The Accounting Toolkit for the Strategic HR Manager

by Nneka Jethro-Iruobe and Tolu Sobande

As the Human Resource (HR) practitioner moves away from playing a "medicine-after-death" role and metamorphoses into the role of a strategic partner; there is a primary need to be equipped with the right tools to enable a smooth transition. This is further buttressed by the present and growing demand for HR practitioners to effectively partner with other business departments to achieve strategic corporate objectives. To be an effective HR Practitioner, the language at the Board (which revolves around an in-depth understanding of financials and financial performance) has to be understood to earn a seat at the executive table. This calls for the HR personnel to be accounting savvy in order to effectively assess the impact of HR & Reward programs on the organisation's financial performance and leverage this knowledge in interacting with business stakeholders. This will guide HR in determining the impact of programs like Recruitment, Reward types (e.g. share based), Workforce Planning (growth plans vs HR capital needs) etc. on the business. It will also furnish HR professionals with the knowledge needed to add value and present viable business ideas using human capital resources. Given the current economic landscape, which demands cost-optimisation and revision to programs by management, HR's role as a strategic business partner cannot be over-emphasised.

The HR Practitioners' Role

Attraction, motivation and retention of the right talents remain at the core of the Human Resource (HR) practice in any organisation. Succeeding at this three-pronged responsibility, requires a good understanding of the business of the organisation and demands proficiency in areas such as communication skills, professional judgment, people management, organisation awareness, integrity and maturity. As the C-suite hammers on employees being the most valuable asset to any organisation; HR is challenged to assist to leverage this powerful asset for organisational success. The need for accounting-savvy HR practitioners is further buttressed by the underlying trend where employees in the core business with a perceived better understanding of business operations are moved to head HR functions as opposed to growing HR talent to occupy these senior roles. In the words of Heather Keen, Director HR, Fonterra (a global leader in dairy nutrition), "*People are now recognised as a company's most important asset. The human capital balance sheet is as important as the financial balance sheet*." Following from this, is the relationship between both balance sheets and ensuring the HR practitioner is competent in leveraging the human capital balance sheet to increase the financial balance sheet.

This article identifies the key aspects of the financial statement/annual report, the accounting language the HR practitioner needs to understand as well as the key links that exist between business accounting and the HR function.

Understanding Financial Statements

Financial statements generally present a structured account of an organisation's financial performance, condition and status of cash flows. They are stewardship statements that give a report on how well Management is utilising the resources entrusted to it by Shareholders / Investors. Financial Statements are presented in line with specific accounting principles and published periodically.

The Financial Statements provide valuable information for assessing a company's size and level of efficiency, which in turn gives an indication of its ability to pay and sustain certain levels of compensation. They also provide valuable insight on the sustainability of the company's current practices and its status as a going concern.

Some of the sections of an Annual Report that tell the business' story are presented in the figure below:

The *Statement of Financial Position* and the *Statement of Profit and Loss and other Comprehensive Income* are critical, as these contain key information on business performance which HR personnel can leverage in discharging its responsibilities.

The Accounting-Savvy HR Practitioner

An HR practitioner can conveniently leverage various financial indices (both size and efficiency indices) deduced from the financial statement to effectively assess a business' performance and optimisation of its human resources. The indices that can be derived vary per industry and business type. Some of the indices/ratios that focus on business size and efficiency levels include:

Nature of Indices	Examples of HR Indices	Description/ Definition	Formula for Indices
Efficiency Indices	Staff cost to turnover ratio	This is aimed at treasuring the percentage of every N1 income that is spent on staff	Staff Cost / Turnover
	Production Cost per Barrel*	This ratio shows how efficient a company is in managing cost of production	Value Added / Number of employees
	Cost to Income ratio**	This measures how costs are changing compared to income	Total Cost / Total Income
Size Indices	Gross Earnings	This refers to the company's sales, income and other sources of income	
	Average Crude Production Per Day*	This ratio measures the size of operations in terms of average number of barrels of crude produced per day.	
	Gross Premium Earned***	This indicates the company's ability to write / generate insurance businesses.	
*Specific to the Oil & Gas Industry	**Specific to the Banking Industry	***Specific to the Insurance Industry	

Table 1: Description and Formulae of Various Size and Efficiency Indices

It is important to not only focus on size in evaluating a business' operations but also to pay attention to efficiency. These, in combination with the business life cycle, provide an appropriate assessment of an organisation's business performance. In measuring this, it is also important to take note of where each index is located in the financial statement.

The chart below illustrates the distinction between efficiency and size indices for some selected banks: Access Bank PLC Nigeria, Diamond Bank PLC, Eco Bank PLC, First Bank of Nigeria Limited, Guaranty Trust Bank PLC and Union Bank of Nigeria PLC. The analysis examines Turnover and Turnover per Staff as indicators of size and efficiency respectively based on an average of 2014 and 2015 results.

