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HUMAN RESOURCE ACCOUNTABILITY--A NEW LOOK  
AT RESPONSIBILITY ACCOUNTING

By

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B.S., University of Nebraska, 1971

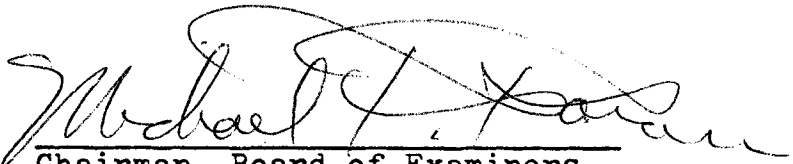
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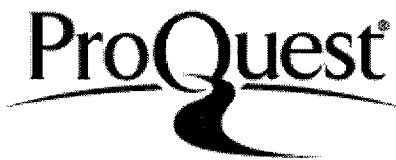


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## CHAPTER I

### HUMAN RESOURCE ACCOUNTING BACKGROUND AND RESEARCH

Starting in the early 1960s and continuing into the 1970s, the growing interest in human resources opened the door to a new type of accounting--Human Resource Accounting (H.R.A.). The American Accounting Association's Committee on Human Resource Accounting recently defined H.R.A. as

the process of identifying and measuring data about human resources and communicating this information to interested parties.<sup>1</sup>

H.R.A. is not only an accounting system used to identify and measure human resources, but also a "way of thinking about the management of people of formal organizations."<sup>2</sup>

The activities of any business are built around the abilities, motivation, and training of those persons who make up such an enterprise. Human beings design and order equipment, secure needed capital, implement new systems, and decide on the accounting methods and procedures to be used. In essence, employees, whether presidents or custodians, are

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<sup>1</sup>Committee on Human Resource Accounting, "Report of the Committee on Human Resource Accounting," The Accounting Review 48 (Supp. 1973): 169.

<sup>2</sup>Academy of Management, Proceedings of Thirty-Second Annual Meeting (Minneapolis, Minn.: n.p., 1972), p. 174.



the life of the business unit. This is the reason for the statement that "our employees are our most valuable asset."<sup>3</sup>

H.R.A. provides business with a method of valuing these "valuable assets" and reporting them in financial statements. It also provides management with important information for making more effective decisions. This system will also aid the managerial accountant whose function has been defined as:

the application of appropriate techniques and concepts in processing historical and projected economic data of an entity to assist management in establishing plans for reasonable economic objectives and in the making of rational decisions with a view toward reaching those objectives.<sup>4</sup>

Management has long realized that the firm's human organization has considerable value. In the past, companies have insured top line employees and named the company as beneficiary. Thus, these companies have recognized the specific value of the employees and have attempted "to compensate for the loss which might result from the death of an important member of the organization."<sup>5</sup> Companies are

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<sup>3</sup>R. Lee Brummet, Eric G. Flamholtz, and William C. Pyle, "Human Resource Measurement--A Challenge for Accountants," The Accounting Review, April 1968, p. 217.

<sup>4</sup>American Accounting Association, A Statement of Basic Accounting Theory (Evanston, Ill.: American Accounting Association, 1966), p. 37.

<sup>5</sup>Harry A. Finney and Herbert E. Miller, Principles of Accounting Advanced, 5th ed. (Englewood Cliffs, N.J.: Prentice-Hall, 1960), p. 128.

only allowed to do this if they have a proven insurable interest in the life of that person. This exists only if the "business has a reasonable ground for expecting some financial benefit or advantage from the continued life of the insured."<sup>6</sup>

Another realization of the value of human resources is displayed in accounting for goodwill. A list of sources of goodwill includes "satisfactory customer relations, efficiency, good employee relations, and marketing or production know-how."<sup>7</sup> When a corporation determines the purchase price of another corporation usually only forty to sixty per cent of the amount is payment for the physical assets. Much of the excess, which accountants label as goodwill, is in fact a measurement of the value of the purchased company's human resources.<sup>8</sup>

There are several different approaches for valuing human resources. The most popular are the accounting, the insurance, and the social-psychological approaches. The accounting approach refers to the historical cost derived from transactions data. "This system quantifies the investment in human assets by measuring cost for (1) recruiting and acquisition, (2) formal training, (3) familiarization,

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<sup>6</sup>Ibid.

<sup>7</sup>Harry A. Finney and Herbert E. Miller, Principles of Accounting Intermediate, 6th ed. (Englewood Cliffs, N.J.: Prentice-Hall, 1965), p. 335.

<sup>8</sup>Rensis Likert, The Human Organization Its Management and Value (New York: McGraw-Hill, 1967), p. 101.

(4) experience, and (5) development."<sup>9</sup> The insurance concept uses the following aspects in determining its value: "(1) the present value of earnings lost by the company as a result of loss of the resources, (2) the cost of outside replacement, and (3) when a manager is lost, the loss of profits attributable to loss of managerial efforts."<sup>10</sup> The social-psychological approach also attempts to value human resources by "using appropriate statistical procedures, relationships can be computed among the causal, intervening, and end-result variables such as costs and earnings. The resulting mathematical relationships will enable one to estimate the productive and earnings capability of any profit center, or smaller unit."<sup>11</sup> All of these estimates provide a basis for attaching a statement of the present value of the human organization. Each basis has its own merits and special problems.

