



HOW AN AUDIT PROGRAM CAN BE FORMED FOR MEASURING THE HUMAN RESOURCES EFFECTIVENESS?

Prof.Dr.Ali ERBAŞ*
Dr. M. Kemal DEMİRÇİ**

ABSTRACT

The aim of HR auditing can be summarized as monitoring current HR activities, identifying HR problem areas and generating possible solutions to these problems, forecasting trends and their impact on HR management, evaluating the costs and benefits of HR activities and offer some alternative solutions.

To achieve above objectives HR departments must set goals for measuring effectiveness and must maintain records to provide a basis for government compliance, documentation, and research on the effectiveness of HR actions. HR Audits are implemented to gather comprehensive information on how well HR activities in the organization are being performed. Research data and information is gathered from several sources during the audit. These sources are interviews, ratio analyses and other measures such as return on investment, economic value added and cost benefit analyses. An audit report is formed as a result of audit work which identifies the major problems and inefficiencies. HR audit report is then submitted to management¹ as well as HR staff members, for corrective actions and to obtain greater commitment to implementing the recommendations.

A. INTRODUCTION

In today's global competition companies focuses on profits, productivity, employee turnover, and human resource practices more than before. Most

* Azerbaijan Institute for Administrating National Economy, Dean of Faculty of Management.

** Azerbaijan Institute for Administrating National Economy, Lecturer, Faculty of Management.

¹ L.E.Boone&D.L.Kurtz. *Contemporary Business*, 8th Edition, The Dryden Press, New York, 1996, p. 525.

organizations devote considerable attention to human resource management, which can be defined as (1) the process of acquiring, training, developing, motivating, and appraising a sufficient quantity of qualified employees to perform the activities necessary to accomplish organizational objectives, and (2) developing specific activities and an overall organizational climate to generate maximum worker satisfaction and employee efficiency.²

However, there is an important relationship between good HR practices, reduced turnover of employees and increased employee productivity. Further, those practices enhances high profitability and high value of the firms nowadays. A high quality, highly motivated workforce is tough for competition to replicate³. To gain improvements in organizational performance is an advantage and this is mainly succeeded through effective HR management⁴. Specific approaches and ideas about measuring effectiveness and auditing of HR activities are discussed in this study.

B. AUDITING OF HR ACTIVITIES

An HR audit is a formal research effort that is done by an auditor or auditing team which evaluates the current conditions of HR management in an organization. Through the development and use of statistical reports and research data, HR audits attempt to evaluate how well HR activities have been performed. According to auditing report management can decide which conditions are needed to be improved.⁵

An HR audit begins with a determination of management objectives that are to be achieved in the HR area. The audit compares the actual situation of HR activities with these objectives, as in the sample audit questionnaire given below. Although a variety of research sources can be used to assess HR effectiveness during the audit, review of all relevant HR documents is useful. The documents to be studied include organization charts, job descriptions, handbooks for employees, labor union contracts, benefit statements, performance appraisals, and other forms used, etc. Interviews are conducted with a cross-section of executives, managers, supervisors, and HR staff members to obtain information about HR practices and problems.⁶

Although HR audits can be conducted by staff members, however, a more objective assessment may be achieved if the organization uses external auditors.

² Boone&Kurtz, p.220.

³ M.K.Demirci, *Dönüştürücü Önderlik Kuramının Önderlik Kuramları Yönünden İncelenmesi*, (Basılmamış Doktora Tezi), DPÜ-SBE, Kütahya, 1998, s.17-22.

⁴ M.Zigarelli, "Human Resources and the Bottom Line," *Academy of Management Executive*, May 1996, p. 63.

⁵ K. Dawson&S. Dawson, "How to Select the Best Service," *HR Magazine*, January 1996, pp. 75-83.

⁶ R L. Mathis&John H. Jackson, *Human Resource Management*, 8th Edition, West Publishing Co., New York, 1997, p. 592.

1. INTERVIEWS WITH DEPARTMENT MANAGERS AND SOME KNOWLEDGABLE PEOPLE

As part of the audit a checklist that consists of specific questions about the evaluations of various areas of HR activities is used⁷. HR management audit questionnaire allows auditor to rate the extent to which an organization has basic HR activities and how well they are being performed. In deciding upon auditor's rating, he should consider also how other managers and some knowledgeable employees would rate the activities. The scores provides a guide for actions and source of information that will improve HR activities in the organization under study.

