communicating this information to interested parties". However "Human Resources" are not yet recognized as 'assets' in the Balance Sheet. The measures of net income which are provided in the conventional financial statement do not accurately reflect the level of business performance. Expenses relating to the human organization are charged to current revenue instead of being treated as investments to be amortized over the economic service life, with the result that the magnitude of net income is significantly distorted.

However, Human Resource Accounting (HRA) involves accounting for the company's management and employees as human capital that provides future benefits. In the HRA approach, expenditures related to human resources are reported as assets on the balance sheet as opposed to the traditional accounting approach which treats costs related to a company's human resources as expenses on the income statement that reduce profit" (Board of Studies, Jan 2015)ICAI

Definition

An attempt to identify, quantify and report about the investments made for human resources in an organization is termed as Human Resource Accounting. As human resources are primary over

other resources and technology to achieve higher and quality productivity, the accounting concepts being implemented so far do not cater the purpose to provide significance to manpower and thus human resources are not yet, despite of being of no less than an asset to an organization, are not disclosed or reported as one in the final accounts. Not valuing human resources has come up as a great issue in effective decision making and management. Human Resource Accounting is useful in knowing practical effect of new rules, regulations and procedures relating to work force and is also of immense help in knowing the monetary effect of the same on the organization.

Review of Literature

Bo Hansson wrote an article on "Is it time to disclose information about human capital investments?" Firms' investments in training their employees constitute a substantial part of the overall investments for an average firm. Despite difficulties in accessing company based data on training, recent research has shown that these investments generate considerable gains for firms in terms of increased productivity and profitability. The absence of reliable, standardized information on training appears to hamper the ability of investors to stay informed about these investments. It is therefore argued from the current state of research that it might be time for mandatory disclosure of employee training in order to achieve a better allocation of resources in the capital market. Reliable information on company training might not only benefit investors but also lead to a labor market that functions better. Training investments comprise a considerable amount of the overall investments for an average firm. Research in labor economics has shown that firms invest in training whether the training is useful to other (competing) firms or not. From the labor economic literature, we also know that part of the returns to training investments is captured by the employees. Despite difficulties in linking training with company performance measures, several recent studies have shown that these investments produce significant future gains for firms.

Ravindra Tiwari authored an article on "Human Resource Accounting-A New Dimension". Human resource accounting (HRA) is an attempt to identify, quantify and report investment made in Human resources of an organization that are not presently accounted for under conventional accounting practice.

Several advocates of HRA, including Herman & Mitchell (2008) ,Flamholtz et al. (2003), Pekin Ogan (1988), Flamholtz (2004), Lev & Schwartz (1971), Elias (1972), Hendricks (1976) and

others have suggested that HRA could benefit external users of financial statements. External decision makers must know the changes in human assets in order to evaluate properly assets and income. The conventional accounting profit may be misstated and the asset base distorted, if the condition of human assets changes during the period, (Flamholtz, 1999).

Flamholtz et al. (2003) utilized the HRA measure of expected realizable value, and found that employees' participation in a management development program increased the value of the individuals to the firm. In addition the authors noted that the HRA measures provided upper level management with an alternative accounting system to measure the cost and value of people to an organization. Thus HRA represented both a paradigm and way of viewing human resource decisions, and the set of measures for quantifying the effects of human resource management strategies upon the cost and value of people as organizational resources.

Pekin Ogan(1988) reported the results of a field experiment designed to assess the impact of HRA information on layoff decisions made by managers. The findings of this study indicates that HRA information does make a difference in personnel layoff decisions and enables managers to increase their level of confidence regarding decisions of this sort.

Tomassini (1977) provided to a sample comprising of accounting students, traditional financial information and information containing human resources accounting. HRA information led to remarkable differences in decision-making.

Schwan (1976) considered the effects of human resource cost measures on banker decision-making. He found that the inclusion of HRA data in published financial statements resulted in, one, significantly different ratings of management's preparedness to meet future challenges and opportunities and, two, statistically different predictions of a firm's net income.

ICAI, Human Resource Accounting (HRA) involves accounting for the company’s management and employees as human capital that provides future benefits. In the HRA approach, expenditures related to human resources are reported as assets on the balance sheet as opposed to the traditional accounting approach which treats costs related to a company’s human resources as expenses on the income statement that reduce profit.

