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"METHODS OF VALUATION OF HUMAN RESOURCE ACCOUNTING"

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ABSTRACT

Human resource Accounting (HRA) involves accounting for expenditure related to human asset in an organization as opposed to traditional accounting which merely expenses these costs and reduces profit which to our mind suboptimise financial reporting.

KEYWORDS: *Methods Of Valuation , Human Resource Accounting , organization.*

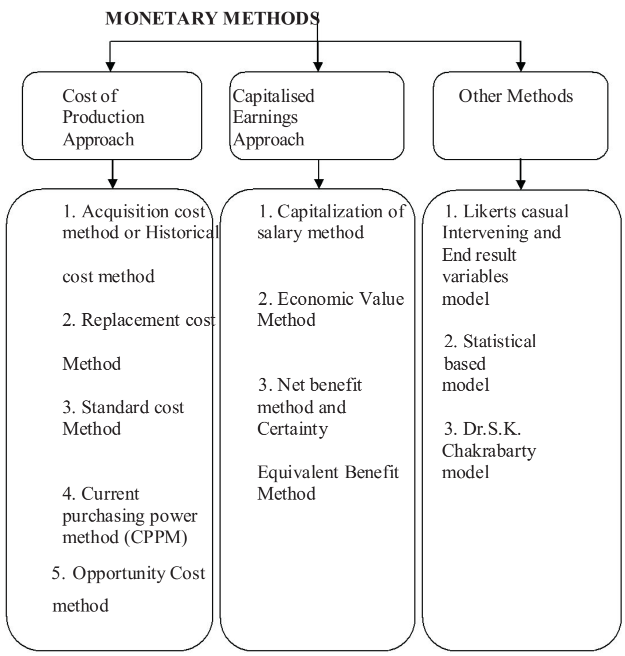
METHODS OF VALUATION OF HUMAN RESOURCE ACCOUNTING

The methods or models suggested in the valuation of human resource are divided into three categories 1) Monetary Methods 2) Economic Models and 3) Non Monetary Methods. These Methods are as follows:

Monetary Methods for Determining Value

The chart 1.1 presents the monetary methods for determining the value of Human resources.

CHART -1.1



Cost of Production Approach
Acquisition Cost Method or Historical Cost Method

It is the only method which has been used both for the valuation of human resources and recording the data in the book of accounts and presenting it in financial statement. Under this method the cost of recruitment, hiring, training, socializing and developing an employee are capitalized and written off over the period for which the employee remains with the firm. If human assets expire before the end of the expected service life period, the remaining net assets value is charged off against the current earnings. However it has the following limitations:
1. It takes into account a part of the employees acquisition, cost ignoring the aggregate value of their potential services.
2. There is a problem in estimating the number of years over which the capitalized expenditure is to be amortized.

REPLACEMENT COST METHOD

It is a measure of the cost to replace a firm's existing human resources. Itindicates as to what would cost the firm if it desires to recruit, place, train and develop human resources to their present level of technical proficiency including familiarity with the company and its operations. But it is difficult to find identical replacement of the existing human resources in actual practice. The determination of such a value will be affected by subjective consideration to a marked extent and therefore, the value will differ widely from person to person. Further it would lack verifiability.

STANDARD COST METHOD

In order to avoid complications of calculation under the replacement cost, standard cost of recruiting, hiring, training and developing per grade of employees are developed and established and made up to date every year. The standard costs arrived for all human beings are treated as the value of human resources for accounting purposes, and will be shown in the balance sheet on year to year basis. In case of new entrant, the total standard costs would be increased by the standard cost relating to that entrant. But if the actual costs incurred are more or lesser than the standard one, the difference should be transferred to various accounts for further analysis and to be dealt with as per firm's policy and would form a useful basis for control.

CURRENT PURCHASING POWER METHOD(CPPM)

Under this method instead of taking the replacement cost to capitalize, the capitalized historic cost of investment in human resources is converted into current purchasing power of money with the help of index number. If the index number is doubled, the value of human resource is also doubled. The converted value will be the value of human resources to be amortized in rest of years as per policy of the firm. The increase /decrease are dealt with as per the Replacement Cost Method. The Standard Cost Method and the current purchasing power method also suffer from all the drawbacks of the replacement cost except that they are simpler in calculation.