HR management audit questionnaire

This HR management audit questionnaire⁸ allows you to rate the level of essential HR activities in the organization under study. The average scores for each question may also provide some clues about the major problems existing in the area of HR activities. Each question should be scaled as below:

| | |
|--|----------|
| VERY GOOD(Done well) | 3 points |
| ADEQUATE (Only some uptating is necessary) | 2 points |
| WEAK (Major improvements are needed) | 1 point |
| VERY WEAK(Basically non-exist) | 0 points |

(2,50 or above) HR activities are effective, complete, and are in comply with legal requirements

(1,50-2,50) HR activities are not being performed as adequately complete or effective as they should be.

Some potential legal risks may exist.

(1,00-1,50) There are major HR problems. A great deal of attention must be given to HR activities in the organization.

(Below 1,00) There are potential legal liabilitis, and it is likely that important HR problems are in existence.

I. LEGAL COMPLIANCE (Please specify if necessary)

- () 1. Immigration laws.....
- () 2. Equal employment opportunity requirements
- () 3. Health and safety
- () 4. Privacy protection
- () 5. Employment contracts
- () 6 Wage and hour laws.....
- () 7. Reporting- compliance to laws, etc.....
- () 8. Others.....

⁷ A. Erbaş. Hastane Yönetim Denetimi, Menderes Yüksck Öğretim ve Bilim Vakfı, Aydın, 1991, s.35- vd.

⁸ Mathis&Jackson,p.593.

II. OBTAINING HUMAN RESOURCES

- ()9. Current job descriptions and specifications.....
- ()10. HR supply-and demand estimates(for the last 4 years).....
- ()11. Physical exam procedures.....
- ()12. Employee selection interviews.....
- ()13. Recruiting procedures.....

III.MAINTAINING HUMAN RESOURCES

- ()14. Employee recognition programs.....
- ()15. HR record keeping systems.....
- ()16. Formal salary system.....
- ()17. Personnel policy manual.....
- ()18. Benefits programs.....
- ()19. Absenteeism control.....
- ()20. Grievance resolution procedures.....

IV. DEVELOPING HUMAN RESOURCES

- ()21. Orientation programs for new employees
- ()22. Development programs for employees.....
- ()23 Job skills training programs.....
- ()24 Assesment of job performance
- ()25 Assesment of the feedback of manager's training.....
- () TOTAL POINTS

2. HR RATIO ANALYSES AND OTHER MEASURES

2.1. Ratio Analyses

A useful way to evaluation HR activities involves calculating ratios. The ratios can be calculated and compared from year to year. Such efforts provides information about changes in HR operations and gives some clues about the state of the organization⁹. For this type of analyses one suggested series of ratios and measures to consider is given below.¹⁰

⁹ E. Zengin-Y.B.Canbolat,"Azerbaycan'da Bulunan Türk İşletmelerinin Yapıları ve Sorunları" *Journal of Qafqaz University*, Vol. 1, Number 2., Azerbaycan 1998. P. 68.

¹⁰ J. Hiltrop&C.Despres, "Benchmarking the Performance of HR Management". *Long Range Planning*, December 1994, p. 53; Mathis& Jackson, p. 594.

| HR FUNCTION | USEFUL RATIOS | |
|---------------------------------|--|--|
| - Selection situation | <u>Long-term vacancies</u> Total Jobs | <u>Vacancies filled internally</u> Total vacancies <u>Time needed to fill vacancy</u> Total vacancies |
| - Training situation | <u>Number of days training</u> Number of employees | <u>Total training budget</u> Total employees |
| - Compensation situation | <u>Total compensation costs</u> Total revenue | <u>Basic salary cost</u> Total compensation cost |
| -Employee relations situation | <u>Employee Resignations</u> Total employees per year <u>Absences of employees</u> Days worked per months | <u>Length of service</u> Total employees <u>Total managers</u> Total employees |
| - Overall HR activity situation | <u>Part-time employees</u> Total employees | <u>HR professionals</u> Total employees |

Ratios and comparisons of ratios with the industry figures can be a reach source of information about the conditions the establishment is in. Effectiveness is best determined by comparing ratio measures with national statistics. Trend analysis should be prepared and the comparisons should be made over time. Through such comparisons and compiles of valuable information, auditors and individual employers would also be able to compare HR costs against national figures annually if national statistics are available.