Purpose

The purpose is to account the human capital in the final accounts of an organization in the same way the other resources as land, capital and machinery are. It is desirable to treat human resources as assets to enable and ensure comparability and complete disclosure of financial statements and pave way for more effective, efficient and timely management of an organizations' resources including manpower and decision making. It will also be beneficial for proper allocation of funds and timely communication of information to the concerned managerial personals and authority(s).

Models of HRA (Board of Studies, Jan 2015)ICAI

Quite a few models have been suggested from time to time for the measurement and valuation of human assets. Some of these models are briefly discussed below:

(A) Cost Based Models

(1) Capitalization of historical costs: R. Likert and his associates at R.G. Barry Corporation in Ohio, Columbia (USA) developed this model in 1967. It was first adopted for managers in 1968 and then extended to other employees of R.G. Barry Corporation. The method involves capitalizing of all costs related with making an employee ready for providing service – recruitment training, development etc. The sum of such costs for all the employees of the enterprise is taken to represent the total value of human resources. The value is amortized annually over the expected length of service of individual employees. The unamortized cost is shown as investment in human assets. If an employee leaves the firm (i.e. human assets expire) before the expected service life period, the net asset value to that extent is charged to current revenue.

This model is simple and easy to understand and satisfies the basic principle of matching cost and revenues. But historical costs are sunk costs and are irrelevant for decision- making. This model was severely criticized because it failed to provide a reasonable value to human assets. It capitalizes only training and development costs incurred on employees and ignores the future expected cost to be incurred for their maintenance. This model distorts the value of highly skilled human resources. Skilled employees require less training and therefore, according to this model, will be valued at a lesser cost. For all these reasons, this model has now been totally rejected.

(2) Replacement Cost: The Flamholtz Model (1973): Replacement cost indicates the value of sacrifice that an enterprise has to make to replace its human resource by an identical one. Flamholtz has referred to two different concepts of replacement cost *viz* 'individual replacement

cost' and 'positional replacement cost'. The 'individual replacement cost' refers to the cost that would have to be incurred to replace an individual by a substitute who can provide the same set of services as that of the individual being replaced. The 'positional replacement cost', on the other hand, refers to the cost of replacing the set of services required of any incumbent in a defined position. Thus the positional replacement cost takes into account the position in the organization currently held by an employee and also future positions expected to be held by him. However, determination of replacement cost of an employee is highly subjective and often impossible. Particularly at the management cadre, finding out an exact replacement is very difficult. The exit of a top management person may substantially change the human asset value.

(B) Economic Value Models

(1) Opportunity Cost: The Hekimian and Jones Model (1967): This model uses the opportunity cost that is the value of an employee in his alternative use, as a basis for estimating the value of human resources. The opportunity cost value may be established by competitive bidding within the firm, so that in effect, managers must bid for any scarce employee. A human asset, therefore, will have a value only if it is a scarce resource, that is, when its employment in one division denies it to another division.

One of the serious drawbacks of this method is that it excludes employees of the type which can be 'hired' readily from outside the firm, so that the approach seems to be concerned with only one section of a firm's human resources, having special skills within the firm or in the labor market. Secondly, circumstances in which managers may like to bid for an employee would be rare, in any case, not very numerous.

(2) Discounted wages and salaries: The Lev and Schwartz Model (1971): This model involves determining the value of human resources as the present value of estimated future earnings of employees (in the form of wages, salaries etc.) discounted by the rate of return on investment (cost of capital). According to Lev and Schwartz, the value of human capital embodied in a person of age τ is the present value of his remaining future earnings from employment. Their valuation model for a discrete income stream is given by the following:

$$V\tau = \sum_{t=\tau}^{T} \frac{I(t)}{(1+r)^{r-\tau}}$$

Where,

$V\tau$ = the human capital value of a person τ years old.

I(t) = the person's annual earnings upto retirement.

r = a discount rate specific to the person.

T = retirement age.

However, the above expression is an ex-post computation of human capital value at any age of the person, since only after retirement can the series I(t) be known. Lev and Schwartz, therefore, converted their ex- post valuation model to an ex-ante model by replacing the observed (historical) values of I(t) with estimates of future annual earnings denoted by I*(t). Accordingly, the estimated value of human capital of a person years old is given by:

$$V_\tau^* = \sum_{t=\tau}^{T} \frac{I^*(t)}{(1+r)^{t-\tau}}$$

Lev and Schwartz again pointed out the limitation of the above formulation in the sense that the above model ignored the possibility of death occurring prior to retirement age. They suggested that the death factor can be incorporated into the above model with some modification and accordingly they recommended the following expression for calculating the expected value of a person's human capital:

$$E(V_\tau^*) = \sum_{t=\tau}^{T} P_\tau(t+1) \sum_{t=\tau}^{T} \frac{I_i^*}{(1+r)^{t-\tau}}$$

Where, P (t) is the probability of a person dying at age 't'.