Besides a system for valuing these capital assets, there must also be a system for recording their expiration. This is achieved by the amortization of the human resources over their "expected life" with the firm. Special attention is required in areas where special skills are required. These costs should be spread over the life of the skill, not

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<sup>9</sup>J. Finley Lee, F. Hutton Barron, Jerry S. Rosenbloom, "Evaluating and Protecting Human Resources," Financial Executive, March 1972, p. 58.

<sup>10</sup>Ibid.

<sup>11</sup>Likert, The Human Organization Its Management and Value, p. 150.

the employee. Methods are also needed for recording write-offs for terminations, health deteriorations, and other occurrences which represent a loss of human resources. Obvious occurrences are easy to spot and simple to adjust for, but others may require periodic review of the resource values.<sup>12</sup>

Approximately fifty different companies in the U.S. have started implementation of some type of system of accounting for human resources. There are great variations in the programs and in the type of corporations involved. Some of the businesses working with H.R.A. are American Airlines, General Electric, Sherwin-Williams, General Motors and several other smaller firms.<sup>13</sup> The most advanced example is the R. G. Barry Corporation of Columbus, Ohio.

The Barry Corporation manufactures and sells a line of leisure apparel, such as slippers and robes, and employees number approximately 1,700 people.<sup>14</sup> The first system of H.R.A. was started with the Barry Corporation in October 1966, and was limited to managerial personnel. This system was summarized as follows:

First, an attempt has been made to identify human resource costs and separate them from other costs to the firm. Techniques and procedures

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<sup>12</sup>R. Lee Brummet, "Accounting for Human Resources," The Journal of Accountancy, December 1970, p. 64.

<sup>13</sup>Thomas M. Rohan, "Who's Worth What Around Here!," Industry Week, November 1972, pp. 28-36.

<sup>14</sup>William C. Pyle, "Monitoring Human Resources-- On Line," Michigan Business Review, July 1970, p. 25.

have been formulated to distinguish between an asset and expense components of human resource costs. The resulting human assets are then classified into functional categories such as recruiting, hiring, training, development, and familiarization. Amounts in the functional asset account are then allocated to "personalized asset accounts" for individual managers. Rules and procedures for recording expirations in assets over their expected useful lives have been formulated. A manual containing instruments for the collection of the system's primary data has also been designed.<sup>15</sup>

The operation was put into effect on 1 January 1968 valuing approximately ninety managers. Since that time, the system has been expanded to include all of the employees of two plants which are operated by the Barry Corporation.

#### Applications and Need for Research

In evaluating the effects of accounting for human resources, information that was previously qualitative in nature must be transformed into quantitative information. H.R.A., by a means of valuation, gives previously unmeasurable qualities a measurable value. It formalizes the intuitive judgment of managers and forces them to expose and evaluate, with a higher degree of probability, what they have done unconsciously for years.<sup>16</sup>

Horngren defines responsibility accounting as:

a system of accounting which recognizes various responsibility centers throughout the organization

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<sup>15</sup>Brummet, Flamholtz, Pyle, "Human Resource Measurement," p. 221.

<sup>16</sup>Charles T. Horngren, Cost Accounting A Managerial Emphasis, 2d ed. (Englewood Cliffs, N.J.: Prentice-Hall, 1967) p. 786.

and which reflects the plans and actions of these centers by allocating particular revenues and cost to the one having pertinent responsibility.<sup>17</sup>

Under this system, a manager's primary concern is with those items with which he is held accountable. Thus, if the system signals that the emphasis should be put on reducing costs, and the individual responds by reducing cost at the expense of human resources, which under present accounting methods are unmeasurable, then he has been motivated, but in the wrong direction. Often what appears to be a successful effort is only increased cash flow from a liquidation of human resources.<sup>18</sup>

