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Human Resources Audit

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Abstract

Human resource management (HRM) has experienced a strong evolution. In order to provide useful information to managers, it is necessary to evaluate the results generated by the design and implementation of personnel policies. This is the goal of the HR audit that includes two different analyses and valuations: the HR policies and their level of fit with the strategy of the firm, and the characteristics of human capital. Several criteria have been used to assess different HR policies. Nevertheless, the measurement of the value that human capital brings to the firm is a very complex topic. Consequently, different models are being presented that aim to properly solve this challenge. This paper will analyze the HR function from two perspectives: the evaluation of the implemented policies and the quality of human capital in relation to real competencies, and the capability to learn and develop new skills. (JEL M10); Int'l Advances in Econ. Res., 8(1): pp. 58-64, Feb. 02. © All Rights Reserved

Conceptualization of HR Auditing

Auditing has evolved, becoming increasingly specific, until the term *functional audit* has emerged. The objective of a functional audit is to diagnose, analyze, control, and advise within the boundaries of each functional area of the company.

The HR audit is a type of functional audit. Thus, as a first approach, one could say that HR auditing consists of diagnosing, analyzing, evaluating, and assessing future lines of action within the framework of HRM.

HR auditing is a basic tool for the management of a company. Its objective is not only the control and quantifying of results, but also the adoption of a wider perspective that will aid in defining future lines of action in the HRM field. Thus, HR auditing must perform two basic functions [Cantera, 1995]. First, it must be a management information system whose feedback provides information about the situation in order to facilitate the development of managing processes or the development of HR. On the other hand, it must be a way of controlling and evaluating the policies that are being applied, as well as the established processes.

It can be understood that in order to secure the operative efficiency and user or client satisfaction, an appraisal of the results of the HR function is necessary. According to this approach, the results obtained can be valued from certain HR policies (an external type of measurement), or from the results of the policies or the policies themselves. The results can be valued through their cost (a measurement internal to the function) [Walker, 1998]. This would lead the company to consider some basic questions. Are adequate HR policies being developed? Are the desired results being obtained? To what extent do they add value to the company?

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The purpose of this work is to offer a few guidelines for the appraisal of the HR function, which is in itself the basis for the auditing process. The objective is to set conceptual limits for its content and to present the different approaches with which the HR audit can be presented.

Approaches to HR Auditing

HR auditing has evolved in recent years to the point that it has ceased to be a mere instrument of control and has become a necessary decision making tool in personnel related matters according to the global objectives of the company. As a result, all of the functions and competencies of HR auditing are being progressively expanded. This is creating a distinction between its component elements and the different types of HR audits. In this way, Walker [1998] differentiates between two approaches relative to HR auditing: those centered in the function's internal aspect, and those centered on the external aspect.

From an internal perspective, as in any staff function, there is a trend of valuing its actions as a result of the activities undertaken and its costs. In this way, the department's capability would be judged on its ability to supply certain services to the organization at the lowest possible cost. Under this approach, the operational measurements traditionally used are those which refer to quantity, quality and reliability, or cost and speed, therefore placing the focus on activities, costs, or productivity ratios.

From an external perspective, if it is understood that the ultimate appraisal of the effectiveness of HR is based on their impact on the company's results, then the measurements should include results obtained outside the function.

Another well-known classification of HR audit approaches, which is used to structure the present work, is the difference between three focuses, which are the legal audit of performance or conformity, the operative or efficacy-based audit, and the strategical audit.

The Legal Approach in HR Auditing

This first concept of HR auditing is based on a legal outlook. According to Antona [1993, p. 2], the audit of performance or conformity consists of "making an inventory of the social situation of the company, considering the labor law norms and regularly verifying the company's compliance with the applicable regulations." Thus, this concept is centered on the verification that the current labor laws are being fulfilled. The audit should verify if the firm's policies, practices, and documents regarding employee hiring, retention, discipline, termination, and post-employment are both fair and legal [Higgins, 1997]. These practices and policies must: prohibit discrimination by offering equal employment opportunities; protect the employment seeker from being discriminated against on the basis of age; carry out minimum wages; and contain provisions regarding mental disabilities and reasonable accommodations for disabled workers.

According to Nevado [1998, p. 49], the basic functions of the audit of conformity or of performance as an element of HR auditing are threefold. The first function is examining to see if the firm is fulfilling all its administrative social obligations, as well as those relative to the collective rights of its personnel. The second is to study the relationship between the employees and the firm based on the legal statutes. The final function is verifying if the firm fulfills its financial obligations (for example, social security payments), as well as its informative ones.

