To Understand HR Standards, Look to GAAP and FASB
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Should standards for human capital look more like generally accepted accounting principles or FASB's financial-reporting standards?

In finance and accounting, "practice standards" (like GAAP) serve a different purpose from "decision standards" like those for financial reporting, with very different requirements.

An independent auditor's report contains an opinion as to whether a company's financial statements "present fairly, in all material respects, an entity's financial position, results of operations, and cash flows in conformity with generally accepted accounting principles," according to the Public Company Accounting Oversight Board.

The *FASB Statement of Accounting Concepts* (No. 8, September 2010, page 1, section OB2) defines financial reporting standards a bit differently: "The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity."

"Practice" standards (like GAAP) describe common and generally used practices that are "feasible at scale" across a wide variety of organizations. It would do little good to set a standard that could be applied only by organizations with the most sophisticated information systems. Indeed, a significant purpose of such practice standards is to encourage all organizations to use common processes and measures, so that they can be compared to each other. Practice standards do not, in themselves, claim to predict organizational performance or assist investor decisions.

“Decision” standards (like financial reporting) go much further. They aspire to describe measures that help predict future performance. For that reason they are recommended as a guide to investors. Such standards would ideally be based on evidence, theory or frameworks that connect them to future performance. They need not be flawless predictors of organizational performance, but they should offer decision value beyond their cost.

With HR standards these distinctions are less clear, and that explains some confusion and controversy.

Consider the published HR standards from the U.S. Society for Human Resource Management (SHRM) in conjunction with the American National Standards Institute (ANSI). These are all practice standards, such as how to calculate cost-per-hire and elements of a performance management system. These standards neither claim to predict organizational performance nor set a requirement that organizations must meet.

In contrast, SHRM last year withdrew a decision standard — called “human resource indices for investors” — from its proposal for new HR standards, amid significant controversy. It had aspired to something akin to the goal of financial-reporting standards: to “represent the effectiveness, quality, and value of human capital in investor instruments.” That goal ultimately set the bar too high. Opposing groups asserted that investors were not asking for such a standard, and that it might be misinterpreted or have very different effects on organizational performance, depending on the situation.

The controversial indices for investors **standard** actually included elements (such as **“**total spending on human capital” and “ability to retain talent”) similar to HR scorecard and employee turnover metrics that **SHRM says are still being developed, and are promoted as *practice* standards rather than decision standards for investors**. HR metrics seem have more success when promoted as practice standards rather than decision standards.

That seems logical, because **the HR decision standards** (indices for investors) appear actually to have been more like practice standards. The **decision standards** described measures commonly reported by HR, but did not provide evidence that they predict future performance, nor that investors know how to use them, as I noted in an earlier column. The lack of such evidence may be a reason they were so vehemently opposed.

It is vital that the distinction between practice and decision standards be as clear in the world of human capital as it is in the world of finance and accounting.

Like GAAP standards, emerging HR standards should describe typical practices or measurements that are "feasible at scale" for most organizations. As more organizations adopt them, we will see more common approaches to measuring things like employee turnover and cost-per-hire, and the resulting data will be more easily compared and analyzed. As research uncovers links with organizational performance, we may in the future see a better case for a set of decision standards that can justifiably be connected to organizational performance. Practice standards are a prerequisite to decision standards in HR, just as they were in finance and accounting.

Finance leaders and HR leaders should collaborate in the standard-setting process in order to exploit a golden opportunity to create truly useful human capital standards. Human capital standard-setting can learn much from the frameworks of accounting and finance standards.

The greatest value may be in shared logic, not shared numbers. Even clarifying the definition of "standard" can make a big difference.

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