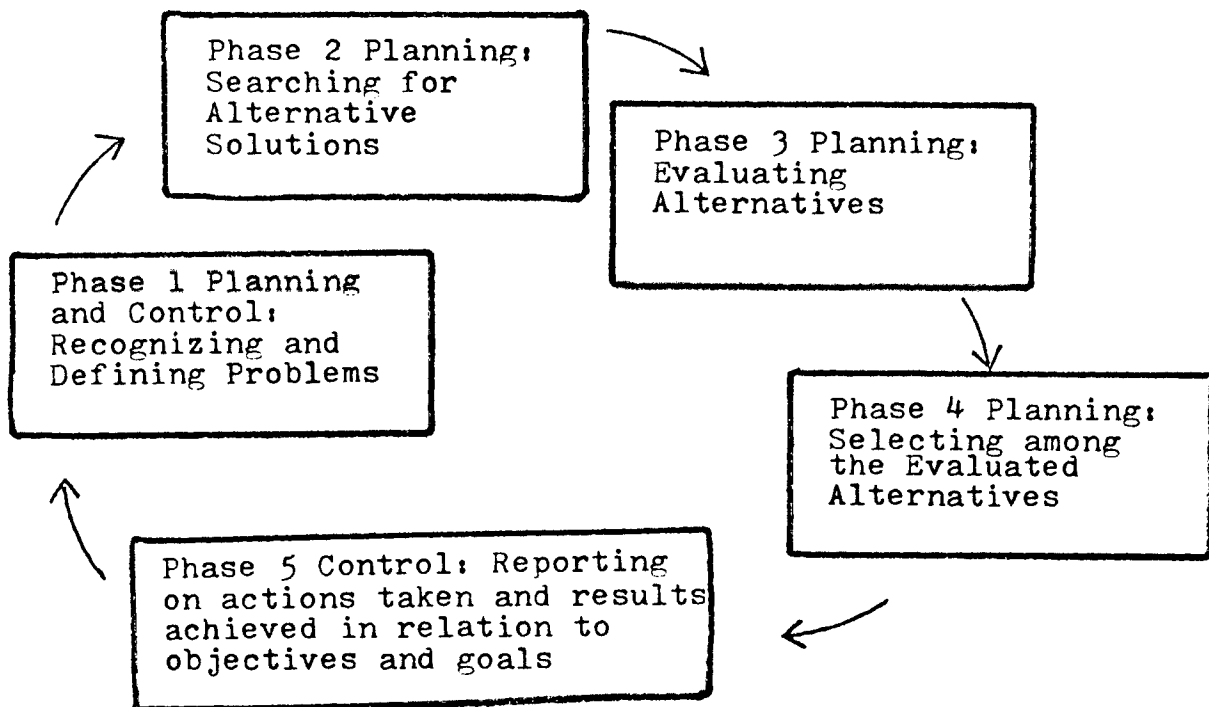
Human resources play an important role in management's planning and control cycle shown below.<sup>19</sup> It can be directly associated with the first, third, and fifth phases of management's planning and control cycle and indirectly with the other two. It is the fifth phase of this cycle that this study is directed toward. That is, to report on actions taken and results achieved in relationship to the goals and objectives of the firm. With H.R.A., standards can now be set where standards were previously missing and end results can be compared against them.

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<sup>17</sup>Ibid., p. 853.

<sup>18</sup>Rensis Likert, "Cost Reduction and Human Capital," Best's Insurance News, August 1967, p. 59.

<sup>19</sup>American Accounting Association, A Statement of Basic Accounting Theory, p. 50.



What then is needed is a method of evaluation which will motivate managers to respond in a manner which is both beneficial to their own self interest and in the best interest of the organization.<sup>20</sup>

. . . managers are led to think that the things that "really count" are the things that "get counted." They tend to emphasize those things that are continually brought to their attention. If the information system of an organization includes measures of human resource condition and change in a form meaningful to managers--and this may mean in dollar terms--these managers will begin to consider this resource in a different light, giving much greater recognition to the "total" impact of their decisions.<sup>21</sup>

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<sup>20</sup>Hornsgren, Cost Accounting A Managerial Emphasis, p. 279.

<sup>21</sup>Brummet, "Accounting for Human Resources," p. 64.

Human Resource Accountability meets these needs by providing a system which measures the human resources of the firm in dollar terms. It places emphasis where it was previously missing and insures that managers receive positive motivation to make decisions which are in their best interest as well as that of the company.

Under the present system of Responsibility Accounting, managers are evaluated by their ability to meet targets stated in terms of costs, revenues, or profits. In many cases, these goals are met through the liquidation of human resources at less than a dollar for dollar exchange. Human resource accountability holds managers responsible for conserving and for providing for the effective and efficient use of human resources in the attainment of the organizational goals. The primary objective of this study was to provide management with a new and effective means of evaluating managerial performance through Human Resource Accounting.



## CHAPTER II

### HUMAN RESOURCE ACCOUNTABILITY

#### GENERAL GUIDELINES

The importance of human resources and a system of accountability for them was identified in Chapter I. In establishing the general guidelines for a system of Human Resource Accountability, there are two overriding features which must be considered. These are: "(a) the executive's sphere of responsibility and his freedom to make decisions and (b) the executive's own motivation."<sup>1</sup>

In assigning responsibility to a particular manager, the question of controllable versus uncontrollable cost is of extreme importance. Webster's Dictionary defines responsibility as a "condition of being answerable or accountable as being the cause."<sup>2</sup> In effect then, a cost is controllable if, as a result of a manager's actions, there is a significant change in the measurable value of the firm's human resources. An example of this would be the shift of the management styles to a more authoritarian type of leadership.

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p. 266. <sup>1</sup>Horngren, Cost Accounting A Managerial Emphasis,

<sup>2</sup>Webster's New World Dictionary of the American Language, College ed. (1957), s.v. "responsibility."

This change might cause less cooperative attitudes, poorer communication, greater "yessing" the boss, and increasing employee turnover. This result, if measured in terms of H.R.A., would show a significant change in the firm's human resources.<sup>3</sup>

When considering the manager's own motivation, the goals and subgoals of the organization must be looked at. Managerial accounting is no longer locked in on profit maximization as the only objective. Instead it is oriented toward "establishing plans for reasonable economic objectives."<sup>4</sup> By putting human resources in financial reports managers will have a more effective means of determining what decisions to make and how these decisions are effecting their department's performance.

General guidelines to implement a system of Human Resource Accountability were described by Flanders. He suggested the following four step approach:

1. Defining human resource measurement
2. Amortizing it
3. Allocating responsibility for it
4. Measuring how well managers conserve it<sup>5</sup>

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<sup>3</sup>Likert, "Cost Reduction and Human Capital," p. 59.

<sup>4</sup>American Accounting Association, A Statement of Basic Accounting Theory, p. 37.