OPPORTUNITY COST CONCEPT

Under this method the value of an employee in his alternative use is determined. That value is taken as the basis for estimating the value of human suggested the use of Competing Bidding Method. In simple words it means if an employee goes out in the market, what amount the employee will get as his salary or how much valuable he is.

Even this method is not free from drawbacks. It excludes the value of employees who can be hired readily or who have no opportunity cost. Are such employees worthless, it is concerned only with one section of firm's human resources, considered as scarce. It may create a behavioural problem in the sense that human beings are auctioned and lead one to think of the revival of the past slavery system. This may also result in lowering the morale and productivity of the employees who are not converted by this method.

COMPETITIVE BID PRICE METHOD

It is developed by Hekimian and Jones. Under this method human resources are valued on the bidding cost. Only scarce resources or employees are considered under this method. The value of human assets is

determined by capitalizing the total
of bid prices of all the scarce employees within the company.

CAPITALIZED EARNINGS APPROACH

Capitalization of Salary Method

It was suggested by Lev and Schwartz (1971). It is also known as the present value method or the present value of future earnings model. In India, it is used by BHEL and ONGC. Under this method the present value of future earnings which the employees will be getting up to the age of their retirement is found out by discounting them at the rate of cost of capital. All employees are grouped and analyzed according to age and skill. The Annual average earnings that an employee will get up to the date of retirement in each group are calculated. This is then discounted at the rate of cost of capital under the capital budgeting decisions. The value thus arrived at will be the value of human beings.

The value is measured by the use of the following formula:

$$Vr = t$$

$$\Sigma\, I\,(t)$$

$$t = r\,(1 + r)\; t - r$$

Where,

Vr	=	the human asset value of a person ‘r’ years old
I (t)	=	the person’s Annual earnings up to retirement.
R	=	A discount rate specific to a person.
T	=	Retirement age.

This method ignores the possibility that an individual may leave the company for reasons other than death or retirement. It also does not take into account the changes which people make during their career from one role to another at one or more times depending upon their age, education, skill etc., obviously this would result in changes in their expected future earnings and ultimately in the value of human resources. It also excludes such considerations as seniority, bargaining capacity, skill, experience etc which may result in the payment of higher or lower salaries depending upon the circumstances.

Economic Value Method

This method has been suggested by Brummet, Flamholtz and Pyle. They have proposed that a group of human resources should be valued by estimating their contribution to the total economic value of the firm without deducting the remuneration paid to human resources. The present value of a portion of the firm’s future earnings attributable to human resources will be the value of human resources.

The EVM uses the following formula:

$$n$$

$$\Sigma Si\; P\,(Si)\; i=1$$

Where,

SI = Services expected from the individual on each service state.
P (SI) = The probability that the individual will occupy a particular servicestate.

The strength of this method includes its focus on the value or worth of an individual to a company. EVM is weakened by many assumptions which are hypothetical and makes its practice difficult and, it also focuses on individuals rather than group (Sveiby, 2001).

Net Benefit Method and Certainty - Equivalent Net Benefit Method

This method is another variation of the Economic Value Method that has been suggested by Morse and Pekin Organ. Under this method instead of taking the total future services, net benefits from the services rendered are derived to calculate the value of human resources. According to Morse the value of human resources will be equal to the present value of the gross value of services to be rendered in future by human beings both in an individual capacity and collective capacity minus the present value of future payments made of them.

Other Methods

Likerts Casual Intervening and End result Variables Model

This model was developed by RensisLikert and David G.Bovers, under this method periodic measurements are made of i) the behaviour of managers and supervisors and their level of technical proficiency and ii) the resulting motivation, loyalties and the behaviour of subordinates and of control process of the divisions' on profit centers. Their effect on performance is then measured and the statistical analysis is made of the variations to find relationship. It is important to note that, although evidence exists, there are definite meaningful relationships among these variables, nothing concrete and in quantitative term has been done to apply these findings to the problem of valuing human resources.

Statistical Based Method

Based on the statistical methods of human beings no accounting is involved except that descriptive information is provided about human resources. Many companies in India and abroad are providing information in this manner.