Lev and Schwartz have shown in the form of a hypothetical example the method of computing the firm's value of human capital. Employees of the hypothetical firm have been decomposed by age groups and degrees of skill and the average annual earnings for each age and skill group have been ascertained. Finally the present values of future earnings for each group of employees have been calculated on the basis of a capitalization rate. The sum of all such present value of future earnings was taken as the firm's value of human capital.

In this model, wages and salaries are taken as surrogate for the value of human assets and therefore it provides a measure of 'future estimated cost'. Although according to economic theory, the value of an asset to a firm lies in the rate of return to be derived by the firm from its employment, Lev and Schwartz model surrogated wages and salaries of the employees for the income to be derived from their employment. They felt that income generated by the workforce is very difficult to measure because income is the result of group effort of all factors of production.

However, this model is subject to the following criticisms:

(a) A person's value to an organization is determined not only by the characteristics of the person himself (as suggested by Lev and Schwartz) but also by the organizational role in which the individual is utilized. An individual's knowledge and skill is valuable only if these are expected to serve as a means to given organizational ends.

(b) The model ignores the possibility and probability that the individual may leave an organization for reasons other than death or retirement. The model's expected value of human capital is actually a measure of the expected 'conditional value' of a person's human capital – the implicit condition is that the person will remain in an organization until death or retirement. This assumption is not practically social.

(c) It ignores the probability that people may make role changes during their careers. For example, an Assistant Engineer will not remain in the same position throughout his expected service life in an organization.

In spite of the above limitations, this model is the most popular measure of human capital both in India and abroad.

(3) Stochastic process with service rewards: Flamholtz (1971) Model: Flamholtz (1971) advocated that an individual's value to an organization is determined by the services he is expected to render. An individual moves through a set of mutually exclusive organizational roles

or service states during a time interval. Such movement can be estimated probabilistically. The expected service to be derived from an individual is given by:

$$E(S) = \sum_{i=1}^{n} S_i P(S_i)$$

Where S_i represent the quantity of services expected to be derived in each state and $P(S_i)$ is the probability that they will be obtained.

However, economic valuation requires that the services of the individuals are to be presented in terms of a monetary equivalent. This monetary representation can be derived in one of the two ways:

(a) by determining the product of their quantity and price, and

(b) by calculating the income expected to be derived from their use.

The present worth of human capital may be derived by discounting the monetary equivalent of expected future services at a specified rate (e.g. interest rate).

The major drawback of this model is that it is difficult to estimate the probabilities of likely service states of each employee. Determining monetary equivalent of service states is also very difficult and costly affair. Another limitation of this model arises from the narrow view taken of an organization. Since the analysis is restricted to individuals, it ignores the added value element of individuals operating as groups.

(4) Valuation on group basis: Jaggi and Lau Model: Jaggi and Lau realised that proper valuation of human resources is not possible unless the contributions of individuals as a group are taken into consideration. A group refers to homogeneous employees whether working in the same department or division of the organisation or not. An individual's expected service tenure in the organisation is difficult to predict but on a group basis it is relatively easy to estimate the percentage of people in a group likely to leave the organisation in future. This model attempted to calculate the present value of all existing employees in each rank. Such present value is measured with the help of the following steps:

(i) Ascertain the number of employees in each rank.

(ii) Estimate the probability that an employee will be in his rank within the organisation or terminated/promoted in the next period. This probability will be estimated for a specified time period.

(iii) Ascertain the economic value of an employee in a specified rank during each time period.

(iv) The present value of existing employees in each rank is obtained by multiplying the above three factors and applying an appropriate discount rate.

Jaggi and Lau tried to simplify the process of measuring the value of human resources by considering a group of employees as valuation base. But in the process they ignored the exceptional qualities of certain skilled employees. The performance of a group may be seriously affected in the event of exit of a single individual.