<sup>5</sup>Academy of Management, Proceedings of Thirty-First Annual Meeting (Atlanta, Ga.: n.p., 1971), pp. 205-206.

The present study expanded upon this four step approach and evaluated each of the steps separately. It then determined the best means for the implementation of a system of human resource accountability.

The following two chapters are broken down into distinct parts: (1) a measurement system and (2) a management control system. In defining a measurement system for human resources the third chapter determined a method of valuing human resources and then evaluated the problem of amortizing them. In defining a management control system for human resource accountability the fourth chapter sets limits for the designation of responsibility and standards to provide the organization with a means of evaluating its management personnel.

## CHAPTER III

### A MEASUREMENT SYSTEM

Since the system of Human Resource Accounting was first proposed, there has been one major stumbling block which has confronted everyone involved with it--a system of valuation. In an effort to overcome this stumbling block several methods of valuation have been suggested and in some cases, such as the R. G. Barry Corporation, have been implemented. These methods include the accounting or acquisition approach, the economic approach, and the social-psychological approach. Although each of these methods differ in the mechanics used to determine the value of human resources, they are all based on the same foundation. That is, human assets are economic resources which represent potential earning power.

Before choosing one of the above valuation methods, it is necessary to determine what type of asset or resource is involved. Meigs and Johnson list the characteristics which are common to most intangible assets. They are "lack of physical substance, lack of realizable value, difficulty of transfer, close relationship to the business as a whole, and dependence upon future earnings as a justification for being on the balance sheet."<sup>1</sup> Human resources meet most of

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<sup>1</sup>Walter B. Meigs and Charles E. Johnson, Accounting: The Basis for Business Decisions (New York: McGraw-Hill, 1967), p. 438.

these characteristics and, therefore, will be treated as such. They are difficult to transfer. Human beings are not owned by a firm and, therefore, no value can be obtained from the sale of these resources; in fact, they cannot be sold. The human resources of a business are for the benefit of that business only. Transfer can be accomplished within the firm, but not to other firms. There are certain exceptions to this, such as professional athletes. These individuals have contracted out their talents allowing themselves to be bought and sold. This is for a limited period of time after which they again become free agents and owned by no one. Human resources have a close relationship to the business as a whole and represent future earnings. It is readily apparent that human resources are closely tied to the profitable operations of the firm and that without these resources no future earnings could be derived.

In determining the value for intangibles, the general objectives are comparable to those of tangible assets. That is, the assets should be accounted for on the basis of the dollars invested in these resources. In the case of a piece of equipment, this would include "all expenditures reasonable and necessary in acquiring the asset and placing it in a position and condition for use in the operations of the business."<sup>2</sup> Human resources should not be treated any differently. All expenditures reasonable and necessary in acquiring

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<sup>2</sup>Ibid., p. 403.

a new employee and in preparing him to assume his position in the normal operations of the business should be the basis for the valuation of that employee. Therefore, the accounting approach provides the most practical and realistic method by which a system of valuation can be determined.

#### A Method of Valuation

In determining the value of human resources, the accounting method can be broken down into two parts: (1) acquisition investments and (2) development investments. These two categories contain all the expenses incurred by the firm in placing an employee in the normal operation of the firm.

Acquisition investments include such things as recruiting, selecting, and hiring costs. These costs are the expenses of the hiring department (meetings, paperwork, planning, etc.) involved in replacing or adding an employee at any level. They should also include any employee's salary or expenses that are reimbursed by the company from the time of initial acquisition to the time the employee reports for work and enters the development period.<sup>3</sup> It may be found that certain portions of these costs are fairly uniform among employees at the different levels of the organization and that a standard cost approach could be used.

Development investments in a human resource are those expenses incurred in preparing an employee to assume or maintain

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<sup>3</sup>Rohan, "Who's Worth What Around Here!," p. 34.

his position in the normal operations of the business. They include the cost for formal training and orientation, on-the-job training, familiarization and initial development.<sup>4</sup> Development investments include two major elements of expense. These are: (1) the salary of the supervisor presenting the initial training, orientation and supervising the on-the-job training, and (2) the salary of the new employee himself. Supervisory costs are easily determined since they involve only the cost of the supervisor's time spent with the new employee. Employee costs are more difficult to determine.

When new employees are hired and prepared to take over their respective positions, a learning or familiarity phenomenon occurs. It is only after this familiarization with his new position that the employee can be considered a working member of the firm.

The time required to break in even one high level manager may consume the better part of his first year with the firm. The significance of such investments is clouded not only because the costs are lumped in with salary expenses but also because their effects are not highly visible.<sup>5</sup>

What proportion then of the employee's salary during this time can be considered as a development investment in human resources?

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<sup>4</sup>R. Lee Brummet, Eric G. Flamholtz, and William C. Pyle, "Human Resource Accounting: A Tool to Increase Managerial Effectiveness," Management Accounting, August 1969, p. 14.

<sup>5</sup>Pyle, "Monitoring Human Resources--On Line," p. 21.