2.2 Other Measures

2.2.1 Return on Investment and Economic Value Added

Both return on investment and economic value added are related approaches to measuring the contribution and cost of HR. *Return on investment* can show the value of expenditures for HR activities. It can also be used to show how long it will take for the activities to pay for themselves. The formula¹¹ given below can be used to compute return on investment(ROI) for a new HR activity:

$$ROI=(A - B) - C + D$$

Where;

ROI= return on investment

A= current operating costs for the time period

B= operating costs for a new or enhanced system for the time period

C= one-time cost of acquisition and implementation

D= value of gains from productivity improvements for the time period

On the other hand, *Economic value added(EVA)* is defined as a firm's net operating profit after the cost of capital is subtracted. Cost of capital is demanded to be the minimum rate of return wanted by the shareholders. An EVA analyses

¹¹ Mathis&Jackson, p. 594.

needs that all policies, procedures, measures, and methods use cost of capital as a benchmark against which their return is judged. Both approaches can be used for human resources decisions and analysis. These two methods together with cost-benefit and interview part of the audit provide valuable information and specific clues about the problems or inefficiencies existing in the organization.¹²

2.2.2 Cost-Benefit Analyses

In *cost-benefit analysis*, the costs and benefits related with specific HR activities are identified through building economic and statistical models. Such models essentially includes equations that gives the relevant factors affecting the HR activity under study. Measures and formulas should be chosen from a series of activities and the variables pertained to those activities. Thus HR costing models can be formed. An example that shows developing an equation for computing interviewing costs is given below.

$$\text{Total interviewing costs=} \frac{\text{Staff Interviewer's time spent} + \text{Staff interviewer's hourly rate} \times \text{hours}}{\text{(per interview)}} \quad N$$

Where:

Staff interviewer's time spent= interviewer's hourly rate x hours spent

Manager's time spent= Manager's hourly rate x hours

N= number of applicants interviewed.

Let's assume that an interview specialist is paid 20.000 Manat per hour. He/she interviews 16 applicants for a job by spending for half an hour each applicant. Following the interview, the applicants are interviewed by a department manager who is paid 30.000 Manat an hour. Department manager spends 15 minutes for each applicant.

Under these conditions the total costs of interview per applicant would be:

$$\frac{(20.000 \text{ Manat} \times 8 \text{ hours}) + (30.000 \text{ Manat} \times 4 \text{ hours})}{16 \text{ interviews}} =$$

$$\frac{160.000 \text{ Man.} + 120.000 \text{ Man}}{16 \text{ interviews}} = 17.500 \text{ Man./applicant}$$

This equation might indicate the benefit of reducing the number of applicants interviewed. Such an goal can be achieved by using better employment screening devices. The costs of such devices, must also be added to total choosing costs.

¹² G.B. Stewart. "EVA Works-but Not If You Make These Common Mistakes", *Fortune*, May 1, 1995, p. 117; "Can EVA Deliver Profits in the Post Office:" *Fortune*, July 10, 1995, p. 29; S.E.O'Connell, "Calculate the Return on Your Investment for Better Budgeting", *HR Magazine*, October 1995, p. 39.

It is suggested that HR auditors and professionals should continuously concentrate on cost/benefit analyses. Auditors and HR professionals should devote themselves for research and assessment approaches and methods in an organization in order to enhance cost-justify expenditures and actions. All the calculations, analysis and work done during the audit of HR activities must be shown on work papers in order to provide a documentation. To face the challenges that organizations face, effective HR management will be essential in organizations both in this country and worldwide.

C. THE CHARACTERISTICS OF HR MANAGEMENT AUDIT REPORT

Sustained competitive advantage depends on the unique characteristics of all the resources including human resources that an organization uses as it competes in its environment.¹³ Beside this, choices made about HR systems and practices can be used to guide changes in the performance of organizations.¹⁴ Therefore to achieve these objectives and targets appraisal of HR activities on a continual and timely basis is a necessity for an organization.

To achieve a more objective assessment of HR activities¹⁵ organizations are suggested to use external auditors. Basing on working papers it is essential for management auditor to prepare a written report. Working papers are prepared according to the data and information gathered from physical inspection of facilities, interviews, ratio analysis, return on investment computations, economic value added and utility in other words cost/benefit analysis etc.

The report should show the methods used, specific observations on the state of HR activities, and recommendations for improvement. It should be sent to management¹⁶, as well as HR staff members, for corrective actions and to obtain greater commitment to implementing the recommendations.

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¹⁴ J.B. Arthur. "Effects of Human Resources, Systems on Manufacturing Performance and Turnover", **Academy of Management Journal** 37 (1994), pp. 670-686.

¹⁵ D.J. Rachman&M.H. Mescon&Courtland L. Bovee&John V. Thill, **Business Today**, 8th Ed. McGraw-Hill, Inc, New York, pp. 283-285.

¹⁶ Boone&Kurtz, p. 525.

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