Concern about labor risks has created a function within HRM with the purpose of altering working conditions by identifying the risks that could stem from them and implementing necessary preventive measures. Such preventive activity could fit perfectly into the legal approach of HR, although the effort that the company can make in this sense can go beyond

the application of the existing risk prevention laws. The requirement for labor security and hygiene is a part of the search for quality of life in the workplace, which is becoming increasingly demanded from companies.

Focus of the Function Audit

The function audit centers on “observing if the procedures applied are the adequate ones and if they function correctly. That is, checking to see if the relationship between objectives and procedures is a satisfactory one and if this has been achieved in the most cost effective manner” [Nevado, 1998, p. 50].

The function of this level of the HR audit is to study and analyze each one of the specific areas of HRM. The analysis should center on the planned measures, the method of implementation, and the results obtained. In order to carry this out, the areas that are to be studied must first be identified. Afterwards, a list of the indicators that will serve to analyze each of them must be made. These indicators can be either quantitatively (absolute numbers or ratios) or qualitatively derived from the responses given by the people involved (management, employees, or external experts). A list of the indicators corresponding to the different areas of the HR function could contain some of the following.

1) *Description of the Company's Staff*

The complete staff can be described by: hierarchic levels, years of service, qualification, sex, and nationality; the number of permanent and temporary employees, interns, and physically or mentally challenged employees; and indexes of personnel rotation and absenteeism.

2) *Job Analysis*

Job analysis can include: the number of described posts and occupants per post; the degree to which the job description cards have been updated; the degree of detail in the job description cards; and the methods used to analyze and describe the jobs.

3) *HR Planning*

Planning includes the methods employed to plan personnel needs, the measures adopted to cover future personnel needs, and the temporary planning horizon.

4) *Recruiting and Personnel Selection*

This includes: the number of days needed to fill a vacant post; the number of applications received by work place categories; the average amount of days between the reception of the application and the final answer; the average cost of recruitment and selection per job post; the degree to which internal and external sources of recruitment are used; the average number of candidates that do not pass the selective tests; a study of the reliability and validity of the selection tests; and the degree to which the recruiting efforts fit the company's business plan.

5) *Training*

The training indicators are: the procedures followed and the frequency with which personnel training needs are analyzed; the criteria followed to define the content of the training programs; the evaluation criteria of the efficacy of the training programs; the percentage of the HR budget dedicated to training; the average number of hours of training per employee; and the percentage of employees that participate in training programs by work place categories.

6) *Development of Professional Careers*

These indicators include: the percentage of people promoted per number of employees; the percentage of vacancies covered internally and externally; and the average time per employee it takes to receive a promotion.

7) *Retribution*

Retribution can be measured by: the average wage per employee and wage difference among employees; the fixed and variable components of retribution; the percentage of remuneration linked to the employee's yield; and the internal equity and external competitiveness of the retribution system.

8) *Performance Evaluation*

Evaluation indicators include: the level of usage for promotion or career; the level of feedback of results to the company's personnel; and the degree to which poorly performing employees are assisted in improving their performance.

9) *Work Conditions*

Work conditions can be assessed by the frequency and index of the graveness of work-related accidents and by the labor accident and sickness prevention policies that are in place.

In searching for adequate measurements, the use of financial references to evaluate the costs and benefits of HR programs has become commonplace [Parsons, 1997]. Financial analysis models applied to HR development programs are increasingly being seen in the literature [Head, 1995; Swanson and Gradous, 1998; Mosier, 1990] and in cases that document their use [Prifrel, 1985; Jacobs et al., 1992; Sleezer et al., 1992].

Grossman [2000] proposes a three-pronged approach for the measurement of the HR function. First, according to this model, there should be efficiency measurements that help to determine the way in which the resources are being used. Within this group are the measurements of turnover, quits, and discharges as a percentage of total employees, average tenure of employees in various jobs, absenteeism, employee productivity, and intellectual capital. After calculating the measurements of efficiency, they must be compared to the results obtained in previous periods. Nevertheless, this is not sufficient, and it is critical to benchmark against others in the same industry or profession. When inefficiencies are revealed, careful analysis of the problem should follow before expenditures are slashed. These cover the efficiency side, but one must also look at the value-creation side. Thus, it is necessary to develop a new set of strategic measurements that connect directly with the mission and strategies of the company.