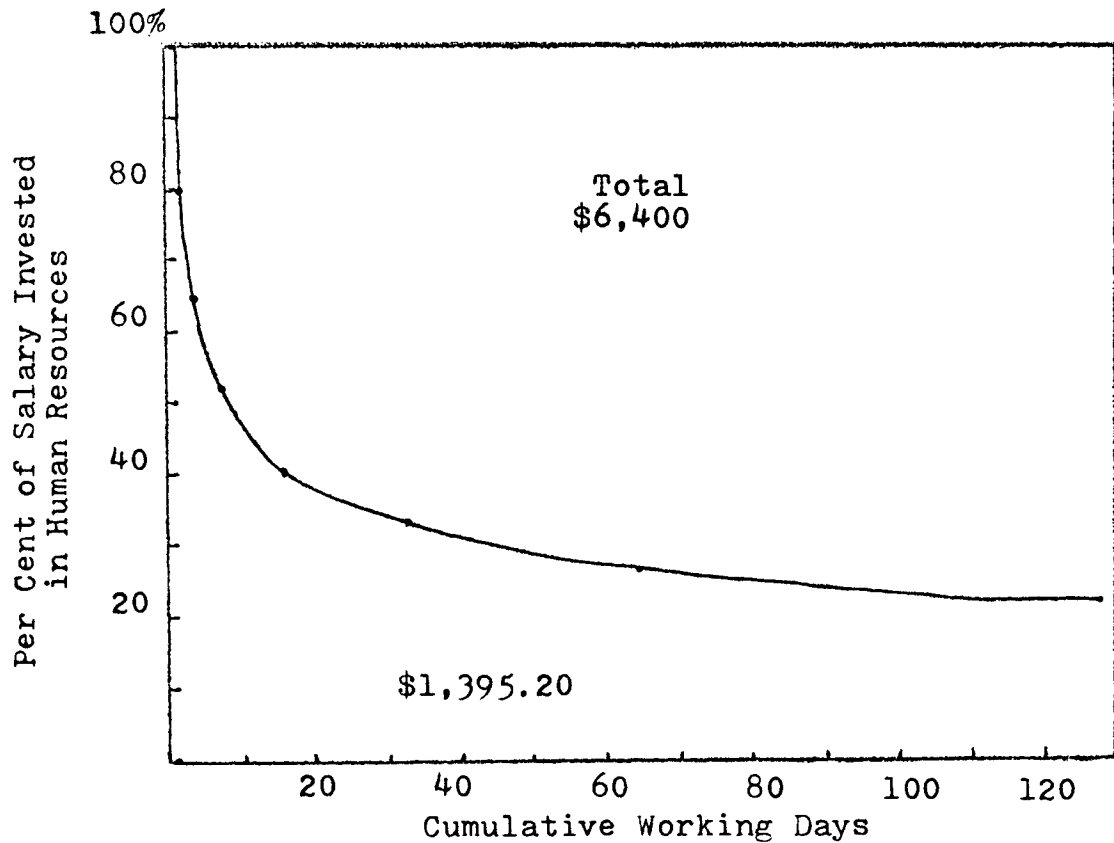
Many companies presently use a learning curve system for setting standards during the start-up phases of production. By applying this technique to the salaries of new employees during their initial development, the proportion of their salary to be considered as part of the investment in human resources can be determined. For example, assume a company hires a junior level executive at an annual salary of \$13,000 a year (\$50.00 per working day for 260 working days). The time required to break in this employee is six months. By applying an 80 per cent learning curve to the employee's salary over time, it is evident that the company has made a substantial development investment in this employee's human resource account. This investment process is shown in Table 1 and Fig. 1.

TABLE 1  
EIGHTY PER CENT LEARNING CURVE

Cumulative work days in new position	Cumulative Salary	Cumulative % of salary invested in human resource	Cumulative investments in human resources
1	\$ 50	100	\$ 50.00
2	100	80	80.00
3- 4	200	64	128.00
5- 8	400	51.2	204.80
9- 16	800	41	328.00
17- 32	1,600	33.8	540.80
33- 64	3,200	27	864.00
65-128	6,400	21.8	1,395.20



Fig. 1. Eighty Per Cent Learning Curve



Through the use of the learning curve, the development investments presently lumped together in salary expenses can be identified. These investments represent the increased value of the employee's "know-how," not only in his specific job knowledge, but also in his understanding and working relationship with others in the firm.

#### A Method of Amortization

Amortization is the accounting process of gradually writing off (transferring to expense) the cost of an intangible asset during the years of its useful life. This is an attempt to match costs to revenues in determining periodic income.

The basis for amortization of intangible assets is service life.

The Committee on Accounting Procedures of the American Institute of Certified Public Accountants has classified intangible assets into two categories, as follows:

- (a) Those having a term of existence limited by law, regulation, or agreement, or by their nature.
- (b) Those having no such limited term of existence and as to which there is, at the time of acquisition, no indication of limited life.<sup>6</sup>

It can be argued that human resources fall into either of these categories. If human resources are considered to have a limited service life, they are subject to amortization and amortized over their expected service life, in most cases by the use of the straight-line method. If human resources are considered to have an unlimited service life, then they are not subject to amortization. If this is the case, they would become subject to write-off only under the following conditions: (1) subsequent to acquisition, conditions indicate that the life of the resource will terminate, or (2) the resource is found to have significantly decreased in expected value.<sup>7</sup>

It is this second method, that of intangible assets with an unlimited service life, that provides management with

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<sup>6</sup>Walter B. Meigs et al., Intermediate Accounting (New York: McGraw-Hill, 1968), p. 436.

