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# UNIT 17 HUMAN RESOURCE AUDIT

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## Objectives

After going through this unit, you should be able to:

- 1 understand the concept of Human Resource Audit;
- 1 to grasp the similarities and difference between the HR Audit and the Financial audit;
- 1 to appreciate the need, purpose and the scope of the HR Audit; and
- 1 develop a perspective on how such Audits are carried.

## Structure

- 17.1 Introduction
- 17.2 Concepts of Human Resource Audit
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- 17.4 The Scope of HR Audit.
- 17.5 The Frequency of HR Audit
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## 17.1 INTRODUCTION

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Conventionally, the independent accountant, after completing an audit, is in a position to render a certificate covering his findings, mentioning the period covered by audit. An assertion is included in the certificate that a review has been made of the company's internal control system and of the accounting procedure followed. A brief statement of the scope of audit is made. Any qualification that are applicable to execution of the assignment or to the company's accounts are prefaced. Finally, the independent accountant renders his opinion regarding the company's financial statements and the basis on which the accounts have been kept. Professional ethics is observed by independent accountants. Material facts are neither missed nor mis-stated.

Again, conventionally, during manpower audit disbursements made on account of payrolls are checked to underlying records. This may even require verification of employees' signatures on payroll receipts to the extent considered necessary. Record of the time of arrival and departure of employees is checked; so also the reports of the number of pieces turned out by piece workers. Payroll records covering bonuses and commission on sales to employees are subjected to scrutiny. Also, certain payroll deductions and contributions in accordance with several social security and welfare laws is checked to compliance and accuracy.

In the matter of quantum of audit and manner of selections, the auditor may introduce the elements of last check and surprise being left to his sole discretion.

It is a general practice for independent accountants to analyse the changes which took place in respect of employees of company during the period covered by the audit. The net increase or decrease in the number of employees in any one function or occupation is discussed with one of the company's senior executives in order to obtain the benefit of his comments regarding the situation.

Careful consideration is given by the independent accountant to the company's system of internal control and check while determining the scope of the programme of audit. Obviously, much of the quantum and thrust of audit can be directly related to effectiveness of the company's internal control system.

The managerial control implies two things: one is checks and the other is measurements. Checks imply monitoring the working of various parts of the organisation by observing the working by getting feedback and take corrective action wherever necessary. In the measurement process, control refers to standards of measurement which are set in advance to determine how well the assigned functions are being performed.

In human resource management, audit is one of the most important devices and significant step in the human resources planning process. Rather, it is considered as the first step in planning of human resources.

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## **17.2 CONCEPTS OF HR AUDIT**

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The word "audit" comes from the Latin verb *audire*, which means, *to listen*. Listening implies an attempt to know the state of the affairs as they exist and as they are expected/ promised to exist. Auditing as a formal process is rooted in this feature of listening. Consequently, it is a diagnostic tool to gauge not only the current status of things but also the gaps between the current status and the desired status in the area that is being audited.

Auditing has been a routine exercise in the area of finance, especially because it is a statutory obligation. However, in case of Human Resource, there is no legal binding to adopt auditing. Some of the companies nevertheless prefer to have HR audits.

Like any audit, the Human Resource Audit is also a systematic formal process, which is designed to examine the strategies, policies, procedures, documentation, structure, systems and practices with respect to the organization's human resource management. It systematically and scientifically assesses the strengths, limitations, and developmental needs of the existing human resources from the larger point of view of enhancing organisational performance.

The human resource audit is based on the premise that human resource processes are dynamic and must continually be redirected and revitalized to remain responsive to the ever changing needs. Human Resource Audits are not routine practices aimed at problem solving. Instead of directly solving problems, HR audits, like financial audits, help in providing insights into possible causes for current and future problems.

The findings of these audits aid decision making in the organisation and are usually internal documents that need not necessarily be shared with the public. Moreover, unlike Financial Audits that are routine, regulated and standardised, Human Resource Audits are non-routine and may be designed to cater to the unique needs of the organisation at a particular point in time. These are in fact, studies of an unusual nature. The manner in which the Audit is conducted could vary from self-directed surveys to interventions by outside consultants.

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## 17.3 NEED OF HR AUDIT

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Human Resource practices and functions have a far reaching impact on the employees morale and performance, which in turn, affects the overall performance of the organisation. This is why they are claimed to be closely related to a business's 'balance scorecard' through "productivity, people, and processes" (Ulrich, ). Given its criticality, a regular assessment of the HR function, like that of finance function, becomes essential for sustaining organisational health and growth. The need for such assessment is even greater in today's dynamic and, at times, turbulent, environment, where human resource management needs continuous up-gradation and re-alignment.