The creation and selection of these ratios is more difficult, given that they depend greatly on the specific company of which one is talking about. Fitz-enz [1999] proposes a measurement that includes quality, efficiency, and service. He suggests using a ratio constructed around five factors that can be applied to anything that one chooses to measure. These five factors are cost, completion time, quantity, quality, and the human reaction. This system concludes with the calculation of measurements of the HR activities, which try to demonstrate their financial viability. These measurements are based on the idea of the ROI ratio, which is calculated by dividing the monetary value of a HR program by its costs. For this, the cost of the program that is being measured must first be determined, then it must be translated into monetary terms.

The Strategic Audit Approach

Nevado [1998] considers that the audit should also analyze if the personnel policies are in alignment with the general objectives and the global strategy of the company. It must also translate the HR strategy into plans and programs. Thus appears a new element of the audit of HR, the strategical audit. Dolan, Schuler, and Valle [1999, p. 390] define it as "the evaluation of the adaptation of the HR policies and practices in their support of the company's general strategy."

The strategical audit of HR helps assure that the HR programs are aligned with the company's long-term objectives. In this way, the HR function is becoming a source of competitive advantage and is ceasing to be considered as a specialized and unrelated function that incurs high costs to the company. When performing this evaluation, the auditor must identify the company's global strategy before designing the HR policies that will contribute to its achievement. These policies are then compared to the HR practices that are currently being applied, which leads to the modification of some policies to better conform to the firm's strategy.

The employee-client-benefit model that was developed and applied at Sears and other companies illustrates this complete alignment of the business and HR measures. This alignment approach presents greater challenges, since the impact of certain actions on the results is frequently not clear. Many HR professionals find it easier to look inside than to connect their results to organizational measures. Yet, with relatively little effort, HR leaders can identify the keys to their business and the actions to apply on the people related to them as well as their results. The main change involved for those responsible for HR is to leave behind their comfort zone and dedicate more time to finding ways of integrating HR into the business.

With this approach, the measurements applied must be useful in identifying if the HR activities are being developed adequately, if the correct results are being obtained, and if such actions add value to the business. As Welbourne and Andrews [1996] highlight, the importance that management gives to its human capital is one of the most important factors that investors look for when assessing the attractiveness of a company.

Recognizing the strategical importance of HR for any organization, the measurements of results can lead to measuring the impact on business through the extraordinary benefits generated as a result of a better trained and motivated work force.

Brown [2000] considers that the measurements used to evaluate the company's personnel reflect neither its value nor its performance. This is why he proposes an alternate procedure that consists of creating a human capital index based on four elements that must be carefully studied considering their relative importance to the company: the number of years in the business or field, the level in the company (by job grade or organizational chart level), the number and variety of positions or assignments held, and the performance rating, which is subjective. It is the result of an evaluation of an employee's performance, which should include an evaluation by a superior and another of objective aspects such as sales, benefits, or other factors. Through the use of this index, the value that each employee has for the company would be obtained over a total of 100 points. This index is easy to calculate and interpret, and it is fair since it is based on a larger number of objective factors. Yet, it is very simple and does not supply information about the knowledge, abilities, values, managing experience, or other factors of each employee. To overcome this inconvenience, Brown has created a second index that attempts to measure the employee's level of experience and aptitudes.

Some companies, on the other hand, have developed and applied a balanced scorecard approach to the HR function and treat it as a business unit in and of itself. HR leaders must use four different techniques to measure client attitudes, financial impacts, operative efficiency, and strategic capability.

Conclusion

Given that the human factor is a prime strategical element, which explains a company's differentiation capacity, it is logical that a measurement effort of the way this function is

undertaken in the company is made. That is the content of the HR audit, which goes beyond the simple investigative function, and is an extension of the traditional concept of the accounts audit.

The existing literature describes different approaches to HR auditing, including the legal approach, the function-based approach, and the strategic approach. All of them have been analyzed in this work.

The legal approach centers on finding out if the company is complying with the current labor laws. Presently, it focuses mainly on the evaluation of the company's efforts in the prevention of work-related risks. The function approach analyzes the application of different HR policies. Several measurement systems have been presented with the same basic ideas, which include the study of planned measures, the method of implementation, and the results obtained. Yet, these two approaches are limited to the operational and tactical fields, and do not evaluate if HRM supports or aids in the achievement of the company's strategy. This is why the strategic approach has been developed as a means of determining if the HR function is a source of competitive advantage for the company. This third approach, through the use of several systems such as the client-employee-benefit model or Brown's human capital index, can make the company's management aware of the true importance of its employees by identifying them as a key resource worth optimizing. This idea can lead to mistakes when the employees come to be considered as property of the company. The correct interpretation would be to think of personnel not as human capital, but as the owners and investors of human capital [Davenport, 2000].

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