<sup>7</sup>Finney and Miller, Principles of Accounting Intermediate, p. 345.

the best and most valuable information source for H.R.A. This is caused by several reasons. First, it is extremely difficult if not impossible, to determine a human resource's service life. It is influenced by the individual's natural life expectancy, his health and emotional state, retirement policies, and his chance for advancement, etc. Each of these items are continually changing thus reducing or increasing the employee's expected service life with the firm.<sup>8</sup>

A second reason for not amortizing human resources is to avoid a duplication of charges against income. Earlier in this chapter, when the learning curve was discussed, it was shown that the longer an individual was with a firm, the greater the investment by the firm. Even after the initial development of an employee, he continues to learn more about the interworkings of the organization, he becomes involved with the implementation of new processes and he establishes informal communication networks helpful to him in his position. This increased value is not accounted for and is charged off against current income in the form of production costs and salary expenses. Thus, by not amortizing human resources, the system compensates for the accounting inconsistency of recording initial dollar investments and not recording later internally developed increases in the value of human resources.

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<sup>8</sup>Eric G. Flamholtz, "A Model for Human Resource Valuation: A Stochastic Process with Service Rewards," The Accounting Review, April 1971, p. 259.

Since human resources are not amortized, another method is needed to write them off. In considering another method, the expiration of the resource's economic benefit is the central question. Indications of this expiration are physical deterioration, obsolescence, or removal from the firm.

Under the conditions stated earlier, if subsequent to acquisition it can be determined that the human resource's economic value will terminate at a set point in time, then his investment account should be written off over that period. An example of this would be an employee who is approaching the forced retirement age. During his last few years with the firm, his account can be written off.

The time period over which his investment account is written off will vary among firms, but a few guidelines can be established. If the firm has a retirement plan in which all employees are members, it would be statistically possible to determine at what point during an employee's service with the firm he considers his investment in that plan great enough to stay with the firm. For example, if after ten years with the firm only five per cent of those employees terminate their service before retirement, then the employee's account could become subject to amortization after ten years with the firm. It would be amortized by the straight-line method over the number of years left with the firm.

The second condition stated earlier was that the resource had significantly decreased in its expected value.

This is caused by either physical deterioration or obsolescence. An employee who is no longer physically capable of performing his job or an employee who requires retraining because of job obsolescence should have his investment account written down accordingly. This write-off should include most, if not all, of the development investments by the firm. Acquisition investments should be retained in the employee's account and the cost of retraining should then be added back into his investment account as development investments.

The employee who is promoted should carry his entire investment with him and the additional development investments should be added to his present balance. For the employee who quits, is fired, or is layed off indefinitely, his entire investment account should be written off in that period, thus, indicating the loss of potential earning power which is associated with that employee.

## CHAPTER IV

### A MANAGEMENT CONTROL SYSTEM

The statement has been made that "to measure is to control"<sup>1</sup> and indeed this is an important aspect of a management control system. Through the use of H.R.A., a value can be placed on the human resources of the firm. The American Accounting Association has stated that "the improvement of control lies in the development of better measures--which in turn depends upon increasing the level of knowledge of the process under examination."<sup>2</sup>

Although measurement is an important aspect of the control process, the process is not complete until the measures are put into proper perspective. Thus, the measurement system must be used to insure that the resources of the firm are handled effectively and efficiently in the accomplishment of the organizational goals--both in the short and the long run. If the organizational goal is profit, then the measurement should be used in that context.

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<sup>1</sup>E. W. Netten, "Responsibility Accounting for Better Management," in Contemporary Issues in Cost Accounting A Discipline in Transition, ed. Hector R. Anton and Peter A. Firmin (Boston: Houghton Mifflin Co., 1972), p. 414.

<sup>2</sup>American Accounting Association, A Statement of Basic Accounting Theory, p. 49.

### Designation of Responsibility

Managerial responsibility facilitates the collection and presentation of information by areas of responsibility. That is, each manager is made responsible for those employees directly under his control. These areas of responsibility are called responsibility units. This concept should create no special problems, since under the present system of responsibility accounting, managers are already being held accountable for the labor costs of the employees in their responsibility units. Human resources can then be handled in the same manner. Expenditures are charged to the lowest level of management from which they can be directly controlled, closest to the point of action.

Are human resources capable of being controlled?  
Can a manager justly be held accountable for an employee?  
Few items, if any, can be considered totally controllable.  
Nevertheless, some useful guides in determining controllable cost follow:

1. If the person has authority over both the acquisition and the use of the services, he should be charged with the costs of such services.
2. If the person can significantly influence the amount of cost through his own action, he may be charged with such costs.
3. Even if the person cannot significantly influence the amount of cost through his own action, he may be charged with those

elements with which the management desires him to be concerned, so that he will help to influence those who are responsible.<sup>3</sup>

All three of these guides are applicable to human resources. Most managers have a say in the hiring and use of a new employee. Managers can influence human resource cost through their management styles and thirdly, and most important, even if a manager cannot directly influence these resources, "management desires him to be concerned" about them.

Fig. 2 represents the normal chain of command and responsibility in a manufacturing organization.<sup>4</sup> Each one of the foremen are held accountable for the employees under their responsibility unit. If a new employee is hired, the investment of the firm in that employee's human resource account will be placed under a foreman's control and he will be held accountable for the effective and efficient use of it. If the foreman fires or lays off an employee, the investment in that employee's account will be written off as an expense, in that time period, against his department. So it goes up the chain of responsibility. The production manager is held accountable for the three foremen and their departments. This process continues all the way up to the president of the organization himself.