Moreover, with increased importance of the human contribution to organisations' competitive advantage, especially in the knowledge driven economy, the human resource function itself is under transformation. It is gradually moving from the role of a service provider to that of a strategic business partner. In order to perform this emerging role effectively, the HR function has to continually assess :

- 1 Whether it is adding tangible value to the organisation through its strategies, policies, processes and practices;
- 1 Whether it is doing so at a competitive cost; and
- 1 Whether it is doing so in a manner that is satisfying to its people, acceptable to the society and the law, and, from a long term perspective, sustainable.

Answers to all these questions need regular HR Audit.

Moreover, HR Audit becomes significantly critical in situations of Merger or Acquisition. Often Human Resource is not even informed about such transactions till they are complete. However, most often if mergers or acquisitions fail, it is due to the people related issues. Consequently, it is important that managements spend adequate time and energy to learn about the human resource component of the target company. An audit or due diligence prior to the closure of the deal can have a direct impact on the success or failure of the acquisition.

Regulatory Compliance is another area of major concern for most organisations. With increased judicial scrutiny and pressures for compliance with the statutory requirements of the country, it has become vital that HR continually remains vigilant with respect to the legal compliance. It must keep itself abreast with the new laws and regulations, ensure that they are being followed and also eliminate the gaps between what it does and what it says, as that by itself, carries legal liability.

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## 17.4 THE SCOPE OF HR AUDIT

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The HR audit usually covers three parameters, namely, the **HR policies and practices, the HR professionals and the HR department.**

With respect to each of these, the Audit tries to find out :

- 1 The actual state;
- 1 The congruence between the desired/professed state and the actual state;
- 1 The alignment with the overall organisational strategy and goals; and
- 1 The compliance with the laws and regulations.

### Auditing HR Practices

All HR departments provide several services that may be clustered into six key domains (Ulrich and Lake, 1990), staffing, training and development, appraisal, rewards, organisation governance and communication. For each of these six domains, Ulrich recommends four types of assessments.

The first is an assessment of activity that not only describes the services being provided by the HR department but also assesses the focus of the HR strategies, the distribution of responsibility, the resource utilisation, and the competencies of the HR portfolio.

The second type of assessment is that of customer value. HR departments may be said to be providing a range of services to customers, who are the employees of the firm. Customer surveys are conducted to capture the employees' perceptions about the importance and the quality of the HR services.

Often Cost benefit or utility analyses of HR functions are made to define the value of each of the HR functions. Formulae that can trace the cost and benefit of the services, are developed and the results compared over time and with the results of other companies, to make an assessment.

Research, involving HR experiments, are also sometimes conducted by using experimental and control groups. These groups may be formed across sites, or across departments. The purpose of these research studies is to identify the effective HR practices by generating comparative data. This data enables the organisation to adopt the best HR practices.

### **Auditing HR Professionals**

An audit of HR professionals is essentially an assessment of the extent to which the professionals demonstrate competence for HR function. Such an assessment requires a 360 degree feedback, and, according to Ulrich, usually employs the following five steps :

1. **Developing a Model of Competencies:** Before embarking on an assessment of competence, it is necessary to first determine what are the competencies that make a successful HR professional. These competencies usually stem from knowledge of business, knowledge of HR, knowledge of change and finally personal credibility. In addition to determining the competencies that account for a successful HR professional, it is also important to determine the behavioural attributes that reflect these competencies. A model that reflects both these aspects may be said to be a comprehensive model for auditing of HR professionals.
2. **Collect data using the Model:** Several techniques may be employed to collect data about the extent to which an HR professional exhibits the modeled competencies. These include interviews, questionnaires and focussed groups.
3. **Summarise data and give feedback to the HR professionals:** The quantitative and qualitative data, that is collected in the above mentioned ways, needs to be synthesised and codified so that specific themes emerge. These themes are then used as aids to help the HR professionals identify his/her strengths and weaknesses.

One of the key activities of an HR audit is to give feedback. This needs to be done in a way that protects the confidentiality of the participants. The manner of the feedback should take into account the sensitivities of the receiver. The tenor of the feedback should neither be accusatory nor defensive. In addition, the individual data that is collected may be integrated into an audit for the overall HR function.