Implications of Human Capital Reporting

"The relevance of the human resource information lies in the fact that it concerns organizational changes in the firm's human resources. The ratio of human to non -human capital indicates the degree of labor intensity of the enterprise. Reported human capital values provide information about changes in the structure of labor force. Difference between general and specific values of human capital is another source for management analysis – the specific value of human capital is based on firm's wage scale while the general value is based on industry- wise wage scale. The difference between the two is an indicator of the level of the firm's wage scale as compared to the industry" (Board of Studies, Jan 2015)ICAI

HRA in India (Board of Studies, Jan 2015)ICAI

"HRA is a recent phenomenon in India. Leading public sector units like OIL, BHEL, NTPC, MMTC, SAIL etc. have started reporting 'Human Resources' in their Annual Reports as additional information from late seventies or early eighties. The Indian companies basically adopted the model of human resource valuation advocated by Lev and Schwartz (1971). This is because the Indian companies focused their attention on the present value of employee earnings as a measure of their human capital. However, the Indian companies have suitably modified the Lev and Schwartz model to suit their individual circumstances. For example BHEL applied Lev and Schwartz model with the following assumptions:

(i) Present pattern of employee compensation including direct and indirect benefits;

(ii) Normal career growth as per the present policies, with vacancies filled from the levels immediately below;

(iii) Weightage for changes in efficiency due to age, experience and skills;

(iv) Application of a discount factor of 12% per annum on the future earnings to arrive at the present value.

However, the application of Lev and Schwartz model by the public sector companies has in many cases, led to over ambitious and arbitrary value of the human assets without giving any scope for interpreting along with the financial results of the corporation. In the Indian context, more particularly in the Public Sector, the payments made to the employees are not directly linked to productivity. The fluctuations in the value of employees' contributions to the organization are seldom proportional to the changes in the payments to employees. All qualitative factors like the attitude and morale of the employees are out of the purview of Lev and Schwartz model of human resource valuation".

Growing Scope of Human Capital Reporting

There is now a shift from the traditional trend of focusing and reporting only of the quantifiable resources (those which can be measured in monetary terms) to a more practical and comprehensive approach to take into consideration the human resources also as measurable resources or assets. Following the method of accounting for fixed assets, the employee related costs like cost of recruitment, training and orientation of employees can be capitalized and then the appropriate part thereof can be amortized over the estimated years of effect of these costs.

The relevance of human resource information lies in the fact that it concerns organizational changes in the firm's human resources. The ratio of human to non-human capital indicates the degree of labor intensity of an organization. Comparison of the specific values of human capital based on the organization's scales of wages and salaries with the general industry standards can be a good source of information to the management. There is no standard human capital reporting format as employment reporting is relatively a new form of reporting. Usually, the report inter alia contains data pertaining to employee numbers, employment and training policies, collective bargaining arrangements, industrial disputes, pension and pay arrangement and disabled employee numbers. (Board of Studies, Jan 2015)ICAI

Human capital reporting provides scope for planning and decision -making in relation to proper manpower planning. Also, such reporting can bring out the effect of various rules, procedures and incentives relating to work force, and in turn, can act as an eye opener for modifications of existing statutes, laws and the like. (Board of Studies, Jan 2015)ICAI

Some other points may also follow:

(i) Recent Reporting Trends: A shift from the traditional methods of accounting and reporting to a more comprehensive approach has been noticed.

(ii) Relevance: Any entity is active and dynamic only because of its human capital. The presence of human capital to non human capital is the indication of labor intensity of a concern. HR policies need to be critically selected and implement keeping the view the comparability factor with general industry norms.

(iii) Purpose: Man power planning and effective and efficient decision making gives rising scope to Human Resource Accounting.

(iv) Accounting: Following the method of accounting for fixed assets, the employee related costs like cost of recruitment, training and orientation of employees can be capitalized and then the appropriate part thereof can be amortized over the estimated years of effect of these costs.