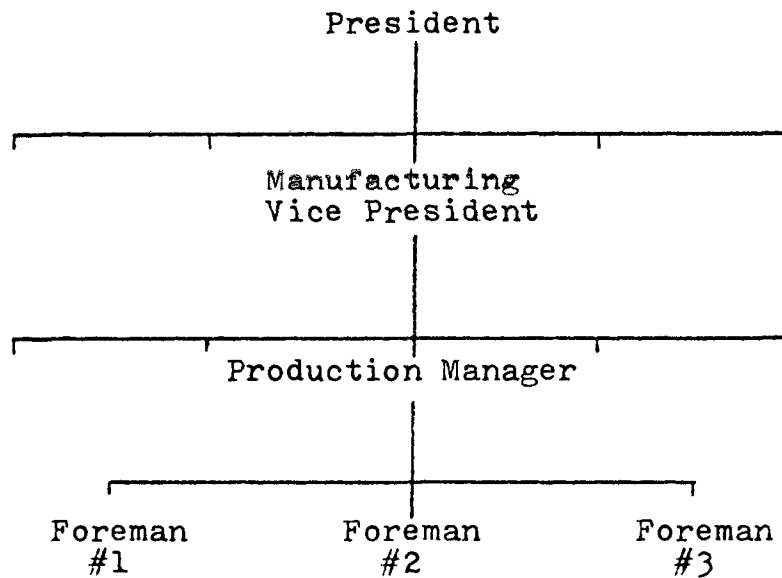
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<sup>3</sup>Charles T. Horngren, "Choosing Accounting Practices for Reporting to Management," in Contemporary Issues in Cost Accounting, p. 13.

<sup>4</sup>Idem, Cost Accounting A Managerial Emphasis, p. 267.



Fig. 2. Chain of Responsibility



#### A Method of Evaluation

"Profit!" That would be the answer received from almost any businessman if asked why he is in business. And so historically then, this is the measure by which most managers are judged. Doesn't it seem ironic then, that after all the careful figuring, managers are still not evaluated fairly. This is what is happening, though, in many firms where managers are not required to account for human resources. The reason for this is that management is not complying with the two criteria required to establish a system of financial responsibility: goal congruence and fairness.<sup>5</sup>

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<sup>5</sup>Richard F. Vancil, "What Kind of Management Control Do You Need?," Harvard Business Review, March-April 1973, p. 77.

By applying the concepts of H.R.A. and through the use of a system of human resource accountability, profitability can again become a realistic measure of managerial performance. If the cost of human resources is considered as investments rather than expenses when incurred and as expenses when these human resources are expended, the profit figure can be brought back in line. Revenues and expenses can again be matched fairly.

Consider the following example. During the recent energy crisis many companies have laid off or released hundreds of employees. The managers of these departments have done this to reduce their responsibility unit costs, in the form of salary expense, in an effort to maintain or even increase short run profits. Presently, conventional financial indicators show a favorable variance as a result of these employee separations. When business conditions improve additional recruiting and training costs are incurred; but since profits are also rising, little if any notice will be taken of the increased expenses. Besides, recruiting costs will most likely be charged to the personnel department and not to the manager's responsibility unit. This process, then, makes those managers who liquidate human resources prematurely look good in the eyes of the organization.

By adhering to the generally accepted accounting principles of expensing cost when incurred, management might try to increase short run profits by

laying off unneeded employees, particularly during slow business periods. Such a policy, however, would inevitably produce long-run damage.<sup>6</sup>

The long-run damage of the above strategy takes the form of increased difficulty in finding well trained and highly qualified employees when the company needs them, and it also creates an uneasiness among those employees retained.

As demonstrated, human resource accountability is one method by which the control system can become a more accurate basis for recognizing and rewarding managers who are best serving the interest of the organization. Under this system, a manager's personnel goals will become more closely related to both the short and long run goals of the organization, benefiting both parties. Thus, the system of human resource accountability has fulfilled the first of the two criteria, goal congruence.

The second of the two criteria is fairness. A manager must believe the financial measurement used to report his performance is fair. This requires that the manager be informed and that he have a clear idea of what is expected of him. Managers must know what they are expected to achieve and then given an idea of whether they are making the grade or not. If they are failing, they will know it and can hopefully correct the situation prior to receiving the final grade.

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<sup>6</sup>Douglas W. Materne and Richard Vangermeersch, "Capitalizing Personnel-Retention Costs," Management Accounting (November 1973), p. 27.

The method by which business passes this information to management is reports. Since managers are familiar with this type of information flow, a similar system should be used for human resource accountability. The R. G. Barry Corporation has already designed and used such a report on a quarterly basis. They call it a human resource capital budget. (See Table 2)

The firm's Vice-President of Human Resources, Robert L. Woodruff, Jr., has described the report as follows:

This quarterly report informs the manager whether planned developmental investments are in fact being made as planned, and whether write-offs of investments due to separations are exceeding his original expectations. For each profit center, the net of new investments less write-offs is applied as an adjustment to the conventional profit figure which reflects either a positive or a negative impact on the important bottom line number.<sup>7</sup>

Such a report then helps to fulfill the criteria of fairness. It gives managers an idea of what is expected and how they are measuring up to these expectations. Managers can see in terms of dollars and cents (the language of business) exactly where they stand. Managers will be forced into considering the effects of their decisions in relationship to the human resources of the firm.