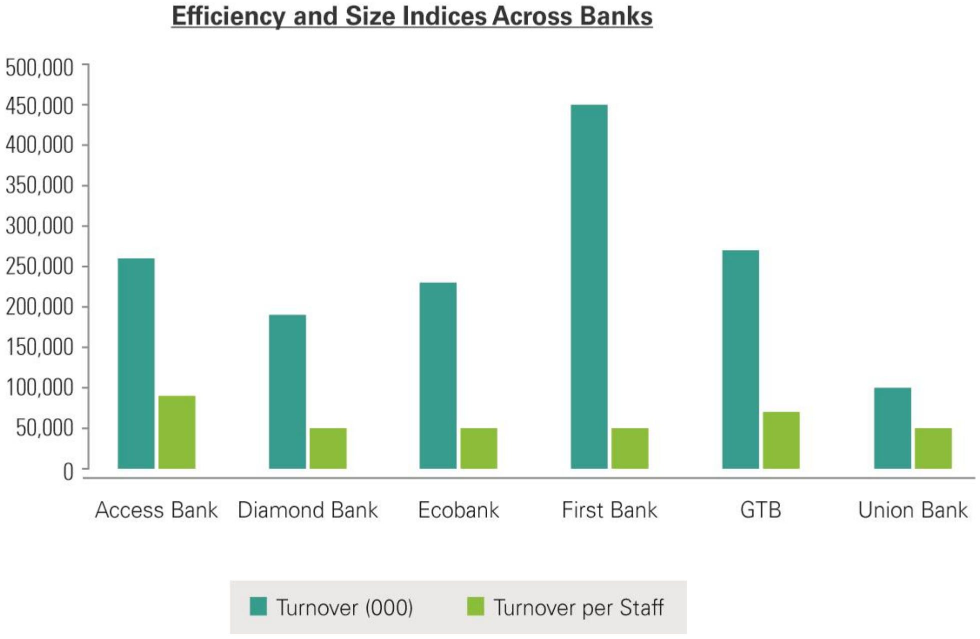

Figure 1: Chart showing Efficiency and Size Indices across Banks

From the above diagram, while First Bank is bigger in size (Turnover), GTB and Access Bank are more efficient as both banks better optimise their human resources and yield higher Turnover per staff.

Knowledge of relevant ratios and information can now be optimized to detect areas requiring adjustments in HR programs and also serve as a basis for measuring the impact of HR programs on the business. For instance, where a company has a lower turnover per staff relative to competition, the HR team may need to commission skills gap analyses and partner with relevant business units to identify areas to improve efficiency levels and optimize available resources. An increase in training programs targeted at improving employee skills level and therefore contribution to business can be assessed by the Turnover / Revenue to Staff Population ratio. Efficiency levels should increase ceteris paribus with an increase in knowledge and skill acquisition.

Impact of Reward Items on the Financial Statement

It becomes even more imperative for HR Practitioners to have a good understanding of financial statements and the information they communicate to be able to understand the impact of reward programs on the company's financials. As an illustration, to be able to effectively introduce a reward scheme such as a share-based scheme, an HR practitioner needs to have an understanding of the impact this will have on the financials of the company, including valuation, disclosure and reporting requirements. If the scheme is equity-settled, there will be an increase in the equity of the company which is reported in the statement of financial position; whereas if it is cash settled, there would be an increase in the company's liabilities. The dilutive effect of equity-settled schemes appears to be a key consideration that Companies consider in determining which scheme to implement.

On another note, in making hiring decisions, an appreciation of the company's current staff cost to turnover ratio could serve as a guide. An already high staff cost to turnover ratio indicates that human resources are not being efficiently utilized, that is, Value added per employee is low and hiring new talent in such a situation would put further pressure on the financials. The focus could therefore be on up-skilling employees to improve output.

Conclusion

The era of accounting knowledge lying strictly with accountants while people services take a back seat is long ended. In this new era, the HR professional needs to assume the role of a strategic partner requiring a continuous evolution in people skills as well as financial and accounting acumen.

Being a strategic business partner comes with a lot of responsibilities as the HR practitioners will need to be business and financial literate. They will also need to be able to successfully measure HR programs and processes in order to rightfully earn a seat at the executive table.

Charles Sturt University's Faculty of Business Course Director, Dr Lan Snell, reports that "…there's been a trend towards looking at financially-based subjects among students doing their Masters degree in HR." He further states that this is not just prevalent among HR practitioners but also amongst those from other disciplines who are pursuing a career in HR.

A good understanding of financial statements and metrics is one of the biggest discerning factors that distinguishes the HR role from being a mere support role to playing a major function as a strategic partner in the business.

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