Progress made by India so far in the field of Human Resource Accounting

"Human resource accounting can be defined as the process of identifying, measuring and communicating information about human resources in financial statements in order to facilitate effective management. Human resource accounting is a recent phenomenon in India. Leading public sector units like OIL, BHEL, NTPC, MMTC and SAIL etc. have started reporting Human Resources in their annual reports as additional information. The Indian Companies basically adopted the model of human resource valuation as advocated by Lev and Schwartz (1971). Indian Companies focused their attention on the present value of employee earning as a measure of their human capital. However the Indian Companies have suitably modified the Lev and Schwartz model to suit their individual circumstances" (Board of Studies, Jan 2015)ICAI

Limitations of Human Resource Accounting

"The central problem in HRA is not what kind of resources should be treated, but rather when the resources should be recognized. This timing issue is particularly important because human resources are not owned by the firm, while many physical resources are. However, the firm also uses many services from physical resources which it does not own. The accounting treatment for such services should, therefore, be the same as the treatment used for human resources". (Board of Studies, Jan 2015)ICAI

"Traditional accounting involves treatment of human capital and non-human capital differently. While non-human capital is represented by the recorded value of assets, the only reference to be found in financial statement about human resources are entries in the income statement in respect

of wages and salaries, directors' fees etc. But it should be kept in mind that measuring and reporting the value of human assets in financial statements would prevent management from liquidating human resources or overlooking profitable investments in human resources in a period of profit squeeze. But while valuing human assets one should not lose sight of the fact that human beings are highly sensitive to external forces and human skills in an organization do not remain static. Skill formation, skill obsolescence or utilization may take a continuous process. Besides, employee attitude, loyalty, commitment, job satisfaction etc. may also influence the way in which human resource skills are utilized. Therefore human resources should be valued in such a way so as to cover the qualitative aspects of human beings. As human beings are highly susceptible to certain behavioral factors (unlike physical assets), any human resource valuation model without behavioral features can hardly present the value of human assets in an objective manner. However while attaching respective weightage to behavioral factors; care should be taken to avoid excessive subjectivity". (Board of Studies, Jan 2015)ICAI

Thus the behavioral portion of human capital is highly unpredictable, keeps changing constantly and is a continuous process due to which measuring and accounting for them becomes complicated. A model to take into account the behavioral aspect of human capital needs to be brought into work.

Some illustrations to bring academic clarity of the concept

Illustration 1:

A company has a capital base of 1 crore and has earned profits to the tune of 11 lakhs. The Return on Investment (ROI) of the particular industry to which the company belongs is 12.5%. If the services of a particular executive are acquired by the company, it is expected that the profits will increase by 2.5 lakhs over and above the target profit. Determine the amount of maximum bid price for that particular executive and the maximum salary that could be offered to him.

Answer

Capital Base	=	1,00,00,000
Actual Profit	=	11,00,000
Target Profit @ 12.5%	=	12,50,000

Expected Profit on employing the particular executive

= 12, 50,000 + 2, 50,000 = 15, 00,000

Additional Profit = Expected Profit – Actual Profit

= 15, 00,000 – 11, 00,000 = 4, 00,000

$$\text{Maximum bid price} = \frac{\text{Additional Profit}}{\text{Rate of Return on Investment}} = \frac{4,00,000}{12.5} \times 100 = 32,00,000$$

Maximum salary that can be offered = 12.5% of` 32, 00,000 i.e., 4, 00,000

Maximum salary can be offered to that particular executive upto the amount of additional profit i.e., 4, 00,000.

Source: CA Final Course Practice Manual (Board of Studies, Jan 2015)ICAI

Illustration 2: From the following details, compute according to Lev and Schwartz (1971) model, the total value of human resources of the employee groups skilled and unskilled.

		Skilled	Unskilled
(i)	Annual average earning of an employee till the retirement age	` 50,000	` 30,000
(ii)	Age of retirement	65 years	62 years
(iii)	Discount rate	15%	15%
(iv)	No. of employees in the group	20	25
(v)	Average age	62 years	60 years

Answer

According to Lev and Schwartz, the value of human capital embodied in a person of age is the present value of his remaining future earnings from employment. Their valuation model for a

discrete income stream is given by the following formula:

$$V = \sum_{t=\tau}^{t} \frac{I(t)}{(1 + r - \tau)^{t}}$$

Where,

V = the human capital value of a person years old.

I(t) = the person's annual earnings up to retirement.

r = a discount rate specific to the person.

t= retirement age.

Value of skilled employees:

$$= \frac{50{,}000}{(1+0.15)^{(65-62)}} + \frac{50{,}000}{(1+0.15)^{(63-61)}} + \frac{50{,}000}{(1+0.15)^{(65-64)}}$$

32,875.81 + 37,807.18 + 43,478.26 = 1, 14,161.25

Total value of skilled employees is: 1, 14,161.25 × 20 = 22,83,225.