Dr.S.K.Chakrabarty Model

In the context of Indian Industry, Dr.S.K.Chakrabarty made a pioneering contribution by suggesting a model for the valuation of human resources of an organisation. He opined that it was the most appropriate to include human assets under the head investments in the position statement of an organisation, prepared at the year end, including it was under the head fixed assets would cause problem of depreciation capital gains of losses upon exit etc. Prof.Chakrabarty is not even in favor of including them in current assets. Thus he feels that it will not be in conformity with the general meaning of the term. In this model, he has valued the human resources aggregate and not on an individual basis.

This model was similar to historical cost model, he noticed the cost of recruiting, learning, selection, training and development of each employee should be considered for acquisition cost method of valuation and be treated as different revenue expenditure, and this is subject to gradual written off. The balance, not the written off amount, should be shown separately in the balance sheet under the head of investment. However in his opinion, managerial and non managerial manpower can be evaluated separately. The value of HR on a group basis can be found out by multiplying the average salary of the group with the average tenure of employmentof the employees in that group. The average Annual salary payments of next few years could be found out by salary grade structure and promotion schemes of thecompany.

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ECONOMIC MODELS FOR DETERMINING VALUE

Goodwill Method

This model was developed by Harmonson and was also called the Harmonson Model. According to this method the additional profit earned by an organisation during a particular period of time was compared to the industry's average rate.

HR value was measured by the following formula:

$$\text{HR value} = \text{Goodwill} \times \frac{\text{Amount invested in HR}}{\text{Total investment}}$$

This model was criticized by the critics on the ground that the additional profits or revenues generated by an organisation during a particular period may be influenced by other external variables and could not be linked to human resources alone. Also this method could not be used unless all the variables and relationshipsthat affected the company's goodwill were correctly defined.

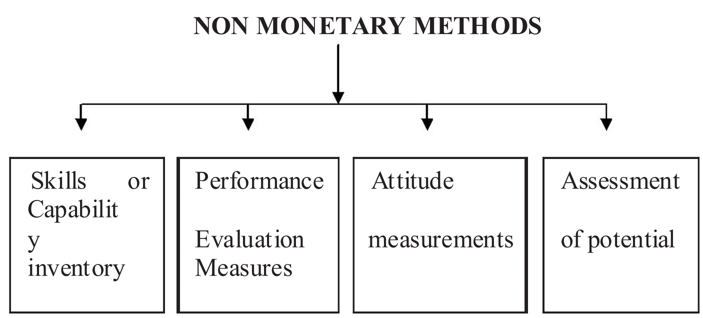
Behavioural Model

This model was developed by RensisLikert. This model established a set of factors through which the psychological and sociological conditions of the employees in the company determined their productivity. These socio-psychological conditions would decide the performance of the company in the long-run. The investments in human resources are integrated with socio-psychological conditions of the employees in the company. Critics however argued that socio psychological factors or conditions could not measure the value of human resource as an asset to the company. Moreover, according to critics, the various relationships in the company could not be correlated to its performance as it was difficult to establish a relationship for every organizational performance. When there was no valid relationship, the true Human Resource Value would not be reflected by the Human Resource Performance.

Non Monetary Methods for Determining Value

The chart 1.2 presents the Non monetary methods for determining the value of Human resource.

CHART 1.2



SKILLS OR CAPABILITY INVENTORY

It is a simple method; it is just listing of the education, knowledge,experience and skills of the firm's human resources.

PERFORMANCE EVALUATION

Performance evaluation measures used in HRA include ratings, and rankings.Ratings reflect a person's performance in relation to a set of scales. These set of scales are scores assigned to examine the characteristics possessed by the individual. These characteristics include skills judgment, knowledge, interpersonal skills, intelligence etc. Ranking is an ordinal form of rating in which the superiors rank their subordinates on one or more dimensions, mentioned above.

ASSESSMENT OF POTENTIAL

It determines capability of a person for promotion and development. It usually employs a trait approach in which the traits essential for a position are identified. The extent to which the person possesses these traits is then assessed.

ATTITUDE MEASUREMENTS

This is used to assess employee's attitude towards their job, pay, working conditions, etc in order to determine their job satisfaction and dissatisfaction.

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