4. **Create action plans:** The HR audit goes beyond defining the competencies and inadequacies of the HR function. It also identifies the measures to develop the competencies at both, the individual and the departmental level. At the institutional level, this may involve doing an 'HR for HR.' At the individual level, the action plan will concentrate on developing a tailored set of trainings, readings, assignments and training opportunities.

5. **Continuous Improvement:** Auditing of HR professionals is not a one time activity but an ongoing continuous process through which HR professionals are able to constantly build on their HR competencies and strengthen the HR functions in the organisation.

### **Auditing HR Function or Department**

Auditing HR function and the HR department may be an integration of individual HR competencies. However, at the same time, there are additional overall indicators of HR functions, such as ratio of total employees to HR professionals, the performance of the department against the plan, the ratio of expenditure on HR to total sales, general costs and other such measures. Temporal and spatial analyses of these can provide an overall assessment of the HR department. Comparisons against benchmarks is also a technique often used in HR audits.

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## **17.5 THE FREQUENCY OF HR AUDIT**

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There is no uniform norm regarding how often the HR Audits should be conducted in an organisation. Generally, it differ in case of different organisations depending upon.

- 1 the purpose of the Audit. For example, if the purpose is to know the extent of compliance with the company policies, Audit may be an annual exercise. Whereas if the purpose is to assess the cultural shift as a result of a planned HR intervention, the Audit may be undertaken once in three or five years ;
- 1 the periodicity of changes in the external business environment. The faster and the more discontinuous the changes, the higher should be the frequency of the audits so that timely actions can be initiated where gaps exist between expectations and the reality.
- 1 the frequency of changes in the strategies, policies, and personnel within the organisation;
- 1 the rapidity of technological changes which are expected to impact the psychology of people; and
- 1 the speed of change in the legal, socio-economic and political conditions.

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## **17.6 CONDUCTING HR AUDIT**

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The Audit can be carried out internally or with the help of an external consultant. Where it is conducted internally, four things are extremely important :

- 1 unless the scope of the Audit is very limited, the Audit should be conducted by a team and not an individual;
- 1 the team should represent a cross-section of the organization's staff, including, the line personnel, middle and upper management, and those responsible for HR functions;
- 1 the team should be trained in survey techniques and data analysis; and
- 1 the organisational culture should be trust based and open. Otherwise, the information given will be distorted and the whole diagnosis will become inaccurate.

Many firms prefer to engage independent consultants to conduct the audit. This is done primarily with a view to obtain greater objectivity and impartiality in diagnosis and reporting. Moreover, consultants are expected to have wider experience and specialization in the field. They, therefore, tend to possess an uncanny eye for details and data that might otherwise be looked as insignificant by the internal personnel. Their audits, thus, are supposed to be both free of prejudice and more professional and accurate.

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## 17.7 AUDITING PROCESS: ESSENTIAL STEPS

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The Auditing process is a function of the objectives and the scope of the Audit, the nature of the organisation and the level of involvement of the top management. Though this process may vary from organisation to organisation, it essentially follows the stages described below.

- 1) **Briefing and orientation:** This is a preparatory meeting of key staff members to:
  - i) discuss particular issues considered to be significant
  - ii) chart out audit procedures, and
  - iii) develop plans and programme of audit

- 2) **Scanning material information:** This involves scrutiny of all available records and documents pertaining to the personnel as well as personnel handbooks and manuals, guides, appraisal forms, material on recruitment, computer capabilities, and all such other information considered relevant.

Human Resource Audit is the critical analysis of the existing human resource management within the organization. To be able to do that, the audit will have to be served with the data that is quantitative, authentic as well as comprehensive. In other words, the success of this stage of human resource planning solely rests upon the manner in which personnel records and other information are maintained. Hence, the quality of the HRIS becomes critical.

- 3) **Surveying employees:** Surveying employees involves interview with key managers, functional executives, top functionaries in the organizations, and even employees representatives, if necessary. The purpose is to identify and enumerate issues of concern, present strengths, anticipated needs and managerial philosophies on human resources.
- 4) **Conducting interviews:** The key issue here is to list the pertinent and probing questions. The decision on these questions depends on the scope and purpose of the Audit as well as on the culture of the organisation. The skill of the interviewer lies in getting relevant and correct information without threatening the interviewees.
- 5) **Synthesising:** The data thus gathered is synthesized to present the:
  - 1 current situation
  - 1 priorities
  - 1 staff pattern, and
  - 1 issues identified.