Human resource accountability has a side benefit also. Managers will be encouraged to build a stable work force in order to reduce costs charged to their responsibility

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<sup>7</sup>Pyle, "Monitoring Human Resources--On Line," p. 26.

units. Communication lines can be set up, both formally and informally, creating a tighter working group and team spirit.

Other methods of evaluation, besides profitability, are also benefited by a system of human resource accountability. Under conventional accounting practices, when a businessman measures his return on assets, he is more or less limited to those tangible assets such as plant and equipment. This makes it impossible to compare two managers, one of whom was controlling a capital intensive shop while the other controls a labor intensive shop. There is no common ground for comparison between the two. With the capability of valuing human resources and assigning responsibility for these resources, these two managers can be evaluated together. A specific value can be applied to the resources under each of their control and it then becomes a test of which manager uses these resources most efficiently and effectively. In other words, a common ground has been created on which all managers, no matter what the ratio of human resources is, can be evaluated.

TABLE 2

## HUMAN RESOURCE CAPITAL BUDGET 1970

Quarter Ending: June 30, 1970		Location: Corporate Total Supervisor: President	
		Beginning Balance \$1,325,000	
Actual # People	Dollars Plan	Actual	New Investments Management Personnel
3	\$ 25,000	\$ 19,500	Additions
7	42,000	51,000	Replacement
18	11,500	10,000	Development
3	21,000	14,000	Transfer In
121	<u>120,000</u>	<u>130,000</u>	Hourly Personnel
	\$219,500	\$225,100	
			Write-Offs Management Personnel
	\$ 17,250	\$ 19,100	Amortization
			Turnover Losses
3	10,000	11,000	Voluntary
1	7,500	4,800	Involuntary
--	17,000	800	Obsolescence
3	21,000	14,000	Transfer Out
111	<u>120,000</u>	<u>117,400</u>	Hourly Personnel
	\$192,750	\$167,100	
			Ending Balance \$1,383,000

SOURCE: William C. Pyle, "Monitoring Human Resources--On Line," p. 27.

## CHAPTER V

### SUMMARY AND RECOMMENDATIONS

"The times, they are a changing." This simple statement probably describes the environment in which business operates better than any other. Businesses have grown from small family operated units into multi-million dollar operations employing thousands. With these changes also come the requirements for new techniques in planning and controlling the operations of the firm. A large portion of the burden in developing these new techniques have been placed on the accountant's back.

Accounting's purpose is to communicate information about economic events--past, present, and future--to persons who will use the information to plan and control activities, and to choose among alternative courses of actions.

Cost accounting is especially capable of serving this purpose, for the scope of its concepts and methodology does not need to be fettered by the superstructure of "generally accepted" accounting principles, customs, and traditions that constrain financial accounting.<sup>1</sup>

To date, responsibility accounting has limited itself to traditional measures of performance and ignored other key measures which were intangible and hard to determine.

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<sup>1</sup>Hector R. Anton and Peter A. Firman, Contemporary Issues in Cost Accounting A Discipline in Transition (Boston: Houghton Mifflin Co., 1972), p. vii.

Now, with the advent of human resource accountability, the system of responsibility accounting must also change and grow with the information needs of the business. Human resource accountability provides a remedy to this informational deficiency through two interrelated approaches: (1) development of a measurement system capable of valuing human resources, and (2) development of a management control system capable of evaluating human resource maintenance and utilization.

This paper provides a summary of the advancements in the field of H.R.A. It has determined the most beneficial method, the accounting approach, in valuing human resources to be used with a system of responsibility accounting, and has provided guidelines for a method of writing off these resources. A system for designation of responsibility for human resources was discussed and the tools for evaluating managers under a system of human resource accountability were provided. Parts of this paper represent totally new approaches to the field of H.R.A., such as the application of the learning curve in valuing these resources, and the overall approach of using H.R.A. in a system of responsibility accounting is relatively new and unexplored territory.

The model presented in this paper was not designed to answer all the questions or problems involved with the implementation of such a system, but rather to provide an insight to facilitate future programs in human resource



accountability. The benefits of such a program are great: it provides management with a method of evaluating multiple organizational goals in one process, those being profitability and employee development; it provides managers with relevant information concerning the changing state of human resources under their control; and lastly, it provides a "greater attention to and awareness of the human being and the value of his unique human qualities which is a goal worthy of attainment--for the company and the employee."<sup>2</sup>

It has been stated that:

Responsibility accounting opens up new ways for the accountant to provide valuable services to his enterprise and to take his place on the management team. Enterprise after enterprise has adopted it and found that it brought very worthwhile benefits through more realistic planning, greater profit consciousness, clearer definition of organizational responsibilities, closer control and better management decisions.<sup>3</sup>

Human resource accountability is a worthwhile addition to such a system. It gives responsibility accounting a new look at the management process of the firm and provides for the effective and efficient use of human resources in the attainment of the organizational goals.

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<sup>2</sup>Academy of Management, Proceedings of Thirty-First Annual Meeting, p. 206.

<sup>3</sup>Netten, "Responsibility Accounting for Better Management," p. 415.

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