Value of unskilled employees:

$$= \frac{30{,}000}{(1+0.15)^{(62-60)}} + \frac{30{,}000}{(1+0.15)^{(62-61)}} = \frac{30{,}000}{(1+0.15)^{2}} + \frac{30{,}000}{(1+0.15)}$$

$$= 22{,}684.31 + 26{,}086.96 = 48{,}771.27$$

Total value of the unskilled employees = 48,771.27× 25 = 12,19,282

∴ Total value of human resources (skilled and unskilled) = 22,83,225 + 12,19,282

= 35,02,507.

Source: CA Final Course Practice Manual (Board of Studies, Jan 2015)ICAI

Illustration 3

The following information is supplied to you about Lookdown Ltd.

Capital & Reserves	
Equity Shares of ` 100 each of which ` 75 has been called up	5,00,000
Equity Shares in respect of which calls are in arrear @ 25 per share	1,00,000
General Reserve	10,00,000
Profit & Loss account (balance at beginning of the year)	(25,00,000)
Profit/(loss) for the year	(1,80,000)
Industry Average Profitability	12.50%
8% Debentures of ` 10 each	8,00,000
Lookdown Ltd. is proposing to hire the services of Mr. X to turn the company aro un d.	
Minimum take home salary per month demanded by Mr. X	4,00,000
Average Income tax rate on salaries after considering the impact of ` 3 lakhs p.a. i.e., the exemption amount	25%
Provident Fund contribution by Employer per month	50,000
Profits over and above target expected by hiring Mr. X	10%

You are required to analyze the proposal and see whether it is worthwhile to employ Mr. X and also suggest

the maximum emoluments that could be paid to him.

Note:

(i) PF contributions are tax exempt.

(ii) Take home salary is that remaining after employee's contribution to PF @ 50,000 per month and after deduction of Income-tax on salary.

Answer

Cost to Company in employing Mr. X

		`
Salary before tax 4,00,000 x 12 =	48,00,000.75	64,00,000*
Add: Employee's PF contribution (50,000 x 12)		6,00,000
		70,00,000
Add: Employer's PF contribution (50,000 x 12)		6,00,000
		76,00,000

Capital base

	`
Equity Share Capital paid up (5,00,000 shares of ` 75 each)	3,75,00,000
Less: Calls in arrears	(1,00,000)
	3,74,00,000
General Reserve	10,00,000
Profit & Loss A/c (balance) at the beginning of the year	(25,00,000)
Loss for the year	(1,80,000)
8% Debentures	80,00,000
Capital base	4,37,20,000
Target Profit 12.5% of capital base (4,37,20,000)	54,65,000
Profits achieved due to Mr. X 54,65,000+ 10% (54,65,000)	60,11,500

Maximum emoluments that can be paid to Mr. X = 60, 11,500

Thus, the company is advised not to hire him as his CTC 76, 00,000 is more than 60, 11,500.

Source: CA Final Course Study Material (Board of Studies, Jan 2015)ICAI

Conclusion

Human Resource Accounting (HRA) is an attempt to identify, quantify and report investments made in human resources of an organization. Leading public sector units like OIL, BHEL, NTPC and SAIL etc. have started reporting human resources in their annual reports as additional information. Although human beings are considered as the prime mover for achieving productivity, and are placed above technology, equipment and money, the conventional accounting practice does not assign significance to the human resource. Human resources are not

thus recognized as 'assets' in the Balance Sheet. While investments in human resources are not considered as assets and not amortized over the economic service life, the result is that the income and expenditure statement comprising current revenue and expenditure gives a distorted picture of the real affairs of the organization.

Accountants have been severely criticized by the Behavioral Scientists for their failure to value human resources, as this has come out as a handicap for effective management. Human resource accounting provides scope for planning and decision making in relation to proper manpower planning. Also, such accounting can bring out the effect of various new rules, procedures and incentives relating to work force, and in turn, can act as an eye opener for modifications of existing statutes and laws. (Board of Studies, Jan 2015)ICAI

Human Capital involves unpredictable attitude and behavior thereby making it complicated to measure them and account for them and report them in the final accounts of an organization. A model needs to be formulated which takes into account these factors also while measuring the human capital, as avoiding these factors in valuation will lead to ambiguous results because one cannot predict the time for which employee will work for the same concern and also whether his skills would remain intact or improve or deteriorate is also a major issue of concern. Similarly there are many other qualitative factors one has to look into when one thinks of accounting for human resources.

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