Similarly, future needs are identified and appropriate criteria developed for spotlighting the human resource priorities and specific recommendations made.

- 6) **Reporting:** Like planning meetings for briefing and orientation, the results of the audit are discussed within several rounds with the managers and staff specialists. In the process, the issues get further crystallized. Based on the findings and the discussion during the meetings, then a final report is prepared and presented formally to the Management. This report should include, the “state of the organisation” report, the assessment of effectiveness and efficiency of various areas covered by the Audit, a legal compliance/ areas of concern report, and critical recommendations for improvement.

## 17.8 COMMON RESEARCH TECHNIQUES IN HRA

As mentioned above, there are several techniques that may be employed in conducting an HR Audit, especially in collecting data. Most of these techniques are, however, variants of Questionnaires, interviews, and methods of Observation.

### Interviews

Interview of key HR stakeholders can provide a valuable insight into the strengths and weaknesses of the HR practices, professionals and department, as perceived by the stakeholders. Interviews can be part of either an exploratory or descriptive mode of inquiry.

Interviews as a part of HR Audits may either be individual interviews or group interviews. While the former is more time consuming, the data generated is less likely to be influenced by group processes and dynamics, especially group think. At different levels in the organisation, the context of the interview and its type varies. Hence, the aim and scope of interviews with the CEO, top management and with HR professionals, the line managers and the field staff are likely to be quite different.

### Questionnaires

In HR Audits, questionnaires may be used for generating data that serves as input to the HR Scorecard. There are several such questionnaires available. They measure HRD systems and their comprehensiveness; the effectiveness of HR functions; the competencies of the HR professionals and the HR staff; and the HR culture in the organisation.

The questionnaires used usually comprise of a series of open-ended and closed - ended questions that cover a number of dimensions like career systems, work planning, development systems and planning, and the overall HRD climate and functioning.

Some of the commonly used questionnaires include the HRD Audit Questionnaire, a 102 item Map your HRD Practice Profile (see La Piana Associates, Inc, 2002) the HRD Climate Survey, the Training Effectiveness Questionnaire, Performance planning, analysis and development questionnaire and the Supervisory and Leadership Beliefs Questionnaire, to name a few.

### Activity A

Assuming you are required to conduct a HR audit interview in your organisation. Prepare a suitable questionnaire covering compensation and performance appraisal.

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### Activity B

Try and assess the major HR audit concerns of your organisation by talking widely to line managers, personnel staff and other employees with useful knowledge. Before doing that, prepare a checklist of key questions to be asked.

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## 17.9 SUMMARY

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Finding out what is inadequate is the first step toward improvement. Similarly, there is no meaning in carrying out an Audit if the management has no intention of taking measures to plug the gaps pointed out by the Audit. HR Audit, therefore, should be undertaken only as a part of the overall improvement/change strategy of the organisation rather than as an isolated activity.

Human resource audit is an important approach to human resource planning. It is practical because, if correctly conducted, it can increase the effectiveness of the design and implementation of human resource policies, planning and programmes. A periodic and systematic audit helps human resource planners develop and update employment and programme plans.

An HR audit reviews the full range of HR activities, including how an organization is structured to deliver the HR function, recruitment/selection, compensation and benefits administration, performance management, employee communications, safety and recordkeeping. Identifying “gaps” between policy and practice can not only increase legal compliance but also increase efficiency and productivity of the organization’s HR activities. It can significantly contribute to the quality improvement processes and employee satisfaction.

However, a comprehensive audit will be most useful if an organization is ready to act on the findings and develop its Human Resource functions to a level where the full potential of HR to support the organization’s goals and objectives can be realized.

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## 17.10 SELF-ASSESSMENT QUESTIONS

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1. Explain the need, purpose and the scope of the HR Audit.
2. Explain the similarities and differences between the HR Audit and Financial Audit.

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## 17.11 FURTHER READINGS

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Ulrich, Dave and Dale Lake. 1990. *Organizational Capability: Competing from the Inside/Out*. New York: Wiley.

Ulrich, D. 1996. *Human Resource Champions: The Next Agenda for Adding Value and Delivering Results*. Harvard Business School Press.

Thierauf, Rober J. (1980) *Management Auditing: A Questionnaire Approach*, AMA COM, NY.

La Piana Associates, Inc (2002): *Introduction to The Human Resources Audit*, Prepared by Bill Coy, Senior Associate for HR Consultation

ÓLa Piana Associates, Inc., [www.lapiana.org/consulting](http://www.lapiana.org/consulting)